CONCEPT OF CONSIDERATION IN CONTRACTS: A
STUDY WITH REFERENCE TO LAW OF INDEMNITY
AND GUARANTEE

A
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SUMMARY

The research work on the Topic “CONCEPT OF CONSIDERATION IN CONTRACTS: A STUDY WITH REFERENCE TO LAW OF INDEMNITY AND GUARANTEE” was shouldered to yield groundbreaking and “avant-garde” ideas on the Law of Contract\(^1\), which though fundamental have remained unaddressed (till date, however the same have been duly addressed in the present Thesis) in the Indian Contract Act, 1872. The work on the thesis focuses on Law of Indemnity and Guarantee under the Indian Contract Act, 1872 with respect to Concept of Consideration in the said contracts.

The work was undertaken to study the applicability of section – 2(d) of the Indian Contract Act, 1872 to Special Contracts, especially, Contract of Indemnity and Guarantee. The study was also undertaken to arrive at a conclusion that neither does section – 2(d) apply to the formation of special contracts, nor does the Act provide for the definition of consideration which has its applicability in the formation of Special Contracts. The Act also fails to provide for the difference between the Future aspect of consideration and the Executory consideration in the contract of indemnity and guarantee. With a view to find answers to the above questions the rights of the parties in the contract of indemnity and guarantee were also studied, as these rights of the parties which are inherent in the contract of indemnity and guarantee, either expressly provided for by the Act or impliedly under the principles of common law are nothing but one of the many aspects of consideration in the said contracts. Therefore, the study of such rights in the contract of indemnity and guarantee was indispensable.

HYPOTHESIS

The researcher feels that since the sense of the expression “Consideration for the promise” given in the Indian Contract Act, 1872 in Section 2(d) is applicable only to present and executed form of agreements, it has no applicability in the Formation of Future Contracts. Due to no precise definition/sense of the expression “Consideration for the promise” dealing with Formation of Future Contracts in the Indian Contract Act, 1872 (Act no. 9 of 1872). The researcher feels that there should be an amendment in the Indian Contract Act, 1972 incorporating the definition/sense the expression “Consideration for the promise” covering the

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\(^1\) In the Law of Indemnity and Guarantee w.r.t Consideration in the said contracts.
Formation of Future Contracts. The researcher further states that since the concept of consideration forms an essential element in the formation of contract. It is therefore, very much present in the contract of indemnity and contract of guarantee. However, the nature of the consideration in such contracts is both future and fluctuating in as much as the parties enter in to contract but none is sure as to what amount will actually be paid in the future time to come, or will not at all paid at all, at the same time none of the them is sure at to the time when the parties could be called to honour the contract. The focus therefore is on the future and fluctuating aspect of the consideration in the special contracts of indemnity and guarantee.

Research Problems

a) The Indian Contract Act, 1872 (9 of 1872) does not attempt to define the expression “Consideration for special contracts”.

b) The “sense” of the expression “Consideration for the promise” as mentioned u/s 2(d) in the Indian Contract Act, 1872 (9 of 1872) does not apply to Formation of Special Contracts.

c) The “sense” of the expression “Consideration for the promise” as mentioned in the Indian Contract Act, 1872 (9 of 1872) does not “define” the said expression.

d) The “sense” of the expression “Consideration for the promise” as mentioned in the Indian Contract Act, 1872 (9 of 1872) does not deal with the future and fluctuating aspect of consideration in case of special contracts viz. contract of indemnity and guarantee.

e) Section – 124 (“Contract of indemnity” defined) and S-125 (Rights of indemnity holder when sued) of the Indian Contract Act, 1872 (9 of 1872) does not comprehensively define the contract of indemnity and also does not deal with rights of the indemnified when not sued respectively.

f) Section – 124 (“Contract of indemnity” defined) and S-125 (Rights of indemnity holder when sued) is not comprehensive in as much as it does not deal with the rights of the indemnifier viz. right of subrogation.

g) Section -127 (Consideration for guarantee) of the Indian Contract Act, 1872 does not comprehensively deal with consideration in the Contract of Guarantee.

i) Difference between Future aspect of Consideration and Executory Consideration is not defined or explained in the Act.

AIMS AND OBJECTIVES

AIM - To identify provisions in the Indian Contract Act, 1872 which relate to concept of consideration in the contract of indemnity and guarantee and to assess the feasibility of the said provisions in the contract of indemnity and guarantee under the Indian Contract Act, 1872.

OBJECTIVES

- To analyse the concept of consideration and identify the roots of the concept of consideration.
- To analyse the concept of consideration under the Indian Contract Act, 1872
- To analyse the definition of the contract of indemnity and guarantee under the Indian Contract Act, 1872.
- To analyse the recommendations made by the Law Commission of India on the subject.
- To analyse and evaluate the concept of consideration under the contract of indemnity and guarantee by way of judicial decision of the Hon’ble Supreme Court of India.

RESEARCH METHODOLOGY

With the view to seek answers to the questions put forward in the hypothesis and systematically solve the research problem. The methodology of the study to be used by the researcher shall primarily be doctrinal. The study encompasses doctrinal method of research by using both primary and secondary sources. The sources include – Acts (Statute); Case Laws; Text Books; Journals; articles/research paper; magazines; power point presentations on the subject. The tools used are e-tools and Libraries, legal data bases viz. JSTOR, Manupatra, Westlaw, E-Books, E-Journals, E-Articles, E-Dictionaries, legal dictionaries, thesaurus, various National and International Repositories etc. to mention a few.

SIGNIFICANCE OF THE RESEARCH

The research was undertaken:
To resolve theoretical questions in the areas of research
To provide a better understanding of the concept of consideration with special reference to the contract of indemnity and guarantee.
To highlight deficiencies in the law of contract w.r.t concept of consideration in the contract of indemnity and guarantee and its applicability to the said contracts.
To demonstrate the need to review the law of contract under the Indian Contract Act, 1872 with reference to concept of consideration in the law of indemnity and guarantee.
To influence government law making in the area of law of contract.

The present study is of great relevance in as much as it embodies the results and answers to questions put forward in the hypothesis in affirmative. With a view to find answers and solutions to the questions, the researcher deemed it necessary to search for the germ of the concept of consideration in the English law, which forms an amorphous, indefinable and essential criterion for distinguishing between enforceable promises and unenforceable promises under the English Common law. The study of the English Common law was also indispensable, since the Indian Contract Act, 1872 has its roots in the English Common law and has been imbibed and firmly rooted in the Indian system. At the same time, since it was the Romans who ruled Britain for nearly four centuries until they seceded in 410 A.D., before the advent of the Anglo-Saxons, it was also fundamental to see the impact Roman law had put on the English Common Law, especially the concept of consideration and whether the genus of concept of consideration may be found in the Roman law. The study of the Roman law highlighted certain important findings on the contract law. It is believed that the Roman law of contract was an earlier development than the English contract law and that contract law is specie of the private law. Under the Roman law, not all private agreements fell within the ambit of law of contract; it was only those agreements to which the state conferred recognition which formed part of the Roman contract law. Accordingly, under the Roman law pact was not synonymous to convention. Mere pact was not enforceable, unless it was impregnated with necessary formalities, to which the state conferred recognition; gradually it was the “causa” under Roman law, which formed an essential ingredient in the formation of contracts. Unlike the English common law which are a later development, under which the sign-post for distinguishing between enforceable and unenforceable promises was “consideration”. Both “causa” and
“consideration” under the Roman law and English Common law are unique to its system respectively and are not synonymous to each other. However, in both the systems it’s the state recognition to the agreements which conferred enforceability to them either by way of presence of “causa” or “consideration” in the formation of contract, under the Roman law and English Common law respectively.

Under the English law, we also find how the law of contract was greatly confounded with the law of property, conveyancing and even criminal law in the early year of its development. The line of differentiation between the law of contract and law of tort was also greatly blurred in the early years of development of the law of contract under the English Common law. It can also be said that since the tendency to maximize one’s self interest is deeply engrained and innate in the human nature, and with a view to achieve the same, human-beings enter into various agreements, the underlying principle of which is promise, such being the case, one cannot therefore conceptualize a society completely destitute from the law of contract, though the same may be extremely rudimentary in its initial years.

The period of English law can be attributed from the time of the Anglo-Saxon period. However, the beginning of the English common law can be attributed to the period of Norman reign, sometime in the eleventh century. We find that the Anglo-Saxons made great use of contracts, though we do find reference of expression “consideration” in some of the cases of the said period, however the same may not be said to mean the genus or origin of concept of consideration in English law. Various theories have been propounded by the jurist w.r.t the origin and evolution of the concept of consideration in the English law. However, most agree and attribute the origin of consideration to various forms of action prevalent during the early English common law period, especially the action of assumpsit and how the expression “quid pro quo” was restricted in use to the action of debt, which could be used only in cases of some specified sum and was not synonymous to “consideration” which formed an essential ingredient in the invoking of action of assumpsit. Unlike today, where the expression “quid pro quo” and “consideration” are used interchangeably. In the action of debt, the basis for determining “quid pro quo” was the benefit to the promisor, as opposed to action of assumpsit in which the basis of determining “quid pro quo” was the detriment to the promisee. In case of unliquidated damages, the contract could only be enforced, if the agreement was made under seal and not otherwise.
The remedy of action of assumpsit, is believed to have made its appearance about in the middle of the fourteenth century, which came as a response to the need for enforcement of simple contracts. Until then it is said that there was no theory of consideration. And its [action of assumpsit] subsequent enlargement was fundamental in the origin and fortification of the concept of consideration in the English common law. The action of assumpsit was primarily a delictual remedy which got gradually converted into a contractual remedy. From being a remedy for misfeasance, to its extension of being remedy for non-feasance, to further absorption of a greater part of action of debt in its ambit and to its extension to remedy the breach of executory contracts; to its further extension to remedy the breach of implied contracts, led to the gradual conversion of the primarily delictual remedy to a contractual remedy. We also find that existence of “consideration” in the formation and enforcement of contract may be traced back in history in the biblical narratives also, though the expression “consideration” is not used in the transactions. The underlying governing principle being something of value which one proposed, in exchange for something that the other valued.

In the early fifteenth century, we find the use of expression consideration as a “noun”, meaning the act of considering. During the late fifteenth and early sixteenth century the expression consideration had already gained familiarity with the lawyers and had begun to develop legal associations but had not acquired a special legal meaning of the expression. It was only in the mid sixteenth century that one finds the express averment of consideration in the pleadings in Newman’s case (1549). The earliest reported case which mentions the consideration in action of assumpsit was in Joscelin’s case (1557). We have also seen that the origin of aspect of consideration viz. benefit and detriment did not take place at the same time rather it is attributed to *indebitatus assumpsit* (where there was an express promise to pay) and special assumpsit respectively. Over the years, since the time of its origin, we can say that no doctrine of English common law has been more firmly established than the doctrine of consideration in the English common law.

Under the Indian law, it is section – 2(d) of the Indian Contract Act, 1872 which deals with the consideration for promise. It is submitted that the said section does not define the expression nor does it provide for the future and fluctuating aspect of consideration, which is of paramount importance in the contract of indemnity and guarantee. The nature of section 2(d) is
procedural rather than substantive and the expression used in the said section for consideration is “something”, which fails to “define” consideration under the said section. Due to these inherent flaws, the applicability of section – 2(d) of the Act on the contract of indemnity and guarantee is seriously doubted. Therefore, either the said provision be enlarged as to expressly “define” the expression “consideration” and to expressly provide for the future and fluctuating aspect of consideration in the contract of indemnity and guarantee or a comprehensive provision on consideration be provided for under the respective law of indemnity and guarantee under the Indian Contract Act, 1872.

Under the English law, the definition of contract of indemnity is wider as compared to the definition of contract of indemnity given under the Indian Contract Act, 1872. The former is wide enough to include loss caused by both human and non-human agency. The latter however, is restricted in as much as it only covers loss caused by human agency and not otherwise. The Indian Contract Act, 1872 does not provide for the whole law of indemnity and there are occasions in which the court has to resort to the principles of justice, equity and good conscience of the English common law. The principles which have been imbibed and applied by the Indian courts in the Indian contract law must be expressly provided for in the Act. A separate legislation on the Special contract can be enacted and the Indian Contract Act, 1872 can be left to deal with the general principles of contract only. Section – 124 of the Act which defines the contract of indemnity must be enlarged on the lines of definition of the contract of indemnity under the English law and the provision must also expressly state that the contract of indemnity can either be expressed or implied under the Act. Section – 125 of the Act does not provide for the time when the indemnity-holder can claim indemnity from the indemnifier as a matter of right viz. the time when the liability of the indemnity-holder/indemnified to pay has become absolute irrespective of the suffering of the actual loss. But in situations where the liability to pay has not become absolute then in such cases, it is the suffering of the actual loss which becomes a prerequisite in the enforcing of a contract of indemnity, as provided in the V. M. Rv. Mr. Ramaswami Chettiar and Anr. v. R. Muthukrishna Iyer And Others case (1967) as decided by the Hon’ble Supreme Court. Section – 125A on rights of the indemnity-holder, be inserted after section – 125 of the Act on similar grounds. The proximity between risk and loss must be of paramount importance in determining the scope of the contract of indemnity, as provided in General Assurance Society case (1966) decided by the Hon’ble Supreme Court. The contract of
indemnity can also be invoked on equitable grounds with a view to honour contractual commitments as provided in United Commercial Bank Ltd. case (1968), decided by the Hon’ble Supreme Court. Further. The promise to save another from the breach of a contract is also a contract of indemnity as provided in M Shah Singh case (1972) by the Hon’ble Supreme Court. A payment can be made “under reserve” relying on the contract of indemnity as provided in the United Commercial Bank case (1981) of the Hon’ble Supreme Court. Loss by Motor Vehicle is covered with in the ambit of contract of indemnity as held in Narcinva V. Kamat and Anr. case (1985) of the Hon’ble Supreme Court. In case of a conditional contract, the fulfilling of the conditions laid down in the contract forms the pre-requisite before the invoking of the contract of indemnity, as laid down in State Bank of India case (1997), decided by the Hon’ble Supreme Court. One must not go by the name/title of the contract, a bank guarantee (title) may actually be a contract of indemnity in the true meaning, sense and spirit of the terms and conditions of the contract, as laid down in State Bank of India case (2007), decided by the Hon’ble Supreme Court. Loss caused due to change in law is not a contract of indemnity u/s 124 of the Act, though in the general sense of the term it is contract of indemnity, further cost is loss within the meaning of contract of indemnity as held in M/s Sumitomo Heavy Industries Limited case (2010).

Under the English law, the doctrine of subrogation is an equitable right. Unlike the Indian Law, where the doctrine of subrogation in the contract of indemnity is an equitable right, only by virtue of the recent decision of the Economic Transport Organisation case (2010). The Act does not expressly provide for the right of subrogation to the indemnifier, the same must be expressly provided for in the Act. The law of indemnity under Indian Contract Act, 1872 fails to expressly provide for the doctrine of subrogation in the contract of indemnity, though it is very much innate in the contract of indemnity; neither does it provide for the rights of the indemnified when not sued, nor does it provide for the rights of the indemnifier.

Under the English law, the contract of guarantee/suretyship has to be writing, in contrast to Indian law under which the contract of guarantee can be both oral or in writing. Under the English law, the doctrine of subrogation is an equitable right. Unlike the Indian Law, in which the doctrine of subrogation in the contract of guarantee is a statutory right under the Indian Contract Act, 1872.
Under the Indian Contract Act, 1872 the section 2(d) which deals with consideration for promise, it is submitted that it fails to define and provide for the future and fluctuating aspect of consideration and is therefore inapplicable to the contract of indemnity and guarantee. The said section only provides the sense of the expression, which is procedural rather than substantive. The law of guarantee, under the Indian Contract Act, 1872 fails to provide for a comprehensive definition of the consideration for guarantee. Section – 127 which deal with the consideration for guarantee, neither does the section define consideration, nor does it provide for a comprehensive provision on consideration for guarantee viz. dealing with the future and fluctuating aspect of consideration in the contract of guarantee; stating the consideration for each of the party in the contract of guarantee and for the dual applicability of the a single consideration under two situations. viz. (i) the consideration by the surety to pay to the creditor the debt amount in case of default of the principal debtor constitutes consideration for two contracts, namely the contract between the surety and the creditor and the contract between the principal debtor and the surety. (ii) the consideration by the creditor to give to the principal debtor the debt amount constitutes consideration for two contracts, namely the contract between the creditor and principal debtor and the contract between the surety and the creditor.

Further, section – 126 of the Act, does not provide for “mere demand” as sufficient to constitute a contract of guarantee and that the condition of default is not a pre-requisite in a contract of guarantee, as held in Maharashtra State Electricity Board, Bombay (1982), decided by the Hon’ble Supreme Court, and that the liability of the surety remains intact, irrespective of liquidation of the principal debtor. Similar observations in Fenner (India) Ltd. (1997) case was made by the Hon’ble Supreme Court. Similarly, the courts also choose not to interfere in case of irrevocable and unconditional commitments and the same must be honoured under all circumstances, unless the case falls in any of the exceptions, viz. fraud etc. as held in U.P. Cooperative Federation Ltd. case (1988) and Dwarikesh Sugar Industries Ltd. case (1997), by Hon’ble Supreme Court. Underlying disputes do not affect the right of the creditor to claim from the surety, as stated in National Thermal Power Corporation Ltd. case (1996) decided by the Hon’ble Supreme Court. Section – 130 does not provide for, no right of the surety to revoke a continuing guarantee as to future transactions, without the permission of the court. Section – 134 does not provide, for the liability of the surety to be intact in case where the remedy against the principal debtor becomes barred by lapse of period of limitation. Section – 141 of the Act
provides for a limited scope on the entitlement of the creditor’s securities to the surety, to all such securities which the creditor had at the time of his becoming a surety. Unlike the English law, which is wide enough to cover all such securities which the creditor had before, at or after the entering into the contract of guarantee, whether the surety had knowledge of it or not. The section does not expressly provide for the time when the surety becomes entitled to all such securities i.e. the time when the creditor is paid in full.

Section – 127 of the Act provides for the “Consideration for Guarantee” which deals with “benefit” as an attribute of consideration in the contract of guarantee, however, the section is restricted to consideration to surety in his entering the contract of guarantee. Even the use of the expression “may” in the section leaves it open for the surety to ask for anything else from the parties in entering the contract of guarantee. The section also do not provide for the consideration of the other two parties also. It also does not provide for the dual applicability of single/same consideration in two instances in the contract of guarantee. The section is also impregnated with the inherent flaws as stated in section – 2(d) (supra mentioned). The surety can ask for security from the principal debtor for entering into a contract of guarantee as stated in Syndicate Bank’s case (1992), decided by Hon’ble Supreme Court.

Further, any loss in the securities of the creditor tantamount to variations/hampering in the right/benefit of entitlement of the surety to have such securities and the surety stands discharged to the extent of the securities loss, as stated in Kaluram’s case (1967) and Amrit Lal Goverdhan Lal’s case (1968), decided by the Hon’ble Supreme Court. Such securities constitute consideration of the surety for entering into the contract of guarantee, unless the contract provide otherwise. The nature of such consideration is both future and fluctuating in as much as the surety is entitled to such securities only when the creditor is paid in full and the surety stands discharged to the extent of the securities lost.

Further, there is nothing in the Act which restricts the right of the creditor proceed against the surety and/ or other parties/securities without first exhaust all the available remedies against other parties and/or securities. The creditor is free to choose between principal debtor, securities and/or surety to proceed against any one or more of them with a view to invoke the contract of guarantee, as stated in Damodar Prasad’s case (1969) and Indexport Registered and Ors. case.
(1992) (as in case of composite decrees) and Satyawati Tandan and Others case (2010) decided by Hon’ble Supreme Court.

Further, giving of extra time by the creditor to the principal debtor to cover up the deficit caused in the securities is per se different from the time given by the creditor to the principal debtor in the invoking of the contract of guarantee. And that the former does not lead to the discharge of the surety on that ground u/s 135 of the Act, as stated in Amrit Lal Goverdhan Lalan’s case (1968), by Hon’ble Supreme Court.

An irrevocable and unconditional contract of guarantee poses an absolute obligation of the part of the surety and/or principal debtor to pay to the creditor, provided the underlying conditions of the contract are duly adhered to, as stated in Tarapore & Co., Madras case (1970).

Further, impairing of surety’s remedy tantamount to varying/hampering of the interest of the surety and the surety stands discharged to that extent as stated in State Bank of Saurashtra case (1980). When in case there is a personal surety and pledged goods, any partying away/loss of the securities/pledged goods hits on the very right of the surety of his entitlement to such securities, on the creditor being paid in full and the surety stands discharged to the extent of partying away/loss of such securities.

Fenner (India) Ltd. (1997) case, decided by Hon’ble Supreme Court, is a good illustration on the future and fluctuating aspect of consideration in the contract of guarantee. Where the bank guarantee provides for a guarantee for “upto” a certain amount, the surety/principal debtor is liable to pay any amount upto the sum provided in the contract.

It is also fundamental to first understand and not to confuse “future” aspect of consideration with the “executory” consideration. By “future” aspect of consideration in the Contract of Indemnity or Contract of Guarantee, we refer to an ingredient of “uncertainty” both objectively (at the time of formation of Contract) and subjectively (at the time of actual execution/implementation of Contract). By “future” consideration in the Contract of Indemnity, we mean uncertainty with respect to happening of loss or not; when the liability to pay for the loss would be incurred etc. The answers to such questions are not in contemplation of the parties at the time of formation of Contract, the consideration (loss) has a future aspect at an objective stage (formation of Contract); but in case of executory consideration the aspect of uncertainty
does not exist at the objective level (formation of Contract). Since the parties have with certainty contemplated the Contract at the formation level itself, it is only its actual execution (subjective aspect) which is pending and this “future” aspect of consideration in the Contract of Indemnity also has a “fluctuating” aspect in as much as there is a degree of uncertainty with respect to the actual liability to be incurred which would be dependent on a future event and not to be exclusively determined by the limit put in the Contract of Indemnity.

During the research study, Thirteenth Report of Law Commission of India, 1958 was also greatly relied in order to study the flaws in the Act and recommendations in the Report and how far the report addressed the issues put forward by the researcher in the hypothesis. Most of the recommendations of the Law Commission of India have been supported by the researcher. However, the Law Commission of India has failed to deal with some of the fundamental questions of the hypothesis in its report. Therefore, the present study is of great relevance as it would open doors for new further research and development on the subject. And suggestions if applied would provide comprehensiveness to the Act.
ARTICLES/RESEARCH PAPERS


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