
Unit – 1

Legal Aspects of Business: Law of Contract



Legal Aspects of Business: Law of Contract

Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning, essentials and classification of contracts.
- Describe the eligibility for capacity to contract, provide free consent and legality of object and consideration.
- Know the criteria for performance and discharge of contracts.
- Assess the remedial actions for breach of contract.
- Also understand the various types of special contracts like Indemnity, Guarantee and Agency.

Structure

- 1.1 Introduction
- 1.2 Meaning & Essentials of Contract
- 1.3 Classification of Contracts
- 1.4 Proposal & Acceptance
- 1.5 Capacity to Contract
- 1.6 Free Consent
- 1.7 Legality of Object and Consideration
- 1.8 Performance and Discharge of Contracts
- 1.9 Remedies for Breach of Contract
- 1.10 Special Contracts – Indemnity, Guarantee and Agency
- 1.11 Let's Sum-up
- 1.12 Key Terms
- 1.13 Self-Assessment Questions
- 1.14 Further Readings
- 1.15 Model Questions



1.1 Introduction

Each one of us enter into varied contracts in our routine life knowingly or unknowingly. Each contract creates certain rights and duties in an express or implied manner. The law which provides the guidelines and principles relating to the contractual relationships is The Indian Contract Act, 1872. The act came into force on 1st September, 1872. The act was passed by British India and is based on the principles of English Common Law. It is applicable to all states of India with an exception of Jammu & Kashmir. The Act deals with the formation of a contract, its performance, breach of contract and its remedies. The significant components of the act are discussed here under.

1.2 Meaning & Essentials of Contract

According to Section 2 (h), “Contract is an agreement enforceable by law”. Agreement means a promise. It is created when a person makes an offer to another person and other accepts it for consideration.

Agreement = Offer + Acceptance of Offer

All agreements are not contract, only those agreements which create legal right and are enforceable by law are contracts.

The following are the essential elements of a valid contract:

1. Plurality of Parties: There must be at least two parties in a contract. Generally they are called promisor and promisee.
2. Offer and acceptance (Agreement): One party should make offer and other should accept it according to the conditions of offer.
3. Intention to create legal relation (Enforceable by law): Both the parties should have an intention to create a legal relationship.
4. Contractual Capacity: Parties under contracts should be major and of sound mind. They should not be disqualified from contracts by law.
5. Consent: It means parties should agree on the same thing and in the same sense.
6. Free Consent: Consent is free if it is not due to coercion (force), undue influence, fraud, misrepresentation and mistake.
7. Consideration: It means something in return whose value is in terms of money.
8. Lawful Object: Every contract must have lawful object otherwise it is called void ab initio. It should not be fraudulent in nature or declared against public policy by the court.



9. Certainty of Meaning: Every word written in the contract should have a certain meaning. No ambiguity should be there.
10. Possibility to Perform: Agreement should be physically and legally possible to perform.
11. Agreement not declared void: Agreements which fulfill the conditions of lawful contract can also be declared void by law.
12. Compliance of legal formalities: All the legal formalities should be fulfilled.

Any agreement to be enforceable by law must have above features otherwise it will not be enforceable by law.

1.3 Classification of Contracts

Contracts may be classified on the following basis:

I According To Enforceability/Legality:

- 1) Valid Agreement (Contract): A valid agreement is a contract enforceable by law. It has all essentials of contract under sec.10.
- 2) Void Agreement: Agreement not enforceable by law is called void. [Sec.2 (g)]. It lacks essentials of valid agreement. Such agreements are void ab initio (void from the beginning) and no restitution is permitted. It means any consideration given to each other by the parties, cannot be restored.
- 3) Void Contract: When a contract is valid at the time of its making but later on due to change in circumstances or in law, it becomes unenforceable, it is a void contract (not valid or legal). Under void contracts restitution and the payment for part performance is allowed.
- 4) Voidable Contract: An agreement which is enforceable by law at the option of one party & not at the option of other party. It means an agreement which is voidable at the option of aggrieved party. Aggrieved party is the party whose consent has been obtained by coercion, undue influence, fraud or misrepresentation. Such contract will remain valid till it is declared invalid by the aggrieved party. Restitution or compensation can be claimed, for loss on non-fulfillment of the contract.
- 5) Illegal Agreement: Agreement is illegal if it is not approved by law, opposed to public policy, criminal or immoral in nature. Such agreements are void ab initio and any collateral agreement will also be void.
- 6) Unenforceable Contract: If a contract cannot be enforced due to some technical defects like incomplete legal formalities, stamp, signature etc.

it is called unenforceable contract. As soon as technical defect is removed, contract becomes enforceable.

II. According to Mode of Formation

1. Express Contract: Contract made in written or spoken words is express contract. It may be on letters, telephone, e-mail etc.
2. Implied Contract: Contract made other than words is implied. It arises from acts & conduct of the parties or by their circumstances. E.g. A calls a taxi on telephone. There is implied contract to pay if the taxi comes.
3. Quasi Contract: It is a contract imposed by the law on the parties & gives rise to obligations similar to a valid contract. E.g. A gives B (mad) some products. As B is mad or lunatic he cannot contract but law can create a contract between A & B on the principle of equity in which A can get money from B's property.

III. According to Extent of Execution

1. Executed Contract: A contract in which all the parties have performed their obligations, is an executed contract. E.g. X sells his car to Y for 1 lakh. X gives the car & Y makes the payment. It is executed contract.
2. Executory Contract: A contract in which the parties still have to perform their obligations, is called executory contract.
3. Bilateral Contract: It is one in which both the parties exchange a promise to each other. One party promises to perform some act in the future in exchange for other party's promise to perform some act. It is similar to executory contract. Each party is both promisor & promisee.
4. Unilateral Contract: A contract in which one party promises to the other to do something if he performs his desired work. E.g. A promises to pay Rs.100 by advertisement to anyone who finds his lost horse. Anyone can search his horse & bind A for payment. But A cannot bind any one to search his horse.

1.4 Proposal & Acceptance

Proposal is an expression of willingness by one person to another to enter into an agreement with a view to obtain assent of the other. Person making proposal/offer is called 'proposer' or 'offerer'. On acceptance, the person making proposal is called 'promisor' & person accepting the proposal is called the 'promisee' or 'acceptor'.



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Acc. To Sec 2 (b), “When the person to whom the proposal is made communicates his assent, the proposal is said to be accepted. It is a communication of his intention to be bound by the terms of the offer.”

Following are not proposals: -

- i) Intention to put a proposal: - It is the declaration by a person that he intends to offer something in future. It is not made to obtain assent of the other. E.g. advertisement for auction sale or sale of goods.
- ii) Invitation to put a proposal: - It is made to receive a proposal from others. E.g. Menu Card of restaurant is an invitation to put an offer. Time Table of railways/Roadways/Airlines is an invitation to put an offer.

1.5 Capacity to Contract

According to Section 11, “Every person is competent to contract who is of the age of majority, who is of sound mind & is not disqualified from contracting by any law”.

The following persons do not have the capacity to contract:

- Minors
- Persons of Unsound Mind.
- Persons disqualified from contracting by any law

A. Minor

According to Sec. 3, “Minor is a person who has not completed 18 years of age.”

But in the following cases, he attains majority when he completes 21 years:

* When guardians has been appointed for minor under Guardians & Wards Act 1890.

* When superintendence of minor’s property is under court of wards.

Law relating to minor’s Agreements:

1. Agreement with minor is void ab initio.
2. No Ratification after attaining majority: Ratification means approving a past contract. Minor’s agreements are void ab initio so they cannot be ratified.
3. Minor can be a beneficiary or can take benefit out of a contract. He cannot be asked to return or mortgage his property.
4. A minor can plead minority i.e. even if he does something wrong he cannot be held responsible for it, in the court. E.g. A (minor) fraudulently represent himself as a major & ask B to lend Rs.1000. B lends the amount but cannot sue A for recovery.



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5. Parents/ Guardians can contract on behalf of minor with an exception that they cannot buy & sell fixed property on his behalf.
6. Minor cannot enter into a contract of partnership of firm but can be a partner in profits.
7. Minor can be an agent and can bind the principal for his acts without being personally liable.
8. Minor's parents are not liable for contracts made by minor with an exception that minor act as agent of his parents.
9. Under negotiable instrument Act, minor can write, accept, endorse bills of exchange but is not liable if they are dishonoured.
10. Minor can be a shareholder for fully paid up shares.
11. For criminal act, minor is fully liable for punishment.
12. Marriage contract by minor is void even after attaining majority.

B. Persons of Unsound Mind

According to Sec. 12, a person has sound mind if:

- He is capable of understanding the contract at the time of making it.
- He is capable of making rational judgment i.e. effect of contract on his interests.

Types of Unsound Mind Persons

Following are the persons who are considered as persons of unsound mind under the act:

1. Idiot: He is a person who has lost his mental ability to understand even ordinary things. It is permanent.
2. Lunatic: He is a person who is mentally affected due to strain or personal shocks. It is temporary & can be cured. He can make valid contract during lucid intervals.
3. Drunken or intoxicated person.
4. Hypnotized person.
5. Mental decay- There may be mental decay due to old age or poor health and such person is not capable of making a valid contract.

C. Persons Disqualified by Law

The following persons are disqualified by law from entering into a contract:

1. Foreign Ambassadors: They have full capacity to contract in India but they cannot be sued in our courts unless central government permits.



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2. Alien Enemy: It means a foreign citizen living in India. Contract with alien friend is valid subject to some restrictions. When alien is declared alien enemy (declaration of war) he cannot contract.
3. Companies: Company can only contract through his human agents. Company's contractual capacity is determined by "Object Clause" of its memorandum of association. Contract made outside its scope is void.
4. Married Women: She can enter into a contract but her personal property (Streedhan) can be made liable but not property of her husband. A husband is liable for contract made by his wife for supply of necessities of life. In this case, she is an agent of her husband by necessity.
5. Convicts: While imprisonment, convict cannot enter into contract & cannot sue on contracts made before conviction. If he gets a license i.e. ticket of leave he can lawfully contract. After imprisonment he can enter into contract.
6. Insolvent: Person declared insolvent cannot contract. His official receiver appointed by court can enter into contracts, sue & be sued on his behalf.

1.6 Free Consent

According to Sec.13, 'When two or more persons agree on same thing in the same sense, they are said to consent.'

'Consensus Ad Idem' means people agree on the same thing in the same sense at the same time.

Consent is considered free if it is not caused by the following factors:

- (i) Coercion
- (ii) Undue Influence
- (iii) Fraud
- (iv) Misrepresentation
- (v) Mistake

I. Coercion (Sec. 15)

It means threatening or use of physical force against a person to compel him to enter into a contract. E.g. Alia Slapped Bhim & dislocated some of his teeth & threatens to repeat the same if Bhim does not lend him Rs. 30,000. The contract is caused by coercion.

Essential Elements:-

- 1) Committing or threatening to commit any act forbidden by Indian Penal Code;- E.g. murder, theft, physical compulsion.
- 2) Threat of suicide is coercion.



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- 3) Unlawful detaining of any property or unlawful threatening to detain any property.
- 4) The intention must be to compel the other person to enter into a contract. E.g. A beats B to take revenge for his insult. This is not coercion.
- 5) Coercion may be from the party or from any other person/stranger.

Effects:

- 1) Contract becomes voidable, at the option of the party whose consent is taken by coercion.
- 2) Restitution: Aggrieved party can restore the benefits given.

II. Undue Influence (Sec. 16)

It is a kind of moral coercion. When relation between parties are such that one party is in a position to dominate the will of the other & use that position to obtain advantage over the other. This is undue influence

Essential Elements: -

- 1) There must be close relation between the parties.
- 2) One party should be in the position to dominate the will. It includes following situations: -
 - a. Real authority over the other like master & servant, doctor & patient.
 - b. When relation of trust & confidence exist between parties. E.g. father & son, husband & wife.
 - c. Undue influence can be used against the person whose mental capacity is affected by old age, illness etc.
- 3) The intention should be to take undue advantage.
- 4) Misuse of position to take advantage.

Effects:

- (1) Contract is voidable at the option of aggrieved party.
- (2) Benefit received is restored to the aggrieved party.

III. Fraud (Sec. 17)

Fraud means willful misrepresentation or concealment of material facts. The intention is to deceive (cheat) the other party & induce him to enter into an agreement. It include the following acts:

- i) Suggestion of that which is not true i.e. given by person who does not believe it to be true.
- ii) Concealment of fact by one who has knowledge of it.
- iii) Promise made without any intention of performing it.
- iv) Such act which law declares to be fraudulent.

Essential Elements:-

- 1) Fraud may be done by a party to the contract or his agent.
- 2) There must be representation which is false. E.g. A intends to deceive B & falsely represents that the car which he offers for sale is imported but actually it is Indian.
- 3) False representation must be of material fact, not an opinion.
- 4) A promise made without intention to perform is a fraud.



- 5) The intention must be to induce the other party to act upon false representation.
- 6) The other party must have been relied upon the statement & must have been deceived & suffered some loss.

Effects:

- (1) Aggrieved party has the right to rescind (declare invalid) the contract (voidable).
- (2) Sue for damages or loss suffered.
- (3) Benefit received is restored.
- (4) Aggrieved party can insist for performance & ask to put him in a position in which he would have been if representation made had been true.

IV. Misrepresentation (Sec. 18)

Any innocent or unintentional false statement of fact made by one party to the other during negotiation of contract is called misrepresentation. It includes:

- 1) When a person positively says that a fact is true when his information does not justify it, although he believes to be true.
- 2) When there is breach of duty by a person (no intention to deceive) which brings advantage to him & loss to the other.

Essential Elements:

- 1) Misrepresentation must be of fact & not mere opinion.
- 2) It must be made to induce other party to contract.
- 3) Intention should not be to deceive the other party.

Effects:

- 1) Contract is voidable at the option of aggrieved party.
- 2) Aggrieved party may insist on performance which will put him in the position if the representation made had been true.
- 3) Benefits may be restored.
- 4) Claim for damages except in following cases: -
 - a. When aggrieved party has means of discovering the truth.
 - b. If aggrieved party gave consent in ignorance of misrepresentation
 - c. If party has not rescinded the contract within reasonable time.

V. Mistake (Sec. 20, 21 & 22)

Mistake means a wrong belief or misunderstanding about something. Generally, mistake does not affect the validity of the contract. According to Sec.20, where both the parties are under a mistake, the agreement is void.

Essential Elements:

- (1) Both parties can be at mistake (bilateral mistake).
- (2) Mistake can be of two types: Mistake of fact and Mistake of law. Mistake of fact is related to the subject matter of the contract. It may be a bilateral or unilateral mistake. If there is mistake of law, the contract is valid

because everyone is assumed to have knowledge of it. & ignorance of law is no excuse.

Effects:

- 1) Acc. To Sec. 22., Contract is not voidable due to unilateral mistake of facts.
- 2) Agreement made on bilateral mistake is void.
- 3) Mistake as to foreign law is treated as a mistake of fact & is excusable.

1.7 Legality of Object and Consideration

The word object is used distinctly to mean 'purpose or design' of the agreement. The word 'consideration' is different from the object. Consideration means the benefit received or suffered under an agreement.

Sec.10 implies that an agreement enforceable by law must be for a lawful consideration and with a lawful object. Every agreement of which the object or consideration is unlawful is void.

Unlawful Consideration or object:

Object or consideration is considered as unlawful in following cases:

- 1) If the act is forbidden by law. E.g. X promised Y to pay Rs.3 lakh for murder of Z. It is unlawful.
- 2) If it defeats the provisions of any law: The act may not be forbidden by law. But, if it is permitted, it will defeat the provisions of any law. E.g. P & Q married under Mohammedan law but agreed before marriage that wife would be allowed to live with her parents after marriage. This agreement is void because it defeats the provisions of Mohammedan law.
- 3) If it is Fraudulent in nature.
- 4) If it involves injury to the person or property of another.
- 5) If Court considers it immoral: E.g. An agreement between husband and wife for future separation is immoral.
- 6) If court considers it opposed to public policy: It means no person can lawfully do something which can cause injury to public welfare. E.g. agreement to sell seat in medical or engineering college, agreement for getting votes in election for consideration, agreement to get a public title like 'Bharat Ratna' for consideration.
- 7) Agreement interfering with parental rights & duties.
- 8) Agreements which restrict personal liberty.
- 9) Agreements which restricts marriage or interfere with marital duties.
- 10) Agreements creating monopoly.
- 11) Agreements not to bid in auction sale.



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1.8 Performance and Discharge of Contracts

Performance of contract means fulfillment of the terms of the contract by the parties under the contract within the time & in the manner prescribed.

Modes of Performance

Performance may be in two ways:

- a. Actual Performance i.e. by performing promises: when both parties have fulfilled their obligations under the contract within the time & manner prescribed.
- b. Attempted Performance i.e. offer or tender to perform: Promisor offers to perform his obligations under the contract it is called tender. It is also called attempted performance. When a promisor offers delivery of goods to promisee, it is tender of goods. An offer to make payment is called tender of money.

Essentials of a Valid Tender/Offer (Sec. 38)

- 1) It must be unconditional.
- 2) It must be an offer to perform in full.
- 3) It must be made at proper time & place.
- 4) Reasonable opportunity to inspect & satisfy should be given to the promisee (applicable to tender of goods).
- 5) It must be in legal tender money: It means current Indian currency notes or coins.

Discharge of Contracts

A contract is discharged when the obligation created between parties come to an end. There are several methods of discharging the contracts namely:

- 1) By performance of promise
- 2) By mutual agreement
- 3) By lapse of time
- 4) By operation of law
- 5) By impossibility of performance
- 6) By breach of contract

I. Discharge by Performance of Promise

When parties perform their promises, then the contract comes to an end or is discharged. It can be performed in two ways – by actual performance or by attempted performance.

II. Discharge by Mutual Agreement

Methods of discharge of an existing contract by a fresh agreement by mutual consent are:



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- 1) **Novation:** It means substitution of a new contract in place of the existing contract. It may be done in two ways:-
 - a. New contract with new terms with same parties.
 - b. New contract on same terms with one party same & one new party.
- 2) **Alteration:** It means change in one or more terms of the contract with the consent of all parties. A valid alteration discharges the original contract & a contract with new terms is created.
- 3) **Rescission:** It means cancellation of contract. Cancellation may be by mutual agreement of both parties or by aggrieved party if free consent is not given.
- 4) **Remission:** It means acceptance of a lesser performance in discharge of a whole promise made.
- 5) **Waiver:** It means intentional withdrawal of rights. When a party entitled to claim performance releases the other party from his obligation to perform it, it is called waiver.
- 6) **Merger:** - It means merger of two or more rights into one contract. When an existing inferior right of party merges into newly acquired superior right by the same party, it is merger of rights. In such case, inferior right automatically stands discharged. E.g. A person holding a property under a lease, buys the property in his name. His rights as a lessee are merged into the rights of ownership.

III. Discharge by Lapse of Time

When time is fixed for the contract & a party does not perform it within that time, the contract is discharged by lapse of time.

IV. Discharge by Operation of Law

The contract discharges by operation of law in the following cases:

- 1) Merger: Inferior right is discharged & not required to be enforced.
- 2) Insolvency: When court declares insolvent, the person is discharged from all obligations of any contract & they are transferred to his official receiver.
- 3) Death: If contract involves use of personal skills of promisor then on his death the contract is discharged. In other cases, the obligation is transferred to legal representatives.
- 4) Unauthorized material alteration in the terms of the contract, without the knowledge & consent of other party, the contract may be discharged by other party (voidable).
- 5) Where evidence of contract is lost, the contract is discharged. E.g. document of contract is lost or destroyed & there is no other evidence available.

V. Discharge by Impossibility of Performance

Where contract is impossible to perform, the contract is void. According to Sec. 56, impossibility may be of two types:

- 1) Existing Impossibility: It refers to the impossibility at the time of agreement.
- 2) Subsequent or Supervening Impossibility: The contract becomes void when the act becomes impossible later on, in the following conditions:
 - a. Destruction of subject matter.
 - b. Non-existence of a state of things necessary for performance. E.g. P hired a room from Q for 1 day for watching King's procession. The procession was cancelled, contract became impossible.
 - c. Change in circumstances.
 - d. Death or personal incapacity of the promisor.
 - e. Change in law
 - f. Outbreak of war. (Alien Enemy contract).
 - g. Order of the court (Court Stay)

Effects of Supervening Impossibility:

- 1) Contract becomes void.
- 2) Compensation for loss if the act known to be impossible to any one of the parties.
- 3) Restitution of benefits.

VI. Discharge by Breach of Contract

It means non-fulfillment of the promise made by any of the parties to a contract. There are two types of breach of contract:

1. Actual Breach: It takes place when a party to a contract refuses or fails to perform his obligation when it is due.

Effects: Claim for damages & can sue in the court.

2. Anticipatory Breach: When a party disables himself or declares that it will not perform the contract prior to the date of performance. It is also called anticipatory or constructive breach of contract.

Effects: Promisee is excused from further performance and he can put an end to the contract & sue other party for default. Alternatively, he may wait till the due date of performance of contract & then avail legal remedies against other party.

1.9 Remedies for Breach of Contract



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A remedy is the means given by the law for enforcement of right. In case of breach of contract, the injured party or aggrieved party has one or more of the following remedies:

I. Rescission of the Contract

Rescission means cancellation or putting an end to the contract. When promisor makes a breach of contract, the promisee can rescind the contract.

Court may grant rescission when contract is voidable or unlawful. Court may refuse rescission in the following cases:

- a. Where the aggrieved party has expressly or impliedly ratified the contract.
- b. When there is no fault of both parties & situation arises due to change in circumstances then the parties cannot restore their original position.
- c. When third parties has, during the subsistence of contract, acquired rights in good faith. E.g. X fraudulent bought a diamond bracelet from Y & pledged it to P who kept it for value & without any notice of fraud. Y cannot rescind the contract.

II. Suit for Damages

Damages may be of four types:

1. Ordinary or natural damages: It is the direct loss suffered by the aggrieved party.

2. Special Damages: They include indirect loss suffered by aggrieved party. They arise due to special circumstances. If special loss can be incurred on breach of contract, it should be communicated to the other party, otherwise damages will not be given.

3. Exemplary Damages: It involves very heavy amount. It happens in the following cases:

- a) Breach of contract to marry: Amount will depend upon injury to lady's feeling & their family reputation.
- b) Dishonor of customer's cheque by the bank without any proper reason. Amount will depend upon loss to goodwill of customer.

4. Nominal Damages: The amount is very small like Rs. 5 or 10. It is given when party has proved breach of contract. It is given to recognize the right of party to claim damages.

Liquidated Damages & Penalty

The Parties decide in advance, the amount to be paid as damages in case of breach of contract. Such amount may be



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a) Liquidated Damages: It represents the amount of probable loss that might result due to breach of contract. This amount is to compensate for breach.

b) Penalty: When amount for damages decided in the contract is very high as compared to likely damages in case of breach, it is called penalty.

III. Quantum Meruit

Quantum Meruit means as much as earned. In certain situations, the party can claim payment of such amount which he has earned. This right is available in addition to the right of damages.

The claim for quantum meruit arises only when original contract is discharged. A party who is not in default can only claim for quantum meruit. Claim can be made only if contract is divisible and express or implied evidence to pay for work is shown.

IV. Specific Performance of Contract

In case where damages are not sufficient remedy, court may ask for specific performance as per the terms of contract. It may be done in the following cases:

1. Where there exist no standard for finding actual damage by non-performance.
2. Where probable amount of compensation in money cannot be received for non-performance.

Specific performance will not be granted in cases where court cannot supervise the performance, where damages are adequate remedy, subject matter does not exist and where contract contains ambiguous terms.

V. Suit for Injunction

It means order of court to a party to do or not to do any particular thing. In case of contract, injunction is the order of a court prohibiting a party from doing a particular thing.

1.10 Special Contracts

The following contracts are special type of contracts:

- Contract of Indemnity (Sec. 124)
- Contract of Guarantee (Sec. 125)
- Contract of Agency (Sec. 126)



Contract of Indemnity (Sec. 124)

According to Sec. 124, a contract of indemnity is 'A contract by which one party promises to save the other from the loss caused to him by the conduct of the promisor himself or by the conduct of any other person.'

The person who promises to indemnify or make good the loss is called indemnifier. The promisee or whose loss is made good is called the indemnified or indemnity holder.

Essential Elements:

- 1) Include all essential elements of valid contract.
- 2) It may be express or implied.
- 3) Loss may be caused by promisor or any other person or accidents.
- 4) The promisee has the right to recover from the promisor the actual cost of indemnity contract.

Rights of indemnity- holder or indemnified

He has following rights against the indemnifier i.e. Promisor:

- 1) Right to recover damages: All damages he may be supposed to pay in any suit to which the indemnity applies.
- 2) Recovery of cost: All costs which he may be made to pay in defending the suit of indemnity.
- 3) Recovery of all sums paid: All sums he has paid in terms of any compromise of any suit.

Rights of Indemnifier

- 1) Right of subrogation: After paying the amount of claim, indemnifier gets all the rights of indemnified against a third party. i.e. to sue & claim for damages & all sums paid against third party.
- 2) Right to refuse claim or indemnity: If loss caused is out of the scope of the contract or indemnified has not acted prudently, then indemnifier can refuse claim.

Contract of Guarantee (Sec. 124)

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 surety. The person against which the guarantee is given is called the principal debtor. The person to whom the guarantee is given is called the creditor.

A guarantee may be given not only for a debt, but also where party wants to buy goods on credit & also for good conduct of another person (Fidelity Guarantee).

Essential Elements:



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- 1) It may be written or oral.
- 2) 3 contracts are there:
 - ❖ Between creditor & debtor
 - ❖ Between surety & creditor
 - ❖ Implied contract between surety & debtor.
- 3) Capacity to contract: The principal debtor may be a minor or a person incapable of entering into a contract. In such cases, surety shall be regarded as principal debtor & will be liable to pay.
- 4) Consideration: The consideration received by the principal debtor must be sufficient consideration to the surety for giving guarantee.
- 5) Surety is personally liable for default of principal debtor.
- 6) Guarantee is given on the request of principal debtor (implied or express).
- 7) Guarantee contract is not a contract of 'Uberrimae Fidei': A contract uberrimae fidei is one which imposes duty on creditor to disclose all material facts to the surety. A creditor is required to disclose only those material facts, which he knows & are likely to affect the degree of responsibility of surety.
- 8) Surety's liability arises from the date the principal debtor commits default & not from the date of guarantee.

Rights of surety:

After performing or discharging the liability of the principal debtor, a surety gets various rights against creditor, principal debtor and co-sureties.

I. Right against Creditor

- 1) Right of exoneration (declare free from blame): When debt has become due, surety is called to pay, he may ask the creditor to sue principal debtor. In case of fidelity guarantee, surety may call creditor to dismiss the employee whose honesty he has guaranteed (if dishonesty is proved).
- 2) Rights on Securities: After paying the creditor, surety can ask him to give all the securities which he has, against principal debtor.
- 3) Rights of Subrogation: After paying creditor, surety get all the rights of creditor against principal debtor.
- 4) Rights to Set-off: Set-off means a right of counter-claim or right of deduction from the amount of debt. This is when creditor sues surety. He can counter-claim against any possession with creditor.

II. Right against Principal Debtor

- 1) Right of subrogation: After paying creditor, he gets all the rights of creditor against principal debtor.
- 2) Right of Indemnity: There is implied promise by principal debtor to indemnify the surety & surety can demand all payments from him.

III. Right against Co-Sureties

- 1) Right to Contribute Equally: When he has paid more than his share, he has the right of contribution from co-sureties.

- 2) Contribution when co-sureties bound to contribute equally subject to the limit of their obligations.

Contract of Agency

An 'agent' is a person employed to do any act for another or to represent another in dealings with third person. The person for whom such act is done, or who is represented is called the 'principal'.

Agency is the relation between an agent & his principal created by an express or implied agreement where agent is authorized by his principal to represent him in dealing with third parties and to contract with them.

Essential Elements:

- 1) Express or implied by an agreement
- 2) Competence of the principal
- 3) Consideration is not necessary
- 4) Free consent of both parties
- 5) Agent is appointed to create contractual relations with third parties.

Creation of Agency

A contract of agency can be created in the following ways:

- 1) By Express agreement
- 2) By Implied agreement
 - i) Agency by Estoppel
 - ii) Agency by Holding Out
 - iii) Agency by Necessity
- 3) By Ratification
- 4) By Operation of Law

I. By Express agreement

When authority is given by the principal by written document or spoken words. The written document is called 'power of attorney'. It should be written & stamped.

II. Agency by Implied agreement

It may be created by conduct or relation of the parties or circumstances of the case. For e.g. X lives in Jaipur & has a shop in Delhi & he visits occasionally. The shop is managed by Y. Y purchases goods from Z & make payment from X's funds with X's knowledge. Y has implied authority from X.



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It includes following types of agencies:

1) **Agency by Estoppel:** The principle of estoppel is that where a person by his words or conduct willfully made other believe that certain state of affairs exists & other person acted on that belief, then he is stopped from denying the truth of such statement. Eg. X tells Y in the presence of Z that X is Z's agent & Z does not object to this statement. Y, later enters into a transaction with X believing that X is Z's agent. Z is bound by this transaction.

2) **Agency by Holding Out:** It is the extended form of agency by estoppel. The principal by his past positive act make third party believe that some other person is doing act on his behalf with authority. This is agency by holding out. For e.g. P usually sends his servant to buy goods for him on credit from Q & P pays for them. Later, servant misuses his authority & buys goods for his personal use. P is responsible for payment to Q as he had held out his servant as his agent by his past positive conduct.

3) **Agency by necessity:** Under some circumstances, law permits a person to act as agent of another person in the time of emergency without instructions from the principal. Such agency is called 'agency by necessity'. For e.g. a ship driver can borrow money at a port where owner of ship has no agent, to carry out necessary repairs of ship to complete the journey. In this situation, he can act as agent but he should act for benefit of the principal.

III. By Operation of Law

Under this case, law assumes a person to be an agent of another. For e.g. a partner is assumed as an agent of his firm.

IV. By Ratification

Ratification means subsequent acceptance & adoption of an act by the principal originally done by the agent without authority. For e.g. A insures B's goods without his authority. If B ratifies A's act, the policy will be valid as if A has authorized to insure the goods.

Ratification will bind the principal and the unauthorized act by agent becomes an authorized act. It applies with retrospective effect i.e. agency arises from the time act was done by agent & not from the date it was ratified.

I. Duties of Agent

- 1) Agent should work within the scope of his authority following the instructions of the principal.
- 2) Carry out act with reasonable skill & honesty.
- 3) Duty to give proper accounts when demanded by principal.
- 4) Duty to communicate with the principal in case of difficulty.
- 5) Duty not to deal on his own accounts and pay all benefits to the principal.

- 6) Duty not to delegate his authority.
- 7) Duty to protect the interest of the principal.

II. Rights of Agent

- 1) Right to retain money for expenses incurred in agency functions.
- 2) Right to receive remuneration if he do not misconduct.
- 3) Right of indemnification: agent has the right to be indemnified by the principal for injuries caused by principal's neglect.
- 4) Right of stoppage of principal's goods in transit in following conditions:
 - a) Where he has purchased goods for principal on personal liability.
 - b) Where he is personally liable to the principal for the price of goods sold.
This right can be exercised only when buyer becomes insolvent.

III. Duties & Rights of Principal towards Agent

The duties of agent are rights of principal & rights of agent are duties of principal.

Termination of Agency

Termination of agency means the end of relation between principal and his agent. All the modes of termination of agency may be classified under the following two heads:

- I. Termination by acts of the parties.
- II. Termination by operation of law.

Termination by Acts of the Parties

An agency stands terminated by any of the following acts of the parties:

1. **Agreement** – An agency may be terminated by the mutual agreement between the principal and the agent at any time and at any stage.
2. **Revocation by principal** – A principal can revoke the agent's authority subject to the following rules:
 - a. The principal cannot revoke the agency where the agent has an interest in the subject-matter of agency.
 - b. Revocation is possible only when the agent has not exercised the authority.
 - c. When the agency is for any fixed period of time, the principal is liable to make compensation to the agent.
 - d. Principal must give a reasonable notice for revocation of agency.
 - e. The revocation may be expressed or implied from the conduct of the principal.

3. **Renunciation (denial) by agent** – An agent may also terminate the agency by renouncing the business of the agency subject to the following rules: -



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prescribed manner 50 percent of that amount or twenty five thousand rupees, whichever is less.



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Conduct of Proceedings

Following are the major provisions regarding the conduct of proceedings of the district forum:

1. Every proceeding referred to above shall be conducted by the President of the district forum and at least one member thereof sitting together. [Sec. 14(2)]
2. Where the member, for any reason, is unable to conduct the proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.
3. Every order made by the district forum shall be signed by its president and the member or members who conducted the proceeding. [Sec. 14 (2A)]
4. Where the proceeding is conducted by the president and one member and they differ on any point or points, they shall state the point or points on which they differ and refer the same to the other member for hearing on such point or points and the opinion of the majority shall be the order of the district forum.
5. Subject to the foregoing provisions, the procedure relating to the conduct of the meeting of the district forum, its sitting and other matters shall be such as may be prescribed by the State Government. [Sec. 14 (3)]

Powers of the District Forum

For the purpose of setting the disputes, the district forum shall have the same powers as are vested in a Civil Court under Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:

- (i) Enforcing the attendance
- (ii) Discovery production of any document
- (iii) Evidence on affidavits
- (iv) Requisitioning of the report
- (v) Examination of any witness

The State Commission

The main provisions regarding the state commission are as under:

Establishment: There shall be established a consumer disputes redressal commission to be known as the State Commission by the State Government in the state by notification. [Sec. 9 (b)]

Composition: Each state commission shall consist of the following:

- (i) A person who shall be its President;

- (ii) At least Two and not more than such number of members as may be prescribed, and one of whom shall be a woman.

Qualifications: The qualifications of the members of a State commission are as follows:

- (i) The President shall be person who is or has been a Judge of a high court.
- (ii) The members shall have the following qualifications:
 - (a) They shall be not less than thirty-five years of age;
 - (b) They shall possess a bachelor's degree from a recognized university; and
 - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

Disqualifications: A person shall be disqualified for appointment as member in any of the following cases:

- (i) If he has been convicted and sentenced to imprisonment for an offence which (in the opinion of the State Government involves moral turpitude.
- (ii) If he is an undischarged insolvent.
- (iii) If he is of unsound mind and stand so declared by a competent court.
- (iv) If he has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government.
- (v) If he has, in the opinion of the State Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member.
- (vi) If he has such other disqualifications as may be prescribed by the State Government.

Appointment of President: The President of State Government shall be appointed by the State Government. However, no such appointment shall be made except after consultation with the Chief Justice of the high court. [Sec. 16 (1) (a)]

Appointment of Members: Every appointment shall be made by the State Government on the recommendation of a selection committee consisting of the following, namely:

- (i) The President of the State Commission -
Chairman
- (ii) Secretary, Law Department of the State -
Member



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(iii) Secretary, in charge of the department dealing with consumer affairs in the State.

- Member

Salary and Terms and Conditions of service: The State and national commission other allowances payable to and the other terms and conditions of service of the members of the state commission shall be such as may be prescribed by the State Government. [Sec.16 (2)]

Terms of Office: Every member of the State Commission shall hold office for a term of five years or up to the age of 67 years, whichever is earlier. [Sec. 16(3)]

Reappointment: A member shall be eligible for reappointment for another term of five years or up to the age of sixty-seven years, whichever is earlier, subject to the condition that he fulfills the qualifications and other conditions for appointment. Such re-appointment shall be made on the basis of the recommendation of the Selection Committee.

A person appointed as a President of the State Commission shall also be eligible for re-appointment in the manner provided in this section.

Resignation and Filling the Vacancy: A member may resign his office in writing under his hand addressed to the State Government. On such resignation being accepted, his office shall become vacant. The vacancy may be filled by the appointment of a person possessing the qualifications in relation to the category of the member who is required to be appointed in place of the person who has resigned.

Jurisdiction of the State Commission: According to section 17, the Jurisdiction of the State Commission is as follows:

- A. To entertain complaints where the value of the goods or services and compensation, if any, claimed exceeds Rs. 20 lakh but does not exceed Rs. 1 crore.
- B. To entertain appeals against the order of any district forum within the State.
- C. To entertain a complaint if the opposite party or each of the opposite parties at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain within the limits of jurisdiction of the commission.
- D. To entertain a complaint if any of the opposite parties at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain within the jurisdiction of the commission.



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Benches of the State Commission

The jurisdiction, powers and authority of the state commission may be exercised by its benches. The constitution and working procedure of a bench shall be as follows:

1. **Composition:** A bench may be constituted by the President with one or more members as the president may deem fit.
2. **Process of Decision Making:** If the members of a bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority. But if the members are equally divided, they shall state the points on which they differ and they shall make a reference to the president.
3. **Circuit Benches:** The state commission shall ordinarily function in the state capital but may perform its functions at such other place as the state government may, in consultation with the state commission, notify in the official gazette, from time to time.

Other Provisions

1. **Transfer of cases:** On the application of the complainant or of its own motion, the state commission may, at any stage of the proceeding, transfer any complaint pending before the district forum to another district forum within the state if the interest of justice so requires.
2. **Procedure applicable to state commissions:** The provisions of sections 12, 13 and 14 and the rules made there under for the disposal of complaints by the district forum shall with such modifications as may be necessary be applicable to the disposal of disputes by the state commission. [Sec. 18]
3. **Appeals:** Any person aggrieved by an order made by the state commission in exercise of its powers conferred by sub-clause (i) of clause (a) of section 17 may prefer an appeal against such order to the national commission within a period of thirty days from the date of the order in such form and manner as may be prescribed. [Sec. 19]
4. **Hearing of Appeal:** An appeal filed before the state commission or the national commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of ninety days from the date of its admission.

The National Commission

The main provisions regarding the National Commission are as under:



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Establishment: There shall be established a National Consumer Disputes Redressal Commission by the Central Government by notification. [Sec. 9 (c)]

Composition: The national commission shall consist of the following:

- (i) A person shall be its President;
- (ii) At least four and not more than such number of members as may be prescribed by the central government. However, one of whom shall be a woman.

Qualifications: The qualifications of the members of a national commission are as follows:

- (i) The President shall be person who is or has been a Judge of the Supreme Court.
- (ii) The members shall have the following qualifications:
 - (a) They shall be not less than thirty-five years of age;
 - (b) They shall possess a bachelor's degree from a recognized university; and
 - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

Disqualifications: A person shall be disqualified for appointment as member in any of the following cases:

- (i) If he has been convicted and sentenced to imprisonment for an offence which involves moral turpitude.
- (ii) If he is an undischarged insolvent.
- (iii) If he is of unsound mind and stand so declared by a competent court.
- (iv) If he has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government.
- (v) If he has, in the opinion of the Central Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member.
- (vi) If he has such other disqualifications as may be prescribed by the Central Government.

Appointment of President: The President of shall be appointed by the Central Government. However, no such appointment shall be made except after consultation with the Chief Justice of India.

Appointment of Members: Every appointment under this clause shall be made by the Central Government on the recommendation of a selection committee consisting of the following, namely:

- (i) A person who is a Judge of the Supreme Court, to be nominated by the chief justice of India

- Chairman

(ii) The Secretary in the Department of legal affairs in the government of India-Member

(iii) Secretary of the Department Dealing with consumer affairs in the Government of India-Member

Salary and Terms and Conditions of service: The Salary or honorarium and other allowances payable to and the other terms and conditions of service of the members of the national commission shall be such as may be prescribed by the Central Government. [Sec. 20 (2)]

Terms of Office: Every member of the National Commission shall hold office for a term of five years or up to the age of 70 years, whichever is earlier. [Sec. 20(2)]

Reappointment: A member shall be eligible for reappointment for another term of five years or up to the age of seventy years, whichever is earlier. Such re-appointment shall be made on the basis of the recommendation of the Selection Committee.

A person appointed as a President of the National Commission shall also be eligible for re-appointment in the manner provided in this section.

Resignation and Filling the Vacancy: A member may resign his office in writing under his hand addressed to the Central Government. On such resignation being accepted, his office shall become vacant. The vacancy may be filled by the appointment of a person possessing any of the qualifications in relation to the category of the member who is required to be appointed in place of the person who has resigned.

Jurisdiction of the National Commission: The Jurisdiction of the National Commission is as follows:

- A. To entertain complaints where the value of the goods or services and compensation, if any, claimed exceeds Rs. 1 crore.
- B. To entertain appeals against the order of any State Commission.
- C. To call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission.

Power and Procedure applicable to the National commission: The provisions of sections 12, 13 and 14 and the rules made there under for the disposal of complaints by the district forum shall, with such modifications as may be considered necessary by the commission, be applicable to the disposal of disputes by the National Commission.

Power to set aside ex party Order: Where an order is passed by the national commission ex party against the opposite party or a complainant, as the case may be, the aggrieved party may apply to the commission to set aside the said order in the interest of justice.



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Transfer of cases: On the application of the complainant or of its own motion, the national commission may, at any stage of the proceeding, in the interest of justice, transfer any complaint pending before the district forum of one state to a district forum of another state or before one state commission to another state commission.

Benches of the national commission: The jurisdiction, powers and authority of the national commission may be exercised by its benches thereof. The constitution and procedure of a bench shall be as follows:

(a) **Constitution:** - A bench may be constituted by the President with one or more members as the president may deem fit.

(b) **Process of Decision Making:** - If the members of a bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority. But if the members are equally divided, they shall state the point or points on which they differ they shall make a reference to the president. The president shall either hear the point or points himself or refer the case for hearing on such points by one or more or the other members. Then such points shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it.

(c) **Circuit Benches:** - The National commission shall ordinarily function in the state capital but may perform its functions at such other place as the central government may, in consultation with the National Commission, notify in the official gazette, from time to time.

Appeal: Any person, aggrieved by an order made by the National commission in exercise of its power conferred may prefer an appeal against such order of Supreme Court within a period of thirty days from the date of the order.

A Comparative Study of District Forum, State and National Commission

Basis of distinction	District Forum	State Commission	National Commission
1. Establishment	A District forum is established by the State Government.	A State Commission is established by the State Government.	A National Commission is established by the Central Government.
2. Number	There can be one or more district forums in a district.	There can be only one state commission in a state.	There can be only one national commission in the country.
3. Geographical jurisdiction	Its jurisdiction extends to the district or part of the district for which it is established.	Its jurisdiction extends to the whole state which it is set up.	Its jurisdiction extends to the whole of India.

4. Monetary Jurisdiction	District forum can entertain all complaints claiming not exceeding Rs. 20 lakh.	State Commission can entertain all appeals against all District Forum of the state and the complaints claiming more than Rs. 20 lakh but not exceeding Rs. 1 crore.	National Commission can entertain all appeals made against award of all complaints claiming exceeding Rs. 1 crore.
5. Number of Members	It consists maximum of three members one of whom shall be a woman.	It consists at least three members one of whom shall be a woman. But members cannot exceed the number prescribed by the Government.	It consists at least five members one of whom shall be a woman. But members cannot exceed the number prescribed by the Government.
6. President	A person who is or has been or is qualified to be a District Judge, may be its president.	A person who is or has been Judge of high court, may be appointed its president.	A person who is or has been Judge of the supreme court may be its president.
7. Age limit of members	A member of district forum can hold office up to the age of 65 years.	A member of state commission can hold his office up to the age of 67 years.	A member of national commission can hold office up to the age of 70 years.
8. Salary and terms of Service	The salary and terms and conditions of service of its members are prescribed by the state government.	For its members also these are prescribed by the state government.	The salary and terms and conditions of service of its members are prescribed by the Central government.
9. Appeal	This forum entertains only complaints for claims. It cannot entertain appeals.	A state commission entertains appeals against the order made by the district forum.	National commission entertains appeals against the orders of the state commissions. Appeal against the order of the national commission can be filed in the Supreme Court of India.



10. Amount to be deposited for appeal	Appeal against the order of the district forum is entertained when appellant has deposited fifty percent of the amount specified in its order or Rs. twenty five thousand, whichever is less.	Appeal against the order of the state commission is entertained when appellant has deposited fifty percent of the amount specified in its order or Rs. thirty thousand, whichever is less.	Appeal against the order of the national commission is entertained when appellant has deposited fifty percent of the amount specified in its order or Rs. fifty thousand, whichever is less.
11. Control	The state commission has administrative control over the District forum.	The national commission has administrative control over the state commission.	The national commission is an independent institution.



3.6 Let's Sum-up

The Consumer Protection Act, 1986 was established to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consumers' disputes and for matters connected therewith. Various consumer dispute redressal agencies has been set up at district, state and national level to resolve the consumer complaints.

3.7 Key Terms

Consumer: A consumer of goods means any person who buys any goods or services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment.

Consumer Protection Council: The councils established to keep a surveillance over the protection of consumer rights are called consumer protection councils.

Dispute Redressal Agencies: To provide speedy and simple redressal of consumer disputes, a three-tier quasi-judicial machinery has been set-up at district, state and national level. These are called consumer redressal agencies.

3.8 Self-Assessment Questions

1. What are the qualifications of the members of a national commission?
2. State the objectives of the Consumer Protection Act, 1986.
3. Discuss the purpose of formulating the Central Consumer Protection Council.



3.9 Further Readings

- Rao K. Madhusudhana, *Cases and Materials on the Consumer Protection Act, 1986*, Asia Law House.
- Singh Avatar, *Consumer Protection (Law and Practice)*, Eastern Book Company.
- Gupta S.P. Sen, *Commentaries on Consumer Protection Act*, Kamal Law House.
- Majumdar P.K., *Law of Consumer Protection in India*, Orient Publishing Company.

3.10 Model Questions

1. Briefly state the important provisions of Consumer Protection Act, 1986.
2. Illustrate the various consumer rights in India.
3. Explain the quasi-judicial machinery available in India, set up for the redressal of the consumer disputes.
4. Differentiate between the working and jurisdiction of State Commission and National Commission.
5. Discuss the procedure of filing a complaint with regards to defective goods.

Answers to Self-Assessment Questions

1. The qualifications of the members of a national commission are as follows:
 - (i) The President shall be person who is or has been a Judge of the Supreme Court.
 - (ii) The members shall have the following qualifications:
 - (a) They shall be not less than thirty-five years of age;
 - (b) They shall possess a bachelor's degree from a recognized university; and
 - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.
2. Consumer Protection Act is formulated to achieve the following objectives:
 - a. To provide for better protection of the interests of the consumers.
 - b. To promote and protect the rights of consumers.

- c. To make provision for the establishment of consumer councils and other authorities for the settlement of consumer disputes.
 - d. To setup quasi-judicial machinery at district, state and central level for speedy and simple redressal of consumer disputes.
3. The purpose of formulating the Central Consumer Protection Council is to promote and protect the rights of the consumers such as:
- (i) The right to be protected against the marketing of goods and services which are hazardous to life and property.
 - (ii) The right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices.
 - (iii) The right to be assured, wherever possible, access to a variety of goods and services at competitive prices.
 - (iv) The right to be heard and to be assured that consumer's interests will receive due consideration at appropriate forums.
 - (v) The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers.
 - (vi) The right to consumer education.



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