Directorate of Distance Education
Centre for Distance and Online Education (CDOE)
NALSAR University of Law, Hyderabad

Reading Material

ONE YEAR ADVANCED DIPLOMA IN DRAFTING, NEGOTIATION AND ENFORCEMENT OF CONTRACTS

1.2 LAW RELATED TO SPECIFIC CONTRACTS

(For private circulation only)

Print 2020
Re-Print 2023

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MODULE I

INDEMNITY AND GUARANTEE

DEFINITION OF INDEMNITY

The definition of indemnity is contained in Section 124 of the Contract Act. The section is produced below for ease of reference:

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

An indemnity is defined in the Act as a promise to save a person harmless form the consequences of the conduct either of the indemnity-giver (indemnifier) or of some other person. This definition would cover a contract to protect someone from the consequences of a legal proceeding filed by a third party. This could be to protect a person from the risk of forgery/fraud or for other reasons.

NATURE AND EXTENT OF INDEMNIFIER'S LIABILITY

In law, the term 'indemnity' has several possible interpretations. A wide interpretation of the term connotes the duty to compensate a person who incurs any sort of loss or liability. Such a duty or obligation may stem either from a contract of indemnity – which could be either implied or express – or from the relation of the parties governed by a statute. This wide approach would make all contracts of insurance and guarantee fall within the ambit of an 'indemnity.'

The narrow interpretation of the term 'indemnity' would limit the applicability of the term to contracts to save a person from the loss caused by the claims of person. Such interpretation would exclude contracts such as marine insurance contracts as well as insurance against liability to third parties.

In India, the term 'indemnity' is used to refer to a contract wherein a person takes an original and independent obligation to indemnify, as distinct from a collateral contract in the nature of a guarantee by which the promisor undertakes to answer for the default of another person. Such person would have a primary liability towards the promisee. Therefore, it is the narrow interpretation which is prevalent in Indian jurisprudence.[1]

Damages and Indemnity - The right to indemnity is distinct from the right to damages that arise as a result of breach of the contract. An indemnity is a right granted by the original contract, whereas a right to claim damages arises in consequence of breach of the said contract. In the event that a contract has an indemnity clause while not excluding damages, the indemnified party has the option to either claim for breach of contract or to claim the payment under the indemnity clause.[2]

Extent of Liability – The extent of liability under a contract of indemnity is dependent on the clauses and terms of such contract and would not be uniform across all cases.[3] In case of a joint indemnity bond, the promisors would have a joint liability to the indemnified party.[4]

COMMENCEMENT OF LIABILITY OF THE INDEMNIFIER

In the case of *Gajanan Moreshwar Parelkar v Moreshwar Madan Mantri*,[5] J. Chagla of the Bombay High Court held that the whole law of indemnity in India is not embodied in sections 124 and 125 of the Contract Act. Therefore, the same equitable principles that the English Courts had developed vis-à-vis indemnity would be applicable in India as well. Therefore, if an indemnified party in India has incurred a liability which has become absolute, he is entitled to call upon the indemnifier to discharge that liability and to pay it off.

[1] NILIMA BHADBHADE, POLLOCK AND MULLA: THE INDIAN CONTRACT ACT, 1872 (14th ed, LexisNexis 2015).

[2] Malayan Banking Bhd v. Basarudin bin Ahmad Khan, [2007] 1 MLJ 613.

[3] Gillespie Bros & Co. Ltd. v. Roy Bowles Transport Ltd., (1973) 1 All ER 193.

[4] Abdul Latif v. Durgah Committee, AIR 1954 Ajm 7(2).

[5] AIR 1942 Bom 302.

The above mentioned case makes is clear that in India, indemnity does not mean to reimburse the money paid, but it means to save the indemnified party from the loss in the first instance itself.

It is possible that the indemnifier makes the promise to indemnify contingent on the fulfilment of certain conditions. These conditions could be both express or implied in nature. In such cases, the liability of the indemnifier would only arise once such condition or conditions are fulfilled, and not before. An illustrative case in this respect is that of *Bentworth Finance Ltd. v Lubert*[6], wherein the court held that in case of a hire-purchase agreement with respect to a car, the contract did not become operative if the log book was not provided, since the same was an implied condition. Therefore, the indemnifier would not be liable in such a case where the implied condition had not been fulfilled.

GUARANTEE

A guarantee, like indemnity, is a specific type of contract in respect of which there are certain provisions contained in the Contract Act. Sections 126 to 147 of the Act lay out the framework with respect to the law of guarantee in India.

DEFINITION OF GUARANTEE

The term 'contract of guarantee' is defined along with the terms 'surety,' 'principal-debtor' and 'creditor' in Section 126 of the Contract Act.

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

[6] [1967] 2 All ER 810.

AUXILIARY NATURE OF GUARANTEE

A guarantee is a promise on the part of the guarantor or surety to pay some debt or perform some duty in the event of the failure to pay or discharge the duty on the part of the principal-debtor.

The obligation to guarantee a debt or performance is a secondary one or an accessory one in the sense that it will not arise unless the condition of default is not fulfilled. Therefore, it is essential that in the case of a guarantee there are at least three fundamental parties to the transaction, making a guarantee a form of a tripartite agreement.

ESSENTIALS FOR A VALID GUARANTEE CONTRACT

The Contract Act has specifically stated that a contract of guarantee could be either oral or written in nature. Further, the guarantee transaction may be contained in more than one document, and the documents would be read and interpreted together while determining the rights and liabilities of the parties.[7] It is not possible for there to be a valid contract of guarantee if there is no liability that exists with respect to the transaction. The very nature of a guarantee arrangement assumes that there is an underlying obligation on the principal debtor, to which the guarantor or surety assumes a secondary obligation. This obligation could be either an existing obligation or it could be a future obligation. In case of a future obligation, if the obligation does not come into existence for any reason, then the guarantee shall not be enforceable, and shall be inchoate.[8]

1. **Consideration**: Section 127 of the Contract Act deals with consideration in case of a contract of guarantee. In case of a contract of guarantee, the consideration for the guarantee does not flow from the principal debtor to the guarantor, but rather flows from the creditor to the guarantor.[9] In certain cases, it may move from both the

[7] S. Chattanatha Karalayar v. Central Bank of India Ltd., (1965) 3 SCR 318.

[8] Re Steyn, (1974) 90 LQR 246.

[9] White v. Cuyler, (1795) 6 Term Rep 176.

creditor as well as from the principal debtor. In such cases, while the consideration may have the effect of benefitting the surety, it is not essential that the guarantor should receive any benefit under the contract.[10]

2. **Conditions precedent**: In the event that the guarantor or surety stipulate certain conditions precedent to the guarantee coming into force, such as the presence of a collateral etc., the guarantee will not come into force until such condition or conditions are fulfilled.

NATURE OF SURETY'S LIABILITY

Section 128 of the Contract Act deals with surety's liability. It states that the liability of the guarantor is co-extensive with that of the principal debtor, unless the contract contains a provision to the contrary.

The surety's liability as per Section 128 does not get extinguished on the failure of the creditor's omission to sue the principal debtor. The creditor is not legally bound to exhaust all of the remedies against the principal debtor before he can proceed against the surety. It is up to the discretion of the creditor to recover the amount either from the principal-debtor or the surety post the default taking place.[11] Therefore, although the liability of the guarantor is co-extensive with that of the principal debtor, it is separate and not alternative.[12] The liability of the surety is joint and several.

DURATION AND TERMINATION OF SUCH LIABILITY

The liability of the surety commences in accordance with the terms of the contract. The commencement of liability of the surety can be made contingent on certain terms being fulfilled.

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[10] Mathra Das v. Shamboo Nath, AIR 1929 Lah 203.

[11] Nandlal Shakarlal Tiwari v. Laxman Umakant Malkarjun, (1970) 72 Bom LR 715.

[12] Industrial Investment Bank Ltd. v. Bishwanath Jhunjhunwala, (2009) 9 SCC 478.

The surety's liability arises when the principal debtor has made a default. On the occurrence of the default, the surety becomes immediately liable for the entirety of the debt which he has guaranteed, unless there is something to the contrary provided in the contract of guarantee. In the absence of express mention in the contract, there is no notice of default that the surety is entitled to.[13]

It is a settled principle of law that the surety's liability will not be unduly extended. The terms of the contract of guarantee are to be strictly interpreted, especially those which relate to the liability of the surety.[14]

EXTENT OF SURETY'S LIABILITY

The word "co-extensive" in Section 128 of the Contract Act is a reference to the quantum of the debt due.[15] The illustration to the section makes it clear as to the meaning of this term. The illustration states that if A has guaranteed to B the payment of a certain bill of exchange which had been accepted by C, then A would be liable to pay not only the principal amount of the bill of exchange, but also the additional dues and interests as the case may be which may have become due on the bill.

The surety can chose to limit the extent of his liability through the contract of guarantee. The surety may either guarantee the whole liability or debt, restricting his liability to a certain amount, or he may guarantee part of the debt or the amount due. The distinction between the two attains significance in situations where the surety becomes insolvent. The surety who guaranteed the whole of the debt up to a certain amount does not get the benefit of any subrogation rights or rights to the dividends etc. until and unless the entire amount up to the limit has been paid. On the other hand, the surety who guarantees a part of the debt would get the benefit of pro rata reductions in the amount of debt and would also get the benefits of any

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[13] Carter v. White, (1883) 25 Ch D 666.

[14] Motilal Ramkumar v. Akbarbhai Fakhruddinn, (1939) 41 BomLR 538.

[15] Gopilal J Nichani v. Trac Inds. and Components Ltd., AIR 1978 Mad 134.

contributions and dividends.[16] For e.g. if the surety guarantees a debt of Rs. 10,000 with respect to the entire amount, but limiting his liability to Rs. 5,000, then such surety would not get the benefit of the surety etc. until the entire Rs. 5,000 is paid. However, in a similar case if the surety guarantees only part of the debt up to Rs. 5,000, he would be entitled to a reduction in the debt in a pro rata manner. This means that if the total debt was reduced from Rs. 10,000 to Rs. 5,000, his liability would similarly be reduced from Rs. 5,000 to Rs. 2,500, and he would be entitled to the securities on the payment of the latter reduced amount.

CONTINUING GUARANTEE

Section 129 of the Contract Act defines a continuing guarantee. A continuing guarantee extends to a series of transactions and goes beyond merely one credit transaction. Section 130 deals with revocation of continuing guarantees, and Section 131deals with the specific instance of revocation of continuing guarantee on account of the surety's death. All three sections and the principles relevant thereto are deliberated upon below.

In the case of a continuing guarantee, until the all of the transactions that are covered by the guarantee are complete or until the guarantee itself has been revoked, the liability of the surety will endure.

The mere fact that the contract proclaims itself to be a continuing guarantee does not mean that it would come under the ambit of the definition contained in Section 129. The question of whether a guarantee is continuing is one which is to be answered taking into account the intention of the parties, which is expressed in the language that they have employed in the contract.[17]

From a practical perspective, a continuing guarantee is usually entered into when security for an overdraft facility extended by a bank is concerned. The reason for this is that the overdraft varies and fluctuates in amount regularly, and usually does not continue for a fixed period.

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[16] Parvateneni Bhushayya v. Pothuri Suryanarayana, AIR 1944 Mad 195.

[17] Coles v. Pack, (1869) LR 5 CP 65.

Insofar as the question of limitation is concerned, as long as the account is a love account in the sense that it is not settled and there is no refusal on the part of the surety vis-à-vis the commission of his obligations, the period of limitation would not begin.[18]

Revocation of Continuing Guarantees

In the case of a continuing guarantee which is given in respect of continuing indebtedness, in the absence of a provision as to notice, the guarantor has the right to terminate the agreement at any point of time. If the guarantor does terminate the guarantee in such a manner, then his responsibility is limited to the sums incurred prior to the notice of termination having been given. He will not be deemed to be liable for sums incurred post the notice of termination being given.[19]

There is an exception to the general rule postulated above. This exception states that when a continuing relationship is entered into on account of the guarantee being given, then such a continuing guarantee cannot be revoked until such relationship lapses.[20] For instance, a guarantee relating to a contract of employment such as that of a servant whose primary duty it would be to collect rents has been held to be a continuing guarantee which cannot be revoked during the course of employment.

It is often seen that the contract of continuing guarantee lays out a certain mode of giving notice of termination of a continuing guarantee by a surety. When such mode is specified in the contract, the revocation must be done through the agreed upon method. Any other method of revocation would be deemed to be ineffective.

The applicability of Section 130 with respect to those continuing guarantees given to court has been the subject matter of a few contrary decisions. In *Mahommad Ali Mamoojee v Hawson Bros,*[21] the Privy Council had held that a surety appointed by the court for receiver

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[18] Margaret Lalita Samuel v. Indo Commercial Bank Ltd., AIR 1979 SC 102.

[19] Coulthart v. Clementson, (1879) 5 QBD 42.

[20] Lloyd's v. Harper, (1880) 16 Ch D 290.

[21] AIR 1926 PC 32.

appointed under a mortgage decree cannot discharge himself simply by giving notice to the decree holder, in the absence of the court's approval to the same.

On the other hand, the Calcutta High Court in the case of *Raj Narain Mookerjee v Ful Kumari Debi*[22] had held that Section 130 was applicable to surety bonds given to a court, and that the administrator of an estate could, as to future transactions, by giving notice, be released from its obligations as surety.

The Law Commission of India had considered the case law on this issue and had recommended that an explanation be added to Section 130 which provides an exception with respect to a guarantee given to the court, for which the court's consent would be a pre-requisite to revocation.[23]

Revocation of continuing guarantee by surety's death

The general rule that is encapsulated in Section 131 is that if there is nothing to the contrary that is contained in the contract of guarantee, the guarantee will be deemed to have been revoked on the death of the surety. One major exception to this is that when a continuing relationship was entered into on account of the continuing guarantee, the death of the surety would not mark the revocation of such continuing guarantee since in such cases the surety would not have been able to terminate the guarantee himself had he been alive.[24]

Section 131, through the presence of the words "contract to the contrary" allows parties to contract out of the ordinary application of this section.

DISCHARGE OF SURETY'S LIABILITY

There are certain scenarios, which, when arise, result in the discharge of the surety from his or her liabilities under the contract of guarantee. The Contract Act contains certain sections

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[22] (1901) 29 Cal 68.

[23] 13th Report of the Law Commission of India, 1958.

[24] cf Lloyd (n 19).

(133-139) which clearly demarcate the contours of the situations in which the surety would be discharged as well as those situations in which such discharge would not take place. It should be noted that in addition to the specific circumstances mentioned in Sections 133-139, a contract of guarantee would also be discharged in any manner through which a general contract would be discharged.

Section 133

Section 133 of the Contract Act deals with the situation of discharge of the surety due to a variance in the terms of the contract. The provision states that in the event that any variance is made in the contract which exists between the principal debtor and the creditor, and such variance has been made without the consent of the surety, the surety is discharged insofar as transactions post the variance are concerned.[25]

The rationale behind Section 133 is that the surety cannot be held to be liable on the basis of something to which he or she has not consented. Even in Section 128, which deals with the liability of the surety, the liability so envisaged pertains to the liability on the contract guaranteed, and does not extend to something beyond the scope of that to which the surety has consented.

The provision of discharge contained in Section 133 has the effect of not only discharging the surety's liability, but also of releasing any such property included in the contract of guarantee as security for the promise so guaranteed.[26]

One important aspect of Section 133 is that it applies to those guarantees in which multiple transactions are contemplated, and will not apply to that type of a guarantee in which only a single transaction is concerned.[27] This is evident from the presence of the phrase "discharges

[25] S. Perumal Reddiar v. Bank of Baroda, AIR 1981 Mad 180.

[26] Bolton v. Salmon, (1891) 2 Ch 48.

[27] Keshav Lal v. Pratabh Singh, AIR 1932 Bom 168.

the surety as to transactions subsequent to the variance" which is present in the text of the provision.

The question of what amounts to variance is something which has been the subject matter of much judicial consideration over the years. In the case of *Sulo Chana v. State,*[28] the factual matrix involved a person who happened to be the highest bidder for some shops in an auction. The government, however, refused to grant a licence with respect to the shops and demanded that a surety bond in respect of the arrears of previous years needed to be given. Consequently, the bidder's wife executed a surety bond in favour of the government insofar as the stated amount was concerned. The actual amount with respect to the arrears happened to be different than the amount which was mentioned in the contract of guarantee. The court stated that just because the amount of arrears had not been determined and that there was a possible difference between the actual amount and the bond amount did not amount to a variance in the contract of guarantee. The court stated that the wife would be liable for the amount mentioned in the surety bond and for any lesser amount, but not over and above that. However, she was not discharged of her liability.

Notably, the effect of Section 133 is not to render the contract void ab initio or to annul the contract, but merely to discharge the surety's liability with respect to future transactions.
With respect to the test of variance, the test has evolved from being one of strict construction where the slightest modification or alteration would be sufficient to discharge the surety, to one of material alteration. The early leading cases, such as *Pegot's Case*[29] expressly stated that even if there was an alteration as mild as the drawing of a line with a pen, the same would be sufficient to meet the test of variance. The court was aware of the materiality argument, and expressly rejected it and held that the slightest variance would render the contract void.

[28] AIR 1984 AP 173.

[29] 11 Coke, 266.

In *Blest v. Brown*,[30] Lord Westbury stated that the surety in a contract of guarantee did not really receive any benefit out of the entire arrangement and therefore such surety should be bound only by a strict construction of the written engagement that he has entered into. If this written engagement was altered even by a single line, then the engagement was not the same one to which the surety had consented, and he was therefore discharged of his liability.

While *Blest v. Brown* represents the position of English law on the issue, the Indian Supreme Court in the case of *M.S. Anirudhan v. Thomco's Bank Ltd.*[31] had the occasion to deliberate on the question of whether the surety would be held to be discharged if the variation was not substantial or material, or is beneficial to the surety? In this case, the Supreme Court held that unsubstantial alterations, which are to the benefit of the surety, do not discharge the surety from his liability. In the event that the alteration or variance is to the disadvantage of the surety, or is not prima facie unsubstantial, then the surety is entitled to be discharged of his obligation.

The present test with respect to variance, as elucidated in the case of *Lakshman Mal v. Narasinharaghava Iyengar*[32] held that in order to come under the purview of Section 133, the variance must be material. A material alteration was understood to be one which results in a change in either the rights, liabilities or legal position of the parties. The court stated that the clarification of a previously uncertain (to the extent of being void) clause in the contract such that the clause post the variance would have effect in a court of law would amount to a material change.

The landmark judgment with respect to the law of variance in India is *S. Perumal Reddiar v. Bank of Baroda*,[33] where the surety had signed on a blank form and the details were filled in subsequently, the surety was discharged of his obligations under Section 133 since the court was of the opinion that material alterations had taken place post the signature and consent of the surety having been obtained.

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[30] (1862) 45 E.R. 1225.

[31] AIR 1963 SC 746.

[32] AIR 1916 Mad 284.

[33] *Supra* note 31.

Section 134

Section 134 of the Contract Act states that if there is a contract entered into between the principal debtor and the surety which results in the discharge of the liability of the principal debtor, then the same shall operate as a discharge against the surety as well.

The principal which lies at the foundation of Section 134 is one which has been discussed earlier – that of the liability of the surety being co-extensive with that of the principal debtor. Therefore, if the liability of the principal debtor is extinguished, the liability of the surety would also be so extinguished.

Another rationale as to the presence of Section 134 in the statute book is revealed on a joint reading of Section 134 and Section 140. Section 140 of the Contract Act provides that post the payment of the liability amount by the surety to the creditor, the surety would have the right to reclaim the same amount from the principal debtor. If the principal debtor is discharged of his liability, then the remedy of the surety under Section 140 of the Act would be adversely affected, causing an unfair burden on him.

A slightly tricky situation arises with respect to Section 134 when the principal debtor has multiple obligations with respect to a creditor and the court has to determine whether performance by the principal debtor results in the discharge of the obligation guaranteed or a separate obligation that the principal debtor may have taken. In such cases, *Chitty on Contracts*[34] states that general and established rule with respect to such situations is that it is the discretion of the principal and the creditor as to which debt they would like to appropriate the payment towards.

A major exception to the rule contained in Section 134 is that the surety is not discharged in those instances wherein the principal debtor's liability is extinguished on account of operation of the law.[35] However, judicial opinion is divided on the question of whether a reduction in the debt amount as a result of the operation of law would also result in the reduction of the liability of the guarantor.

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[34] Chitty, J., & Beale, H. G. (2008).

[35] Khushalchand v. Gauri Shankar, AIR 1835 Lah 906.

The Nagpur High Court in the case of *Bal Krishna v. Atma Ram*[36] held that the debt recovery proceedings as a result of which the debt had been reduced for the principal debtor was one to which the surety was not a party at all and to whom the judicial order did not apply at all. Therefore, the court in this case stated that the surety was liable to pay off the debt amount in full and was not entitled to the proportionate decrease as ordered by the court. In *Subramanyan v. Narayana Swami,*[37] the Madras High Court had held that the surety would be liable only for the reduced amount in such a scenario, keeping in mind the principle contained in Section 128 of the Contract Act which states that the liability of the surety is co-extensive with that of the principal debtor. The latter view is the one which has received greater academic and judicial endorsement.

If the principal debtor is discharged not by an express contract with the creditor but as a result of an act or omission of the creditor, then even in such a scenario the surety would be discharged of his liability. The important factor to be considered is that the legal consequence of the act or omission of the creditor should be the discharge of the principal debtor. However, if the creditor does not sue the principal debtor within the period of limitation, although this does deter the right of the surety, it does not result in his discharge.[38]

Where the amount owed by the principal debtor is reduced pursuant to the provisions of the a debt relief statute, the question arises as to what is the impact of the same on the liability of the surety? It has been held that in such cases neither will the surety be discharged, nor will the surety be liable for the full original amount, but rather the surety would be liable for the reduced amount.[39]

Section 135

Section 135 of the Contract Act provides for the discharge of the surety in certain instances such as if the creditor makes a composition with the principal debtor or otherwise agrees not

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[36] AIR 1948 Nag 277.

[37] AIR 1951 Mad 48.

[38] Mahant Singh v. Uhayi, AIR 1939 PC 110.

[39] Subramania Chettiar v. M.P. Narayanswami Gounder, AIR 1951 Mad 48.

to sue or to give time to the principal debtor without the consent of the surety. The meaning that is attributed to the word "composition" in common parlance is that of an agreement, arrangement or a compromise.

The foundation of the rule found in Section 135 is attributable to the common law principle that was laid down in the seminal case of *Ress v. Bessingtan,*[40] wherein Lord Borough stated that it was evident that no transaction must be brought to fruition without the privity of that person who would be necessarily concerned with such a transaction. It would be unfair to keep such a person bound to the terms of the broader transaction, and to alter the same without his consultation and consent.

When it comes to contracts wherein the creditor gives time to the principal debtor, the surety is released irrespective of the fact whether the act of giving time causes prejudice to the surety or not.[41] If the time is extended by a day or even for an hour, and even if it positively benefits the guarantor, he would nevertheless be discharged taking into account the principles of equity.

With regard to the application of Section 135 when there is a consent decree passed by a Court of law, the courts have held that the facts and circumstances of the individual case would determine whether the surety would be discharged or not.

The primary test that is used by courts to determine whether a compromise decree would attract the rule contained in Section 135 or not is the intention of the parties as encapsulated in the terms of the contract.

In *Charan Singh v. Security Finance (P) Ltd.,*[42] the creditor had proceeded against the principal debtor and the surety simultaneously, obtaining a joint decree against them. Subsequently, the creditor and the principal debtor reached an agreement whereby the

[40] 2 Vergs 540.

[41] Amrit Lal Goverdhan Lalan v. State Bank of Travancore, AIR 1968 SC 1432.

[42] AIR 1988 Del 130.

creditor agreed to accept a lesser amount and also agreed not to sue the principal debtor for the remainder. On account of this settlement, the surety claimed that he was entitled to be discharged. However, the Court in this case stated that once the liability has been converted to a decreed-debt, the terms and constraints of the prior contract of guarantee ceased to be effective, and the same were replace with the terms of the decree. Therefore, the surety was no longer liable as a guarantor in a guarantee arrangement, but rather he was liable as a debtor under the decree.

Section 135 is not usually attracted just by the mere forbearance of the creditor with respect to taking action against the principal debtor. This sort of passive indulgence would not be sufficient to constitute a composition etc. unless the forbearance causes a breach of specific contractual terms, or possesses elements of fraud or mala fides.

Section 136

This section provides for a statutory exception to the rule laid down in Section 135. Section 136 states that in cases wherein the contract to give time is entered into not between the creditor and the principal debtor, but is entered into between the creditor and a third party, then the surety would not be discharged.

Section 137

Section 137 of the Contract Act clarifies the exception which has been discussed earlier in the part pertaining to Section 135. The provision lays down that the passive indulgence of the creditor by forbearing to sue the principal debtor upon default does not necessarily have the effect of discharging the surety from his obligations under the contract of guarantee.

There is a difference a mere forbearance to sue and an omission to sue. This distinction gains importance in the context of discharge of a surety's obligations, since a mere forbearance on the part of the creditor may not discharge the surety from his obligations, but an omission to sue may result in such discharge. In the case of forbearance to sue, the creditor has the discretion whether to sue at a certain point as a result of either the terms of the contract governing the transaction or as per the provisions of law. On the other hand, in the case of omission to sue, the creditor must have a duty to sue at a certain point either under the terms of the contract or under the provisions of the law.

An example of an omission to sue would be a situation where the surety reasonably suspects that the principal debtor in the concerned transaction would flee the jurisdiction of India and try to evade legal proceedings and consequences, and pursuant to this apprehension informs the creditor of the same and tells him to sue the principal debtor at the earliest. In such a case, if the creditor does not sue the principal debtor and the said principal debtor does happen to flee the nation, then the creditor's abstinence to sue would amount to an omission to sue.

The Privy Council in the case of *Mahanth Singh v. U Ba Yi*[43] held that if the only consequence of striking out the original trustees from an action for the recovery of debt was that the creditor would not be able to bring a fresh suit against them on the same subject matter, then the same did not amount to a release or a discharge of the debt. There was a merely a procedural rule which prevented the creditor from himself bringing an action upon the debt, and in no way discharged the surety from his liability.

Further, in *Syndicate Bank v. Channaveerappa Beleri*[44] the Supreme Court stated that in the event that the contract of guarantee stipulated that the surety's liability would arise only on a notice of default being received from the creditor, then such notice would have to be sent prior to the lapse of the limitation period. In the event that the creditor failed to send such notice to the surety prior to the limitation period getting over, then the surety would be discharged of his liability.

Section 139

Section 139 of the Contract Act contains, in substance, the rule that the creditor who has secured the guarantee from a surety is bound to protect the rights of the surety to the best of

[43] Mahanth Singh v. U Ba Yi, AIR 1939 PC 410.
[44] AIR 2006 SC 1874.

his ability. If the violation of the afore-mentioned duty adversely and materially affects the rights of the surety, then the surety is discharged from performing his obligations.

Among the sections discussed above, Section 139 is residuary in nature. For this residuary section to apply, the litmus test is whether the eventual remedy of the surety is impaired.[45] Therefore, in a case where the terms of the contract provided that the trees could be removed only post the payment was made in full by the principal debtor and the creditor permitted the removal of certain fallen trees even though the principal debtor had defaulted on the payment necessary, the Court held that the surety would be discharged of his liability.[46] The Court in that case stated that the reason for the holding was that by permitting the removal of the trees, the creditor had impaired the surety's eventual remedy against the surety.

In so far as Section 139 is concerned, mere laches and delays on the part of the creditor or the passive acquiescence of the creditor to certain acts which are contrary to the terms of the contract of guarantee may not be sufficient to result in the discharge of the surety.

THE RIGHT OF SUBROGATION

Section 140 of the Contract Act imports the longstanding common law principle that when the surety does discharge the obligation to the creditor, he steps into the shoes of the creditor and can proceed against the principal debtor to recover the debt that he has so discharged. This important right is known as the right of subrogation.

The most practical implication of Section 140 of the Contract Act is brought to specific effect by Section 141 of the Contract Act, which states that the surety is entitled to the benefit of every security which the creditor has as against the principal debtor. It is immaterial whether the surety is aware of the existence of such security at the time of entering into the contract of guarantee. In the event that the creditor parts with such security covered under Section 141,

[45] Central Bank of India v. B.K. Nayar, AIR 1985 P&H 161.

[46] State of M.P. v. Kuluram, AIR 1967 SC 1105.

or impairs the security in any manner, in line with the principle contained in the section, the surety would be discharged to the extent of the security which is so impaired or parted with.

In the English case of *Craythorns v. Swinburm,*[47] the Court noted that the principles of contribution and principal rests not on the foundation of a contract, but rather exists upon the established principles of equity. Therefore, the surety's right to those securities which the creditor has as against the principal debtor is not founded in contract, but rather is based on established principles of natural justice.

While interpreting the meaning of the term "security" in Section 141, the courts have shunned narrow interpretations, holding that the term is to be given a wide purport to include within its ambit the varied types of rights which the creditor possesses against the principal debtor.[48]

One important difference exists between the rule as exists in English Law and the rule as imported into Indian jurisprudence vide Section 141. The English position is that the surety is entitled to those securities which the creditor possesses regardless whether the said securities were obtained by the creditor prior to or post the execution of the contract of guarantee. In India, Section 141 provides that the surety would have the right to all the securities which the creditor possesses as on the date that the contract of guarantee was entered into. However, insofar as those securities are concerned which the creditor may have gotten hold of post the contract of guarantee coming into existence, courts have held that the creditor would be entitled to the benefit of the same in the event that the creditor still has them in his possession at the time that the debt is discharged. However, unlike the position of law with respect to those securities that the creditor has before or at the time of entering into the guarantee, with respect to those securities that the creditor has obtained post the contract being executed, the surety will not be able to claim a discharge of the amount equivalent to the value of the security in the event that the creditor has lost or otherwise hindered the value of the security.

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[47] (1807) 14 ves 160.

[48] State of Madhya Pradesh v. Kalusan, AIR 1967 SC 1105.

While the Contract Act clearly provides that the surety is entitled to the security that the creditor possesses, it is unclear as to exactly when does the security pass from the creditor to the surety. In *Goverdhandas v. Bank of Bengal,*[49] the court stated that the surety would only be entitled to the security that the creditor possesses once the obligation was fully satisfied by the surety, and not before. The rationale of the court in holding in this manner was that the creditor usually insists on a guarantee when the collateral or other security is insufficient with respect to the loan. It would be antithetical to the very purpose of the guarantee if surety got the creditor's security on payment of only part of the obligation.

BANK GUARANTEE

NATURE OF BANK GUARANTEE: INDEPENDENT AND AUTONOMOUS

A bank guarantee is an undertaking by a bank or a banking institution to undertake to pay against the beneficiary's demand for payment. Where a bank unconditionally and irrevocably promises to pay on demand (i.e. guarantees payment), the amount of liability undertaken in the guarantee without any reference to any dispute or demur happening, the liability of the bank becomes absolute and unequivocal. Under an unconditional bank guarantee, the guaranteeing bank's liability becomes fixated when the conditions mentioned in the guarantee are fulfilled (for example, the production of a bill of lading by a seller/shipper in case of sale of goods). Such fulfilment of conditions mentioned in the guarantee instrument is to be seen without regard to the underlying main transaction between the person for whose obligation a guarantee is given and the beneficiary.

In the famous case of *RD Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*[50] The obligation of the bank in the case of a guarantee undertaken by it was considered in the following terms:

> "*It is only in the exceptional cases that the Courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international*

[49] (1890) 15 Bom 48.

[50] RD Hardbottle(Mercantile) Ltd. v. National Westminster Bank Ltd., (1977) 2 All ER 862.

commerce. Such obligations were regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the Courts will leave the merchants to settle their disputes under the contract by litigation or arbitration as available to them or stipulated in the contracts. The Courts are not concerned with their difficulties to enforce the claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honored, free from interference by the Courts. Otherwise, trust in international commerce could be irreparably damaged."

Therefore, the nature of a bank guarantee is that it is independent and autonomous of the underlying transaction, in the fulfilment of which it may be tendered. It and its enforcement is not qualified or circumscribed by the primary contract between the person for whom it is given and at whose instance it is give. Therefore, a bank must make good its promise to pay regardless of any dispute or proceeding between the parties.[51] Therefore while considering whether or not a bank is liable to pay as per the terms of an unconditional guarantee, it need not, at all, in any scenario pay attention or give regard to what may be the underlying or primary transaction between the parties. In *R.D. Harbottle*, the Queen's Bench of England explained the value of this feature of bank guarantees in the world of international commercial transactions.

This position was cemented in Indian law by the High Court of Delhi in the case of *Banwari Lal Radha Mohan v. Punjab State Co-op Supply and Marketing Federation Ltd.*[52]. Since an irrevocable bank guarantee being a separate transaction, the payment under it being at once made subject to invocation, shall not be stayed or stopped or impeded, pending any settlement of any disputes between the parties. Payment under a bank guarantee is such solid a commitment that it is not even affected by any winding up order that may have been passed

[51] POLLOCK & MULLA, INDIAN CONTRACT & SPECIFIC RELIEF ACTS 1369 (2012).
[52] AIR 1983 Del 86.

against the company that may have become bankrupt.[53] A beneficiary is entitled to realize a bank guarantee only and only subject to the terms stipulated in the guarantee instrument, unaffected by any term in the main or underlying contract. The Supreme Court of India affirmed this position in the landmark case of *Uttar Pradesh State Sugar Corporation v. Sumac International Ltd*.[54] In another case decided by it, it held that pendency of arbitration proceedings emanating from the underlying contract were not a reason to prevent the beneficiary from invoking the guarantees.[55]

TYPES OF BANK GUARANTEES

There are two major types of bank guarantee used in businesses, which are as follows:

Financial Guarantee – These guarantees are generally issued in lieu of security deposits. Some contracts may require a financial commitment from the buyer such as a security deposit. In such cases, instead of depositing the money, the buyer can provide the seller with a financial bank guarantee using which the seller can be compensated in case of any loss.

Performance Guarantee – These guarantees are issued for the performance of a contract or an obligation. In case, there is a default in the performance, non-performance or short performance of a contract, the beneficiary's loss will be made good by the bank. For example, A enters into a contract with B for completion of a certain project and the contract is supported by a bank guarantee. If A does not complete the project on time and does not compensate B for the loss, B can claim the loss from the bank with the bank guarantee provided.

DISTINGUISHING BANK GUARANTEES AND LETTERS OF CREDIT

A Letter of Credit is a financial document which imposes an obligation on the bank to make payment to the beneficiary on completion of certain services as required by the applicant.

[53] Gas Authority of India Ltd. v. Official Liquidator, AIR 2004 Bom 220.
[54] Uttar Pradesh State Sugar Corporation v. Sumac International Ltd., AIR 1997 SC 1644.
[55] National Thermal Power Corporation Ltd. v. Flowmore Pvt. Ltd., AIR 1996 SC 445.

Letter of Credit is issued by the bank when the buyer requests his bank to make payment to the seller on the receipt of certain goods or services. That is, when the buyer runs into cash flow difficulties or similar situations and thus cannot make immediate payment to the seller, he will approach his bank to make the payment to the seller on submission of certain documents. The bank will later recover the amount paid from the buyer along with the required charges.

On the other hand, under a Bank Guarantee, the bank is required to make payment to the third-party only if the applicant fails to make the payment to the third-party or does not fulfil the required obligations under the contract. A Bank Guarantee is essentially used to ensure a seller from loss or damage due to the non-performance by the other party in a contract.

Letters of Credit are generally misunderstood as Bank Guarantees since they share some common characteristics. They both play a significant role in trade financing when the parties to the transactions don't have established the business relationships.

INJUNCTION AGAINST ENCASHMENT OF BANK GUARANTEES

As has already been pointed out, a Bank Guarantee is an independent and autonomous obligation undertaken by a bank. It thus forms a distinct contract between the bank and the beneficiary, and is not qualified by the underlying transaction and the primary contract between the person at whose instance the bank guarantee is given. Where a bank gives a guarantee to pay on *'first demand'*, and *'without contestation'* and *'without reference to such party'* or *'notwithstanding any disputes between the parties'*, the guarantor is obliged to pay according to the contractual obligations and the court will not give an injunction restraining the bank for payment.[56]

The law regarding granting to injunctions for restraining payments under bank guarantees has evolved over the course of time through successive High Court and Supreme Court verdicts.

[56] POLLOCK & MULLA, INDIAN CONTRACT & SPECIFIC RELIEF ACTS 1373 (2012).

There thus exist very limited grounds on which courts in India have granted injunctions against encashment of such unconditional obligations in nature of bank guarantees.

In the case of *Maharashtra State Electricity Board v. Official Liquidator*[57], The appellant State electricity board invited tenders for supply of goods which was won by the respondent company. In accordance with the terms of tender the company offered a bank guarantee for a certain sum of money for supply of goods to the board. As security for the guarantee, the Bank took from the company in a fixed deposit receipt and some quantity of imported zinc ingots and the Bank had certain rights in respect of these securities. Meanwhile, the company went into liquidation and a winding up order was passed against it. For failure in supplying goods, the electricity board went for encashment of the bank guarantee. Payment was resisted by the official liquidator on the ground that such action of the bank would affect the assets of the company in liquidation as the bank was also a secured creditor in liquidation proceedings. This was contended to be an exceptional circumstance for the courts to intervene.

The Supreme Court however refrained from granting injunction reiterating the independent, autonomous and unconditional nature of obligation under a bank guarantee. Thus, any proceedings or dispute concerning the principal debtor does not absolve the guarantor of its duty under a bank guarantee; such is not an exceptional circumstance.

As to what are these exceptional circumstances was laid down by The Supreme Court in *Uttar Pradesh State Corporation Ltd. v. Sumac International.*[58] In this Case, The appellant, U.P. State Sugar Corporation entered into an agreement with the respondent, M/s Sumac International Pvt. Ltd. under which the respondent agreed to design, to prepare an engineering lay-out and to manufacture or procure and supply to the appellant the machinery and equipment for a complete sugar plant. The supplier was required to furnish a bank guarantee in respect of guaranteed performance of the plant and machinery which they did.

[57] Maharashtra State Electricity Board (MSEB) v. Official Liquidator Ernakulam, AIR 1982 SC 1497.
[58] Supra Note 5.

The work was not carried out within the time envisaged under the contract and the state sugar corporation went for encashment of bank guarantees.

On adjudging whether an exceptional circumstance exist for intervention, The Supreme Court carved out only two exceptions:

> **Fraud**: *'Fraud unravels all'*, a fraud in connection with a bank guarantee would vitiate the very foundation of such a bank guarantee. Hence if there is such a fraud of which the beneficiary seeks to take advantage, he can be restrained from doing so.
>
> **Irretrievable Harm or Injustice**: Cases where allowing the encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties concerned. The harm or injustice contemplated under must be of such an exceptional and irretrievable nature as would override the terms of the guarantee and the adverse effect of such an injunction on commercial dealings in the country.

There was no exceptional circumstance within the laid down exceptions and hence injunction was not granted. Court emphasized that the two grounds are not necessarily connected, though both may co-exist in some cases. Further, on the nature of the irretrievable injury, it was held that it must be of the kind which was the subject-matter of the decision in the ITEK Corporation case.

In the American case of *ITEK Corporation v. First National Bank of Boston*[59], an exporter in the U.S.A. entered into an agreement with the Imperial Government of Iran and sought an order terminating its liability on standby letters of credit issued by an American bank in favour of an Iranian Bank as part of the contract. The relief was sought on account of the situation created after the Iranian revolution when the American Government cancelled the export licences in relation to Iran and the Iranian Government had forcibly taken some American citizens as hostages. The U.S. Government had blocked all Iranian assets under the jurisdiction of United States and had cancelled the export contract. It was contended by the exporter that any claim for damages against the purchaser if decreed by the American Courts

[59] ITEK Corporation v. First National Bank of Boston., 566 Fed. Supp. 1210.

would not be executable in Iran under these circumstances and realisation of the bank guarantee/Letters of credit would cause irreparable harm to the plaintiff.

The Federal court held that to satisfy the exception of irretrievable harm or injustice, The Court must find:

1) That a plaintiff will suffer irreparable injury if the injunction is not granted;
2) That such injury outweighs any harm which granting injunctive relief would inflict on the defendant;
3) That plaintiff has exhibited a likelihood of success on the merits; and
4) That the public interest will not be adversely affected by the granting of the injunction.

The situation of the exporter fulfilled all these requirements and thus an injunction was granted restraining payment under the Letters of Credits issued. The standard laid down by US Federal Court was incorporated in the Indian jurisprudence through *Sumac case.*[60]

Thus, a Bank Guarantee is an irrevocable commitment and cannot be interfered except when a case of fraud or apprehension of irretrievable injustice is made out. In order to restrain the operation either of letter of credit or bank guarantee, there should be serious dispute and there should be a good prima facie case of fraud and special equities in form of preventing irretrievable injustice between the parties. Otherwise, the very purpose of such obligations will be defeated and internal commerce and trading operations will get jeopardized.

[60] Supra Note 5.

MODULE II

BAILMENT & PLEDGE

BAILMENT

A bailment may be described as a delivery on condition, to which the law usually attaches an obligation to redeliver the goods, or otherwise deal with them as directed, when the condition is satisfied; but there may be, in particular cases, a bailment without an enforceable obligation.[61] Bailment does not result in a transfer of ownership, and does not bestow the person who has been entrusted with the goods the ability to act on behalf of the owner of goods.

Chapter IX of the Indian Contract Act (Sections 148 to 179) regulates the contracts of bailment, including pledges, a specific form of bailment in Sections 170 to 179.

FUNDAMENTALS OF BAILMENT

DEFINITION OF BAILMENT

The terms "*Bailment*", "*Bailor*" and "*Bailee*" are defined in §148.

- A "***bailment***" is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.
- The person delivering the goods is called the "***bailor***".
- The person to whom they are delivered is called the "***bailee***".

CORE ELEMENTS OF BAILMENT

The core elements of bailment as per §148 are as follows:

[61] *R v. McDonald,* [1885] 15 QBD 323; *Mulla on Contracts,* p. 1425.

i. Delivery of possession from one person to another
ii. Identification (and Communication) of a specific purpose
iii. Acting in accordance with the instructions of disposal

DELIVERY OF POSSESSION

POSSESSION

Possession refers to the situation where one is legally entrusted with the legal responsibility of goods, and not merely the situation where one has access and is able to use the goods. A guest who uses the silverware of his host, might have a social obligation to take care of it, but legally it would be considered "*mere custody*" and not legal possession.[62] The most common test used to determine the existence of possession is to examine whether a person has *de facto* control of the property. Thus, a contract of bailment is established only when the Bailee has control over the goods. The following cases may be juxtaposed to understand this concept clearly.

[62] *Annamalai Timber Trust Ltd. v. Trippunithura Devaswom,* AIR 1954 TC 305.

Illustrative Cases

ULTZEN v NICOLS (1894) 1 QB 92	KALIAPERUMAL PILLAI v. VISALAKSHMI ACHI 1937 SCC OnLine Mad 399
Initial Facts	
Customer entered a restaurant and the waiter took his coat without being asked to and hung them on a hook behind the customer	Lady handed over jewels to a goldsmith for the purposes of melting and making new jewels.
Control of the Bailor	
The coat was not the in view of the customer	Every evening, lady would receive half-made jewels from goldsmith and store it in a box in the goldsmith's shop
Control of the Bailee	
The coat was hung on a hook in the restaurant premises	The jewels were stored in a locked box kept in the goldsmith's shop, but the **keys were with the Lady**
Eventual Disposal of Goods	
The Coat was lost when the Customer finished his meal	The jewels were lost one night
Status of Bailment	
The Contract was a **Contract of Bailment**. Bailee was held Liable.	The Contract was **NOT** a contract of Bailment. Bailee was not held Liable.

DELIVERY OF POSSESSION TO BAILEE - §149

Bailment requires that the Bailor transfers the exclusive right of possession to the Bailee for there to be a contract of bailment between the parties. §149 lays out the ways in which the delivery maybe made.

> **"*S. 149***
>
> ***The delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf.*"**

§149 thus indicates that a contract of bailment commences with putting the goods in the possession of the intended bailee or their representative.

TIMING OF DELIVERY OF POSSESSION

The Explanation to §148 clarifies that the transfer of goods to deliver possession may occur either before, after or simultaneously with an agreement of bailment.

> ***"If a person is already in possession of the goods of another, contracts to hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor of such goods, although they may not have been delivered by way of bailment."***

Thus, if the parties agree upon a contract of bailment, they are bound by it irrespective of whether they shared a bailor-bailee relationship when the goods were physically delivered.

MODE OF DELIVERY – ACTUAL & CONSTRUCTIVE POSSESSION

§149 indicates that goods may be delivered either by physical delivery of goods or constructively. Courts and scholars agree that a physical transfer of goods is not required for the delivery of possession from the bailor to the bailee.[63]

In ***State Bank of Chittoor v Narasimhulu***[64] the Andhra Pradesh High Court held that a person who had pledged his projection machinery with the bank, even though the contract allowed him to keep the goods in his physical possession was a contract of bailment. The

[63] *Avatar Singh*, p. 673.
[64] AIR 1966 AP 163.

court held the Bank liable as a Bailee because there had been a change in the "***legal character of the physical possession of goods***" despite there being no change in the physical custody of the goods.

Further, even when there is physical delivery of goods to an individual, the delivery of possession maybe to another. In ***N.R. Srinivasa Iyer v. New India Assurance Co. Ltd.***[65], the bailor delivered his car which was involved in an accident to the garage for repairs. However, since this was done at the behest of the Insurer Company, it was the Insurer who was the Bailee, and the garage was a sub-bailee. Thus, the Insurer was held liable as a Bailee.

CONTRACT FOR SPECIFIC PURPOSE

The delivery of possession must be accompanied with a specific condition that the bailee will return the specific goods placed under bailment, or a condition describing how the goods must be disposed is essential to a contract of bailment.[66] In imposing this condition, it is integral that the specific movable property are returned or accounted for.[67] This primary conditions is usually accompanied by other conditions which deal with the finer aspects of entrustment.

IDENTIFICATION OF SPECIFIC MOVABLE PROPERTY

Bailment needs to identify or earmark specific moveable property and levy conditions for their re-delivery or disposal. A contract that imposes obligations equivalent to dealing with those goods cannot constitute a bailment.

- For instance, when bags of grain are delivered to a miller upon a condition that an equivalent quantity of grain or an equivalent amount of money may be paid, it is not a contract of bailment.[68]

[65] (1983) 3 SCC 458.
[66] *State of Maharashtra v. Britannia Biscuits Co. Ltd.*, (1995) 2 Supp SCC 72.
[67] *Mulla on Contracts*, p. 1425.
[68] *Bridges v. Garrett*, (1870) LR 5 CP 451; *Shankar Lal v. Bhura Lal*, AIR 1951 Ajm 24.

- When several promissory notes are delivered with the condition that a promissory note of an amount equivalent to the sum of all those notes shall be delivered to the depositor, the contract is not a bailment.[69]
- However, a condition which accounts for the specific entrusted goods but allows for them to change form, like a block of silver entrusted to be returned as silver jewellery would create bailor-bailee obligations.[70]

BAILMENT WITHOUT CONTRACTS – CONSTRUCTIVE BAILMENT

Common Law recognizes that bailment may take place without a contract. Cheshire & Fifoot state that an explicit contract is a usual, not an essential element of bailment.[71] Pollock & Wright also identify that bailment under common law is a *sui generis* contract which is completed by the physical act of bailment itself unless the parties agree to lay out more onerous conditions.[72] The fundamental principle underlying such implied contracts is the Common Law notion of acting in a fair, just and reasonable manner.

The Law Commission of India has sought to insert a broad clause upon the principles of justice to create and regulate the notion of "constructive bailment".[73] However, this has not been part of the Indian Contract Act. However, Indian Courts have been forthcoming to accept bailment without contract in the context of seizure of goods by government departments. The Supreme Court has held several times that the Contract Act only governs those obligations of bailment that arise from explicit contracts between the parties.[74] However, government departments are under an obligation as bailees to take reasonable care of goods and against reasonably foreseeable dangers.

IMPLIED CONDITION

Bailment without a contract must be contrasted with situations where there is a contract between the parties, but conditions maybe implied into them, interpreting the contractual

[69] *Secy of State v. Sheo Singh*, (1875-1880) 2 All 756.
[70] *Sitla Bakksh Singh v. Baij Nath*, AIR 1936 Oudh 264.
[71] Law of Contract (6th Edn, 1964) p. 73.
[72] Possession in the Common Law, p. 143.
[73] Thirteenth Report of the Law Commission of India, 1958, para 120.
[74] *State of Gujarat v. Memon Mahomed Haji Hasan*, (1967) 3 SCR 938; *Basavva Kom Dyamangouda Patil v. State of Mysore*, (1977) 4 SCC 358.

negotiations and the terms of the contract specifying the conditions. The Bombay High Court in the illustrative case of ***Governor General of India in Council v The Jubilee Mills, Ltd.***[75] held that where, with the consent of the station-master, the goods were stored on the platform of the railway company, the wagons were not available, the company was held liable when they were damaged by a fire caused by a passing engine.

TYPES OF BAILMENT

Bailment may be classified based on the following criteria, in the following ways.

BASED ON COMPENSATION RECEIVED BY BAILEE

Based on whether the Bailee receives compensation for the possession of goods, the transaction may be classified into:

i. <u>*Gratuitous Bailment*</u>

Where neither the Bailor nor the Bailee receives compensation for entrustment of goods. Usually, contracts where the Bailor does not receive compensation are also called "Bailment for the benefit of the Bailee", and vice versa.

ii. <u>*Bailment for Consideration/Reward*</u>

Where consideration flows between the parties for the bailment.

The distinctions that the Contract Act makes based on the two types, are referred to in the subsequent sections, wherever appropriate.

BASED ON NATURE OF TRANSACTION

i. Deposit of Goods

ii. Hire-Purchase Agreements

iii. Pledge Agreements

iv. Loan of Goods

All of these kinds of bailment may be agreed to with or without compensation to either party.

[75] 1952 SCC OnLine Bom 10.

Rights & Duties of a Bailor

Rights of the Bailor

The Indian Contract Act does not explicitly stipulate the rights of the bailor. However, based on the duties of the Bailee, it can be inferred that the Bailor has:

i. The right to entrust goods in the manner of his choice
ii. The right to receive the delivered goods or for goods to be disposed according to the terms of entrustment
iii. The right to receive compensation if there is damage to the bailed goods

Duty of the Bailor - §150

The Indian Contract Act makes a distinction between the duties of a gratuitous bailor and a bailor who bails the goods for reward, and explicitly lists only one duty of the Bailor – the duty to disclose faults in the goods.

Duty of a Gratuitous Bailor

All bailors are bound to disclose the faults in the goods bailed, provided:

i. Bailor was aware of the faults before the bailment AND
ii. The faults materially interfere with the use of the goods OR exposes the bailee to extraordinary risks

If the Bailor fails to make the requisite disclosure, the Bailor would be liable to the Bailee for damages directly arising from such faults.

Duty of a Bailor for Reward

When the Bailor bails the goods for reward, his duty and liability are accentuated. The Bailor for Reward is liable for all damages which arise irrespective of whether she was aware of the existence of the faults.

A Bailor for Reward must therefore take care that the goods are examined and ensuring that the goods are of the requisite quality as promised.

Both types of Bailors are required to disclose the existence of dangerous components including explosive and other combustible items that exist in the goods.[76]

RIGHTS & DUTIES OF A BAILEE

RIGHTS OF A BAILEE

RIGHT TO COMPENSATION - §164

The Bailee has the right to receive compensation if she undergoes losses due a lack of capacity on part of the Bailor. **§**164 envisages three instances where the Bailor did not have the right to:

i. Bail the goods
ii. Receive the goods
iii. Provide directions regarding them

RIGHT TO REPAYMENT OF NECESSARY EXPENSES - § 158

This right is available to Bailees who perform three kinds of Bailment without remuneration:

i. Storage of goods
ii. Carrying of goods
iii. Working upon the goods

In such a situation, the Bailee is entitled to receive all necessary expenses incurred to undertake these three tasks, from the Bailor.

It must be noted however, that when the Bailment is for the benefit of the Bailee (Gratuitous Bailor scenario), the Bailee is not entitled to compensation for expenses that would flow

[76] *Dwarkanath Raimohan Choudhuri v River Steam Navigation Co Ltd*, AIR 1917 PC 173.

naturally from the use for which it was bailed, as the Bailee is presumed to bear the expenses for which she bailed the goods.

This right is distinct from the Right to Lien, explained below. It must be noted that a Right to Lien exists only as long as the Bailee is in possession of the goods. However, Courts have upheld that even when the possession has been parted with, the Bailee is entitled to recover necessary expenses.[77]

RIGHT OF LIEN §170 - §171

Lien refers to a Common Law right where a person who is in lawful possession of some goods, may continue to hold those goods in her possession until her rightful demands concerning the goods are fulfilled.[78] The Contract Act envisages two scenarios of Lien.

PARTICULAR LIEN OF BAILEE - §170

§170 envisages the Bailee has a right of lien over the specific goods envisaged, provided:

i. That the Bailee has rendered a service <u>involving skill or exercise of labour</u> on those specific goods AND
ii. Such action is in line with the purpose of bailment AND
iii. There is no contract to the contrary

Such a right of lien would extend until requisite remuneration is provided for the services rendered.

"PARTICULAR" LIEN V. GENERAL LIEN

This Lien is called "particular lien", because the right of the Bailee extends to retaining <u>only those goods</u> upon which she rendered the service, until compensation is received for the same

[77] See *Surya Investment Co v State Trading Corpn of India (P) Ltd*, AIR 1987 Cal 46.
[78] *Syndicate Bank v Vijay Kumar*, (1992) 2 SCC 330; HALSBURY'S LAWS OF ENGLAND, Vol 20 (2nd Edn) 552, para 695.

set of services. Even amongst an array of goods legally in the possession of the Bailee, only those upon which she has exercised skill or labour are eligible to exercise lien over.[79]

This must be contrasted against General Lien envisaged under **§**171 where goods might be retained by the Bailee, for any debts owed in the general balance of account between the Parties.

POSSESSORY RIGHT

The Right of Lien accrues to the Bailee as long as she is in the rightful possession of the goods. Thus, the Bailee needs to have rightfully completed his obligation completely before exercising his Right of Lien. Possession may not be retained after having completed obligations partially and make *quantum meruit* claims to compensation.[80]

In ***EC Eduljee v. Cafe John Bros***,[81] the Bailee who had performed services on a refrigerator had a legitimate right to lien over the fridge. However, this was lost because he delivered the goods back to the bailor before claiming such lien. He could not re-claim this lien when he received the fridge the next time for additional repairs.

SKILL OR EXERCISE OF LABOUR

The legal standard for "skill or exercise of labour" requires a positive involvement of the Bailee resulting in an improvement in the condition of the goods. Mere storage of goods[82] or maintenance of the *status quo* of goods[83] without any positive improvement <u>will not constitute</u> an exercise of skill or labour. In ***Hutton v Car Maintenance Co.***,[84] the Court explained the standard through an apt example of a job-master who cleans and feeds the horses, contrasting it with a trainer who develops the abilities of the horse. The former does not exercise skill or labour, while the latter does.

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[79] *Chase v Westmore*, (1816) 15 M&S 180.
[80] *Skinner v. Jager*, (1883) 6 All 139.
[81] *EC Eduljee v. Cafe John Bros*, AIR 1943 Nag 249.
[82] *Kalloomal Tapeshwari Prasad & Co. v. Rashtriya Chemicals & Fertilizers Ltd.*, AIR 1990 All 214.
[83] *Hutton v Car Maintenance Co*, (1915) 1 Ch 21.
[84] *Ibid*.

GENERAL LIEN OF CERTAIN INDIVIDUALS - §171

The Indian Contract Act, under **§**171 stipulates a general lien for the following classes of bailees, unless there is a contract to the contrary.

i. Bankers
ii. Factors
iii. Wharfingers
iv. Attorneys of a High Court and
v. Policy brokers

The list is exhaustive and stipulates that no other individuals have a right of general lien to hold goods bailed to them as security for a general balance of account. However, parties may contractually allow a right of general lien to other classes of bailees.

It must be noted that the right of general lien is restricted only to the extent of retaining goods as security and does not include the right to sell the goods, unlike the rights of a pledgee.[85]

BANKER'S GENERAL LIEN

The General Lien of the Banker has always been a contentious area of law, and prone to varied judicial interpretation. Chitty on Contracts, a common law treatise which has been cited by the Supreme Court provides the following definition and scope of Banker's General Lien:

> *"By mercantile custom the banker has a general lien over all forms of commercial paper deposited by or on behalf of a customer in the ordinary course of banking business. The custom does not extend to valuables lodged for the purpose of safe custody and may in any event be displaced by an express agreement or circumstances which show an implied agreement inconsistent with the lien. ... The lien is applicable to negotiable instruments which are remitted to a banker from the customer for the purpose of collection. When collection has been made the proceeds may be used by*

[85] *Bank of India Ltd. Rustom Fakirji Cowasjee,*AIR 1955 Bom 419.

the banker in reduction of the customer's debt balance unless otherwise earmarked."[86]

Thus, it must be noted that while the lien of the banker is broad in principle, there are a few inherent restrictions. Courts on different occasions have allowed banks to exercise general lien over valuables can be held in general lien for overall debts owed to the bank,[87] negotiable instruments remitted by the customer for collection,[88] bank guarantees, and instruments issued by the customer for the security of the same.

JOINT ACCOUNTS

The banker's right of general lien is not available with respect to a joint account. This was held by Lahore High Court in ***Simla Banking and Industrial Company Limited, Ambala City v. Mt. Bhagwan Kuar***.[89] The Calcutta High Court adopted the same approach too.[90] These case are latter approved by the Supreme Court in ***Anumati v Punjab National Bank*.**[91] The reason is that joint accounts are multi-partite contracts, between all the contract holders on one hand and the bank on the other. Thus, even if such deposit is identified as bailment, lien being exercised for a bipartite transaction of default between one customer (account holder) and the bank, over jointly held property is fundamentally opposed to the principle of privity of contract.[92]

DEPOSIT V BAILMENT – LIEN OVER MONEY

However, it must be noted that not all deposits made with the bank may be considered contracts of bailment. Situations where a deposit has been made to a bank like deposits into a

[86] *Syndicate Bank v Vijay Kumar,* (1992) 2 SCC 330.
[87] *Official Assignee of Madras v. S.R.M.M.R.M. Ramaswami Chetty,* (1920) 43 Mad 747.
[88] *Mohammad Maqbool Kunash v. Jammu and Kashmir Bank Ltd, AIR 2013 J&K 14.*
[89] AIR 1928 Lah 316.

[90] *Nath Bank Ltd.(In Liqn.) v. Sisir Sarkar*, AIR 1954 Cal 303.
[91] (2004) 8 SCC 4998.
[92] See *Simla Banking and Industrial Company Limited, Ambala City v. Mt. Bhagwan Kuar,* AIR 1928 Lah 316.

credit account,[93] or deposits of guarantee amounts[94] have been considered deposits of money, and not bailments, thus preventing banker's general lien over such sums of money. Similarly, the deposit needs to be actively bailed with the bank, and not casually left at a banker's table after refusal by him to advance a loan were not within the spell of banker's general lien.[95]

Sums of money deposited with the bank do not maintain their identity and cannot be earmarked for return, which is a basic requirement of any agreement of bailment and in turn, lien.[96] Further, it has been held that any amount that is paid to the bank, especially in a creditor-debtor relationship would indicate that the money deposited in the bank is owed to the bank and therefore owned by the bank.[97] A banker therefore, cannot exercise general lien on a sum of money owned by him.

MONEY ALLOCATED FOR SPECIAL PURPOSE

It might be posited that the simplest way to maintain the identity of sums of money would be when they are earmarked for specific purposes. Indian courts have upheld that earmarked funds may be subject to general lien.[98] Sometimes, this earmarking requirement has been fulfilled by identifying that the sums of money were in a savings account.[99]

However, Courts have categorically held that a sum of money earmarked for a special purpose cannot be subject to a general lien, especially when that purpose is for a special transaction and a purpose inconsistent with the general lien of the Banker. Thus, goods deposited for safekeeping with the bank[100] and securities deposited for exchange for fresh bills[101] are inherently unsuitable for the exercise of general lien. The Sindh High Court has upheld this principle with reference to sums of money earmarked for a specific purpose in ***Mercantile Bank of India Ltd. v. Rochaldas Gidumal and Co***[102] where a sum of money

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[93] *Devendrakumar Lalchandji v. Gulabsingh Nekhesingh*, 1945 SCC OnLine MP 24.
[94] *State Bank of India v. Madhya Pradesh Iron & Steel Works Pvt. Ltd., Raipur and others, AIR 1998 MP 93*
[95] *Lucas v Dorrein*, (1817) 7 Taunt 278: 129 ER 112.
[96] *Avtar Singh*, p.702.
[97] *Ibid.*
[98] *Radha Raman Choudhary v. Chota Nagpur Banking Assn Ltd.,* AIR 1944 Pat 368.
[99] *State Bank of India v. Deepak Malviya,* AIR 1996 All 165; *Krishna Kishore Kar v. United Commercial Bank,* AIR 1982 Cal 62.
[100] *Avtar Singh*, p. 703.
[101] *C.R. Narasimha Setty v. Canara Bank*, ILR 1990 Kar 674.
[102] AIR 1926 Sind 225.

earmarked specifically for telegraphic transmission could not be subject to Banker's general lien. However, another decision of the Punjab High Court ruled that when a sum is earmarked, and the transaction fails, then the sum of money may be held in lien by the bank.[103]

FIXED DEPOSITS

The money in a fixed deposit account is considered to be a loan to the bank and the depositor no more owns it. The bank is free to use it the way it wants. The only limitation it has is the obligation to repay the debt on maturity.

However, the Gauhati High Courts have held that payments held that a fixed deposit is basically a loan in the hands of the bank.[104] The money in a fixed deposit account is considered to be a loan to the bank and the depositor no more owns it. The bank is free to use it the way it wants. The only limitation it has is the obligation to repay the debt on maturity.

But the Supreme Court in ***Syndicate Bank v Vijaya Kumar***[105] has in very clear terms recognized banker's right of general lien even with respect to a fixed deposit account. Though in the above case the customer had given consent to the bank to exercise general lien over the two fixed deposit receipts the Court went to the extent of stating that the said right of a banker can be exercised even in the absence of such a consent. Further, the Karnataka High Court has held that the right would extend to the fixed deposits of the customer including those of his/her spouse.[106] This has sometimes been extended to the fixed deposit receipts of the guarantor, for payments owed as surety due to default of debtor.[107] Accordingly, the bank was allowed to adjust the amount towards the loan account. Hence, there is no bailor-bailee relationship, but a creditor-debtor relationship[108] and no right of general lien exists.[109]

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[103] *Firm Jai Kishan Das Jinda Ram v Central Bank of India Ltd*, AIR 1955 Punj 250; *Bank of New South Wales v Valley Butter*, 1902 AC 543.
[104] *Tilendra Nath Mahanta v. United Bank of India and Ors.*, AIR 2002 Gau 1.
[105] 1992 2 SCC 330.
[106] *Smt. K.S. Nagalambika v. Corporation Bank, Virajpet*, AIR 2000 Kar 201.
[107] *SBI v Goutmi Devi Gupta*, AIR 2002 MP 61.
[108] *Union Bank of India v Venugopalan*, (1990) 1 KLT 262.
[109] *Devendrakumar v Gulabsingh*, AIR 1946 Nag 114.

BANKER'S LIEN V RIGHT TO SET-OFF

The contentious debate surrounding where the General Lien of the Banker extends could be reasonably settled if the right of lien is compared against the right to set-off of the banker. General lien requires both the earmarking of goods and the specific identity of good bailed. However, the right of the banker to set-off the debts owed by the customer does not require such identity of goods or earmarking of the monies.

Therefore, in ***Punjab National Bank Ltd. v Arura Mal Durga Das And Anr.***[110] and more recently in ***Indian Bank, Rasipuaram v Sri Annapoorna Finance***[111] High Courts have ruled that:

> *"There is a distinction between a Banker's lien and the Bank's right to set-off. A lien is confined to securities and property in Bank's custody. Set-off is in relation to money and may arise from a contract or from mercantile usage or by operation of law. The right of a Bank to apply a deposit to an indebtedness due from the depositor, results from the right of set-off which obtains between persons occupying the relation of debtor and creditor, and between whom there exist mutual demands. Mutuality is essential to the validity of a set-off, and in order that one demand may be set-off against another, both must mutually exist between the same parties."*

Both of these courts, relying on Common Law jurisprudence, held therefore, that the banker's General lien is confined to securities and properties in the bank's custody, the set-off is in relation to money and may arise from a contract or from the mercantile usage or by operation of law.[112] Therefore, the bank would always have the right to set-off debts owed to it, but not a general lien over monies owed to it. Early Indian caselaw confirms the same position.[113]

[110] AIR 1960 P&H 632.
[111] AIR 2002 Mad. 180.
[112] Pagent's Law of Banking, 8th Ed, p. 500; Hart, Law of Banking, 3rd Ed, p.810.
[113] *Devendrakumar Lalchandji* v. *Gulabsingh Nekhesingh*, AIR 1930 382 (F.B.); *Llyods Bank Ltd.* v. *Administrator-General of Burma*, AIR 1957 Punj. 169.

Although the end-result for both the customer and the banker would be the same, the recognition of the right to set-off and general lien being distinct from each other would result in legal certainty and commercial efficiency.

FACTOR'S GENERAL LIEN

"Factor" refers to an agent entrusted with the possession of goods for the purpose of selling them to his principal. In the ordinary course of his business, he is given possession of the goods for the purpose of sale. For his balance of account against the principal, he has a general lien on the products of his client.

The two important considerations are:[114]

i. The sum owed to the Factor should have accrued to him in his capacity as a Factor
ii. It should be in the course of business

WHARFINGER'S GENERAL LIEN

A wharfinger is the owner or occupier of a wharf, who, for hire, receives merchandise on his wharf, either for the purposes of forwarding or for delivery to the consignee on such wharf. The fact that the manufacturer has a wharf on which the products delivered to him by the customer are purchased does not allow the producer to demand a bond as a check on the products.[115] A wharfinger's lien is usually only applicable when it comes to lawsuits against the proprietor of the products. He has no responsibility as against the buyer for charges that become due from the seller after he has been informed of the sale.[116]

ATTORNEY'S GENERAL LIEN

An attorney has the general lien until her fees and other accrued costs are paid in full.[117] In ***RD Saxena v. Balaram Prasad Sharma***,[118] the Supreme Court held that the Advocate's

[114] See *Dixon v Stansfield*, (1850) 10 CB 398: 16 LT 150.
[115] *Miller v. Nasmyths Patent Press Co. Ltd.,* (1882) ILR 8 Cal 312.
[116] *Barry v. Longmore*, (1840) 12 A&E 639, 54 RR 654.
[117] *Sheffield v Eden*, (1878) LR 10 Ch D 291 (CA); *Mangal Chand Maloo v. Purna Chandra Basu*, 1944 SCC OnLine Cal 120.
[118] AIR 2000 SC 2912 .

papers for a specific case were not 'goods' and that the Advocate was not entitled to exercise lien under the §171. This judgement has reversed previous High Court decisions which equated the Common Law right of the solicitor in England to Indian attorneys, including allowing attorneys to exercise lien over the case files.

Further, the ***RD Saxena*** judgement also states that the goods over which lien could be exercised needed to be saleable goods in line with the Sale of Goods Act. Thus, an advocate's general lien would extend only to goods that may be sold, not case files and documents.

POLICY BROKERS

An insurance agent working to carry out a marine insurance scheme is called a policy broker. His lien applies from the person who employed him to effect the policy to any balance on any insurance account owed to him.

RIGHT TO SUE §180 - §181

The Bailee has a right co-terminus with the Bailor to bring a suit against any third party wrongfully, deprives the bailee of the use or possession of the goods bailed, or does them any injury as per §180. Further, the Bailee is entitled to use any legal instruments and make any required interventions that are available to the owner of the goods.

When either the bailor and/or the bailee is successful in such a recovery suit, such relief or compensation is to be apportioned between the Bailor and the Bailee with due regard to their interest in the bailed goods, according to §181.

DUTIES OF THE BAILEE

DUTY OF REASONABLE CARE §151-§152

§151 and §152 lay out the most basic duty of a Bailee, which is to take reasonable care of the goods bailed to her, and further expound the standard of care that is applicable to a contract of bailment. This duty also extends to sub-bailees.

§151 stipulates that all bailees are required to take care of the bailed goods:

i. As a man of ordinary prudence
ii. Would take of his own goods
iii. Under similar circumstances
iv. With due regard to the nature of goods such as bulk, quality and value of goods bailed

The standard of care under Indian law is uniform, and applies both to gratuitous bailees and bailees for reward. Although Common Law precedent (including in India) previously made a distinction between the two types of bailees, the distinction has been blurred recently.[119]

Thus, a bailee is liable for any negligence committed by her, care taken was according to popular practice, but was inherently risky and unreasonable.[120]

BURDEN OF PROOF

The burden of proof always lies on the bailee to prove that the amount of care taken was reasonable.[121] A series of cases have laid out that the damage that occurs to the bailed goods is *prima facie* evidence of the negligence of the bailee.[122] Thus, the bailee must refute it.

The Supreme Court has also laid out recently that the bailee needs to prove that it had discharged the standard of care under §151 before it can rely on any exemption clause that limits or exempts the liability of the Bailee.[123]

The Burden of Proof is integral due to **§**152, which explicitly states that the Bailee is absolved of all responsibility for damage that is caused despite the Bailee undertaking the standard of care stipulated in **§**151.[124]

A cast-iron standard does not exist to examine cases under **§**152. It involves an enquiry into the specific facts and circumstances of the case, and examining the degree of causal relationship between the actions of the Bailee and the damage caused to the goods.[125]

[119] *Blount v War Office*, [1953] 1 WLR 736.
[120] *Gour Chandra Mukherjee v. Andrew Yules Co-op Credit Society Ltd.*, AIR 1977 Cal 336.
[121] *Lilavati Kirtilal Mehta Medical Trust* v. *Unique Shanti Developers*, (2020) 2 SCC 265.
[122] *Dharwad Dist Khadi Gramudyog Sangh*, (2000) 5 SCC 78. See also *Mulla on Contracts*, p. 1463.
[123] *Ibid*.
[124] *Central Bank of India v. Grains and Gunny Agencies*, AIR 1989 MP 28.
[125] *Shanti Lal and another v. Tara Chand Madan Gopal*, AIR 1933 All 158.

VICARIOUS LIABILITY

The principles of vicarious liability remain intact in determining the duty of care for bailment. Therefore, the bailee is liable for the negligence of her servants, provided the negligent act was in the course of employment, and apparent scope of authority of the servant.[126] Further, the bailee, as a reasonable person is expected to employ competent servants and supervise their actions. For instance, a workshop inviting vehicles to repair was owned by the bailee. Thus, the bailee is held liable for any harm caused to a vehicle sent for repair if it is caused by his servant; irrespective of whether the servant has behaved in a reckless, deceptive or dishonest manner.[127]

SPECIAL CONTRACT

It must be noted that **§**151 does not allow for contracting out of the obligations. However, **§**152 begins with *"In the absence of a special contract"*. Therefore, judicial discussion exists about whether a bailee may contract himself out of the duties specified in Section 151 and avoid liability for negligence.

The Punjab & Haryana High Court[128] and the Bombay High Court[129] have upheld the right of a bailee to contract out of the obligations under **§**151. However, the Gujarat High Court[130] and the Kerala High Court[131] have refused to uphold such clauses holding the Bailee liable despite such clauses.

DUTY TO MAKE AUTHORISED USE - §154, §153

§154 strictly lays out that the bailee may only use the bailed goods for the purposes stipulated in the bailment contract, and in turn would be liable for any damage that arises to the goods for any unauthorized use of the goods. This standard is one of strict compliance, and once

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[126] *Beard v. London General Omnibus Co.*, [1900] 2 QBD 530.
[127] *Ponnamma v. Ramanathan*, AIR 1973 Ker 49.
[128] *State Bank of India v. Quality Bread Factory and Others*, 1982 SCC OnLine P&H 373.
[129] *The Bombay Steam Navigation Company Limited v. Vasudev Baburao Kamat*, AIR 1928 Bom 5.
[130] *Mahendra Kumar Chandulal v C.B.I.*, AIR 1984 Guj (NOC) 53.
[131] *United India Insurance Co Ltd v Pooppally Coir Mills*, (1994) 2 Ker LT 473.

unauthorised use of the goods is undertaken, the fact that the damage occurred due to an Act of God or an inevitable accident is not a valid defence.

For instance, A vehicle was delivered to a repair workshop where the workshop owner permitted an unlicensed employee to drive the vehicle and caused an accident that resulted in a person's death. It was held that the bailee was responsible to compensate the deceased as well as the vehicle owner as it was an unauthorized use of the vehicle and the responsibility was absolute.[132]

Apart from being entitled to compensation, the Contract Act also allows the Bailor to avoid the contract of bailment altogether if the Bailee makes unauthorised use of the goods. However, there exists Common Law precedent to suggest that there needs to be an explicit inconsistency with the purpose, and not a mere irregular invocation of existing rights, such as a sub-pledge or a premature sale by a pledgee.[133]

DUTY NOT TO MIX - §155 - §157

§155-157 deal with the commercially relevant stipulation of earmarking and storing goods separately from the goods of the bailee herself or of other bailors, in order to keep the identity of the goods intact. These provisions are particularly relevant to the agriculture and the food and beverage industry where non-discrete goods like grains, flour, cotton, etc,. are stored in similar package. The import of the three sections may be summarized into the following four points:

i. The Bailee must not combine his own product with bailor's and without the consent of the Bailor. [§155]
ii. When the product is mixed with the bailor 's consent, both will have a proportionate interest in the mixture thus made. [§155]
iii. If the mixture is made without the permission of the bailor and the products can be separated or split, the bailee shall bear the separation costs. [§156]

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[132] *Alias v. E.M. Paul*, 2003 SCC OnLine Ker 177.
[133] *Halliday v. Holgate*, (1868) LR 3 Ex 299.

iv. If the mixture is inseparable, then the Bailor is entitled to compensation for the loss of goods. [§157]

DUTY TO RETURN - §159, §160, §161, §165

§160 stipulates the foundational duty of the Bailee to return the goods that have been bailed to her, after the purpose of bailment has been accomplished. This may involve either a re-delivery of goods to the bailor or disposal in any manner as instructed by the Bailor. It must be noted that this return must happen without a demand by the Bailor and within a reasonable time.[134]

Concomitantly, the Bailee is liable for all losses and deteriorations that occur from the time at which the goods were originally due to the Bailor. Judicial interpretation of §161 has been strict and held the Bailee liable for all damage post the default of the duty to return, even if the actual damage occurred due to an inevitable accident or Act of God following the Bailee's default.[135] A Karnataka High Court judgement has stated that the Bailee is liable for all inevitable accidents, except when the damage is caused due to *Force Majeure* or Act of God.[136] Thus, the duty to return definitely governs accidents post-default, while the facts would have to be considered in events of Act of God or *Force Majeure*.

DUTY OF RETURN OF GRATUITOUS BAILMENT - §159

A bailor who has bailed the goods for use gratuitously, including where they are for a specified period or intent, may claim their return at any period; but if such a bailee has behaved in such a way that the return of the goods will result in a loss exceeding the profit resulting from the bailment, the bailor will be liable to pay the bailee for the amount by which the loss exceeds the gain.[137]

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[134] *Dhian Singh Sobha Singh v. Union of India*, 1958 SCR 781.
[135] *Shaw & Co. v. Symmons & Sons*, (1917) 1 KB 799.
[136] *Prakash Road Lines v. Oriental Fire & General Insurance Co. Ltd*, ILR 1987 Kar 3576.
[137] *Mulla on Contracts*, p. 1476.

MANNER OF RETURN WHEN BAILMENT IS BY JOINT BAILORS - §165

When goods are bailed by joint bailors, upon accomplishment of the purpose, the Bailee may return the goods or dispose them according to the directions of one of the Bailors, without having to seek consent from all of them. This however is subject to an agreement to the contrary where the Parties may agree upon a particular modality of return of goods.

DUTY TO RETURN INCREASE - §163

The Bailee is duty bound to re-deliver any increase or profits that have accrued from the bailed goods during the course of the bailment to the Bailor or dispose it according to her directions. Examples would include bailed cattle which has delivered calves[138], pledged securities[139] which received dividends or plants which deliver fruits during the bailment. In all these instances, the Bailor is entitled to the original goods and their by-products.

DUTY TO NOT OBJECT TO BAILOR'S TITLE - §166

A bailee is estopped from setting up against his bailor's demand for a redelivery of the goods bailed, based on the reason that the goods belong to a third party. This is because the Bailee, who re-delivers goods to the Bailor <u>in good faith</u> is not held liable for conversion of goods, even when the Bailor does not have title to the goods.

GOOD FAITH

However, when the Bailee had notice of the transfer of title from the original bailor to a third party, she was held liable for conversion as it was not a delivery of goods in good faith.[140]

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[138] Illustration to §163.
[139] *Standard Chartered Bank v. Custodian*, (2000) 6 SCC 427.
[140] *K.J. Patel v. T.K.V.R.V. Chettyar*, AIR 1940 Rang 249.

RIGHTS OF THIRD PARTY - §167

A third party, other than the Bailor however, may apply to the Court to:

i. Stop the delivery of goods from the Bailee to the Bailor AND/OR
ii. To decide the title of the goods

FINDERS AS BAILEES

§§168-169 deal with the rights and obligations of finders. Finders are Bailees under the Indian Contract Law and therefore bound by the duties of reasonable care. Across both sections, it must be noted that the primary duty of the finder is to trace the owner and return the goods to him.

GENERAL RIGHTS OF FINDER

Given that obligation, §168 makes the following stipulations:

- Having located the owner, the Finder may not sue the Owner for any expenses occurred in order to preserve the found goods or locate the owner
- However, the Finder may hold the goods in lien, until she is repaid for all the expenses reasonably occurred to preserve the goods and locate the owner

In the event that the Owner of the goods has specified a reward or compensation for a finder, then the Finder has both the right to sue for such a reward <u>and</u> hold the goods in lien until such reward is received.

FINDER OF SALEABLE GOODS

§169 refers to finder of goods which are commonly the subject of sale. It allows the finder to sell such goods provided:
The finder of goods may sell the goods found if[141]:

[141] *Mulla on Contracts*, p. 1497.

i. the thing is commonly the subject of sale;

ii. the owner cannot be found with reasonable diligence, or if found, he refuses to pay the lawful charges of the finder; AND

iii. either the goods are in danger of perishing or losing their value; or the lawful charges of the finder amount to two-thirds of their value.

PLEDGE

The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor is in this case called the "pawnor". The bailee is called "pawnee". Sections 172 to 179 of the Indian Contract Act, 1872 contain the law regarding pledge. Section 172 defines Pledge as-

It is pertinent to note that for a valid pledge to arise, there should be actual or constructive delivery of the property to the pawnee. Further, the pawnee only acquires a special right in the property and the general property remains with the pawnor. The general property reverts to the pawnor once the debt is discharged.

There is no pledge of goods unless there is an actual or constructive delivery of goods to the pawnee. However, in case of hypothecation, delivery of goods is not necessary to constitute a valid contract. In a hypothecation, the owner retains the possession of the property, and certain rights in that movable property are transferred to the person in whose favour the property is hypothecated.

In light of the above discussion, the following are the key features of pledge:

1. **The property under pledge shall be either actually or constructively delivered to the pawnee**

   Constructive possession is usually given when it is not possible to give actual possession for example when the goods are bulky or when the pawnor requires them for a special purpose. A constructive delivery can be affected by a symbolic act of handing over the keys of the warehouse where the goods are kept. It is pertinent to note that in case of constructive possession, the test is whether control over the goods pledged remains with the pawnor under the delegated authority of the pawnee or the pawnor holds the goods independently. It is not necessary that the bailee himself should be in physical possession of the goods. A bailor, holding possession of the goods pledged on behalf of the bailee, e.g., in trust for the latter, being constructive delivery, constitutes a valid bailment.[142] In the case of *Morvi Mercantile Bank Ltd, by Official Liquidator v Union of India*,[143] the Supreme Court held that delivery of goods by one person to another under a contract as security for payment of debt in accordance with Sections 148 and 172 of the Indian Contract Act, 1872 is a pledge and ordinarily delivery of tangible property is essential to a true pledge; where, however, the law recognises that delivery of tangible symbol involves a transfer of possession of the property symbolised such symbolic possession takes the place of physical delivery. Since railway receipt is a document of title and its transfer for consideration effects constructive delivery of goods, these receipts can be pledged and the endorsee of the railway receipt is held to be pledgee of goods and not only of document of title.

2. **The delivery shall be for the purpose of security**;
3. **The delivery shall be upon the condition that the same be returned on fulfillment of the promise or payment of the debt**.

RIGHTS OF PAWNEE

1. **Right to retain the goods**: Sections 173 and 174 of the Indian Contract Act entitle the Pawnee to retain goods pledged to him by the pawnor. The right entails that if the pawnor fails to make the payment of a debt or does not perform as per the promise made, the pawnee has the right to retain the goods pledged as security. Moreover, thepawnee can also retain goods for non-payment of interest on debt or non-payment of expenses incurred by him for possession or preservation of the goods. However, the pawnee cannot retain goods for any debt or promise other than that agreed for in the contract. Further, if the Pawnee denies the pledge and sues for the debt and the pledge is proved, the pawnee cannot have thepayment of

[142] *Bank of Chittoor Ltd. v. P. Narasimhulu Naidu,* AIR 1966 AP 163.
[143] *Morvi Mercantile Bank Ltd, by Official Liquidator v Union of India,* AIR 1965 SC 1954

the debt and also retain the goods. He is only entitled to recover the difference between the debt and theprice of the goods if it is less than the debt. A pawnee cannot sue on the debt and realise the amount due, unlesshe redelivers the same goods on payment of the debt by the pawnor.

The right of retainer is thus in the nature of a particular lien and yet lien is different from pledge. A lien is merely a personal right, whereas a pledge gives to the pawnee a 'special property' in the goods pledged. A lien gives no power of sale or disposition of the goods, whereas a pawnee has the power to sell in case of default. Lien is not transferable, but a pledge is assignable. The pawnee gets a special property in the goods pledged. The general property remains in the pawnorand wholly reverts to him on discharge of the debt. The right to property vests in the pledgee only so far as is necessary to secure the debt.[144]

2. **Right to extraordinary expenses**: In terms of Section 175 of the Indian Contracts Act, the pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. For such expenses, however, he does not have the right to retain the goods. The word used in this section is not 'retain', as in two preceding sections, but 'receive'. A pawnee has therefore, no right of lien for 'extraordinary' expenses, as he has in the case of 'necessary' expenses under section 173, but has only a right of action in respect of them.

3. **The right to bring a suit for repayment of debt and the right to sell the pledged goods**: As per Section 176 of the Indian Contracts Act,upon a default being made by the pawnor in the payment of the debt or performance of the promise, the pledgee gets two distinct rights. First, the pledgee may sue upon the debt and retain the goods as a collateral security.[145] Secondly, he may sell the goods after reasonable notice of the intended sale to the pawnee.[146]In the former case, the pawnee retains the goods with himself as collateral security and initiate the court proceedings. He need not provide any notice of such proceedings to the pawnor.[147] And in the latter case, the Pawnee can sell the goods after giving due notice of

[144]*Sarvopari Investments (P) Ltd v. Soma Textiles and Industries Ltd,* (2003) 4 ICC 604 (Cal)
[145]*S.K. Engg Works v. New Bank of India*, AIR 1987 P&H 90.
[146]*Mahalinga Nadar v. Ganapathi Subbien,* ILR (1903-05) 27 Mad 528
[147]***T.R.S Kotagi v. Tehsildar, Gadag, A.I.R 1985 Kant. 265.***

sale to the pawnor.In case of pledge, however, the legal title to the goods pledged would not vest in the pawnee. The pawnee has only a special property. A pawnee has no right of foreclosure, since he never had the absolute ownership at law, and his equitable title cannot exceed what is specifically granted by law.

It was held by Cotton L.J. in Re Morrit, that a contract of pledge carries with it the implication that the security may be made available to satisfy the obligation, and enables the pledgee in possession (though he has not the general properly in the thing pledged, but a special property only) to sell on default in payment and after notice to the pledgor although the pledgor may redeem at any moment upto sale.[148]

The Supreme Court in *Lallan Prasad v Rehmat Ali* held that-

"*Once the pawnee after reasonable notice to the pawnor of his intention to sell the goods pawned, sells them under Section 176 of the Contract Act, the pawnor's right of re-delivery is extinguished but his right to redeem continues upto sale, i.e. at any moment upto the time of exercise by the pawnee of his power of sale by entering into a valid contract of sale. After sale, it is the pawnee's ordinary right to recover the balance of the loan unsatisfied on the sale of the pledge*".[149]

- ***Requirement of reasonable notice***- Beforethe sale of pledged goods, the pawneeis under a duty to give to the pawnor a reasonable notice of his intention to sell. This requirement of 'reasonable notice' is a statutory obligation and therefore, it cannot be excluded by a contract to the contrary.[150]

  In *Prabhat Bank v. Babu Ram*,[151] the Allahabad High Court undertook an analysis of the loan agreement in question. The terms enabled the lending banker to sell the securities without any notice to the pawnor. The pawnorhad defaulted in the payment. Thereafter, the bank sent a reminder but the pawnor requested for more time. The bank thereupon disposed of the securities. The High Court opined that the sale was bad in law. The Court stated, "*what is contemplated by section 176, is not merely a notice but a reasonable notice, meaning thereby a notice of intended sale of the*

[148]*Re Morrit, ex parte Official Receiver*,(1886) 18 QBD 222 Cotton LJ at 232.
[149]*Lallan Prasad v. Rahmat Ali*, (1967) 2 SCR 233,
[150]*KamaliSarojini v. Indian Bank*, AIR 2008 AP 71
[151]***Prabhat Bank v. Babu Ram***, AIR 1966 All 134

security by the creditor within the certain date so as to afford an opportunity to the debtor to pay an amount within the time mentioned in the notice." The court refused to agree with the bank's contention that the sale notice should be inferred from the pawnor's request for time. In the view of the High Court, "*a notice of the character contemplated by section 176 cannot be implied. Suchnotice must be clear and specific in its language and must indicate the intention of the pawnee to dispose of the security*".[152]

However, where the pawnee has consented to the sale, no further intimation to him is required;[153] nor can the pawnor be allowed to allege non-compliance of this section where the pawnor was a consenting party to the sale, and was aware of the proceedings of the sale transaction.[154]

Sale without notice is invalid, and cannot be upheld.[155] Such a sale would amount to conversion giving rise to damages to be assessed at the market rate on the date of conversion, i.e., the date of sale.[156] Sale without notice is void, and a vendee without notice of the pledge, takes only the limited rights or interest of the pawnee, in other words, he steps into the shoes of the pawnee.[157]

- ***Proceeds from Sale***

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

When the pawnee sells the pledged goods, he does not do so as full owner, but by virtue of an implied authority from the pawnee to do so. The sale must be for the benefit of both the parties. After sale, it is the pawnee's ordinary right 'to recover the balance of the loan unsatisfied on the sale of the pledge'.[158] And if there is any surplus amount from such sale, it must be accounted for and refunded to the pawnor. The

[152] ***Prabhat Bank v. Babu Ram***, AIR 1966 All 134
[153] *MadholalSindhu v. Official Assignee of Bombay*, (1949) FCR 441
[154] *Tapanga Light Foundry v. State Bank of India*, AIR 1987 Ori 174.
[155] *T.S. Kotagi v. Tahsildar, Gadag*, AIR 1985 Kant 265
[156] *F. NanakchandRamkishan Das v. Lal Chand GaneshiLal*, AIR 1958 Punj 222 at 227
[157] *T.S. Kotagi v. Tahsildar, Gadag*, AIR 1985 Kant 265
[158] *Jones v. Marshall*, [1889] 24 QBD 269 at 271.

words 'such sale' in the second paragraph indicate that no liability can be fastened on the pawnor for loss, if the pawnee does not exercise his right of sale according to section 176.[159] Before a sale, the goods are the property of the pawnor in pawnee's custody. If there arises dispute regarding the quality of the goods, the pawnee cannot proceed in the matter without referring to the pawnor. In such a situation, pawnee is the agent of the pawnor.

RIGHTS OF PAWNOR

In terms of Section 177 of the Indian Contract Act, 1872, the pawnor has the right to redeem his property. If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or in performance of the promise by the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; however he must, in that case, pay, in addition, any expenses which have arisen from his default. The right of redemption is extinguished once the actual sale is done by the pawnee as per his right under section 176 of the Indian Contract Act, 1872.

It has been pointed out by the Supreme Court in a case of *Jaswantrai Manilal Akhaney v. State of Bombay*,[160] that:

"The special interest of the pledgee comes to an end as soon as the debt for which the goods were pledged is discharged. It is open to the pledger to redeem the pledge by full payment of the amount for which the pledge had been made at any time if there is no period fixed for redemption, or at any time after the fixed date and the right continues until the thing pledged is lawfully sold."

Redemption means the enforcement of the right to have the title to corpus of the pledged property restored to the pawnor free and clear of the pledge. A suit for redemption has to be

[159] *Surilal v. Shyamlal*, AIR 1956 MB 74
[160] ***Jaswantrai Manilal Akhaney v. State of Bombay***, AIR 1956 SC 575

filed for exercising this specific remedy and not just for a declaration of the right of redemption.[161]

PLEDGE BY SPECIFIC PERSONS MENTIONED IN THE INDIAN CONTRACT ACT

Ordinarily, the owner of the goods pledges them to secure a loan. However, under certain circumstances, the law permits a non-owner who is in the possession of the goods to pledge the goods. Thus, the following non-owners may create a valid pledge:

1. *Mercantile Agent*

As per Section 178, a mercantile agent who is in possession of the goods or the documents of title of the goods with the consent of the owner can pledge these goods while acting in the ordinary course of business. This pledge is as valid as if the owner of the goods expressly authorizes him to do so. However, it is valid only when the Pawnee acts in good faith and at the time of pledge is unaware of the fact that the mercantile agent did not have the authority to pledge. The expressions 'mercantile agent' and 'documents of title' have the meanings as assigned to them under the Indian Sale of Goods Act, 1930. The section seeks to protect those persons who, in good faith, deal with persons whom they know to be mercantile agents, but of the details of whose agency they are not aware. The section applies only when the pawnee is aware that the pawnor is a mercantile agent goods after the sale is valid only when the Pawnee acts in good faith and at the time of pledge is unaware of the sale of goods to the buyer.[162]

2. Pledge by seller or buyer in possession of goods after the sale

A pledge by a seller who is in possession of the goods after the sale is valid only when the pawnee acts in good faith and at the time of pledge is unaware of the sale of goods to the buyer.

[161] *Nabha Investment (P) Ltd v. Harmishan Dass Lukhmi Dass*, (1995) 58 DLT 285
[162] *Ah Cheung v. Ah Wain*, AIR 1938 Rang 243

3. *Pledge by pawnor having limited interest*

As per Section 179, when the pawnor not being the owner of the goods and having only a limited interest in the goods, further pledges them, the pledge is valid only to the extent of such limited interest.[163]

4. *Pledge by a co-owner*

When a co-owner in possession of the goods with the assent of all the other co-owners pledges them, it is a valid pledge.

5. *Possession under a voidable contract*

As per Section 178A, a person may obtain possession of goods under a contract which is voidable at the option of the lawful owner on the ground of fraud, misrepresentation or coercion (Section 9), or on the ground of undue influence (Section 19A). Possession so obtained is not by free consent as defined in Section 14 of the Contract Act. It is, nevertheless, possession by consent, and the person in possession may make a valid pledge of the goods, provided the contract.

[163] *Jaswantrai Manilal Akhaney v. State of Bombay,* (1956) SCR 483

MODULE III

AGENCY

AGENT' AND 'PRINCIPAL' DEFINED

An agent is someone who can act on behalf its principal. Section 182 of the Indian Contract Act, 1872 defines both an agent and a principal as follows:

> "An agent is a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the principal."[164]

The cornerstone of a contract of agency is the ability of the agent to affect the principal's legal relationships with third parties. When he or she acts on behalf of the principal, the agent represents the principal. Even a servant acts for and on behalf its master in a contract of employment. But what sets a contract of agency apart and distinct is his or her "*representative capacity coupled with a power to affect the legal relations of the principal with third persons*".[165]

Any contract entered into between an authorised agent and a third-person makes the principal liable thereunder.[166] In *P. Krishna Bhatta v. Mundila Ganapathi Bhatta*,[167] the Madras High Court had conceptually defined "agency" in the following words:

> "In legal phraseology, every person who acts for another is not an agent. A domestic servant renders to his master a personal service; a person may till another's field or tend his Hocks or work in his shop or factory or mine or may be employed upon his roads or ways; one may act for another in aiding in the performance of his legal or contractual obligations to third persons, as when he serves a public carrier, warehouse-man or innkeeper in performance of the latter's duties to the public. In

[164] Section 182, Indian Contract Act, 1872.

[165] AVTAR SINGH, CONTRACT AND SPECIFIC RELIEF, 710 (2012).

[166] Mohesh Chandra Bosu v. Radha Kishore Bhattacharjee, 1908, 12 Cal WN 28.

[167] AIR 1955 Mad 648.

> none of these capacities he is an 'agent' within the above meaning as he is not acting for another in dealings with third persons. It is only when he acts as representative of the other in business negotiations, that is to say, in the creation, modification, or termination of contractual obligations between that other and the third persons, that he is an 'agent'. Representation of another in business negotiations with third persons so as to bind such other by his own acts as if they were done by the former, is of the essence of the relation of agency and the distinguishing feature between art 'agent' and other persons who act for another."

Therefore, it may be said that an agent is simply one who steps into the shoes of the principal and act as if it were actually the principal. Or, an agent is merely an extended hand of the principal which takes it to places it doesn't itself go, and contracts on its behalf with other parties.[168] For example, Section 229 of the Indian Contract Act, 1872 provides that:

> "Any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the same legal consequences as if it had been given to or obtained by the principal."

To find out whether a relationship between two persons actually amounts to a relationship of agency (i.e. one of them is the agent of another who is the principal), the "*true nature*" of the contract between them inter se has to be determined. Accordingly, merely referencing an agreement between two persons as that of agency, or merely calling one the agent of the another on paper will not suffice it to prove a contract of agency. Hence, even if one person refers to himself as being the agent of another, a court might find that the relationship between them is not that of agency but that of something else. Thus, what matters is the substance and not the form of the relationship between two persons. The hallmark defining the relationship of agency is the purported agent's ability to affect and modify his principal's legal relationships.

[168] National Textile Corporation Ltd. v. Nareshkumar Badrikumar Jagad, (2011) 12 SCC 695.

WHO MAY EMPLOY AN AGENT

The genesis of an agency lies in a contract. Being a special form of contract, it has its own special rules of formation and functioning. Section 183 of the Indian Contract Act, 1872 very succinctly informs as to who may employ an agent, in the following words:

> "Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent."

This means that a minor (a person who has not completed eighteen years of age) cannot appoint an agent. In *Shepherd v. Catrwright*,[169] Lord Denning observed to the following effect:

> "An infant cannot appoint an agent to act for him neither by means of a power of attorney, nor by any other means. If he purports to appoint an agent, not only is the appointment itself void, but everything done by the agent on behalf of the infant is also void and incapable of ratification…An infant has not sufficient discretion to choose an agent to act for him. He is all too likely choose a wrong man; and so the law declares him to be incapable of choosing an agent at all."

However, a lawful guardian of a minor may appoint an agent to act on behalf of the minor.[170] A lawful guardian is either a natural guardian or one who is appointed by a court of law having the jurisdiction to do so.

Moreover, a person cannot appoint an agent to perform any act which is personal in character, or when it is so annexe to a public office or to an office involving any fiduciary obligation. That means that a judge or a public servant cannot appoint an agent to act on her behalf.[171]

WHO MAY BE APPOINTED AS AGENT

On the other hand, *per se,* an agent need not be competent to contract. Section 184 of the Indian Contract Act, 1872 clearly adopts a twofold approach to lay down the law answering the question as to who may be appointed as an agent. It reads as follows:

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[169] 1953 Ch 728.

[170] Madanlal Dhariwal v. Bherulal, AIR 1956 Mys 272.

[171] T.C. Mathai v. District and Sessions Judge, (1999) 3 SCC 614.

> "*As between* the principal and third person any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be *responsible to his principal* according to the provisions in that behalf herein contained." (Emphasis supplied)

This provision can be divided into two parts: one relating to "*as between the principal and third person*", and the other relating to the said agent being "*responsible to his principal*". When read accordingly, it may be said that any person can be appointed as an agent, but only those agents who have attained competency including reaching the age of majority will be responsible towards their principals. This, a person may contract through a minor agent, but the minor agent will not be responsible to his principal.[172] No consideration is necessary to create a contract of agency and the same if clarified by Section 185 of the Indian Contract Act. In ordinary business dealings, an agent is usually remunerated through transaction-based commissions. But no consideration is immediately necessary at the time of entering into the contract of agency.

DISTINCTION BETWEEN AGENT, SERVANT AND AN INDEPENDENT CONTRACTOR

The pivotal point which distinguishes an agent from any other contractual relationship is her or his ability affect the legal relationships of the principal with third parties.

The distinction between an "agent" and a "servant" has been explained by the Supreme Court of India in the case of *Lakshminarayan Ram Gopal & Sons Ltd. v. Government of Hyderabad*:[173]

> (a) "Generally, a master can tell his servant what to do and how to do it. Generally, a principal cannot tell his agent how to carry out his instructions. A servant is under more complete control than an agent.
>
> (b) Generally, a servant is a person who not only receives instructions from his master but is subject to his master's right to control the manner in which he

[172] Foreman v. Great Western Railway Company, (1878) 38 LT 851.

[173] AIR 1954 SC 364. Also see POWELL'S LAW OF AGENCY (1952), 19-20.

carries out those functions. An agent receives his principal's instructions but is generally free to carry out those instructions according to his own discretion

(c) Generally, a servant, qua servant, has no authority to make contracts on behalf of his master. Generally, the purpose of employing an agent is to authorise him to make contracts on behalf of his principal.

(d) Generally, an agent is paid by commission upon effecting the result which he has been instructed by his principal to achieve. Generally, a servant is paid by wages or salary."

The Halsbury's Laws of England distinguishes an agent-principal relationship from that between a master and her servant as follows:

> "The difference between the relations of master and servant and of principal and agent may be said to be this: a principal has the right to direct what work the agent has to do: but a master has the further right to direct how the work is to be done."[174]

In another volume of the Halsbury's Laws of England, the difference between an agent and an independent contractor is explained as follows:

> "An agent is to be distinguished on the, one hand from a servant, and on the other from an independent contractor. A servant acts under the direct control and supervision of his master, and is bound to conform to all reasonable orders given him in the course of his work; an independent contractor, on the other hand, is entirely independent of any control or interference, and merely undertakes to produce a specified resulted employing his own means to produce that result. An agent, though bound to exercise his authority in accordance with all lawful instructions which may be given to him from time to time by his principal, is not subject in its exercise to the direct control or supervision of the principal."[175]

Therefore, an independent contractor enjoys the highest degree of freedom among them all in terms of carrying out the tasks to be performed under a contract. However, depending upon the context a person may be both - an employee (i.e. a servant) of the company and its agent. For example, internally, a director of a company is its employee but when contracting with

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[174] HALSBURY'S LAWS OF ENGLAND (Volume 22, Hailsham Edition), 113.

[175] Hailsham Edition-,Volume 1, at page. 193, article 345

third parties, she becomes an agent of the company. As said above, a court is not chained by the phraseology employed by the parties in question and it has to substantively look at their relationship and find out whether or not they are in a principal-agent setup.

VARIOUS METHODS OF CREATION OF AGENCY

At a principled level, the Supreme Court of India has observed that "*the relation of agency arises whenever one person called the agent has authority to act on behalf of another called the principal and consents so to act.*"[176] This relation can come into being through any of the following means:

(a) by express appointment;
(b) by the conduct or situation of the parties;
(c) by necessity of the case; or
(d) by subsequent ratification of an earlier unauthorised act.

We shall discuss each of these ways one by one.

Any person who can contract may expressly appoint an agent for itself. The express appointment of an agent may take place either orally or in writing. The consent or will of the principal, and the said agent is sacrosanct in creating the relationship of agency. A deed called a "*power of attorney*" can also bring an agency into existence.[177]

Even where there is no express agreement creating an agency, the relationship of principal-master may come into being impliedly. Implied agencies come into being from the conduct, situation or relationship of the parties. In an English case, it was held that were a woman allowed her son to drive her car, and she undertook to pay all the expenses of operating it, it was held that the son was an implied agent of the mother.[178] The practical consequence of this holding being that the mother could be sued for any loss caused to a road-user owing to the negligent or rash driving of the son. In another case of implied agency,[179] an employer

[176] Syed Abdul Khader v. Rami Reddy, (1979) 2 SCC 601.

[177] Amina Begum v. Mohd. Ramzan, AIR 2005 Raj 41; State of Rajasthan v. Basant Nahata, (2005) 12 SCC 77.

[178] Smith v. Mosse, (1940) 1 KB 424.

[179] Life Insurance Corporation of India v. Mukesh Devi, AIR 2002 Raj 404.

collecting insurance premiums from its employees was held to be an agent of the insurer (or the insurance company).[180] Another way in which an implied agency may be inferred is by way of estoppel (or the principle of holding out). This was explained in the American case of *Johnson v. Milwaukee* in the following words:

> "Where a principal has by his voluntary act placed an agent in such situation that a person of ordinary prudence, conversant with business usages and the nature of the particular business, is justified in presuming that such agent has authority to perform with the agent, the principal is estopped as against such third person from denying the agent's work."

This makes a principal bound by the deeds of its agents which stand the test of ordinary prudence, business usages and custom.

An agency might also result out of a necessity, where extraordinary emergencies may empower and authorise an agent to perform extraordinary tasks which would have otherwise fell outside his or her scope of authority. This mode of creating a principal-agent relationship first arose in cases concerning marine adventures where unforeseen emergencies could arise at any point in time in the wide open ocean where the master of a ship would, back then, be unable to communicate with the principal. In those cases, the master had the power to do what had to be done to the goods in order to save their value. Whatever the carrier did was held to be binding upon the consigner. This was later also applied to carriers by land which used trains and trucks. In *Sims & Co. v. Midland Rly Co.* it was held that an agency to sell perishable goods in cases of delay in transit had arisen out of necessity whereby the transporter possessed the authority as the agent of the owner of such goods who became the principal.[181] Another set of cases which occasion an agency of necessity is that where an injured person may be in a dire need of medical care. Any person or doctor who helps him or her assumes the position of an agent, who must be compensated for the expenditure incurred in attending to the injured principal.[182] The general guidelines to find out where can an

[180] Delhi Electric Supply Undertaking v. Basanti Devi, (1999) 8 SCC 229.

[181] (1913) 4 KB 103.

[182] Matheson v. Smiley, (1932)2 DLR 781.

agency of necessity come into being have been laid down by Justice McCardie in *Prager v. Blastpiel Stamp & Heacock Ltd.*:[183]

(a) The agent must be an unable to communicate with the principal. This means that if it could be proved that the agent could have communicated with the principal, then an allegation of there being an agency of necessity will not be upheld.[184]

(b) The act carried out by the agent must be reasonably necessary to be carried out. This means that totality of surrounding circumstances must be taken into account, for example, danger, distance, accommodation, expense, costs and benefits and so forth.[185] Where the goods in question are non-perishable in nature, and can be dealt with in a manner that had been earlier agreed upon in the foreseeable future, there could be no necessity to dispose of them.

(c) The agent must carry out the act in the *bonafide* interest of the principal.[186]

The principle behind creating agency out of necessity has been incorporated into Section 189 of the Indian Contract Act, 1872 which reads as follows:

> "An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case under similar circumstances."[187]

Lastly, an agency might also come into being by way of subsequent ratification of an unauthorised act. Here, a pretending agent's act can be adopted by the purported principal and an agency can come into being where there was none. We shall discuss this in the later part of this chapter.

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[183] (1924) 1 KB 566.

[184] Gwilliam v. Twist, (1895-99) All ER Rep 1200 (CA).

[185] Phelps James & Co. v. Hill, (1891) 1 QB 605.

[186] Tronson v. Dent, (1853) 8 Moo PC 419.

[187] Illustrations appended to it further exemplify its operation: "(a) An agent for sale may have goods repaired if it be necessary. And (b) A consigns provisions to B at Calcutta, with directions to send them immediately to C, at Cuttack. B may sell the provisions at Calcutta, if they will not bear the journey to Cuttack without spoiling."

AUTHORITY OF AGENT

Only those acts of the agent, which fall within the scope of his authority (under the contract of agency) will bind the principal. This can be found in Section 226 of the Indian Contract Act, 1872 which lays down as follows:

> "Contracts entered into through an agent, and obligations arising from acts done by an agent, *may be enforced in the same manner, and will have the same legal consequences*, as if the contracts had been entered into and the acts done by the principal in person."[188] (Emphasis supplied)

This means that whenever faced with a contract of agency seeking to bind the principal, first of all, it is the authority of the agent in question which must be assessed and ascertained. There is widespread debate around the subject-matter concerning the scope of an agent's authority. This is because the contours of an agent's authority originate from multiple sources, including not only his or her contract with the principal, but also other aspects such as the purpose of the agency, surrounding circumstances and a policy objective to protect good faith commerce and business.

The authority of an agent is the sum-total of all acts which can be said to have been explicitly or implicitly agreed upon to be performed by the agent for and on behalf of the principal. Broadly, a discussion around the subject of an agent's authority can be divided into the two components of **(a) actual authority** and **(b) apparent authority.**

ACTUAL AUTHORITY

Actual authority means that which is conferred upon the agent by the principal, either explicitly or impliedly. Sections 186 and 187 of the Indian Contract Act, 1872 explain what is meant by actual authority:

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[188] The following illustrations have been appended to this Section in the statute itself: (a) A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a. suit by the principal, set-off against that claim a debt due to himself from B. and (b) A, being B's agent with authority to receive money on his behalf, receives from C a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

> "186. Agent's authority may be expressed or implied.—The authority of an agent may be expressed or implied."
>
> 187. Definitions of express and implied authority.—An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case."

The definitions of express and implied authorities are quite straightforward and self-explanatory. A power of attorney is a deed which is executed to usually create agencies. However, in some cases, even the most precisely worded deeds can raise genuine problems of interpretation. The canons of interpretation which may be applicable in such circumstances are well-settled.

On the other hand, "*an authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written or the ordinary course of dealing, may be accounted circumstances of the case*". For example, an illustration appended to Section 187 illustrates this point:

> "A owns a shop in Serampor, living himself in Calcutta, and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop."

Implied authority is a sub-category of actual authority, for it is traceable and deducible from the principal's conferment itself. A finding of there being an implied agency must be made from the attendant facts and circumstances. While express authority is a product of the words, employed by the parties, an implied authority is a product of their conduct. In *Ryan v. Pilkington*,[189] an estate agent had the express authority from his principal to find a buyer for a property. He accepted a deposit from a prospective buyer, but misappropriated the sum of money. The prospective buyer raised a claim against the principal, and successfully argues

[189] (1959) 1 WLR 403.

that the agent had an implied authority to collect a deposit. Avtar Singh therefore notes that the extent of an agent's authority, both express and implied is dependent upon the following:

(a) the nature of the act or business he is appointed to;
(b) things which are incidental to the business or are usually done in carrying it out; and
(c) the usual customs and usages of the trade.[190]

The legal provision bridging an agent's authority from it being express to implied is Section 188 in the Indian Contract Act which lays down:

> "188. Extent of agent's authority.— An agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act.
>
> An agent having an authority to carry on a business, has authority to do every lawful thing necessary for the purpose, or usually done in the course, of conducting such business."

An example of there being an implied authority in the conduct of business came up in the case of *Dingle v. Hare*.[191] There, an agent was appointed to sell artificial manure. Expressly, he had not been bestowed with any authority to make any claims about the quality of the goods in question. Yet he warranted to the purchaser that the manure he was selling contained thirty percent of lime phosphates. It was held that because in the ordinary conduct of business in the sector of artificial manures, it was usual to give warranties of this kind, therefore the principal would be liable on account of the agent having an implied authority to give out warranties. Therefore, the trade practices, customs and usages in which the agent is functioning can help in ascertaining the scope of implied authority wielded by an agent. The principle laid down in *Dingle v. Hare* is of most generic application where an agent employed to sell something will always be deemed to have the implied authority to make warranties about those goods.

The principal will be bound by such business practices and usages notwithstanding his or her ignorance thereof.[192] However, Section 188 provides a *caveat*, and circumscribes the scope

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[190] AVTAR SINGH, CONTRACT AND SPECIFIC RELIEF, 761 (2012).

[191] (1859) 7 CB (NS) 145.

[192] Scott & Harton v. Godfrey, (1901) 2 KB 726.

of the agent's implied authority to the boundaries of law when it reads that an agent only has so much authority as much it is lawful for her or him to do.

A custom which changes or flips the very nature of the principal-agent relationship is unreasonable as it contravenes the parent contract of agency. Accordingly, in *Robinson v. Mollett*,[193] the plaintiff had authorised the broker defendant to purchase a good. However, the defendant, who was hired as a broker sold his own good to the plaintiff, as it was said to be customary in the trade concerned for such brokers to buy the good in their own name, which was then sold to their principal as contracted for. The House of Lords held such a custom to be unreasonable as it converted the purported agent into a wholesaler, therefore raising a conflict of interest within the defendant between his duty to his principal and his personal interest.

APPARENT AUTHORITY

Whereas so far, the subject-matter of our discussion was actual authority of agents; we shall now proceed to discuss the concept of ostensible or apparent authority.

The most apt description of apparent authority in cases of principal-agent relationship has been laid down by Lord Denning in the case of *Hely-Hutchinson v. Brayhead Ltd.*[194] as follows:

> "Ostensible or apparent authority is the authority of an agent as it appears to others. It often coincides with actual authority. Thus, when the board appoints one of its members to be a managing director, they invest him not only with implied authority, but also with ostensible authority to do all such things as fall within the usual scope of that office. Other people who see him acting as managing director, assume that he has the usual authority of the managing authority. But sometimes ostensible authority exceeds actual authority. For instance, when the board appoints the managing authority, they may explicitly limit his authority by saying he is not to order goods worth more than 500 sterling pounds without the board's sanction. In that case, his

[193] (1874) LR 7 HL 802.

[194] (1968) 1 QB 549: (1967) 3 WLR 1408.

> actual authority is subject to the 500 sterling pounds limitation, but his ostensible authority includes all the usual authority of a managing director. The company is bound by his ostensible authority in his dealings with those who do not know of the limitations. Thus, if he orders goods worth 500 sterling pounds, the company is bound to the other party who does know the 500 sterling pounds limitation."

Therefore, to say that an act falls within the scope of an agent's ostensible authority is to mean that it appeared to be so. In *Watteau v. Fenwick*,[195] the defendants had forbidden the manager of their hotel from buying cigars on credit. However, the plaintiff did supply cigars to the manager on credit. The manager's name did appear on a display board. The manager being unable to repay the credit amount, the plaintiff sued the defendant principal. Justice Wills held that once a principal-agent relationship is established on facts, then all the necessary outcomes such as ostensible authority binding the principal follow. Ostensible authority directly binds the principal towards a third party to whom it was so visible.

However, as between the principal and the agent, ostensible authority might have different consequences compared to the concept of implied authority. The difference between implied authority and ostensible authority has been explained as follows:

> "Implied authority is real authority [or in other words, actual authority], the exercise of which is binding not only between the principal and the third party, but also as between the principal and the agent. It differs only from an express authority in that it is conferred by no express words, but is to be gathered from surrounding circumstances. The term ostensible authority on the other hand, denotes *no authority at all*. It is a phrase conveniently used to describe the position which arises when one person [that is, the principal] has clothed another, or allowed him to assume an appearance of authority to act on his behalf, without actually giving him any authority either express or implied, by which appearance of authority a third party is misled into believing that a real authority exists".[196] (Emphasis supplied)

[195] (1893) 1 QB 346.

[196] Smith and Watt, Mercantile Law (18^{th} ed. 1924) 177 as cited in Valapad Coop Stores v. Srinivasa Iyer, AIR 1954 Ker 176.

Therefore, it may be said that the concept of bringing into force an apparent authority as against the third party is an instrument to protect such party who is deceived by the appearance. Section 237 of the Indian Contract Act, 1872 lays down the law on this concept:

> "When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority."[197]

Here, an unauthorised act of the agent can still cause for the principal to be liable. Therefore, a principal may cause to agent inflate his or her agent's authority by way of "words" or "conduct" or both. Where such inflation of authority is believed in and relied upon by a third party, such reliance produces a binding commitment on the part of the principal. This is what Section 237 provides for. An appearance of authority may arise from the course of dealing of the principal vis-à-vis an agent. The principal must have caused the agent to assume some non-conferred non-actual authority. Simply an agent's own conduct or acts cannot create an apparent authority so as to make the principal liable. For example, in *Bissessardas v. Kabulchand*,[198] a banking firm was held liable as the principal on account of misappropriation of funds of its customer by an ostensible agent who was accepting funds on its behalf without its authorisation, but with its knowledge. The Nagpur High Court referred to a decision of the Judicial Committee of the privy Council in *Ram Pertab v. Marshall*[199] to hold as follows:

> "[T]he right of a third party against the principal on the contract of his agent though made in excess of agent's actual authority was nevertheless to be enforced when the evidence showed that the contracting party had been led into an honest belief in the existence of the authority to the extent apparent to him."

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[197] An illustration appended to it illuminates as follows: "A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract."

[198] AIR 1945 Nag 121: ILR 1945 Nag 2014.

[199] ILR (1898) 26 Cal 701.

However, in an American case reported as *Kannelles v. Locke,*[200] the principal was made liable to compensate for the act of a complete imposter. Here, a woman had checked into a hotel and deposited her belongings to the person who had greeted her at the reception counter. The person had received the goods claiming to be the hotel's (that is the principal) agent, issuing a receipt in the latter's name. He fled with the articles, and the hotel-keeper was held liable because it was observed that the imposter could not have occupied the position of apparent authority but for the hotel keeper's negligence. Therefore, not just positive conduct, but also passive negligence on the part of the principal can create the illusion of authority, that is, an ostensible or apparent authority. It can therefore be said that, to some extent, an agent's authority, just like beauty, lies in the eyes of the beholder (that is the third party).

It has been held that an unreal authority so appearing continues and subsists until a notice of its termination has been particularly delivered to the third-party. It cannot be ended merely by way of private correspondence as effected between the principal and the appearing agent.[201]

However, where a third-person has a notice (either actual or constructive) of the restrictions on or the total lack of an appearing agent's ostensible authority, he or she is bound by it. In such circumstances, the principal cannot be made liable under Section 237. In *Jacobs v. Morris*,[202] an agent was authorised to operate a business. Despite not having the explicit power to borrow money, he took out a loan from a third party by producing a copy of the power of attorney executed between him and his principal. The lender (third party) loaned a sum of money without having read the power of attorney. It was held that he could not recover the sum from the principal for he negligently did not read the agency-creating document that was made available to him, thereby putting him into a constructive notice of the agent's lack of authority to take a loan.

[200] (1919) 12 Ohio App 210.

[201] Dodsley v. Varley, (1840) 12 A&E 632; Ryan v. Sams, (1848) 12 QB 640. Section 208 of the Indian Contract Act, 1872 reads as follows: "When termination of agent's authority takes effect as to agent, and as to third persons. — The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them."

[202] (1902) 1 Ch 816 (CA).

RIGHTS, DUTIES OF PRINCIPAL AND AGENT - SCOPE AND LIMITATIONS

Both the principal and the agent have a gamut of rights and duties traceable to their relationship. At a principle level, such rights and duties are pivoted and premised on the very nature of the principal-agent contractual relation. The Indian Contract Act, 1872 spells them out in some of its provisions, which shall be discussed herein below.

AGENT'S DUTIES

Agent's duties as an employee of the principal emanate from the objective of the agency to promote the latter's business. In this regard, Section 211 of the Indian Contract Act, 1872 provides that "*an agent is bound to conduct the business of his principal according to the directions given by the principal, or in the absence of any such directions according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business*". Section 212 further provides that "*an agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business"* unless the principal is aware of the agent lacking the relevant skills. If the agent acts negligently, and any loss is occasioned due to the same, then such agent is required to pay compensation to the principals. The nexus between the negligence and loss caused must be direct and not remote. Under Section 213, the agent is required to make available proper account-books to the principal whenever solicited by the latter. It is also the agent's duty to maintain proper communications with the principal and obtain relevant instructions in the performance of her or his functions emanating under the principal-agent relationship.[203] When the agent receives any sums of money on behalf of its principal, she or he is bound to forward them to the principal as provided under Section 218.

Agent's Rights

[203] Section 214, Indian Contract Act, 1872.

Section 217 of the Indian Contract Act, 1872 entitles an agent to "*retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent*". This provision realistically contextually the position of the agent vis-à-vis the principal and lays down a financially efficient mode of remunerating the agent for her or his services. In other scenarios, Section 219 further provides with respect to the agent's remuneration as follows:

> "In the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act; but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete."

Section 221 of the Act also provides for the agent's right to mark a lien on the principal's property "*until the amount due to himself for commission*" has been paid to him. Section 222 indemnifies it against any such losses that may be caused owing to carrying out of lawful actions in the exercise of such authority as was bestowed upon him.[204]

PRINCIPAL'S RIGHTS

The most basic right that a principal enjoys out of its relationship with an agent is to benefit from all profits resultant out of the agent's carrying out of its business. In some circumstances, the principal also enjoys additional rights. Section 215 of the Act covers the situation where an agent deals on his own account, in the business of agency *sans* the principal's consent. It reads as follows:

[204] Section 223 also creates another indemnity. It reads as follows: "Agent to be indemnified against consequences of acts done in good faith. — Where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it may cause an injury to the rights of third persons."

> "If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows, either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him."

Section 216 safeguards the principal's right to benefit gained by agent dealing on his own account in business of agency. Because the principal-agent relationship is an objective and target driven, Section 220 protects the principal against remunerating the agent for any misconducted business:

> "An agent who is guilty of misconduct in the business of the agency, is not entitled to any remuneration in respect of that part of the business which he has misconducted."

PRINCIPAL'S DUTIES

At the most basic level, all rights which are statutorily protected for an agent impose corresponding duties upon the principal. For example, the right of an agent to be indemnified against the lawful consequences of running an agency can also be read as the principal's duty to indemnify as per Section 222 of the Indian Contract Act, 1872. Some other provisions can be read as imposing certain special duties upon a principal. Section 225 of the Act entitles an agent to receive compensation from the principal if she or he suffers an injury caused by the principal's "*neglect or want of skill*". The illustration appended to this Section demonstrates its application:

> "A employs B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put up, and B is in consequence hurt. A must make compensation to B."

Here, it can be said that the principal is under a duty to take due care and have the requisite skills for enabling its agent to carry out the agency.

LIABILITIES OF PRINCIPAL AND AGENT

The central feature of the principal-agent relationship is the latter's representative character to bind the former in his dealings with third parties. The core liability resultant out of the working of an agency is that of the principal. This is expressed in Section 226 of the Indian Contract Act, 1872 in the following words:

> "Contracts entered into through an agent, and obligations arising from acts done by an agent, *may be enforced in the same manner, and will have the same legal consequences*, as if the contracts had been entered into and the acts done by the principal in person."[205] (Emphasis supplied)

The other core feature of this relationship is the agent's substitutive role and secondary position. Therefore, unless it has been decided otherwise, an agent is not normally able to personally enforce or bind by any contacts which he makes on behalf of the principal. This finds a recognition in Section 230 of the Act, which reads as following:

> "In the absence of any contact to that effect an agent cannot personally enforce contracts"

These two aforementioned provisions can be said to be laying down the fundamental tenets of liability resultant from a principal-agent relationship. More specifically, the liabilities of principals and agents are addressed hereinafter in more detail.

LIABILITY OF PRINCIPALS

Depending upon the circumstances, the liability of the principal can differ from one case to another where an agent exceeds his authority. Such *ultra vires* exercise of authority binds the principal, in such manner as provided under the following provisions depending upon whether or not the unauthoritative part of the agent's action is separable from the authoritative part.

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[205] The following illustrations have been appended to this Section in the statute itself: "(a) A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a. suit by the principal, set-off against that claim a debt due to himself from B. and (b) A, being B's agent with authority to receive money on his behalf, receives from C a sum of money due to B. C is discharged of his obligation to pay the sum in question to B."

"**Section 227. Principal how far bound, when agent exceeds authority.**—When an agent does more than he is authorized to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority is binding as between him and his principal."[206]

"**Section 228. Principal not bound when excess of agent's authority is not separable.—**Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction."[207]

Therefore, it can be said that where an agent exceeds and breaches the limits of her or his authority, the principal is not liable unless the exceeded authority is separable from that what was authorised.

Principals are also liable for misrepresentation or fraud committed by their agents in the course of their authority. This rule is laid down in Section 238 and gives effect to the fundamental principle that an agent represents, and act on behalf of its principal:

"**Section 238. Effect, on agreement, of misrepresentation or fraud by agent.—** Misrepresentation made or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made or committed by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals."

The aforementioned provision gives effect to the principle of vicarious liability, and although the particular fraudulent or misrepresentative act in question may not have been authorised, it will still extend the liability to the principal if it was committed in the course of carrying on

[206] An illustration appended thereto explains the provision as follows: "A, being owner of a ship and cargo, authorizes B to procure an insurance for 4,000 rupees on the ship. B procures a policy for 4,000 rupees on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo."

[207]An illustration appended thereto explains the provision as follows: "A, authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of 6,000 rupees. A may repudiate the whole transaction. A, authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of 6,000 rupees. A may repudiate the whole transaction."

the overall authorised business. This was noted in the case of *Citizens' Life Assurance Co. v. Brown*[208] by Lord Lindley as follows:

> "Although the particular act which gives the cause of action may not be authorised, still, if the act is done in the course of employment which is authorised then the master is liable for the act of his servant."

However, in the later English cases, this position has been somewhat revised to the extent that a principal is not liable for fraud committed by his agent's acts unless:

> "(a) he intends or knowingly permits the agent to make a false statement; or (b) his agent acting within the actual or apparent scope of his authority makes a statement with knowledge of its falsity or recklessly not caring whether it be true or false."[209]

Similarly, when an agent commits a tort while acting in the course of its authority, it is the principal upon whom the liability shall be affixed. This is the doctrine of *respondeat superior* (let the superior answer). In *Schultz v. La Croses City Rly Co.*,[210] an agent kicked a boy from a moving streetcar and the director in charge of the principal company was held liable for having committed the tort of assault and battery. In *Chicago City Rly Co. v. McMohan*,[211] an agent supervising a trial on behalf of the principal was collecting certain evidence to be presented before a court of law. He ended up offering a bribe to lure a third party to present oral evidence. It was held that the act fell within the course of the agent's employment and therefore the principle was liable. Clearly here, it was the principle, for whose purported benefit the agent had offered the bribe. But in *Lloyd v. Grace Smith & Co.*,[212] the House of Lords held that the principle would still be liable even where the agent sought to selfishly serve his own ends by having committed the tort. Here, the defendant was a firm of solicitors which had been approached by Mrs. Lloyd, a widow for seeking advice regarding two immovable properties held by her. The firm's clerk, who was the in-charge for conveyancing business, advised her to dispose of the properties, and fraudulently got them transferred in his

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[208] 1904 AC 423: (1904-07) AllER Rep 925.

[209] L.C.B. Gower, Agency and Fraud, 15 MODERN LAW REVIEW 232 (1952).

[210] (1907) 133 Wis 420.

[211] 1882 ILJ 485.

[212] 1912 AC 716: (1911-13) AllER Rep 51 (HL).

name. Having misappropriated the money, he fled and now the question was whether the law firm could be made liable for his act. It was held that the "*firm was responsible for the fraud committed by their representative in the course of his employment*".

LIABILITY OF AGENTS

The general rule governing liability of agents dictates that they will not be held liable under any contract which they enter in the course of their authority of being an agent for their principal.[213] For example, when the existence and name of the principal is disclosed by the agent while entering into a contract with a third party, Section 226 Indian Contract Act, 1872 would be applicable and only the principal and not the agent can be sued. This rule goes as far back as the case of *Montgomerie v. United Kingdom Mutual SS Association*[214] where Justice Wright had observed as follows:

> "The contract [entered into by the agent for the principal] is of the principal, not that of the agent, and *prima facie* at common law the only person who can sue is the principal and the only person who can be sued is the principal."

Section 230 of the Act provides as follows:

> "In the *absence of any contact to that effect* an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them. Presumption of contract to contrary— Such a contract shall be presumed to exist in the following cases:—
>
> (1) where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;
>
> (2) where the agent does not disclose the name of his principal;
>
> (3) where the principal, though disclosed, cannot be sued."

Therefore, under certain circumstances even an agent may be held to be liable for a contract that she or he may have otherwise entered into on behalf of the principal. First of all, the very

[213] Jaytee Exports v. Navtar Parekh Industries Ltd., AIR 2001 Cal 150.

[214] (1891) 1 QB 370.

agreement entered into between the agent and a third party provides for the liability of the agent. There being freedom to contract with the agent, there is no problem if the agent so decides to make itself liable even in contracts where it is only contracting on behalf of and for the principal. This is the contract to the contrary effect which Section 230 begins with, where the agent may contractually undertake to be personally liable for the performance of the contract on behalf of the principal.

In the latter part of Section 230, we have three scenarios where it would be presumed that an agent contracted to make itself liable despite it being a contract, firstly of the principal.

First of these presumptive circumstances is where the principal is a "*merchant resident abroad*". This has its roots in early English law where it was very difficult to institute suits against foreign residents. But later, the situation changed with the increase in global trade and cross-border commerce. However, the presumption still lies on the Indian statute and therefore applies with full force. For example, a company incorporated in England, which did business in India was held to be a foreign principal for the purposes of Section 230.[215]

Another such circumstance raising the presumption of agent's personal liability is where the facts of the existence and the name of the principal are not disclosed. This led to the courts to develop the doctrine of undisclosed principal, where neither the name of the principal nor its representative character is disclosed by the agent in question. Insofar as the relation between the agent and the third party is concerned, there is nothing unusual or extraordinary and having contracted in its own name, the agent can sue and can be sued upon such contract. However, since the principal's rights are also entangled in the contract, it is imperative that she or he too has a right to intervene and assert a position as an undisclosed party to the contract. This is covered by Section 231 of the Indian Contract Act, 1872 which provides as follows:

> "If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal, the same rights as he would have had as against the agent if the agent had been principal.

[215] Tutika Basavraju v. Parry & Co., ILR (1904) 27 Mad 315; Also see Shaw Wallace & Co. Ltd. v. Union of India, (2004) 5 CTC 308.

> If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract, if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract."

Therefore, it is a two-way street where, beyond the principal, even the third-party's right to decide its business relationships is safeguarded. The latter part of Section 231 entitles such third party to avoid the contract if it has not been completed, and if he can show that he would not have entered into the contract if he knew the undisclosed real party (principal) behind the agent. Moreover, Section 232 further safeguards the third-party's rights in light of the lack of knowledge of the real principal. If A (the agent of B) contracts with C, and C had a debt to be settled as against A, then the principal B cannot enforce the contract without honouring the set-off that C may have contemplated within the contract with A. The provision reads as follows:

> "Where one man makes a contract with another, neither knowing nor having reasonable ground to suspect that the other is an agent, the principal, if he requires the performance of the contract, can only obtain such performance subject to the right and obligations subsisting between the agent and the other party to the contract."[216]

This provision subjects the principal's rights to equities of the third-party, where such third-party must not be put to any disadvantage by the intervention of the hitherto undisclosed and unknown principal. He or she had contracted with a person, not knowing it to be the agent and any rights that it may have against such person now known to be the agent of another must be reasonably upheld.[217] However, the third-party's right to repudiate will be effectuated only where it can show that the identity of the contracting party was material to the very nature of the contract in question. An illustration of this came in *Said v. Butt*[218] where a theatre ticket was purchased by one person through an agent (who did not disclose the fact of the agency) knowing fully that a ticket would not have been issued to him directly

[216] The illustration appended thereto explains the provision: "A, who owes 500 Rupees to B, sells 1,000 Rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set-off A's debt."

[217] Montagu v. Forwood, (1893) 2 QB 350 (CA).

[218] (1920) 3 KB 497: 1920 AllER Rep 232.

by the theatre operator. Since the identity of those permitted to watch theatre was material to the contract, that was the ticket to enter the theatre premises, it was held that the theatre-owner had the right to repudiate the contract and refuse admission.

Lastly, the presumption under Section 230 may also trigger where the principal is either non-existent or incompetent. This covers the situation where the agent contracts for a minor, where the third party may be unaware of the fact of the principal's minority. In another scenario, this presumption used to come to the rescue of those persons who may contract with the promoters of a company (a projected company) that had not yet been incorporated at the time of their entering into a contract with it. Where a person supplies goods to a agent contracting for a yet to be incorporated company, she or he may sue the agent directly and personally before the company is formed.[219]

In such cases, where both, the principal and the agent are liable on a contract (for any of the aforesaid reasons or grounds), then the third-party who makes them liable can choose to enforce its right against either or both of them. This is recognised in Section 233 of the Act, which reads as follows:

> "In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them liable."[220]

If it can be proved that the third party, at the time at which it entered into the contract induced either the agent or the principal that either of them alone will be liable, then it cannot later make the other liable. This is provided by Section 234:

> "When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively."

Lastly, an agent may be made liable for pretending to be an agent wherein actually he was not an agent. This result follows from Section 235 which reads as follows:

[219] Kelner v. Baxter, (1861-73) AllER Ext 2009.

[220] An illustration of this has been provided in the Act: "A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton."

> "A person untruly representing himself to be the authorized agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employer does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing."

Unless, the act of such pretended agent is subsequently ratified by the principal, it gives the third party a right to seek compensation from such pretending agent. However, the third party must prove that the false representation was the cause behind its entering into the contract.[221]

DELEGATION OF AGENCY

Under Section 190 of the Act, an agent, subject to certain exceptions, cannot delegate work to a third person. This section is a mere exposition of the Latin maxim *delegatus non potest delegare.* In other words, the principal reposes trust and confidence in the skill and competence of the agent whom he has chosen to delegate work. Thus, the agent cannot further delegate the work which has been delegated to him by the principal.[222] Section 190 imposes a general duty on the agent to not delegate work. However, this duty has been qualified by certain exceptions.

WHEN AGENT CAN DELEGATE

An agent may lawfully delegate work delegated to him by the principal if;

1. Such delegation becomes necessary due to the "nature of the work."
2. The existence of a trade custom allows delegation of work
3. Work requiring personal or professional skill.
4. The principal has given consent to delegate, either expressly or impliedly.

In any of the aforementioned exceptions, the agent may appoint a "sub-agent" to undertake the principle's work. Under Section 191, "a "sub-agent" is a person employed by, and acting under the control of, the original agent in the business of the agency". The appointment of a sub-agent creates two legal relationships i.e. between the sub-agent and the principal and the

[221] Shet Manibha v. Rani Rupaliba, ILR (1899) 24 Bom 160.

[222] AVTAR SINGH, CONTRACT AND SPECIFIC RELIEF 742 (11th ed., Eastern Book Company 2013).

agent and the sub-agent. The nature of these relationships is solely dependent of whether the sub-agent has been properly or improperly appointed.

IMPROPER DELEGATION

Delegation is deemed to be improper if it does not fall squarely within any of the aforementioned exceptions. Section 193 explicates the effect of improper delegation. It states that the principal is neither represented by nor bound by the acts of an improperly appointed sub-agent. Moreover, that sub-agent is also not responsible to the principal. Only, the agent would be responsible to the principal for the actions of that sub-agent. The agent would also be liable to third-parties as he is deemed to occupy the principal's position for the acts and omissions of the sub-agent.[223]

PROPER DELEGATION

As per Section 192, proper delegation gives rise to the following three relationships;

i. The sub-agent represents and creates contractual relations with third parties on behalf of the principal. The principal is responsible for the acts and omissions of the sub-agent as if he was an agent appointed by him/her in the first place.

ii. The agent is liable to the principal for the acts of the sub-agent. If the sub-agent misappropriates the funds of the principal, the agent would be held responsible for the same.

iii. The principal cannot sue the sub-agent, except for wilful wrong and fraud. In *Calico Printers' Assn v. Barclays Bank*[224], Wright J. explained that genesis of this principle. As per him, the principal does not have the capacity to sue the sub-agent because there is no "privity of contract" between himself and the sub-agent. However, if the principal is successful in proving the existence of wilful wrong and fraud, he can either sue the agent or the sub-agent.[225]

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[223] Id, at 744.

[224] (1931) 145 LT 51 (CA).

[225] Nensukhdas v. Birdichand, (1917) 19 Bom LR 948.

In *Calico Printers*, the sub-agent was responsible for insuring the goods of the principle. However, he failed to do so and the goods were subsequently gutted in a fire. The principal was not allowed to recover damages from the sub-agent. At this juncture, it would be pertinent to draw a distinction between negligence and fraud/wilful wrong. The principal may sue the sub-agent for fraud/wilful wrong, but not for negligence.

The rights and duties of a sub-agent cannot exceed those of an agent. The sub-agent cannot go beyond the mandate given to him by the agent unless necessity demands him to act unilaterally to safeguard the interests of the principal. The court will examine the terms of appointment and the prevailing market practices to determine whether the sub-agent has exceeded the authority he has been clothed with.[226]

SUBSTITUTED AGENT

Sections 194 and 195 are special provisions which govern "substituted agents." As per Section 194, where an agent has been conferred with express or implied authority by the principal to appoint a person to act on his behalf and the agent has been successful in making such an appointment, the person appointed will be treated as agent for the principal in respect of the tasks which he has been entrusted with. Such a person is considered to be a substituted agent, rather than a sub-agent.

One needs to distinguish a substituted agent from a sub-agent. There exists direct privity of contract between the principal and the sub-agent. However, there exists no privity between the agent and the substituted agent. The agent is only responsible insofar as the appointment of the substituted agent is concerned. He is not responsible for the acts and omissions of the substituted agent[227]. Section 195 stipulates that "in selecting such agent for his principal, the agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected."

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[226] Crema v. Cenkos Securities plc, 2011 Bus LR 943 (CA).

[227] AVTAR SINGH, supra note 1 at 746.

RATIFICATION

The doctrine of ratification governs acts and omissions one person does on the behalf of the other without his consent or knowledge. It allows the person on whose behalf certain acts or omissions were done to either ratify or disown them. This doctrine is captured by Section 196 of the Act. Ratification may either be express or implied as laid down in Section 197. Ratification by implication may involve any act or omission that demonstrates an intention to adopt the contract obligation or even acquiescence or silence.[228] A valid ratification is qualified by the following conditions:

ACT DONE ON BEHALF OF PRINCIPAL

It is absolutely necessary that the agent must have done the act in question on behalf of an identifiable principal who has the capacity to ratify or revoke the same. The agent should have acted as an agent and not in his personal capacity. If the agent acts in his personal capacity and makes “”no allusion to agency,”[229] his acts omissions are not capable of ratification by the principal or any other person, even if he was acting on behalf of another in his own mind. This principle was enunciated in *Keighley Maxseted & Co v Durant.*[230]

In this case, the principal has authorised their agent to procure wheat at specified rates. Wheat could not be procured at those rates. The agent procured what at a higher rate hoping that the principal would be adopted by the principal. However, instead of mentioning or alluding to the principal, he chose to contract in his own name. The principal refused to take delivery of the consignment even after expressly approving the transaction,. The vendor sued the agent for recover of the price. The agent was held liable as he had contracted in his own name. Thus, his actions could not be ratified by the principal in the first place. Lord Macnaghten famously claimed that, “obligations cannot be created by, or founded upon, undisclosed intentions”[231] However, Section 196 does not insist on the disclosure of the

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[228] Bank of Melli Iren v. Barclays Bank, (1951) 2 TLR 1057; Ashok Kumar J. Pandya v. Suyog Coop Housing Society Ltd, AIR 2003 Guj 118 (NOC).

[229] GEOFFERY C. CHESHIRE & CECIL H. FIFOOT, THE LAW OF CONTRACT 405 (6th edn., Oxford University Press 1964).

[230] 1901 AC 240, 256.

[231] KEIGHLY V. DURANT, supra note 9, at 247.

principal's name. Mere allusion or a description of the principal is to enough to establish contractual relations.[232]

PRINCIPAL MUST BE COMPETENT

This principle prohibits a person from ratifying a contract entered while he was a minor. Ratification usually "relates back" to the date on which the agent entered into the contract which needs to be ratified. Therefore, it is absolutely necessary for the principal who is supposed to ratify to be in existence and competent to contract on that date.

WHAT ACTS CANNOT BE RATIFIED

Under Section 200, the following acts are incapable of ratification:

UNLAWFUL ACTS: In *Banque Jacques-Cartier v. Banque d'Epargne*[233], the Privy Council observed that ratification "must be in relation to a transaction which may be valid in itself and not illegal." Thus, acts or omissions which are void to begin with are not capable of ratification. Contracts which are entered into using forged signatures cannot be ratified subsequently as forgery is a criminal offence. [234]

ACTS WHICH CAUSE DAMAGE TO THIRD PARTY: Any act which becomes injurious to third parties by virtue of being affirmed by the principal is incapable of ratification. It would be pertinent to refer to Illustration (b) of Section 200. Herein, an authorized person issued a notice of termination of lease to the lessee. This notice cannot be later ratified by the lessor as it would cause injury to the lessee as the lease was terminable on three months' notice by the lessor or an authorized person.[235]

In addition to the aforementioned conditions, ratification is deemed to be ineffective if it does not meet certain statutory and judicial requirements. *Firstly*, under Section 198, a person who

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[232] Raja Rai Bhagwat Dayal Singh v. Debi Dayal Sahu, (1907-08) 35 IA 48, R. Raghavachari v. Pakkiri Mahmed, (1916) 30 MLJ 497.

[233] (1887) 13 AC 111 (PC); Mulamchand v. State of M.P., AIR 1968 SC 1218; State of U.P. v. Murari Lal & Bros Ltd, AIR 1971 SC 2210.

[234] Brook v. Hook, (1871) 6 Exch 89.

[235] Similar facts in Cassim Ahmed v. Eusuf Haji Azam, (1916) 23 Cal LJ 453.

is misinformed or not fully aware of the facts leading up to the transaction that needs to be ratified is incapable of undertaking a valid ratification. *Secondly*, under Section 199, a ratification of an unauthorised act which constitutes a part of a transaction is deemed to have ratified the whole transaction. In other words, one cannot ratify a part of the transaction which is beneficial to him and repudiate the rest. *Lastly,* the ratification needs to be communicated within a reasonable time. If parties have fixed a date for performance of the contract, then ratification need to be communicated before that date has passed.[236]

EFFECTS OF RATIFICATION

Ratification is nothing but the affirmation of past unauthorized acts by the agent. The principal adopts the older contract in its original form. The effect of ratification is captured by the maxim *retihabito retrotrahitur et mandato priori aequiparatur.* This means that an "effective ratification places all parties similar to a position which they would have occupied at the material time if the agent had actual authority to perform the acts ratified."[237] Once, an act is ratified, it establishes the following relationships;

i. Contractual relationship between the principal and the third party.
ii. Relationship of principal and agent is created retrospectively. The agent who acted in excess of authority conferred to him is no longer personally responsible to either the principal or the third party. In fact, he is entitled to recover commission and expenses from the principal for his services.

WHEN DOES RATIFICATION TAKE EFFECT

As mentioned earlier, the doctrine of relation back demands that ratification be effective from the date on which the agent entered into a contract with a third person. The contract which is formed between the principal and the third person comes into effect from that date of entering into contractual relations, rather than the date of ratification.

[236] Portugese Consolidated Copper Mines Ltd, Re, (1890) 45 Ch D 16 (CA); Dibbins v. Dibbins, (1896) 2 Ch 348.

[237] Kadiresan Chettiar v. Ramanathan Chetti, AIR 1927 Mad 478.

This effect of this doctrine was reiterated in *Bolton Partners v. Lambert*.[238] Herein, A made an offer to B. C accepted the offer in B's name despite not being given authority to do so. B later ratified C's acceptance. However, A had already attempted to revoke his offer in the time between B's acceptance and C's ratification. The court ruled that A's revocation was ineffective. A valid contract between A and C subsisted from the date on which B accepted A's offer. However, this principal is criticized on the ground that it leaves the third party worse off. If he had the opportunity to contract with the principal directly, he could have withdrawn his offer until the principal had accepted the same. Because an unauthorized person offered to accept his offer in the name of the principal, neither was he in a binding contract until ratification with the principal nor was his withdrawal effective.[239]

A different effect of the aforementioned doctrine was articulated in the *American Restatement of the Law of Agency*. Herein, ratification is only effective if it has been made before the other person has withdrawn his offer and communicated the same either to the principal or agent.[240] However, this principal has not been accepted very widely. The judicial trend seems to be in favour of the traditional application of the doctrine as was done in *Bolton Partners v. Lambert.*[241] However, there are two major exceptions to the doctrine of relation back.

Firstly, the aforementioned doctrine does not apply if the agent and the third party by mutual consent have cancelled the contract which is yet to be ratified by the principal.[242] *Secondly*, and more importantly, the doctrine does not apply if the agent has accepted the offer of third party "subject to approval or ratification." In *Watson v. Davies*[243], Maugham J. explained the effect of an acceptance expressly dependent on ratification by the principal. He treated such

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[238] (1889) 41 Ch D 295 at 308-09.

[239] SINGH, supra note 1 at 800.

[240] State of Indiana Legislators, Restatement of the Law of Agency with Annotations to the Indiana Decisions, 11 NOTRE DAME L. REV. 195 (1936).

[241] SINGH, supra note 1 at 800

[242] Walter v. James, (1871) LR 6 Ex 124.

[243] (1931) 1 Ch 455, at 468-69.

an acceptance as a legal nullity which was not binding on the other party in the same way as an unaccepted offer which was withdrawn before acceptance.

TERMINATION OF AGENCY

An agency is deemed to subsist in the absence of any act or omission which establishes its termination.[244] Thus, it is a question of fact rather than that of a law. Section 201 contains different grounds under which an agency can be brought to an end. These grounds are as follows;

(i) Revocation of the agent's authority by the principal (S. 203-07)
(ii) Renunciation of business of agency by agent (S. 205)
(iii) Death or Insanity (S. 209)
(iv) Completion of business (S. 201)
(v) Insolvency of Principal (S. 201)

However, the grounds enumerated in Section 201 are not exhaustive.[245] The termination of an agency implies the termination of a contract. A contract may be terminated by virtue of performance, frustration etc. Thus, an agency may also come to an end by reason of[246];

(i) Expiry of time
(ii) Destruction of subject-matter
(iii) Mutual Agreement
(iv) The agency becoming subsequently unlawful
(v) Dissolution of Principal (where principal is a firm or a corporation)

REVOCATION OF AGENT'S AUTHORITY

Under Section 203, the principal may revoke the agent's authority at any time before he has exercised his authority so as to bind the principal. In *Rhodes v. Farwood*[247], it was held that,

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[244] Kishen Devi v. Banwari Lal, AIR 1928 Lah 688-89; Banarshi Agarwall v. Sankarlal Agarwalla, AIR 1961 Assam 13.

[245] Janradhan Jaikrishna v. Gangaram Mangalchand, AIR 1917 Mad 398.

[246] The 13th Report of the Law Commission of India 1958, para 158.

[247] (1876) 1 A C 256.

in the absence of any special agreement that the principal shall to continue to carry on his business for a definite period of time, it cannot for a moment be assumed that the principal is bound to continue carrying on his/her business for the benefit of the agent.

As specified in Section 207, the revocation of an agent's authority by the principal may be express or implied. An example of implied revocation may be found in cases where the principal acted unilaterally without consulting his lawyer with whom he had executed an agreement granting power of attorney. Such unilateral actions by the principal were treated as implied revocation of the power of attorney.[248] However, the principal is bound to honour any contract which was entered into by virtue of the power of attorney before the implied revocation took place.[249]

Thus, the principal can revoke the agent's authority as and when he deems fit, without incurring any liability. The liability to compensate or indemnify the agent only arises if;

i) Agent has already exercised his authority partly.

ii) The principal chooses to terminate the agency created for a fixed duration without giving reasonable notice or showing sufficient cause.

WHERE AGENT HAS PARTLY EXERCISED HIS AUTHORITY

Section 204 creates an exception to the rule contained in Section 203. As per this section, the principal cannot revoke the authority of an agent who has partly exercised it. The principal has to fulfil obligations which have arisen in the course of the agent having exercised his authority. He may only prospectively revoke the agent's authority to act on his behalf. The agent is entitled to be compensated or indemnified by the principal for the part exercise of authority.

This rule is derived from the duty of the principal to indemnify his agent under Section 222. In *Pricket v. Badger*,[250] the agent was appointed to sell a parcel of land at a certain price. The agent found a seller. However, the principal refused to sell the land and also dissolved the agency. The agent was entitled to be compensated for the labour and skill he had exercised

[248] Deb Ratan Biswas v. Anand Moyi Devi, AIR 2011 SC 1653.

[249] Shamli Das v. Swadesh Ghose, (2010) 2 SCC 40 (Cal).

[250] (1856) 1 CBNS 296.

till the revocation of his authority. This rule is aimed at protecting the agent from any legal liability incurred while acting in the interests of the agency till the time his authority has been revoked. However, the agency cannot claim any compensation for the period after revocation.[251]

LACK OF REASONABLE NOTICE OR SUFFICIENT CAUSE

Sections 205 and 206 provide that if an agency which was created for a definite period of time is revoked by the principal or renounced by the agent before the expiry of the stipulated period without sufficient cause or notice, then he/she is bound to compensate the other. The aforementioned section gives the impression that agencies having a fixed tenure are "irrevocable" until the expiry of time. However, this does not seem to be the case. The principal can revoke the agency at any time. Section 205 only makes the principal liable to the agent for damages arising due to breach of contract and indemnity for acts done, or liability incurred before revocation.[252] The right to claim damages is solely dependent on the existence of an obligation on part of the principal to continue the agency for a specified period of time.

SUFFICIENT CAUSE

Under Section 205, damages can be recovered by the agent or principal if either of them terminates the agency without giving sufficient cause. The existence of a sufficient cause would depend, "upon the nature of the business to which the agency relates, the personal qualifications which existed when the contract was entered into, the altered conditions which since came into existence and their probable effect on the interests of the employer. No hard and fast rule can be laid down for any class of cases."[253] In *Boulton Bros & Co Ltd. v. New*

[251] Denmark Production Ltd v. Bascobel Productions Ltd., (1969) 1 QB 699; Roberts v. Elwells Engineers, (1972) 3 WLR 1.

[252] Venkatachalam Chetty v. ANRM Narayan Chetty, AIR 1916 Mad 281; Landav & Sons v. Ahmed Ayub, AIR 1922 Sind 25.

[253] Boulton Bros & Co. Ltd. v. New Victoria Mills Co. Ltd., AIR 1929 All 87 per Sen J at 96.

Victoria Mills Co Ltd.,[254] a company appointed an agent under the mistaken impression that he was influential in commercial circles. The company revoked the agent's authority after discovering that the agent had no such influence. The agent could not recover any damages as the company had a sufficient cause for revocation.

REASONABLE NOTICE

Under Section 206, if the notice given before premature termination of agency was not reasonable, then the party receiving such notice is entitled to be compensated for damages resulting from such notice. The length of the notice will depend, among other things, on the length of the agency. In *Sohrabji v. Oriental Govt Security Assurance Co,*[255] the Privy Council held that a notice of three and a half months was inadequate to terminate an agency which had lasted for nearly half a century, under which a large business had been built at great expense. The judges opined that a notice of two years would be reasonable. There is difference is judicial opinion as to whether Section 205 applies to all kinds of agencies or only those which have a fixed tenure. Indian courts have refused to award compensation for premature termination of agency which was not created for a fixed duration. On the other hand, the Law Commission of India has recommended that reasonable notice should be given even when the agency was not created for a fixed duration.[256] In *Bright Bros (P) Ltd. v. J.K. Sayani*,[257] the Madras High Court refused to award compensation for the premature termination of agency, which though created without any stipulation as to its duration, lasted for a period of 12 years.

RENUNCIATION OF AUTHORITY BY AGENT

Under Section 205, an agent is allowed to renounce the principal's authority in the same manner as the principal may revoke the agent's authority. *Firstly*, if the agency is for a fixed

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[254] Id.

[255] AIR 1946 PC 9.

[256] LAW COMMISSION OF INDIA, supra note 24, para 162.

[257] AIR 1976 Mad 55.

duration, then the agent has to compensate the principal for damages incurred due to premature renunciation without showing sufficient cause. *Secondly*, under Section 206, the agent has to also give reasonable notice. His failure to do so entitles the principal to claim compensation.

DEATH OR INSANITY

The death or insanity of either principal or agent results in the agency being terminated automatically. However, parties are still bound by acts or omissions committed before death or insanity. The death or insanity of an agent will bring the agency to an end. But it will not obliterate acts done or obligations undertaken on behalf of the principal by the agent before he died or became of unsound mind. In *Girshan Industrial Co Ltd v, Inerchem Corp,*[258] the appointment of a counsel by an attorney for his principal was held to be valid and subsisting even after the death of the attorney. As long as the principal was alive, any act done by the attorney or counsel was valid. However, the counsel could not acted after the death of the principal. Under Section 209, it is the duty of an agent to take reasonable steps to protect the interests of the principal who has died or become a person of unsound mind.

COMPLETION OF BUSINESS

An agency is automatically terminated when the business for whose conduct it was appointed is completed. Thus, the authority of an agent who was appointed to sell goods is taken away by operation of law after completion of sale.[259] He cannot alter the terms of the sale after its completion. However, at least two High Courts have held that agency is deemed to be terminated not on completion of the sale but on payment of the proceeds of the sale to the

[258] 1970 Curr LJ 387.

[259] Venkatachalam v. Narayanan, ILR (1914) 39 Mad 376; Alliance Bank of Simla v. Amritsar Bank, AIR 1915 Lah 214.

principal.[260] Once the sale is complete, the agent has a subsequent obligation to account for proceeds of the sale and remit them to the principal.[261]

Similarly, agency created for a fixed term is deemed to be terminated on the expiration of the term, whether the purpose for which the agency was constituted has been achieved or not.[262]

Agency Coupled with Interest

Under Section 202, an agency becomes irrevocable when the agent has a personal interest in the subject-matter of the agency. In *Smart v. Sanders*[263], Wilde CJ articulated the rule "that where an agreement is entered into on a sufficient consideration, whereby an authority is given for the purpose of securing some benefit to the donee of the authority, such an authority is irrevocable." An example of the occurrence of such an agency would be when the principal owes something to the agent and authorises him to sell the former's goods and pay himself out of the proceeds of the sale.[264] But the authority to pay debts which the principal owes to third parties does not make the agency irrevocable.[265]

An agency coupled with interest cannot be terminated by the death, insolvency or insanity of the principal.[266] Such an agency is only revocable if the agreement creating the agency contains an express stipulation to that effect. However, Section 202 does not apply to an agency established for a definite period of time.[267]

This rule is qualified by two conditions. *Firstly*, the interest of the agent must exist at the time of the creation of agency. *Secondly*, the primary purpose of the agency should be to protect the interests of the agency.

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[260] Babu Ram v. Ram Dayal, ILR (1890) 12 All 541; W.R. Fink v. Buldeo Dass, ILR (1899) 26 Cal 715.

[261] This obligation is created under Section 228. It reads as follows: "Agent's duty to pay sums received for principal.—Subject to such deductions, the agent is bound to pay to his principal all sums received on his account."

[262] Lalljee v. Dadabhai, (1915) 23 Cal LJ 190, 202.

[263] (1848) 5 CB 895.

[264] Subba Rao v. Varadaiah, AIR 1934 Mad 482.

[265] Clerk v. Laurie Public Officer , (1857) 2 H&N 199.

[266] Shantadevi v. Savjibhai S Patel, (1999) 4 GCD 3190; Loonkaran Sathiya v. Ivon E. John, AIR 1977 SC 336.

[267] P Sukhadev v. Commr of Endowments, AIR 1997 AP 271.

EXISTENCE OF INTEREST AT THE TIME OF CREATION OF AGENCY

In *Smart v. Sanders,*[268] the agent was instructed to sell the principal's goods. Subsequently, the agent made advances to the principal on the credit of the goods which were to be sold. It was held that implied authority to sell which was conferred to the agent was not an authority coupled with interest. It was merely the conferral of independent authority, with an interest arising subsequently. Thus, a subsequent advance or a future debt cannot create an agency coupled with interest. The interest needs to be in existence at the time of the creation of the agency. However, the agent's interest need not be pre-existing. It may arise simultaneously with the creation of agency.[269]

A mere mention that the agency is irrevocable does not make it so.[270] The concept of an irrevocable agency is unknown to commercial jurisprudence unless it is coupled with an interest. The interest of the agent in the subject-matter of the agency need not be stipulated expressly in the contract creating the agency. It may be inferred in the course of dealings between parties. Thus, "it is the existence of interest and not the manner in which it is recorded by parties, that is of importance."[271]

PROTECTION OF EXISTING INTEREST

One needs to ascertain the "primary object" of conferring authority to the agent to find out whether an irrevocable agency was created in his favour or not. The authority must be given with the primary object of securing some interest of the agent. If the primary object was to recover for the principal the proceeds of the sale of his goods, and in the process, the agent's interest was also incidentally protected, then the agency is revocable. The prospect of earning commission by affecting the sale of principal's goods does not constitute an interest for the purposes of Section 202. Moreover, an arrangement that the agent's commission would be

[268] Supra note 23.

[269] AVTAR SINGH, supra note 1 at 808.

[270] Barses J.A. D'Souza v. Municipal Corpn of Greater Bombay, (2003) 6 Bom CR 846.

[271] Kondayya Chetti v Narasimhulu Chetti, (1896) 20 Mad 97, 105.

paid out of the rent of the principal's property also does not imply that an interest in favour of the agent was created in the plaintiff's property.[272]

EFFECT OF TERMINATION

Under Section 208, the termination of the agent's authority takes effect;

(i) as against the agent, from the time when it becomes known to him.

(ii) as against third parties, with whom the agent has contracted, from the time when it becomes known to them.

If the authority of an agent who was appointed to sell goods was revoked, the revocation will only take effect when it comes to the knowledge of the agent. If he had already sold goods before receiving notice of revocation, then the principal is bound by the sale. If the agent sells the goods even after receiving notice of revocation, the principal would still be bound by the sale and the third party will get a good title provided that he was not aware of the revocation. Reliance is placed on the Madras High Court's decision in *Khatoon Bivi Ammal v. Arulappa Nadar*.[273] It was held that "policy of law apparently in the interest of trade and commerce is that agent's action should bind the principal even though the principal might have cancelled the agent's authority, unless the third party with whom the agent enters into the contract knows the termination of the agency." Even when the agency is terminated due to the principal's death, the termination is only effective when it becomes known to the agent or the third party.

Section 210 is an extension of the rule laid down in Section 208. It postulates that termination of the authority of the agent will cause the termination of the authority of all sub-agents which were appointed by him for the conduct of business for the principal.

[272] Vishnucharya v. Ramchandra, ILR (1881) 5 Bom 253.

[273] AIR 1970 Mad 76.

MODULE IV

CONTRACTS WITH GOVERNMENT & TENDERS

CONTRACTS WITH GOVERNMENT

A government entering into a contract for fulfilling its multifarious functions is an essential facet of the modern polity. Government being an artificial person is competent to enter into a contract. The law relating to Government contracts are laid down under Articles 298 which states that the executive power of the Union and of each State shall extend to the carrying on of any trade or business and to the acquisition, holding and disposal of property and the making of contracts for any purpose; Article 299 states that all contracts made in the exercise of the executive power of the Union or the State shall be expressed to be made by the President, or by the Governor; and finally Article 300 states that the Government of Indian may sue or be sued by the name of the Union of Indian and the Government of a state may sue or be sued by the name of the State and may, subject to a provisions which may be made by Act of Parliament or the Legislature of such State enacted by virtue of power conferred by this Constitution. The contract to be valid must, however, fulfill the requirements laid down in Art 299 of the Constitution of India:

ARTICLE 299 OF THE INDIAN CONSTITUTION

"All contracts made in the exercise of the executive power of the Union or of a State shall be expressed to be made by the President, or by the Governor of the Sate, as the case may be, and all such contracts and all assurances of property made in the exercise of that power shall be executed on behalf of the President or the Governor by such persons and in such manner as he may direct or authorize."

Neither the President nor the Governor shall be personally liable in respect of any contract or assurance made or executed for the purposes of this Constitution, or for the purposes of any enactment relating to the Government of India heretofore in force, nor shall any person making or executing any such contract or assurance on behalf of any of them be personally liable in respect thereof.

In K.P. Chowdhary v State of Madhya Pradesh [1966] 3 SCR 919, the Court held that there was no contract between the appellant and the government before he bid at the auction, nor was there any contract between him and the Government after the auction was over as required by Art 299 (1) of the Constitution. Further, in view of the mandatory terms of Art 299 (1), no implied contract could be spelled out between the Government and the appellant at the stage of bidding for Art 299 in effect rules out all implied contracts between Government and another person.

POSITION OF ARTICLE 299

The position resulting from Article 299 can be stated as (a) Government contracts must be expressed as to be made by the President or Governor; (b) they shall be executed by the competent person and in the prescribed manner.

RESTITUTION AND QUASI-CONTRACT

If the above requirements are not complied with: (i) the Government is not bound by the contract, because Article 299 is mandatory; (ii) the officer executing the contract would be personally liable on the contract; (iii) the government, however, if it enjoys the benefit of performance by the other party to the contract, would be bound to give recompense on the principles of quantum merit or quantum valebat (service or goods received). This is on the ground of restitution and quasi-contract (Sections 65 and 70 of the Indian Contract Act 1872); (iv) besides this, the doctrine of promissory estoppel may apply on the facts ie. there is no estoppel against the government if it seeks to nullify a contract which is not in the form as prescribed by Art. 299. In M Ramanatha v State o Kerala AIR 1973 SC 2461[274]; the Court held that: "There is no question of estoppel or ratification in such a case." Therefore, Art. 299 (1) cannot be bypassed by invoking the doctrine of estoppel.

[274] M Ramanatha v State o Kerala, AIR 1973 SC 2461.

ARTICLE 299 AND STATUTORY CONTRACTS

Art. 299 does not apply to a statutory contract ie. a contract made in the exercise of statutory powers and not general executive powers. In Ramana Dayaram Shetty v International Airport Authority (AIR 1979 SC 1628; the Supreme Court laid down the following principles relating to the government contracts: (i) The government does not have an open and unrestricted choice in the matter of awarding contracts to whomsoever it likes; (ii) the Government is to exercise its discretion in conformity with some reasonable non-discriminatory standards or principles; The government is bound by the standards laid down by it; (iv) the government can depart from these standards only when it is not arbitrary to do so and the departure is based on some valid principle which in itself is not 'irrational, unreasonable or discriminatory'.

No Implied Contract

If the contract between the Government and another person is not in compliance with Art. 299 or if Art. 299 is violated there is no implied contract. It would be no contract at all and could not be enforced either by the Government or by the other person as a contract as was held in K.P. Chowdhry's case.

Mandatory Application of Article 299

The provisions of Art. 299 are mandatory and their non-compliance would render a contract void. It follows that no suit against the Government Union or State can be brought if the requirements laid down in Art. 299 are not complied with. Equally the contract will not be enforceable by the Government as was held in Perumal v Union of India AIR 1955 SC 468.

Ratification of Contracts

Focusing the "Ratification of Contracts" it must be noted that all the conditions in Art. 299 (1) are mandatory and a defective contract cannot be ratified by the government thereby give validity for such contract. In Mulanchand v State of M.P. AIR 1968 SC 1218; the Supreme Court held that if the contract was not in accordance with the constitutional provisions in the eyes of law, there was no contract at all and the government cannot ratify it, because ratification gives validity to a contract from the date of its formation and if it is allowed it amount to dispensing with the mandatory provisions of the Constitution by the executive authority which ratifies the contract.

Protection from Personal Liability

Art. 299 (2) protects the President and the Governor from personal liability for the contracts entered into by the government in the name of the President or the Governor as the case may be.

Benefit derived out of Quasi- Contract

However, if the Government under quasi-contracts derives any benefit under a contract made without complying with Art. 299 it can be held liable to compensate the other contracting party on the basis of quasi-contractual liability ie. to the extent of benefit received by it, by applying Section 70 of the Indian Contract Act 1872. For invoking quasi-contractual obligation three conditions must be satisfied; (i) the person must have done something lawfully to the government; (ii) the government must have enjoyed benefits out of that and (iii) he must have acted non-gratuitously.

ARTICLE 226 AND BREACH OF CONTRACT

A question arose whether Art. 226 can be applied in cases of breach of contract in D.F.O. v. Biswanath Tea Co, AIR 1981 SC 1368; and the Supreme Court ruled that a party could not claim under Art. 226 its enforcement of contractual obligations and recover damages. Proper relief for the arty would lie to seek specific performance of the contract or damages in a Civil Court. The court has reiterated that it will not enforce the terms of a contract qua contract in Karnataka State Forest Industries Corporation v Indian Rocks (2009) 1 SCC 150.[275]

SUITS AGAINST GOVERNMENT

Art. 300 provide that the Union or the State may sue or be sued in its respective names. The suits by or against the Government or Public Officers in their official capacity will lie under Section 79-82 Order 27 of the Code of Civil Procedure (Act V of 1908). Filing a suit must

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[275] Karnataka State Forest Industries Corporation v Indian Rocks (2009) 1 SCC 150

adhere some requirements ie., (i) there should be description of the parties; (ii) Sections 80-81 Order 27 Rules 4-8 of the Code of Civil Procedure contemplated that the Government should be given an opportunity to consider the claims against it or its officers, so that in suitable cases it may settle the matter and it may not be necessary for a party to go to a Court.

TENDERS

INTRODUCTION

A tender is a submission made by a prospective supplier in response to an invitation to tender issued by an organisation. It makes an offer for the supply of goods or services. Inviting tenders enables the inviting authority to have a wide field of choices amongst eligible participants. The inviting authority specifies the technical and financial eligibility in the notice inviting tender in order to ensure that the bidder not only has sufficient experience and expertise to execute the project of the dimension for which the tender has been floated but also the infrastructure required to successfully fulfill the contract. The tendering process allows the inviting authority to obtain competitive bids and select a bidder, who is qualified and capable of performing the contract.[276]

The government and its agencies, with an aim to provide public goods and infrastructure, procure goods and services from the private sector, and thereby, generate significant market opportunity for businesses. The government invites tenders for a wide spectrum of activities ranging from infrastructure development to supply of office stationery. The award of public contract through open tender is to ensure transparency in public procurement, to maximise economy and efficiency in public procurement, to promote healthy competition among tenderers.[277]

The courts cannot strike down the terms of the tender, which have been prescribed by the government merely because it is of the view that some other terms in the tender would

[276] Dr. Jain Video on Wheels Ltd. through Authorized Representative v. State of Uttar Pradesh, (2014) 5 AWC All 4869.

[277] *Tender Stage*, Central Vigilance Commission, available at: http://www.cvc.nic.in/sites/default/files/3%20Tender%20Stage.pdf (last visited Sept. 25, 2019).

have been fair, wiser or logical. The contractual freedom of the government mandates that the government must have a free hand in setting the terms of the tender.[278] It, thus, becomes imperative to understand the scope of the term 'tender' through the lens of contractual law.

ISSUANCE OF TENDER NOTICE ONLY AMOUNTS TO AN INVITATION TO OFFER

A tender notice does not amount to an offer or a proposal. It is merely an invitation to contractors for making an offer. A notice calling for tenders, therefore, is not a proposal within the meaning of section 2(a) of the Indian Contract Act, 1872, as it only invites a proposal.[279]

The process of tendering is a stage anterior to the execution of a contract. The object of inviting tenders is to ensure that the authority on whose behalf the notice inviting tenders is issued can obtain competitive bids and can select a bidder, who is able to meet the technical and financial qualifications required under the tender notice. Specification of norms of technical capacity and financial ability lie within the discretion of a body which invites tenders. Thus, the general principle of law is that it is for the authority, which invites bids, to determine what should be the appropriate conditions governing the tender.[280]

In the case of *Bharat Sanchar Nigam Ltd. v. Telephone Cables Ltd.*,[281] the tender notice mentioned that the bidder with the highest vendor rating (V-1) was to be considered for placing the order for about 30% of the tendered quantity and the balance quantity was to be distributed among the remaining selected bidders in each group in direct ratio of their vendor rating. Thus, the quantity for which a purchase order was to be placed by BSNL on a bidder was dependent upon the vendor rating of such a bidder. BSNL did not follow the formulae laid down in the tender document while assigning vendor ratings, and as a result, the respondent failed to receive the highest vendor rating (V-1) and secure the requisite purchase order. On the directions of the Delhi High Court, BSNL again undertook the process of assigning vendor ratings as per the formulae laid down in the tender document,

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[278] Directorate of Education v. Educomp Datamatics Ltd., (2004) 4 SCC 19.
[279] Executive Engineer, Sundargarh R. & B. Division and Others vs. Mohan Prasad Sahu, AIR 1990 Ori 26.
[280] M/s. Sai Construction through Partner Smt. Jyoti Singh v. State of Uttar Pradesh, (2014) 106 ALR 790.
[281] Bharat Sanchar Nigam Limited v. Telephone Cables Limited, (2010) 5 SCC 213.

and the respondent was to be given V-1 rating on a re-evaluation. However, by the time of re-evaluation, contracts had already been awarded in respect of most of the tendered quantity and only a negligible quantity remained. The respondent sought damages for loss of profit from BSNL on account of the failure on the part of BSNL to adjudge it with V-1 rating initially, and the consequential failure to place a purchase order for 30% tendered quantity. The question before the court was whether the respondent, in order to seek damages, could invoke the arbitration agreement under the 'General Conditions of Contract' that shall apply to contracts made by BSNL for the procurement of goods. The 'General Conditions of Contract' formed a part of the 'Bid Documents' of the tender process. The Supreme Court, while denying the claim of the respondent, noted that:

> "*At the outset, what should be noticed is that there was no contract or agreement between the parties... Bid documents did not constitute a contract, or an agreement or an agreement to enter into a contract. It was merely an invitation to make an offer. It informed the prospective bidders, how they should make their bids; how the bids would be processed by BSNL; how contracts would be entered by placing purchase orders; and what terms would govern the contracts, if purchase orders were placed.*"

In the case of *Purxotoma Ramanata Quenim vs. Makan Kalyan Tandel,*[282] the concerned authority invited tenders for a lease on the basis that the highest tender shall finally be accepted. However, the notice inviting tender provided that the concerned authority reserved the right to select any tender or reject any tender without assigning any reason. Three tenders were submitted pursuant to the said invitation. The competent authority rejected the tender of the respondent, who was the highest bidder, and negotiated with the next highest tenderer and accepted his revised offer, which was higher than that of the respondent. The Supreme Court held that the concerned authority was not bound to accept the highest tender and that the concerned authority did not act arbitrarily in negotiating subsequently with the next highest tenderer and accepting the higher offer. In doing so, the Supreme Court distinguished between an auction and an invitation to tender:

[282] Purxotoma Ramanata Quenim vs. Makan Kalyan Tandel, (1974) 2 SCC 169.

"*An auction, as stated in Halsbury's Laws of England, is a manner of selling or letting property by bids, and usually to the highest bidder by public competition. An invitation to tender is a mere attempt to ascertain whether an offer can be obtained within such margin as the building owner or employer is willing to adopt, or, in other words, is an offer to negotiate, an offer to receive offers, an offer to chaffer (see Halsbury's Laws of England). There is, in our opinion, difference between auction and invitation for tenders*."

In the case of *Nine Paradise Hotels Pvt. Ltd. v. National Textile Corporation Ltd.*,[283] the Bombay High Court held that merely because the petitioners had submitted a tender, which happened to be the highest and had furnished a bank guarantee of Rs. 150 crores, per se does not render the decision of the respondent to cancel the tender process arbitrary. The court stated that there was a valid reason for cancelling the tender process, which was based on commercial principles, i.e. the price offered by the highest tenderer being 40% lower than the reserved price. The Bombay High Court, further, enunciated the guiding contractual principle applicable to tender notices: "*Inviting tenders is merely an invitation to offer and does not vest any indefeasible or legal right in the applicant-bidder to claim that he alone should be awarded the contract*."

FLOATING OF TENDER IN RESPONSE TO TENDER NOTICE CONSTITUTES AN OFFER

The law of contract treats the tender notice as an 'invitation to offer', whereas, a tender floated in response to such tender notice comes within the purview of the term 'offer' under section 2(a) of the Indian Contract Act, 1872. It is for the competent authority either to accept this offer or reject it.[284] Unless the bid of a tenderer, which is in the nature of a proposal or an offer, is accepted by the competent authority and the acceptance is communicated to the tenderer, no contract can be said to have been concluded between the parties.[285] The contractual obligation under Indian Contract Act, 1872 arises only when

[283] Nine Paradise Hotels Pvt. Ltd. v. National Textile Corporation Ltd., (2009) 2 Bom CR 629.
[284] Kashmir Handloom Industries v. The State, AIR 1997 J&K 108.
[285] Executive Engineer, Sundargarh R. & B. Division and Ors. vs. Mohan Prasad Sahu, AIR 1990 Ori 26.

proposal given by one person is accepted by another person. In *Kashmir Handloom Industries v. The State*,[286] the court noted that:

> "*A tender for work amounted to an offer and the contract could be completed only when this offer was accepted…An advertisement inviting tenders for supply of goods is only an invitation for offer.*"

The Allahabad High Court, in the case of *Maharia Re-Surfacing and Constructions (P.) Ltd. v. Greater Noida Industrial Development Authority*,[287] has noted that a contract comes into existence only if the tender is accepted unconditionally, as a tender floated in response to a notice inviting tender amounts only to an offer. However, if the offer is accepted subject to some conditions, it is not an acceptance but a counter offer. For a contract to come into existence, the acceptance must be absolute and unqualified vide Section 7 of the Contract Act, 1872.

In another case of the Delhi High Court,[288] the two questions before the court were: (i) whether the appellant was correct in accepting the offer of the respondent and forfeiting the earnest money on non-performance of the tender even though the respondent had withdrawn his offer before it could be accepted by the appellant in light of section 5 of the Indian Contract Act, 1872; and (ii) whether any condition in the tender document prohibiting the respondent from withdrawing his bid during its period of validity is in violation of section 5 of the Indian Contract Act, 1872. The court, while upholding the forfeiting of the earnest money by the appellant, observed that:

> *"In the normal course, where there are offers and counter offers, the point of time up to which a proposal can be withdrawn will undoubtedly be covered by Section 5 of the Indian Contract Act. However, in case both parties agree to be bound by the understanding that any offer made will remain open for acceptance by the other party up to a specified date, and that the offeror is*

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[286] Kashmir Handloom Industries v. The State, AIR 1997 J&K 108.

[287] Maharia Re-Surfacing and Constructions (P.) Ltd. v. Greater Noida Industrial Development Authority, (1999) 1 AWC All 122.

[288] Food Corporation of India v. Prem Chand Jain, (2013) 136 DRJ 369.

bound to keep his offer open for that period; then the offeror cannot vary this understanding, and withdraw his offer prematurely, without the consent of the other party."

In the case of ***Dresser Rand S.A. v. Bindal Agro Chem Ltd. & K.G. Khosla Compressors Ltd.,***[289] the respondent invited global tenders for supply of various equipment and materials, and the appellant sent a letter offering to supply the same. Resultantly, letters of intent were issued in favor of the appellant. However, the appellant was later informed that the respondent would instead purchase the tendered equipment and materials from a third party, which, thus, gave rise to a dispute between the parties. One of the issues considered by the Supreme Court, while adjudicating the dispute, was whether the letter of intent can be deemed as an expression of conclusion of a contract between the parties. The court noted:

"The question whether the letter of intent is merely an expression of an intention to place an order in future or whether is a final acceptance of the offer thereby leading to a contract, is a matter that has to be decided with reference to the terms of the letter. Chitty on Contracts observes that where parties to a transaction exchanged letters of intent, the terms of such letters may, of course, negative contractual intention; but, on the other hand, where the language does not negative contractual intention, it is open to the courts to hold the parties are bound by the document; and the courts will, in particular, be inclined to do so where the parties have acted on the document for a long period of time or have expended considerable sums of money in reliance on it."

In this case, the 'Instructions to Bidders' expressly provided that the purchase order would be deemed to be a contract, and since the purchase order had not been issued but only a letter of intent, the court held that the contract had not come into existence and the issuance of the letter of intent cannot amount to an acceptance of the offer.

[289] Dresser Rand S.A. v. Bindal Agro Chem Ltd. & K.G. Khosla Compressors Ltd., (2006) 1 SCC 751.

REQUIREMENTS OF A VALID TENDER

The pre-requisites of a valid tender have been examined in-depth by the Supreme Court in *Tata Cellular v. Union of India*.[290] The Supreme Court, in this case, noted that:

> *"A tender is an offer. It is something which invites and is communicated to notify acceptance. Broadly stated, the following are the requisites of a valid tender:*
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> 1. *It must be unconditional.*
> 2. *Must be made at the proper place.*
> 3. *Must conform to the terms of obligation.*
> 4. *Must be made at the proper time.*
> 5. *Must be made in the proper form.*
> 6. *The person by whom the tender is made must be able and willing to perform his obligations.*
> 7. *There must be reasonable opportunity for inspection.*
> 8. *Tender must be made to the proper person.*
> 9. *It must be of full amount."*

The holding in *Tata Cellular v. Union of India* has been affirmed by the Supreme Court in subsequent cases,[291] and the same has become the grundnorm of the tender jurisprudence.

STRICT COMPLIANCE WITH THE TERMS AND CONDITIONS OF THE TENDER

It has been widely recognised that the tender terms being contractual in nature, the government inviting tenders has a free hand in setting them and the courts do not have jurisdiction to judge as to how the tender terms should be framed. However, the courts have often been confronted with the question of whether there should be strict compliance with the terms of the tender.

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[290] Tata Cellular v. Union of India, (1994) 6 SCC 651.
[291] Global Energy Ltd. v. Adani Exports Ltd., (2005) 4 SCC 435; Glodyne Technoserve Ltd. v. State of Madhya Pradesh, (2011) 5 SCC 103; Indore Development Authority v. Shailendra, (2018) 3 SCC 412.

In the case of *W.B. State Electricity Board v. Patel Engineering Co. Ltd*.,[292] the Supreme Court observed that it is in public interest to adhere to the rules and conditions subject to which bids are invited. The subsequent courts have extensively relied on this principle to hold that there should be strict compliance with the terms of the tender. In *Sorath Builders v. Shreejikrupa Buildcon Ltd.*,[293] one of the terms and conditions of the bid was that the pre-qualification documents were required to be sent by 27.11.2008, whereas, the bid of the respondent was sent three days after the due date. Due to the delay, the appellant rejected the said bid. The Supreme Court held that the respondent was not sincere in submitting his pre-qualification documents within the time schedule laid down despite the fact that he had information that there is a time schedule attached to the notice inviting tender. Relying on various judgments, the Supreme Court held that the terms and conditions of the tender are required to be adhered to strictly, and therefore, the appellant was justified in rejecting the bid.

Similarly, in the case of *Chaudhary Construction Co. v. Brihanmumbai Municipal Corporation*,[294] the respondent issued a notice inviting tender for certain drainage work. However, prior to the last date of the submission of the tender, the respondent amended one of the terms and conditions of the tender, and as a result, the bid of the petitioner was rejected due to its failure to meet the amended condition. The petitioner contended that unreasonable conditions were introduced at a subsequent stage with the intention to oust the petitioner. The Bombay High Court, while rejecting the contention of the petitioner, stated that the petitioner not only participated in regard to the issuance of clarification and the amendment of conditions but actually received the subject-matter and varied conditions. The court further held that "*the terms inviting the tender need to be adhered to strictly, more so with regard to prequalification conditions as regards experience and compliance in relation to submission of documents*."

However, these rulings do not impinge on the powers of the concerned authority to grant relaxations from the performance of some of the conditions, if the tender conditions

[292] W.B. State Electricity Board v. Patel Engineering Co. Ltd., (2001) 2 SCC 451
[293] Sorath Builders v. Shreejikrupa Buildcon Ltd., (2009) 11 SCC 9.
[294] Chaudhary Construction Co. v. Brihanmumbai Municipal Corporation, 2009 (4) Bom CR 344.

allow for such relaxation. This was recognised by the Supreme Court in the case of *Air India Ltd. v. Cochin International Airport*[295] in the following terms:

> "*It is free to grant any relaxation, for bona fide reasons, if the tender conditions permit such a relaxation. It may not accept the offer even though it happens to be the highest or the lowest. But the State, its corporations, instrumentalities and agencies are bound to adhere to the norms, standards and procedures laid down by them and cannot depart from them arbitrarily.*"

The power of relaxation can only be exercised, if the concerned authority has been conferred with such powers under the tender conditions. If the concerned authority has not been vested with any power of general relaxation, then the same shall not be exercised ordinarily and the principle of strict compliance will be applicable.[296]

EFFECT OF MINOR DEVIATIONS FROM THE TERMS AND CONDITIONS OF THE TENDER

The effect of minor deviation from the terms and conditions of the tender, if the power of relaxation has not been conferred upon the competent authority by the tender documents, has been considered extensively by the courts. The Supreme Court has noted that to insist upon a strict compliance with each and every tender document is not the law.[297] In the case of *Poddar Steel Corporation v. Ganesh Engineering Works*,[298] the Supreme Court postulated the theory of essential and non-essential (ancillary or subsidiary) terms of a notice inviting tender. It was held in this case that though the appellant deviated from the terms of the tender notice by offering earnest money through banker's cheque of a bank other than the State Bank of India, it was sufficient for meeting the conditions of the notice, the condition being ancillary or subsidiary to the main object to be achieved by the stipulation. In other words, the Supreme Court declared that while there can be no deviation from the essential tender terms, deviation from the ancillary or non-essential terms is permissible.

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[295] Air India Ltd. v. Cochin International Airport, (2000) 2 SCC 617.
[296] Mr. B.S.N. Joshi & Sons Ltd. v. Nair Coal Services Ltd., (2006) 11 SCC 548.
[297] Tata Cellular v. Union of India, (1994) 6 SCC 651.
[298] Poddar Steel Corporation v. Ganesh Engineering Works, (1991) 3 SCC 273.

Thus. the requirements in a tender notice can be classified into two categories: (i) the terms which lay down the essential conditions of eligibility; and (ii) the terms which are merely ancillary or subsidiary to the main object to be achieved by the conditions. The first category is strict compliance category. Under this category, the essential conditions of eligibility are required to be enforced strictly, and it may not be open to the authority to relax the conditions. The second category is substantial compliance category. Under this category, it must be open to the authority to deviate from and not to insist upon the strict literal compliance of the condition in appropriate cases. If the strict compliance test is to be applied in accordance with the tender documents, the law treats all the conditions as mandatory; whereas, if the substantial compliance test is to be applied, all the conditions are treated as valid, leaving it to the decision-making authority to treat whether the contesting tenderers have complied with the tender conditions or not.[299]

In *Ram Gajadhar Nishad v. State of Uttar Pradesh,*[300] the tender conditions required the tenderer to submit solvency certificate to the Collector. The Supreme Court interpreted the condition as requiring strict compliance and that non-compliance with the condition would lead to non-acceptance of the tender. The Supreme Court, in *B.S.N. Joshi & Sons Ltd. v. Nair Coal Services Ltd*.,[301] laid down the general principles regarding compliance with the terms of the tender:

i. *If there are essential conditions, the same must be adhered to;*
ii. *If there is no power of general relaxation, ordinarily the same shall not be exercised and the principle of strict compliance would be applied where it is possible for all the parties to comply with all such conditions fully;*
iii. *If, however, a deviation is made in relation to all the parties in regard to any of such conditions, ordinarily again a power of relaxation may be held to be existing*
iv. *The parties who have taken the benefit of such relaxation should not ordinarily be allowed to take a different stand in relation to compliance of*

[299] Poddar Steel Corporation v. Ganesh Engineering Works, (1991) 3 SCC 273; Goldstone Exports Limited v. Government of Andhra Pradesh, 2003 (2) ALT 288.
[300] Ram Gajadhar Nishad v. State of Uttar Pradesh, (1990) 2 SCC 486.
[301] Mr. B.S.N. Joshi & Sons Ltd. v. Nair Coal Services Ltd., (2006) 11 SCC 548.

another part of tender contract, particularly when he was also not in a position to comply with all the conditions of tender fully, unless the court otherwise finds relaxation of a condition which being essential in nature could not be relaxed and thus the same was wholly illegal and without jurisdiction.

The determination of whether a term is an essential term or only a collateral term was explained by the Supreme Court in the case of *G.J. Fernandez v. State of Karnataka,*[302] by holding that a condition could be ascertained to be essential or collateral by reference to the consequence of non-compliance with the condition. If non-fulfillment of the condition would result in the rejection of the tender, then it would be an essential part of the tender. Otherwise it is only a collateral term.

However, the fundamental question of whether a court can ascertain that a term is essential or collateral, remains highly conflicted. In the case of *Rashmi Metaliks Limited v K.M.D.A.,*[303] one of the terms of the tender required a bidder to submit "*valid PAN No., VAT No., copy of acknowledgment of latest income tax return and professional tax return*." The employer interpreted this term to be an essential term for qualifying for the bidding process. However, the Supreme Court held it only to be a collateral term by stating that:

"We think that the income tax return would have assumed the character of an essential term if one of the qualifications was either the gross income or the net income on which tax was attracted…since it is indicative of the commercial standing and reliability of the tendering entity. This feature being absent, we think that the filing of the latest income tax return was a collateral term."

A similar approach was adopted by the court in the case of *B.S.N. Joshi & Sons Ltd. v. Nair Coal Services Ltd.,*[304] where the acceptance of the appellant's tender was challenged on the grounds that it had failed to fulfill some of the terms of the tender. The court deemed

[302] G.J. Fernandez v. State of Karnataka, (1990) 2 SCC 488.
[303] Rashmi Metaliks Limited v. Kolkata Metropolitan Development Authority, (2013) 10 SCC 95.
[304] Mr. B.S.N. Joshi & Sons Ltd. v. Nair Coal Services Ltd., (2006) 11 SCC 548.

that the said terms were not collateral but rather essential in nature and directed the concerned authority to reconsider the offer of the appellant to ensure compliance with the essential terms of the tender. Thus, in the above-mentioned cases, the court, in effect, substituted its view for that of the employer, who interpreted the terms of the tender differently from the court.

However, in the recent case of *Central Coal Fields Limited v. SLL-SML*,[305] the Supreme Court disagreed with and deviated from the position of law in *Rashmi Metaliks* and *B.S.N. Joshi & Sons*, by holding that the court cannot execute the decision-making function of the employer and make a distinction between essential and non-essential terms contrary to the intention of the employer and thereby, redraw the contractual agreement. The court noted that:

> *"Whether a term of the NIT is essential or not is a decision taken by the employer which should be respected. Even if the term is essential, the employer has the inherent authority to deviate from it provided the deviation is made applicable to all bidders and potential bidders. However, if the term is held by the employer to be ancillary or subsidiary, even that decision should be respected. The lawfulness of that decision can be questioned on very limited grounds, but the soundness of the decision cannot be questioned, otherwise this Court would be taking over the function of the tender issuing authority, which it cannot."*

Thus, the recent jurisprudence indicates that it is not for the court to substitute its own opinion as to the relevancy of the terms and conditions of the tender. It is only for the competent tender evaluation authority and not for the court to decide whether the non-compliance with the conditions would result in the disqualification or the rejection of the tender.[306]

[305] Central Coal Fields Limited v. SLL-SML (Joint Venture Consortium), (2016) 8 SCC 622.
[306] Central Coal Fields Limited v. SLL-SML (Joint Venture Consortium), (2016) 8 SCC 622*;* Tamil Nadu Police Housing Corporation Limited v. P and C Projects (P) Ltd., 2018 (5) CTC 387*;* TBAS Construction Supreme Infrastructure India Ltd. vs. Union of India, 2018 SCC OnLine Ker 3490.

SANCTITY OF THE TENDER PROCESS

The courts in India have laid down several principles and precepts regarding the tender process and the award of contract. The courts have stressed upon the need to maintain the sanctity and integrity of the tender process.[307] While permitting minor deviations from the terms and conditions of the tender, the competent tender evaluation authority has to bear in mind that the deviation does not vitiate the sanctity of the tender process. The Supreme Court has observed that while considering the decision-making process of the state or its instrumentality in awarding contracts, the process should be transparent, fair, bona fide and in public interest, and should not be tainted by discrimination, arbitrariness and favouritism.[308]

The Supreme Court in the case of *National Highways Authority of India (NHAI) v. Gwalior Jhansi Expressway Limited*,[309] has shed light on the need to maintain the sanctity of the tender process by a tender evaluation authority. In this case, NHAI entered into a concession agreement with a contractor. Owing to a dispute, NHAI terminated the agreement and invited a fresh tender for the completion of the remainder of the work. The contractor abstained from participating in the fresh tender process, however, later moved an application seeking the right to first refusal or the option to match the lowest bidder in the fresh tender process. The Supreme Court, while rejecting the validity of the application of the contractor, held that:

> *"Only the entities who participate in the tender process pursuant to a tender notice can be allowed to make grievances about the non-fulfillment or breach of any of the terms and conditions of the concerned tender documents. The respondent who chose to stay away from the tender process, cannot be heard to whittle down, in any manner, the rights of the eligible bidders who had*

[307] *See generally* West Bengal State Electricity Board v. Patel Engineering Co. Ltd., (2001) 2 SCC 451; Sorath Builders v. Shreejikrupa Buildcon Ltd., (2009) 11 SCC 9; Glodyne Technoserve Ltd v. State of Madhya Pradesh, (2011) 5 SCC 103; Larsen & Turbo Ltd. v. Union of India, (2011) 5 SCC 430.

[308] Siemens Public Communication Network Pvt. Ltd. v. Union of India, (2008) 16 SCC 215; Glodyne Technoserve Ltd. v. State of Madhya Pradesh, (2011) 5 SCC 103.

[309] National Highways Authority of India v. Gwalior Jhansi Expressway Limited, (2018) 8 SCC 243.

participated in the tender process on the basis of the written and express terms and conditions."

In the case of *Monnet Power Company Ltd. v. Union of India*,[310] the petitioners called into question the validity of the notifications issued by the central government that placed a cap on the capacity charge component of power tariff in respect of power generating companies that had been declared as successful bidders for coal mines. The Delhi High Court highlighted the need to preserve the integrity of the tender process by holding that the governmental notifications had drastically altered the conditions of the tender process, and therefore, the successful bidders were entitled to withdraw from the contracts and secure refund of the bid security submitted by them without penalty. Similarly, in the case of *Essar Power Limited v. Uttar Pradesh Electricity Regulatory Commission*,[311] Noida Power Company, after having carried out the tariff based competitive bidding and having selected the qualified bidders, proposed to enter into a power purchase agreement with a generating company, which had not participated in the competitive bidding process, at a negotiated price lower than that of the appellant, who was the lowest qualified bidder. The Appellate Tribunal for Electricity held that the conduct of Noida Power Company indicated its acceptance of the bid of the appellant under section 8 of the Indian Contract Act, 1872 and the subsequent conduct of Noida Power Company of negotiating with a third party impinged on the sanctity of the tender process. The court stated that "*if the Noida Power is permitted to have a negotiation with the third party and go back to the Commission for adoption of the tariff of third party, it would amount to nullifying the sanctity of the bidding process*."

Thus, the case-law indicates that even though the tender evaluation authority is permitted to allow minor deviations from the terms of the tender, it has to ensure the observance of the sanctity and integrity attached to a competitive bidding process.

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[310] Monnet Power Company Limited v. Union of India, (2017) 239 DLT 10.
[311] Essar Power Limited v. Uttar Pradesh Electricity Regulatory Commission, 2012 ELR (APTEL) 182.

REMEDIES AVAILABLE IN CASE OF BREACH OR REPUDIATION OF THE AWARD OF TENDER

The breach and the repudiation of the award of tender are governed by the provisions of the Indian Contract Act, 1872 and the Specific Relief Act, 1963. The preferred remedy of the aggrieved party for the breach or the repudiation of the award of tender used to be a claim for damages subject to negative covenants. The remedy of specific performance was viewed as an exception owing to the discretionary nature of the remedy. However, this position has substantially altered with the introduction of the Specific Relief (Amendment) Act, 2018, which aims to minimise the discretion of the courts in cases seeking specific performance of contracts and grants a right to an aggrieved party to seek specific performance of a contract subject to certain provisions mentioned in the Act.

This section, however, aims to highlight that there exists a difference in the attitude of the courts regarding the nature of reliefs granted in cases involving the breach or the repudiation of contracts issued by public authorities as opposed to contracts between private parties. Given the public interest involved in contracts entailing public goods, the courts have moulded reliefs to do complete justice in cases entailing the breach or the repudiation of the award of tender by public authorities.

In *Raunaq International Limited v. I.V.R. Construction Limited*,[312] the Maharashtra State Electricity Board (MSEB) invited tenders for a certain project, for which none of the tenderers could meet the qualifying criteria. MSEB granted the contract to the appellant by relaxing some of the criteria in favour of the appellant. The rival tenderer sought an interim stay on the award of tender, which was rejected by the Supreme Court on appeal. The court cautioned that interim stay should not be granted easily while dealing with petitions challenging the award of tender by the government in favour of a party, as the commercial transactions of state or public body may involve an element of public law or public interest. As the grant of an interim stay may delay the project and escalate the costs of the project, the court observed that:

[312] Raunaq International Limited v. I.V.R. Construction Limited, (1999) 1 SCC 492.

"*The petitioner asking for interim orders, in appropriate cases should be asked to provide security for any increase in cost as a result of such delay, or any damages suffered by the opposite party in consequence of an interim order. Otherwise public detriment may outweigh public benefit in granting such interim orders. Stay order or injunction order, if issued, must be moulded to provide for restitution.*"

In the case of *Shivashakti Sugars Limited v. Shree Renuka Sugar Limited*,[313] the Supreme Court highlighted the need for the courts to consider the economic impact of their judicial decisions. The court stated that:

"On the application of law and while interpreting a particular provision, economic impact/effect of a decision, wherever warranted, has to be kept in mind. Likewise, in a situation where two views are possible or wherever there is a discretion given to the Court by law, the Court needs to lean in favour of a particular view which subserves the economic interest of the nation. Conversely, the Court needs to avoid that particular outcome which has a potential to create an adverse effect on employment, growth of infrastructure or economy or the revenue of the State. It is in this context that economic analysis of the impact of the decision becomes imperative."

However, at the same time, the Supreme Court has cautioned regarding the exercise of regulatory powers to alter any provisions of the contract while moulding reliefs, if the contract and the accompanying statutory guidelines specifically deal with the issues in question.[314] In the landmark case of *Energy Watchdog v. Central Electricity Regulatory Commission*,[315] the Supreme Court was tasked with the question of providing compensatory tariff relief to private bidders, who knowingly assumed the risks of the statutory contract. The court, while granting limited relief on account of change in law due to the amendment to the New Coal Distribution Policy, rejected the claim of frustration of the contract owing to increase in the price of Indonesian coal and shortfall in domestic coal supply. The court held

[313] Shivashakti Sugars Limited v. Shree Renuka Sugar Limited, (2017) 7 SCC 729.
[314] Energy Watchdog v. Central Electricity Regulatory Commission, (2017) 14 SCC 80.
[315] *Ibid.*

that the doctrine of frustration did not apply to the present case, as the fundamental basis of the contract remained unaltered. The court cited that:

> *"Since the subject matter of the doctrine of frustration is contract, and contracts are about the allocation of risk, and since the allocation and assumption of risk is not simply a matter of express or implied provision but may also depend on less easily defined matters such as "the contemplation of the parties", the application of the doctrine can often be a difficult one. In such circumstances, the test of "radically different" is important: it tells us that the doctrine is not to be lightly invoked; that mere incidence of expense or delay or onerousness is not sufficient; and that there has to be as it were a break in identity between the contract as provided for and contemplated and its performance in the new circumstances.*"

Thus, the jurisprudence regarding the remedies available for the breach or the repudiation of the award of tender by public authorities indicates that the courts would take into consideration the economic impact of their judicial decisions while carving out remedies, given the public interest involved in such projects. However, at the same time, the economic realities of the contract cannot be used as a pretext to insulate the private bidders from the risks of the contract that they knowingly assume.

IS IT MANDATORY FOR PUBLIC AUTHORITIES TO UNDERTAKE THE COMPETITIVE BIDDING PROCESS?

The holding of the Supreme Court in the case of *Union of India v. Centre For Public Interest Litigation*,[316] generated a fierce debate as to whether it is mandatory for the public authorities to undertake the competitive bidding process for alienation or disposal of public goods. In this case, the court was required to determine whether the first-come-first-served method of allocation of resources is violative of Article 14 of the Constitution. The court, while striking down the first-come-first-served basis for allocation of spectrum, noted that:

[316] Union of India v. Centre For Public Interest Litigation, (2012) 3 SCC 104.

> *"When it comes to alienation of scarce natural resources like spectrum etc., it is the burden of the State to ensure that a non-discriminatory method is adopted for distribution and alienation, which would necessarily result in protection of national/public interest. In our view, a duly publicised auction conducted fairly and impartially is perhaps the best method for discharging this burden."*

Pursuant to the ruling of the Supreme Court in *Union of India v. Centre For Public Interest Litigation*, the President of India made a reference to the Supreme Court under Article 143 of the Constitution, seeking answers to the primary question of "*whether the only permissible method for disposal of all natural resources across all sectors and in all circumstances is by the conduct of auctions*."[317] The court clarified that the conduct of auction is not the only method for the disposal of public goods and held that the method adopted should subserve the common good. The court noted that:

> *"Revenue maximization is not the only way in which the common good can be subserved. Where revenue maximization is the object of a policy, being considered qua that resource at that point of time to be the best way to subserve the common good, auction would be one of the preferable methods, though not the only method. Where revenue maximization is not the object of a policy of distribution, the question of auction would not arise. Revenue considerations may assume secondary consideration to developmental considerations. Therefore, in conclusion, the submission that the mandate of Article 14 is that any disposal of a natural resource for commercial use must be for revenue maximization, and thus by auction, is based neither on law nor on logic…Economic logic establishes that alienation/allocation of natural resources to the highest bidder may not necessarily be the only way to subserve the common good, and at times, may run counter to public good. Hence, it needs little emphasis that disposal of all natural resources through auctions is clearly not a constitutional mandate."*

[317] In Re: Special Reference No. 1 of 2012, (2012)10 SCC 1.

The court held that the state possesses the freedom to enter into direct negotiations with a third party by observing that:

> *"The State must be free in such a case to negotiate with a private entrepreneur with a view to inducing him to set up an industry within the State and if the State enters into a contract with such entrepreneur for providing resources and other facilities for setting up an industry, the contract cannot be assailed as invalid so long as the State has acted bona fide, reasonably and in public interest."*[318]

Thus, the position of the Supreme Court on tender process as a method for alienation of public goods can be said to be best encapsulated by the words of Justice Chinnappa Reddy in the case of *Sachidanand Pandey v. State of West Bengal*: "*Though that (tender) is the ordinary rule, it is not an invariable rule. There may be situations where there are compelling reasons necessitating departure from the rule but then the reasons for the departure must be rational and should not be suggestive of discrimination.*"[319]

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[318] *Ibid.*
[319] Sachidanand Pandey v. State of West Bengal, AIR 1987 SC 1109.