CHAPTER

Valid Contract and its Elements

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What is a Contract?

When we talk of a contract, the first question that comes up is to define what exactly is a contract. In other words, what are the essentials of a valid contract. Generally speaking a contract is an understanding or an agreement between two parties. But this does not completely or clearly define a contract. To understand the meaning of a contract, we need to have a look at the definition of a contract given by 'intellectuals' and experts of mercantile law.

Definitions

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

Sir William Anson defines a contract as "*an agreement enforceable by law made between two or more persons by which rights are acquired by one or more to acts or forbearances on the part of the other or others.*"

According to **Leake,** "*an agreement as the source of legal contract imparts that one party shall be bound to some performance, which the other shall have a legal right to enforce.*"

Sir Fredric Pollock opines that "*every agreement and promise enforceable by law is a contract.*"

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

The above definition and the Indian Contract Act make it abundantly clear that every contract must have two basic characteristics:

An agreement between the parties.

The agreement should be enforceable by law.

For an agreement to be enforceable by law, it becomes imperative that it is based on valid and legal grounds — otherwise it will not be enforceable by law. A contract can only be enforceable by law when it imposes some legal obligation on the parties to the contract, In other words, agreement and obligation are the two fundamental elements of a contract. This means that the commitment of the parties must meet, or there must be *consensus ad idem*. Consider an example – A has two buildings No. 1 and No.2, and wants to sell building No. 1 to B, whereas B wants to buy building No.2. In this case, there is no consensus between A and B, and as such, there is no possibility of a contract between the two.

For an agreement to be a contract, it is imperative that certain obligations are imposed on the parties concerned. These obligations need to be legal, not social obligations. At the same time, the Contract Act is also not the whole law of obligation.

Essentials of a Valid Contract

The essential features or elements of a valid contract are discussed in the following sections. Even if one of these elements is missing in an agreement, the agreement will not be enforceable by law and as such would not constitute a valid contract.

(1) Agreement – Proposal and Acceptance: A valid contract essentially involves two or more parties because an individual cannot enter into an agreement with himself. Section 2(e) of the Act stipulates that "every promise and every set of promises forming the consideration for each other is an agreement." To reach an agreement, it is implied that one party makes a proposal and the other party accepts the proposal. According to Section 2(b): When the person to whom the proposal is made signifies his assent thereto, the proposal is accepted. A proposal, when accepted, becomes a promise. Until the proposal is accepted, there is no promise and, as such, there cannot be an agreement. For example, if Mohan makes a proposal to sell his car to Sohan for ₹ 50,000 and Sohan accepts the proposal, there will be a valid agreement between the two.

(2) Competency or Contractual Capacity of Parties: The second essential feature of a valid contract is that the parties concerned are legally competent to enter into it. According to Section 11 of the Act, every person is competent to contract if he: (a) is of the age of majority, (b) is of sound mind, and (c) is not disqualified from contracting by any law to which he is subject. Every person who has attained the age of 18 years is a major. If a person is a minor who has a guardian appointed by the court or one whose property is under the supervision of the Court of Wards, such person would be considered a major when he attains the age of 21. Being of sound mind implies that, at the time of entering into a contract, one is capable to understand the terms of the contract and one's rights under such terms. Those who have been declared incompetent to enter into a contract as per the law include enemies of the country, diplomatic personnel, bankrupts and those who have been sentenced to terms of imprisonment, etc.

(3) Free Consent of Parties: The third element of a valid contract is that there must be a free and genuine consent of the parties to the agreement. According to Section 13, the consent of the parties is said to be free when they are of the same mind on the material terms of the contract. The parties are said to be of the same mind when they agree about the subject matter of the contract in the same sense and at the same time. The *identity of views* is the pre-requisite. If such identity is not there, no agreement is possible. As per Section 14 of the Act, an agreement induced by coercion, undue influence; fraud, etc., would not be enforceable by law.

To cite an example, A makes a proposal to B to sell his Fiat car for ₹ 80,000. B accepts to buy the car, which he thinks is a Maruti because it is more popular than a Fiat. In this example, there is a proposal by A which is accepted by B – but there is a difference between the concepts of A and B – and no agreement can be reached between the two. A wants to sell his car and B wants to buy a car. Even the price is acceptable, but the concepts of A and B are different. B thinks that he is buying a Maruti while A thinks he is selling a Fiat – and no agreement can be reached between the two. Consent of a party is free when there is no coercion, undue influence, fraud, misrepresentation or mistake. As per Section 14 of the Act, the agreement is invalid if free consent of the parties is not there.

(4) Lawful Consideration and Legal Object: The consideration or object of the contract is another essential feature. Except for special cases listed in Section 25, a valid contract has to have an object. As per Section 2(d), "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 abstains from

doing an act, such act or abstinence or promise is called a consideration for the promise." For a valid contract, the consideration need not necessarily be in terms of a price – the consideration can even be in the past, present or future – but the consideration needs to be real. For example, Ajay offers to sell his book to Vijay for ₹ 20 and Vijay accepts the offer. In this case, ₹ 20 is the consideration for Ajay and the book is the consideration for Vijay. The object of the agreement must be lawful. In other, words, it means that the object must not be (a) illegal, (b) immoral or (c) opposed to public policy (Section 23). If an agreement has a legal flaw, it would not be enforceable by law.

(5) Agreements not Expressly Declared Void: For a contract to be valid, it is essential that the agreement has not been declared void under the Indian Contract Act, 1872. Specifically void agreements include agreements related to interference or sabotage in marriage ceremony (except in the case of a minor), agreements that interrupt or sabotage a legal activity, that are related to gambling or promise to do impossible things.

(6) Writing and Registering Agreements: A contract may be by word of mouth or in writing. As per law, there is no difference between a contract in writing and a contract made by word. It is, however, in the interest of the parties that the contract is in writing. Some other formalities also need to be complied with to make the contract legally enforceable. In some cases, the document in which the contract is made is to be stamped and registered (like under the Transfer of Property Act). In some other cases, there is a statutory requirement that the contract be made in writing or in the presence of witnesses or registered. In such cases the statutory formalities must be complied with.

(7) Capable of Performance: A valid contract must be reasonable and practical to be performed. It must not promise the impossible – like injecting new life in a dead body or finding treasure by magic. A valid contract must be certain and definite – not vague and indefinite. The law does not recognize, an impractical, indefinite or vague agreement and, as such, does not help enforce it.

If an agreement does not meet the above criteria, then it cannot be a contract. It will remain an agreement.

The differences between an agreement and a contract are listed in the table that follows.

Differences between an Agreement and a Contract

No.	Basis of Difference	Agreement	Contract
1.	Section	Is defined in Section 2 (e)	Is defined in Section 2(h)
2.	Definition	Every promise or every set of promises forming the consideration for each other is an agreement.	An agreement enforceable by law is a contract.
3.	Scope	Has a very wide scope because each contract is first an agreement.	The scope is limited because all agreements are not contracts.
4.	Nature	Covers legal and extra-legal affairs.	Covers only legal affairs.
5.	Base	Is based on proposal and acceptance of proposal.	Is based on agreement.
6.	Legality	Parties have no legal obligation.	Parties have legal obligations that are defined in the contract.
7.	Effect	Is not enforceable by law.	Is enforceable by law.

Kinds of Agreements

Broadly, agreements can be classified as under, depending upon what they are based on.

(1) Based on Obligation

Such agreements are further classified into:

(a) Unilateral Agreements

(b) Bilateral Agreements

(a) Unilateral Agreement: In a unilateral agreement, one party to the agreement has fulfilled the commitment while the other has yet to do it. For example, A agrees to sell goods to B on one month's credit and immediately despatches the goods. A has fulfilled his commitment while B has yet to do it.

(b) Bilateral Agreement: An agreement in which both parties have to fulfil a commitment or commitments simultaneously, and each party's promise is a consideration for the other party is a bilateral agreement. The promises made in a bilateral agreement are called 'reciprocal promises'. To modify the example, given before, A agrees to sell goods to B at an agreed price after one month, and, B agrees to pay for the goods when he receives them. Both A and B have committed, and one's promise is the consideration for the other. This is a typical bilateral agreement.

(2) Based on Mode of Creation

Agreements based on mode of creation are classified as:

(a) Express Agreements,

(b) Implied Agreements

(a) Express Agreement: When a proposal is made and accepted explicitly, by word of mouth or in writing, the agreement reached is an 'express agreement'. For example, A wants to sell his car for ₹ 50,000, and makes a proposal to B, who wants to buy it. B accepts the proposal by word of mouth or in writing. The agreement thus reached would be an 'express agreement'.

(b) Implied Agreement: Agreements which are not express are called 'implied agreements'. These agreements are not expressed orally or in writing but are reflected in the thinking, behaviour, rites and customs of the parties concerned. For example, the bus driver does not orally invite the passengers to board the bus, he merely stops the bus at the bus stop and the passengers board without being invited. This silent or tacit invitation by the driver and its acceptance by the passengers is an implied agreement.

(3) Based on Enforceability

Agreements based on enforceability comprise:

(a) Void Agreements

(b) Voidable Agreements

(a) Void Agreement: According to Section 2(g) of the Indian Contract Act, any "Agreement not enforceable by law is said to be a void agreement". A void agreement does not imply any legal rights or obligations for the parties to the contract. Such agreement does not have any legal effect, it is a nullity or *void ab initio* from the beginning. An agreement with a minor or one without consideration would be a void agreement. An agreement is also void when the parties to the agreement are mistaken about an essential element of the agreement. Consider an example. A agrees to buy some goods from B. The goods are on a ship on the high seas on way to India. Both A and B agree on the terms, but come to

know later that before they reached the agreement, the goods had been destroyed because the ship had sunk. In the circumstances, their agreement would be considered void.

(b) Voidable Agreement: "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others" is a voidable agreement as per Section 2(i) of the Indian Contract Act. Such an agreement lacks the essential element of free consent. When the consent of a party to the agreement is not free, or is caused by coercion, undue influence, misrepresentation of facts or fraud, the agreement is voidable. The party who has been coerced or influenced, and whose consent is not free, may repudiate, rescind or avoid the agreement, or may decide to be bound by it. The agreement is valid till it is rescinded or disowned by the party who is entitled to do so - which is the aggrieved party. Consider an example. Ajay threatens to kill Vijay if he does not agree to sell his property to the former at a price which is not even half of its market value, and makes Vijay sign an agreement to that effect. The agreement thus reached is a voidable agreement. Vijay can either be bound by it and accept the price offered, or he can repudiate the agreement as per law.

(4) Based on Law

Agreements based on law are:

(a) Legal Agreements

(b) Illegal Agreements

(a) Legal Agreement: Such an agreement has all the basic elements that are essential for a valid agreement. If A agrees to sell his car to B for ₹ 50,000 and B agrees to buy it at that price, it would be a legal agreement.

(b) Illegal Agreement: Any agreement that transgresses some rule of basic public policy, is criminal in nature or is immoral, is an illegal agreement. Being immoral implies its going against the accepted public or social norms, and being criminal implies its going against the law of the land. Such an agreement is not only forbidden by law, it is a punishable offence and the parties to it invite the wrath of law by entering into an illegal agreement. Consider the following example. A proposes to B that he will give B ₹ 50,000 if the latter kills C, and B agrees to do the killing. In the first place, the agreement is illegal because it involves B doing a criminal act. If B does the job and kills C, and A goes back on his word and refuses to pay the promised amount, B cannot go to the court of law - if he does that, he would land himself in prison.

A void agreement is a much wider term as compared to an illegal agreement. All illegal agreements are void, but all void agreements or contracts are not necessarily illegal. An illegal agreement is not only void between the immediate parties to the agreement, it has the further effect that even the collateral transactions to the original agreement are also tainted with illegality. A collateral transaction is one that is subsidiary, incidental or auxiliary to the agreement. The following examples illustrate the issue.

A and B arrive at agreement that if it rains tomorrow, then A will pay ₹ 100 to B; and if it does not, then B will pay the amount to A. In the first place, this is a 'betting' or a 'gambling' agreement, as winning or losing is a game of chance. But if one party to the agreement approaches C for a loan of ₹ 100 and, being aware of the purpose for which the loan is being sought, C lends the amount of money to him, it will constitute a collateral transaction to the agreement between A and B. Take another example. A agrees with B to kill C for a consideration of ₹ 1,00,000 to be paid to A by B. Since B does not have the money, he approaches D for a loan of the required amount. D is aware of the purpose for which the

loan is being sought, but gives the amount to B. The transaction between B and D is a collateral to the agreement between A and B, and is illegal since the original agreement is illegal.

(5) Based on Performance

Agreements based on execution can be:

(a) Executed Agreements (b) Executory Agreements

(a) Executed Agreement: Executed means that which has been done. Such an agreement is one in which the parties to the agreement have performed their respective obligations. For example, A agrees to buy a scooter from B for ₹ 10,000. When B delivers the scooter, and A pays ₹ 10,000, i.e. when both the parties have preformed their obligations, the agreement is said to be executed.

(b) Executory Agreement: 'Executory' means that which needs to be done. An executory agreement is one that remains to be executed and the parties have yet to perform their obligations. For example, A applies for a job and B agrees to give the job to A starting next month. The agreement reached is executory in the sense that both A and B have to fulfil their commitments.

An agreement can also be partly executed and partly executory. To cite an example, A agrees to paint B's house for a price. B pays the price but A has not yet finished painting the house. B has executed but A has not.

(6) Based on Enforceability

Agreements based on enforceability are:

(a) Enforceable Agreements (b) Unenforceable Agreements

(a) Enforceable Agreement: An enforceable agreement is a valid agreement that has no loopholes. Such an agreement is enforceable by law because it incorporates all the provisions of the law.

(b) Unenforceable Agreement: An unenforceable contract is one that cannot be enforced in a court of law. The non-enforceability can be because of some technical defect, such as the execution of the agreement being barred by lapse of time or the conditions or terms being not clear in the agreement. The contract may be carried out by the concerned parties, but if there is a breach of contract by one party, the aggrieved party cannot claim damages or reimbursement. To take the recourse of law, the complainant has to file the complaint on a stamped paper of a specified value, otherwise the court will not admit the suit. Likewise, under the Limitation Act, if the period specified in the contract is over; or under the Stamp Act, if the stamp is not of the specified value, or the affidavit is not properly stamped, it will not be registered.

It should be noted here that even if a party to a contract is deprived of its competence to enforce the contract because of such deficiency, it does not make the contract void or voidable. That being so, there could be collateral effects which could be important. The law provides various remedies for such deficiencies, and once these have been implemented, the contract becomes enforceable. For example, if a contract is written on a stamped paper of lesser value than is required, the defaulting party can be allowed to put additional stamps on the payment of a penalty.

Kinds of Contract

The following section discusses the kinds of contracts.

Proposal or Offer and Acceptance

The primary element of a valid contract is an agreement between the parties to the contract. In an agreement, one party makes a proposal and the other gives an acceptance to it. An agreement (or contract) is essentially between two parties. According to Section 2(c), "The person making the proposal is called the 'promisor' and the person accepting the proposal is called the 'promisee'." The British refer to it as an 'offer' but in the Indian Contract Act, it is called a 'proposal'.

Proposal or Offer

According to Section 2(a) of the Indian Contact Act, "When one person signifies to another his willingness to do, or to abstain from doing, anything with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal."

To cite an example, If A says to B that he wants to sell his watch for ₹ 150, it is a proposal from A. If B says to A that he should not sell his watch to anybody for a week, after which he would buy it for ₹160, it is a proposal that abstains A from selling his watch.

Elements or Main Features of a Proposal

The definition of a proposal specifies the following three characteristics:

(1) Existence of two parties: One cannot obviously make a proposal to oneself – a proposal is always made to another person. It logically follows that there need to be two persons for a proposal to be made.

(2) Choice to do or not to do (abstain): A proposal reflects the desire of the party making the proposal for the other party to do, or abstain from doing, something. Examples: A proposes to B to buy his car for ₹ 1,00,000; or X proposes to his neighbour Y to look after his garden while he is on vacation. If A proposes to B that if he (B) does not oppose his selection as the Managing Director, he (A) would offer him to become his deputy, it would be a proposal for not doing, or abstaining from doing, something.

(3) Object of the Proposal: The proposal has an object – the person making the proposal wants the consent or acceptance of the proposal by the person to whom the proposal is made. If a proposal is not made with the intention of getting the acceptance (or consent) of the person to whom the proposal is made, it cannot be termed a 'proposal' because its acceptance will not result into a contract (or agreement). There could be a situation where the proposal is for the other party to make a 'proposal'. There is a difference between an 'intention to make an offer' and an 'invitation to make an offer'. According to this view, the following cannot be considered as proposals.

(a) Intention to make an offer: At times a person might declare his intention to make an offer, and not actually make the offer. Such a declaration gives no right of action to another – it only means that an offer will be made or invited in future and not that it is made now. An advertisement for a concert or an auction does not amount to a proposal to hold the concert or the auction. The case of **Harris vs Nickerson** can be cited as an example. In this case, the defendant had advertised that he would auction some goods at a place far from London. The plaintiff had to go to the place where the auction was supposed to be held, and found that there was no auction. He, thereupon, filed a suit against the advertiser for wasting his time and money. But the court held that the advertiser had merely declared his intention to make an offer, and had not actually made an offer.

(b) Invitation to make an offer: When a tender is called for the purchase of goods or a shopkeeper displays goods in the show window with the price tags, or a company advertises its products and responds to queries from potential customers, it does not constitute an offer – it is merely an invitation to a seller or a buyer to make an offer. Catalogues, brochures, advertisements or circulars to potential customers are not offers but invitations to make an offer. Some things might look or sound like an offer while they are only invitations to make an offer – and there is a big difference between the two. In an invitation to make an offer, one person invites the other to make the offer. Such invitation is not an offer on the part of one who is making it. In the case of a shopkeeper displaying his goods with price tags in a show window, he is not making an offer to sell the goods at the prices displayed – he is only inviting potential customers to 'offer' to buy them at those prices. A company that advertises to sell its shares cannot be said to be making an offer to the public; it is only inviting the public to make an offer to buy the shares. When it allocates shares to an individual, it is accepting the individual's offer. Likewise, a tender for a construction job is an invitation to the builder to make an offer.

Legal Rules for a Proposal or Offer

The Indian Contract Act and the precedents of judgements of the courts of law of the country have laid down some rules that are of legal and practical importance. These are discussed in what follows.

(1) The offer must be made to create a legal obligation: While making the offer, the aim of the offeror should be to primarily create a legal obligation. An offer that creates only social or moral obligations does not constitute a valid agreement or contract. A proposal to go to picnic to or to play a cricket match does not create a legal obligation – it is not legally binding on the person making the proposal or the one who is accepting it. For example, if A invites B for lunch but, for some reason, is not at home when B comes for lunch, it does not have any legal obligation for A, and B cannot sue A for not keeping his commitment because an invitation to lunch is a social affair and does not create a legal obligation for either party. As cited in an earlier chapter, the verdict in **Balfore** vs **Balfore** illustrates the point. In this case, Mr. Balfore who was employed in Sri Lanka promised to send his wife in London £30 every month – which was a promise that he could not or did not keep. When Mrs. Balfore moved the court, the court decreed that she could not force her husband to pay the amount since there was no legal obligation on his part to do so.

(2) The terms of the offer must be unambiguous and definite: They must not be vague or indefinite. An indefinite or vague proposal is not a 'proposal' from the legal point of view, and its acceptance cannot create any contractual relationship. If A offers to B to take his building on a three-year lease if B repairs it thoroughly and 'furnishes it according to the latest style', it cannot be said to constitute an offer because it is too vague to result in a contractual relationship. Likewise, if X who has three cars, offers to sell 'a car' to Y, it is not a definite offer because X has not specified which car he

would sell to Y. Such offers or proposals are not obligatory or binding because the conditions of the proposal or offer are vague and not definite.

(3) The offer may be general or specific: An offer is called specific when it is made to an individual or a group of individuals. In case of a specific offer, only the person or group of persons to whom the offer is made can accept or reject the offer. For example, if Abdulla offers to sell his watch to Naidu for ₹ 3000, it is a specific offer which only Naidu, and nobody else, can accept or reject. If it were a general offer, Abdulla would have said that he would sell his watch to anybody who pays him ₹ 3000. A general offer is enforceable by law by anybody who accepts the offer. An example of a general offer could well be that A has lost his briefcase that had important papers and he gives an advertisement that while travelling from Lucknow to Delhi by Shatabdi Express, he has lost his briefcase and anybody who has found it and returns it to him would be paid ₹ 10,000. This would be a general offer. Somebody who finds A's briefcase and returns it to him is entitled to receive ₹ 10,000 from A, and the finder of the briefcase can legally enforce A to pay the amount. The verdict in **Carlill** vs **Carbolic Smoke Ball Co** is an example of a general offer. The company had advertised that if a person took 'smoke ball' as per the instructions and fell a prey to influenza, he or she would be entitled to claim £100 from the company. Mrs. Carlill used the medicine as per instructions in the advertisement, yet she fell a prey to influenza and claimed for £100. The company pleaded that since the offer was an advertisement, Mrs. Carlill should have been in touch with the company and informed it of her acceptance of the offer. The court decreed that in such a situation, the notice of acceptance was not mandatory, and that Mrs. Carlill had accepted the offer by using the medicine in the prescribed manner and was therefore entitled to £100.

(4) The offer may be express or implied: An offer does not necessarily need to be express – it can also be implied. According to Section 9, a specific offer can be made in words – written or oral. If A offers to sell his scooter to B for ₹ 5,000, it is a specific oral proposal. A's implied offer need not necessarily be expressed in words. A company that plies trams on roads for urban citizens makes an implied offer by its conduct to transport passengers from one destination to another at a fixed fare.

(5) The offer should be a request and not an order: The person making the offer has the right to set conditions to the acceptance of the offer, but he does not have any right to set conditions to the non-acceptance of the offer. For example, the offeror cannot set the condition that if the acceptance of the offer is not received within a specified period, the offer will be deemed to be accepted.

(6) The offer must be for a possible act: Man can do only what is possible, and the law accepts that. An offer or a proposal to do the impossible is devoid of practicality or meaning. To make an offer which is humanly impossible is not recognized by law and, as such, there can be no compliance.

(7) The offer must be communicated: An offer, to be complete, must be communicated to the person to whom it is made so that he can accept or not accept the offer. Unless the offer is communicated by the offeror (or by his agent) to the offeree, there can be no acceptance of the offer and, as such, no agreement can be reached. According to **Lord Lydley**, "a state of mind not communicated cannot be regarded in dealings between man and man." This law applies to both general and specific proposals. If A has announced a reward for anybody who finds an item that A has lost, he is not bound by law to give such reward to a person who has found the item but does not know that there is a reward for finding it. The case of ***Lalman Shukla*** vs. ***Gauri Dutt*** illustrates the principle of this law. Lalman was an employee of Gauri Dutt whose nephew was missing. He sent Lalman to trace his nephew and then announced that anybody who traced his nephew would be entitled to a reward. Lalman traced the boy

and brought him home, but he was ignorant of the reward. Subsequently, when he came to know of it, he claimed the reward and filed a suit to get it. But the court ruled that he was not entitled to the reward because he was not aware of it when he went to search for the boy. Acceptance of an offer is a 'must' for a contract – if Lalman was not aware of the offer, how could he give his acceptance and how could there be a contract.

Acceptance

Acceptance of an offer is of primary importance for a valid agreement. When the offeree, or the person to whom the offer is made, gives his acceptance, the offer is said to be accepted. An offer becomes a promise or an agreement only after its acceptance. The person who makes the offer is called the promisor, and the person to whom the offer is made is called the promisee.

According to **Sir William Anson**, "An acceptance is to an offer what a lighted match is to a train of gun-powder. Just as a lighted match will blast a train load of gunpowder, an offer becomes an agreement after its acceptance."

As per Section 2(b) of the Indian Contract Act, "When the person to whom the offer is made signifies his assent thereto, the offer is said to be accepted."

Example: A says to B that he wants to sell his car for ₹ 1,00,000. B says to A in reply that he is prepared to buy his car for ₹ 1,00,000. Here B has accepted the proposal of A.

Who can Accept?

When an offer is made to a particular person, it can only be accepted by the person to whom it is made. Acceptance by any other person is not a valid acceptance. The rule of law is very clear on this – if an offer is made by A to B, only B can accept or reject the offer. But if it is a 'general' offer, then anybody can accept it. In this connection, a case in point is **Boulton vs. Jones**. In this case, a merchant sold his business to his manager Boulton. The day the business was sold, that evening an old customer – Jones who did not know that the business had been sold – sent his requirement of goods to the owner's name (which had changed that day). The new owner Boulton, without informing the customer that the ownership had changed hands, despatched the goods as per the order and asked for the payment. But Jones refused to make the payment. Boulton filed a suit against Jones. The court decreed that Boulton could not force Jones to pay for the goods because the offer to buy was made to the previous owner who owed money to Jones, and it was not in the power of Boulton to step in and accept since there was no contract between the two and the offer was not made to Boulton.

But if there is no specific offer, then anybody can accept the offer. The case of **Carlill vs. Carbolic Smoke Ball Co.** has already been cited in this respect. In short, a specific offer can only be accepted by a specific person whereas a general offer can be accepted by anybody.

Rules of Acceptance

Acceptance of an offer is the essence of a contract. As per the sections of the Act and the precedents set by court decisions, the legal rules as to acceptance are discussed in what follows.

(1) Acceptance must be absolute and unconditional: It must conform with the offer. If it does, the offer or proposal becomes a promise. The acceptance, to be binding, must be absolute and unqualified. A qualified acceptance is not a contractual acceptance. If the terms of acceptance are different from the terms of offer, it is termed as a *counter offer* and is not recognised by law as an

acceptance until the original offeror accepts the qualified terms. Conider an example. A proposes to sell his watch to B for ₹ 1,000. to which B says that he is prepared to pay only ₹ 800 for it. This is a counter offer from B to A. When a counter offer is made, the original offer is no more valid. And until the counter offer is accepted by the original offeror there can be no agreement. If A offers to sell his land for ₹ 1,00,000. and B accepts the offer and encloses a cheque for ₹ 20,000 with a promise to pay the balance by monthly instalments of ₹ 20,000 each, it would not mean a contract between the two as the acceptance is not unconditional.

(2) Acceptance must be made in the prescribed manner: According to Section 7(2) of the Act, if the person making the offer has prescribed a method for its acceptance, the acceptance must be by that method. For example, if the proposer wants the acceptance to be communicated by telegram, it must be done telegraphically. Or if the offeror wants to specify a time limit for the acceptance of the offer, the acceptance must be within that limit. If the manner of acceptance is not prescribed and there is no time limit set for acceptance, the acceptance should be in an appropriate manner and within appropriate time. Appropriate time and method is an issue which is case-specific and would depend upon the circumstances of the case.

(3) The proposer cannot prescribe the method of refusal: The proposer needs to be informed if the offer made by him is accepted, but he cannot insist on him being informed of its non-acceptance. It is the right of the offeree to accept the proposal or not to accept it.

For example, A writes to B that he wants to sell his car to him for ₹ 1,00,000, and if he (A) does not hear from him by return post, he would presume that B has agreed to buy the car, B is not bound to reply to A and if A does not receive B's letter it does not imply acceptance of A's offer.

(4) An offer, once rejected, cannot be accepted until it is renewed: A rejected offer is a dead offer, so to say, and needs to be revived before it can be considered for acceptance. If A offers to sell 100 quintals of sugar to B at ₹ 1,000 per quintal, and B writes back that he is prepared to buy sugar only at ₹ 750 per quintal, B has rejected A's proposal. And if B sends another telegram saying that he is prepared to buy at ₹ 1,000 per quintal, A is not bound by it because A's original offer has been rejected by B. Technically, the second communication from B to A is a new proposal from B.

(5) Acceptance must be communicated to the offeror: To reach an agreement or conclude a contract, the acceptance of the offer needs essentially to be communicated to the person making the offer. If the acceptance of offer is not communicated to the person making the offer, the acceptance is not valid in terms of law. Mere mental acceptance is not enough. Unless the acceptance is communicated in a perceptible manner – in writing or by word of mouth – is not termed as acceptance. The case of **Brogdon vs. Metropolitan Rail Company** can be cited as an example. A draft agreement relating to the supply of coal was sent to the manager of the company for his approval. The manager wrote the word 'approved' and put the draft agreement in his drawer intending to send it to the company's solicitor for a formal agreement to be drawn up. The document remained in the drawer by oversight, and the court ruled that there did not exist a contract since the acceptance was not communicated to the offeror. In some cases, however, the communication of acceptance may not be necessary. In **Carlill vs. Carbolic Smoke Ball Co.**, Carlill used the smoke balls of the company according to the directions and contracted influenza. It amounted to acceptance of the offer by doing the required act and she could claim the reward. Her communication of acceptance of the offer was ruled to be not necessary.

(6) Acceptance may be express or implied: Express acceptance may be written or by word of mouth whereas implied acceptance could be reflected by the action or behaviour of the person

accepting the offer. The latter is also called tacit acceptance. According to Section 8 of the Act, tacit acceptance can be acceptance by performing conditions or acceptance by receiving consideration. For example, if a reward has been announced for the restoration of a missing item, and a person who knows about such announcement finds and restores the missing item, it would be deemed to be an acceptance of the offer of reward by the person restoring the item. Likewise, when a passenger boards a bus to go to a particular place for a fixed fare to be charged by the bus company, it is a tacit acceptance of the company's offer which is symbolised by the passenger's action in boarding the bus.

(7) An action without the knowledge of the proposal is no acceptance: Without the knowledge of the proposal, even if the action conforms to the conditions of the proposal, it does not constitute an acceptance. Acceptance can be given only by the person to whom the proposal is made. If a person does not have a knowledge of the proposal, the proposal obviously has not been made to him and he cannot give his acceptance as such. **Lalman Shukla** vs. **Gauri Dutt** is a case in point. In this case, Lalman Shukla was the employee of Pt. Gauri Dutt. When Gauri Dutt's nephew was missing, he sent Lalman to search for him. Later he announced that whoever finds his nephew would be rewarded ₹ 501. Lalman did not know of the announcement. As per earlier instructions, he found Gauri Dutt's nephew and brought and brought him back. He had no right to the reward because he had no knowledge of Gauri Dutt's proposal.

(8) Acceptance can only be given by the person to whom the offer is made: This is true of a specific proposal which can only be accepted or not accepted by the person to whom it is made. However, a general proposal which is made to the public at large can be accepted by any person who has a knowledge of the proposal.

In the case of **Boulton vs. Jones**, a merchant sold his business to his manager Boulton, which information was not communicated to the customers of the business. After the sale, the same evening, a customer Jones who had dealings with the previous owner sent his order for some goods. Without informing the customer that the ownership had changed hands, Boulton despatched the goods to Jones. On learning about the change in the ownership of the business, Jones refused to accept the delivery of goods. When Boulton approached the court, the court ruled that Boulten could not claim damages since Jones' proposal was made to the previous owner, and Boulton's acceptance was not valid.

(9) Acceptance must be made before the lapse or withdrawal of an offer: If the person making the offer has set a time limit for its acceptance, the offer must be accepted within that time. If no time limit has been set, the offer must be accepted within a reasonable time. 'Reasonable time' depends upon the circumstances or the conditions of the offer, but the acceptance must be given before the offer lapses or is withdrawn. Otherwise the acceptance is not valid and no agreement is possible. When an offer lapses or is withdrawn, there is no longer an offer and the question of its acceptance does not arise. For example, A offers to sell his scooter to B for ₹ 10,000, and wants B's acceptance or otherwise within a week, and receives no response from B for a week. B sends his acceptance on the eighth day. In such circumstance, the proposal has lapsed, and B cannot hold A answerable for his offer.

What is Contractual Capacity?

An important element of a valid contract is that the parties to the contract should have the capacity to enter into a contract. For an 'agreement' to become a 'contract', it is important that such agreement is between persons who have the capacity to contract. *Capacity* here means *competence* of the parties to enter into a valid contract. According to Section 11 of the Indian Contract Act, "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject."

On the basis of the above definition, it becomes clear that a party to a contract must:

1. Be a major.
2. Be of sound mind.
3. Not be disqualified by any law.

Thus, Section 11 declares the following persons to be incompetent to enter into a contract.

1. Minors
2. Persons of unsound mind
3. Persons disqualified by any law to which they are subject.

Burden of Proof

In the eyes of the law, every person is competent to enter into a contract. If a person wants to absolve himself of the obligations under a contract on the ground of incompetency, then the onus is on him to prove that he was incompetent at the time of contracting. Indian law does not disqualify a person to contract on the basis of religion, sex and culture. A woman cannot be disqualified, or she cannot disqualify herself, from entering into a contract on the basis of sex or culture.

(1) Minor

According to Section 3 of the Indian Majority Act, 1875, "a minor is a person who has not completed eighteen years of age." But where a guardian of a minor's person or property has been appointed under the Guardian and Wards Act, or where the superintendence of a minor's property is by a Court of Wards, the person attains majority after twenty one years of age. In English law, the age of eighteen years is taken as majority age in all situations.

Being a minor, and as such not being competent to contract, cannot be called a disadvantage. On the contrary, it is an advantage that the law provides to protect minors against their own inexperience

and the possible improper or unlawful designs of those more experienced. And if a minor does enter into a contract, and makes a promise or commits a fraud, no suit can be filed against him, neither can a minor's property be attached for non-performance of an obligation. A minor is liable to pay out of his property for 'necessaries' supplied to him or to anyone whom he is legally bound to support. The claim arises not out of contract but out of what are called quasi-contracts. And then, it is the minor's property which is liable for meeting any liability arising out of such contracts. The minor is personally not liable. The law has provided this exception intentionally. Were it not so, the law would not be protecting minors, it would make it impossible for minors even to live.

Minor's Agreements

Section 11 clearly states that a minor is not competent to contract. If a person enters into a contract with a minor, then such contract is void and inoperative *ab initio*. The Privy Council affirmed emphatically in the case of **Mohri Bibi vs. Dharmodas Ghosh** that agreements with minors are void. The law protects the minors since minors need protection because they have no experience of legal issues involved in a contract. A minor can receive benefit of action but is not bound by any obligation or answerable for any action. The law goes to the extent that even if a minor enters into a contract by telling a lie, no legal action can be taken against him. But according to Section 68, the property of a minor is liable to pay for the 'necessaries' required by the minor or his wife. The main purpose of this section is to protect the rights of those supplying these 'necessaries' to the minor. But what is important to note is that the minor personally cannot be held liable – it is his property that is liable, not the minor,

Being a minor is called being incompetent to contract, but it is, in fact, a protection given to minors by law. According to Salmond, "The law protects their (minors') persons, preserves their rights and estates, excuses their laches (negligence or undue delay in enforcing a right such as to disentitle) and assists them in their pleadings; the judges are their counsellors, the jury their servants and law is their guardian."

(2) Persons of Unsound Mind

Any person with an unsound mind is incompetent to contract; only a person with a sound mind can contract. The vital question is: who can be said to be of sound mind? Section 12 lays down the following criterion: A person is said to be of sound mind for the purpose of making a contract if, at the time he makes it, he is capable of understanding it and framing rational judgement as to its effect upon his interests.

Section 12 also clarifies that a person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind. On the other hand, a person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind. Soundness of mind of a person depends upon:

(i) His capacity to understand the basics of the business concerned, and

(ii) His ability to form a rational judgement as to their effect upon his interests.

If a person is incapable of both, he is of unsound mind. Whether a party to a contract is of sound mind or not is decided by the court. The following paragraphs discuss the types of persons of unsound mind.

(i) Idiot

An idiot is a born fool who has completely lost his mental powers. He does not have the faculty to think or understand even the ordinary matters. A lunatic suffers from intermittent fits of sanity and insanity whereas an idiot is always insane. A person who can answer simple queries about name, age, etc., is not deemed to be an idiot. An idiot can never enter into a contract. If such a person has been provided the necessaries of life for which there has been no payment, such payment can be realised from his property (if he has any) but the idiot personally cannot be held responsible. The law protects such people by making them incompetent to contract because it would be very simple for anybody to deprive them of their rights.

(ii) Lunatic

A person who has lost his mental powers because of accident, illness or personal tragedy is called a lunatic. Lunacy denotes periodic insanity and periodic sanity. Such a person is incompetent to make a contract when his state of mind is not sound. Such persons can be categorised as under:

(i) Those who are normally alright, but have periodic fits of lunacy. Such persons are incompetent to contract when they are of unsound mind.

(ii) Those who are normally insane but are sometimes of sane mind. Such persons are competent to contract when their state of mind is sound.

All contracts for procuring the necessaries of life for a lunatic and his dependants are valid contracts.

(iii) Drunkard or Delirious Person

A person who is intoxicated by drinking, or is under the influence of drugs, or is delirious because of pain or sickness cannot make a rational decision and, as such, is incompetent to make a contract. In the case of **Mathews vs. Barter**, the court held that a person denying an obligation under a contract on the plea that he was drunk or delirious while making the contract has to prove that his state of mind was not sound when he made the contract.

It is pertinent to mention here that 'old age' does not come under the provisions of this section unless it is proven beyond doubt that the party to the contract was of unsound mind because of old age when the contract was made.

Section 12 of the Contract Act makes it clear that a person with an unsound mind is incompetent to make a contract, and any contract made by such person is void. A contract cannot be held void because of an allegation that the person making the contract was of unsound mind. To enforce the legal implications, it is mandatory to prove that the party to the contract did not, or could not, understand or comprehend the conditions thereto. Once it is established that the person was of unsound mind, then it is not required to prove whether or not the other party was aware of this weakness. All contracts made under such conditions are void.

(3) Other Disqualified Persons

Others classified as incompetent to contract under Indian Law include:

(a) Alien enemy: An alien enemy, who is the subject of a foreign state, cannot make a contract with an Indian subject as per law. An alien enemy is one with whose country India is at war. If a contract has been made before the commencement of hostilities, it stands suspended and may be renewed after the hostilities are over. But in national interest, such contracts can be held void even after the state of

war has ended. Even an Indian subject who resides voluntarily in a hostile country, or who is carrying on business there, would be treated as an alien enemy.

(b) Foreign sovereigns, diplomatic staff and accredited representatives: Foreign sovereigns, diplomats and accredited representatives are not governed by Indian law and are beyond the jurisdiction of Indian courts. They cannot, generally, be sued unless they submit to the jurisdiction of the court on their own. They can enter into contracts and enforce those contracts in our courts, but an Indian citizen has to obtain prior sanction of the Central Government to sue them in our law courts. As per Sections 80 to 87 of the Civil Procedure Code, such sanction is obtainable in the following situations:

(i) When the foreign sovereign, diplomat or accredited representative has filed a suit in a court against the person desiring to sue him.

(ii) When the foreign sovereign, diplomat or accredited representative or his agent is carrying on trade within the jurisdiction of the court, and

(iii) When the foreign sovereign, diplomat or accredited representative has immovable property in the jurisdiction of the court and is to be sued with reference to such property.

(c) President of India: No Indian can file a suit against the President of the Republic in any court of law.

(d) Professional Ineligibility: Some persons cannot contract because of their high profession. For example:

(i) In England, a barrister cannot file a suit to claim his fee for professional service because of the so-called 'professional etiquette'. In India also, a barrister could not claim his fee through a court of law, but after the Bar Council Act, 1927, a barrister can get himself registered as an advocate, and as an advocate can file a suit to claim his fee. The case of **Nihal Chand vs. Dilawar Khan** is an example.

(ii) Till not very long ago, a physician in India was not allowed to file a suit to claim his fee, but the situation is changed now.

(e) Disqualification Due to Legal Status: Some persons and institutions are not competent to make a contract. These include:

(i) Convicts undergoing imprisonment awarded by a court cannot make a contract, but after they have served their term of imprisonment, or on being reprieved, they become competent to make a contract.

(ii) Debtors who have been declared insolvent and whose property vests in the Official Receiver or Official Assignee is deprived of their power to make a contract or deal in property till the court passes an order of discharge, after which they become competent to make a contract.

(iii) Public corporations or companies that include local bodies, public companies and municipal corporations cannot enter into contracts of a personal nature because these are artificial and not natural persons. They can purchase or dispose off property or terminate a contract. Such documents must be officially stamped by the corporation's or the public company's stamp and must be signed by the authorised representative of that body.

A company is a legal entity like an individual and can function as such, but it cannot go beyond what has been stated in its memorandum of association or articles of association. A company is not disqualified to make a contract – only its qualification is limited.

CHAPTER

6

Free Consent of Parties

An Introduction to Consent

An essential element of a valid contract is that the agreement is arrived at with the consent of the parties thereto. It is essential that the parties agree upon the same thing in the same sense at the same time and that such agreement is free and voluntary.

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."

As per the above definition, the following are essential for consent:

1. There must be at least two parties. The parties may be more than two, but it cannot be only one.
2. There must be only one subject of contract at one time.
3. The parties must agree on the subject in the same sense.

In other words, there must be *consensus ad idem* between the parties, or the concept or understanding of the parties of the subject of the contract must be the same. If the understanding or concept of one party differs from that of the other, then there is no identity of views between the parties. In the absence of such consensus, there cannot be any consent and, as such, no contract can be made. For the parties to reach a consensus, it is essential that:

- there is no mistake relating to the nature of the contract.
- there is no mistake relating to the identity of the person making the contract, and
- there is no mistake relating to the subject matter of the contract.

The case of **Raffles vs. Wichelhaus** illustrates the point. In this case, one party agreed to buy 125 bales of cotton from the other to arrive on a ship named Peerless from Bombay. There were two ships of that name sailing from Bombay, one in October and the other in December. One party thought it was the ship sailing in October, while the other thought it was the one sailing in December. The court held that there was a mutual or bilateral mistake and therefore there was no contract.

In the case of Sarat Chander vs. Kanai Lal, one party got the other to sign a document by misrepresentation. The party signing the document believed that he was signing as a witness whereas the first party got his signature as a party to the contract. The court held that a contract did not exist because the parties had agreed to an act with different concept.

What is Free Consent?

A valid contract requires not only the consent of the parties to the contract, it also requires that such consent is free. Consent is said to be free when it is not caused by:

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

1. Coercion

According to Section 15 of the Indian Contract Act, "*Coercion is 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 the person to enter into an agreement.*"

Coercion can be by any party against any other party, but the purpose of such act is to coerce or compel a party to agree to the terms of the contract. It need not necessarily proceed from a party to the contract and may even proceed from a stranger to the contract. Likewise, it may be directed against anybody – not necessarily the other contracting party. The intention of the person using it should, however, be to cause a party to enter into an agreement. As per Section 15, "It is immaterial whether the Indian Penal Code is or is not in force in the place where coercion is employed."

For example, A commits an act illegal as per Indian law while on board a British ship in international waters and compels B to make a contract. Later when the ship reaches Bombay, B files a suit to repudiate the contract because it was made under coercion, even if such coercion was committed in international seaway beyond the jurisdiction of Indian law, B would be entitled to repudiate or disown the contract in such a case.

If we analyse its definition, we can conclude that coercion is:

(1) Committing an act forbidden by Indian Penal Code: Such an act can include murder, dacoity, preventing a dead body from being cremated, kidnapping, physical beating or torture, etc. In the case of **Ranganayakamma vs. Alwar Satti**, a widow of 13 years was forced to adopt a boy by her husband's relatives before they allowed her to cremate the body of her dead husband. The court held that her consent was not free but caused by coercion because preventing the cremation of a dead body is an offence under Section 296 of the Indian Penal Code. Consequently, the adoption was set aside.

(2) Threatening to commit any act forbidden by Indian Penal Code: A threat to commit an unlawful act to make a person agree to a proposal is deemed to be coercion. **Ammiraju vs. Seshamma** is a case in point where a person threatened his wife and son that he would commit suicide unless they signed a release deed of their property in his favour. The court set aside the release deed and ruled that it was obtained under coercion since a threat to commit suicide is an offence under the Indian Penal Code.

(3) Unlawful detention of property: *Detaining any property by unlawful means amounts to coercion. In one case, an agent refused to hand over the books of account to a new agent till such time*

that the principal released him from all obligations, and the principal was forced to give a release deed as demanded. The court later ruled that the release deed was obtained under coercion and, therefore, voidable at the principal's option.

(4) Threatening to detain property unlawfully: To make a threat to unlawfully detain a person's property to harm him or compel him to agree to contract is deemed to be coercion. In the case of **Bansraj vs. Secretary of State**, the state threatened to confiscate the property of a person if his son did not pay the fine that the state had imposed on him. The party paid the fine, but the court held that it was a contract induced by coercion.

A lawful threat – which implies a threat to take the recourse of law – is not illegal. If a person who has given a loan threatens to go to court if the debtor does not repay the loan, it would be a valid threat and would not be deemed as coercion.

Indian and English Laws of Coercion

The near equivalent term for coercion under the English law is 'duress' or 'menace', but coercion has in fact, a much wider scope. If a person physically harms or molests another, or threatens to do so, and thereby obtains the other party's consent, such person would be using duress. Coercion is more of a threat with regard to goods or property in the form of detaining or threatening to detain such goods or property unlawfully. Duress involves actual or threatened violence by one party or his agent over the person of another (or his wife, child or parent) to obtain his agreement or consent, whereas coercion can be by any party against any other to obtain such consent.

Effect of Coercion

A contract made by use of force or coercion is voidable at the option of the party whose consent has been obtained by coercion. If the party that has been coerced so desires, he can repudiate the contract, or he can fulfil his obligation under the contract and make the other party do the same.

Under Section 72, if the person whose consent is not free and is obtained by coercion wants to repudiate the contract, then he has to return the consideration that was received by him under the contract.

Burden of Proof

The party that wants to repudiate a contract on the plea that his consent has been obtained by coercion has to prove the usage of coercion by the other contracting party. The burden of proof lies on the party making such plea.

What is Included in Coercion?

Coercion includes: (i) physical discomfort, (ii) fear and (iii) threat of physical or financial harm. It is not necessary that there be actual physical harm or injury – a threat of such harm or injury to induce fear is tantamount to coercion. Besides, any act which is unlawful under the Indian Penal Code, or a threat to commit such act, also constitutes coercion. Unlawful activities under the Indian Penal Code include murder, rape or molestation of a woman, theft or dacoity, beating and physical torture, preventing the cremation of a dead body, threat to commit suicide, etc. To unlawfully detain, or threaten to detain, goods or property to cause harm to a person also comes under coercion.

Is Threat to Commit Suicide Coercion?

The issue whether a threat to commit suicide amounts to coercion was raised in **Amirazu vs. Seshamma** case in which a person threatened to commit suicide if his wife and son did not execute a release deed in respect of their property in his favour. Both, wife and son complied and did as they were told. Madras High Court held the view that the threat to commit suicide was tantamount to coercion. Justices Wallis and Ayyar held that while a *threat* to commit suicide is not punishable under the Indian Penal Code, an *attempt* to commit suicide is punishable under Section 309 of the Penal Code. But Justice Oldfield was of the opinion that Section 15 needed to be interpreted in the correct perspective. An act (threat to commit suicide) which is not punishable by law cannot be declared illegal by law. The second interpretation would seem to be more relevant.

2. Undue Influence

According to Section 16(1) of the Contract 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 uses that position to obtain an unfair advantage over the other.*"

According to its definition, the following constitute what is termed as 'undue influence'.

(a) There being such agreement between the parties where one party is in a position to influence the free consent of the other.

(b) The party in such position making use of his position to gain undue advantage over the other.

(c) The party in such position gaining undue advantage.

To establish the existence of undue influence, firstly it is necessary to prove that one party to the contract was in a position 'to dominate the will of the other' and secondly that the party had used that position 'to obtain an unfair advantage over the other'. If any of the two conditions is not there, then there can be no undue influence.

Position to Dominate the Will

Having clarified what is undue influence, it is pertinent to ask how and under what situations can one party dominate the will of the other. Under Section 16(2) of the Act, a party is deemed to be in a position to dominate the will of another in the following conditions:

(a) When one party holds a real or apparent authority over the other. Examples of such authority would include the relationship between teacher and student, master and servant, father and son, landlord and labourer, religious teacher and disciple, etc.

(b) When the party stands in a fiduciary relationship, i.e., a relationship of trust and confidence with the other, like the relation between an advocate and client.

(c) When the party makes a contract with a person whose mental capacity is temporarily or permanently impaired for reason of age, illness or mental or physical distress. Such relationship exists, for example, between a doctor and his patient.

However, there are relationships where such domination cannot be deemed to be undue influence – like the relation between husband and wife, or between mother and daughter. Some examples of what constitutes undue influence are discussed in what follows:

A is a rich landowner and B a poor Farmer. B has a Jersey cow valued at ₹ 5,000. If A uses his authority and forces B to sell the cow for ₹ 2,000, he would be using undue influence.

A advanced some money to his son B when the latter was a minor. When B became a major, A

used his parental authority to get a bond from B for an amount greater than the sum due in respect of the advance. In this case, A has used undue influence.

A is a patient writhing in the agony of physical pain. The doctor refuses to give him a pain killer unless he signs an affidavit and, because of sheer incapacity to suffer more pain, A signs the required affidavit. Here, the doctor has used undue influence.

A is a village money-lender who promises to give a loan to B on conditions that are totally unreasonable because he knows that B is in desperate need of money. Here, A is using undue influence. The burden of proof that A was using undue influence lies with B whose will A was trying to dominate.

There could be situations where the conditions imposed by a party might sound like undue influence, but it may really not be the case. For example, A approaches a banker for a substantial loan when the money market is very tight. Because of the market condition, the banker wants a rate of interest that is higher than the normal interest rate. A agrees to take the loan at the higher rate of interest. This contract is a normal business transaction. Since money is scarce, the rate of interest is higher, and there is no undue influence exercised by the banker.

Burden of Proof

In any action to repudiate a contract on the ground of undue influence, the party wanting to repudiate the contract needs to establish:

(a) That the other party was in a position to dominate the will of party seeking repudiation. Mere proof of nearness of relationship is no ground to assume that one relation was in a position to dominate the will of the other.

(b) That the other party actually used his influence to obtain the first party's consent to the contract; and

(c) That the transaction was unconscionable or unreasonable.

Effects of Undue Influence

According to Section 19(A), undue influence in a contract has the following effects.

(i) The contract is voidable at the option of the party whose consent was obtained by undue influence.

(ii) The contract may be set aside absolutely or, if the party entitled to repudiate such contract has received any benefit thereunder, upon such terms and conditions as may seem just and equitable to the court.

Some leading cases relating to undue influence are cited in what follows:

(1) Dila Ram vs. Sardha: An old man, extremely ill and weak, under undue influence, was made to contract to pay an exorbitant fee to the doctor for his treatment. The court set aside the contract because it was made under undue influence.

(2) Mannu Singh vs. Umadatt Pande: A spiritual guru induced his devotee to execute a gift deed of all his property in favour of the guru in return of a promise of salvation. The court held that the consent of the devotee was given under undue influence.

(3) Ranee Annapurni vs. Swaminathan: A poor widow was induced by a money-lender to agree to pay 100 per cent interest on a loan of ₹ 1500. She needed the money to establish her right to maintenance. Madras High Court held that it was a case of undue influence and reduced the rate of interest to 24 per cent.

3. Fraud

According to Section 17, fraud means and includes any of the following acts committed by a party to a contract or with his connivance, or by his agent with intent to deceive or induce a person to enter into a contract:

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

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

A promise made without any intention of performing it;

Any other act meant to deceive;

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

Sometimes, being silent and not saying anything can also be a fraud. Some examples of acts of fraud are listed hereunder:

(1) **The suggestion that a fact is true when it is not true:** If a party to a contract wilfully and knowingly says something which is not true, and he knows it to be untrue, he is guilty of fraud. For

example, if A sells a shoe to B and says that it is made from calf leather, while in reality the shoe is made from ordinary leather, A would be committing a fraud, and the contract is voidable at the option of B. But for a party to express an opinion or a desire with regard to something is not a fraud. If A buys B's car, and B tells him 'I' think the car will give you 15 kilometers to a litre, B is not committing a fraud – he is just expressing an opinion. If a person makes a statement which is not true, but he believes it to be true, it will not be a fraud but a false statement.

(2) Active concealment of a fact: If a party to a contract conceals a fact that he is duty-bound to disclose, he is guilty of fraud. The law stipulates that a person buying something is aware of the quality, quantity, price, etc., of what he is buying. Even if he buys something defective or not of the quality he is looking for, he cannot blame the seller. The seller is not obliged to explain every detail about what he is trying to sell. He is only obliged to explain the product details which are not apparent or which are not noticeable or beyond the understanding of a normal man. Concealment of a fact cannot be termed a fraud unless it is obligatory for the person concealing it to disclose the fact. In other words, when a contract is based on trust and confidence, there is no concealment of facts between the parties to the contract.

For example, A sells a motorcycle to B. There is a defect in the motorcycle which is not apparent, but which is a major defect. A conceals this fact from B. Here A has committed a fraud and the contract is voidable at B's option.

(3) Promise with the intention of non-performance: If the party making the contract does not intend to perform the contract or stick to the terms of the contract, then it will be a case of fraud. For example, if A takes a loan from B and promises to pay it back by certain date while in reality he has no such intention, he would be committing an act of fraud. But a mere allegation of a party's intention of non-performance does not make the contract void.

(4) Any other act done to deceive or a fraudulent act: Man is an ingenious being and is adept in finding newer and unusual ways to commit an act of fraud. It is, therefore, very difficult to confine the parameters of fraud to its stated definition. The law recognizes all acts as fraudulent which are not listed in the sections of the Contract Act and can be used by one party by misrepresentation or concealment to persuade the other to make a contract.

(5) Any act or omission declared to be fraudulent by law: Acts, or omissions thereof, which have been declared fraudulent by law are acts of fraud. According to Company Law, a misrepresentation in a company's prospectus is an act of fraud. Under the Insolvency Act, if an insolvent transfers his property to deceive or mislead his creditors, it is deemed to be a fraud.

(6) Sometimes silence is also fraud: Section 17 does not hold silence to be an act of fraud even when it influences a party in making or not making a contract. But if the conditions are such that it becomes the lawful duty of a person to speak, then silence becomes a fraud. It also is a fraud when such silence is equivalent to speech. For example, A sells his horse in an auction to B. A knows that the horse is unsound, but he does not say anything about it. This act is not fraud. But if B is A's son, then the relationship warrants that A disclose the fact of the horse being unsound to B. Here the relationship between the two makes it A's duty to disclose the fact to B. If he does not do so, it will amount to fraud. Here A's silence is equivalent to speech.

Elements of Fraud

If we analyse the definition of fraud, the following become discernable as the elements of an act of fraud:

(1) Fraudulent work can be done by a party or his agent: In this connection, the case of **Reese Rive Silver Mining Co. vs. Smith** can be cited as an example. The company had issued a prospectus that gave false information about the unbounded wealth of Nevada. A shareholder who had bought the shares of the company wanted to repudiate the contract. The court held the contract to be voidable because the company directors had committed fraud as the company's agents.

(2) The object of the fraudulent act must be to deceive the other party: The intention must be to deceive the other party and the party must have succumbed to such deception. If the object is not to deceive the other party, but the party is deceived for whatever reason, the act is not deemed to be fraudulent. Mere falsehood is not enough reason to give the right to a party to repudiate the contract. It must have induced the party to act upon it. A deceit which does not deceive is not fraud. Consider an example. A obtained a false certificate from an animal specialist that a horse he wanted to sell was sound and displayed it on the stable door. B took the certificate to be genuine and bought the horse. The court held that the contract was based on fraud. If B had not read the certificate and bought the horse, the contract could not have been held void because there would have been no fraud.

(3) The fraud must be against the party or his agent: A fraudulent act need not necessarily be against the party to the contract. It can also be against agent of the party. The intention of the party doing the act of fraud must be to induce the other party – directly or indirectly through the party's agent – to make a contract.

(4) The other party must have suffered some loss: It is a common rule of law that there is 'no fraud without damage'. As such 'fraud without damage' or 'damage without fraud' does not invite an action on deceit.

Consideration and Object-An Introduction

Another important element of a valid contract is lawful **consideration or object**. Barring a few exceptions, a contract without consideration or object is termed a 'gamble' or 'a game of chance', and is void. 'Consideration' and 'object' represent the same thing from the point of view of the parties to the contract. A contract is an agreement between two parties, and what is an **object** for one party is the **consideration** for the other. For example, A makes a contract to sell his watch to B for ₹ 1,000. Here, selling the watch is A's object and B's consideration. Likewise, the payment of ₹ 1,000 is the consideration for A while it is the object of the contract for B.

Meaning of Consideration

In everyday language, a consideration is 'something for something'. If a person does, or promises to do, something, he expects (and is promised) something in return – which is the quid pro que or compensation – without which the promise is not valid. This 'something' is called consideration. In other words, 'consideration is the price that is paid for buying somebody's promise'. When one person makes a promise to another, he does so to receive or gain something which the other person has or which can be made available by him to the person making the promise. A consideration can be a profit or loss, a benefit or damage, or an obligation, but a contract without consideration is not enforceable by law. If A promises to give a gift worth ₹ 10,000 to B, and expects nothing in return, it is not a contract. If A later changes his mind, B cannot sue him for breach of promise.

According to **Blackstone**, "*Consideration is the recompense given by the party contracting to the other.*" **Pollock** defines it "*as the price for which the promise of the other is bought, and promise thus given for value is enforceable.*" According to Section 2(d) of the Indian Contract Act, "*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 abstain from doing something, such act or abstinence or promise is called a consideration for the promise.*"

In English law, a valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit occurring to one party for some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

Elements of Consideration

As per its definition in Section 2(d), a consideration has the following essential elements:

(1) **Consideration must be the result of the promisor's desire:** Any action, or abstinence from action, must be at the desire or request of the promisor. If such an action, or abstinence thereof, is

at the instance of a third party, or is done without the consent or desire of the promisor, then it is not a consideration. In other words, if a person does not need a thing or service which is provided to him, he does not become liable to pay for it if it is provided without his express demand. Hence, a promisor's desire or instruction is a pre-requisite for consideration. If A sells his car, which is valued at ₹ 1,00,000, to B for ₹ 50,000, it does not make the transaction illegal because the contract involves a consideration that has been defined and is at the desire of the promisor. The case of **Durga Parsad vs. Baldeo** is an important example. In this case, a party, B, spent some money on the construction of a market, at the desire of the Collector of the District. In consideration of this, D, who was using the market promised to pay some money to B. The court held the contract void because the consideration for B was not defined by D and he had not constructed the market at the instance of D.

(2) Consideration may move from the promisee or any other person: It is not necessary that the consideration is from the promisee; it may come from any other person. In this connection, the law recognizes the *Doctrine of Constructive Consideration* which stipulates that even if the consideration is not from the promisee, the promisee must be a party to the consideration. This implies that as long as there is consideration for a promise, it is immaterial who has furnished it, but a stranger to a consideration will be able to sue only if he is a party to the contract. In the case of **Chinayya vs. Ramayya**, a father left his entire property to his daughter under the condition that she will pay a certain amount of money annually to her uncle (i.e. father's younger brother). The daughter promised to pay the agreed amount annually, but stopped doing it after a time on the plea that no consideration moved from her uncle to herself, but the plea was rejected by the court. It was held that an indirect consideration had moved from her uncle. The law stipulates that 'a stranger to consideration can sue but a stranger to a contract cannot.'

(3) Consideration may be a promise to do or abstain from doing something: It can be for a negative or a positive act. In a positive act, the promisee does something at the express wish of the promisor whereas, in a negative act, the promisee abstains from or postpones doing something at the wish of the promisor. For example, A makes a contract to sell his house for ₹ 10 lakh to B. In this case, ₹ 10 lakh is a positive consideration for A. On the other hand, if A has given a loan of ₹ 10 lakh to B to be paid back by a certain date, and is thinking of filing a suit because he has not received repayment, and is approached by B with a request not to file the suit and accept ₹ 1 lakh as interest for one year, after which he will repay the loan, it will be a negative act which is a consideration for A for not filing the suit.

(4) Consideration may be past, present or future: The Indian Contract Act recognises past, present and future considerations whereas the English law does not recognise a past consideration. These are briefly discussed in what follows.

Past Consideration: When a consideration by a party for a present promise was given in the past, i.e., before the date of the promise, it is said to be a past consideration. It implies consideration for having done, or having abstained from doing, something in the past. For example, A renders a service to B that the latter wants. After a week, B promises to pay ₹ 1,000 to A for the service. It is a past consideration and A is entitled to the promised amount.

The English law does not recognize a past consideration. According to Anson, a past consideration "*is a mere sentiment of gratitude or honour prompting a return for benefits received.*"

Present Consideration: A consideration to do or abstain from doing something given simultaneously with the promise is a present consideration. A cash sale, for example, is a *present consideration.*

Future Consideration: When the consideration from one party to the other is to pass subsequent

to the act of doing or abstaining from doing something, it is called a future consideration. For example, if A promises to sell 100 quintals of rice from the coming crop at ₹ 800 per quintal to B, and B promises to make the payment for the same within a week of its receipt, it is a case of future consideration.

(5) Consideration must be legal, real and certain: A contract wherein the consideration is illegal, unreal or uncertain is void, the parties to such contract cannot take the recourse of law to enforce their rights. For example, if A promises to pay ₹ 10,000 to B to beat up C against whom he has a grudge, it would be an illegal consideration for B to accept because if he does beat up C and A refuses to pay the amount, he cannot take the recourse of law to get it. If X promises to give an amount of money to Y, and Y promises to pray for X's long life, it would be a consideration which is not real for X. Similarly, if A promises to sell his car to B for whatever B wants to pay for it, it would be an uncertain consideration for B, and the contract would be void.

(6) Consideration need not be adequate: As said earlier, consideration is 'something in return'. The 'something in return' need not necessarily be equal to 'something given'. The law provides that a contract should be supported by a consideration. So long there is a consideration, the law is not concerned about its being adequate, as per Section 25, but a contract must have a consideration. An agreement does not become void because of the consideration not being adequate. If A decides to sell his car valued at ₹ 1,00,000 for ₹ 10,000 to B, it is his 'free consent' and the agreement will be deemed to be a contract.

What Constitutes Performance?

After a contract is made, the parties to the contract are obliged by law to fulfil the promises they have made. When both the parties have fulfilled their respective obligations, the contract is deemed to be performed. Section 37 (para 1) of the Indian Contract Act states:

"The parties to a contract must either perform or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of this Act or any other law."

According to the Indian Contract Act, performance of a contract covers the following issues:

Obligation of parties to the contract.

Effect of refusal to accept offer of performance.

Identity of the performer.

Time and place of performance.

Performance of reciprocal promises.

Appropriation of payments.

Obligation of Parties to Contracts (Section 37)

Performance of a contract takes places when the parties to the contract fulfil their obligations arising under it within the time and in the manner prescribed in the contract.

According to Section 37, the parties to a contract must "either perform or offer to perform" their obligations. If there is no exception by law when there exists no mutual agreement for a party not to perform, performance of a contract is obligatory. Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract. If a party to a contract dies before the performance of his obligation, the onus of such performance passes on to his legal representative, if it is not stipulated otherwise in the contract. For example, if A promises to deliver certain goods against a payment of ₹ 2,00,000 on a certain date to B, and A dies before that date, A's legal representative is bound to deliver the said goods on the said date.

Section 37 makes it clear that a contract can be fulfilled in two ways:

Actual performance

Attempted performance or an offer of performance.

(1) Actual Performance: When each party to a contract has fulfilled his obligation(s) under the contract it is termed as *actual performance* of the contract. For actual performance, it is essential that each party actually fulfils his obligation. For example, A makes a contract to sell his horse to B. If A delivers this horse to B at the appointed time, and B accepts the horse and makes the requisite payment to A, both parties fulfil their obligations under the contract. In case A dies before the performance of his obligation, in case of no alternative being mentioned in the contract, A's representative is bound by the terms of the contract.

But if the performance of a party involves the party's personal skill, then such performance can only be done by the party, and the party's representative cannot be bound to fulfil the obligation on the death of a party. For example, A promises to make a painting for B for a price, and delivers it by a certain date. If A dies before the painting is finished, his representatives cannot be bound by law to fulfil A's obligation.

(2) Attempted Performance or Offer of Performance: Sometimes a promisor might offer to perform his obligation at the proper time and place, but the promisee may not accept such offer. When a person who is bound under a contract by law to perform a certain act, informs the promisee of his intention to perform his obligation, such offer is known as 'attempted performance' or 'tender'. A tender is not an actual performance, it is only a proposal to perform the obligations under a contract. According to Section 38 of the Indian Contract Act, an offer by the promisor to perform his obligation in a tender is deemed to be equivalent to attempted performance, except in a money tender. It absolves the promisor from further performance and entitles him to his right. But for the offer of performance to be valid, it is essential that it is unconditional and is made at the requisite time and place.

Essentials of a Valid Tender (Section 38)

The offer to perform can be for the delivery of goods or the payment of a price for goods. Both offers need to meet some essential requisites to be termed as a valid tender. These are discussed in what follows.

(1) The tender must be unconditional: If the promisor makes a conditional offer of performance, then it is not deemed to be a valid offer. An offer becomes conditional when it is not in accordance with the terms of the contract.

(2) The tender must be for the whole quantity or the whole obligation: A tender of an instalment is not binding on the promisee. For example, A promises to pay ₹ 2,000 to B on a certain date. On that date, A offers to pay him ₹ 1500. B is not bound by law to accept A's offer because it is not the total performance of A's promise.

(3) The tender must be made at the proper time and place: If the contract specifies a time and place for the offer to be made, it is obligatory that the promisor makes the offer when and where it is required to be made. If no time or place is specified, the offer should be made during working hours at the promisee's business address.

(4) The promisee must be given a reasonable opportunity for verification: Reasonable opportunity implies that the promisee should be able to see and make his own judgment about the goods conforming to his requirements and the promisors' capacity to deliver the goods as per the conditions of the contract.

(5) A tender made to one of the joint promisees is a valid tender: An offer made to an

unauthorised person is not valid. But if there are several promisees, an offer made to any one of the promisees has the same effect as a tender to all the promisees.

(6) In case of a money tender: The offer must be made by the debtor or his representative to the creditor or his representative at the specified time and place, and as per the terms of the contract. The offer should be for the total amount in legal tender money. The payment can also be made by cheque if the promisee decides to accept it.

Effects of Refusal of Promisor to Perform the Promise Wholly — Section 39

When a promisor under a contract refuses to perform or disables himself from performing his promise in totality, the promisee may put an end to the contract. But if the promisee has given his tacit assent in words or by conduct for the continuance of the contract, he cannot repudiate such contract.

For example, A is a singer who enters into a contract with the manager of a theatre B to sing in his theatre two nights a week for the next two months, and B agrees to pay him ₹ 500 for a night's performance. A absents himself wilfully and does not perform on the sixth night. B has the right to terminate the contract if he so desires. But if he permits A to perform on the seventh night, then he gives his tacit consent to continue the contract with A, and cannot put an end to it. B, however, is entitled to a compensation for the damage suffered by him because of A's failure to perform on the sixth night.

In the above example, if A were absent on the sixth night because of a valid reason, like being sick or having a bad throat, then he is not deemed to be answerable foe his non-performance, and is not liable to pay any compensation for the loss suffered by B.

By Whom Contracts Must be Performed? — Sections 40-45

A vital question with respect to the performance of a contract is – Do the parties need to personally fulfil their obligations, or can these obligations be fulfilled by a third party? According to Section 40, if there is something in the contract that indicates that it was the intention of the parties that the promise should be performed by the promisor, then such promise must be performed by the promisor. If the contract does not indicate such intention, then it can be performed by anybody nominated by the promisor or his representative. The obligations arising from a contract can be fulfilled in any one of the following ways:

(1) Performance by the promisor himself: Contracts which involve the exercise of personal skill, experience or diligence of the promisor– e.g., a contract for a painting or for singing in a concert; or contracts that are founded on personal confidence between the parties; e.g., contracts of marriage – need to be performed by the promisor. It was reiterated in the case of **Dobson vs. Drumond** that contracts involving personal skill or mutual confidence must be performed personally. For example, A has confidence that B is a good artist and he contracts to get a painting done by B for a certain price. Here the performance of the contract must be done by B himself and nobody else.

(2) Performance by the agent of promisor: In a contract where personal ability or skill of the promisor is not a consideration, the performance can be by the promisor or his agent. For example, if A promises to give a sum of money to B, it is not essential that he should personally give such sum to B; he can also ask a third party to give the money to B.

(3) Performance by the legal representative or heir of the promisor: According to Section 37, if the promisor in a contract dies before performing his promise, and if the contract is not

founded on the personal ability or skill of the promisor, then the legal representative of the deceased promisor is bound for such performance unless there is a contrary intention apparent from the contract. The obligation of the legal representative, however, is limited to the value of the property that the representative has inherited from the deceased. For example, if A promises to deliver goods to B for a certain price on a certain date, and dies before that date, his representative is bound by law to deliver the goods to B, and the latter is bound to pay the agreed price of goods to A's representative.

(4) Performance by a third party: According to Section 41, "When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor." Under English law, when a third party carries out an obligation on behalf of the promisor, such performance should either be authorised by the promisor or it should be ratified by him after the performance by the third party.

Joint Promise and Its Performance

The law allows two or more persons to make a contract with one or more than one persons. In such a situation, there may be one promisor and joint promisees, joint promisors and one promisee or joint promisors and joint promisees. For example, A and B might jointly promise to pay ₹ 50,000 to C and D. Such joint promises come under the purview of Sections 42-45, and are discussed in what follows:

(1) Devolution of joint liabilities: As per Section 42, when two or more persons have made a joint promise, unless there is an apparent intention to the contrary in the contract, all joint promisors are lawfully bound to jointly fulfil the promise. If any of them dies, his legal representative must, jointly with the surviving promisors, fulfil the promise. If all of them die, then the legal representatives of all must jointly fulfil the promise. Under English law, in the case of death of a joint promisor, the responsibility for the fulfilment of the promise devolves on the surviving promisor(s), and the deceased's representative is not held liable to contribute to its fulfilment.

(2) Any one of the joint promisors may be compelled to perform: According to Section 43, when two or more persons make a joint promise, and there is no express agreement to the contrary, the promisee may compel any one or more of the promisors to perform the whole of the promise. For example, if A, B and C jointly promise to pay ₹ 50,000 to D, D can legally enforce A or B or C to pay the amount. Under the Indian law, the obligations of joint promisors are both joint and several. In the case of the contract not being implemented, the promisee can sue all the promisors jointly and can enforce any one of the promisors to fulfil the terms of the contract. Under English law, there can only be joint enforcement of the promisors.

(3) Each promisor may compel contribution from other joint promisors: According to Section 43, when one of the joint promisors is compelled to perform the whole of a promise, he may compel the other promisors to contribute equally with himself to the performance of the promise unless a contrary intention is apparent in the contract. For example, A, B and C have made a joint promise to pay ₹ 30,000 to D. A is compelled to pay the whole amount to D. He may recover ₹ 10,000 each from B and C.

(4) Sharing of loss by default in contribution: Section 43 also stipulates that, if any of the joint promisors makes a default in his contribution or fails to fulfil his share of the promise, the remaining joint promisors must equally share the loss arising from such default. In other words, if a joint promisor becomes an insolvent, the resultant loss will be shared equally by the other joint promisors. For example, A, B and C jointly promise to pay ₹ 30,000 to D. C is compelled to pay the whole amount. A is an

insolvent, but his assets are enough to pay half his debts. In such a case, C is entitled to recover ₹ 5,000 from A's assets (which is one-half) of A's share and ₹ 12,500 (being one half of loss because of A being insolvent plus B's share) from B.

(5) Effect of release of one of the joint promisors: According to Section 44, a release by the promisee of any of the joint promisors does not discharge the other joint promisors from liability, nor is the released joint promisor absolved of his responsibility to the other joint promisors. Under the English law, when one joint promisor is released by the promisee, all joint promisors are deemed to be released.

Rights of Joint Promisees

According to Section 45, when a person has made a promise to two or more persons, unless a contrary intention is apparent in the contract, all the joint promisees have the right to claim the performance of the promise. When one of the joint promisees dies, the right to claim performance rests with his legal representative jointly with the surviving promisees. With the death of all the joint promisees, the right to claim performance rests with their legal representatives. For example, A takes a loan of a sum of money from B and C jointly, and promises to repay it with interest on a specific date. B is dead before that date. The right to claim the performance of A's promise rests with B's representative and C during C's lifetime. If C also dies before A's performance, the right to claim performance devolves on the legal representatives of B and C.

It is important to note that for the recovery of a loan given by a partnership concern, it is valid for the partners of the firm, or the representative of a deceased partner jointly with the remaining partners, to file a suit in a court of law because they are joint promisees. The *karta* of a joint Hindu family or a trustee of a trust, likewise, can file a suit for the enforcement of performance of a promise.

In case of there being more than one promisees, it is not essential that each promisee has to file a claim for the performance of the promise individually. A verdict given in the case of one promisee is applicable; and would be the same for all promisees.

Time and Place for Performance

–Sections 46-50

When and where should the performance of a contract take place? It is an important question. The normal practice is that, if the time and place of performance has been agreed to by the parties to the contract, it must be on the agreed place at the agreed time. But if the time and place has not been defined in the contract, then the performance should be at the appropriate time and place. This raises another vital question – what is appropriate time and place for performance? – and would depend on the special circumstances of a case. Sections 46 to 50 of the Contract Act lay down the following rules in this regard.

(1) Where no application is to be made and no time is specified: According to Section 46, when the promisor is to perform his promise in the contract without an application from the promisee, and no time for performance has been specified, the promise must be performed within a reasonable time. 'What is a reasonable time?' – This is a question that is related to the special circumstance of the situation or the practices and customs related to a specific trade. For example, A is a bookseller and sends an order for some books to a publisher B on the 10th of July, but he does not specify the time when he wants the books. In this case, B should despatch the books at the earliest he can because the peak period for the sale of books is about mid-July when schools and colleges open after vacation. Had A sent the order in May or June, it would not be unreasonable if B took more time in despatching the

books. In this connection, the case of **Bengal Coal Co. vs. Wadia and Co.** is an important example. In this case, the two companies made an agreement under which it was agreed that whenever there was a demand for coal, Wadia and Co. would give a reasonable notice and inform the other of its requirement. Once there was a very substantial demand and Wadia and Co. gave a notice of 40 days to the supplier. The court held that since the demand was extraordinarily substantial, a 40-day notice was not reasonable to meet such a huge requirement.

(2) Where time is specified: As per Section 47, when the promise is to be performed on a certain day, and no application is required from the promisee for such performance, the promisor may perform the promise at any time during the usual hours of business on the appointed day at the appointed place. For example, A promises to deliver certain goods at B's warehouse. On the appointed day, A brings the goods to the warehouse after business hours when the warehouse is closed, and the goods cannot be received. In this case, A has not performed the promise he made in the contract.

(3) When application is to be made by the promisee for performance on a certain day: According to Section 48, when the day for performance of a promise is fixed, the promisor may undertake its performance after an application by the promisee to that effect. In such a case, it becomes the duty of the promisee to make an application for performance at a proper place and time. What are the proper place and time would depend on the circumstance of a case, and would be decided as such. For example, if X promises to deliver 10 bags of sugar on 20 June, 2006 to Y, it becomes Y's duty to specify a reasonable time and place for the delivery to X.

(4) Application by promisor when no place is fixed for performance: According to Section 49, "*When a promise is to be performed without application by the promisee, and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise, and to perform it at such a place.*" For example, A promises to deliver 100 tons of coal to B on a fixed day. The place of delivery is not defined in the contract. It would be A's duty to ask B where he would want the delivery to be made, and make the delivery after B has named a reasonable place.

But if a place for performance has been decided beforehand in the contract, the delivery should be made only at the place.

(5) Performance in manner or at time prescribed by promisee: According to Section 50, "The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions." For example, X owes ₹ 10,000 to Y. As a part payment of the debt, X sends goods worth ₹ 8,000 to Y, which the latter accepts. X's debt is thereby reduced by that amount.

What is Discharge of Contract?

A contract involves two parties—a promisor and a promisee. When a contract is made, certain obligations devolve on the parties to the contract. When the parties to the contract fulfil their obligations, the contract is said to be executed. Discharge of contract implies termination of the contractual obligations. In other words, the rights and obligations created by a contract cease to be operative when the contract is terminated.

A contract defines the rights and obligations of the parties, and the fulfillment of obligations by the parties is the termination or discharge of a contract. Performance of obligations, therefore, is the accepted primary mode of the discharge of a contract. There may be situations where the parties to the contract do not actually have to perform their promises, and the contract is terminated. These situations, in one way or the other, terminate a contract. The discharge, or termination, of a contract can be:

1. By performance.
2. By mutual consent or agreement.
3. By impossibility of performance.
4. By lapse of time.
5. By operation of law, and
6. By breach of contract.

The various modes of discharge are discussed in what follows.

1. Discharge by Performance

Performance is the general accepted method of discharge of a contract. Performance implies doing what is stipulated in the contract. Discharge takes place when the parties fulfil their obligation within the time and in the manner prescribed in the contract. For example, A makes a contract to sell his house to B for ₹ 10,00,000. Here, when B pays ₹ 10,00,000, and takes possession of the house, the contract is deemed to be complete because both the parties have fulfilled their promises. Each party to a contract is obliged by law to either actually perform or offer to perform (i.e. tender) its promise under the contract. Offer of performance implies that one party (the promisor) offers to perform his obligation but the other party (the promisee) may or may not accept the performance. The effect of an offer to perform (or a tender) is equivalent to actual performance. Whether a contract is dischargeable by actual performance or by an offer to perform depends upon the kind and structure of the contract.

2. Discharge by Mutual Consent or Agreement

A contract is made by the consent or agreement of the parties to it. It can likewise be terminated by the agreement of the parties to the contract. According to Section 62, if the parties to a contract agree to make a new contract, or reject the prevailing contract, or make changes in it, then the performance of the prevailing contract becomes irrelevant and is not required. A contract may be terminated by mutual consent in the following ways:

(i) Novation: When both parties, by mutual consent, agree to make a new contract to replace the existing one between the parties, novation is said to take place. In this process, the new contract is substituted for an existing contract. Novation can take place between the parties to an existing contract, or between one of the parties to an existing contract and a third party. Novation of a contract can imply not only a change in the parties to a contract, but also a change in the nature of the contract. For example, A makes an agreement with B to supply him 500 quintals of rice at ₹ 900 per quintal on a certain date. Before the date of delivery, B proposes to buy 800 quintals of wheat from A at ₹ 250 per quintal instead of rice, to which A agrees. This would amount to a novation of the contract between the two.

Under novation, one party to the original contract may be absolved of his obligations and a new party might accept to perform these obligations. The new contract signifies the end of the original contract. For example, A owes some money to B, and an agreement is reached between A, B and C whereby A agrees to consider C as his debtor instead of B. In this case, the original agreement between A and B is no more valid, and a new agreement is made between A and C. But the point to be noted is that the new third party must accept the obligation under the contract. If he does not, then there is no new agreement and no novation.

(ii) Alteration: Parties to a contract have the right to alter the terms of the original contract by mutual consent. In case of such alteration, when it is done by the consent of the parties, the parties are lawfully bound to the performance of the altered contract, and the original contract is discharged. In other words, alteration signifies the discharge of all obligations under the original contract. Alteration can be regarding time, place, quantity or price, etc. For example, A promises to supply 3000 metres of a certain cloth at ₹ 10 per metre to B within 3 months. Later, A and B make an alteration in the contract to the effect that A will supply 200 metres of a superior quality of cloth at another price within 4 months. This alteration discharges the old contract between the two.

In this way, novation and alteration both result in a new contract to replace the original. But there is an important difference between the two. Novation absolves the parties of their obligations under the old contract when they substitute it with a new one, or when a new party enters into the contract to replace one of the parties; while in alteration, the parties to the contract remain the same, only the old contract is replaced by a new one with altered terms and conditions.

(iii) Remission or Waiver: According to Section 63 of the Indian Contract Act, a promisee has the right to dispense with or remit the performance of a promise by the promisor, or to extend the time for performance or accept any other satisfaction instead of performance. Such acceptance of a lesser or delayed fulfillment of a promise by the promisee is called *remission* or *wavier*. For example, A owes B ₹ 5,000. B is in acute shortage of money and decides to accept ₹ 2,000 from A at the time and place, agreed in discharge of the whole debt.

(iv) Accord and Satisfaction: When both parties to a contract agree to make a new contract to absolve themselves of performance under the original contract, and the promisor performs the promise given under the new contract, the original contract is deemed to have been discharged with accord and

satisfaction. It is so called because the new contract is made with the accord of the parties to the original contract, and its performance gives satisfaction to both parties. For example A owes ₹ 2,000 to B. He also owes money to C, D and others. A makes a contract with all creditors whereby he promises to pay 50 paise to a rupee to all his creditors. If he pays ₹ 1,000 to B, it will be deemed that he has cleared his debt to B. Here the payment of 50 paise to a rupee is by the 'accord' of A and B, and ₹ 1,000 is the 'satisfaction' of A.

3. Discharge by Impossibility of Performance

Section 56 makes it clear that if an agreement contains an undertaking to perform an impossible act, it is void *ab initio*. Any such agreement is deemed to be void. For example, if A makes an agreement with B to find a lost treasure by magic, it will be a void agreement.

But there could be cases where the performance of a contract is possible and practical when it is made, but later becomes impossible or unlawful because of the occurrence of some event over which the promisor has no control. In such cases, the parties to the contract are absolved of their obligations under the contract and are not required to perform their promises. Such a situation is called supervening impossibility. The abrogation of a contract because of impossibility of performance is also termed as the Doctrine of Frustration.

Supervening impossibility can be the result of an act of a party to the contract, or it is because of something which is beyond the control of the parties to the contract. The following are the situations where such impossibility can occur.

(i) Destruction of subject matter: When the subject matter of a contract is destroyed after the contract is made, and neither of the parties to the contract can be blamed for its destruction, the contract becomes void. In the case of **Taylor vs. Coldwell,** a theatre was booked for a musical performance, but there was a fire and it was completely destroyed. The court held the contract to be void and released the promisor from performing.

(ii) Change of law: If a person makes a contract to perform an act which is within the law when the contract is made but later becomes unlawful because of a change in law or a new law, the contract is discharged. For example, A makes a contract to supply a particular variety of wood from a forest. After the contract is made, a new law prohibits the cutting of wood from the forest. The contract is deemed to be void. In the case of **Noorbux vs. Kalyan,** a party made a contract to transport goods by road from one place to another. After the contract was made, the government requisitioned all the trucks, and the contract was held to be void.

(iii) Non-occurrence of an event: If the contract is based on the occurrence of an event, the non-occurrence of such event will make the contract void. In the case of **Krell vs. Henry,** Henry rented a room for two days from Krell for witnessing the coronation procession of King Edward VII. Krell knew the purpose for which the room was rented, but it was not mentioned in the contract. The procession was cancelled because of the king being sick. The court excused Henry from paying the rent because it held that the basis of renting the room was the procession, and its cancellation discharged the contract.

(iv) Personal incapacity or death: When the execution of a contract is dependent on the personal skill or qualification of a party, the contract is discharged on the incapacity or death of that party. In the case of **Robinson vs. Davidson,** Davidson made a contract to work for Robinson in a theatre for six months, but was so sick that he could not do so on many occasions, and was sued. The court held the performance of the contract on these occasions to be impossible.

(v) Outbreak of war: All contracts made with an alien enemy during wartime are void. Even when the parties make the contract when the relations between the countries are friendly, the outbreak of war makes the performance of the contract impossible. In such cases, either the contract is deemed to be discharged or is suspended till the war is over. In the case of **Bank Line Ltd. vs. Capell and Co.**, a contract was held to be impossible because the government had taken over a ship for wartime operations.

Unforeseen impossibility of performance makes a contract void. If a party has gained something under such a contract from the other party, then such party can be bound by law to reimburse the other. If the promisee has suffered a loss because of some act of the promisor, the latter has to compensate the former for such loss.

4. Discharge by Lapse of Time

If a contract is to be performed within a specified time, each party to it must perform his promise within the stipulated time. On the completion of the stipulated time, the contract is discharged. Under the Indian Limitation Act, the parties can claim the rights under a contract within a specified period or the contract is terminated. For example, if a debtor does not pay his debt by the agreed date, the creditor must file a suit within three years. If he does not sue within that period, he loses the legal right to claim the debt, and the debtor is not lawfully bound to pay.

5. Discharge by Operation of Law

In some situations, a contract may be terminated by the operation of law. According to Section 37, if, under the provisions of the Act or any other law, the contract is discharged or terminated, it is not necessary for the parties to perform their obligations under the contract. For example, a contract based on the personal skill or qualification of a party to it is terminated by the death of a party.

A contract may be discharged by the operation of law by the following ways:

(i) By Merger

(ii) By Unauthorised Alteration

(iii) By Insolvency.

(i) Discharge by Merger: When an inferior right accruing to a party under a contract merges into a superior right accruing to the same party under the same or some other contract, a merger is said to take place. For example, when the lessee of an immovable property becomes the legal owner of the property, the lease deed is terminated.

For a merger to take place, the following conditions need to be met:

(a) The parties to the contract must be the same.

(b) There must be no change in the basic ingredient of the contract.

(c) The rights under the contract must be different. One right should be superior and the other inferior.

(ii) Discharge by Unauthorised Alteration: When a material alteration is made in the terms of the original contract by one party without the knowledge and consent of the other, the contract is discharged and can be avoided. If some written document is lost, or the rate of interest is altered in a written document, or there is an alteration in the amount to be paid to or by a party, the contract is terminated.

(iii) Discharge by Insolvency: If a debtor is declared insolvent under the provision of law, he is absolved of all obligations under the contract, and the contract terminates.

6. Discharge by Breach

According to Section 39, if a party to a contract, without a valid or lawful reason, refuses to perform his obligation under the contract, or makes the contract impossible to be performed, the other party has the right to repudiate the contract. When such contract is repudiated, the aggrieved party has the right to sue for his rights under the contract. A breach of contract can be:

(i) Actual breach

(ii) Anticipatory or constructive breach.

(i) Actual breach: If a party to a contract fails to perform his obligation under the contract in the stipulated time or refuses to perform such obligation, then such breach of contract is called actual breach. For example, Harish promises to deliver a horse to Shyam on 19 April. On the appointed day, he refuses to deliver the horse. It is a case of actual breach.

(ii) Anticipatory or constructive breach: If a party to a contract, before the stipulated time of his performance, by word of mouth or by behaviour, makes known his intention not to perform his promise, or wilfully disables himself for such performance, it is deemed to be anticipatory or constructive breach of contract. In the preceding example, if Harish informs Shyam before 19 April of his intention not to deliver the horse and sells the horse to Ashok before that date, it will be a case of anticipatory and constructive breach of contract on the part of Harish.

In a situation of anticipatory or constructive breach of contract, the aggrieved party has the right to:

(i) assume the anticipatory breach to be an actual breach of contract and sue for breach of promise.

(ii) not to assume the anticipatory breach to be an actual breach and wait for the performance of contract on the stipulated date, and sue for breach of promise if the promisor fails to perform.

Effect of Breach of Contract

According to Section 39 of the Indian Contract Act, if a party to a contract does not perform his obligation or disables himself to perform such obligation, the other party can repudiate the contract. But if other party, i.e. the promisee, conveys by word of mouth or by his behaviour to continue the contract, then the first party, i.e., the promisor, can perform his obligation under the contract. The aggrieved party can also file a suit for damages against the party responsible for breach of contract.

Doctrine of Frustration

If a contract is entered into on the basis of existence or occurrence of a particular state of things or an event, and there is a change in the state of things or the event does not occur, the contract is discharged. This kind of failure of the object of a contract is often called 'frustration of the contract'. In old England, a set of rules were established under the Common Law which stipulated that, unless it was clearly specified at the time of making the contract, a contract cannot deemed to be discharged on the grounds of impossibility of performance, and the promisor was answerable for such breach of contract. This law was applied in the case of **Paradine vs. Jane,** where it was held that, in the absence of an agreement to the contrary, each party was lawfully bound to perform his promise under all circumstances. The court explained this law as under:

What is Breach of Contract?

A contract gives rise to rights and obligations. When the obligations under a contract have been performed, the contract terminates. A contract is discharged only by performance of obligations. On the other hand, if a party to a contract does not perform his obligations, or expressly refuses to perform the contract, it amounts to what is called 'breach of contract'.

In the case of a breach of contract, the party who does not, or refuses to, perform his obligations is called the defaulting party whereas the other party is the aggrieved party.

Remedies Available to Aggrieved Party

When a party to a contract commits a breach of contract, the other party can take recourse of some remedies that the law provides. The remedies available to the aggrieved party in case of breach of contract are as under:

(1) Exoneration: When one party to a contract refuses or fails to perform, i.e., commits a breach of contract, the aggrieved party can assume the contract to terminate, rescind the contract and is exempted from further performance. For example, Mohan makes a contract to sell certain goods to Sohan for ₹ 10,000, and Sohan promises to make the payment on delivery. If Mohan refuses to deliver the goods at the promised time, Sohan can assume the contract to terminate. In this case, he is freed from his commitment to pay ₹ 10,000.

Exceptions: In the following situations, the aggrieved party is not exempted from performance, i.e., the aggrieved party cannot rescind the contract.

(a) When the aggrieved party who wants to be exonerated from the contract has given his express or tacit confirmation to the contract. For example, if Ramesh buys some shares knowing that the company's prospectus contains false information, and makes a profit by selling some of them, he cannot later rescind the contract and be exonerated.

(b) When the contract is not divisible, the aggrieved party cannot rescind one part of the contract.

(c) When, without the fault of parties to the contract, the circumstances change, and it is no more possible for the parties to go back to the old state, the aggrieved party cannot be exonerated from performance.

(d) When the contract is in a state of change with the entrance of a third party, and the third party has, lawfully and in good faith, acquired the right of performance of the whole, or a part of the contract, the aggrieved party cannot be exonerated.

(2) Claim for damages: Damages are a monetary compensation allowed to the aggrieved party by law for the loss or injury suffered by him for the breach of a contract. The aggrieved party can sue for claiming such right under the contract. It is important to note here that damages are a compensation for the loss suffered by, or the damage done, to the aggrieved party by the breach, and consequent abrogation, of contract. The law, therefore, will allow such damages as are commensurate with the loss of the aggrieved party. The purpose here is to help the party who has suffered a loss to retain the position it had before the loss was imposed upon the party by the breach of contract. For example, A promises to deliver 100 cycle tyres at ₹ 50 each to B on 1 May, 2005, but does not perform his promise on that date. In such circumstances, if the price of a cycle tyre on 1 May is ₹ 55 per tyre, then B is entitled to claim damages at ₹ 5 per tyre from A, and can sue for such damages.

(3) Claim for 'quantum merit': *Quantum merit* literally means 'as much as earned' and implies payment to a party of as much money as the party would have earned, had there been no breach of contract. When one party, at the request of another does something or supplies some goods to the other party, and if the compensation for such goods or services has not been defined at the time of the contract, then the law decides what should be an adequate compensation for such goods or services, which is what is called 'quantum merit'. How much or what would be such compensation depends upon the circumstances of the case.

This provision of law has a lot of importance in the case of a breach of contract. The aggrieved party has the right to be adequately compensated for an obligation performed under a contract which, in the case of a breach of contract, is determined by law. For example, A promises to construct a house for B for ₹ 50,000. After A has started construction, but before its completion, B abrogates the contract and stops A from work. In such situation, A can sue for an adequate compensation for the work that he has already done and can also sue for damages.

But if a contract is made that defines the compensation to be paid to a party for a complete job, and only a part of the job is completed, the party doing the job cannot claim to be paid under the 'as much as earned' principle. For example, a builder who has contracted to construct a building, and has constructed only a part of the building, cannot sue for compensation under *quantum merit*. But if it has been defined in the contract that the builder is to receive a specified payment as and when he has completed the construction of a specified portion of the building, the principle of quantum merit is operative, and the builder is entitled to such payment.

For the law of *quantum merit* to be operative, it is necessary for the contract to be divisible in the sense that it is possible to estimate the value of the part that has been executed. It is also essential that the contract is not abrogated by the party making the demand for compensation. If a party abrogates the contract, he is not entitled to sue for payment under the law of quantum merit. For example, Narain contracts to write a book for a publisher. After having written two chapters, he refuses to complete the book. In this case, Narain cannot claim to be paid to the two chapters he has written.

(4) Claim for specific performance: When, in the case of a breach of contract, damages are not deemed to be an adequate remedy, the aggrieved party can sue the party in breach to carry out his

promise; in other words, the party in breach can be lawfully bound to perform as per the terms of the original contract. This is a direction by the court for specific performance of the contract at the suit of the aggrieved party. For example, A is looking for a house in a locality for his residence, and finds one. He contracts with the owner B to buy the house. Later B refuses to sell the house to A. In this case, damages from B for such breach of contract are not an adequate remedy for A because damages will not enable A to have the type of house he wants in the locality. In such situation, A can appeal to the court for the specific performance of the contract.

Specific performance is at the discretion of the court when the court feels that damages are not an adequate remedy because there is not other remedy for the aggrieved party than the performance of the contract. Situations have been defined in the Specific Relief Act in which the aggrieved party does have a right to specific performance of the contract, and damages are not deemed to be an adequate remedy. Specific performance is not applicable in case of contracts involving personal service.

(5) Claim for injunction: An injunction is a means of claiming specific performance where such performance involves restraining a party from doing what he has promised not to do. It is a negative order by the court that restrains a party from doing something. For example, A is a singer who contracts to perform twice a week in a theatre for two months, and not to perform in any other theatre in town during this period. After the fifth night, she is absent. The owner of the theatre is entitled to damages from A in this case and, though he cannot enforce her to perform in his theatre, he can get an injunction through the court that prevents A from performing in any other theatre. In the case of **Warner Bros. vs. Nelson,** a film actress agreed to act exclusively for Warner Bros for a year, and for no other producer. During the year, she contracted to act for another producer. It was held that she could be restrained by injunction from doing so.

CHAPTER 19

Contract of Sale

Introduction

With reference to the formation of the contract of sale of goods, it is important to clarify the following:

1. What is a contract of sale?
2. How is it legally made?
3. What is the subject-matter of the contract?
4. What is the price of goods?

What is Contract of Sale?

According to Section 4(1): "*A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a certain price.*"

According to Blackstone, when one person transfers the ownership of goods to another for the consideration of a price, a sale is said to have been made.

A contract of sale can be absolute or conditional. When a person buys something outright, it is an 'absolute' sale, but if he takes it for approval or trial, the sale contract is conditional. 'Contract of sale' is a wide term, and includes a 'sale' and an 'agreement to sell'. According to Section 4(3), when the right of ownership of goods is transferred from the seller to the buyer under a contract, the transaction is called a sale; but when the transfer of ownership is to be made at some future date, or is to be made on the fulfillment of some condition, the contract is called an 'agreement to sell'. When the condition in such agreement has been fulfilled, or the transfer of ownership of goods has occurred, the *agreement to sell* becomes a *sale*.

Characteristics of a Contract of Sale

Essentials

The following are the characteristics of a contract of sale:

(1) Buyer and Seller: Like in other contracts, a contract of sale also has two parties who make the contract. The parties in a contract of sale are the *buyer* and the *seller*. The person who buys the goods or makes an agreement to buy is called the buyer, and the person who sells goods or makes an agreement to sell is called the seller. The two parties, i.e., the buyer and the seller, are two different persons. A person obviously cannot buy something from himself. Such verdict has been given in the case of **Bell vs. Lever Bros.** But where, in law, one person has the right to sell another's goods, the owner may himself buy such goods to stop the transfer of ownership of goods to the other. According to Section 4(1), in circumstances where the seller has acquired the right to sell some goods, even though he is not the owner of such goods, such sale is lawful and the owner of goods can also be a buyer. A pawnee, if he is not paid the amount he has advanced against some goods, has the right to sell the

goods. The pawnor—who is the owner of the goods—can buy the goods himself. A partner of a firm can also be a buyer of goods belonging to the firm. An agent can be a buyer of goods that belong to the principal. A part-owner of goods may be a buyer of the other owner's share or a seller of his own share. For example, if Ram and Shyam are equal co-owners of a stock of wheat, Ram can make a contract to sell his share of stock to Shyam.

(2) Goods: The subject-matter of the contract of sale is essentially the goods. Goods, as per the Sale of Goods Act, are movable property other than actionable claims and money. Under the definition of goods laid down in the Act, stocks and shares, growing crops, grass or other things attached to, or being a part of, land which are separated from land before the sale, or have been agreed to be separated under the contract of sale are classified as goods. Ancient and rare coins are also classified as goods.

(3) Price: Goods are always sold for a price. Price is a consideration in terms of money. There must be a consideration for the sale of goods, and the consideration must be in terms of money. Money is the prevalent legal tender of the country. In other words, in a valid contract of sale, the goods must be exchanged for money. Exchange of goods for goods—i.e., a barter—is not deemed to be a sale. But, in the case of **Aldridge vs. Johnson**, it was held that a transaction partly for money and partly for goods was a sale.

(4) Transfer of Ownership: In a contract of sale, it is essential that the ownership of goods is transferred from the seller to the buyer. The transfer of ownership can be at the time of making the contract, or it can be at a future date. When the transfer takes place at the time of the contract, it is called a 'sale'. If the transfer is to take place at a future date, it is called an 'agreement to sell'.

(5) Elements of a Valid Contract: A contract of sale is a distinct type of contract, and must essentially have, the basic elements of a valid contract. A contract of sale can be 'express' or it can be 'implied'. An express contract may be made by word of mouth, or it may be in a written form. There are no specific formalities to be observed in a contract of sale. When one party makes an offer to sell some goods that he owns to another, and the other party accepts the offer, a contract is made. It is also not essential that the price of goods is paid immediately. The price can also be paid later.

Performance of a Contract of Sale

According to Section 31 of the Sale of Goods Act, the gist of a contract of sale is the performance of their obligations by the parties to the contract. It is the duty of the seller to deliver the goods and of the buyer to accept the delivery and pay for the goods. The contract is completed when both parties have carried out their obligations.

Payment and Delivery—Concurrent Conditions

According to Section 32, unless there is an agreement to the contrary, the delivery of goods and the payment of the price of goods are concurrent conditions, i.e., the seller must be willing and ready to deliver the goods, and the buyer must be willing and ready to accept the goods and pay the price to the seller.

The condition 'unless there is a agreement to the contrary' in the beginning of the section have a special importance. It implies that the payment and delivery need not always be concurrent and that parties can agree to other conditions with regard to 'payment of the price' and delivery of goods, i.e., the payment or the delivery can be non-concurrent and either may be done later as per the agreement between the parties, or it may be divisible and may be made in instalments.

Delivery

As per the terms of the contract, essentially the most important obligation of the seller is to deliver the goods. Section 2 of the Act defines delivery as the "voluntary transfer of possession of goods from one person to another." The goods must be in a deliverable state before the delivery can be made. Depending upon what the parties have agreed to, the delivery can be concurrent or at a future date, or in instalments.

The control of the seller on the goods terminates when he makes a delivery of goods, and that of the buyer commences. Besides the seller, the seller's agent can also transfer the control of goods to the buyer. Goods here refer to the goods which are the subject matter of the contract. If the contract of sale is about future goods that need to be manufactured or procured, the seller cannot deliver other similar goods and be absolved of his obligation under the contract.

Types of Delivery

The delivery of goods is of three types. It can be:

1. Actual delivery
2. Constructive delivery
3. Symbolic delivery

(1) Actual delivery: An actual delivery is a physical delivery of goods, and refers to the physical delivery of goods by the seller to the buyer. Any act of the seller or his agent that results in delivering the goods in the possession of the buyer is deemed to be actual delivery.

(2) Constructive delivery: Such delivery is also referred to as fictitious delivery. In a constructive delivery, the goods remain in the possession of the seller or his agent, or in the possession of a third party on behalf of the buyer but are deemed to have been delivered to the buyer. Such delivery is deemed to have been made in the following situations:

(a) When the goods are in the possession of the seller and he agrees to keep them in his possession on behalf of the buyer.

(b) When the goods are in the possession of the buyer, and the seller gives his consent to the buyer to retain the goods as an owner.

(c) When the goods are in the possession of a third party, and the party confirms to the buyer that he is keeping the goods on behalf of the buyer.

(3) Symbolic delivery: When the goods are of such large quantity or weight that it is not possible to deliver the goods physically, the delivery of title documents of the goods, or any other document or thing that serves as a proof of the transfer of possession to the buyer is deemed to constitute delivery; for example, delivering the key of the warehouse where the goods are stored, or the Bill of Lading or Railway Receipt to the buyer constitutes what is called symbolic delivery of goods.

According to Section 33 of the Sale of Goods Act, the delivery of goods in a sale contract is any such act which both the parties to the contract deem to constitute 'delivery', or which transfers the control and possession of goods to the buyer or, with the consent of the buyer, to a third party nominated by the buyer.

Effect of Partial Delivery

According to Section 34, if the seller has initiated the process of making the delivery of goods to the buyer and has made partial delivery, it has the same effect as that of complete delivery of goods. But if the delivery is in instalments, the delivery of one instalment does not have the effect of the total delivery being made. The partial goods delivered and the total goods to be delivered can be determined from the facts or circumstances of the case. For example, A sells 10 tons of coal to B. A's carrier has the capacity to transport one ton at a time. A, therefore, makes the first delivery of one ton. The effect of making the first delivery in this case would be the same as that of the total delivery. But if A expects to be paid for the one ton that he has delivered and then makes the next delivery, it will completely be a different scenario, and such delivery does not have the effect of total delivery, because here A's intention is to separate the one ton of coal that has been delivered from what is yet to be delivered.

Buyer's Application for Delivery

According to Section 35, unless there is no specific contract, the seller is not lawfully bound to deliver the goods to the buyer till such time that the buyer applies for the delivery. This provision of law

gives the right to the seller of goods that, if he so desires, he can deliver the goods without the buyer's request. The verdict in the case of **Alpaty Moorty vs. Polisetti Satyanaryana** held that the buyer was not only liable to pay the price of goods, he also was liable to ask for their delivery from the seller.

Rules Governing the Delivery of Goods

Under the provisions of the Sale of Goods Act, the rules that apply to the delivery of goods are as under:

(1) Place of delivery: As a general rule, the contract of sale specifies where the goods have to be delivered, and it is the duty of the seller to deliver the goods at the place specified in the contract of sale. According to Section 36(1), if there is no agreement between the parties as to the place of delivery, then the goods sold will be delivered at the place where they were sold. If the goods are not in existence when they are sold, they will be delivered at the place where they are manufactured, unless there is an agreement to the contrary between the parties, in which case the goods will be delivered at the stipulated place.

(2) Time of delivery: If the time of delivery is specified in the contract, the seller should deliver the goods at the time specified. But, if the contract does not specify any time of delivery, according to Section 36(2), the seller should deliver the goods within a reasonable time. What is a reasonable time depends upon the circumstance of the case.

(3) Goods in possession of a third person: According to Section 36(3), when the goods sold are in the possession of a third person, delivery is only made when the party possessing the goods promises to keep the goods on behalf of the buyer. The title to the goods, in any case, has to be transferred to the buyer.

Example: Ashok buys a watch from Vijay which is in the possession of Suman. Suman says that she will keep the watch with her on behalf of Ashok till such time as Ashok wants her to keep it, and Ashok agrees to it. This will be a case of delivery of goods in the possession of a third person.

(4) Expense of delivery: According to Section 36(5), unless there is an agreement to the contrary, all expenses on the delivery of goods will be borne by the seller.

(5) Delivery of wrong quantity: Delivering an excess or a lesser quantity of goods is called a delivery of wrong quantity, but a marginal difference either way is not deemed to be delivery of wrong quantity unless the goods are very expensive, like gold, platinum or diamonds. If the difference in quantity is marginal, the buyer does not have the right to refuse to accept the delivery of goods. As a general rule, the quantity of the goods should be the same as agreed to in the contract. If the quantity of goods delivered is more or less, then the following rules are applicable.

(a) Delivery of goods in less quantity: According to Section 37(1), if the seller makes the delivery of goods to the buyer in a lesser quantity than agreed to in the contract, the buyer is entitled to refuse to accept the goods. But, if the buyer accepts a lesser quantity of goods, he must pay for the goods at the rate agreed to in the contract.

(b) Delivery of goods in excess quantity: According to Section 37(2), if the goods delivered are in excess of the quantity agreed to in the contract, the buyer can: (i) accept the agreed quantity and return the surplus, (ii) refuse to accept the delivery or (iii) accept the total goods. If the buyer accepts all the goods, he has to pay for them at the rate agreed to in the contract.

(c) Delivery of specified goods mixed with others: According to Section 37(3), if the seller mixes the goods specified in the contract with other goods, and delivers the lot to the buyer, the buyer is at liberty to refuse to accept the delivery, or to accept the goods that conform to the specifications and reject the others.

For example, A places an order with B to send him two tea-sets of Gowalior Potteries, and B sends him one tea-set of Gowaliar Potteries and the other of Hitkari Potteries. In this case, A can reject both the sets, or he can keep the one from Gowalior Potteries and return the other.

(6) Instalment deliveries: According to Section 38(1), if there is no such agreement in the contract, the buyer is not bound to accept instalment deliveries. But if there is such a provision in the contract, the seller can make instalment deliveries.

When the delivery of goods is in instalments and each instalment is to be paid for separately, and if one or more instalments are not delivered or the goods delivered are defective, or if the buyer refuses to take delivery of, or neglects to make the payment for, one or more instalments, and the contract is deemed to have terminated, the question as to which party is liable for damages depends upon the circumstances of the case and the terms of the original contract.

(7) Delivery of goods to a carrier or wharfinger: According to Section 38:

(a) If the seller, according to the terms of the contract, has delivered the goods to the carrier or wharfinger, the delivery is deemed to have been made to the buyer.

(b) In the absence of a contract to the contrary, the seller is expected to deliver the goods to a carrier who is capable and has the infrastructure to transport the nature, size and weightage of the goods that are to be delivered so that the goods are not damaged in transit. If the goods are damaged because of the seller's neglect in selecting a proper carrier, the buyer can refuse to take the delivery of goods, and hold the seller liable for damages.

(c) In the absence of a contract to the contrary, if the goods are to be transported by sea, and the circumstances are such that the goods need to be insured, the seller must communicate the same to the buyer so that the goods are insured against damage in transit; otherwise the seller will be liable for the damage.

(8) Risk where goods are delivered at distinct place: According to Section 40, when the goods are lying with the seller, the buyer, even in such case, is liable to any damage to the goods after the sale has been made but before the goods are delivered. But if the goods are destroyed before or during transit, the responsibility and risk are the seller's.

(9) Buyer's right of examining the goods:

(a) Section 41(1) specifies that, where the contract of sale is about goods that the buyer has not seen or examined, the buyer cannot be bound to accept their delivery till he has not had a reasonable opportunity to examine the goods and satisfied himself that they conform to the specifications.

(b) Section 41(2) lays down that, if there is no contract to the contrary, and if the buyer wants to examine the goods before they are delivered to satisfy himself that the goods conform to the specifications, the seller is bound to provide such opportunity to the buyer to examine the goods. The seller cannot hold the buyer liable to accept the goods without examining them.

Who is an Unpaid Seller?

A person who has sold goods to another person but has not been paid for the goods, or has been paid partially, is called an unpaid seller. According to Section 45 of the Sale of Goods Act, an unpaid seller is one:

(1) Who has not been paid the price of the goods he has supplied, or has been partially paid for the goods.

(2) Who has been given a negotiable instrument like a bill of exchange that has been dishonoured. It is immaterial whether the seller is directly involved in the transaction, or he is acting through his agent.

Rights of an Unpaid Seller

The unpaid seller has the following rights:

1. Rights against the goods
2. Rights against the buyer of goods

(1) Rights against the goods: According to Section 46, when the buyer has not paid the full or partial price of the goods supplied to him, then the seller who has transferred the ownership of goods to the buyer has the following rights with regard to the goods:

(a) Right of lien.

(b) Right of stopping the goods in transit if the goods are no more in his custody.

(c) Right to re-sell the goods, if the ownership of goods has not been transferred to the buyer.

(a) Right of lien: According to Section 47, if the seller of goods has not been paid, and the ownership of goods has been transferred to the buyer but the goods are in the possession of the seller, the seller has the right to retain the goods till he receives the price of goods from the buyer. The seller has this right in the following circumstances:

(i) When the goods have not been sold on credit.

(ii) When the payment has not been made on the promised date, if the goods were sold on credit.

(iii) When the buyer has become an insolvent.

Even if the seller has the possession of goods as an agent or bailee of the buyer, he still has the right

of lien of the goods. When an unpaid seller has made partial delivery of goods, he can exercise his right of lien on the goods not delivered unless the part of delivery was made in circumstances to show an intention to waive the lien.

Termination of lien: According to Section 49, the lien of an unpaid seller terminates in the following circumstances.

(i) When the seller delivers the goods to a carrier or any other bailee for the purpose of transmission to the buyer without reserving the right of disposal of goods.

(ii) When the buyer or his agent lawfully obtains the possession of goods.

(iii) When the seller has waived his lien on the goods.

(b) Right of stoppage of goods in transit: According to Section 50, when the seller has delivered the goods to a carrier for transmission to the buyer and the goods are in transit, if he receives information that the buyer has become insolvent, the seller has the right to stop the goods in transit and retain their possession till such time as he is not paid the price of goods. The seller has the right of stoppage of goods in the following circumstances:

(i) When the price of goods has totally or partially not been paid.

(ii) When the buyer has become insolvent before paying for the goods.

(iii) When the goods are in transit.

Duration of transit: According to Section 51, when the seller has delivered the goods to the carrier or bailee for transmission to the buyer, until the goods are received by the buyer or his agent is the duration of transit. Even if the goods have reached the destination, the seller's right of lien does not terminate till the buyer or his agent has taken the possession of goods. The rules determining as to when the goods are deemed to be in transit are discussed in what follows:

(i) Delivery of goods to the carrier or bailee: The goods are deemed to be in transit when they have been delivered by the seller to the carrier or bailee for transmission to the buyer, and the duration of the period in transit is till the buyer or his agent takes possession of the goods.

(ii) The buyer taking delivery before destination: If the buyer or his agents takes the delivery of goods before the destination, the duration of transit is lawfully ended.

(iii) Holding the goods by the carrier on behalf of the buyer: If, after the goods have reached the destination, the carrier is holding the goods on behalf of the buyer, the duration of transit is deemed to have ended.

(iv) When the goods are rejected by the buyer: If the buyer rejects the goods and the possession of goods remains with the carrier or bailee, the duration of transit is deemed to have ended.

(v) When the goods are delivered to a ship chartered by the buyer: When the goods are delivered on board a ship chartered by the buyer, it depends upon the circumstance of the case whether the ship's owner (i.e. the shipping company) accepts the goods in the capacity of a carrier or an agent of the buyer. If the shipping company accepts the goods as an agent of the buyer, the duration of transit terminates.

(vi) When the carrier or bailee refuses to deliver the goods: When the carrier or bailee, with malafide intention, refuses to deliver the goods to the buyer or his agent, the duration of transit is deemed to end.

(vii) When partial delivery has been made to the buyer: In case a part of goods has been delivered to the buyer or his agent, and the rest of the goods are in transit, and if the partial delivery is made with the intention that it is not deemed to be total delivery, the seller has the right to stop the remaining goods in transit.

How Stoppage of Goods in Transit is Affected?

According to Section 52, the stoppage of goods in transit is affected by:

(i) taking actual possession of goods.

(ii) giving notice of the seller's claim to the carrier or any other person having the control of goods. Such notice is given to the person who has the control of goods, or the principal of the person if he is an agent acting on behalf of another person. Notice to the principal, must be given in such manner that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent delivery to the buyer.

When the notice by the seller stopping the goods is given to the carrier or bailee, the latter should return the goods to the seller or his agent as directed by the seller, who will be liable for all expenses undergone by the carrier in doing so.

Lien vs. Right of Stoppage in Transit

There are three major differences between lien and right of stoppage.

(1) Both are used when the ownership of goods has been transferred to the buyer, but lien implies that the goods are in the possession of the seller. On the other hand, stoppage of goods is affected when the seller does not have the possession of the goods but the goods have not yet reached the buyer, i.e., they are in the possession of the carrier or the bailee.

(2) Another difference between lien and stoppage in transit relates to the circumstances of their usage. The seller can exercise his right to stop the goods in transit only when the buyer has been declared insolvent, but the right of lien can be exercised by the seller at any time to recover the payment for goods from the buyer.

(3) The object of lien is to hold the goods that the unpaid seller has in his possession till such time that he receives their payment whereas the object of stoppage in transit is to get the goods that are in the possession of a third party back to the possession of the seller.

(c) Right of Re-sale: Besides the right of lien and stoppage of goods in transit, an unpaid seller has the right to re-sell the goods. Section 54 defines the general rules for the re-sale of goods by an unpaid seller. The major rules are as under.

(i) The unpaid seller may re-sell the goods if the goods are perishable.

(ii) When the unpaid seller has acquired the possession of goods by virtue of lien or stoppage in transit, and has given notice to the buyer of his intention to re-sell the goods, and if the buyer does not pay for the goods, the unpaid seller can re-sell the goods. The seller is also entitled to claim from the buyer any loss that he may suffer in re-selling the goods. If the unpaid seller makes a profit by re-selling the goods, the defaulting buyer has no claim on such profit because the law does not permit a defaulter to profit by his default.

(iii) In case of a default on the part of the buyer, when the seller has secured the right to re-sell in a clear and certain procedure, he can proceed with the resale of goods.

When an unpaid seller plans to re-sell the goods, he is obliged by law to give one last opportunity to the buyer by informing him of his intention to do so, so that the buyer can assure himself, if he desires, that the goods are sold at a reasonable price. If the unpaid seller does not inform the buyer of his intention to re-sell the goods and is put to a loss in the re-sale, he cannot later claim such loss from the defaulting buyer or keep with himself any profit that may result from the re-sale.

Rights Against the Buyer

An unpaid seller has the following rights against the buyer:

(a) Suit for price: According to Section 55, if the ownership of goods has been transferred to the buyer and he refuses to make the payment for the goods, the seller has the right to file a suit against the buyer.

According to Section 55(2), if, according to the terms of the contract of sale, the payment for the goods is to be made by a certain time or date by the buyer and such payment has not been made, the seller has the right to sue the buyer even if the ownership of goods has been transferred to the latter.

(b) Suit for damages: According to-Section 56, if the buyer refuses to accept the goods or defaults in making the payment for them with a malafide intention, or refuses to accept the goods or to pay for the same, the seller has the right to file a suit against the buyer for damages.

(c) Repudiation of contract before due date: According to Section 60, if the buyer repudiates the contract before the due date for the delivery of goods and the seller does not accept the repudiation and waits lor the due date, to make the delivery, he reserves the right to sue the buyer for repudiating the contract.

(d) Suit for interest: The unpaid seller, according to Section 61, has the right to be paid interest by the buyer for any delay in making the payment. Such interest is affective on the amount of payment for the period of delay after the due date.

25 Negotiable Instruments Act, 1881

The Negotiable Instruments Act was enacted in India in 1881. Prior to its enactment, the provisions of the English Negotiable Instrument Act were applicable in India, and the present Act is also based on the English act with certain modifications. The Act is applicable throughout India except in the state of Jammu and Kashmir from the 1st of March 1882.

Meaning of Negotiable Instrument

'Negotiable' means transferable by delivery, and 'instrument' is a written document which creates a right in favour of any person. Therefore, a negotiable instrument is a written document which creates a right in favour of any person and which is transferable by delivery.

Definition: 'A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer'. —Section 13

The above definition is not a comprehensive definition of a negotiable instrument as it is very limited in its scope and many instruments such as *hundi*, etc., will not qualify as negotiable instruments as per this definition. Secondly, the definition merely tells us that cheques, bills of exchange and promissory notes are negotiable instruments and does not highlight in any manner the nature and characteristics of negotiable instruments.

However, some authorities have given much more scientific definitions of negotiable instruments, and the following are the prominent ones among them.

According to **Thomas,** "*A negotiable instrument is one which is, by a legally recognised custom of trade or law, transferable by delivery or by endorsement, and delivery in such circumstance that (a) the holder of it for the time being may sue on it in his own name, and (b) the property in it passes free from equities, to a bonafide transferee for value, notwithstanding any defect in the title of the transferor.*"

According to **Justice Willis,** "*A negotiable instrument is one, the property and the title in which is acquired by any one who takes it as bonafide and for value notwithstanding any defect in the title of the person from whom he took it.*"

The above definitions make it clear that a negotiable instrument is different from other commodities. The normal law relating to the transfer of any property is that no buyer can become the owner of a property unless he purchases it from the owner or from any person so authorised by the owner. However, negotiable instruments are the exceptions to the above law, because if a person purchases them in good faith and for value, then he becomes the actual owner of the instrument even if he has purchased the same from a person other than the owner thereof.

Essential Characteristics of a Negotiable Instrument

The essential characteristics of a negotiable instrument are enumerated below:

1. It is a written document.
2. A negotiable instrument payable to bearer is transferable merely by delivery, whereas a negotiable instrument payable to order is transferable by endorsement and delivery.
3. The holder of a negotiable instrument can sue upon it in his own name.
4. The consideration is not mentioned on the negotiable instrument. It is presumed that the negotiable instrument has been drawn for a valuable consideration.
5. It works in the same manner as money and, like money, it may also be transferred from one person to another.
6. The transferor does not need to give notice to any person at the time of transferring the instrument.
7. It is the simplest and most convenient mode of assignment of a debt.
8. The title to the instrument received by a bonafide transferee is not affected by any defect in the title of the transferor.

As per the above mentioned characteristics, railway receipts, dividend warrant, debentures of port trusts or improvement trusts will also qualify as negotiable instruments. However, money orders, postal orders, share certificates, bill of lading, etc., are not negotiable instruments as, even though they are transferable by endorsement and delivery, they do not give the transferee a better title than that of the transferor. If there is a defect in the title of the transferor, the transferee also gets a defective title.

Kinds of Negotiable Instruments

Section 13 of the Negotiable Instruments Act states "*A negotiable instrument means a promissory note, bill of exchange or a cheque payable either to order or to bearer.*" Therefore, even though the Act acknowledges the existence of other kinds of negotiable instruments, it specifically mentions the aforesaid three kinds of negotiable instruments.

Promissory Note

According to Section 4 of the Indian Negotiable Instruments Act, 1881, "*A promissory note is an instrument in writing (not being a bank note or currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to, or to the order of a certain person.*"

Characteristics of Promissory Note

Based upon the above definition, the following are the main characteristics of a promissory note:

1. A promissory note is unconditional.
2. It is always in writing; a verbal promise to pay a specified sum of money is not a promissory note.
3. It is made and signed by the debtor.
4. A promissory note is made as payable to a specified person or to the order of the specified person or to the bearer, after the expiry of a specified duration.
5. A promissory note should be payable in the currency of the country.
6. A promissory note drawn for a specified duration should be adequately stamped according to its value.
7. A bank note or currency note is not a promissory note.
8. A promissory note should be drawn for the payment of a specified sum. However, the acknowledgment of a debt such as an I.O.U is not a promissory note.
9. The consideration for and the date and place of making the promissory note need not be mentioned in the promissory note.

(Specimen of Promissory Note)

₹ 1500

Bahadurgarh,
20th January, 2006

On demand (or three months after date), I promise to pay Shri Ashok Kumar or order the sum of rupees one thousand Five Hundred with interest @ 10% per annum until payment for value received.

Stamp

Ram Kishore

Signature

For example, if A signs an instrument containing the following conditions:

(i) I promise to pay B or order ₹ 1500, or

(ii) I acknowledge myself to be indebted to B to the extent of ₹ 1500 payable on demand, for value received, then the instrument will qualify as a promissory note.

However, if A signs an instrument containing any of the following conditions, it will not be a promissory note.

1. I am indebted to B for ₹ 1,500, or
2. I promise to pay B ₹ 1,500 along with any other sum which may be payable to him, or
3. I promise to pay B ₹ 1,500 after deducting therefrom any sum which may be due from B to me, or
4. I promise to pay B ₹ 1,500 ten days after I get married to C, or
5. I promise to pay B ₹ 1,500 on the death of C, provided C leaves me enough money to pay B, or
6. I promise to pay B ₹ 1,500 along with a black horse on the next 1st of January.

Parties to a Promissory Note

There are two parties to a promissory note. They are:

(1) Maker: He is the debtor who makes the promissory note promising to pay a specified sum after the expiry of a specified duration. There may be one or more makers of a promissory note.

(2) Payee: He is the creditor in whose favour the promissory note is made.

Bills of Exchange

According to the Negotiable Instruments Act, 1881, *"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."*

Characteristics of a Bill of Exchange

A bill of exchange has the following characteristics:

(1) Written: A bill of exchange must always be in writing.

(2) Unconditional: A bill of exchange is unconditional, i.e., there is no condition attached to it.

(3) Order letter: A bill of exchange is an order letter. It is drawn by the creditor on the debtor and it is in the form of an order and not a request.

(4) Signature of the drawer: A bill of exchange must be signed by the drawer as well as the drawee.

(5) Fixed amount: A bill of exchange is drawn in the form of an order to pay a fixed sum of money.

(6) Payment to a specified person: A bill of exchange is payable to the person specified therein, or to the order of the specified person or to the bearer as the case may be.

Kinds of Bills of Exchange

Bills of exchange are mainly of two types:

(1) Inland Bill: An inland bill of exchange is one which is drawn by a business man for acceptance by another businessman of the same country. Therefore, an inland bill of exchange is one in which both the parties are in the same country.

(2) Foreign Bill: When a businessman from one country draws a bill of exchange on a businessman belonging to another country, in other words, the drawer and the acceptor live in different countries, then such a bill of exchange is known as a foreign bill of exchange. Such a bill is drawn in one country but is payable in another country, and is used mainly in the course of foreign trade. In the case of a foreign bill of exchange, three copies of the bill are made and each copy bears reference of the other two copies. All the three copies are dispatched to the acceptor by a different mode. This is done because in case the acceptor does not receive the first copy despatched by post, then at least he will receive the remaining two copies. However, on payment of the first copy of the bill of exchange, the other two copies become redundant. Another point to be kept in mind in relation to a foreign bill is that a foreign bill is stamped twice, once in the country of the drawer and once in the foreign country. A specimen of a foreign bill of exchange is given below:

£ 5,00 New Delhi;
31 January, 2006

Stamp

Sixty days after sight of this first Bill of Exchange (Second and Third of the same tenure and date unpaid) Pay to Grindlays Bank or order the sum of five hundred pounds only, for value received.

For New Delhi Enterprises,
Ashok Kumar
Manager

To
Fedders Lloyd Corporation
(West Germany)

Difference between Inland and Foreign Bill of Exchange

S. No.	Basis of Difference	Inland Bill	Foreign Bill
1.	Parties	The drawer and acceptor of an inland bill of exchange are of the same country.	In case of a foreign bill of exchange, one of the parties is a foreigner.
2.	Language	An inland bill is drawn in the language prevalent in the country in which it is drawn.	A foreign bill is always drawn in English.
3.	Stamp	An inland bill is stamped only once.	A foreign bill is stamped twice.
4.	Copies	Only one copy of an inland bill of exchange is prepared.	In case of a foreign bill of exchange, three copies of the bill are prepared.

Other Kinds of Bills

Apart from inland and foreign bills, there are many other kinds of bills of exchange, which are discussed in what follows.

(1) Accommodation Bill: Those bills which are drawn without any actual consideration, merely to help out friends and relatives are known as Accommodation Bills. Such bills are drawn and accepted in order to help either one or both the parties to the bill.

(2) Inchoate Bill: When any person signs, stamps and delivers to another person a totally blank bill or an instrument which is only partly filled up and authorises such person to fill up the remaining part of the instrument, such an instrument is known as an inchoate instrument. Whosoever signs such an instrument is liable for that instrument, since the transfer of the instrument is a proof that the maker of the instrument has given the transferee the right to complete the instrument. —Section 20

(3) Undated Bill: As per Section 18, the holder of an undated instrument may enter the date of drawing or acceptance. In case the holder of an instrument bonafide enters a wrong date, then such date will be considered as correct as long as all other legal formalities have been complied with. —Section 18

(4) Ambiguous Bill: If an instrument is written in such a manner that it can be classified as both a promissory note as well as a bill of exchange, then such an instrument is known as an ambiguous instrument. In case where the drawer and the drawee are one and the same person, or when the drawer is a fictitious person or when the drawer is a person not competent to contract, then the holder of the instrument may treat it as a promissory note or a bill of exchange at his option. —Section 17

(5) Fictitious Bill: In case the drawer or the drawee or the payee of a bill is a fictitious person, or is a person who is no longer alive, then as per the English Act, such a bill is payable to the bearer. In India, however, if any party to a bill of exchange is a fictitious person, then such a bill is not enforceable; but even in a fictitious bill the rights and interests of a holder in due course are protected.

(6) Documentary Bill: A documentary bill of exchange is one which is accompanied by documents such as shipping documents, bill of lading, insurance policy, invoice, etc., and these documents are released by the bank only on the acceptance or payment of the bill, as the case may be.

(7) Banker's Draft: It is a bill of exchange in which a bank orders its branch or another bank, as the case may be, to pay a specified amount to a specified person or to the order of the specified person.

Cheque

Definition: According to Negotiable Instruments Act, 1881—A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. (Section 6)

"A cheque is an unconditional order in writing drawn by a customer on his bank, requesting the specifying bank to pay on demand a certain sum of money to a person named in the cheque or to the bearer or to the order of a stated person."

A cheque being a bill of exchange must possess the following requirements:

1. A cheque must be drawn upon a specified banker.
2. A cheque must be payable on demand.
3. A cheque must be signed by the drawer.
4. A cheque must be an unconditional order to pay a certain amount of money.
5. A cheque must be dated (it can be post-dated).

Payment of Cheque

As far as payment of cheques drawn by customers is concerned, the paying banker is always in a privileged position. As long as he pays the open cheques, i.e., bearer cheques and cheques drawn to order, with due care and diligence, after properly matching the signature of the customer, in the appropriate form and at the proper counter, then under Section 85, the banker is absolved of his liability on the cheque. A crossed cheque is always paid to another bank and is not encashable at the bank counter. In case of special crossing, payment will be made only to the bank in whose favour the cheque has been crossed. Therefore, under Section 126, a banker is absolved of his liability on a crossed cheque if he makes the payment to another bank or, in case the cheque is specially crossed, if he makes the payment to the bank in whose favour the cheque has been crossed or to the agent of such a bank. However, Section 126 also contains a provision that in case, apart from being crossed in favour of an agent, a cheque also contains more than one special crossings, then the paying bank should refuse the payment of such a cheque. Section 128 states that if a bank has paid a cheque drawn upon it in the proper manner, the bank is absolved of its liability even if the payment of the amount does not reach the actual owner. The main reason for providing this protection to the banker is that a banker cannot be expected to know the signature of all the people in the world. However, it is very necessary for the banker to know the signature of his customer and is legally bound to know the signature of his customer. Therefore, if the signature of the customer are proved to be faulty, then no such protection will be available to the banker. However, in such a situation also, in case the banker is able to prove that the fault is due to the carelessness of the customer, then the above protection will be available to the bank, and the banker will not be liable for any damages suffered by the customer. In actual practice, before paying a cheque drawn to order, the bank usually insists on getting the signature of the person receiving the payment attested, and this demand is usually met by getting an old customer having an account in the bank to attest the signature. In such a case, the person attesting the signature agrees to become a surety for the bank as he knows and recognises the person to whom the payment is being made.

Marking of Cheque

A cheque is a kind of bill of exchange which is always drawn upon a specific bank and is payable on demand. Normally, for payment, a cheque need not be accepted by the bank. This is so because a cheque is drawn for the immediate payment thereof. However, in United Sates of America, cheques are marked in order to certify them as being good for payment. The process by which the cheque is marked or certified by the bank is known as certification or marking of the cheque. The marking of a cheque amounts to the acceptance by the bank that the cheque is payable and, upon marking the cheque, the bank is bound to pay the amount of the cheque to the creditor or the bearer. In India, however, the practice of marking of cheques is not very prevalent at present, and even if an Indian banker marks a cheque as being good for payment, he is not equally bound to pay the amount thereon.

A banker marks a cheque as being good for payment, in the following circumstances:

(1) **Marking at drawer's instance:** A drawer may want a cheque to be marked as good for payment in order to establish his credibility among outsiders. The bank, upon ensuring that enough money has been deposited into the account, stamps the cheque and notes some words such as 'good' on the face of the cheque and then usually keeps the amount of the cheque separately. However, if, before the cheque is presented for payment, excess funds are withdrawn by the drawer, and there are insufficient funds to pay the marked cheque, then the banker has the right to dishonour the cheque.

(2) Marking at holder's instance: The marking of a cheque at the holder's instance means that the bank certifies that there are enough funds in the account of the drawer at the time of marking to pay the cheque. However, if, before the payment is actually demanded, such sum is withdrawn by the drawer, making it impossible to fully pay the cheque, the bank may dishonour the cheque.

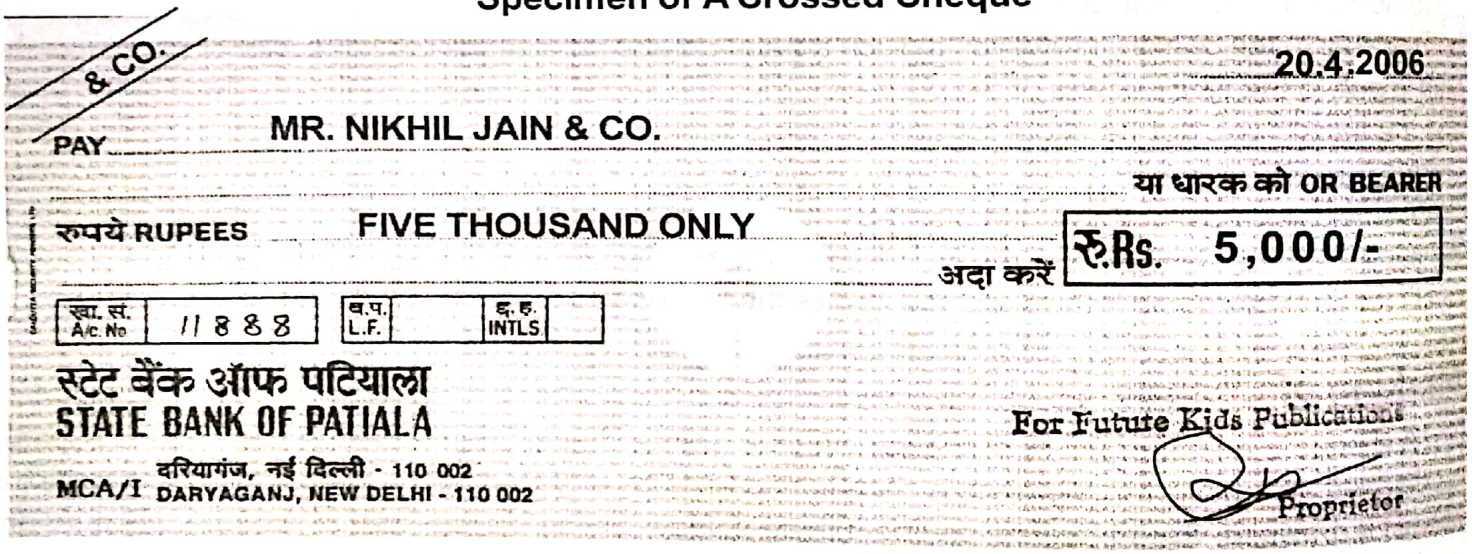
(3) Marking at collecting banker's instance: When the cheque is late in reaching the bank for collection, the bank, keeping in mind the interests of the customer, sends the cheque to the concerned bank for marking. The paying bank, thereupon after ensuring that there are enough funds in the account of the drawer, writes 'Good' on the face of the cheque and dates it. As per normal banking customs, such cheques are cleared if they are presented at the time of the next clearing.

Crossing a Cheque

Meaning of Crossing: When two angular parallel lines are drawn on the face of the cheque, the cheque is said to have been crossed. These lines are usually drawn on the upper left hand corner of the cheque. Sometimes some words are mentioned in between these lines, otherwise they are left blank.

"A crossed cheque is one on which two parallel lines are drawn across its face, with or without any words between these lines."

Specimen of A Crossed Cheque



A crossed cheque is considered to be much safer from the point of view of payment. A cheque payable to order is safer than a cheque payable to bearer, and a crossed cheque is even safer than a cheque payable to order because a crossed cheque, unlike a bearer cheque, cannot be encashed at the counter of a bank. The payee of a crossed cheque has to deposit the cheque in the bank in which he has an account and in order to withdraw the amount, he has to issue a fresh cheque. Therefore, no person other than the payee can receive the payment of a crossed cheque.

If any bank makes payment of a crossed cheque at its counter, it does so at its own risk in that, if the person receiving the payment is not the actual payee, then the bank will have to make the payment again to the actual payee. Therefore, the main purpose of crossing is to make the cheque more secure. If a cheque has been crossed, then it remains secure and, even if it is stolen, the loss is insured as the actual owner of the cheque can always be found out.

Types of Crossing

There are two main ways in which a cheque may be crossed, namely:

1. General Crossing, and
2. Special Crossing

(1) General Crossing: When two angular parallel lines are drawn on the face of the cheque, and the words 'and company' or '& Co.' are written in between them, or even if they are left blank (with or without the words 'Not Negotiable'), then such a crossing is a general crossing. It should be noted that, in general crossing, no name of any bank is mentioned.

The following are a few specimens of general crossing: —Section 123

1.

& Co.

2.

and Company

3.

Not Negotiable

(2) Special Crossing: When in between two angular parallel lines on the face of the cheque, the name of any specific bank is mentioned, then it is known as a special crossing. It is necessary to specify the name of a bank in special crossing. In case of a special crossing, the payment can be received only from the bank which is mentioned in the specified crossing. If the payee does not have an account in the specified bank, then he will have to open an account there. Apart from the name of the bank, the other words mentioned in general crossing are also mentioned in special crossing. The main aim of special crossing is to make the cheque even more secure. Some specimens of special crossing are given below.

& Co.
Punjab National Bank

Payee's A/c only
Union Bank

Not Negotiable
Bank of India

A/c Payee
Bank of America

Who May Cross a Cheque

(a) Before the cheque is issued, the drawer may cross the cheque either generally or specially.

(b) If the cheque has not been crossed, the holder thereof may cross it generally or specially.

(c) If the cheque has been crossed generally, the holder may cross it specially.

(d) If the cheque has been crossed generally or specially, the holder may add the words 'Not Negotiable' to it.

Parties to Negotiable Instruments

The following are the various parties to the three different kinds of negotiable instruments:

(a) Parties to a Promissory Note

(1) Maker or drawer: is the person who makes the promissory note in which he promises to pay another person a fixed sum of money.

(2) Payee: is the person who has to receive the payment for the promissory note.

(3) Holder: is the person who has the right to possess the promissory note in his own name and to receive the amount due thereon. He may either be the original payee or the endorsee who has purchased the promissory note.

(4) Endorser: is the holder of a promissory note who endorses it in favour of another person.

(5) Endorsee: is the person in whose name the promissory note has been endorsed.

(b) Parties to a Bill of Exchange

(1) Drawer: The drawer is the person who draws the bill of exchange.

(2) Drawee: The drawee is the person on whom the negotiable instrument has been drawn.

(3) Acceptor: He is the person who accepts the bill of exchange and is liable for the amount thereon. Normally, the drawee is also the acceptor of the bill, however some other person may also accept it on behalf of the drawee.

(4) Payee: The person who has to receive the payment of the bill of exchange is known as the payee. The payee is usually the drawer or the person ordered by the drawer as payee.

(5) Holder: The holder is the person who is entitled to the bill of exchange. He may either be the original payee or any other person in whose favour the bill of exchange has been endorsed by the original payee. In case the bill has been drawn as payable to bearer, the bearer of the instrument shall be the holder thereof.

(6) Endorser: When the holder of a bill of exchange endorses it in favour of another person, then he is known as the endorser.

(7) Endorsee: The endorsee is the person in whose name the bill of exchange is endorsed.

(8) Drawee in case of need: Apart from the above mentioned parties, another party known as 'drawee in case of need' may also be included in the bill of exchange if it is so desired by the drawer. Such a person is included in the bill by the drawer or the endorser so that, in case the bill is not accepted by the principal drawee or the principal drawee refuses to make payment thereof, then he may be called upon to do the same. If the name of such a person is included in the bill of exchange, then such a bill shall not be considered as dishonoured unless it has been dishonoured by the drawee in case of need.

(9) Acceptor for honour: In case the principal drawee refuses to accept a bill of exchange or in case the bill has been presented for better security by the Notary Public and the original drawee refuses to grant the same, then some other person may accept the bill in order to save the honour and reputation of the drawee or the endorsee. Such a person is known as an acceptor for honour.

(c) Parties to a Cheque

(1) Drawer: is the person who writes the cheque.

(2) Drawee: The drawee in the case of a cheque is always a bank on which the cheque is drawn.

(3) Payee: is the person who is to receive payment for the cheque.

(4) Holder: of a cheque is a person who is legally entitled to the possession of the cheque.

(5) Endorser: the person who endorses the cheque in favour of another person.

(6) Endorsee: is the same as in the case of a promissory note or a bill of exchange.

Holder of a Negotiable Instrument

There are three different kinds of holders in relation to negotiable instruments. They are:

1. Holder
2. Holder for value
3. Holder in due course

(1) Holder: As per Section 8, any person who is legally entitled to the possession of a negotiable instrument and receive the payment thereof on the due date is known as its holder. It is clear from the above definition that the mere transfer of possession of a negotiable instrument to a person does not make him the holder. Therefore, a person does not automatically become the holder of a negotiable instrument as soon as he receives its possession. In order to be a *de jure* holder (valid holder) the person should be entitled to possess the instrument in his own name. The same has been held in the case of **Bojianna vs. Venkataramayya, Madras**. "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." —Section 8

Therefore, in order to be a holder, a person should posses the following two rights: (i) He should be entitled to the possession of the instrument in his own name (whether as bearer or as payee or endorsee). An agent entrusted with an instrument of the principal for safe- keeping is not entitled to its possession in his own name. (ii) He should be entitled to receive the payment in his own name. Therefore, if a person is in the possession of a negotiable instrument but is not entitled to receive payment thereon, for example, a thief, or the finder of a lost instrument, such person is not a holder of the instrument.

For example, a promissory note is drawn as payable to A or to his order, then A will be the holder thereof as soon as the instrument comes in his possession. However, if A gives the instrument to B for safe-keeping, then B is not the holder thereof even if he is in possession of the instrument. This is so because A has not endorsed the instrument in favour of B and B cannot file a suit for the recovery of the amount of the instrument. If however, A had endorsed the instrument in favour of B, then B would have been the holder thereof.

(2) Holder for value: If any person is the holder of a negotiable instrument the value of which has been paid at any time in the past, then he is known as a holder for value. Who actually has paid the value is not a relevant question. Such a holder does not acquire the instrument for any consideration but even he has all the rights of payment against all the prior parties. However, such holder has no rights against the person who has actually paid the value. For example, A receives a cheque of ₹ 5,000 from a person who owes him that amount. He donates the same to a charitable trust. In such a situation it is A who has paid the value of the instrument and not the trustees of the charitable trusts. Therefore, the trustees of the charitable trust are holders for value of the negotiable instrument.

(3) Holder in due course: "Holder in due course means any person who for consideration becomes the possessor or of a promissory note, bill of exchange or cheque if payable to the bearer or to the payee or endorsee thereof (if payable to order), before the amount mentioned on it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived the title."

—Section 9

Therefore, in order to be a holder in due course, a person will have to prove the following:

(a) That he is the holder of the instrument. In case the instrument is payable to bearer, then he is in possession of the instrument, and if the instrument is payable to order, then he is the payee or endorsee thereof.

(b) That he became the holder of the instrument before the payment became due thereon, i.e., before the date of maturity. This is so because if a negotiable instrument remains in circulation even after its maturity, doubts may arise in relation to such an instrument. Therefore, as per Section 39, if any person acquires any instrument after its maturity then he will get the same title to the instrument as that of the transferor.

(c) That he became the holder of the negotiable instrument for a consideration in pursuance of a contract. Therefore, any person who comes into possession of a negotiable instrument which was donated to him may be the holder thereof, but he is not a holder in due course. He gets the same title to the negotiable instrument as that of the transferor.

(d) That there was no valid reason for him to believe that the title of the person from whom he acquired the instrument was defective. In case any person is careless in checking the title of the transferor or knowingly ignores any defect in the title of the transferor, then he can be stripped of his rights as a holder in due course.

Liabilities of Parties to Negotiable Instruments

The individual liabilities of various parties to a negotiable instruments are as under:

(1) Liability of the drawer of a bill of exchange: As per Section 30, the drawer of a bill of exchange is not primarily liable to the holder thereof. He merely takes the responsibility that when the bill of exchange is presented for acceptance, the drawee will accept it and when, on maturity, the bill is presented for payment, the acceptor (i.e. the drawee) will pay the amount due thereon. Therefore, if the drawee refuses to accept the bill of exchange or if the drawee after accepting the bill of exchange, refuses to make payment thereof, then the drawer of the bill of exchange is liable to the actual holder or endorsee of such bill for the amount due thereon. However, in order to hold the drawer liable, it is necessary that he has been served and has actually received proper notice of dishonour.

In the case of **Miller vs. National Bank of India**, it was held that it is necessary that the notice of dishonour is received by the drawer, and until the notice of the dishonour is served upon the drawer, the holder of the negotiable instrument cannot proceed against him.

(2) Liability of the maker of a promissory note: The maker of a promissory note is bound to pay the amount due thereon on the date of maturity to the bearer if the promissory note is payable to bearer and if the promissory note is payable to a specified person or his order, then to such specified person or to his order. In case he fails to make such payment, the maker is liable to indemnify the affected party of any damages that may be suffered by it. —Section 32

(3) Liability of the drawer of a cheque: If the bank dishonours a cheque or refuses to make the payment thereof, the drawer of the cheque is bound to pay the holder of the cheque the amount due thereon. In order for the drawer to be held liable, it is necessary that proper notice of dishonour has been served and has actually been received by him. —Section 30

(4) Liability of acceptor of a bill: The drawee of a bill of exchange is not bound to accept the bill and, in case he refuses to accept the bill, no liability arises to him. However, if he accepts the bill, he is bound to make the payment thereon on the expiry of the duration of the bill and, if he commits a default in such payment, he is liable to compensate the other party to the bill for any damages that may be suffered by it due to the default in payment. — Section 32

As regards a previous endorsee (i.e. a person in whose favour a bill had been endorsed prior to its acceptance), the acceptor of the bill cannot be relieved of his liability on the instrument on the ground that such endorsement was forged if at the time of accepting the bill he knew that the endorsement was forged or had sufficient grounds to believe the same. —Section 41

In case of a bill drawn in a fictitious name and payable to the order of the drawer, the acceptor of such bill cannot hold against the holder in due course that the name mentioned on the bill is fictitious. —Section 42

(5) Liability of the drawee of a cheque: The drawee of the cheque, or the bank on which the cheque is drawn, should pay the amount of the cheque at the time it is presented for payment provided there are sufficient funds in the account of the drawer of the cheque. If the bank refuses to pay the cheque without any valid reason, it is liable to compensate the customer for any damages that may be suffered by him by reasons of such non-payment. —Section 31

(6) Liability of the endorser: The endorser of a negotiable instrument is liable on a negotiable instrument in the same manner as is the drawer. In case a person endorses a negotiable instrument before its maturity without limiting his liability thereon, he shall be liable to all subsequent parties in case the instrument is dishonoured provided he is served, and has received, proper notice of dishonour. —Section 35

The endorser, however, can relieve himself of his liability on the instrument by specifically mentioning it on the instrument at the time of endorsement. In like manner, he can also make his liability on the instrument conditional upon the happening of a specific event.

When the holder of a negotiable instrument without the consent of the endorser damages his right against any prior party (for example, by cancelling a prior endorsement), the endorser is relieved of his liability in the same manner as when the instrument is actually paid upon its maturity. —Section 40

(7) Liability of prior parties: As per Section 36, every party to a negotiable instrument is liable to all subsequent parties as well as the holder in due course until the instrument is actually paid. The parties of a negotiable instrument are discharged of their liability only when the instrument is actually paid. —Section 36

Negotiation

By negotiation is meant keeping a negotiable instrument in circulation. In other words, negotiation means the transfer of the right, title and interest of the holder of a negotiable instrument in such manner that the transferee gets a good title to the instrument and he becomes a holder in due course even if there is some defect in the title of the transferor. However, in case an instrument is payable to order

and the signature of the holder has been forged, or the instrument is void *ab initio*, or an inchoate instrument is transferred after it has been stolen, or the instrument is acquired from a person other than the drawer or holder then such a transfer will not qualify as negotiation.

As per Section 14, "When a promissory note, bill of exchange or cheque is transferred to any person so as to constitute the transferee as the holder thereof, the instrument is said to be negotiated." Therefore, negotiation occurs only when the transferee becomes entitled to hold the instrument in his own name and to receive or recover the amount due thereon from the concerned parties.

If we analyses the definition in detail, there are two main factors in order for a transfer to qualify as negotiation:

(1) The transfer should be made to another person so that he receives a good title to the instrument and becomes a holder in due course even if the title of the transferor is defective.

(2) When a negotiable instrument is transferred by negotiation, the transferee receives the title to the instrument and becomes entitled to receive the payment for the instrument in his own name, provided the signatures on the negotiable instrument have not been forged or it is not void *ab initio*, or it is not an inchoate instrument transferred after it has been stolen.

Modes of Negotiation

A negotiable instrument can be negotiated in the following manner:

When any instrument is payable to bearer, it can be negotiated by mere delivery thereof. If a negotiable instrument is payable to order, it can be transferred only by endorsement and delivery thereof.

It is clear that the delivery of the instrument is necessary for negotiation in both the circumstances. By delivery, we mean the voluntary transfer of the rights in the negotiable instrument. The delivery may be actual or constructive. — Section 46

(1) Negotiation by mere delivery: When a promissory note, bill of exchange or cheque is payable to bearer, it may be negotiated by mere delivery. If any negotiable instrument has been delivered on the condition that it shall be effective only on the occurrence of a specified event, it shall not be considered as negotiated until the happening of the said event. This rule is, however, not applicable in the case of a holder in due course. — Section 47

Examples: (1) A who is the holder of a negotiable instrument payable to bearer delivers it to the agent of B for holding it on behalf of B. The instrument has been negotiated in this case.

(2) A is the holder of a negotiable instrument, payable to bearer, which is in the custody of his bank. The bank is also the bank of B. A orders the bank to deposit the said instrument in B's account in the bank. The bank does as ordered and by doing so holds the instrument as an agent of B. In such a case the instrument has been negotiated and B is now the holder thereof.

(2) Negotiation by endorsement and delivery: When the negotiable instrument is not payable to bearer but instead is payable to a specified person or to his order, such instrument is known as payable to order and can be negotiated only by endorsement and delivery. Until the holder duly endorses and signs the instrument, the transferee does not become the holder. If there are more than one drawers, each of the drawers must endorse the instrument. As long as a negotiable instrument is payable to bearer and it is delivered without endorsement, the delivery will amount only to assignment and not negotiation, and the holder of such an instrument will not get the right of a holder in due course and hence he cannot negotiate the instrument to any third person. — Section 48

ii. The delivery of the instrument is [illegible]

Kinds of Endorsement

(1) Blank or general endorsement: As per Section 13, if the person making the endorsement does not mention the name of the person in whose favour the instrument is being endorsed and merely signs his name, such an endorsement is known as a blank or general endorsement. A blank endorsement has the effect of converting the instrument into a bearer instrument, thereby making it negotiable merely by delivery. —Section 18

For example, if A gives B a cheque of ₹ 1,000 payable to order, and B merely puts his signature on the back of the cheque and delivers it to C, such an endorsement is a blank endorsement.

(2) Complete or special endorsement: When the person making the endorsement, before signing his name thereon, adds an order to the effect that the amount of the instrument shall be payable to a specific person or to his order, then such an endorsement is known as a complete or special endorsement. In case of a special endorsement, along with the signature of the endorser, the name of the person to whom or to whose order the instrument is payable should also be mentioned. 'Pay Ram' or 'Pay Ram or to his order' are examples of special endorsement. —Section 16

Conversion of blank or general endorsement into special endorsement: The holder of a negotiable instrument containing a general endorsement can, by mentioning the name of any person as endorsee to whom or to whose order the instrument shall be payable, convert the general endorsement into a special endorsement without having to sign his name thereon. In such a case, the holder does not incur any liability as the endorser of the instrument. Therefore the main benefit of converting a general endorsement into a special one is that, even though the holder transfers the instrument to another person, he does not incur any liability as the endorser. For example, if A writes above the signature of B in a general endorsement. 'Pay C or to his order', then A does not incur any liability as the endorser and it merely amounts to a special endorsement by B in favour of C. —Section 49

(3) Restrictive endorsement: When the endorser, while making the endorsement, uses certain words to the effect that the instrument shall no longer be endorsable in the future, such an endorsement is known as a restrictive endorsement. In such an endorsement the word 'only' is attached after the name of the endorsee. In other words, we can say that restrictive endorsement is resorted to when the

endorsee wants that the amount of the instrument shall be payable only to the specified person and not to anybody else. 'Pay to A only' is an example of a restrictive endorsement. Once the instrument is in circulation, any endorser can make a restrictive endorsement on it. —Section 57

(4) Partial endorsement: When the endorser orders to pay only a part of the amount mentioned on the instrument, such endorsement is known as partial endorsement. Normally, such an endorsement is not considered proper. —Section 56

Example: A is the holder of an instrument for Rupees 1,000. He endorses the instrument as 'Pay to B or his order the sum of Rupees 500'. Then such an endorsement is a partial endorsement and hence is not a valid endorsement.

A partial endorsement does not amount to negotiation. However, if a part of the amount of the instrument has been paid, then a remark to that effect can be made on the instrument, and it can be endorsed for the remaining value. An endorsement as 'Pay A or order Rupees 500 being the unpaid residue of the bill' is a valid endorsement because the word residue signifies that only Rupees 500 are remaining unpaid in the bill. Therefore, in a manner it is an endorsement for the full value of the bill only and hence it can be negotiated.

(5) Conditional endorsement: When the endorser, while making the endorsement in clear words, limits his liability thereon or, instead of totally negating his liability, makes it conditional upon the happening of an uncertain event, or makes the right of the endorsee to receive the payment thereon conditional upon the happening of an uncertain event, thereby limiting his liability on the instrument, such an endorsement is known as a conditional endorsement. A conditional endorsement is different from a restrictive endorsement in the sense that a restrictive endorsement prohibits the further negotiability of the instrument whereas a conditional endorsement mainly limits the liability of the endorser on the instrument. —Section 52

The endorser can, while making the endorsement, limit his liability on the instrument or make his liability conditional in the following ways:

(a) By sans recourse endorsement: When the person making the endorsement makes it clear that he shall not be liable to the endorsee or the subsequent holders of the instrument in case the instrument is dishonoured, such an endorsement is known as a sans recourse endorsement. In such an endorsement, the words 'sans recourse' or 'without recourse' must be used in the endorsement. 'Pay A or order sans recourse' or 'Pay A without recourse to me' are examples of sans recourse endorsement.

(b) Facultative endorsement: When the endorser, at the time of making the endorsement clearly states that in the event of the instrument being dishonoured, no notice of dishonour needs to be served upon him, such an endorsement is known as a facultative endorsement. This is so because, in this case, the endorser on his own releases the holder of his duties in case of dishonour of the instrument. 'Pay A or order, Notice of dishonour waived' is a facultative endorsement and the endorsee continues to be liable on the instrument even if notice of dishonour is not served upon him.

Negotiation back: Sometimes, it may so happen that, during negotiation, the instrument reaches back to the same person who had on a previous occasion endorsed it in favour of some other person. This is known as negotiation back. It is a situation where the instrument again reaches the hands of the endorser in his own rights, and a previous endorser becomes the holder of instrument once again. The main effect of negotiation back is that the intermediary parties are no longer liable towards the holder of the instrument and are relieved of their liability thereon.

Dishonour

A negotiable instrument is said to be dishonored when the drawee (debtor) refuses to accept the same or make payment thereon. Therefore, an instrument may be dishonoured by the following two modes:

1. Dishonour by non-acceptance
2. Dishonour by non-payment

A bill of exchange can be dishonoured by both the above modes, whereas a cheque or a promissory note can only be dishonoured by non-payment. As soon as the negotiable instrument is dishonoured, the holder of the instrument must serve notice of dishonour on all the parties thereto so that they may be held liable thereon. If the holder does not serve notice on dishonour to all the parties to the instrument, then he loses his rights against all prior parties to the instrument. However, there are certain situations in which notice of dishonour is not required.

1. Dishonour by non-acceptance: A bill of exchange is said to be dishonoured by non-acceptance:

(a) When the drawee (in case of more than one drawees, any one of them) commits a default in accepting the bill of exchange, i.e., fails to accept the bill of exchange within 48 hours of presentment or refuses to accept the bill of exchange.

(b) When presentment for acceptance is not required and the bill is not accepted.

(c) When the drawee is incapable to contract.

(d) When the acceptance is qualified.

(e) When the drawee is a fictitious person and cannot be found even after due search.

—Section 91

2. Dishonour by non-payment: A promissory note, bill of exchange or cheque is said to be dishonoured due to non-payment when the maker of the promissory note, acceptor of the bill of exchange, or the drawee of the cheque commits a default in payment on the instrument being presented for payment.

—Section 92

Differences between Dishonour by Non-Acceptance and Dishonour by Non-Payment

The following are the main differences between dishonour by non-acceptance and dishonour by non-payment:

Dishonour by Non-Acceptance	Dishonour by Non-Payment
1. Dishonour by non-acceptance occurs when the bill is presented by the drawer to the debtor for acceptance and acceptance is not granted by him.	Dishonour by non-payment occurs when the maker of the promissory note, the acceptor of a bill of exchange or the bank (in case of a cheque) refuses to make payment thereof.
2. In case of dishonour by non-acceptance, a suit cannot be filed against the debtor, since he is not a party to the instrument before he accepts the same.	In case of dishonour by non-payment the holder can file a suit if he has served notice of dishonour on all other parties.
3. In case of dishonour by non-acceptance, the creditor can file a suit only for the recovery of the amount of the loan.	In case of dishonour by non-payment, the drawer can file a suit for recovering the noting and protesting charges, interest, etc., along with the amount of the loan.

Effect of dishonour: All the endorsers of the instrument as well as the drawee are liable to the holder, and can he held liable by him in case the instrument is dishonoured by non-acceptance or by non-payment provided adequate notice of dishonour has been served upon them. However, the drawer of the instrument is liable only in case the instrument is dishonoured by non-payment.

Notice of dishonour: In case a negotiable instrument is dishonoured by non-acceptance or by non-payment, then the holder of the instrument should serve notice of dishonour on all such parties whom he intends to hold liable thereon. —Section 93

Each party, on receiving such notice of dishonour, must, within reasonable time of receiving such notice, serve upon all such parties, whom he intends to hold liable on the instrument, the notice of such dishonour. —Section 95

The notice of dishonour is so important, that if it is not sent, except for the drawer or acceptor, all other parties are relieved of their liability on the instrument.

Mode in which notice of dishonour may be given: The notice of dishonour should be served on the person entitled to receive such notice or to his authorised agent or, in case such person is deceased, to his legal representative and, in case such person has been declared insolvent, the notice should be served on the assignee of such person. The notice of dishonour may be served orally or in writing. In case it is served in writing, it may be despatched by post. The notice of dishonour may be in any form but it should have the effect of conveying to the party on which it is served that the instrument has been dishonoured and that he is being held liable thereon. Such notice should be served within reasonable time of the instrument being dishonoured at the place of business of the person on whom it is being served. In case there is no such place of business, then it should be served at his residence. —Section 94

In case of death of the party on whom the notice of dishonour is served and the person serving the notice is not aware of his death, such a notice will be sufficient to hold the party liable. —Section 97

When Notice of Dishonour is not Necessary

In the following circumstances the notice of dishonour is not required:

(1) When the party entitled to receive such notice voluntarily waives his right thereto. For example, when any endorser writes the words 'notice of dishonour not required' while making the endorsement, or when the drawer himself informs the holder that the bill of exchange has been dishonoured, no notice of dishonour is required.

(2) When the drawer has himself ordered against making the payment on such instrument, the notice of dishonour need not be served on the drawer. For example, when the drawer of a cheque himself orders the bank not to make the payment thereon, no notice of dishonour need be served on such drawer.

(3) When the party liable on the instrument does not incur any loss due to non-service of the notice. For example, in case, while writing a cheque, the drawer does not have sufficient funds in his account, then the drawer does not incur any loss due to non-service of notice.

(4) When the party entitled to such notice of dishonour cannot be found even after due search.

(5) When the notice of dishonour cannot be served due to circumstances beyond the control of the holder. For example, death of the holder or of his agent, or when the holder is seriously sick or in other like situations, the non-service of notice of dishonour may be excused.

(6) When the acceptor himself is the drawer. For example, if any firm draws a bill of exchange on another of its own branches, or when a firm draws a bill of exchange on another firm who is its partner in business, a notice of dishonour is not necessary.

(7) When the promissory note ceases to be negotiable. Such a promissory note cannot be endorsed and, in case it is endorsed, the endorsee does not get any right against the maker on endorser. Therefore, no loss is suffered by these parties due to the default in serving the notice of dishonour.

(8) When the party entitled to the notice of dishonour promises to unconditionally pay the dishonoured instrument.

Noting and Protest

(1) Noting: In case the promissory note or bill of exchange is dishonoured by non-acceptance or by non-payment, then the holder of such instrument, after giving due notice of dishonour, is entitled to sue the other parties to the instrument. As per the Negotiable Instruments Act, noting is a convenient way of certifying that the instrument has been dishonoured. In case any negotiable instrument has been dishonoured by non-acceptance or non-payment, then the holder can get such dishonour noted on the instrument by the Notary Public. Such noting may be made either on the negotiable instrument or on the *allonge*.

The Notary Public is an officer appointed by the State Government for certifying the negotiable instrument or for noting the dishonour of bills of exchange or promissory notes under the Negotiable Instruments Act.

The noting should be made within reasonable time of the instrument being dishonoured, and the note should always contain the following:

(a) date of dishonour

(b) the reason for the dishonour

(c) in case the instrument has not been specifically dishonoured, the reason why the holder of the instrument considers it as dishonured, and

(d) the expenses for noting the instrument (fees of the Notary Public, etc.) —Section 99

(2) Protest: In case any bill of exchange or promissory note is dishonoured due to non-acceptance on non-payment, then the holder of the instrument may get it noted and certified by the Notary Public

within a reasonable time of the instrument being dishonoured. The certificate so received from the Notary Public is known as 'protest'. In other words, a protest is a certificate which certifies that the instrument has been dishonoured and it is based on the noting made in relation to the dishonour of the instrument. —Section 100

Protest for better security: When the acceptor for a bill of exchange becomes insolvent before its maturity, or if his goodwill in the eyes of the public falls, the holder can demand better security from the acceptor, through the Notary Public and, in case of refusal by the acceptor, get the same noted and protested within reasonable time. Such a certificate is known as a 'protest for better security'.

Contents of a protest: The following are the essential contents of a certificate:

(a) The original instrument and a copy thereof.

(b) The names of the parties for whom, and against whom the instrument has been protested.

(c) The fact that the instrument has been dishonoured and, the reasons thereof.

(d) The time and place of dishonour of the instrument and, in case better security for the instrument has been refused, the time and place of such refusal.

(e) The description of the Notary Public making the certification.

(f) If the instrument has been accepted for honour or paid for honour, then proper description thereof.

Notice of protest: When, as per the provisions of the Act, it is mandatory to get any bill of exchange or promissory note protested, notice of such protest should be served on all parties thereto. In such a case the notice of dishonour need not be served. The notice of protest must be served in the same manner and in the same conditions as the notice of dishonour. However, in case of notice of protest, it can also be served by the Notary Public. —Section 102

Attestation of foreign bills: If, as per the law of the country in which the foreign bill of exchange has been drawn, it is necessary to get the bill of exchange protested, then such bill of exchange must be protested. —Section 104

When is noting equivalent to protest? In case it is necessary to get a promissory note or bill of exchange protested within a specified duration, then it is sufficient if such bill of exchange or promissory note is got noted within such duration since the protest is related to the date of noting only. The protest of the instrument may be acquired later. —Section 104(A)

Reasonable time: In order to determine the reasonable time for presentment for acceptance or payment, or for serving notice of dishonour, or for getting the dishonour of the negotiable instrument noted, the nature of the negotiable instrument and the normal custom of trade relating to such kind of negotiable instruments must be kept in mind. While calculating the reasonable time, public holidays should not be included therein. —Section 105

Reasonable time for notice: In case the holder of the instrument and the person on whom the notice of dishonour is to be served reside or carry on their business in different places, if the notice of dishonour is served within the next day proceeding. The dishonour of the instrument or by the next post, then such notice will be deemed to have been served within reasonable time.

If both the parties reside or carry on their businesses in the same place, if the notice of dishonour is served within the next day proceeding the dishonour of the instrument, then such notice will be deemed to have been served within reasonable time. —Section 106

Digital Signature and Electronic Signature

Digital signature means authentication of any electronic record by a subscriber by means of an electronic method or procedure. It is an electronic analogue of a written signature. The Act gives legal recognition to electronic records and digital signatures and provides the conditions subject to which an electronic record may be authenticated by means of affixing digital signature. The digital signature is created in two distinct steps. First the electronic record is converted into a message digest by using a mathematical function known as "hash function" which digitally freezes the electronic record thus ensuring the integrity of the content of the intended communication contained in the electronic record. Any tampering with the contents of the electronic record will immediately invalidate the digital signature. Secondly, the identity of the person affixing the digital signature is authenticated through the use of a private key which attaches itself to the message digest and which can be verified by any person who has the public key corresponding to such private key. This will enable any person to verify whether the electronic record is retained intact or has been tampered with. It will also enable a person who has a public key to identify the originator of the electronic message. The Information Technology Amendment Bill, 2008 has changed the heading of the chapter from Digital signature to 'Electronic signature'.

Authentication of Electronic Records

(1) Subject to the provisions of this section, any subscriber may authenticate an electronic record by affixing his digital signature.

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

(3) Any person by the use of a public key of the subscriber can verify the electronic record.

(4) The private key and the public key are unique to the subscriber and constitute a functioning key pair. **(Section 3)**

Electronic Signature

1. A subscriber may authenticate any electronic record by such electronic signature or electronic authentication technique which:

   (a) is considered reliable, and

   (b) may be specified in the second schedule.

2. Any electronic signature or electronic authentication technique shall be considered reliable if:

   (a) The signature creation data or the authentication data are, within the context in which they are used, linked to the signatury or as the case may be, the authenticator and to no other person;

   (b) The signature creation data or the authentication data were, at the time of signing, under the control of the signatury or, as the case may be, the authenticator and of other person;

   (c) Any alteration to the electronic signature made after affixing such signature is detectable;

   (d) any alteration to the information made after its authentication by electronic signature is detectable; and

   (e) if fulfills such other conditions which may be prescribed.

3. The central Government may prescribe the procedure for the purpose of ascertaining whether electronic signature is that of the person by whom it is purported to have been affixed or authenticated.

(Section 3A)

Electronic Governance

Legal provisions regarding electronic governance are as under:

Legal Recognition of Electronic Records

Where any law requires that information or any other matter shall be in writing or in the typewritten or printed form, then such law, such requirement shall be deemed to be satisfied if such information or matter is:

(a) rendered or made available in an electronic form; and

(b) accessible so as to be usable for a subsequent reference. **(Section 4)**

Legal Recognition of Electronic Signatures

Where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person, then, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of electronic signature affixed in such manner as may be prescribed by the Central Government.

The provision of Section 5 provides for legal recognition of electronic signatures as a substitute for handwritten signature. **(Section 5)**

Use of Electronic Records and Electronic Signatures in Government and its Agencies

Section 6 lays down the foundation of electronic governance. The filing of any form, application or other documents, creation, retention of preservation of records, issue or grant of any license

or permit or receipt or payment in Government offices and its agencies may be done through the means of electronic form. The appropriate government may Prescribe by rules:

(a) the manner and format in which such electronic records shall be filed, created or issued;

(b) The manner or method of payment of any fee or charges for filing, creation or issue of any electronic record under above clause. **(Section 6)**

Delivery of services by Service Provider

1. The appropriate Government may authorise, by order, any service provide to set up, maintain and upgrade the computerised facilities and perform such other services as it may specify by notification in the Official Gazette.
2. The appropriate Government may also authorise any service provider to collect, retain and appropriate such service charges as may be prescribed by the appropriate Government for the purpose of providing such services, from the person availing such service.
3. The appropriate Government shall by notification in the Official Gazette, specify the scale of service charges which may be charged and collected by the service providers.
4. The appropriate Government may specify different scale of service charges for different types of services. **(Section 6A)**

Retention of Electronic Records

Where any law requires that documents, records or information shall be retained for any specific period, then that requirement shall be deemed to have been satisfied if the same is retained in the electronic form. Certain requirement have to be satisfied for the retention of electronic records. These are:

(a) the information contained therein remains accessible so as to be usable for a subsequent reference;

(b) the electronic record is retained in the format in which it was originally generated, sent or received or in a format which can be demonstrated to represent accurately the information originally generated, sent or received;

(c) the details which will facilitate the identification of the origin, destination, date and time of dispatch or receipt of such electronic record are available in the electronic record.

However the clause (c) does not apply to any information which is automatically generated solely for the purpose of enabling an electronic record to be despatched or received. Further this section is not applicable to any law the expressly provides for the retention of documents, records or information in the form of electronic records. **(Section 7)**

Audit of documents, etc., maintained in electronic form

Where in any law for the time being in force, there is a provision for audit of documents, records or information, that provision shall also be applicable for audit of documents, records or information processed and maintained in the electronic form. **(Section 7A)**

Publication of rule, regulation etc., Electronic Gazette

Where any law requires the publication of any rule, regulation, order, bye-law, notification

or any other matter should be published in the Official Gazette, then such requirement shall be satisfied if the same is published in an electronic form. It also provides where the Official Gazette is published both in the printed as well as in the electronic form, the date of publication shall be the date of publication of the Official Gazette which was first published in any form.
(Section 8)

No right conferred to insist that document should be accepted in electronic form

The provisions of sections 6, 7 and 8 shall not confer any right upon any person to insist that any Ministry or Department of the Central Government or the State Government should accept, issue create, retain and preserve any document in the form of electronic records or effect any monetary transaction in the electronic form.
(Section 9)

Power to make rules by Central Government in respect of digital signature

The Central Government may for the purposes of this Act, by rules prescribe:

(a) the type of electronic signature;

(b) the manner and format in which the electronic signature shall be affixed;

(c) the manner or procedure which facilitates identification of the person affixing the electronic signature;

(d) control processes and procedures to ensure adequate integrity, security and confidentiality of electronic records or payments; and

(e) any other matter which is necessary to give legal effect to electronic signatures.
(Section 10)

Validity of contracts formed through electronic means

Where in a contract formation, the communication of proposals, the acceptance of proposals, the revocation of proposals and acceptances, as the case may be, are expressed in electronic form or by means of an electronic record, such contract shall not be deemed to be unenforceable solely on the ground that such electronic form or means was used for that purpose.
(Section 10A)

Attribution, Acknowledgment and Despatch of Electronic Records

The Act contain the principles for determining the person to whom the electronic records can be attributed and the principles for determining the time, place of despatch and receipt of electronic records.

Attribution of Electronic Records

An electronic record shall be attributed to the originator:

(a) if it was sent by the originator himself.

(b) by a person who had the authority to act on behalf of the originator in respect of that electronic record; or

(c) by an information system programmed by or on behalf of the originator to operate automatically.
(Section 11)

Business Law

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Unit -I

1.) What is Contract, explain its essential features and kinds of contract.

2) What do you mean by offer and acceptance. Discuss legal rules governing them.

3.) Explain performance of contract, how contract can be discharged and what are the consequences of Breach of contract.

Unit -II

1.) What is sale contract, explain essentials and formalities of a sale contract.

2.) Explain the provisions relating to performance of contract of sale, rules of delivery of goods and rights of unpaid seller.

Unit -III

1.) What do you mean by negotiable instruments, explain the features and types.

2) a) what is negotiation, explain types of endorsement

b) what does dishonour of instruments mean and what will be liabilities of parties in case of dishonour.

Unit -IV

1.) What are the objectives of FEMA Act and when it is applicable.

2.) Digital signature certificate, electronic governance, electronic records.

3) Regulation and Management under FEMA, Difference between FEMA & FERA.