

Chapter 6
Special Contracts

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Learning Objectives

- Explain the basic principles of special contract laws
- Describe the features of the contract of indemnity and guarantee
- Familiarise with the terms bailment, pledge and finder of goods
- Discuss the contract of agency
- Outline the importance of contract management



Indemnity and Guarantee

The Indian Contract Act, 1872 can be viewed and interpreted in two parts:

The general principles related to
the law of contract

Special Contracts

The special contracts are further divided into three types, namely:

Contract of
Indemnity and
Guarantee

Contract of
Bailment and
Pledge

Contract of
Agency



Indemnity and guarantee are special contracts having all the essentialities of a valid contract, e.g., consideration, competency of the parties, free consent, legal object, etc.

The special legal provisions of these contracts are contained in Sections 124 to 147 of the Indian Contract Act.



Contract of Indemnity

The term 'indemnity' literally means 'making somebody safe' or 'paying somebody back'. It means security or protection against any financial liability.

It normally takes place in the form of a contractual agreement made between two parties wherein one party agrees to pay for losses or damages incurred by the other party.

According to Section 124 of the Indian Contract Act 1872, "A contract by which one party promises to save the other, from loss caused to him by the conduct of the promise himself or by the conduct of any other person, is called a contract of indemnity."



Contract of Guarantee

The object of the contract of guarantee is to enable a person to obtain employment, a loan, or some goods or service on credit.

According to Section 126 of the Indian Contract Act, 1872, “A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default.”

Guarantee is an undertaking by one person to pay a third party the amount due from another person.

The person who gives the guarantee is called the ‘surety’ or ‘guarantor’ and 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’ or ‘beneficiary’.



Parties Involved In The Contract Of Indemnity And Guarantee

Parties involved in the Contract of Indemnity

The contract of indemnity includes two parties, namely indemnifier and indemnity holder. The party who gives indemnity or promises compensation for or to make up the loss, is called an 'Indemnifier' and the party for whose protection or safety, the indemnity/compensation is given or the party whose loss is made good is called 'indemnified' or 'indemnity holder'.

Parties involved in the Contract of Guarantee

A guarantee contract includes three parties, namely creditor, principal debtor and surety. The person who grants loan is called 'creditor', the one who takes the loan is the 'principal debtor' and the one who stands guarantee for the payment of loan is called a 'surety or guarantor'. In the case of a guarantee contract, the principal debtor has the primary liability, whereas the secondary liability is of the surety.



Difference between the Contract of Indemnity and the Contract of Guarantee

S. No.	Point of Difference	Contract of Indemnity	Contract of Guarantee
1	Number of Parties	There are two parties, namely Indemnifier and Indemnified/Indemnity Holder	There are three parties, namely Creditor, Principal debtor and Surety
2	Number of Contracts	One contract	3 independent contracts between the principal debtor and creditor; between the principal debtor and surety; and between the creditor and surety.
3	Nature of Liability	Liability of indemnifier is primary	Primary liability is of principal debtor. Liability of surety is secondary arising only on default by the principal debtor.
4	Risk	Liability of indemnifier is contingent	Liability of surety is an existing one
5	Right of Recovery	After compensating the loss of indemnity-holder, the money cannot be recovered from anyone by the indemnifier	If surety makes payment to the creditor, he/she/it (surety) can recover that amount from the principal debtor
6	Interest of Parties	Indemnifier may have other interest than indemnity such as a Del Credere agent getting commission in return for indemnification	Surety has no interest in the transaction apart from guarantee



Kinds of Guarantee

Kinds of Guarantee

Specific Guarantee

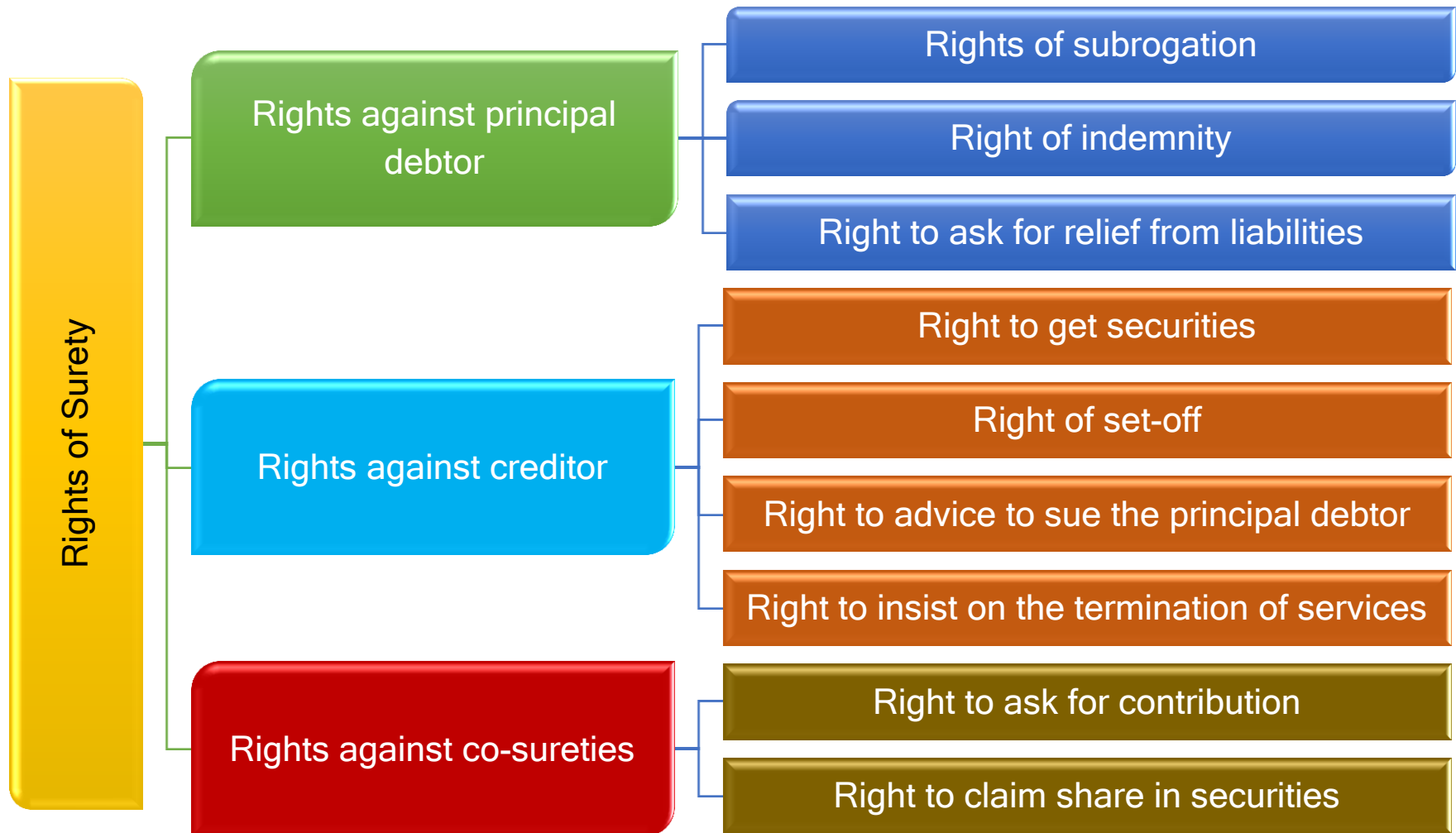
Continuing Guarantee

It is a guarantee given for a specific transaction. Such a guarantee comes to an end as soon as the transaction is duly performed or the debt is duly discharged.

Continuing guarantee under Section 129 is a guarantee which extends to a series of transactions or debts and does not come to an end on the performance of a single transaction. However, the surety can fix up a limit on the extent of his liability. Thus, a continuing guarantee can be for a fixed amount or period.



Rights Of Surety Against Principal Debtor And Creditor



Discharge of Surety

A surety is supposed to be discharged from liability when his/her liability under the contract ceases.

Various modes of discharge of the surety are as under:

By notice of revocation of the surety

By death of the surety

By variance in terms of contract (Section 133)

By release or discharge of the principal debtor (Section 134)

By composition with the principal debtor (Section 135)

By giving more time to the principal debtor (Section 135)

By loss of security (Section 141)

Invalidation of the contract of guarantee (in between the creditor and the surety)



Rights of the Indemnified in Contract of Indemnity

Under Section 125, the indemnity holder has the following rights:

Rights to claim for
all damages/losses
[Section 125(1)]

The indemnified has the right to recover all the damages which he/she had paid in any suit from the indemnifier, in respect of the contract of indemnity.

Rights to claim for
all costs which are
related to the
contract

The indemnified has the right to recover from the indemnifier all costs which he had paid in bringing or defending any suit in respect of a contract of indemnity.

Rights to claim for
all sums which he
may have paid for
the contract

The indemnified has the right to recover the whole amount from the indemnifier, which he had paid under the terms of the compromise of such suit.



Commencement of Indemnifier's Liability

As per the Indian Contract Act, there is no provision regarding the time of commencement of the indemnifier's liability.

Thus, the purpose of knowing the time of commencement of indemnifier's liability, i.e., when does the indemnifier become liable to pay, we have a look into the observations of the courts in various judicial decisions.

As there is a difference of opinion among different high courts, some have held that the indemnifier is not liable until the indemnified has incurred an actual loss.

Some high courts have held that the indemnifier becomes liable to pay even before the indemnified had incurred the actual loss.

The latter view is generally accepted and it lays down the equitable principle that as soon as the liability of the indemnified to put him in a position to meet the claim.

Following judicial observations are worth noting in this regard: *"Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay."*



Bailment, Pledge and Finder of Goods

Bailment

Bailment under Section 148 of the Indian Contract Act, 1872 is:

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

Pledge

As per Section 172 of the Indian Contract Act, 1872, pledge (or pawn) is defined as under:

*The bailment of goods as security for payment of a debt or performance of a promise. The person who offers security is called a *pawner (or pledgor)* and the person to whom the goods are delivered as security for the payment of a debt or performance of promise is called the Pawnee or Pledgee. Therefore, in the case of a pawn or pledge (i) there should be bailment of goods, and (ii) the object of such bailment should be to hold the goods as a security for the payment of a debt or performance of promise and not for safe custody or any other purpose.*



Nature And Essential Features Of Bailment And Pledge

Bailment includes the following elements:

Agreement

There should be an agreement between the bailor and the bailee. This agreement could be either expressed or implied. However, a bailment is implied by the law too. For example, the bailment between a finder and the owner of goods.

Delivery of goods

The delivery of goods must take place. It means that the possession of goods must be transferred by the bailor to the bailee for some purpose on a contract.

Purpose

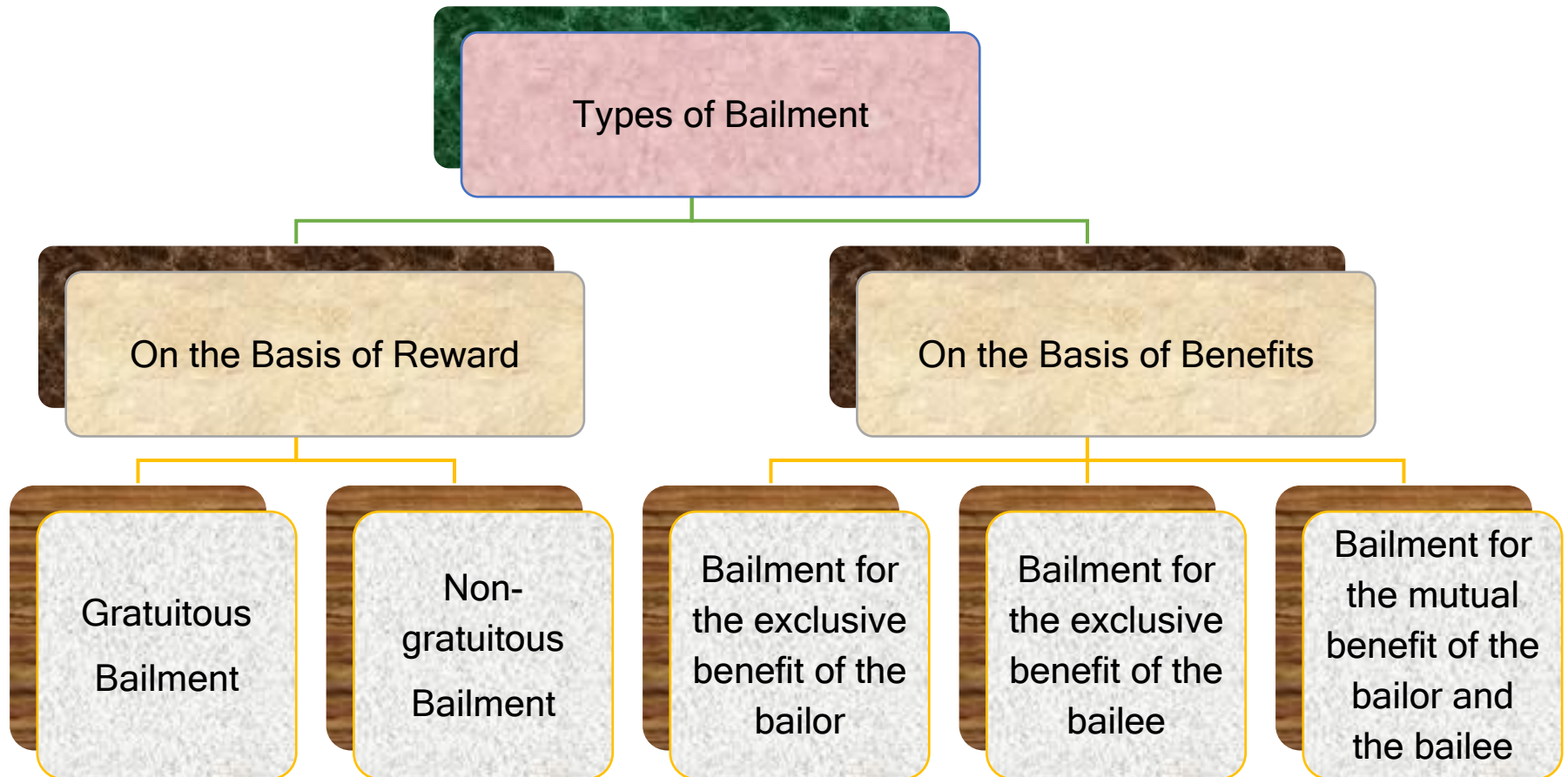
There should be some intended purpose for the delivery of goods. For example, wrong delivery of goods to Jaipur Roadways instead of Patel Roadways does not create any bailment.

Return of specific goods

Goods which are the subject matter of a bailment should be returned to the bailor or else disposed of according to the bailor's directions after the purpose is achieved or after the period of the bailment is expired.



Kinds of Bailment



Bailment for Reward and Gratuitous Bailment

Gratuitous bailment is a kind of a contract of bailment wherein no consideration passes from the bailor and the bailee.

In this type of bailment, neither the bailor nor the bailee is entitled to any remuneration or reward.

Such a kind of bailment may be for the full benefit of either of the parties.

Bailment for the exclusive benefit of the bailor:

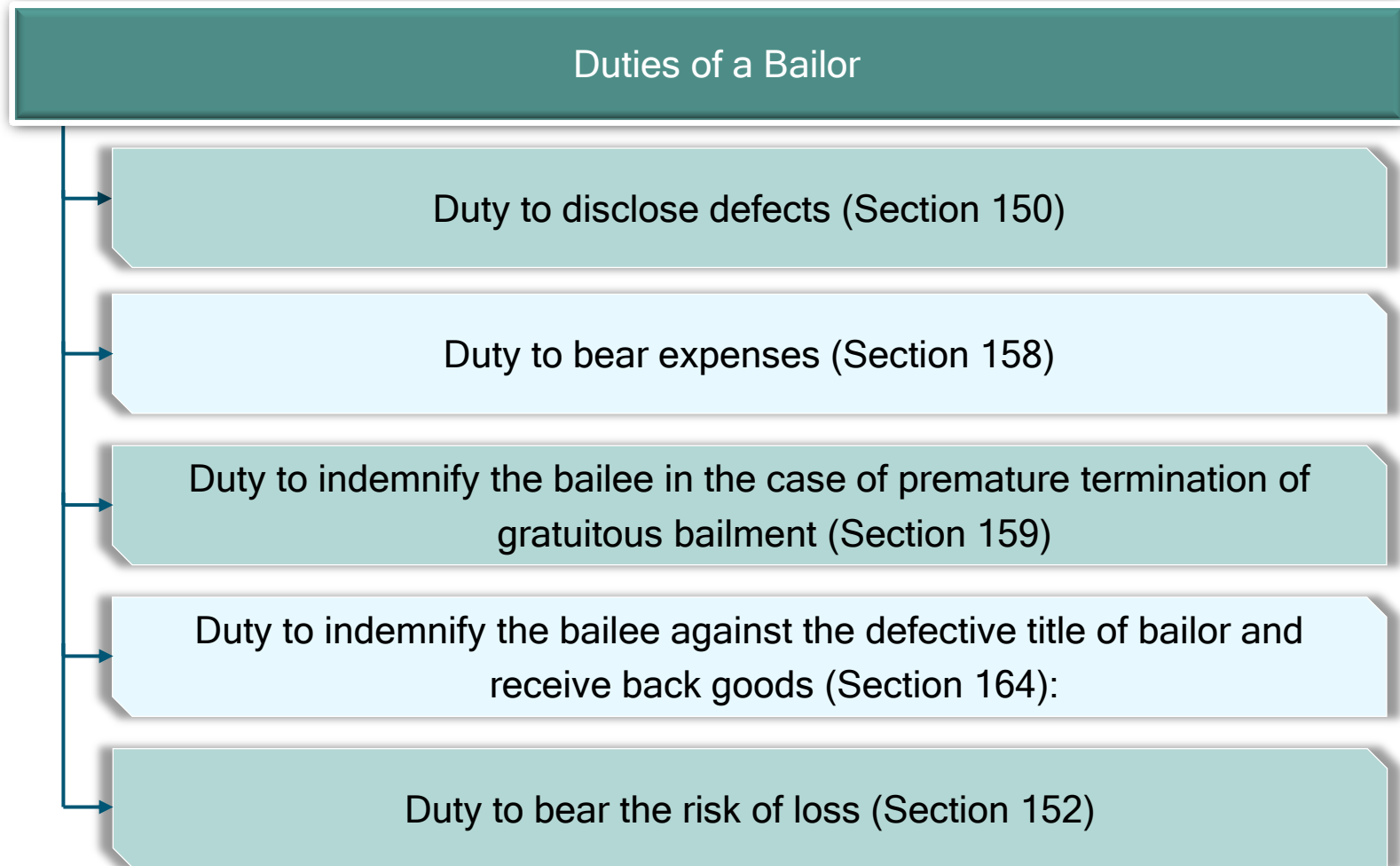
In this case, goods delivered by the bailor are for the exclusive benefits and the bailee does not derive any benefit out of it.

Bailment for the exclusive benefit of the bailee:


This is the case where the goods are delivered by the bailor to the bailee for the bailee's exclusive benefits and the bailor does not gain anything from the contract himself.



Duties and Rights of a Bailor



Rights of a Bailor



Right to claim damage in the case of negligence (Section 152)

Right to terminate the contract in the case of an unauthorised use (Section 153)

Right to claim compensation in case of an unauthorised use (Section 154)

Right to claim the separation of goods in case of unauthorised mixture of goods (Section 156)

Right to claim compensation in the case of unauthorised mixture of goods which cannot be separated (Section 157)

Right to demand return of goods (Section 160)

Right to claim compensation in case of unauthorised retention of goods (Section 161)

Right to demand accretions to goods (Section 163)



Duties and Rights of a Bailee

Duties of a Bailee




Duty to take care of the goods bailed (Sections 151 & 152)

Duty not to make any unauthorised use of goods (Section 154)

Duty not to mix bailer's goods with his own goods (Section 155 to 157)

Duty to return the goods (Sections 160 & 161)

Duty to return accretion to the goods (Section 163)



Duty not to set up any adverse title

Rights of a Bailee



Right to claim damage (Section 150)

Right to claim the reimbursement of expenses (Section 158)

Right to be indemnified in case of the premature termination of gratuitous bailment (Section 159)

Right to recover loss in the case of bailor's defective title (Section 164)

Right to recover loss in the case of bailor's refusal to take the goods back (Section 164)

Right to deliver goods to any one of the joint bailors (Section 165)

Right to deliver goods to the bailor in the case of bailor's defective title (Section 166)

Right to particular lien (Section 170)



Termination of Bailment

I. Termination of every contract of bailment (whether gratuitous or not)

II. Termination of Gratuitous Bailment

Every contract of bailment comes to end under the following circumstances:

On the expiry of a fixed period

On the fulfilment of the purpose

Inconsistent use of goods

Destruction of the subject matter of bailment



Comparison between Pledge and Bailment

Pawn (pledge) and bailment are similar in many aspects. In both the cases only movable goods are delivered, they have a condition of being delivered back after the purpose of contract is over or after the expiry of stipulated time.

Both of the contracts are created by agreement between the two parties. However, pawn/ pledge is different from bailment in the sense that pawn is made for a specific purpose i.e. for the repayment of a debt or performance of a duty, whereas, the bailment is for all kind of purposes.

Secondly, the pawnee is not allowed to use the goods pawned, but, in bailment, the bailee could use the goods which are bailed if the terms of bailment have such provision.

Thirdly, the pawnee can sell the goods, pledged with him after he/she gives a notice to the pawnor, whereas a bailee may either keep in his possession or sue bailor for his dues.



Rights and Duties of Pledgee (Pawnee) and Pledgor (Pawnor)

Rights of Pawnee

Right of retainer (Section 173)

Right to claim the reimbursement of all extraordinary expenses
(Section 173)

Right to sue pawnor (Section 176)

Right to sell (Section 176)

Right against true owner (Section 178A)



Rights and Duties of Pledgee (Pawnee) and Pledgor (Pawnor)

Duties of a Pawnee

Duty to take reasonable care of the goods pledged

Duty not to make unauthorised use of goods

Duty not to mix pawnor's goods with his own goods

Duty to return goods

Duty to return accretion to the goods



Rights and Duties of a Pledgor (Pawnor)

Rights of a Pledgor (Pawnor)

Right to get pawnee's duties duly enforced

Right to redeem (Section 177)

Duties of a Pledgor (Pawnor)

Duty to comply with the terms of pledge

Duty to compensate the pawnee for extraordinary expenses (Section 185)



Finder of Lost Goods

Rights of a finder
of goods are as
follows:

Right of Lien

Right to Sue for
Reward

Right of Sale



Duties of a Finder of Goods

Under Section 71 of the Contract Act, a finder of goods has the same duties as that of a bailee with regards to the goods found. Hence,

The finder must take good care of the goods which are found.

The goods should not be taken in his/her personal use.

The goods found should not be mixed with his/her own goods.

It becomes his/her duty to find the real owner of the goods and then to assign the goods to him.

For example, if in any event, an attendee guest finds a gold chain and she reports it to the host of that event and also few other people present about it, then she has performed her duty to find the owner.



Contract of Agency

A legal contract which involves creating a trustee relationship through which the first party (“the Principal”) agrees to the actions of a second party (“the agent”) is an agency agreement.

It binds the “principal/first party” to agreements made by the agent/second party as if the principal had himself made them personally.

An agency is a relationship between an agent his principal created by an agreement. Section 182 of the Contract Act defines an Agent as “*a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or whom is so represented is called the principal*”.



Essential features of Agency

Essential features of
Agency are:

The principal

The agent

An agreement

Consideration not necessary

Representative capacity

Good faith

The competence of the principal



Creation of Agency

The Agency may be created by any of the following ways:

Agency by express agreement (Expressed Agency, Section 187)

Agency implied from circumstances (Implied Agency, Section 187)

Agency of necessity

Agency by estoppel (Section 237)

Agency by Ratification (Section 196 to 200)



Conditions for Agency by Ratification

In order to ratification be legal and valid, the following essentials must be satisfied:

The act should be in the principal's name.

Principal should have been in presence and competent to do contract at the time when the agent acted on his behalf as well as on the date of ratification.

The act must be legal which is under the competency of the principal. It should be done with full knowledge of all the material facts (Section 198).

Since ratification of a part of act is not valid, therefore it should relate associate or link to the whole act and not to a part of it (Section 199).

If an act is prejudiced for a third person then that act would not be considered to be valid. (Section 200).

There should be a fixed time or a reasonable time allocated for ratification of an act after the contract was entered into by the agent.



Termination of Agency

The termination of agency stands for the revocation or cancellation of the agent's authority.

The modes of termination of agency may be classified as:

Termination of Agency by the Act of the Parties

Termination of Agency by the Operation of Law



Agent and Principal

Agent

An agent is a person who does services for some other person (the principal) under an expressed or implied agreement and who is under the direct of the principal or his manner of providing services is controlled by the principal.

One can also be an agent without receiving compensation for services provided.

The agency agreement may be oral or written. An agent can be given the power of attorney by the principal.

Thus, he has an authority to act on behalf of the grantor, as specified by the grantor in a power of attorney document.



Kinds of Agents

Following are different kinds of agents:

Mercantile/commercial agent

It may be defined as an agent who has the authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods or to raise the money on the security of the goods on behalf of his principal [Section 2(9) of the Sale of Goods Act].

Non-mercantile/non-commercial agent

It may be defined as an agent who does not usually deal in the buying or selling of goods. As a matter of fact, he/she is the agent appointed by his/her principal to do some acts which are not done by mercantile agents.



Extent of Agent's Authority (Section 186 to 189)

Principal has the liability of his/her agent's acts done within the scope of his authority. An authority is said to be expressed when it is verbally given or in written manner.

An authority is implied when it is inferred from the circumstances of the case (Sections 186 to 187).

The agent's authority extends to every legal performance required to do an act for which he/she has been appointed (Section 188).

An agent has been authorised to do every act legally in order to prevent the principal from loss as would have been done by him for himself normally.

The emergency must be real not permitting the agent to communicate with the principal (Section 189).



Principal

According to Section 182 of Indian Contract Act, 1872 a principal is described as under:

A person for whom an act is done or who is so represented is called principal.
The relationship between the principal and the agent is called the “agency”.

Example: A appointed B to purchase 100 bags of wheat on his behalf. In this case, A is the Principal, and B is the Agent. And the relationship between A and B is called an Agency.



The Agent's Duty to the Principal

The agent's duties/obligations are widely defined by the terms of the contract but some additional duties are established by agency law, unless they are clearly excluded or modified by the contract itself.

The duties arise from the trust and confidence which lays the base of an agency relationship and are called fiduciary duties. They are owed by the agent to his/her principal.



The Agent's Duty to the Principal are as follows:

Loyalty

An agency relationship exists for the benefit of the principal, hence an agent must try to benefit the principal and support his interests by making true and best efforts.

Duty to Act with Skill and Care

An agent should perform his/her duties with the similar skill and care of what any person in similar location and circumstances would do.

Duty to Notify

An agent should notify the principal immediately on important issues that are either related to or might be associated with the business of the principal.

Duty to Account

An agent must forward all money, property, or incidental benefits that are received during the course of the agency relationship, to the principal's account.



Remedies of the Principal

Following remedies are available for the principal in case an agent breaches a duty either fiduciary or established in the contract:

If the relationship was through a contract, the principal is liable to recover damages from the breach of contract.

The agency contract could be abrogated if the agent works for two principals with conflicting interests without the disclosure of relevant facts.

If an agent retains money or property despite being due to the principal, then the agent should pay the full amount of unjust enrichment.

Many criminal acts allow recovery for negligent actions or misappropriating the principal's property (conversion) by theft, transfer or destruction.



Principal's Duties to the Agent

Agency law establishes that there are several duties that a principal has towards the agent, most of which can be modified or eliminated by the agreement between the parties:

Duty to compensate: Generally, the agent's due compensation is fixed in the contract. Although in case of no such provisions. The conditions around the agency relationship determine the level of compensation.

Duty of reimbursement and indemnity: The agent is liable for the reimbursement of expenditure borne on behalf of the principal, unless he/ she is on a contingent fee basis, or otherwise agreed upon.

Remedies of the Agent: Generally, the breach of duty by a principal is on a contract basis and the remedies available for such contract disputes are available except for specific performance, which might aggravate the problems between the agent and the principal's relationship.



Contract Management

The process wherein the contract creation, execution and analysis is managed to maximise operational and financial performance in any organisation, focusing on financial risk reduction is called contract management.

Here, contract management is a time-consuming element of business, which expedites the need for effective and automated contract management system.

When two companies do business with each other, then a contract would specify activities entered by both organisations and the terms which will make them each fulfil their parts of the agreement.

Effective contract management can help create a robust business relationship and pave the road to greater profitability over the long-term.



Elements of Successful Contract Management

•Because of the presence of processes and software companies which satisfy increasing compliance and analytical needs, employees must be developed.

When a contract management strategy is successfully implemented, organisations can expect to see that the:

(i) expected business benefits and financial returns are being realised.

(ii) supplier is cooperative and responsive to the organisation's needs.

(iii) organisation encounters no contract disputes or surprises.

(iv) delivery of services is satisfactory to both parties



Activities that Make up Good Contract Management

The basis of contract management depends on successfully exercising the post-award and crucial activities.

During the pre-award stage, employees are to focus on establishing contract if the supplier is able to fulfil agreement terms.

One requires additional consideration to know how the contract will work once awarded.

Both the parties involved should be flexible and willing to adapt with contract terms to a certain level for a successful contract management.

Above all, organisations should be foreseeing the problems as they are inevitable, and be prepared for them and ready to accommodate for any changes if required because of the problems occurred.



Stages of Contract Management

Contracts have an important role in the end-of-quarter crunch and are divided into stages to structure and organise efforts in the contract making process. Creating a contract manually is a time-consuming process.

The process includes
the following steps:

1. Preparing the contract

2. Drafting the contract

3. Negotiating the contract

4. Getting approval before finalising the contract

5. Executing the contract

6. Keeping up with amendments and revisions

7. Managing after the signature—obligations, auditing, and renewals



Till now, you have learned about:

- The basic principles of special contract laws
- The features of the contract of indemnity and guarantee
- The terms bailment, pledge and finder of goods
- The contract of agency
- The importance of contract management

In the next chapter, you will learn about:

- The basic principles and definitions of the Sale of Goods Act, 1930
- Formalities of a contract of sale
- The importance of goods
- The significance of price
- Distinguish between conditions and warranties

Thank You