e cannot claim compensation for loss which is really due not to the breach but due to his own neglect to mitigate the loss after the breach. This rule is incorporated in the Explanation to Sec. 73.

8. Difficulty of assessment

Although damages which are incapable of assessment cannot be recovered, the fact that they are difficult to assess with certainty or precision does not prevent the aggrieved party from recovering them. The Court must do its best to estimate the loss and a contingency may be taken into account.

Example. *H* advertised a beauty competition by which readers of certain newspapers were to select fifty ladies. He himself was to select twelve out of these fifty. The selected twelve were to be provided theatrical engagements. *C* was one of the fifty and by *H*'s breach of contract she was not present when the final selection was made. *Held*, *C* was entitled to damages although it was difficult to assess them [*Chaplin* v. *Hicks*, (1911) 2 K.B. 786].

9. Cost of decree

The aggrieved party is entitled, in addition to damages, to get the cost of getting the decree for damages. The cost of suit for damages is in the discretion of the Court.

10. Damages agreed upon in advance in case of breach

If a sum is named in a contract as the amount to be paid in case of its breach, or if the contract contains any other stipulation by way of a penalty for failure to perform the obligations, the aggrieved party is entitled to receive from the party who has broken the contract, a reasonable compensation not exceeding the amount so named (Sec. 74).

Examples. (*a*) *A* contracts with *B* to pay *B* Rs. 1,000 if he fails to pay *B* Rs. 500 on a given day. *B* is entitled to recover from *A* such compensation not exceeding Rs. 1,000 as the Court considers reasonable.

(*b*) *A* gives *B* a bond for the payment of Rs. 1,000 with interest at 12% at the end of six months, with a stipulation that in case of default, interest shall be payable at the rate of 75% from the date of default. This is a stipulation by way of penalty, and *B* is only entitled to recover from *A* such compensation as the Court considers reasonable.

Liquidated damages and penalty

Sometimes parties to a contract stipulate at the time of its formation that on the breach of the contract by either of them, a certain specified sum will be payable as damages. Such a sum may amount to either 'liquidated damages' or a 'penalty'. '*Liquidated damages*' represent a sum, fixed or ascertained by the parties in the contract, which is a *fair and genuine pre-estimate of the probable loss* that might ensue as a result of the breach, if it takes place. A '*penalty*' is a sum named in the contract at the time of its formation, which is *disproportionate* to the damage likely to accrue as a result of the breach. It is fixed up with a view to securing the performance of the contract. In other words, 'penalty' means an amount fixed *in terrorem without any regard to the probable loss.*

The English Law gives effect to 'liquidated damages' but relieves a party against 'penalty'. In India, no such distinction is observed. The Courts in India allow only 'reasonable compensation' (Sec. 74).

The rules for determining whether a stipulation is by way of a penalty or by way of liquidated damages are as follows :

1. The parties to a contract may use the words 'penalty' or 'liquidated damages' interchangeably. The Court is not bound by the phraseology used, for "equity looks to the *intent* rather than to the *form*". It must ascertain whether a sum is in truth a penalty or liquidated damages.

2. The essence of a penalty is the payment of money stipulated as *in terrorem* (a condition which is intended to frighten or intimidate) of the offending party, that is to say, its intention is to compel the performance of the contract by providing something by way of punishment if the contract is not performed. The essence of liquidated damages is a *genuine pre-estimate* of damage which seems likely to be caused should the breach occur.

3. The question whether a sum stipulated is a penalty or liquidated damages is a question of construction, to be decided upon the terms of the contract and circumstances of each particular case, judged of as at the time of making the contract, and not as at the time of breach.

Example. *D* sold tyres to *N* who contracted not to re-sell them, or offer them for sale, at a price below *D*'s list price. *N* agreed to pay a sum of £ 5 by way of liquidated damages for every breach of the agreement. *N* sold a tyre at less than the list price. *D* filed a suit for damages for breach. *Held*, the sum fixed by the parties was a genuine pre-estimate of the damage and not a penalty [*Dunlop Pneumatic Tyre Co.* v. *New Garage & Motor Co. Ltd.*, (1915) A.C. 79].

4. The sum stipulated is a penalty if—

(*a*) it is extravagant or unconscionable (unreasonable) in amount compared with the greatest loss which could conceivably be proved to have flowed from the breach ;

(*b*) the breach consists of not paying a sum of money by a certain time, and the sum fixed is greater than the sum to be paid.

Examples. (*a*) *A* agrees to pay *B* Rs. 1,000 on January 1, and if he fails to make the payment at the stipulated time he agrees to pay Rs. 1,500 as liquidated damages. The extra Rs. 500 will be a penalty.

(*b*) A chit fund contract which provided for payment of money in instalments, stipulated that on default in payment of any of the instalments all the future instalments shall be payable at a time with interest. *Held*, the stipulation was not penal in nature [*K.P. Subbarama Sastri* v. *K.S. Raghavan*, (1987) 2 SSC 424].

5. When a single lump-sum is made payable on the occurrence of one or more of several events, some of which may occasion serious and other trifling damage, there is a presumption that the sum is a penalty.

Example. *F* agreed to act at *K*'s theatre and to conform to all the regulations of the theatre. Each party agreed that on breach by either of them of the agreement to pay £ 1,000 as liquidated damages. *F* broke the contract and damages payable by him were assessed at £ 650. *Held*, the £ 1,000 was a penalty because it was payable even if *F* had broken any of the smallest regulations of the theatre and hence *K* could only recover £ 650 [*Kemble* v. *Farren*, (1829) 6 Bing. 141]

Payment of interest

The largest number of cases decided under Sec. 74 relate to

stipulations in a contract providing for payment of interest. The following rules are observed with regard to payment of interest :

1. *Payment of interest in case of default.* A stipulation for payment of interest in case of default is not in the nature of a penalty, if the interest is reasonable. If the Court finds that the rate of interest is exorbitant and is penal in character, it may grant relief.

2. *Payment of interest at higher rate*—

(a) *from the date of the bond.* A stipulation for increased interest from the date of the bond, and not from the date of default, is *always* in the nature of a penalty, and relief is granted against it.

(b) *from the date of default.* A stipulation for increased interest from the date of default *may* be a stipulation by way of penalty. When it is so, relief is granted against it. Whether such a stipulation is penal is a question of construction dependent on the terms of the contract and the circumstances of each case.

3. *Payment of compound interest on default*—

(a) *at the same rate as simple interest.* A stipulation in a bond for payment of compound interest on failure to pay simple interest at the same rate as was payable upon the principal is not a penalty.

(b) *at the rate higher than simple interest.* A stipulation in a bond for the payment of compound interest at a rate higher than that of simple interest is a penalty and would be relieved against.

4. *Payment of interest at a lower rate, if interest paid on due date.* Where a bond provides for payment of interest say at 24 per cent per annum with a proviso that if the debtor pays interest punctually at the end of every year, the creditor would accept interest at a lower rate say 18 per cent per annum, the creditor is entitled on failure of payment of interest on the due date to interest at the higher rate of 24 per cent per annum. Such a clause is not in the nature of a penalty.

3. QUANTUM MERUIT

The phrase '*quantum meruit*' literally means 'as much as earned'. A right to sue on a *quantum meruit* arises where a contract, partly performed by one party, has become discharged by the breach of the contract by the other party. The right is founded not on the original contract which is discharged or is void but on an implied promise by the other party to pay for what has been done. For details, see next Chapter.

4. SPECIFIC PERFORMANCE

In certain cases of breach of a contract, damages are not an adequate remedy. The Court may, in such cases, direct the party in breach to carry out his promise according to the terms of the contract. This is a direction by the Court for *specific performance* of the contract at the suit of the party not in breach.

Some of the cases in which specific performance of a contract may, in the discretion of the Court, be enforced are as follows :

(a) When the act agreed to be done is such that compensation in money for its non-performance is not an adequate relief.

(b) When there exists no standard for ascertaining the actual damage caused by the non-performance of the act agreed to be done.

(c) When it is probable that the compensation in money cannot be got for the non-performance of the act agreed to be done.

Specific performance will not be granted where—

(a) damages are an adequate remedy ;

(b) the contract is not certain, or is inequitable to either party ;

(c) the contract is in its nature revocable ;

(d) the contract is made by trustees in breach of their trust ;

(e) the contract is of a personal nature, *e.g.*, a contract to marry ;

(f) the contract is made by a company in excess of its powers as laid down in its Memorandum of Association ;

(g) the Court cannot supervise its carrying out, *e.g.*, a building contract.

5. INJUNCTION

Where a party is in breach of a negative term of a contract (*i.e.*, where he is doing something which he promised not to do), the Court may, by issuing an order, restrain him from doing what he promised not to do. Such an order of the Court is known as an '*injunction*'.

Examples. (a) *W* agreed to sing at *L*'s theatre, and during a certain period to sing nowhere else. Afterwards *W* made contract with *Z* to sing at another theatre and refused to perform the contract with *L*. *Held*, *W* could be restrained by injunction from singing for *Z* [*Lumley* v. *Wagner*, (1852) 5 De G.M. & G. 604].

(b) *N*, a film actress, agreed to act exclusively for *W* for a year and for no one else. During the year she contracted to act for *Z*. *Held*, she could be restrained by injunction from doing so [*Warner Bros.* v. *Nelson*, (1937) 1 K.B. 209].

The grant of an injunction by the Court is normally discretionary, but there seems no reason why the Court should refuse the grant of an injunction to restrain the breach of a contract—

(a) whereby a promisor undertakes not to do something, *e.g.*, not to carry on a certain trade [*Nordenfelt* v. *Maxim Nordenfelt Co. Ltd.*, (1894) A.C. 535] ; or

(b) which is negative in substance though not in form.

Example. *G* agreed to take all the electric energy required by his premises from *M*. *Held*, this was in substance an agreement not to take energy from any other person and it could be enforced by injunction [*Metropolitan Electric Supply Co.* v. *Ginder*, (1901) 2 Ch. 792].

RECTIFICATION OR CANCELLATION

When through fraud or a mutual mistake of the parties, a contract or other instrument does not express their real intention, either party may institute a suit to have the instrument rectified. In such a case, if the Court finds that there has been a fraud or mistake, it may ascertain the real intention of the parties, and may, in its discretion, rectify the instrument so as to express that intention (Sec. 26 of the Specific Relief Act, 1963). But this must not prejudice the rights acquired by third persons in good faith and for value. If rectification is not possible, the Court orders for the cancellation of the contract.

A written document which is void or voidable against a person may cause him in some cases a serious injury, if it is left outstanding. In such a case, if he has any such apprehension, he may file a suit to have the document adjudged void or voidable. The Court may, in its discretion,

adjudge such a document void or voidable and order it to be delivered up and cancelled (Sec. 31 of the Specific Relief Act, 1963).

Example. A, the owner of a ship, fraudulently representing the ship to be seaworthy, induces B, an underwriter, to insure the ship. B may obtain the cancellation of the policy.

SUMMARY

In case of breach of a contract, the injured party has one or more of the following remedies :

1. **Rescission.** When there is breach of a contract by a party, the injured party may sue to treat the contract as rescinded. He is also absolved of all his obligations under the contract.

2. **Damages.** Damages are monetary compensation awarded to the injured party by Court for the loss or injury suffered by him. The foundation of modern law of damages, both in India and England, is to be found in the judgment in the case of *Hadley* v. *Baxendale*. Sec. 73 of the Indian Contract Act which deals with "compensation for loss or damage caused by breach of contract" is based on the judgment in the case of *Hadley* v. *Baxendale*. Damages may be of four types :

(1) *Ordinary damages.* These are damages which actually arise in the usual course of things from the breach of a contract.

(2) *Special damages.* Damages which may reasonably be supposed to have been in the contemplation of both the parties at the time when they made the contract as the probable result of the breach of it, are known as special damages and may be recovered.

(3) *Vindictive or exemplary damages.* These damages are allowed in case of the breach of a contract to marry or dishonour of a cheque by a banker wrongfully.

(4) *Nominal damages.* Where the injured party has not suffered any loss by reason of the breach of a contract, the Court may award a very nominal sum as damages.

Liquidated damages and penalty. 'Liquidated damages' represent a sum, fixed or ascertained by the parties in the contract, which is a *fair and genuine pre-estimate* of the probable loss that might ensue as a result of the breach. A 'penalty' is a sum named in the contract at the time of its formation, which is disproportionate to the damage likely to accrue as a result of the breach. The Courts in India allow only 'reasonable compensation'.

3. **Quantum meruit.** A right to sue on a *quantum meruit* (as much as earned) arises where a contract, partly performed by one party, has become discharged by the breach of the contract by the other party. This right is founded on an implied promise by the other party arising from the acceptance of a benefit by that party.

4. **Specific performance.** In certain cases the Court may direct the party in breach of a contract to actually carry out the promise, exactly according to the terms of the contract. This is called specific performance of the contract.

5. **Injunction.** It is a mode of securing the specific performance of the negative terms of a contract.

TEST QUESTIONS

1. What remedies are available to an aggrieved party on the breach of contract ?

2. State briefly the principles on which damages are awarded on the breach of a contract.

3. "If a contract is broken, the law will endeavour, so far as money can do it, to place the injured party in the same position as if the contract had been performed." Comment.

4. Examine critically the rule in *Hadley* v. *Baxendale*, and indicate to what extent the said rule is applicable in India.

5. "The damages which the other party ought to receive in respect of breach of a contract should be such as may fairly and reasonably be considered either arising naturally from such breach of contract itself or such as may reasonably be supposed to have been in the contemplation of both the parties at the time they made the contract, as the probable result of the breach of it." Comment.

6. Define : Special Damages ; Exemplary Damages ; Nominal Damages ; Liquidated Damages ; Injunction.

7. Explain and illustrate the circumstances in which a party may maintain action for breach of a contract without having himself fully performed his own obligation under the contract.

8. "Where a party to a contract refuses altogether to perform, or is disabled from performing his part of it, the other party has a right to rescind it." Discuss fully this statement in the light of the provisions of the Indian Contract Act, 1872.

9. What is the distinction between 'liquidated damages' and 'penalty' and what bearing has this distinction in India upon the question of compensation on the breach of a contract ?

10. If the damages are fixed in the contract itself, can the party in breach of the contract be bound to pay full amount mentioned therein ?

11. Under what circumstances is a party entitled to specific performance ?

12. When does a claim on *quantum meruit* arise ?

PRACTICAL PROBLEMS

Attempt the following problems, giving reasons :

1. *A*, a merchant of Agra, made a contract to despatch 100 quintals of gur to *B* at Delhi at a certain price and *B* paid Rs. 500 as earnest money. None of the parties knew that the Government had, sometimes previously, passed a law prohibiting transport of gur from one State to another. *A* was unable, by reason of this law, to send the gur. *B* claims damages for non-performance as well as refund of the earnest money. Is he entitled to these remedies ?

[*Hint* : The agreement is void *ab initio*. *B* can claim refund of the earnest money but not damages (Sec. 65)].

2. *X*, having contracted with *Y* to supply him 1,000 tons of iron at Rs. 12,000 a ton, to be delivered in a stated time, contracts with *Z*, for the purchase of 1,000 tons of iron at Rs. 11,000 a ton. *X* does not tell *Z* of the sale to *Y*. *Z* fails to perform the contract with *X* who cannot procure other iron, and *Y*, in consequence rescinds the contract. What damages can *X* claim from *Z* ?

[*Hint* : *X* can claim the difference between the contract price and the market price at the date of the breach (*Thol* v. *Henderson*, (1881) 1 Q.B.D. 457)].

3. A agreed to erect a plant for *B* by 31st January, 1991. The contract provided that *B* should pay Rs. 500 per month for every month that *A* took beyond the agreed date. *A* was late by six months. *B* sued *A* for Rs. 6,500 the actual loss caused to him as a result of the delay. To what damages, if any, is *B* entitled ?

[*Hint* : Rs. 3,000 (*Hadley* v. *Baxendale*, Sec. 73)].

4. *A* agreed to sell to *B* certain shares to be delivered on 1st March 1991. On that date the shares had gone down in price and *B* refused to take the shares. *A* subsequently sold the shares at a price higher than that agreed to be paid for them by *B*. (*a*) Is *A* entitled to sue *B* for breach of contract ? (*b*) If so, what would be the measure of damages ?

[*Hint* : (*a*) Yes. (*b*) The damages would be equal to the difference between the market price and the contract price on 1st March (Sec. 73)].

5. Owing to *A*'s failure to lend *B* Rs. 10 lakhs as agreed, *B* was unable to perform a Government contract. The Government sued him to judgment and he in turn sued *A* for compensation under the following heads : (*i*) loss of profits on the Government contract, (*ii*) loss of future contracts with the Government, (*iii*) damages and cost of the suit awarded to the Government, (*iv*) his cost of defending the suit, (*v*) mental distress and consequential ill health, and (*vi*) loss of reputation in his business as a contractor. What will *A* have to pay ?

[*Hint* : If the fact that the money was required by *B* for the execution of a particular contract was known to *A*, he will be liable under heads (*i*), (*iii*) and (*iv*). Damages under heads (*ii*), (*v*) and (*vi*) will not be recoverable as they are too remote. If the fact of use of money was not known to *A*, *A* will have to pay excess interest that *B* will have to pay in raising a loan of Rs. 10 lakhs from some other source on the date of *A*'s failure to lend (Sec. 73)].

6. The wife of a person died from tin poisoning caused by the tinned salmon bought from a dealer. What damages can the husband claim ?

[*Hint* : The husband can rescind the contract and claim damages incurred by employing extra servants by reason of the loss of his wife's services, medical expenses during her illness and pecuniary loss occasioned by her death (Sec. 73)].

7. A cow was sold with a warranty that it was free from disease. The cow was suffering from foot and mouth disease at the time of sale. As a result of it, not only the cow purchased died but infected the other cows of the purchaser also. What damages can be recovered in this case ?

[*Hint* : The purchaser can, in this case, claim not only the loss occasioned by the death of the cow purchased, but the entire loss which flows as a result of the breach of warranty (*Smith* v. *Green*, (1876) 1 C.P.Q.D. 92 ; Sec. 73 ; *Hadley* v. *Baxendale*)].

8. *B* was an employee in a partnership firm for a certain period. The firm was dissolved before the expiry of the period for which he was employed. Two of the partners continued the business and offered to employ *B*. *B* refused. What damages can he claim from the firm for breach of contract ?

[*Hint* : *B* is entitled to claim only nominal damages as the continuing partners were willing to employ *B* who refused to accept the employment (*Brace* v. *Calder*)].

9. *A* hired *B*'s rooms for a series of lectures. *B* discovered that the lectures would be of a seditious nature and refused to allow *A* to use the rooms. *A* sued *B*. Advise *B*.

[*Hint* : The object of the agreement in this case is unlawful and hence *A* will not succeed (Sec. 23)].

10. In a bond there is a stipulation for payment of compound interest on failure to pay simple interest at (*a*) the same rate as simple interest, (*b*) a higher rate as was payable on the principal. Discuss whether this stipulation is a penalty.

[*Hint* : Payment of compound interest on default (*a*) at the same rate as simple interest is not a penalty within the meaning of Sec. 74 (*Ganga Dayal* v. *Bachu Mal*, (1906) 25 All. 26). (*b*) at a rate higher than simple interest is a penalty within the meaning of Sec. 74 [*Sunder Koer* v. *Rai Sham Krishan*, (1905) 34 Cal. 150)].

11. *S* agreed to act as sales manager for Company *X* for a period of three years at a monthly salary of Rs. 1,000. *S* worked for six months and then left and joined another company at a higher salary. What are the rights of Company *X*?

[*Hint* : Company *X* may not only treat the contract as rescinded but also bring suit against *S* to recover any monetary loss suffered by it as a result of the breach].

12. *M*, a retailer of milk, supplied *C* with milk which was consumed by *C* and his family. The milk contained typhoid germs and *C*'s daughter was infected thereby and died. Discuss the legal position of the parties.

[*Hint* : *C* can recover damages from *M* (*Frost* v. *Aylesbury Dairy Co. Ltd.*, (1925) 1 K.B. 608 Also refer to Problem 6 of this Chapter].

13. *A* gives *B* a bond for the repayment of Rs. 1,000 with interest @ 12% at the end of six months, with a stipulation that in case of default, interest shall be payable @ 75% from the date of default. *A* makes a default. Can *B* claim compensation as per the stipulation ?

[*Hint* : No. The stipulation is by way of penalty and *B* is only entitled to recover from *A* such compensation as the Court considers reasonable (Sec. 74)].

14. *A* undertook to write a book in six volumes. After completing four volumes *A* died. Can his legal representatives get payment for the work done ?

[*Hint* : No, as the contract to write the book in six volumes is indivisible].

15. *A* agrees to print a book for *B* not knowing that it contains libellous matter. After printing a part he discovers that it contains libellous matter. Can *A* (*a*) lawfully refuse to print the rest of the book, (*b*) sue *B* for the work done by him ?

[*Hint* : (*a*) Yes. (*b*) He can sue for the work done on *quantum meruit*].

16. *A* commenced a periodical publication called, 'the Armour, and engaged *B* to write a volume on ancient armour for it. For this *B* was to receive the sum of Rs. 10,000 on completion of the work. When he had completed a part, but not the whole of his volume, *A* abandoned the publication. *B* sued *A* for recovery of the amount contracted for. Advise *B*.

[*Hint* : *B* is entitled to claim compensation on *quantum meruit*].

12

Quasi-Contracts

Under certain circumstances, a person may receive a benefit to which the law regards another person as better entitled, or for which the law considers he should pay to the other person, even though there is no contract between the parties. Such relationships are termed *quasi-contracts*, because, although there is no contract or agreement between the parties, they are put in the same position as if there were a contract between them. These relationships are termed *quasi-contracts* or *constructive contracts* under the English Law and "*certain relations resembling those created by contracts*" under the Indian Law.

A quasi-contract rests on the ground of equity that a person shall not be allowed to enrich himself unjustly at the expense of another. The principle of unjust enrichment requires :

first, that the defendant has been 'enriched' by the receipt of a 'benefit' :

secondly, that this enrichment is at the expense of the plaintiff ; and

thirdly, that the retention of the enrichment is unjust [*Mahabir Kishore* v. *State of M.P.*, A.I.R. (1990) S.C. 313].

Law of quasi-contracts is also known as the law of restitution.

Strictly speaking, a quasi-contract is not a contract at all. A contract is intentionally entered into. A quasi-contract, on the other hand, is created by law. In an American case *Miller* v. *Schloss*, 918 N.Y. 400, N.E. 337, it was observed :

"In truth it (quasi-contract) is not a contract at all. It is an obligation which the law creates in the absence of any agreement, when the acts of the parties or others have placed in the possession of one person, money or its equivalent, under such circumstances that in equity and good conscience he ought not retain it, and which *ex aequo et bono* (in justice and fairness) belongs to another."

KINDS OF QUASI-CONTRACTS

Secs. 68 to 72 deal with five kinds of quasi-contractual obligations. These are discussed below :

1. Supply of necessaries (Sec. 68)

If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person. This has already been considered in detail in connection with minors agreements in Chapter on "Capacity of Parties".

Examples. (*a*) *A* supplies *B*, a lunatic, with necessaries suitable to his condition in life. *A* is entitled to be reimbursed from *B*'s property.

(*b*) *A* supplies the wife and children of *B*, a minor, with necessaries suitable to their condition in wife. *A* is entitled to be reimbursed from *B*'s property.

2. Payment by an interested person (Sec. 69)

A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.

Example. B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law the consequences of such sale will be annulment of B's lease. B to prevent the sale and the consequent annulment of his own lease, pays to the Government the sum due from A. A is bound to make good to B the amount so paid.

The essential requirements of Sec. 69 are as follows :

(1) The payment made should be *bona fide* for the protection of one's interest.

Example. P left his carriage on D's premises. D's landlord seized the carriage as distress for rent. P paid the rent to obtain the release of his carriage. *Held*, P could recover the amount from D [*Exall* v. *Partrige*, (1799) 8 Term R. 308].

(2) The payment should not be a voluntary one.

Example. A canal company owned a canal and was under a statutory duty to keep the bridge on the canal under repair. The bridge fell into disrepair and the plaintiffs, the highway authority, called upon the canal company to repair it. When the canal company failed to do so, the plaintiffs themselves repaired the bridge and brought an action to recover the money paid. *Held*, the plaintiffs could not recover as they acted as mere volunteers [*Macclesfield Corporation* v. *Great Central Rail.*, (1911) 2 K.B. 528].

(3) The payment must be such as the other party was bound by law to pay.

Examples. (*a*) W was the owner of a warehouse. G imported certain goods and kept them in the warehouse. The goods were stolen without any negligence on the part of W. The authorities made a demand on W for the payment of the custom duties which W paid. *Held*, W could recover the amount from G [*Brook's Wharf Ltd.* v. *Goodman Bros.*, (1937) 1 K.B. 534].

(*b*) The goods belonging to A were wrongfully attached in order to realise arrears of Government revenue due by G. A paid the amount to save the goods from sale. *Held*, he was entitled to recover the amount from G [*Abid Hussain* v. *Ganga Sahai*, (1928) 26 All. L.J. 435].

3. Obligation to pay for non-gratuitous acts (Sec. 70)

When a person lawfully does anything for another person or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered.

Examples. (*a*) A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay for them to A.

(*b*) A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

Before any right of action under Sec. 70 arises, three conditions must be satisfied :

(1) The thing must have been done *lawfully*.

(2) The person doing the act should not have intended to do it *gratuitously*.

(3) The person for whom the act is done must have enjoyed the *benefit* of the act [*Union of India* v. *Sita Ram*, A.I.R. (1977) S.C. 329].

Examples. (*a*) A village was irrigated by a tank. The Government effected certain repairs to the tank for its preservation and had no intention to do so gratuitously for the zamindars. The zamindars enjoyed the benefit thereof. *Held*, they were liable to contribute [*Damodar Mudaliar* v. *Secretary of State for India*, (1894) 18 Mad. 88].

(*b*) P agreed to transfer 50 partly paid shares in a company to his son. Before the shares were transferred the company went into liquidation. The liquidator demanded the balance due on the shares from P who paid the amount. The shares, however, were valueless. *Held*, P could not recover the amount from his son, as when P paid the amount, the son was under no obligation to pay, and that he did not enjoy any benefit [*Suranarayanamurthy* v. *Ayappa*, A.I.R. (1960) A.P. 146].

Sec. 70 is not based on contract but embodies the equitable principles of restitution and prevention of unjust enrichment [*C.I. Abraham* v. *K.A. Cheriyan*, A.I.R. (1986) Ker. 60]. It has no application to persons incompetent to contract and as such they are under no obligation to compensate the other person for any benefit received by them.

4. Responsibility of finder of goods (Sec. 71)

A person, who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee. He is bound to take as much care of the goods as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value. He must also take all necessary measures to trace its owner. If he does not, he will be guilty of wrongful conversion of the property. Till the owner is found out, the property in goods will vest in the finder and he can retain the goods as his own against the whole world (except the owner, of course).

Example. F picks up a diamond on the floor of S's shop. He hands it over to S to keep it till true owner is found out. No one appears to claim it for quite some weeks in spite of the wide advertisements in the newspapers. F claims the diamond from S who refuses to return. S is bound to return the diamond to F who is entitled to retain the diamond against the whole world except the true owner.

The finder can sell the goods in the following cases :

(1) when the thing found is in danger of perishing ;

(2) when the owner cannot, with reasonable diligence, be found out ;

(3) when the owner is found out, but he refuses to pay the lawful charges of the finder ; and

(4) when the lawful charges of the finder, in respect of the thing found, amount to two-thirds of the value of the thing found (Sec. 169).

5. Mistake or coercion (Sec. 72)

A person to whom money has been paid, or anything delivered, by

mistake or under coercion, must repay or return it to the person who paid it by mistake or under coercion. The word 'coercion' is used in Sec. 72 in its general sense and not as defined in Sec. 15 [*Seth Kanhaya Lal* v. *National Bank of India*, (1913) 40 I.A. 56].

Examples. (*a*) *A* pays some money to *B* by mistake. It is really due to *C*. *B* must refund the money to *A*. *C*, however, cannot recover the amount from *C* as there is no privity of contract between *B* and *C*.

(*b*) *A* and *B* jointly owe Rs. 100 to *C*. *A* alone pays the amount to *C*, and *B*, not knowing this fact, pays Rs. 100 over again to *C*. *C* is bound to pay the amount to *B*.

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

Sec. 72 does not draw any distinction between a mistake of fact and a mistake of law [*D. Cawasji & Co.* v. *State*, A.I.R. (1969) Mys. 23].

Examples. (*a*) *K* paid sales tax on his forward transactions of bullion. Subsequently this tax was declared *ulra vires*. *Held*, *K* could recover the amount of sales tax and that Sec. 72 is wide enough to cover not only mistake of fact but also a mistake of law [*Sales Tax Officer, Benares* v. *Kanhaiya Lal Mukand Lal Safaf*, (1959) S.C.J. 53].

(*b*) An insurance company paid the amount on a policy under the mistake that the goods had been destroyed by a peril insured against. The goods in fact had been sold. *Held*, the money could be recovered by the insurance company [*Norwich etc., Society Ltd.* v. *Price (W.H.) Ltd.* (1934) A.C. 455].

(*c*) An insurance company paid the amount on a policy which had lapsed by reason of non-payment of premiums by the assured. The company knew this fact but it was overlooked at the time of payment. *Held*, the company could recover the amount "however careless the party (company paying money) may have been in omitting to use the diligence to inquire into the fact" [*Kelly* v. *Solari* (1841) 9 M. & W. 54].

Quantum meruit

"*Quantum meruit*" literally means "*as much as earned*" or "*as much as is merited*". When a person has done some work under a contract, and the other party repudiates the contract, or some event happens which makes the further performance of the contract impossible, then the party who has performed the work can claim remuneration for the work he has already done. Likewise, where one person has expressly or impliedly requested another to render him a service without specifying any remuneration, but the circumstances of the request imply that the service is to be paid for, there is implied a promise to pay *quantum meruit*, *i.e.*, so much as the party rendering the service deserves. The right to claim *quantum meruit* does not arise out of *contract* as the right to damages does ; it is a claim on the *quasi-contractual obligation* which the law implies in the circumstances.

The claim for *quantum meruit* arises only when the original contract is discharged. If the original contract exists, the party not in default cannot have *quantum meruit* remedy ; he has to take resort to remedy in damages [*Planche* v. *Colburn*, (1831) 8 Bing. 14]. Further the claim for *qunatum* meruit can be brought only by the party who is not in default.

The claim for *quantum meruit* arises in the following cases :

(1) *When an agreement is discovered to be void* (Sec. 65). When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it.

Example. CE was employed as a managing director in a company. After he rendered service for three months, it was found that the directors were not qualified to appoint him. *Held*, *CE* could recover remuneration for the services rendered by him on *quantum meruit* [*Craven-Ellis* v. *Cannon Ltd.*, (1936) 2 K.B. 403].

(2) *When something is done without any intention to do so gratuitously* (Sec. 70). When a thing is lawfully done or goods are supplied by a person without any intention to do so gratuitously to another person and such other person enjoys the benefit thereof, he is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered.

(3) *When there is an express or implied contract to render services but there is no agreement as to remuneration.* In such a case, reasonable remuneration is payable. What is reasonable remuneration is determined by the Court ; and this reasonable remuneration is *quantum meruit*.

Example. There was an implied agreement between *P* and a fire brigade for the services of the brigade. *Held*, reasonable remuneration was payable by *P* for the services received by him [*Upton Rural District Council* v. *Powell*, (1942) 1 All E.R. 220].

(4) *When the completion of the contract has been prevented by the act of the other party to the contract.*

Examples. (*a*) *C* engaged *P* to write a book on ancient armoury to be published by instalments in a periodical called "The Juvenile Library" for the fee of £ 100. After a few issues of the periodical had appeared, it was abandoned. *Held*, *P* could recover on *quantum meruit* for the work he had done under the contract [*Planche* v. *Colburn*, (1831) 8 Bing. 14].

(*b*) *P* wrongfully revoked *A*'s (his agent's) authority before *A* could complete his duties. *Held*, *A* could recover *quantum meruit* for the work he had done and the expenses he had incurred in the course of his duties [*De Bernady* v. *Harding*, (1853) 8 Ex. 22].

(5) *When a contract is divisible*. When a contract is divisible and the party not in default has enjoyed the benefit of the part performance, the party in default may sue on *quantum meruit*. But if the contract is not divisible, *i.e.*, where it requires complete performance as a condition of payment, the party in default cannot claim remuneration on the ground of *quantum meruit*.

Examples. (*a*) *S* undertook to build two houses and a stable for *H* for £ 965. After having done the work to the value of £ 333 he abandoned the contract. *H*, afterwards, completed the work himself. *Held*, *H* could not recover the value of the part he had completed because the payment was to be made only on the completion of the entire work. The adoption by *H* of the part of the work completed is no plea for awarding remuneration on *quantum meruit* as *S* had no

alternative but to accept the part completed [*Sumpter* v. *Hedges*, (1898) 1 Q.B. 673].

(*b*) *P* agreed to a pay *C*, appointed as second mate, 30 guineas on the completion of a voyage from Jamaica to Liverpool. *C* died before the completion of the voyage. *Held*, *C*'s widow was not entitled to claim proportionate payment for the part of the voyage completed as the contract imposed one indivisible obligation which had not been performed [*Cutter* v. *Powell*, (1795) 6 T.L.R. 320]

(6) *When an indivisible contract is completely performed but badly.* When an indivisible contract for a lump sum is completely performed, but badly, the person who has performed the contract can claim the lump sum ; but the other party can make a deduction for bad work.

Examples. (*a*) *A* agreed to repair *B*'s house for £ 265, payable on completion in accordance with a specification. He did the repairs but these were defective. *Held.* *A* was entitled to recover £ 265, less a reduction in respect of the defective work [*Dakin (H) & Co. Ltd.* v. *Lee*, (1916) 1 K.B. 566].

(*b*) *P* agreed to decorate *D*'s flat for a lump sum of £ 750, certain requirements having been laid down. *P* did the work but *D* complained of faulty workmanship. It cost *D* £ 204 to remedy that defect. *Held*, *P* could recover from *D* £ 750 less £ 204 [*Hoenig* v. *Issacs*, (1952) All E.R. 176].

Money had and received

Money which is paid to one person which rightfully belongs to another, as where money is paid by *A* to *B* on a consideration which has wholly failed, is said to be money had and received by *B* to the use of *A*, and it is recoverable by action by *A*.

Compensation for failure to discharge obligation created by quasi-contracts (Sec. 73, para 3)

When an obligation created by a quasi-contract is not discharged, the injured party is entitled to receive the same compensation from the party in default, as if that person had contracted to discharge it and had broken his contract.

SUMMARY

In certain cases the law imposes an obligation and allows an action to be brought on it as if it arose out of an agreement, though none was present in fact. Such cases, strictly speaking, are not contracts, but the law recognises them as "certain relations resembling those created by contracts". In English Law, such relations are called quasi-contracts.

Quasi-contracts rest on the ground of equity that a person shall not be allowed to enrich himself unjustly at the expense of another.

Secs. 68 to 72 deal with the following quasi-contracts :

(1) Claim for necessaries supplied to a person incapable of contracting or on his account (Sec. 68).

(2) Reimbursement of a person paying money due by another in payment of which he is interested (Sec. 69).

(3) Obligation of a person enjoying benefit of a non-gratuitous act (Sec. 70).

(4) Responsibility of finder of goods (Sec. 71).

(5) Liability of person to whom money is paid or thing delivered by mistake or under coercion (Sec. 72).

Quantum meruit. This means "as much as is earned".

TEST QUESTIONS

1. What are quasi-contracts ? Enumerate the quasi-contracts dealt with under the Indian Contract Act, 1872.

2. "In quasi-contracts, the promise to pay is implied by of law and is not based on any express agreement." Explain giving illustrations.

3. Discuss the rights and obligations of a finder of goods.

4. When can a finder of goods sell the goods ?

5. "Quasi-contracts rest on the ground of equity that a person shall not be allowed to enrich himself unjustly at the expense of another." Explain.

6. Does the law of contract impose any obligation on a person enjoying benefit of a non-gratuitous act of another person done for the former ?

7. What do you understand by *quantum meruit* ? When does the claim on *quantum meruit* arise ?

PRACTICAL PROBLEMS

Attempt the following problems giving reasons :

1. *A* and *B* jointly owe Rs. 200 to *C*. *A* pays the amount to *C*. *B*, not knowing this fact, pays Rs. 100 over again to *C*. Discuss the rights of *A* and *B* as against *C*.

[*Hint* : *C* is bound to repay the amount to *B* (Sec. 72)].

2. *A*, a tradesman, sends some goods ordered by *B*. *A*'s servant delivers the goods by mistake at *C*'s house. *C* uses the goods. Can *A* recover the price of the goods from (*i*) *B*, or (*ii*) *C* ?

[*Hint* : *A* can recover the price of the goods from *C* (Sec. 70)].

3. Is a claim enforceable on the ground of *quantum meruit* in the following cases ?

(*a*) *A* is engaged by *B* to a write a book to be published by instalments in a weekly magazine. The magazine is abandoned after a few issues.

(*b*) *A* is employed as a managing director in a company. After he renders service for some time it is found that the directors were not qualified to appoint him as such.

(*c*) *A* undertakes to build a house for *B* for Rs. 25,000, but after having done half the work he abandons the contract. *B* afterwards completes the house.

(*d*) *A* decorates *B*'s flat and fits a wardrobe and a book-case for a lump sum of Rs. 15,000. The work is done but *B* complains of faulty workmanship.

[*Hint* : In cases (*a*) and (*b*), *A* can recover on *quantum meruit* for the work done by him under the contract and the service rendered by him (*Planche* v. *Colburn* ; *Craven Ellis* v. *Canons Ltd.*. In case (*c*), *A* cannot recover the value of the part that he has completed as the contract is indivisible (*Sumpter* v *Hedges*). In case (*d*), *A* can recover Rs. 15,000 *less* the cost to remedy the faulty workmanship (*Hoenig* v. *Issacs*)].

4. The goods belonging to *A* are wrongfully attached in order to realise arrears of Government revenue due by *B*. *A* pays the amount to save the goods from sale. Is he entitled to recover the amount from *B* ?

[*Hint* : Yes (Sec. 69)].

5. *A* supplied rice and wheat to the wife and children of *B* who is a lunatic. *B* has assets worth one lakh of rupees. (*a*) On non-payment, can *A* proceed against the assets of *B* ? (*b*) Would your answer be the same, if *B* instead of being a lunatic, were a minor ?

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

6. *X* saves *Y*'s property from fire intending to do so gratuitously. Subsequently he claims compensation from *Y* on the ground that *Y* enjoyed the benefit of *X*'s act. Will he succeed ?

[*Hint* : No (Sec. 70)].

7. *A* got property of *B* attached in execution of a money decree. The decree was as a matter of fact against another person of a similar name. In order to save his property from being sold away, *B* paid the amount of the decree. Subsequently, he sued *A* for getting the amount back. Will he succeed ?

[*Hint* : Yes (*Manilal* v. *Chandulal*, (1930) 32 Bom L.R. 424 ; Sec. 69)].

8. S & Co., a firm of printers, agree to print 1,000 copies of a book for *B* & Co., a firm of publishers. After printing the book and delivering all copies to *B* & Co., *S* & Co. discover for the first time that parts of the book are libellous. *B* & Co. are now refusing to pay *S* & Co., the contract price. Advise *S* & Co.

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[*Hint* : S & Co. can recover the printing charges on *quantum meruit*].

9. *A* left his carriage on *B*'s premises. *B*'s landlord seized the carriage as distress for rent. *A* paid the rent to obtain the release of his carriage. Can *A* recover the amount from *B*?

[*Hint* : Yes (Sec. 69, *Exall* v. *Partridge*)]

10. *A* pays some money to *B* by mistake. It is really due to *C*. Can *C* recover the amount from *B* ?

[*Hint* : No, as there is no priority of contract between *B* and *C* ; but *A* can recover (Sec. 72)].

11. *A* transport company refuses to deliver certain goods to the consignee, except upon the payment of an illegal charge of carriage. The consignee pays the sum charged in order to obtain the goods. Discuss the rights of the consignee as against the transport company.

[*Hint* : The consignee is entitled to recover the amount from the transport company (Sec. 72)].

12. *D* voluntarily renders substantial assistance to *B* whose house has caught fire. Can *D* claim any compensation from *B* for such assistance ?

[*Hint* : No, *D* cannot claim any compensation from *B* unless the circumstances show that he did not intend to act gratuitously (Sec. 70)].

PART TWO—SPECIAL CONTRACTS

1

Indemnity and Guarantee

Contracts of indemnity and guarantee are a species of the general contract. As such the principles of the general law of contract are applicable to them. The special principles relating to them are contained in Chapter VIII (Secs. 124 to 147) of the Indian Contract Act, 1872, and are discussed below.

CONTRACT OF INDEMNITY

A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a 'contract of indemnity' (Sec. 124). The person who promises to make good the loss is called the *indemnifier* (promisor) and the person whose loss is to be made good is called the *indemnified* or *indemnity-holder* (promisee). A contract of indemnity is really a class of contingent contracts.

Examples. (*a*) *A* contracts to indemnify *B* against the consequences of any proceedings which *C* may take against *B* in respect of a certain sum of Rs. 200. This a contract of indemnity.

(*b*) *A* and *B* claim certain goods from a railway company as rival owners. *A* takes delivery of the goods by agreeing to compensate the railway company against loss in case *B* turns out to be the true owner There is a contract of indemnity between *A* and the railway company.

(*c*) *A* and *B* go into a shop. *B* says to the shopkeeper, "Let him (*A*) have the goods, I will see you paid." The contract is one of indemnity [*Goulston Discount Co. Ltd.* v. *Clark*, (1967) 2 Q.B. 493].

Definition is not exhaustive. The definition of 'contract of indemnity' as given in the Indian Contract Act is not exhaustive. It includes : (*a*) express promises to indemnify, and (*b*) cases where the loss is caused by the conduct of the promisor himself or by the conduct of any other person. It does not include : (*a*) implied promises to indemnify, and (*b*) cases where loss arises from accidents and events not depending on the conduct of the promisor or any other person.

In India, it has been held that "Sections 124 and 125 of the Contract Act are not exhaustive of the law of indemnity and the Courts here would apply the same equitable principles that the Courts in England do." [*Gajanan Moreshwar* v. *Moreshwar Madan*, A.I.R. (1942) Bom. 302]. Moreover, if Sec. 124 is strictly interpreted even contracts of insurance would have to be excluded from the definition. Such a strict application of the definition was not intended by the Legislature.

In English law, a contract of indemnity has been defined as "a promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor." This definition covers the loss caused by events or accidents which do not depend on the conduct of any person. The English definition is much wider in its scope

As such the English Law in respect of indemnity is followed by the Indian Courts.

A contract of indemnity may be *express* or *implied*. An implied contract of indemnity may be inferred from the circumstances of the case or from relationship of the parties.

Example. A, on the instruction of *T*, sold certain cattle belonging to *O*. *O* held *A* liable for it and recovered damages from him for selling it. *Held*, *A* could recover the loss from *T* as a promise by *T* to *A* from any such loss would be implied from his conduct in asking *A* to sell the cattle [*Adamson* v. *Jarvis*, (1927) 4 Bing. 66].

Sec. 69 also implies a promise to indemnify.

A contract of indemnity is a species of the general contract. As such it must have all the essential elements of a valid contract.

Rights of indemnity-holder when sued. Sec. 125 deals with rights of indemnity-holder (*i.e.*, indemnified) when sued. According to it, an indemnity-holder is entitled to recover from the promisor (*i.e.*, indemnifier)–

(1) all damages which he may be compelled to pay in any *suit* in respect of any matter to which the promise to indemnify applies ;

(2) all costs which he may be compelled to pay in *bringing or defending* such *suits*. But the indemnified should have acted as any prudent man would act under similar circumstances in his own case, or with the authority of the indemnifier ; and

(3) all sums which he may have paid under the terms of any *compromise* of any such suit. The compromise should not be contrary to the orders of the indemnifier and should be prudent or authorised by the indemnifier.

Rights of indemnifier. The Indian Contract Act is silent regarding the rights of the indemnifier in a contract of indemnity. It may be said, on the authority of the English Law, that the rights of the indemnifier are analogous to the rights of a surety under Sec. 141. The rights of surety are discussed later in this Chapter.

Time of commencement of the indemnifier's liability

The Indian Contract Act (Sec. 125) does not state the time of the commencement of the indemnifier's liability under the contract of indemnity. Different High Courts have been observing different rules in this connection. Some High Courts have held that the indemnifier is not liable until the indemnified has incurred an actual loss. Others have held that the indemnified can compel the indemnifier to make good his loss even before he actually discharges his liability [*Osman Jamal & Sons* v. *Gopal*, (1919) 56 Cal. 262]. In this regard, it has been observed by Buckley L.J. in *Richardson, ex parte etc., Re* (1911) 2 K.B. 705 : "Indemnity is not given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay."

The latter view, which is based on equitable principles, has now almost come to stay. It has been rightly observed in an English case, *Liverpool Insurance Co.'s Case*, (1914) 2 Ch. 617 :

".....To indemnify does not merely mean to reimburse in respect of moneys paid, but to save from loss in respect of liability against which the indemnity has been given...if it be held that payment is a condition precedent to recovery, the contract may be of little value to

the person to be indemnified, who may be unable to meet the claim in the first instance."

A similar observation was made by Chagla, J. in the case of *Gajanan Moreshwar* v. *Moreshwar Madan*, A.I.R. (1942) Bom. 302, that "If the indemnified had incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from that liability and pay it off."

CONTRACT OF GUARANTEE

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 (Sec. 126). It may be *express* or *implied* and may even be inferred from the course of conduct of the parties concerned.

S, P and C. Unless otherwise, stated, in the following pages of this Chapter, *S* stands for surety, *P* for principal debtor, and *C* for creditor.

Examples. (*a*) *S* requests *C* to lend Rs. 500 to *P* and guarantees that if *P* fails to pay the amount, he will pay. This is a contract of guarantee. *S*, in this case, is the *surety*, *C*, the *creditor* and *P*, the *Principal debtor*.

(*b*) *S* and *P* go into a shop. *S* says to the shopkeeper, *C*, "Let *P* have the goods, and if he does not pay, I will." This is a contract of gurarantee [*Birkmyr* v. *Darnell*, (1704) 1 Salk. 27].

A contract of guarantee is a tripartite agreement which contemplates the principal debtor *P*, the creditor *C*, and the surety *S*. In it, there is a *triangular relationship* in which the following three collateral contracts may be distinguished :

(1) *As between C and P*, there is a contract out of which the guaranteed debt arises.

(2) *As between S and C*, there is a contract by which *S* guarantees to pay to *C*, *P*'s debt in case of his (*P*'s) default.

(3) *As between S and P*, there is a contract that *P* shall indemnify *S* in case *S* pays in the event of a default by *P*. This contract, if it is not expressed between the parties, is always implied.

Essential features of a contract of guarantee

1. *Concurrence*. A contract of guarantee requires the concurrence of all the three parties to it, *viz.*, the principal debtor, the creditor, and the surety.

Example C enters into a contract with *P*. *S*., without any communication with *P*, undertakes for a consideration moving from *C* to indemnify *C* against any damage that may arise from a breach of *P*'s obligation. This does not make *S* a surety for *P*, for a person cannot become a surety without the consent of the principal debtor.

2. *Primary liability in some person.* There must be a primary liability in some person other than surety. The word 'liability' as used in the definition of guarantee (Sec. 126) means "a liability which is enforceable at law." If that liability does not exist, there cannot be a contract of guarantee. But a guarantee given for the debt of a minor is an exception to this rule.

Example. *P* owes a debt to *C*. *S* gives a guarantee to *C* for the payment of the debt after it is barred by the Law of Limitation. *S* pays the amount to *C*. He cannot recover the amount from *P* as there is no enforceable liability against *P*.

The primary liability in a contract of guarantee is that of the principal debtor. The liability of the surety is secondary. It arises only when there is a default by the principal debtor.

3. *Essentials of a valid contract.* A contract of guarantee must have all the essential elements of a valid contract. But the following two points should be noted :

(1) All the parties must be capable of entering into a valid contract, though the principal debtor may be a person suffering from incapacity to contract. In such a case, the surety is regarded as the principal debtor and is liable to pay personally even though the principal debtor (*e.g.*, a minor) is not liable to pay [*Kashiba* v. *Shripat*, (1895) 19 I.L.R. Bom. 697].

(2) Consideration received by the principal debtor is sufficient for the surety, and it is not necessary that it must necessarily result in some benefit to the surety himself. It is sufficient if something is done or some promise is made for the benefit of the principal debtor. Sec. 127 lays down this rule as follows : "Anything done, or promise made for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee."

Examples. (*a*) *P* requests *C* to sell and deliver to him goods on credit. *C* agrees to do so, provided *S* will guarantee the payment of the price of the goods. *S* promises to guarantee the payment in consideration of *C*'s promise to deliver the goods. This a sufficient consideration for *S*'s promise.

(*b*) *C* sells and delivers goods to *P*. *S* afterwards requests *C* to forbear to sue *P* for the debt for a year. He promises that if *C* does so, he will pay for the goods in default of payment by *P*. *C* agrees to forbear as requested. This is a sufficient consideration for *S*'s promise.

(*c*) *C* sells and delivers goods to *P*. *S*, afterwards without consideration, agrees to pay for them in default of *P*. The agreement is void.

4. *Writing not necessary.* A guarantee may be either oral or written (Sec. 126). It may be express or implied. Implied guarantee may be inferred from the course of conduct of the parties concerned. But in England a guarantee must be in writing and signed by the party to be charged.

Guarantee is not a contract of uberrimae fidei

A contract of guarantee is not a contract of *uberrimae fidei*, *i.e.*, one requiring full disclosure of all material facts by the principal debtor or creditor to the surety before the contract is entered into. Fraud on the part of the principal debtor is not enough to set aside the contract, unless the surety can show that the creditor or his agent knew of the fraud and was a party to it. When a guarantee is given to a banker, there is no obligation on the banker to inform the intending surety of matters affecting the credit of the debtor or any circumstances connected with the transaction which render the position of the surety more hazardous [*Wythes* v. *Labouchere*, (1859) 3 De. G. & J. 593].

Example. *S* guaranteed the account of *P* with the bank. *P* afterwards drew on this account and paid off an overdraft he had

with another bank. *Held*, the fact that the bank was suspicious that *P* was defrauding *S*, and did not communicate its suspicions to *S*, did not discharge the guarantee [*National Provincial Bank of England* v. *Glanusk*, (1913) 3 K.B. 335].

If the guarantee is in the nature of an insurance, as in a fidelity guarantee, all material facts must be disclosed, otherwise the surety can avoid the contract.

Example. *C* engaged *P* as a clerk to collect money for him. *P* misappropriated some of *C*'s receipts and failed to account for them. This sum was made good by *P*'s relations and *C* agreed to retain *P* in his service on having a fidelity guarantee. *S* gave his guarantee for *P*'s duly accounting. *C* did not acquaint *S* with *P*'s previous dishonesty. *Held*, the guarantee could not be enforced against *S* owing to the non-disclosure of *P*'s previous dishonesty [*London General Omnibus Co.* v. *Holloway*, (1912) 2 K.B. 72].

Distintion between a contract of indemnity and a contract of guarantee

Contract of indemnity	*Contract of guarantee*
1. There are *two parties* to the contract, *viz.*, the indemnifier (promisor) and the indemnified (promisee).	1. There are *three parties* to the contract *viz.*, the creditor, the principal debtor and the surety.
2. The liability of the indemnifier to the indemnified is *primary* and independent.	2. The liability of the surety to the creditor is *collateral* or *secondary*, the primary liability being that of the principal debtor.
3. There is *only one contract* in the case of a contract of indemnity, *i.e.*, between the indemnifier and the indemnified.	3. In a contract of guarantee, there are *three contracts* : one between the principal debtor and the creditor, the second between the creditor and the surety and the third between the surety and the principal debtor.
4. It is *not necessary* for the indemnifier to *act at the request of the indemnified*.	4. It is necessary that the surety should give the *guarantee at the request of the debtor*.
5. The liability of the indemnifier arises only on the *happening of a contingency*.	5. There is usually an *existing debt* or *duty*, the performance of which is guaranteed by the surety.
6. An indemnifier *cannot sue a third party* for loss in his own name, because there is no privity of contract. He can do so only if there is an assignment in his favour.	6. A surety, on discharging the debt due by the principal debtor, steps into the shoes of the creditor. *He can proceed against the principal debtor* in his own right.

EXTENT OF SURETY'S LIABILITY

1. Nature of surety's liability—It is co-extensive

Sec. 128 deals with the nature of the surety's liability. It provides that "the liability of the surety is *co-extensive* with that of the principal debtor, unless it is otherwise provided by the contract." In other words, the quantum of obligation of a surety is the same as that of the principal debtor unless there is a contract to the contrary.

Example. S guarantees to C the payment of a bill of exchange by P, the acceptor. The bill is dishonoured by P. S is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

The surety is liable for what the principal debtor is liable. The liability of the surety can neither be more nor less than that of the principal debtor, though by a special contract, it may be made less than that of the principal debtor, but never greater. The cardinal rule is that the surety must not be made liable beyond the terms of his engagement. Further, a creditor is not bound to proceed first against the principal debtor before suing the surety, unless otherwise agreed. He can sue the surety without suing the principal debtor.

2. Limitation of surety's liability

Although liability of the surety is co-extensive with that of the principal debtor, he may limit his liability. In this connection, a difference between a *guarantee for a part of the entire debt* and a *guarantee for the entire debt subject to a limit* may be noted.

Example. P owes C Rs. 8,000 on a continuing guarantee given by S. S may have given this guarantee in either of the following two forms :

(*i*) "I guarantee the payment of the debt of Rs. 5,000 by P to C."

(*ii*) "I guarantee the payment of any amount lent by C to P subject to a limit of Rs. 5,000."

In case (*i*), the guarantee is only for a part of the entire debt. In case (*ii*), the guarantee is for the entire debt subject to a limit. This distinction between the two forms of guarantee becomes important when P is declared insolvent. In such a case, suppose P's estate pays a dividend of 25 paise in a rupee.

If the guarantee is only for a part of the entire debt, C will recover Rs. 5,000 from S (*i.e.*, the full guaranteed amount) and Rs. 750 (1/4th of the balance of Rs. 3,000) from P's estate. S after making payment to C will step into C's shoes and recover Rs. 1,250 (being 1/4th of Rs. 5,000) from P's estate.

If the guarantee is for the entire debt subject to a limit, C will recover Rs. 5,000 from S (*i.e.*, up to the guaranteed limit) and Rs. 2,000 (1/4th of the entire debt of Rs. 8,000) from P's estate. He will, therefore, get Rs. 7,000 in all. S will not get any dividend from P's estate till the full amount of Rs. 8,000 is paid to C.

3. Liability under continuing guarantee (Sec. 129)

This will be discussed under the heading "Kinds of Guarantee".

Liability of surety when the contract between creditor and principal debtor is void or voidable

The contract between the surety and the creditor is an independent contract and not a collateral one, and there is no such thing that the

surety will be liable only if the principal debtor is liable (though it can be done so by a specific agreement). Where the original agreement is void, as in the case of a minor's agreement, the surety is liable as a principal debtor, for in such a case the contract of the surety is not a collateral contract, but a principal contract [*Kashiba* v. *Shripat*, (1895) 19 I.L.R. Bom. 697]. A creditor can fall back on the contract of guarantee (*i.e.*, the promise by the surety to make good the loss of the creditor) and enforce the liability of the surety, if the contract between the principal debtor and the creditor is found for any reason to be void or voidable. Similarly, where the creditor does not sue the principal debtor within the period of limitation the surety is not discharged [*Mahanth Singh* v. *U. Ba*, (1939) P.C. 110]. Also discharge of the principal debtor by operation of law does not discharge the surety [*Dane* v. *Mortgage Insurance Corpn., Ltd.*, (1894) 1 Q.B. 54]. The death of the principal debtor also does not release the surety from his obligations incurred during his lifetime.

However in *E.K. Nambiar* v. *V.K. Raman*, A.I.R. (1975) Mad. 164, it has been held that if the contract between the principal debtor and creditor is void, the liability of the surety does not arise as his liability is secondary. If no liability attaches to the principal debtor, the question of liability of surety does not arise. This view does not appear to be correct.

KINDS OF GUARANTEE

The function of a contract of guarantee is to enable a person to get a loan, or goods on credit, or an employment. A guarantee may therefore be given for (1) the repayment of a debt, or (2) the payment of the price of the goods sold on credit, or (3) the good conduct or honesty of a person employed in a particular office. In the last case, the guarantee is called a *'fidelity'* guarantee.

A guarantee may be given for an existing, or a future, debt or obligation. In the former case, it is called *'retrospective'* guarantee and in the latter case, *'prospective'* guarantee.

A guarantee may be in respect of a single transaction or in respect of a number of transactions.

Specific gaurantee. When a guarantee extends to a single *transaction* or debt, it is called a *specific* or *simple* guarantee. It comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

Continuing guarantee. When a guarantee extends to a *series of transactions*, it is called a *continuing* guarantee (Sec. 129). The liability of the surety in case of a continuing guarantee extends to all the transactions contemplated until the revocation of the guarantee.

Examples. (*a*) S, in consideration that C will employ P in collecting the rents of C's zamindari, promises C to be responsible to the amount of Rs. 5,000 for the due collection and payment by P of these rents. This is a continuing guarantee.

(*b*) S guarantees payment to C, a tea-dealer, to the amount of Rs. 10,000 for any tea he may from time to time supply to P. C supplies P with tea to the value of above Rs. 10,000 and P pays C for it. Afterwards C supplies P with tea to the value of Rs. 20,000. P fails to pay. The guarantee given by S is a continuing guarantee, and he is accordingly liable to C to the extent of Rs. 10,000.

Whether a guarantee is a continuing guarantee or not depends on the language of the guarantee, the subject-matter and the surrounding circumstances.

Example. "I agree to be answerable to *K* for the amount of five sacks of flour, to be delivered to *T*, payable in one month." *Held*, it was a guarantee for five sacks delivered at one time, but not a continuing guarantee to cover subsequent deliveries though not exceeding in the whole five sacks [*Kay* v. *Groves*, (1829) 6 Bing. 276].

There can be a continuing guarantee for a fixed period. A continuing guarantee only speaks of continuing transactions and not the period of such transactions [*Eastern Bank Ltd.* v. *Parts Services of India Ltd.*, A.I.R. (1986) Cal. 61].

Revocation of a continuing guarantee. A continuing guarantee can be revoked as to future transactions in the following ways :

1. *By notice.* A continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor (Sec. 130).

Examples. (*a*) *S* stands surety for *P* for any amounts which *C* may lend to *P* from time to time in the next twelve months up to a maximum of Rs. 10,000. Afterwards at the end of three months *S* revokes the guarantee when *C* had lent to *P* Rs. 3,000. This revocation discharges *S* from all laibility to *C* for any subsequent loans. But *S* is liable to *C* for Rs. 3,000 on default of *P* [*Offord* v. *Davies*, (1862) 12 C.B.N.S. 478].

(*b*) *S* guaranteed the payment of rent by *P* to *C* who let his cottage to *P* on the terms that the rent was paid initially for three months and thereafter from week to week. After the four months *S* gave notice to *C* revoking his guarantee. *Held*, *S* was not liable for the rent which became due after he had revoked his guarantee [*Wingfield* v. *de St. Croix*, (1919) 35 T.L.R. 432].

2. *By death of surety.* The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions (Sec. 131). The liability of the surety for previous transactions however remains.

3. *By other modes.* A continuing guarantee is also revoked —

(1) By novation (Sec. 62).

(2) By variance in the terms of contract (Sec. 133).

(3) By release or discharge of the principal debtor (Sec. 134).

(4) By compounding with the principal debtor (Sec. 135).

(5) By creditor's act or omission impairing surety's eventual remedy (Sec. 139).

(6) By loss of security (Sec. 141).

These modes have been explained under the topic "Discharge of Surety".

RIGHTS OF SURETY

A surety has rights against—

(1) the creditor,

(2) the principal debtor, and

(3) the co-sureties.

1. Rights against creditor

(1) *Before payment of the guaranteed debt.* A surety may, after the guaranteed debt has become due and before he is called upon to pay, require the creditor to sue the principal debtor. However, the surety will

have to indemnify the creditor for any expenses or loss resulting therefrom. In case of fidelity guarantee, the surety can ask the employer to dismiss the employee in the event of his proven dishonesty.

(2) *Right of set-off.* On being sued by the creditor, the surety can rely on any set-off or counter-claim which the debtor has against the creditor [*Bechevaise* v. *Lewis*, (1872) L.R. 7 C.P. 372].

(3) *On payment of the guaranteed debt*, the surety is subrogated to all the rights of the creditor and gets the right to demand from the creditor at the time of payment all the securities whether they had been received before, at or after, the creation of the guarantee (Sec. 141). The right exists irrespective of the fact whether the surety knows of the existence of such securities or not.

Example. *C* advances to *P*, his tenant, Rs. 2,000 on the guarantee of *S*. *C* has also a further security for Rs. 2,000 by a pledge of *P*'s furniture. *C* cancels the pledge. *P* becomes insolvent, and *C* sues *S* on his guarantee. *S* is discharged from liability to the amount of the value of the furniture.

(4) *Right to equities.* On payment of the guaranteed debt, the surety is entitled to all equities which the creditor could have enforced not only against the principal debtor himself, but also against persons claiming through him.

(5) *Right of subrogation.* Where a guaranteed debt has become due and the surety has paid all that he is liable for, he is invested with all the rights which the creditor had against the principal debtor (Sec. 140). This means on payment of the guaranteed debt, the surety steps into the shoes of the creditor.

2. Rights against principal debtor

A surety has the following two rights against the principal debtor :

(1) *Right to be relieved of liability.* Before the payment has been made, the surety can compel the principal debtor to relieve him from liability by paying off the debt. But before he can do so, the debt must be ascertained. Once the principal debtor's liability accrues as a fixed sum, the surety can ask him to exonerate him from that liability.

(2) *Right to indemnity.* In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety ; and the surety is entitled to recover from the principal debtor all payments properly made (Sec. 145). After the surety makes payment under the guarantee, he becomes a creditor of the principal debtor and can recover from the latter the amount he has paid with interest. If he sustains any damage beyond the amount paid, he can recover that damage also.

Examples. (*a*) *P* is indebted to *C*, and *S* is surety for the debt. *C* demands payment from *S* and, on his refusal, sues him for the amount. *S* defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from *P* the amount paid by him for costs, as well as the principal debt.

(*b*) *C* lends *P* a sum of money, and *S* at the request of *P* accepts a bill of exchange drawn by *P* upon *S* to secure the amount. *C* the holder of the bill demands payment of it from *S*, and on *S*'s refusal to pay, sues him upon the bill. *S*, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He

can recover from *P* the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

3. Rights against co-sureties

Right of contribution. When a debt is guaranteed by two or more sureties, they are called co-sureties. The co-sureties are liable to contribute, as agreed, towards the payment of the guaranteed debt. When one of the co-sureties makes payment to the creditor, he has a right to claim contribution from the other co-surety or co-sureties. The doctrine of contribution applicable here is not founded on contract but on equity, *i.e.*, there is equality of burden and benefit as between co-sureties. This rule is contained in Secs. 146 and 147.

(1) *Co-sureties liable to contribute equally* (Sec. 146). Where there are two or more co-sureties for the same debt or duty and the principal debtor makes a default, the co-sureties, *in the absence of any contract to the contrary*, are liable to contribute equally to the extent of the default. This principle will apply whether their liability is joint or several, and whether their liability arises under the same or different contracts, and whether with or without the knowledge of each other.

Examples. (*a*) S_1, S_2 and S_3 are sureties to *C* for the sum of Rs. 3,000 lent to *P*. *P* makes default in payment. S_1, S_2 and S_1 are liable as between themsevles to pay Rs. 1,000 each.

(*b*) S_1, S_2 and S_3 are sureties to *C* for the sum of Rs. 1,000 lent to *P* and there is a contract between S_1, S_2 and S_3 that S_1 is to be responsible to the extent of one-quarter, S_2 to the extent of one-quarter, and S_3 to the extent of one-half. *P* makes default in payment. As between the co-sureties S_1 is liable to pay Rs. 250, S_2 Rs. 250 and S_3 Rs. 500.

(2) *Liability of co-sureties bound in different sums* (Sec. 147). Where the co-sureties have agreed to guarantee different sums, they have to contribute equally subject to the maximum amount guaranteed by each one. The fact that the sureties are liable jointly or severally under one contract or several contracts, or without the knowledge of each other, is immaterial.

As between co-sureties, the right of contribution arises only when a co-surety has paid more than he is liable to pay. And if a co-surety obtains from the creditor any security of the principal debtor, the other co-sureties have a right to share in the proceeds of the security.

To sum up, it may be said that, between co-sureties, there is equality of burden and benefit.

Example. S_1, S_2 and S_3, as sureties for *P*, enter into three separate bonds each in a different penalty, namely, S_1 in the penalty of Rs. 10,000, S_2 in that of Rs. 20,000 and S_3 in that of Rs. 40,000, conditioned for *P*'s duly accounting to *C*. *P* makes default to the extent of (*i*) Rs. 30,000, (*ii*) Rs. 40,000, and (*iii*) Rs. 60,000.

In case (*i*), S_1, S_2 and S_3 are each liable to pay Rs. 10,000.

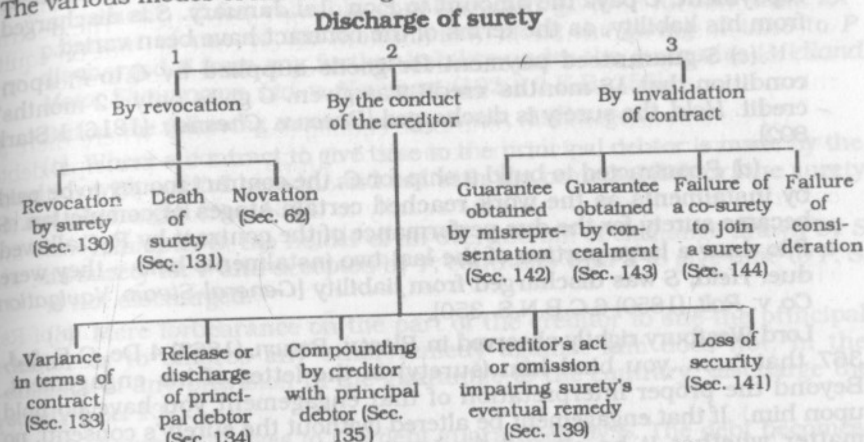
In case (*ii*), S_1 is liable to pay Rs. 10,000 and S_2 and S_3 Rs. 15,000 each.

In case (*iii*), S_1, S_2 and S_3 are liable to pay Rs. 10,000, Rs. 20,000 and Rs. 30,000 respectively.

(3) *Release of a co-surety.* Where there are co-sureties, a release by the creditor of one of them does not discharge the others, neither does it free the surety so released from his responsibility to the other sureties (Sec. 138).

DISCHARGE OF SURETY

A surety is said to be discharged when his liability comes to an end. The various modes of his discharge are shown in the chart given below :



1. Discharge of surety by revocation

(1) *Revocation by surety by giving a notice.* A specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor (Sec. 130). But the surety remains liable for transactions already entered into.

(2) *Revocation by death.* The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions (Sec. 131). The deceased surety's estate will not be liable for any transactions entered into between the creditor and the principal debtor after the death of the surety, even if the creditor has no notice of the death.

(3) *Revocation by novation* (Sec. 62). Novation means substitution of a new contract of guarantee for an old one either between the same parties or between one of the old parties and a new party, the consideration for the new contract being the mutual discharge of the old contract. The original contract of guarantee in such a case comes to an end.

2. Discharge of surety by the conduct of the creditor

(1) *Variance in terms of contract.* A surety is liable for what he has undertaken in the contract. When the terms of the contract between the principal debtor and the creditor are varied without the surety's consent, the surety is discharged as to the transactions subsequent to the variance (Sec. 133). But where the guarantee is for the performance of several *distinct* duties or obligations or for the payment of distinct debts, a variance in the nature of one of them will not discharge the surety as to the rest. Where the guarantee is a continuing one, any such variance will discharge the surety as to the transactions subsequent to variance.

Examples. (*a*) *C* agrees to appoint *P* as a salesman to sell goods at a yearly salary, upon *S*'s becoming surety to *C* for *P*'s duly accounting for money received by him as a salesman. Afterwards without *S*'s knowledge or consent, *C* and *P* agree that *P* should be paid by a commission on the goods sold by him and not by a fixed salary. *S* is not liable for subsequent misconduct of *P*.

(*b*) *C* contracts to lend *P* Rs. 5,000 on 1st March. *S* guarantees repayment. *C* pays the amount to *P* on 1st January. *S* is discharged from his liability, as the terms of the contract have been varied.

(*c*) *S* guaranteed payment for goods supplied by *C* to *P*, upon condition that 18 months' credit was given. *C* gives only 12 months' credit. *Held*, the surety is discharged [*Bacon* v. *Chesney*, (1816) 1 Stark 892].

(*d*) *P* contracted to build a ship for *C*, the contract money to be paid by instalments as the work reached certain stages of completion. *S* became surety for the due performance of the contract by *P*. *C* allowed *P* to draw a large portion of the last two instalments before they were due. *Held*, *S* was discharged from liability [*General Steam Navigation Co.* v. *Rolt*, (1859) 6 C.B.N.S. 350].

Lord Westbury rightly observed in *Blest* v. *Brown*, (1862) 4 De. G.F. & J. 367 that "........you bind him (surety) to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him. If that engagement be altered (without the surety's consent), no matter whether it be altered for his benefit, no matter whether the alteration be innocently made, he has a right to say, 'The contract is no longer that for which I engaged to be surety ; you have put an end to the contract that I guaranteed and my obligation therefore is at an end'."

It is immaterial whether the variation is prejudicial to the surety or not, the principle being, "if the creditor does intentionally violate any right which the surety had when he entered into the suretyship, even though the damage be nominal only, he shall forfeit the whole remedy." [Blackburn, J. in *Polak* v. *Everett*, (1876) 1 Q.B.D. 669].

(2) *Release or discharge of principal debtor.* The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released. The surety is also discharged by any act or omission of the creditor, the legal consequence of which is discharge of the principal debtor (Sec. 134). But the surety is not discharged by operation of law.

Examples. (*a*) *C* employs *P* at one place on *S* standing surety for *P*. This employment is terminated. *C* employs *P* afresh at a different place, taking a security bond from another person. *S* is discharged.

(*b*) *P* contracts with *C* for a fixed price to build a house for *C* within a stipulated time, *C* supplying the necessary timber. *S* guarantees *P*'s performance of the contract. *C* omits to supply the timber. *S* is discharged from his suretyship.

(*c*) *P* contracts with *C* to grow a crop of indigo on his (*P*'s) land, and to deliver it to *C* at a fixed rate. *S* guarantees *P*'s performance of this contract. *C* diverts a stream of water which is necessary for irrigation of *P*'s land and thereby prevents him from raising the indigo. *S* is no longer liable on his guarantee.

However the omission of the creditor to sue within the period of limitation does not discharge the surety.

(3) *Compounding by creditor with principal debtor.* A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract (Sec. 135).

Example. *P* purchased a motor car fom *C* under a hire-purchase agreement on guarantee of *S* for the due performance of the agreement. *C* for valuable consideration gives *P* further time for payment of one of the instalments. *Held*, the giving of time to *P* discharged *S* from any further liability under the guarantee [*Midland Motor Showrooms, Ltd.* v. *Newman*, (1929) 2 K.B. 256].

But in the following cases a surety is not discharged :

(*a*) Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged (Sec. 136).

Example. *C*, the holder of an overdue bill of exchange drawn by *S* as surety for *P* and accepted by *P*, contracts with *T* to give time to *P*. *S* is not discharged.

(*b*) Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety (Sec. 137).

Example. *P* owes to *C* a debt guaranteed by *S*. The debt becomes payable. *C* does not sue *P* for a year after the debt has become payable. *S* is not discharged from his suretyship.

(*c*) Where there are co-sureties, a release by the creditor of one of them does not discharge the others ; neither does it free the surety so released from his responsibility to the other sureties (Sec. 138).

(4) *Creditor's act or omission impairing surety's eventual remedy.* If the creditor does any act which is inconsistent with the rights of the surety, or omits to do some act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged (Sec. 139).

Examples. (*a*) *P* contracts to build a ship for *C* for a given sum to be paid by instalments as the work reaches certain stages. *S* becomes surety to *C* for *P*'s due performance of the contract. *C*, without the knowledge of *S*, prepays to *C* the last two instalments. *S* is discharged by this prepayment.

(*b*) *S* puts *P* as apprentice to *C* and gives a guarantee to *C* for *P*'s fidelity. *C* promises on his part that he will, at least once a month, see *P* make up the cash. *C* omits to see this done as promised and *P* embezzles. *S* is not liable to *C* on his guarantee.

(*c*) *S* gives a guarantee for the fidelity of the manager of a bank. The manager indulges in some malpractices to which the directors wilfully shut their eyes. *S* stands discharged from the obligation by conduct of the directors.

Again if the creditor does some act which by implication releases the principal debtor from his liability, the surety is discharged.

Example. *C* let some goods to *P* under a hire-purchase agreement. *S* guaranteed the instalments payable under the agreement. On the instalments being in arrear, *C* determined the contract and seized the

goods, and then sued S on his guarantee. *Held*, as C had determined the contract, he could not recover from S [*Hewison* v. *Rickets*, (1894) 63 L.J.Q.B. 711].

(5) *Loss of security*. If the creditor loses or, without the consent of the surety, parts with any security given to him at the time of the contract of guarantee, the surety is discharged from liability to the extent of the value of security (Sec. 141). If there are two or more debts each secured by separate security, the surety for one of the debts is not discharged if the creditor loses or parts with the security or securities relating to other debts.

Examples. (*a*) C advances to P, his tenant, Rs. 2,000 on the guarantee of S. C has also a further security for Rs. 2,000 by a pledge of P's furniture. C cancels the pledge. P becomes insolvent, and C sues S on his guarantee. S is discharged from liability to the amount of the value of the furniture.

(*b*) C, a creditor, whose advance to P is secured by a decree, receives also a guarantee for that advance from S. C afterwards takes P's goods in execution under the decree, and then, without the knowledge of S, withdraws the execution. S is discharged.

3. Discharge of surety by invalidation of contract

(1) *Guarantee obtained by misrepresentation*. Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid (Sec. 142).

(2) *Guarantee obtained by concealment*. Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid (Sec. 143).

Examples. (*a*) C engages P as a clerk to collect money for him. P fails to account for some of his receipts and C, in consequence, calls upon him to furnish security for his duly accounting. S gives his guarantee for P's duly accounting. C does not acquaint S with P's previous conduct. P afterwards makes default. The guarantee is invalid.

(*b*) S guarantees to C payment for iron to be supplied by him to P to the extent of 2,000 tons. P and C have privately agreed that P should pay C Rs. 500 per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from S. S is not liable as a surety.

(3) *Guarantee on contract that creditor shall not act on it until a co-surety joins*. Where a person gives a guarantee upon a contract that a creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join (Sec. 144). This means if the surety agrees to be only one of several co-sureties, he will not be liable unless the others execute the guarantee.

Example. S_2 signed a guarantee given to a bank which, on the face of it, was intended to be the joint and several guarantee of S_1, S_2, S_3 and S_4. S_4 did not sign and he afterwards died. The bank did not agree with S_1, S_2 and S_3 to dispense with S_4's signatures. Held, S_2 was not liable [*National Provincial Bank of England* v. *Brackenbury*, (1966) 22 T.L.R. 727].

(4) *Failure of consideration*. Where in a contract of guarantee there is a failure of consideration as between the creditor and the principal debtor, the surety is discharged.

SUMMARY

CONTRACT OF INDEMNITY

A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a 'contract of indemnity' (Sec. 124). The person who promises to make good the loss is called the *indemnifier* (promisor) and the person whose loss is to be made good is called the *indemnified* (promisee) or *indemnity-holder*

A contract of indemnity is a species of the general contract. It must as such have all the essential elements of a valid contract. It may be *express* or *implied*.

CONTRACT OF GUARANTEE

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 (Sec. 126).

A contract of guarantee must have all the essential elements of a valid contract. But the principal debtor may be a person suffering from incapacity to contract and it is not necessary that the contract must necessarily result in some benefit to the surety himself.

Kinds of guarantee. A guarantee may be given (1) for the payment of a debt, or (2) for the payment of the price of the goods sold on credit, or (3) for the good conduct or honesty of a person employed in a particular office, in which case the guarantee is called a 'fidelity guarantee'. A guarantee may also be a *specific* or *simple* guarantee (which extends to a *single transaction*) or a *continuing* guarantee which extends to a *series of transactions* (Sec. 129).

Nature of surety's liability. The liability of the surety is *co-extensive* with that of the principal debtor, unless it is otherwise provided by the contract (Sec. 128).

RIGHTS OF SURETY

1. *As against the creditor*. (1) Before payment of the principal debt, a surety can file a suit for declaration that the principal debtor shall be the person liable to pay the amount.

(2) On payment of the principal debt, the surety steps into the shoes of the creditor, *i.e.*, he is entitled to be placed in the position of the creditor.

2. *As against the debtor*. The surety, upon payment of performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor (Sec. 140). He is also entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully (Sec. 145).

3. *As against the co-sureties*. The co-sureties are, in the absence of any agreement to the contrary, liable to contribute equally (Sec. 146). If they are bound in different sums, they are liable to pay equally as far as the limits of their respective obligations permit (Sec. 147). As between co-sureties, there is *equality of burden and benefit*.

DISCHARGE OF SURETY

A surety is discharged from liability :

1. *By revocation*. This includes revocation by (1) surety by giving a notice (Sec. 130), (2) death of surety (Sec. 131), and (3) novation (Sec. 62).

2. *By conduct of creditor*. This covers cases of (1) variance in terms of contract (Sec. 133), (2) release or discharge of principal debtor (Sec. 134), (3) compounding by creditor with principal debtor (Sec. 135), (4) creditor's act or omission impairing surety's eventual remedy (Sec. 139), and (5) loss of security (Sec. 141)

3. *By invalidation of contract*. This includes guarantee (1) obtained by misrepresentation (Sec. 142) or concealment (Sec. 143), (2) given on a condition that the creditor shall not act upon it until a co-surety joins the surety and the co-surety does not join (Sec. 144). A surely is also discharged where there is failure of consideration.

TEST QUESTIONS

1. What is a contract of indemnity ? Illustrate your answer.
2. Explain and illustrate the distinction between a contract of indemnity and a contract of guarantee. What is the nature of an insurance contract ?

3. What are the rights of an indemnity-holder when sued ? What is the time of commencement of the indemnifier's liability ?
4. What is the nature of a surety's authority ? State his rights against (i) the creditor, (ii) the principal debtor, and (iii) the co-sureties.
5. What is a continuing guarantee ? When and how is it revoked ?
6. (a) "The liability of surety is secondary".
(b) "The liability of surety is co-extensive with that of the principal debtor"
(c) "The surety is a favoured debtor." Discuss these statements.
7. On payment of the debt, what are the rights of the surety against (a) the creditor, (b) the principal debtor, and (c) the co-securities ? Can he exercise these rights before actually making the payment.
8. State the circumstances in which a surety is discharged from liability.
9. (a) When is a contract of guarantee held to be invalid ?
(b) Does the creditor's omission to sue the principal debtor within the period of limitation discharge the surety ?
(c) Is the surety discharged if without his knowledge the creditor accepts interest in advance from the principal debtor ?
10. Comment on the following statements :
(a) A surety is undoubtedly and not unjustly an object of some favour both at law and at equity.
(b) The liability of a surety is co-extensive with that of the principal debtor.
(c) The death of a surety puts an end to the contract of guarantee.
(d) Between co-sureties there is equality of burden and benefit.

PRACTICAL PROBLEMS

Attempt the following problems, giving reasons :

1. X and Y go into a shop. X says to the shopkeeper, "Let Y have the goods and if he does not pay, I will." What kind of contract is this ? Would it make any difference in your answer if X had said to the shopkeeper, "Let Y have the goods. I will see you paid" ?
[*Hint* : The first contract is one of guarantee ; the second contract is one of indemnity (*Birkmyur v. Darnell*)].
2. X lent money to Y on the recommendation of Z. Subsequently Z promised to pay the amount to X in default of Y. (a) Can X recover from Z the amount from Z? (b) Can X recover from Z if Z had gone along with Y to X and said to the latter, "Please give the money to Y and if he does not pay, I will" ?
[*Hint* : (a) No. (b) Yes].
3. C guarantees A against trade debts to B contracted by B as a running balance of account to any amount not exceeding Rs. 3,000 and B becomes indebted to A for Rs. 5,000. Afterwards, B is adjudged insolvent and a dividend of 50 paise in the rupee is declared. State the amounts that A will get from C and from B's estate.
[*Hint* : A will get Rs. 2,500 (one-half of Rs. 5,000) from B and the balance Rs. 500 (Rs. 3,000 -- Rs. 2,500) from C].
4. A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards C obtains from B a further security for the same debt. Subsequently C gives up the further security. Is A discharged ?
[*Hint* : No (Sec. 141)].
5. A contracted to buy from B 100 bales of cotton at Rs. 5,000 per bale for the March, 1991 delivery. The performance of this contract by B was guaranteed by C. Soon after, A contracted to sell to B 10 bales of cotton of the same kind at Rs. 6,000 per bale, for the same delivery. Is C discharged from his guarantee ?
[*Hint* : No, as the second agreement is an independent one].
6. A stands as a surety for the good conduct of B who is employed by a bank on a monthly salary of Rs. 1,600. Three months after when the financial position of the bank deteriorates, B agrees to accept a monthly salary of Rs. 1,500. Two months after, it is discovered that B has been misappropriating cash all through. What is the liability of A ?
[*Hint* : A is liable as a surety for the loss suffered by the banker due to misappropriations by A during the first three months only (Sec. 133)].
7. A advances to B, a minor, Rs. 5,000 on the guarantee of C. On demand for repayment, B refuses to pay on the ground of his minority. Can A recover the amount from C ?
[*Hint* : Yes].

8. B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. Is A discharged from his suretyship ?
[*Hint* : No (Sec. 133)].
9. C contracts to lend B Rs. 5,000 on 1st March, 1991. A guarantees payment. C pays Rs. 5,000 on 1st January, 1991. Is A liable if B makes a default ?
[*Hint* : No (Sec. 133)].
10. A, B and C as sureties for D enter into three bonds, each in a different penalty, namely, A in the penalty of Rs. 10,000, B in that of Rs. 20,000 and C in that of Rs. 40,000 conditioned for D's duly accounting to E. D makes default to the extent of (i) Rs. 30,000 ; (ii) Rs. 40,000 ; (iii) Rs. 50,000 ; (iv) Rs. 60,000 ; (v) Rs. 70,000 ; (vi) Rs. 80,000. Apportion the liabilities of A, B and C.
[*Hint* : The liability of A, B and C respectively in different cases will be as follows : Case (i) Rs. 10,000, Rs. 10,000, Rs. 10,000. Case (ii) Rs. 10,000, Rs. 15,000, Rs. 15,000. Case (iii) Rs. 10,000, Rs. 20,000, Rs 20,000. Case (iv) Rs. 10,000, Rs. 20,000, Rs. 30,000. Cases (v) and (vi) Rs. 10,000, Rs. 20,000, Rs. 40,000].
11. B appointed A as his agent to collect his rents and required him to execute a fidelity bond in which C was surety. Some time after the execution of the bond, C died. A committed various acts of dishonesty after C's death. Is C's estate liable for loss caused to B ?
[*Hint* : No (Sec. 131)].
12. A undertakes to build a house for B within a certain period, B supplying the necessary materials. C guarantees the performance of the contract. B fails to supply the necessary materials. Discuss the position of C.
[*Hint* : C is discharged of liability (Sec. 134)].
13. A sells and delivers goods to B. C afterwards without consideration agrees to pay for them in default of B. Is the agreement valid and enforceable ?
[*Hint* : No, as the agreement is void for want of consideration (Sec. 127)].
14. S guaranteed C against the misconduct of P in an office to which P is appointed by C and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, P misconducts himself in respect of a duty not affected by the latter Act. Is S liable as a surety ?
[*Hint* : No. S is not liable for P's misconduct (Sec. 133)].
15. A agrees to indemnify B, a newspaper proprietor, against claims arising out of the libels printed in the newspaper concerning a person of repute. Is this a valid agreement ?
[*Hint* : No, as the consideration is unlawful (Sec. 23)].
16. A stands as a surety for the good conduct of B who is employed in a bank. B misappropriates some moneys but the bank excuses him without informing A of B's misconduct. B again misappropriates. Is A liable to the bank ?
[*Hint* : No (Sec. 139)].
17. C advances to B, his tenant, Rs. 2,000 on the guarantee of A. C has also a further security for Rs. 2,000 by a pledge of B's furniture. C cancels the pledge. B becomes insolvent. Has C any claim against A ?
[*Hint* : C has a claim against A for Rs. 2,000 *less* the value of furniture (Sec. 141)].
18. B owes A Rs. 10,000 and C has stood surety for Rs. 6,000. B becomes insolvent and a dividend of 25 paise in a rupee is declared out of his estate. Discuss the right of A and C if the guarantee was (i) limited to Rs. 6,000 out of the total debt, or (ii) extended to the whole debt subject to a limit of Rs. 6,000.
[*Hint* : In case (i), A can recover Rs. 6,000 from C (*i.e.*, the full guaranteed amount) and Rs. 1,000, (*i.e.*, one-fourth of the balance Rs. 4,000) from B's estate. C can recover Rs. 1,500 (being one-fourth of Rs. 6,000) from B's estate. In case (ii) A can recover Rs. 6,000 from C and Rs. 2,500 (one-fourth of the entire debt of Rs. 10,000) from B's estate].
19. Calls on shares by P in A Ltd. were guaranteed by S. On non-payment of the last call, the company forfeited the shares. Is S discharged of his liability ?
[*Hint* : Yes. Sec. 141)].

2

Bailment and Pledge

Contracts of bailment and pledge are a special class of contracts. These are dealt with in Chapter IX (Secs. 148 to 181) of the Indian Contract Act, 1872. The Contract Act, however, does not deal with all types of bailments. There are separate Acts, *e.g.*, the Carriers Act, 1865, the Railways Act, 1989, the Carriage of Goods by Sea Act, 1925, which deal with special types of bailments. The Contract Act deals with the general principles underlying contracts of bailment.

BAILMENT

The word 'bailment' is derived from the French word '*ballier*' which means '*to deliver*'. Etymologically, it means any kind of 'handing over'. In legal sense, it involves change of possession of goods from one person to another for some specific purpose.

Sec. 148 defines 'bailment' as 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*' and the person to whom they are delivered is called the '*bailee*'.

Examples. (*a*) *A* delivers a piece of cloth to *B*, a tailor, to be stitched into a suit. There is a contract of bailment between *A* and *B*.

(*b*) *A* lends a book to *B* to be returned after the examination. There is a contract of bailment between *A* and *B*.

(*c*) *A* sells certain goods to *B* who leaves them in the possession of *A*. The relationship between *B* and *A* is that of bailor and bailee.

(*d*) An insurance company places a damaged insured car of *A* in possession of *R*, a repairer. *A* is the bailor, the insurance company is the bailee, and *R* is the sub-bailee [*N.R. Srinivasa Iyer* v. *New India Ass. Co. Ltd.*, A.I.R. (1983) S.C. 899].

Sometimes there may be bailment even without a contract. For example, when a person finds goods belonging to another, a relationship of bailee and bailor is automatically created between the finder and the owner.

Example. *E*'s ornaments having been stolen and recovered by the police disappeared from police custody. *Held*, the State was liable, the contract of bailment having been implied [*Basavva K.D. Patil* v. *State of Mysore*, (1977) 4 S.C.C. 358].

Requisites of bailment

1. *Contract.* A bailment is usually created by agreement between the bailor and the bailee. The agreement may be express or implied. In certain exceptional cases, bailment is implied by law as between a finder of goods and the owner.

2. *Delivery of possession.* A bailment necessarily involves delivery of possession of goods by bailor to bailee. The basic features of possession are *control* and an *intention to exclude others*. As such, mere custody of goods does not create relationship of bailor and bailee. A servant who

receives certain goods from his master to take to a third party has mere *custody* of the goods ; possession remains with the master and the servant does not become a bailee.

Example. A lady employed a goldsmith for melting her old jewellery and making new one out of it. Every evening she received the unfinished jewellery and put it into a box kept at the goldsmith's premises. She kept the key of that box with herself. One night the jewellery was stolen from the box. *Held*, there was no bailment as the goldsmith had re-delivered to the lady (the bailor) the jewellery bailed with him by her [*Kaliperumal* v. *Visalakasmi*, A.I.R. (1938) Mad. 32].

Delivery of possession may be *actual* or *constructive*. Actual delivery may be made by physically handing over the goods bailed to the bailee. Constructive or symbolic delivery may be made by doing some thing which has the effect of putting the goods in the possession of the intended bailee or any person authorised to hold them on his behalf (Sec. 149). This means possession is transferred to the bailee without actually handing over the goods physically. The delivery of a railway receipt amounts to delivery of the goods.

3. *For some purpose.* The delivery of goods from bailor to bailee must be for some purpose. If goods are delivered by mistake to a person, there is no bailment.

4. *Return of specific goods.* It is agreed between the bailor and the bailee that as soon the purpose is achieved, the goods shall be returned or disposed of according to the directions of the bailor. If the goods are not to be specifically returned, there is no bailment. But there is a bailment even if the goods bailed are, in the meantime, altered in form, *e.g.*, when a piece of cloth is stitched into a suit.

Bailment is concerned only with goods. Goods, as defined in Sec. 2 (7) of the Sale Goods Act, 1930, mean every kind of movable property other than money and actionable claims. Moreover, in a contract of bailment it is only *possession* that passes from the bailor to the bailee and *not ownership*. Thus if the property in goods is transferred for money consideration, it is a sale and not a bailment. Similarly where money is deposited in a banking account (not in a safe deposit vault), the relationship of debtor and creditor is created ; there is no bailment. The bank is not liable to return, when asked to do so, the very same money.

Other examples of bailment. (*a*) A hire-purchase contract. It is not merely a contract of bailment. It has two aspects ; a bailment *plus* an element of sale [*Instalment Supply (Pvt.) Ltd.* v. *Union of India*, A.I.R. (1962) S.C. 53].

(*b*) Seizure of goods by custom authorities, who after seizure are in the position of a bailee [*State of Gujarat* v. *M.M. Haji Hassan*, A.I.R. (1967) S.C. 885].

(*c*) Acceptance of goods by a transport company or railway for carriage [*Shiv Nath* v. *Union of India*, A.I.R. (1965) S.C. 1666].

(*d*) Acceptance of articles by Post-Office as Value Payable Parcel [*Income-tax Commr.* v. *P.M. Rathod*, A.I.R. (1959) S.C. 1394].

Consideration in a contract of bailment

In a contract of bailment, the consideration is generally in the form of money payment either by the bailor or the bailee, as for example, when