CA FOUNDATION

BUSINESS LAWS

Concept Book

- 100% ICAI syllabus coverage
- Exam-relevant keywords highlighted
- Simplified, exam-focused concepts
- Examples & Case laws included

CA Nikesh Agrawal

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Preface

At **CA Wallah by PW**, our mission is simple—to help CA Foundation aspirants build strong conceptual clarity through content that is accurate, structured, and fully aligned with ICAI's standards.

We are delighted to introduce the **First Edition of the CA Foundation Business Laws - Concept book by CA Nikesh Agrawal Sir**, a book designed to prioritize clarity, relevance, help students develop concepts systematically, and approach the subject with confidence

This book has been developed through close collaboration between experienced **faculty**, **subject matter experts**, **academic reviewers** and **designers**. Their combined expertise ensures that every chapter is presented in a student-friendly manner, enhancing the overall quality while maintaining conceptual depth and alignment with ICAI standards.

The guiding philosophy of this book is **"Strong Concepts with Smart Revision"**. Designed as a detailed concept companion, it works best when paired with the **Summary Book** in your regular study plan, especially for last-stage exam preparation.

KEY FEATURES

- **100% coverage of the latest ICAI Study Material**, ensuring complete syllabus alignment.
- **Relevant keywords highlighted** to help students frame scoring, exam-oriented answers
- **Complex legal concepts simplified** through a structured and exam-focused approach
- **Examples** and **Case Laws** for better conceptual understanding

We hope this Concept Book becomes a reliable companion in your CA Foundation preparation and helps you master Business Laws with clarity and confidence.

Wishing you focused preparation and great success!

About the Author

CA Nikesh Agrawal is a result-driven Chartered Accountant, Educator, and Mentor with a strong passion for teaching and student development. He is widely appreciated for his structured approach, conceptual clarity, and exam-oriented guidance.

With over 5+ years of teaching experience, he has guided 20,000+ students at the CA Foundation and CA Intermediate levels, helping them not only achieve academic success but also develop confidence, discipline, and the right mindset required to clear the CA examinations.

He firmly believes that success in the CA course is a combination of clarity, consistency, and correct strategy, and his teaching methodology reflects this belief in every classroom interaction.

Content

1. Indian Regulatory Framework.....1-11
2. The Indian Contract Act, 1872.....12-148
3. The Sale of Goods Act, 1930 149-196
4. The Indian Partnership Act, 1932 197-234
5. The Limited Liability Partnership Act, 2008 235-246
6. The Companies Act, 2013 247-278
7. The Negotiable Instruments Act, 1881.....279-298

CA WALLAH

TOP RANKS EVERY ATTEMPT

KUSHAGRA ROY

1 AIR

CA INTERMEDIATE MAY 2024

ADARSH MAURYA — 13 AIR

ABHIMANYU GOYAL — 14 AIR

SAKSHAM AGARWAL — 15 AIR

ADITI SAPRA — 23 AIR

CHURAMANI REGMI — 25 AIR

PIYUSH GUPTA — 27 AIR

ROHAN GUPTA — 30 AIR

KUSHAGRA HANDA — 31 AIR

SIYA — 31 AIR

AMAN VERMA — 31 AIR

ANKIT GOYAL — 33 AIR

VANSH GUPTA — 34 AIR

MOHIT — 34 AIR

KESHAV LADDHA — 34 AIR

GARVIT — 35 AIR

SHIVAM SINGLA — 36 AIR

SHRISHTI — 37 AIR

ANGELICA — 38 AIR

FATIMA ANSARI — 39 AIR

PRINCE — 39 AIR

ANSH — 41 AIR

KRUNAL RAJKUMAR S. — 41 AIR

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KALMARUDAPPA H N — 43 AIR

KUSH AGARWAL — 45 AIR

BHUMIKA — 46 AIR

VANSH MODI — 46 AIR

ROUNAK RATWANI — 47 AIR

ARMAAN KHAN — 48 AIR

JAY SANJEEV KAROSHI — 49 AIR

YASH MISHRA — 50 AIR

24 AIRs IN LAST 2 ATTEMPTS

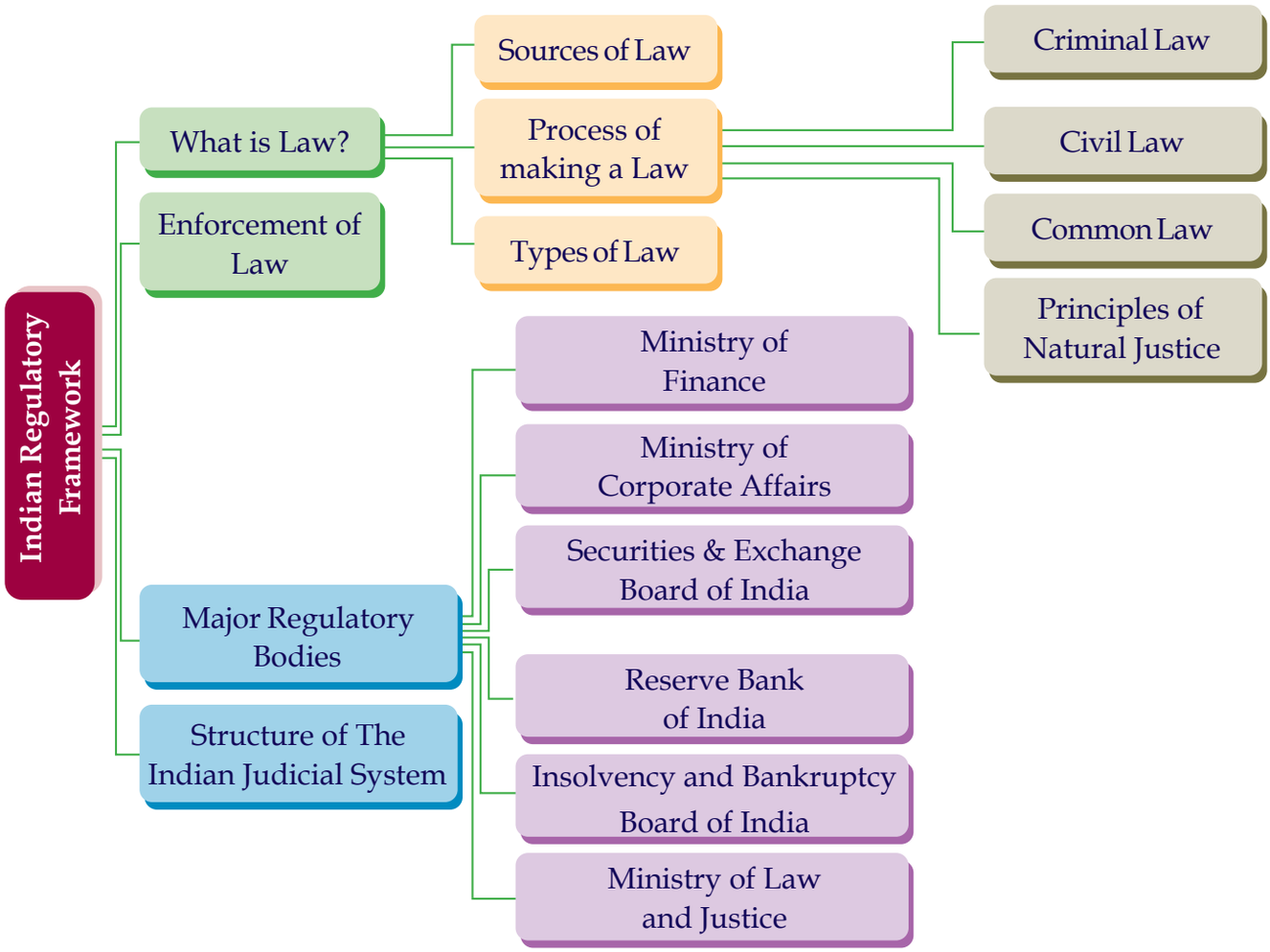
CHAPTER

01

Indian Regulatory Framework

TABLE OF CONTENTS FOR THE CHAPTER

- INTRODUCTION 2
- WHAT IS LAW? 3
- SOURCES OF LAW? 3
- PROCESS OF MAKING A LAW? 4
- ENFORCING THE LAW 6
- STRUCTURE OF THE INDIAN JUDICIAL SYSTEM 10



❒ INTRODUCTION

Awareness of the law is essential to become a full-fledged Chartered Accountant. This is because a **Chartered Accountant is the first level of contact on many legal matters**. So, we should possess knowledge of law so that we can **advise** our management and clients on legal matters at a basic or threshold level.

Purpose

The purpose of a regulatory framework is to provide a set of **uniform rules and regulations** that will govern the **conduct** of people interacting with each other in **personal** as well as business relationships.

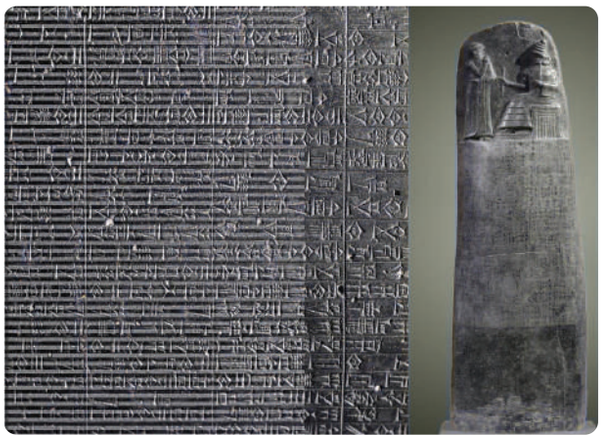
Earlier Laws

If we talk about **ancient law**, on the basis of information available from different sources "**Code of Hammurabi" is known for oldest law** in written form.

King Hammurabi ruled Babylon for the period from 1792 BC to 1758 BC.

He **carved the code on bulky stone** slabs and ordered to place those stones on different places all over the city so that the public may have the knowledge of codes.

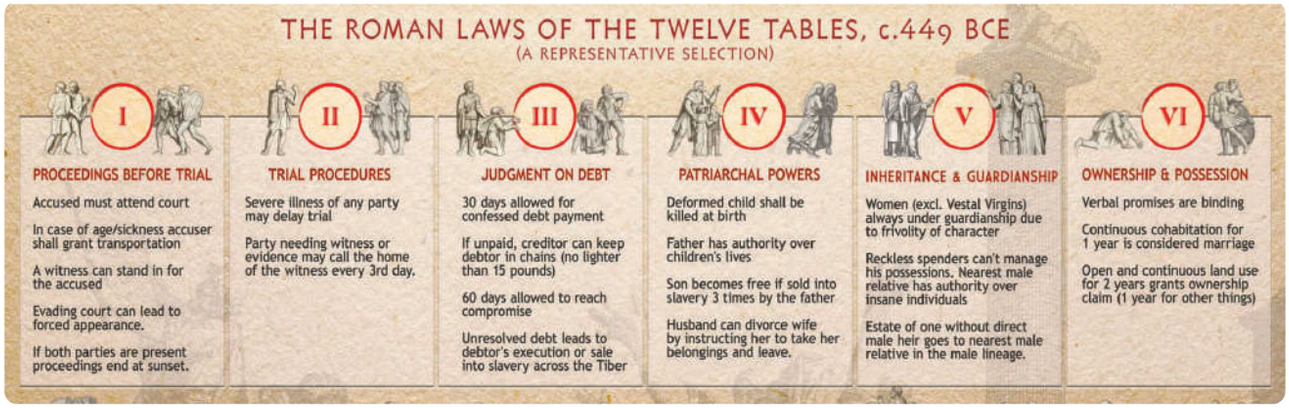
He also **appointed judges** to check whether public is following the laws or not.

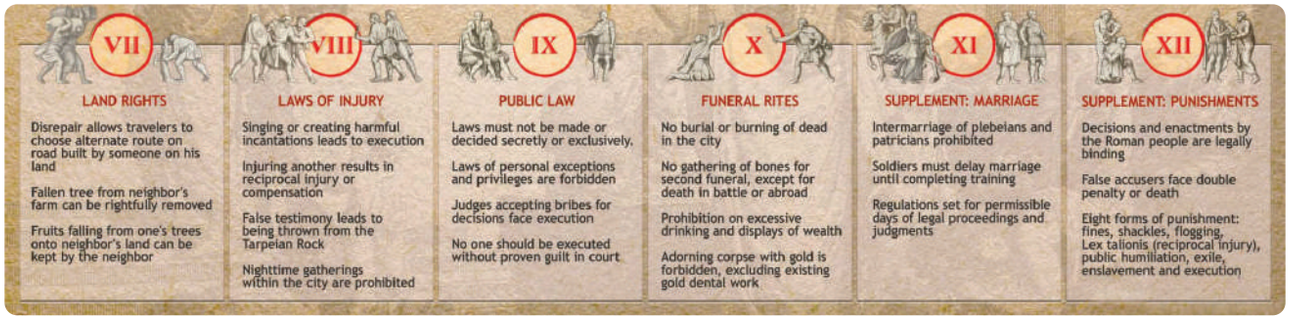


In 450 BC, a set of laws was engraved on **12 bronze tablets in Rome** which is considered as **first most detailed code of any of the civilisations** and **called Twelve Tables**.

The **purpose** of these tables was to **protect the rights of public and to provide remedy for wrongs.**

All the citizens of Rome were supposed to have the knowledge of these tables. Over the time, many amendments were done in these laws as per the requirements.





❒ WHAT IS LAW?

- Law is a **set of obligations and duties imposed by the government for securing welfare and providing justice to society.** India's legal framework reflects the **social, political, economic, and cultural aspects** of our vast and diversified country.

❒ SOURCES OF LAW?

- The **main sources of law in India are the Constitution**, the **statutes** or laws made by Parliament and State Assemblies, **Precedents or the Judicial Decisions** of various Courts and in some cases, established **Customs and Usages.**
- You must be aware that **India is a parliamentary democracy**. We have a constitution which is the basis and source for all laws. **We elect our representatives** to the parliament as well as to the legislative assemblies of various States.

  These representatives of the people make laws in parliament or in their state assemblies as the case may be. So, Parliament is the ultimate law-making body. The **laws passed by parliament may apply throughout all or a portion of India, whereas the laws passed by state legislatures apply only within the borders of the states concerned.**
- The Government of India Act, 1935, passed by the Parliament of the United Kingdom is the precursor for the Constitution of India. **It defined the characteristics of the Government from "unitary" to "federal". Powers were distributed between Centre and State to avoid any disputes**. In 1937, Federal Court was established and had the jurisdiction of appellate, original and advisory.

  The **powers of Appellate Jurisdiction extended to civil and criminal cases whereas the Advisory Jurisdiction was extended with the powers to Federal Court** to advise Governor-General in matters of public opinion. The Federal Court operated for 12 years and heard roughly 151 cases. **The Federal Court was supplanted by India's current Apex Court, the Supreme Court of India.**
- **The Constitution of India, 1950** is the **foremost law** that deals with the **framework** within which our democratic system **works,** and our laws are made **for the people, by the people.** The Constitution also provides for and **protects certain Fundamental rights** of citizens.

  It also lays down **Fundamental duties as well as the powers** and duties of Governments, both Central and State. The **laws in India** are **interconnected** with each other forming a **hybrid legal system.**

- The people who wrote the Constitution decided to divide the **law-making power** between the **Central Government** and the various **State Governments**. So, the Indian **Constitution** has **three lists** Viz., Central List, State List and Joint List.

Constitution of India

Union List
Includes subjects like.

- Defense
- Atomic
- Energy
- Foreign
- Affairs
- War and Peace
- Banking
- Railways
- Post and Telegraph
- Airways
- Ports
- Foreign Trade
- Currency & Coinage

Union Legislature alone can make laws on these matters.

State List
Includes subjects like

- Agriculture
- Police
- Prison
- Local
- Government
- Public Heath
- Land
- Liquor
- Trade and Commerce
- Livestock and Animal
- Husbandry
- State Public
- Services

Normally only the State Legislature can make laws on these matters

Concurrent List
Includes subjects like

- Education
- Transfer of Property other than Agricultural land
- Forests
- Trade Unions
- Adulteration Adoption and Succession

Both Union and State Legislature alone can make laws on these matters.

- Depending on the list in which it figures a matter would become the subject for Central law or a State law. For **example, Income Tax is a Central subject**. So, throughout India we have only one law for Income Tax which is **implemented by the Central Government through the Ministry of Finance.** We also have matters for which both Central as well as State Governments can pass laws.

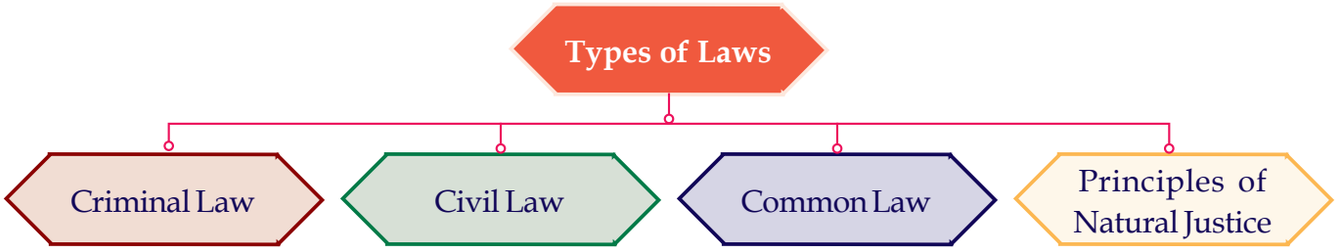
  Levy of stamp duty is such an example. Both Central Government and State Government have laws governing Levy of stamp duty.

PROCESS OF MAKING A LAW?

- When a law is **proposed** in parliament it is called a **Bill.**
- After **discussion and debate,** the law is **passed in Lok Sabha.**
- Thereafter, it has to be **passed in Rajya Sabha.**
- It then has to obtain the **assent of the President** of India.
- Finally, the law will be **notified** by the Government in the publication called the **Official Gazette of India.**
- The law will become **applicable** from the **date mentioned** in the notification as the effective date.
- Once it is notified and effective, it is **called an Act of Parliament.**

Types of Laws in the Indian Legal System

The laws in the Indian legal system could be broadly classified as follows:



Criminal law

- **Criminal law** is concerned with laws pertaining to **violations** of the rule of law or public wrongs and **punishment** of the same.
- **Criminal Law is governed under the Indian Penal Code, 1860, and the Code of Criminal Procedure, 1973 (Crpc).**
- **The Indian Penal Code, 1860, defines the crime, its nature, and punishments** whereas the Criminal Procedure Code, 1973, **defines exhaustive procedure** for executing the punishments of the crimes.
- **Murder, rape, theft, fraud, cheating** and assault are some examples of criminal offences under the law.

Civil law

- **Matters of disputes between individuals or organisations are dealt with under Civil Law**.
- Civil courts enforce the **violation of certain rights and obligations** through the institution of a civil suit.
- Civil law primarily **focuses on dispute resolution rather than punishment**. The act of process and the administration of civil law are **governed by the Code of Civil Procedure, 1908 (CPC).**
- Civil law can be further **classified into Law of Contract, Family Law, Property Law, and Law of Tort**.
- Some **examples** of civil offences are breach of contract, **non-delivery of goods, non-payment of dues** to lender or seller defamation, breach of contract, and disputes between landlord and tenant.

Common law

- **A judicial precedent or a case law is common law**.
- A **judgment** delivered by the **Supreme Court** will be **binding** upon the courts within the territory of India under **Article 141** of the Indian Constitution.
- The **doctrine of Stare Decisis is the principle supporting common law**. It is a Latin phrase that means "to stand by that which is decided."
- The doctrine of Stare Decisis **reinforces the obligation of courts to follow the same principle or judgement established by previous decisions while ruling a case where the facts are similar or "on all four legs" with the earlier decision.**

Principles of natural justice

- Natural justice, **often known as Jus Natural deals with certain fundamental principles of justice going beyond written law.**
- **Nemo judex in causa sua** (Literally meaning "No one should be made a judge in his own cause, and it's a Rule against Prejudice), **audi alteram partem** (Literally meaning "hear the other party or give the other party a fair hearing), and **reasoned decision** are the rules of Natural Justice.
- A **judgement can override or alter a common law, but it cannot override or change the statute**.

❒ ENFORCING THE LAW

- **After a law is passed in parliament it has to be enforced**. Somebody should **monitor** whether the law is being followed. This is **the job of the executive.** Depending on whether a law is a **Central law or a State law** the Central or State Government will be the enforcing authority. For this purpose government functions are **distributed to various ministries.** Some of the **popular Ministries** are the Ministry of Finance, the Ministry of Corporate Affairs, the Ministry of Home Affairs, the Ministry of Law and Justice and so on. **These Ministries are headed by a minister and run by officers of the Indian administrative and other services**.
- The Government of India exercises its **executive authority through** a number of Government **Ministries** or Departments of State. **A Ministry is composed of employed officials, known as civil servants, and is politically accountable through a minister.** Most major Ministries are **headed by a** Cabinet Minister, who sits in the Union Council of Ministers, and is typically supported by a team of junior ministers called the Ministers of State.
- **For example, the Income Tax Act** is implemented and enforced by the Ministry of Finance through the Central Board for Direct Taxes coming under the Department of Revenue and is administered by the officers of the Indian Revenue Service. We will see some of the major Ministries and the laws which are enforced by them:

The Ministry of Finance

- The Ministry of Finance (Vitta Mantralaya) is a Ministry within the Government of India.
- **Concerned with** the economy of India, serving as the Treasury of India. In particular, it **concerns itself with** taxation, financial legislation, financial institutions, capital markets, centre and state finances, and the Union Budget.
- As a **Chartered Accountant,** many of your **day-to-day work** life will be impacted by this ministry and its proclamations.
- This Ministry is so important that many ministers have **preferred** to hold the portfolio of Finance Minister also.
- **One of the important functions** of the Finance Ministry is the presentation of the **Union Budget.**
- This annual event is **eagerly awaited** by professionals and the common man as it provides for the rates of taxes and budget allocations for the ensuing year.

- Who presented the Maximum number of Union Budgets as Finance Minister?

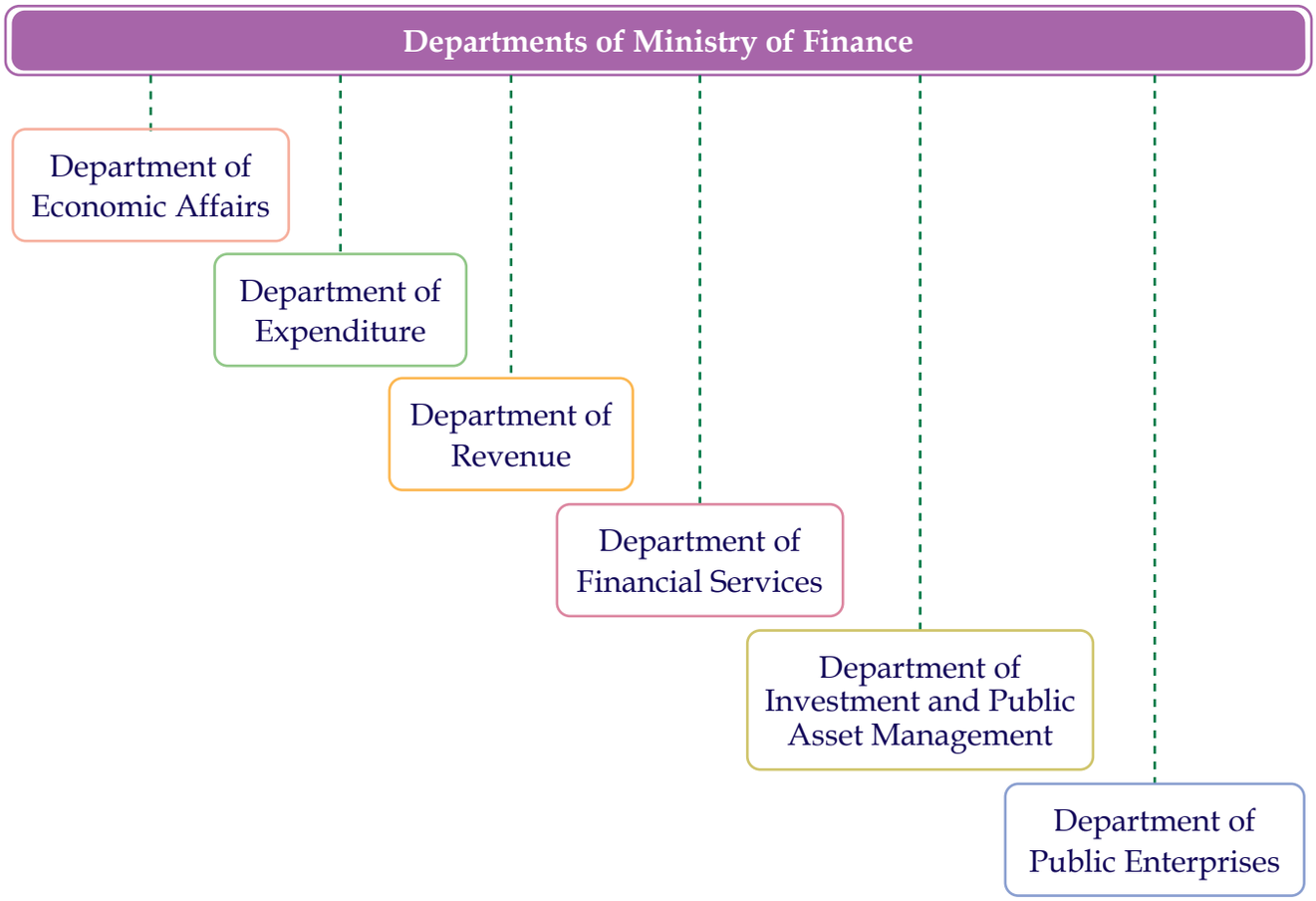
  Shri. Morarji Desai during his stint as Finance Minister between 1962 and 1969 has **presented 10 Union Budgets making it the highest**.
- The next on the list is Shri. P Chidambaram at 9, followed by Shri. Pranab Mukherjee at 8. Shri. Yashwant Sinha and Dr. Manmohan Singh have presented 8 and 6 budgets respectively.

Constitution of the Ministry of Finance

Ministry of Finance

- is the **apex controlling authority**
- of **four Central Civil Services,** namely:
  - Indian Revenue Service
  - Indian Audit and Accounts Service
  - Indian Economic Service and
  - Indian Civil Accounts Service
- Also the **apex controlling authority** of one of the central commerce services namely
- Indian Cost and Management Accounts Service

Departments under the Ministry of Finance



(i) Ministry of Corporate Affairs (MCA)

Ministry of Corporate Affairs

- Is an Indian Government Ministry.
- **Primarily concerned** with **administration** of the **Companies** Act 2013, the Companies Act 1956, the **Limited Liability Partnership** Act, 2008, and the **Insolvency and Bankruptcy Code,** 2016.
- **Responsible mainly for** the **regulation of Indian enterprises** in the industrial and services sector.
- The Ministry is mostly **run by** civil servants of the **ICLS cadre.**
- These officers are **elected through** the Civil Services Examination **conducted by** Union Public Service Commission.
- The **highest post,** Director General of Corporate Affairs **(DGCoA),** is fixed at Apex Scale for the ICLS.

Ministry of Home Affairs (Grha Mantralaya)

- Is a ministry of the Government of India.
- As an **interior ministry** of India, it is **mainly responsible** for the maintenance of **internal security and domestic policy.**
- The Home Ministry is **headed by** Union Minister of Home Affairs.

Departments of Ministry of Home Affairs

- Department of Border Management
- Department of Internal Security
- Department of Official language
- Department of States
- Department of Jammu, Kashmir and Ladakh Affairs
- Department of Home

Department of Official Language

- Central Translation Bureau
- Central Hindi Training Institute
- Directorate of Census Operations

Ministry of Law and Justice

Ministry of Law and Justice

- In the Government of India is a **Cabinet Ministry**
- deals with the
  - Management of the **legal affairs,** through the **Legislative Department**
  - **Legislative activities** through the Department of **Legal Affairs**
  - **Administration of justice** in India through the **Department of Justice**
- The Department of **Legal Affairs** is concerned with **advising the various Ministries** of the Central Government while the **Legislative** Department is concerned with **drafting** of principal legislation for the Central Government.

Departments of Ministry of Law and Justice

- Department of Legal Affairs
- Legislative Department
- Department of Justice

(ii) Securities & Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI)

- Is the **regulatory body**
- For **securities and commodity** market in India
- Under **the ownership of Ministry of Finance** within the Government of India.
- It was **established on** 12 April, 1988 as an executive body and was given **statutory powers** on 30 January, 1992 through the SEBI Act, 1992.

(iii) Reserve Bank of India (RBI)

Reserve Bank of India

- Is **India's Central Bank** and regulatory body **responsible for regulation of the Indian banking system.**
- It is under the **ownership of Ministry of Finance**, Government of India.
- It **is responsible** for the **control, issue and maintaining supply** of the Indian rupee.
- It also manages the country's **main payment systems** and works to **promote** its economic development.
- **Bharatiya Reserve Bank Note Mudran (BRBNM)** is a specialised division of RBI through which it prints and mints Indian currency notes (INR) in two of its currency printing presses located in Nashik (Western India) and Dewas (Central India).

- RBI established the **National Payments Corporation of India** as one of its specialised division to regulate the payment and settlement systems in India.
- **Deposit Insurance and Credit Guarantee Corporation** was established by RBI as one of its specialised division for the purpose of providing insurance of deposits and guaranteeing of credit facilities to all Indian banks.

(iv) Insolvency and Bankruptcy Board of India (IBBI)

Insolvency and Bankruptcy Board of India (IBBI)

- Is the regulator for **overseeing insolvency proceedings and entities** like Insolvency Professional Agencies **(IPA),** Insolvency Professionals **(IP)** and Information Utilities **(IU)** in India.
- It was **established on** 1 October 2016 and given statutory **powers through** the Insolvency and Bankruptcy Code, which was passed by Lok Sabha on 5th May 2016.
- It **covers** Individuals, Companies, Limited Liability,

  Partnerships and Partnership firms. The new code will **speed up** the **resolution process for stressed assets** in the country.
- It attempts to **simplify the process** of insolvency and bankruptcy proceedings.
- It handles the **cases using two tribunals** like NCLT (National company law tribunal) and Debt recovery tribunal.

STRUCTURE OF THE INDIAN JUDICIAL SYSTEM

When there is a **dispute between citizens or between citizens and the Government**, these disputes are resolved by the judiciary.

The **functions** of judiciary system of India are:

- **Regulation of the interpretation** of the Acts and Codes.
- **Dispute Resolution**.
- **Promotion of fairness** among the citizens of the land.

In the **hierarchy of courts, the Supreme Court is at the top**, followed by the **High Courts** and **District Courts. Decisions of a High Court are binding** in the **respective state** but are only persuasive in other states. **Decisions of the Supreme Court** are **binding** on **all High Courts** under Article **141** of the Indian Constitution. In fact, a **Supreme Court decision is the final word** on the matter.

Supreme Court

- **The Supreme Court** is the **apex body** of the judiciary.
- It was **established on 26th January, 1950**.
- The **Chief Justice of India** is the **highest authority** appointed under Article **126**.
- The **principal bench** of the Supreme Court **consists of seven members** including the Chief Justice of India.

- **Presently,** the number has increased to **34** including the Chief Justice of India due to the **rise in the number of cases** and workload.
- An individual can **seek relief** in the Supreme Court by filing a writ petition **under Article 32**.

High Court

- The **highest court of appeal in each state and union territory** is the High Court.
- **Article 214** of the Indian Constitution states that there must be a High Court in each state. The High Court **has appellant**, **original** jurisdiction, and **Supervisory** jurisdiction.
- **However, Article 227 of the Indian Constitution limits a High Court's supervisory power. In India, there are twenty-five High Courts**, one for each state and union territory, and one for each state and union territory.
- **Six states share a single High Court**. An individual can seek remedies against violation of fundamental rights in High Court by filing a writ under Article 226.
- **Question:** Which is the oldest High Court in India?

  Answer: The oldest high court in the country is the Calcutta High Court, established on 2nd July, 1862.

District Court

- **Below the High Courts** are the District Courts. The Courts of District Judge **deal with Civil law matters** i.e. contractual disputes and **claims for damages etc**., The **Courts of Sessions deals with Criminal** matters.
- Under pecuniary jurisdiction, **a civil judge can try suits valuing not more than Rupees two crore**.
- Jurisdiction means the power to control. Courts get **territorial Jurisdiction based on the areas covered by them.** Cases are decided based on the **local limits** within which the **parties reside** or the **property under dispute** is situated.

Metropolitan Court

- Metropolitan courts are **established in metropolitan cities in consultation with the High Court** where the **population is ten lakh or more**.
- **Chief Metropolitan Magistrate** has powers as Chief Judicial Magistrate and **Metropolitan Magistrate has powers** as the Court of a Magistrate of the first class.

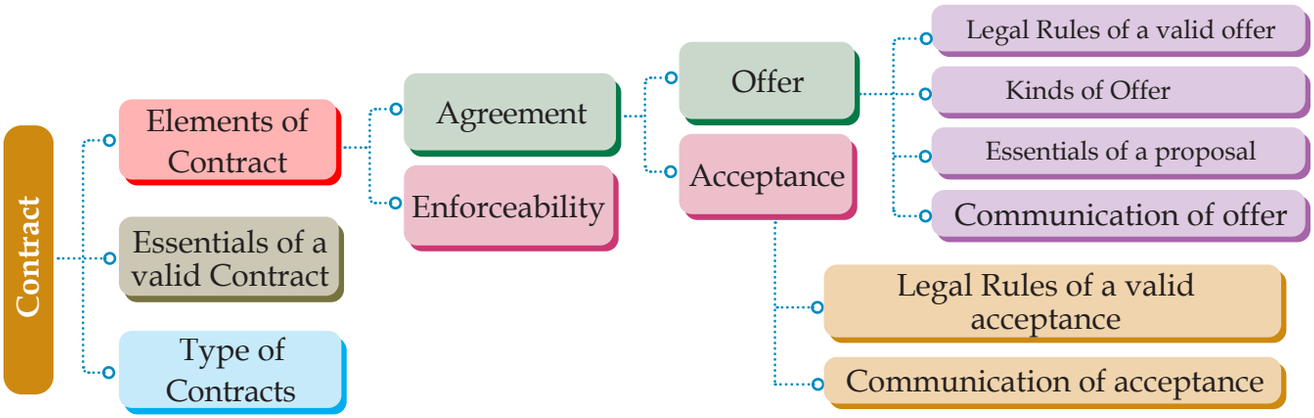
CHAPTER

02 The Indian Contract Act, 1872

UNIT 01 NATURE OF CONTRACTS

TABLE OF CONTENTS FOR THE CHAPTER

- LAW OF CONTRACT - INTRODUCTION 12
- WHAT IS A CONTRACT? 13
- ESSENTIALS OF A VALID CONTRACT 15
- TYPES OF CONTRACTS 19
- PROPOSAL OFFER - SEC 2(A) OF THE ICA, 1872) 24
- ACCEPTANCE 31
- COMMUNICATION OF OFFER & ACCEPTANCE 34
- COMMUNICATION OF PERFORMANCE 37
- REVOCATION OF OFFER & ACCEPTANCE 38



LAW OF CONTRACT - INTRODUCTION

- The Law of Contract constitutes the most important branch of mercantile or commercial law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the civilized world. The law relating to contract is governed by the Indian Contract Act, 1872.
- It was formed on April 25, 1872 and came into force on September 01, 1872. The preamble to the Act says that it is an Act "to define and amend certain parts of the law relating to contract".

It extends to the whole of India including the state of Jammu and Kashmir after removal of Article – 370 of Indian Constitution.

- The Act mostly deals with the general principles and rules governing contracts. The Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, e.g., Indemnity and guarantee, bailment, pledge, and agency.
- As a result of increasing complexities of business environment, innumerable contracts are entered into by the parties in the usual course of carrying on their business. 'Contract' is the most usual method of defining the rights and duties in a business transaction. This branch of law is different from other branches of law in a very important aspect. It does not prescribe so many rights and duties, which the law will protect or enforce; instead it contains a number of limiting principles subject to which the parties may create rights and duties for themselves.
- The Indian Contract Act, 1872 codifies the legal principles that govern 'contracts'. The Act basically identifies the ingredients of a legally enforceable valid contract in addition to dealing with certain special type of contractual relationships like indemnity, guarantee, bailment, pledge, quasi contracts, contingent contracts etc. It basically defines the circumstances in which promises made by the parties to a contract shall be legally binding on them.

WHAT IS A CONTRACT?

- The term contract is defined under section 2(h) of the Indian Contract Act, 1872 as- "an **agreement enforceable by law".**
- The contract consists of two essential elements:
  - (i) an a**greement**, and
  - (ii) its **enforceability by law.**
    - (i) Agreement - The term 'agreement' given in Section 2(e) of the Act is defined as- "**every promise and every set of promises**, forming the **consideration** for each other".

      Section 2 (b) defines promise as- "when the person to whom the **proposal is made** signifies his **assent** there to, the proposal is said to be **accepted.** Proposal **when accepted,** becomes a **promise**".

      The following points emerge from the above definition:

      1. when the person to whom the proposal is made
      2. signifies his assent on that proposal which is made to him
      3. the proposal becomes accepted
      4. accepted proposal becomes promise

- Thus, we say that an agreement is the result of the proposal made by one party to the other party and that other party gives his acceptance thereto of course for mutual consideration.

  Agreement = **Offer/Proposal + Acceptance + Consideration**

  (ii) Enforceability by law - An agreement to become a contract must give rise to a legal obligation which means a duly enforceable by law.

  Thus, from above definitions it can be concluded that -

  Contract = **Agreement + Enforceability** by law

- On elaborating the above two concepts, it is obvious that contract comprises of an agreement which is a promise or a set of reciprocal promises, that a promise is the acceptance of a proposal giving rise to a binding contract. Further, section 2(h) requires an agreement capable of being enforceable by law before it is called 'contract'. Where parties have made a binding contract, they created rights and obligations between themselves.

Example 1:

A agrees with B to sell car for ₹ 2 lacs to B. Here A is under an obligation to give car to B and B has the right to receive the car on payment of ₹ 2 lacs and also B is under an obligation to pay ₹ 2 lacs to A and A has a right to receive ₹ 2 lacs.

Example 2:

Father promises his son to pay him pocket allowance of Rs. 500 every month. But he refuses to pay later. The son cannot recover the same in court of law as this is a social agreement. This is not created with an intention to create legal relationship and hence it is not a contract.

- So, Law of Contract deals with only such legal obligations which has resulted from agreements. Such obligation must be contractual in nature. However, some obligations are outside the purview of the law of contract.

Example 3:

An obligation to maintain wife and children, an order of the court of law etc. These are status obligations and so out of the scope of the Contract Act

Difference between Agreement and Contract

Basis	Agreement	Contract
Meaning	Every promise and every set of promises, forming the consideration for each other. (Promise + Consideration)	Agreement enforceable by law. (Agreement + Legal enforceability)
Scope	It's a wider term including both legal and social agreement.	It is used in a narrow sense with the specification that contract is only legally enforceable agreement.
Legal obligation	It may not create legal obligation. An agreement does not always grant rights to the parties	Necessarily creates a legal obligation. A contract always grants certain rights to every party.
Nature	All agreement are not contracts.	All contracts are agreements.

❒ ESSENTIALS OF A VALID CONTRACT

	As given by Section 10 of Indian Contract Act, 1872		Not given by Section 10 but are also considered essential
1.	Agreement	1.	Two parties
2.	Free consent	2.	Intention to create legal relationship
3.	Competency of the parties	3.	Fulfilments of legal formalities
4.	Lawful consideration	4.	Certainty of meaning
5.	Legal object	5.	Possibility of performance
6.	Not expressly declared to be void [as per Section 24 to 30 and 56]		

- In terms of Section 10 of the Act, "all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void".
- Since section 10 is not complete and exhaustive, so there are certain other sections which also contains requirements for an agreement to be enforceable. Thus, in order to create a valid contract, the following elements should be present:

1. Two Parties

One **cannot contract with himself.** A contract involves **at least two parties**- one party making the offer and the other party accepting it.

A contract may be made by **natural persons** and by other persons having **legal existence,** e.g. companies, universities etc.

It is necessary to remember that **identity** of the parties be **ascertainable.**

To constitute a contract of sale, there must be two parties- seller and buyer. The seller and buyer must be two different persons, because a person cannot buy his own goods.

Case Law: State of Gujarat Vs. Ramanlal S & Co.

Facts: In State of Gujarat vs. Ramanlal S & Co. when on **dissolution of a partnership**, the **assets** of the firm were **divided** among the partners, the **sales tax officer wanted to tax** this transaction.

It was held that it was **not a sale**. The **partners being joint owner** of those assets **cannot** be both **buyer and seller.**

2. Parties must Intend to Create Legal Obligations

There must be an **intention** on the part of the parties to **create legal relationship** between them.

Social or domestic type of agreements are **not enforceable** in court of law and hence they do not result into contracts.

Example 4:

- A **husband** agreed to pay to his **wife** certain amount as **maintenance** every month while he was abroad.

Husband failed to pay the promised amount.

Wife sued him for the **recovery** of the amount.

Here, in this case, **wife could not recover** as it was a **social agreement** and the **parties did not intend** to create any **legal relations**. (Balfour v. Balfour)

Example 5:

Mr. Lekhpal promises to pay ₹ 5 lakhs to his son if the son passes the CA exams. On passing the exams, the son claims the money. Here, the son could not recover as it was a social agreement.

Example 6:

A sold goods to B on a condition that he must pay for the amount of goods within 30 days. Here A intended to create legal relationship with B. Hence the same is contract. On failure by B for making a payment on due date, A can sue him in the court of law.

3. Other Formalities to be Complied with in Certain Cases

A contract may be **written or spoken**. As to legal effects, there is no difference between a written contract and contract made by word of mouth. But in the **interest of the parties** the contract must be **written**. In case of **certain contracts** some **other formalities** have to be complied with to make an agreement legally **enforceable.**

For e.g. Contract of Insurance is not valid except as a written contract. Further, in case of certain contracts, registration of contract under the laws which is in force at the time, is essential for it to be valid, e.g. in the case of immovable property.

Thus, where there is any statutory requirement that any contract is to be made in writing or in the presence of witness, or any law relating to the registration of documents must be complied with.

4. Certainty of Meaning

The **agreement** must be **certain** and **not vague** or **indefinite**.

Example 7:

A agrees to sell to B a hundred tons of oil. There is nothing certain in order to show what kind of oil was intended for.

Example 8:

XYZ Ltd. agreed to lease the land to Mr. A for indefinite years. The contract is not valid as the period of lease is not mentioned.

5. Possibility of Performance of an Agreement

The **terms** of agreement should be **capable of performance**. An agreement to do an act **impossible** in itself **cannot be enforced.**

Example 9:

A agrees with B to discover treasure by magic. The agreement cannot be enforced as it is not possible to be performed

- Now, according to Section 10 of the Indian Contract Act, 1872, the following are **the essential elements of a Valid Contract:**

I. Offer and Acceptance or an Agreement

An agreement is the first essential element of a valid contract. According to Section 2(e) of the Indian Contract Act, 1872, "Every promise and every set of promises, forming consideration for each other, is an agreement" and according to Section 2(b) "**A proposal when accepted, becomes a promise**". An agreement is an outcome of offer and acceptance for consideration.

II. Free Consent

Two or more persons are said to **consent** when they **agree** upon the **same thing in the same sense**. This can also be understood as identity of minds in understanding the terms **viz consensus ad idem.** Further such consent must be free.

Consent would be considered as **free consent** if it is **not caused by coercion, undue influence, fraud, misrepresentation or mistake.**

Example 10:

A, who owns two cars is selling red car to B. B thinks he is purchasing the black car. There is no consensus ad idem and hence no contract

- To determine consensus ad idem the language of the contract should be clearly drafted.
- Thus, if A says B "Will you buy my red car for ₹ 3,00,000?". B says "yes" to it. There is said to be consensus ad idem i.e. the meaning is taken in same sense by both the parties.

Example 11:

A threatened to shoot B if he (B) does not lend him ₹ 2,00,000 and B agreed to it. Here the agreement is entered into under coercion and hence not a valid contract.

III. Capacity of the Parties

Capacity to contract means the **legal ability** of a person to enter into a valid contract.

Section 11 of the Indian Contract Act specifies that **every person is competent** to contract **who**

(a) is of the age of **majority** according to the law to which he is subject and

(b) is of **sound mind** and

(c) is **not otherwise disqualified** from contracting **by any law** to which he is subject.

Capacity To Contract	
Yes	No
Contract is Valid	Contract is Invalid
Must be Major	Minor
Sound Mind	Unsound Mind
Not Disqualified by Law	Disqualified by Law

- A person for being competent to contract must fulfil all the above three qualifications.

  Qualification (a) refers to the age of the contracting person i.e. the **person entering** into contract must be of **18 years of age.** Persons **below 18** years of age are **considered minor**, therefore, **incompetent** to contract.

  Qualification (b) requires a person to be of sound mind i.e. he should be **in his senses** so that he **understands** the **implications** of the contract at the time of entering into a contract. A **lunatic,**

an **idiot**, a d**runken perso**n or under the influence of some **intoxicant** is **not** supposed to be a person of **sound mind.**

Qualification (c) requires that a person entering into a contract should **not be disqualified** by his **status,** in entering into such contracts.

Such persons are an **alien enemy, foreign sovereigns, convicts etc.**

They are disqualified unless they fulfil certain formalities required by law.

Contracts entered by persons not competent to contract are not valid.

IV. Consideration

It is referred to as **'quid pro quo'** i.e. **'something in return'**.

A valuable consideration in the sense of law may c**onsist either in** some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

Example 12:

A agrees to sell his books to B for ₹ 100.

B's promise to pay ₹ 100 is the consideration for A's promise to sell his books.

A's promise to sell the books is the consideration for B's promise to pay ₹ 100.

V. Lawful Consideration and Object

The consideration and object of the agreement must be **lawful**.

Section 23 states that consideration or object is **not lawful** if it is **prohibited by law**, or it is such as would **defeat the provisions of law**, if it is **fraudulent or involves injury** to the **person or property of another** or court regards it as **immoral** or opposed to **public policy.**

Example 13:

'A' promises to drop prosecution instituted against 'B' for robbery and 'B' promises to restore the value of the things taken. The agreement is void, as its object is unlawful.

Example 14:

A agrees to sell his house to B against 100 kgs of cocaine (drugs). Such agreement is illegal as the consideration is unlawful.

VI. Not Expressly Declared to be Void

The agreement entered into must **not be which** the **law declares** to be either **illegal or void**.

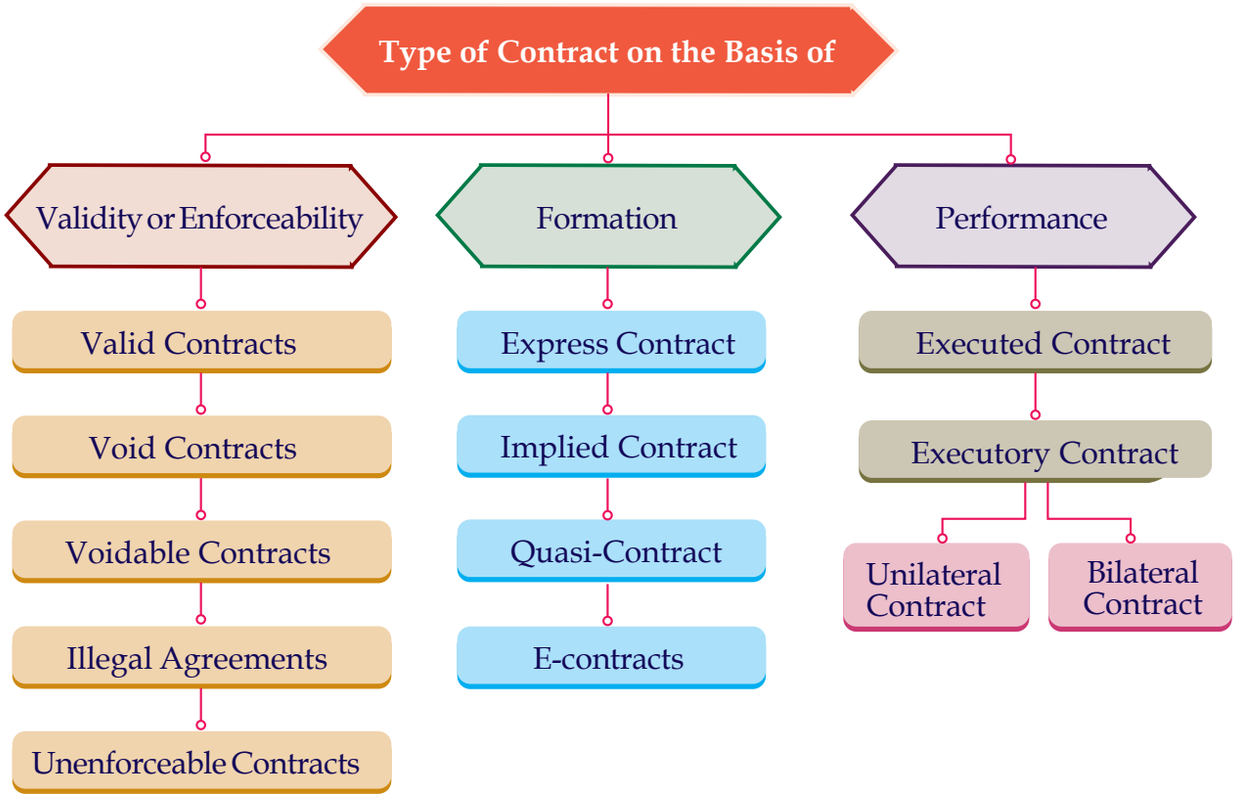
An **illegal** agreement is an agreement expressly or impliedly **prohibited by law**. A void agreement is one without any legal effects.

Example 15:

Threat to commit murder or making/publishing defamatory statements or entering into agreements which are opposed to public policy are illegal in nature. Similarly, any agreement in restraint of trade, marriage, legal proceedings, etc. are classic examples of void agreement.

❒ TYPES OF CONTRACTS

Now let us discuss various types of contracts.



I. On the Basis of the Validity

1. Valid contract

An agreement which is **binding and enforceable** is a valid contract.

It contains all the essential elements of a valid contract.

Example 16:

A ask B if he wants to buy his bike for ₹ 50,000. B agrees to buy bike. It is agreement which is enforceable by law. Hence, it is a valid contract.

2. Void contract

Section 2 (j) states as follows: "A contract which **ceases to be enforceable** by law becomes void when it ceases to be enforceable". Thus, a void contract is one which **cannot be enforced** by a court of law.

Example 17:

Mr. X agrees to write a book with a publisher. Such contract is valid. But after few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract. Thus, a valid contract when cannot be performed because of some uncalled happening becomes void.

Example 18:

A contracts with B (owner of the factory) for the supply of 10 tons of sugar, but before the supply is effected, the fire caught in the factory and everything was destroyed. Here the contract becomes void.

- It may be added by way of clarification here that when a contract is void, it is not a contract at all but for the purpose of identifying it, it has to be called a [void] contract.

3. Voidable contract

Section 2(i) defines that "an agreement which is **enforceable** by law at the **option of one or more parties** thereto, but **not at the option** of the other or others is a **voidable contract**".

This in fact means where one of the parties to the agreement is in a position or is legally entitled or authorized to avoid performing his part, then the agreement is treated and becomes voidable.

Following are the situations where a contract is voidable

(i) When the **consent** of party **is not free** is caused by coercion, undue influence, misrepresentation or fraud.

Example 19:

X promise to sell his scooter to Y for ₹ 1 Lac. However, the consent of X has been procured by Y at a gun point. X is an aggrieved party, and the contract is voidable at his option but not on the option of Y. It means if X accepts the contract, the contract becomes a valid contract then Y has no option of rescinding the contract.

(ii) When a person **promises to do something** for another person, but the **other person prevents** him from performing his promise, the contract becomes **voidable** at the option of first person.

Example 20:

There is a contact between A and B to sell car of A to B for ₹ 2,00,000. On due date of performance, A asks B that he does not want to sell his car. Here contract is voidable at the option of B.

(iii) When a party to a contract **promise to perform a work within a specified time**, could **not perform** with in that time, the contract is **voidable** at the option of promisee.

Example 21:

A agrees to construct a house for B upto 31-3-2022 but A could not complete the house on that date. Here contract is voidable at the option of B.

- At this juncture it would be desirable to know the distinction between a Void Contract and a Voidable Contract. These are elaborated hereunder:

S No.	Basis	Void Contract	Voidable Contract
1	**Meaning**	A Contract ceases to be enforceable by law becomes void when it ceases to be enforceable.	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.

2	**Enforceability**	A void contract cannot be enforced at all.	It is enforceable only at the option of aggrieved party and not at the option of other party.
3	**Cause**	A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties.	A contract becomes a voidable contract if the consent of a party was not free.
4	**Performance of contract**	A void contract cannot be performed.	If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming the performance of the contract.
5	**Rights**	A void contract does not grant any legal remedy to any party.	The party whose consent was not free has the right to rescind the contract within a reasonable time. If so rescinded, it becomes a void contract. If it is not rescinded it becomes a valid contract.

4. Illegal contract

It is a contract which the **law forbids to be made**. The court will **not enforce** such a contract but **also the connected contracts.** All illegal agreements are void but all void agreements are not necessarily illegal. Despite this, there is similarity between them is that in both cases they are void ab initio and cannot be enforced by law.

Example 22:

Contract that is immoral or opposed to public policy are illegal in nature. Similarly, if R agrees with S, to purchase brown sugar, it is an illegal agreement.

According to Section 2(g) of the Indian Contract Act, "an agreement not enforceable by law is void". The Act has specified various factors due to which an agreement may be considered as void agreement. One of these factors is unlawfulness of object and consideration of the contract i.e. illegality of the contract which makes it void. The illegal and void agreement differ from each other in the following respects:

Basis of Difference	Void Agreement	Illegal Agreement
Scope	A void agreement is not necessarily illegal.	An illegal agreement is always void.
Nature	Not forbidden under law.	Are forbidden under law.
Punishment	Parties are not liable for any punishment under the law.	Parties to illegal agreements are liable for punishment.
Collateral Agreement	It's not necessary that agreements collateral to void agreements may also be void. It may be valid also.	Agreements collateral to illegal agreements always void.

5. Unenforceable contract

Where a **contract is good in substance** but because of **some technical defect** i.e. absence in writing, barred by limitation etc. one or both the parties **cannot sue** upon it, it is described as an unenforceable contract.

Example 23:

A bought goods from B in 2018. But no payment was made till 2022. B cannot sue A for the payment in 2022 as it has crossed three years and barred by Limitation Act. A good debt becomes unenforceable after the period of three years as barred by Limitation Act.

Similarly, an agreement for transfer of immovable property should be written for being enforceable.

II. On the Basis of the Formation of Contract

1. Express contracts

A contract would be an express contract if the terms are expressed by **words or in writing.** Section 9 of the Act provides that if a proposal or acceptance of any promise is made in words, the promise is said to be express.

Example 24:

A tells B on telephone that he offers to sell his house for ₹ 20 lacs and B in reply informs A that he accepts the offer, this is an express contract.

2. Implied contracts

Implied contracts in contrast come into existence **by implication**. Most often the implication is by **action or conduct** of parties or **course of dealing**s between them. Section 9 of the Act contemplates such implied contracts when it lays down that in so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied.

Example 25:

Where a coolie in uniform picks up the luggage of A to be carried out of the railway station without being asked by A and A allows him to do so, it is an implied contract and A must pay for the services of the coolie detailed by him.

Example 26:

A drinks a coffee in restaurant. There is an implied contract that he should pay for the price of coffee.

Tacit Contracts

The word **Tacit means silent**. Tacit contracts are those that are **inferred through the conduct of parties without** any **words spoken or written**. A classic example of tacit contract would be when cash is withdrawn by a customer of a bank from the automatic teller machine [ATM]. Another example of tacit contract is where a contract is assumed to have been entered when a sale is given effect to at the fall of hammer in an auction sale. It is not a separate form of contract but falls within the scope of implied contracts.

3. Quasi-contract

A quasi-contract is **not an actual contract**, but it **resembles** a contract. It is created by law under certain circumstances. The **law** creates and **enforces legal rights** and obligations **when no real contract exists**. Such obligations are known as quasi-contracts. In other words, it is a contract in which there is no intention on part of either party to make a contract but law imposes a contract upon the parties.

Example 27:

Obligation of finder of lost goods to return them to the true owner or liability of person to whom money is paid under mistake to repay it back cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent. These are said to be quasi-contracts.

Example 28:

T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

4. E-contracts

When a contract is entered into by two or more parties using **electronics means,** such as e-mails is known as e-commerce contracts. In electronic commerce, different parties/persons create networks which are linked to other networks through ED1 - Electronic Data Inter change. This helps in doing business transactions using electronic mode. These are known as EDI contracts or Cyber contracts or mouse click contracts.

III. On the Basis of the Formation of Contract

1. Executed Contract

The **consideration** in a given contract could be an **act or forbearance**. When the act is **done or executed or the forbearance** is brought on record, then the contract is an executed contract.

Example 29:

When a grocer sells a sugar on cash payment it is an executed contract because both the parties have done what they were to do under the contract.

2. Executory contract

In an executory contract the **consideration is reciprocal promise** or obligation. Such consideration is to be **performed in future only** and therefore these contracts are described as executory contracts.

Example 30:

Where G agrees to take the tuition of H, a pre-engineering student, from the next month and H in consideration promises to pay G ₹ 1,000 per month, the contract is executory because it is yet to be carried out.

Unilateral or Bilateral are kinds of Executory Contracts and are not separate kinds.

(a) Unilateral contract

Unilateral contract is a **one sided contract** in which one party has **performed** his duty or obligation and the **other party's obligation is outstanding.**

Example 31:

M advertises payment of award of ₹ 50,000 to any one who finds his missing boy and brings him. As soon as B traces the boy, there comes into existence an executed contract because B has performed his share of obligation and it remains for M to pay the amount of reward to B. This type of Executory contract is also called unilateral contract.

(b) Bilateral contract

A Bilateral contract is one where the **obligation or promise is outstanding** on the part of **both the parties**.

Example 32:

A promises to sell his plot to B for ₹ 10 lacs cash down, but B pays only ₹ 2,50,000 as earnest money and promises to pay the balance on next Sunday. On the other hand, A gives the possession of plot to B and promises to execute a sale deed on the receipt of the whole amount. The contract between the A and B is executory because there remains something to be done on both sides. Such Executory contracts are also known as Bilateral contracts.

❒ PROPOSAL OFFER - SEC 2(A) OF THE ICA, 1872)

Definition of Offer/Proposal

According to Section 2(a) of the Indian Contract Act, 1872, "when **one person signifies to another his willingness to do or to abstain** from doing anything with a **view to obtaining the assent** of that other to such act or abstinence, he is said to make a **proposal**".

The essentials of a proposal/offer are

1. The **person making** the **proposal** or offer is called the 'promisor' or 'offeror': The person to **whom the offer is made** is called the 'offeree' and the person **accepting** the offer is called the 'promisee' or 'acceptor'.
2. For a **valid offer,** the party making it must **express his willingness 'to do' or 'not to do'** something: There must be an expression of willingness to do or not to do some act by the offeror.

Example 33:

A willing to sell his good at certain price to B.

Example 34:

A is willing to not to dance in a competition if B pays him certain sum of money.

3. The willingness must be **expressed** with a view to **obtain the assent** of the other party to whom the offer is made.

Example 35:

Where 'A' tells 'B' that he desires to marry by the end of 2022, it does not constitute an offer of marriage by 'A' to 'B'. Therefore, to constitute a valid offer expression of willingness must be made to obtain the assent (acceptance) of the other. Thus, if in the above example, 'A' further adds, 'Will you marry me', it will constitute an offer.

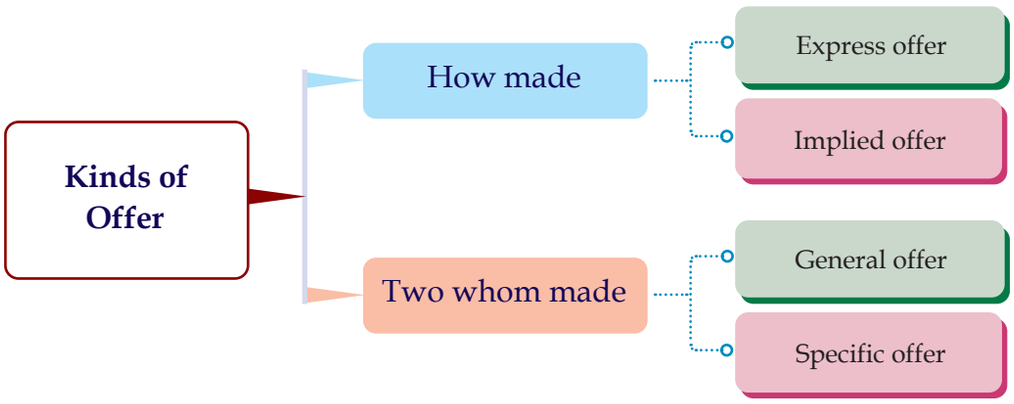
4. An offer can be **positive** as well as **negative:** Thus "doing" is a positive act and "not doing", or "abstinence" is a negative act; nonetheless both these acts have the same effect in the eyes of law.

Example 36:

A offers to sell his car to B for ₹ 3 lacs is an act of doing. So in this case, A is making an offer to B.

Example 37:

When A ask B after his car meets with an accident with B's scooter not to go to Court and he will pay the repair charges to B for the damage to B's scooter; it is an act of not doing or abstinence.



Classification of Offer

An offer can be **classified as** general offer, special/specific offer, cross offer, counter offer, standing/ open/ continuing offer.

Now let us examine each one of them.

(a) General offer

It is an offer made to **public at large** and hence **anyone can accept** and do the desired act (Carlill Vs. Carbolic Smoke Ball Co.). In terms of Section 8 of the Act, **anyone** performing the **conditions**

of the offer can be considered to have **accepted** the offer. Until the **general offer** is retracted or withdrawn, it **can be accepted by anyone** at any time as it is a **continuing offer.**

Case Law: **Carlill Vs. Carbolic Smoke Ball Co.** (1893)

Facts: In this famous case, Carbolic smoke Ball Co. advertised in several newspapers that a reward of £100 would be given to any person who contracted influenza after using the smoke balls produced by the Carbolic Smoke Ball Co. according to printed directions. One lady, Mrs. Carlill, used the smoke balls as per the directions of company and even then, suffered from influenza. Held, she could recover the amount as by using the smoke balls she had accepted the offer.

(b) Special/specific offer

When the offer is made to a **specific or an ascertained person,** it is known as a specific offer. Specific offer can be **accepted only by that** specified person to whom the **offer has been made.** [Boulton Vs. Jones]

Example 38:

'A' offers to sell his car to 'B' at a certain cost. This is a specific offer.

(c) Cross offer

When **two parties exchange identical offers** in **ignorance** at the time of each other's offer, the offers are called cross offers. There is **no binding contract** in such a case because offer made by a person cannot be construed as acceptance of the another's offer.

Example 39:

If A makes a proposal to B to sell his car for ₹ 2 lacs and B, without knowing the proposal of A, makes an offer to purchase the same car at ₹ 2 lacs from A, it is not an acceptance, as B was not aware of proposal made by A. It is only cross proposal (cross offer). And when two persons make offer to each other, it cannot be treated as mutual acceptance. There is no binding contract in such a case.

(d) Counter offer

When the **offeree offer**s to qualified acceptance of the offer subject to **modifications and variations** in the **terms** of original offer, he is said to have **made a counter offer**. Counter-offer amounts to **Rejection of the original** offer. It is also **called as Conditional Acceptance.**

Example 40:

A' offers to sell his plot to 'B' for ₹ 10 lakhs. 'B' agrees to buy it for ₹ 8 lakhs. It amounts to counter offer. It will result in the termination of the offer of 'A'. If later on 'B' agrees to buy the plot for ₹ 10 lakhs, 'A' may refuse.

(e) Standing or continuing or open offer

An offer which is allowed to **remain open** for acceptance **over a period of time** is known as standing or continuing or open offer. Tenders that are invited for supply of goods is a kind of standing offer.

Essential of a Valid offer

1. It must be capable of creating legal relations

Offer must be such as in law is **capable of being accepted** and giving rise to **legal relationship. If** the offer does **not** intend to give rise to legal consequences and creating legal relations, it is **not** considered as a **valid offer** in the eye of law. A social invitation, even if it is accepted, **does not** create **legal relations** because it is not so intended.

Example 41:

A invited B on his birthday party. B accepted the proposal but when B reached the venue, he (B) found that A was not there. He filed the suit against A for recovery of travelling expenses incurred by him to join the birthday party. Held, such an invitation did not create a legal relationship. It is a social activity. Hence, B could not succeed.

2. It must be certain, definite and not vague

If the terms of an offer are v**ague or indefinit**e, its acceptance **cannot create** any **contractual relationship.**

Example 42:

A offers to sell B 100 quintals of oil, there is nothing whatever to show what kind of oil was intended. The offer is not capable of being accepted for want of certainty.

If in the above example, A is a dealer in mustard oil only, it shall constitute a valid offer.

3. It must be communicated to the offeree

An offer, to be complete, must be **communicated to the person** to whom it is **made, otherwise** there can be **no acceptance of it**. Unless an offer is communicated, there can be no acceptance by it. An **acceptance** of an offer, in **ignorance of the offer,** is **not acceptanc**e and does not confer any right on the acceptor.

Case Law: Lalman Shukla Vs. Gauri Dutt

This can be illustrated by the landmark case of **Lalman Shukla Vs. Gauri Dutt**

Facts: G (Gauridutt) sent his servant L (Lalman) to trace his missing nephew. He then announced that anybody who traced his nephew would be entitled to a certain reward. L traced the boy in ignorance of this announcement. Subsequently when he came to know of the reward, he claimed it. Held, he was not entitled to the reward, as he did not know the offer.

4. It must be made with a view to obtaining the assent of the other party

Offer must be made with a view to obtaining the assent of the other party addressed and not merely with a view to **disclosing the intention** of making an offer.

5. It may be conditional

An offer can be made **subject to any terms and conditions** by the offeror.

Example 43:

Offeror may ask for payment by RTGS, NEFT etc. The offeree will have to accept all the terms of the offer otherwise the contract will be treated as invalid.

6. Offer should not contain a term the non-compliance of which would amount to acceptance

Thus, one **cannot say** that if **acceptance is not communicated** by a certain **time** the offer would be **considered** as **accepted**.

Example 44:

A proposes B to purchase his android mobile for ₹ 5000 and if no reply by him in a week, it would be assumed that B had accepted the proposal. This would not result into contract.

7. The offer may be either specific or general

Any offer can be **made to either public at large** or to the **any specific person.** (Already explained in the heading-types of the offer)

8. The offer may be express or implied

An offer may be made either by words or by conduct.

Example 45:

A boy starts cleaning the car as it stops on the traffic signal without being asked to do so, in such circumstances any reasonable man could guess that he expects to be paid for this, here boy makes an implied offer.

9. Offer is Different from a mere statement of intention, an invitation to offer, a mere communication of information, A prospectus and Advertisement.

(i) A statement of intention and announcement

Example 46:

A father wrote his son about his wish of making him the owner of all his property is mere a statement of intention.

Example 47:

An announcement to give scholarships to children scoring more than 95% in 12th board is not an offer.

(ii) Offer must be distinguished from an answer to a question

Case Law: Harvey Vs. Facie [1893] AC 552

Facts: In this case, Privy Council succinctly explained the distinction between an offer and an invitation to offer. In the given case, the plaintiffs through a telegram asked the defendants two questions namely,

(i) Will you sell us Bumper Hall Pen? and

(ii) Telegraph's lowest cash price.

- The defendants replied through telegram that the "lowest price for Bumper Hall Pen is £ 900". The plaintiffs sent another telegram stating "we agree to buy Bumper Hall Pen at £ 900". However, the defendants refused to sell the property at the price.
- The plaintiffs sued the defendants contending that they had made an offer to sell the property at £ 900 and therefore they are bound by the offer.

- However, the Privy Council did not agree with the plaintiffs on the ground that while plaintiffs had asked two questions, the defendant replied only to the second question by quoting the price but reserved their answer with regard to their willingness to sell. Thus, they made no offer at all. Their Lordships held that the mere statement of the lowest price at which the vendor would sell contained no implied contract to sell to the person who had enquired about the price.
- The above decision was followed in Mac Pherson vs Appanna [1951] A.S.C. 184 where the owner of the property had said that he would not accept less than £ 6000/- for it. This statement did not indicate any offer but indicated only an invitation to offer.

(iii) A statement of price is not an offer

Quoting the price of a product does not constitute it as offer. (refer case of Harvey Vs. Facie as discussed above)

Example 48:

The price list of goods does not constitute an offer for sale of certain goods on the listed prices. It is an invitation to offer.

(iv) An invitation to make an offer or do business

In case of "an invitation to make an offer", the person making the invitation does not make an offer rather invites the other party to make an offer. His objective is to send out the invitation that he is willing to deal with any person who, on the basis of such invitation, is ready to enter into contract with him subject to final terms and conditions.

Example 49:

An advertisement for sale of goods by auction is an invitation to the offer. It merely invites offers/bids made at the auction.

When goods are sold through auction, the auctioneer does not contract with anyone who attends the sale. The auction is only an advertisement to sell but the items are not put for sale though persons who have come to the auction may have the intention to purchase. Similar decision was given in the case of **Harris vs. Nickerson (1873).**

Similarly, Prospectus issued by a company, is only an invitation to the public to make an offer to subscribe to the securities of the company.

10. A statement of price is not an offer

What is Invitation to Offer?

An offer should be distinguished from an invitation to offer**.** An offer is definite and capable of converting an intention into a contract. Whereas an invitation to an offer is **only a circulation of an offer,** it is an attempt to **induce offer**s and **precede**s a definite offer. An invitation to offer is an act **precedent to making an offer. Acceptance** of an invitation to an offer **does not result** in the contract and **only an offer emerges** in the process of negotiation.

When a person advertises that he has stock of books to sell or houses to let, there is no offer to be bound by any contract. Such advertisements are offers to negotiate- offers to receive offers. In order to ascertain whether a particular statement amounts to an 'offer' or an 'invitation to offer', the test would be intention with which such statement is made. Does the person who made the statement intend to be bound by it as soon as it is accepted by the other or he intends to do some further act, before he becomes bound by it. In the former case, it amounts to an offer and in the latter case, it is an invitation to offer.

Difference Between offer and Invitation to Make an offer

In terms of Section 2(a) of the Act, an offer is the final expression of willingness by the offeror to be bound by the offer should the other party chooses to accept it. On the other hand, offers made with the intention to negotiate or offers to receive offers are known as invitation to offer. Thus, where a party without expressing his final willingness proposes certain terms on which he is willing to negotiate he does not make an offer, but only invites the other party to make an offer on those terms. Hence the only thing that is required is the willingness of the offeree to abide by the terms of offer.

In order to ascertain whether a particular statement amounts to an offer or an invitation to offer, the test would be intention with which such statement is made. The mere statement of the lowest price which the vendor would sell contains no implied contract to sell at that price to the person making the inquiry.

If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer. Thus, the intention to be bound is important factor to be considered in deciding whether a statement is an 'offer' or 'invitation to offer.'

Following are instances of invitation to offer to buy or sell:

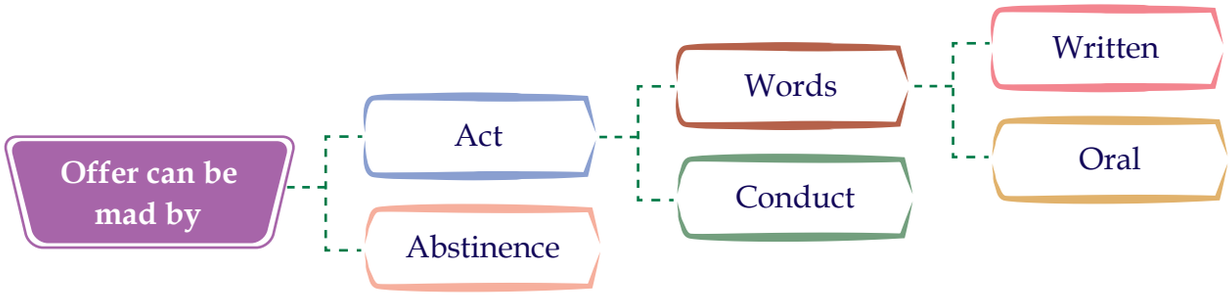
(i) A Prospectus by a company to the public to **subscribe for its shares.**

(ii) **Display** of goods for sale in shop windows.

(iii) **Advertising auction sales** and

(iv) **Quotation of prices** sent in reply to a query regarding price.

Basis	Offer	Invitation to Offer
Meaning	Section 2(a) of the Act, an offer is the final expression of willingness by the offeror to be bound by the offer should the other party chooses to accept it.	Where a party without expressing his final willingness proposes certain terms on which he is willing to negotiate he does not make an offer, but only invites the other party to make an offer on those terms.
Intention of the parties	If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer.	If a person has the intention of negotiating on terms it is called invitation to offer.
Sequence	An offer cannot be an act precedent to invitation to offer.	An invitation to offer is always an act precedent to offer.



ACCEPTANCE

Definition of Acceptance: In terms of Section 2(b) of the Act, 'the term acceptance' is defined as follows:

"When the person to whom the **proposal is made signifies his assent** thereto, proposal is said to be **accepted**. The **proposal**, **when accepted**, **becomes a promise**".

Analysis of the above definition

1. When the person to whom proposal is made - for example if A offers to sell his car to B for ₹ 2,00,000. Here, proposal is made to B.
2. The person to whom proposal is made i.e. B in the above example and if B signifies his consent on that proposal, then we can say that B has signified his consent on the proposal made by A.
3. When B has signified his consent on that proposal, we can say that the proposal has been accepted.
4. Accepted proposal becomes promise.

Relationship between offer and acceptance: According to Sir William Anson "Acceptance is to offer what a lighted match is to a train of gun powder". The effect of this observation is that what acceptance triggers cannot be recalled or undone. But there is a choice to the person who had the train to remove it before the match is applied. It in effect means that the offer can be withdrawn just before it is accepted. Acceptance converts the offer into a promise and then it is too late to revoke it. This means as soon as the train of gun powder is lighted it would explode. Train of Gun powder [offer] in itself is inert, but it is the lighted match [the acceptance] which causes the gun powder to explode. The significance of this is an offer in itself cannot create any legal relationship but it is the acceptance by the offeree which creates a legal relationship. Once an offer is accepted it becomes a promise and cannot be withdrawn or revoked. An offer remains an offer so long as it is not accepted but becomes a contract as soon as it is accepted.

Drawing

Legal Rules Regarding a Valid Acceptance

1. Acceptance can be given only by the person to whom offer is made

In case of a **specific offer**, it can be **accepted** only by the **person to whom it is made.** **[Boulton vs. Jones (1857)]**

Case Law: Boulton Vs. Jones (1857)

Facts: Boulton bought a business from Brocklehurst. Jones, who was Broklehurst's creditor, placed an order with Brocklehurst for the supply of certain goods. Boulton supplied the goods even though the order was not in his name. Jones refused to pay Boultan for the goods because by entering into the contract with Blocklehurst, he intended to set off his debt against Brocklehurst. Held, as the offer was not made to Boulton, therefore, there was no contract between Boulton and Jones.

In case of a **general offe**r, it can be **accepted** by **any person** who has the **knowledge** of the offer. [Carlill vs. Carbolic Smoke Ball Co. (1893)]

2. Acceptance must be absolute and unqualified

As per section 7 of the Act, acceptance is valid only when it is **absolute and unqualified** and is also expressed in **some usual and reasonable manner unless** the proposal **prescribes** the **manner** in which it must be accepted. If the proposal prescribes the manner in which it must be accepted, then it must be **accepted accordingly**.

M offered to sell his land to N for £280. N replied purporting to accept the offer but enclosed a cheque for £ 80 only. He promised to pay the balance of £ 200 by monthly instalments of £ 50 each. It was held that N could not enforce his acceptance because it was not an unqualified one. [Neale vs. Merret [1930] W. N. 189].

A offers to sell his house to B for ₹ 30,00,000/-. B replied that, "I can pay ₹ 24,00,000 for it. The offer of 'A' is rejected by 'B' as the acceptance is not unqualified. B however changes his mind and is prepared to pay ₹ 30,00,000/-. This is also treated as counter offer and it is upto A whether to accept it or not. [Union of India v. Bahulal AIR 1968 Bombay 294].

Example 50:

'A' enquires from 'B', "Will you purchase my car for ₹ 2 lakhs?" If 'B' replies "I shall purchase your car for ₹ 2 lakhs, if you buy my motorcycle for ₹ 50,000/-, here 'B' cannot be considered to have accepted the proposal. If on the other hand 'B' agrees to purchase the car from 'A' as per his proposal subject to availability of valid Registration Certificate / book for the car, then the acceptance is in place though the offer contained no mention of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore, the acceptance in this case is unconditional.

3. The acceptance must be communicated

To conclude a contract between the parties, the acceptance must be **communicated** in some **perceptible form**. Any **conditional** acceptance or acceptance with varying or too deviant conditions is **no acceptance**. Such conditional acceptance is a **counter proposal** and has to be **accepted by the proposer**, if the original proposal has to materialize into a contract. Further when a proposal is accepted, the **offeree must have the knowledge** of the offer made to him. If he **does not have the knowledg**e, there can be **no acceptance.** The acceptance must **relate specifically** to the **offer** made. Then only it can materialize into a contract. The above points will be clearer from the following examples:

Case Law: Brogden Vs. Metropolitan Railway Co. (1877)

Facts: B a supplier, sent a draft agreement relating to the supply of coal to the manager of railway Co. viz, Metropolitan railway for his acceptance. The manager wrote the word "Approved" on the same and put the draft agreement in the drawer of the table intending to send it to the company's solicitors for a formal contract to be drawn up. By an over sight the draft agreement remained in drawer. Held, that there was no contract as the manager had not communicated his acceptance to the supplier, B.

Where an offer made by the intended offeree without the knowledge that an offer has been made to him cannot be deemed as an acceptance thereto. (Bhagwandas v. Girdharilal)

A mere **variation in the language** not involving any difference in substance would **not make** the **acceptance ineffectiv**e. [Heyworth vs. Knight [1864] 144 ER 120].

Example 51:

A proposed B to marry him. B informed A's sister that she is ready to marry him. But his sister didn't inform A about the acceptance of proposal. There is no contract as acceptance was not communicated to A.

4. Acceptance must be in the prescribed mode

Where the **mode** of acceptance is **prescribed** in the proposal, it must be a**ccepted in that manner.** But if the proposer **does not insist** on the proposal being accepted in the manner prescribed after it has been accepted otherwise, i.e., not in the prescribed manner, the proposer is **presumed to have consented** to the **acceptance**.

Example 52:

If the offeror prescribes acceptance through messenger and offeree sends acceptance by email, there is no acceptance of the offer if the offeror informs the offeree that the acceptance is not according to the mode prescribed. But if the offeror fails to do so, it will be presumed that he has accepted the acceptance and a valid contract will arise.

5. Time

Acceptance must be **given within** the s**pecified time** limit, if any, and if **no time** is stipulated, acceptance must be given **within the reasonable time** and **before** the **offer lapses**. What is **reasonable time** is nowhere defined in the law and thus would depend on **facts and circumstances** of the particular case.

Example 53:

A offered to sell B 50 kgs of bananas at Rs. 500. B communicated the acceptance after four days. Such is not a valid contract as bananas being perishable items could not stay for a period of week. Four days is not a reasonable time in this case.

Example 54:

A offers B to sell his house at Rs. 20,00,000. B accepted the offer and communicated to A after 4 days. Held the contract is valid as four days can be considered as reasonable time in case of sell of house.

6. Mere silence is not acceptance

The acceptance of an offer **cannot be implied from the silence** of the offeree **or his failure** to answer, **unless** the offeree has in any **previous conduct indicated** that his silence is the **evidence** of acceptance.

Case Law: Felthouse Vs. Bindley (1862)

Facts: F (Uncle) offered to buy his nephew's horse for £30 saying "If I hear no more about it I shall consider the horse mine at £30." The nephew did not reply to F at all. He told his auctioneer, B to keep the particular horse out of sale of his farm stock as he intended to reserve it for his uncle. By mistake the auctioneer sold the horse. F sued him for conversion of his property. Held, F could not succeed as his nephew had not communicated the acceptance to him.

Example 55:

'A' subscribed for the weekly magazine for one year. Even after expiry of his subscription, the magazine company continued to send him magazine for five years. And also 'A' continued to use the magazine but denied to pay the bills sent to him. 'A' would be liable to pay as his continued use of the magazine was his acceptance of the offer.

7. Acceptance by conduct/implied acceptance

Section 8 of the Act lays down that "the **performance of the conditions** of a proposal, or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, **constitutes an acceptance** of the proposal. This section provides the acceptance of the proposal by conduct as against other modes of acceptance i.e. verbal or written communication.

Therefore, when a **person performs the act intended** by the proposer as the consideration for the promise offered by him, the performance of the act **constitutes acceptance.**

Example 56:

When a tradesman receives an order from a customer and executes the order by sending the goods, the customer's order for goods constitutes the offer, which has been accepted by the trades man subsequently by sending the goods. It is a case of acceptance by conduct.

❒ COMMUNICATION OF OFFER & ACCEPTANCE

- Communication of offer: In terms of Section 4 of the Act, "the communication of offer is **complete** when it comes to the **knowledge of the person** to **whom it is made**".

Example 57:

Where 'A' makes a proposal to 'B' by post to sell his house for ₹ 5 lakhs and if the letter containing the offer is posted on 10th March and if that letter reaches 'B' on 12th March the offer is said to have been communicated on 12th March when B received the letter.

Thus, it can be summed up that when a proposal is made by **post**, its communication will be **complete** when the **letter** containing the proposal **reaches** the person to **whom it is made. Mere receiving** of the letter is **not sufficien**t, he must **receive or read** the message contained in the letter.

He receives the letter on 12th March, but he reads it on 15th of March. In this case offer is communicated on 15th of March, and not 12th of March.

Communication of acceptance

- There are two issues for discussion and understanding. They are: The modes of acceptance and when is acceptance complete?

  Let us, first consider the modes of acceptance. Section 3 of the Act prescribes in general terms two modes of communication namely, (a) by any act and (b) by omission, intending thereby, to communicate to the other or which has the effect of communicating it to the other.

Communication by act

- Would include any expression of words whether written or oral. Written words will include letters, telegrams, faxes, emails and even advertisements. Oral words will include telephone messages. Again communication would **include** any conduct intended to communicate like **positive** acts or signs so that the **other person understands** what the person 'acting' or 'making signs' means to say or convey.

Communication of acceptance by 'omission' to do something

- Such omission is conveyed by a conduct or by forbearance on the part of one person to convey his willingness or assent. However, **silence** would **not be treated** as **communication** by 'omission'.

Example 58:

A offers ₹ 50,000 to B if he does not arrive before the court of law as an evidence to the case. B does not arrive on the date of hearing to the court. Here omission of doing an act amounts to acceptance.

Communication of acceptance by conduct

- For instance, delivery of goods at a price by a seller to a willing buyer will be understood as a communication by conduct to convey acceptance. Similarly, one need not explain why one boards a public bus or drop a coin in a weighing machine. The first act is a conduct of acceptance against its communication to the offer by the public transport authority to carry any passenger. The second act is again a conduct conveying acceptance to use the weighing machine kept by the vending company as an offer to render that service for a consideration.
- The other issue in communication of acceptance is about the effect of act or omission or conduct. These indirect efforts must result in effectively communicating its acceptance or non acceptance. If it has no such effect, there is no communication regardless of which the acceptor thinks about the offer within himself. Thus, a **mere mental unilateral** assent in one's own mind would **not amount to communication**. Where a resolution passed by a bank to sell land to 'A' remained uncommunicated to 'A', it was held that there was no communication and hence no contract. [Central Bank Yeotmal vs Vyankatesh (1949) A. Nag. 286].
- Let us now come to the issue of when communication of acceptance is complete. In terms of Section 4 of the Act, it is complete,

  (i) As against the **proposer**, when it is **put in the course of transmission** to him so as to be o**ut of the power of the acceptor to withdraw** the same;

  (ii) As against the **acceptor**, when it comes to the **knowledge of the proposer.**

- Where a proposal is accepted by a letter sent by the post, the communication of acceptance will be complete as against the proposer when the letter of acceptance is posted and as against the acceptor when the letter reaches the proposer.
- For instance in the above example, if 'B' accepts, A's proposal and sends his acceptance by post on 14th, the communication of acceptance as against 'A' is complete on 14th, i.e. when the letter is posted. As against 'B' acceptance will be complete, when the letter reaches 'A'.

Here 'A' the proposer will be bound by B's acceptance, even if the letter of acceptance is delayed in post or lost in transit. The golden rule is proposer becomes bound by the contract, the moment acceptor has posted the letter of acceptance. But it is necessary that the **letter is correctly addressed**, adequately **stamped** and **duly** posted. In such an event the **loss of letter** in transit, wrong delivery, non delivery etc., will **not affect** the validity of the contract.

However, from the view point of acceptor, he will be bound by his acceptance only when the letter of acceptance has reached the proposer. So, it is crucial in this case that the letter reaches the proposer. If there is no delivery of the letter, the acceptance could be treated as having been completed from the viewpoint of proposer but not from the viewpoint of acceptor. Of course this will give rise to an awkward situation of only one party to the contract, being treated as bound by the contract though no one would be sure as to where the letter of acceptance had gone.

Acceptance over telephone or telex or fax

- When an offer is made of instantaneous **communication** like telex, telephone, fax or through e-mail, the **contract is only complete** when the a**cceptance is received** by the offeree, and the contract is made at the place where the acceptance is received (Entores Ltd. v. Miles Far East Corporation). However, in case of a **call drops and disturbances** in the line, there may **not be a valid contract.**

Communication of special conditions

- Sometimes there are situations where there are contracts with special conditions. These **special conditions** are **conveyed** tacitly and the **acceptance** of these conditions are also conveyed by the offeree again **tacitly** or **without** him even **realizing it.**

Example 59:

Where a passenger undertakes a travel, the conditions of travel are printed at the back of the tickets, sometimes these special conditions are brought to the notice of the passenger, sometimes not. In any event, the passenger is treated as having accepted the special condition the moment he bought his ticket.

When someone travels from one place to another by air, it could be seen that special conditions are printed at the back of the air ticket in small letters [in a non-computerized train ticket even these are not printed] Sometimes these conditions are found to have been displayed at the notice board of the Airlines office, which passengers may not have cared to read. The question here is whether these conditions can be considered to have been communicated to the passengers of the Airlines and can the passengers be treated as having accepted the conditions. The answer to the question is in the affirmative and was so held in Mukul Datta vs. Indian Airlines [1962] AIR cal. 314 where the plaintiff had travelled from Delhi to Kolkata by air and the ticket bore conditions in fine print. But such terms and condition should be **reasonable.**

Example 60:

Where a launderer gives his customer a receipt for clothes received for washing. The receipt carries special conditions and are to be treated as having been duly communicated to the customer and therein a tacit acceptance of these conditions is implied by the customer's acceptance of the receipt [Lily White vs. R. Mannuswamy [1966] A. Mad. 13].

Case Law: Lilly White Vs. Mannuswamy (1970)

Facts: P delivered some clothes to drycleaner for which she received a laundry receipt containing a condition that in case of loss, customer would be entitled to claim 15% of the market price of value of the article, P lost her new saree. Held, the terms were unreasonable and P was entitled to recover full value of the saree from the drycleaner.

In the cases referred above, the respective documents have been accepted without a protest and hence amounted to tacit acceptance.

Standard forms of contracts

It is well established that a standard form of contract may be enforced on another who is subjectively unaware of the contents of the document, provided the party wanting to enforce the contract has given notice which, in the circumstances of a case, is sufficiently reasonable. But the acceptor will not incur any contractual obligation, if the document is so printed and delivered to him in such a state that it does not give reasonable notice on its face that it contains certain special conditions. In this connection, let us consider a converse situation. A transport carrier accepted the goods for transport without any conditions. Subsequently, he issued a circular to the owners of goods limiting his liability for the goods. In such a case, since the special conditions were not communicated prior to the date of contract for transport, these were not binding on the owners of goods [Raipur transport Co. vs. Ghanshyam [1956] A. Nag.145].

❒ COMMUNICATION OF PERFORMANCE

- We have already discussed that in terms of Section 4 of the Act, communication of a **proposal** is complete **when it comes to the knowledge of the person** to whom it is meant. As regards **acceptance** of the **proposal,** the same would be viewed from two angles. These are:

(i) from the viewpoint of proposer and

(ii) the other from the viewpoint of acceptor himself

From the viewpoint of **proposer,** when the acceptance is **put into a course of transmission**, when it would be **out of the power of acceptor**. From the viewpoint of acceptor, it would be complete when it comes to the knowledge of the proposer.

At times the offeree may be required to communicate the performance (or act) by way of acceptance. In this case, it is not enough if the offeree merely performs the act but he should also communicate his performance unless the offer includes a term that a mere performance will constitute acceptance. The position was clearly explained in the famous case of Carlill Vs Carbolic & Smokeball Co.

In this case the defendant a sole proprietary concern manufacturing a medicine which was a carbolic ball whose smoke could be inhaled through the nose to cure influenza, cold and other connected ailments issued an advertisement for sale of this medicine. The advertisement also

included a reward of $100 to any person who contracted influenza, after using the medicine (which was described as 'carbolic smoke ball'). Mrs. Carlill bought these smoke balls and used them as directed but contracted influenza.

It was held that Mrs. Carlill was entitled to a reward of $100 as she had performed the condition for acceptance. Further as the advertisement did not require any communication of compliance of the condition, it was not necessary to communicate the same. The court thus in the process laid down the following three important principles:

(i) An offer, to be capable of acceptance, must contain a definite promise by the offeror that he would be bound provided the terms specified by him are accepted;

(ii) An offer may be made either to a particular person or to the public at large, and

(iii) If an offer is made in the form of a promise in return for an act, the performance of that act, even without any communication thereof, is to be treated as an acceptance of the offer.

❒ REVOCATION OF OFFER & ACCEPTANCE

◈ In term of Section 4, communication of revocation (of the proposal or its acceptance) is complete.

(i) As **against the person who makes it** when it is **put into a course of transmission** to the person to whom it is made so as to be **out of the power** of the person who makes it, and

(ii) As **against** the person to whom **it is made**, when it **comes to his knowledge**.

The above law can be illustrated as follows: If you revoke your proposal made to me by a telegram, the revocation will be complete, as far as you are concerned when you have dispatched the telegram. But as far as I am concerned, it will be complete only when I receive the telegram.

But the important question for consideration is when a proposal can be revoked? And when can an acceptance be revoked? These questions are more important than the question when the revocation (of proposal and acceptance) is complete.

Ordinarily, the offeror can revoke his offer before it is accepted. If he does so, the offeree cannot create a contract by accepting the revoked offer.

Example 61:

The bidder at an auction sale may withdraw (revoke) his bid (offer) before it is accepted by the auctioneer by fall of hammer.

An offer may be revoked by the offeror before its acceptance, even though he had originally agreed to hold it open for a definite period of time. So long as it is a mere offer, it can be withdrawn whenever the offeror desires.

Example 62:

X offered to sell 50 bales of cotton at a certain price and promised to keep it open for acceptance by Y till 6 pm of that day. Before that time X sold them to Z. Y accepted before 6 p.m., but after the revocation by X. In this case it was held that the offer was already revoked.

In terms of Section 5 of the Act a proposal can be revoked at any time before the communication of its acceptance is complete as against the proposer. An acceptance may be revoked at any time before the communication of acceptance is complete as against the acceptor.

Example 63:

A proposes, by a letter sent by post, to sell his house to B. B accepts the proposal by a letter sent by post. A may revoke his proposal at any time before or at the moment when B posts his letter of acceptance, but not afterwards. Whereas B may revoke his acceptance at any time before or at the moment when the letter communicating it reaches A, but not afterwards.

An acceptance to an offer must be made before that offer lapses or is revoked

The law relating to the revocation of offer is the same in India as in England, but the law relating to the revocation of acceptance is different.

In English law, the moment a person expresses his acceptance of an offer, that moment the contract is concluded, and such an acceptance becomes irrevocable, whether it is made orally or through the post. In Indian law, the position is different as regards contract through post.

Contract through post

- As acceptance, in English law, cannot be revoked, so that once the letter of acceptance is properly posted the contract is concluded. In Indian law, the acceptor or can revoke his acceptance **any time before** the letter of **acceptance reaches** the offeror, if the **revocation** telegram **arrives before** or at the **same time** with the letter of acceptance, **the revocation is absolute.**

Contract over telephone

- A contract can be made over telephone. The rules regarding offer and acceptance as well as their communication by telephone or telex are the same as for the contract made by the mutual meeting of the parties. The contract is **formed** as soon as the **offer is accepted** but the offeree must **make it sure** that his **acceptance is received** by the offeror, otherwise there will be no contract, as communication of acceptance is not complete. If telephone unexpectedly **goes dead** during conversation, the acceptor must **confirm again** that the words of acceptance were duly heard by the offeror.

Revocation of proposal otherwise than by communication

- When a proposal is made, the proposer may not wait indefinitely for its acceptance. The offer can be revoked otherwise than by communication or sometimes by lapse.

Modes of Revocation of Offer

(i) By **notice** of revocation:

Example 64:

A offered B to sell goods at Rs. 5,000 through a post but before B could accept the offer A received highest bid for the goods from C. So, A revoked the offer to B by informing B over the telephone and sold goods to C.

(ii) By **lapse of time:** The time for acceptance can lapse if the acceptance is not given within the specified time and where no time is specified, then within a reasonable time. This is for the reason that proposer should not be made to wait indefinitely. It was held in Ramsgate Victoria Hotel Co. Vs Montefiore (1866 L.R.Z. Ex 109), that a person who applied for shares

in June was not bound by an allotment made in November. This decision was also followed in India Cooperative Navigation and Trading Co. Ltd. Vs Padamsey Prem Ji. However, these decisions now will have no relevance in the context of allotment of shares since the Companies Act, 2013 has several provisions specifically covering these issues.

(iii) By **non-fulfilment of condition precedent:** Where the acceptor fails to fulfill a condition precedent to acceptance the proposal gets revoked. This principle is laid down in Section 6 of the Act. The offeror for instance may impose certain conditions such as executing a certain document or depositing certain amount as earnest money. Failure to satisfy any condition will result in lapse of the proposal. As stated earlier 'condition precedent' to acceptance prevents an obligation from coming into existence until the condition is satisfied. Suppose where 'A' proposes to sell his house to be 'B' for ₹ 5 lakhs provided 'B' leases his land to 'A'. If 'B' refuses to lease the land, the offer of 'A' is revoked automatically.

(iv) By **death or insanity**: Death or insanity of the proposer would result in automatic revocation of the proposal but only if the fact of death or insanity comes to the knowledge of the acceptor.

(v) By **counter offer**

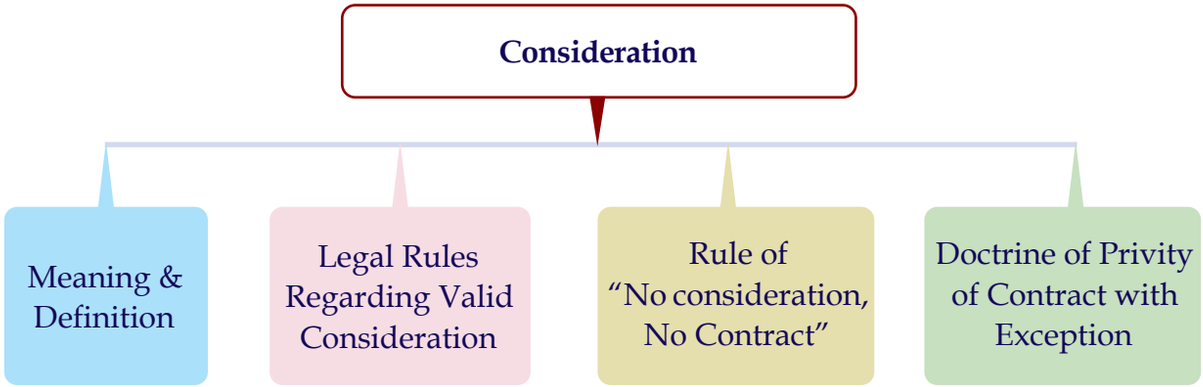
(vi) By the **non-acceptance** of the offer according to the prescribed or usual mode

(vii) By **subsequent illegality.**

UNIT 02 CONSIDERATION

TABLE OF THE CONTENTS FOR THE CHAPTER

- WHAT IS CONSIDERATION? 41
- SUIT BY A THIRD PARTY TO A CONTRACT 44
- VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION 46



WHAT IS CONSIDERATION?

- Consideration is the price agreed to be paid by the **promisee** for the obligation of the **promisor**. The word consideration was described in a very popular English case of Misa v. Currie as:

  "A valuable consideration in the sense of law may consist either in some right, interest, profit or benefit accruing to one party (i.e. promisor) or forbearance, detriment, loss or responsibility given, suffered or undertaken by the other (i.e. the promisee)."

- Section 2(d) defines consideration as follows: "When at the **desire** of the **promisor**, the **promisee** or any other person has done or abstained from doing, or does or **abstains from doing** or **promises to do** or abstain from doing something, such an act or **abstinence or promise** is called **consideration** for the promise".

1. Consideration is an act- doing something.

Example 1:

Ajay guarantees Bhuvan for payment of price of the goods which Bhuvan wanted to sell on one month credit to Chaitanya. Here selling of goods on credit by Bhuvan to Chaitanya is consideration for A's promise.

Example 2:

A college promises students, who will score above 95% for the job in MNC. Consideration need not to be monetary. Here the promise for recruitment of candidate will be considered as consideration for the act of students scoring above 95%.

2. **Consideration is abstinence- abstain from doing something.**

Example 3:

Abhishek promises Bharti not to file a suit against him if she (Bharti) would pay him (Abhishek) ₹ 1,00,000. Here abstinence on the part of Abhishek would constitute consideration against Bharti's payment of ₹ 1,00,000 in favor of Abhishek.

Example 4:

ABC has a shop of electric items. XYZ wishes to open another electric shop next to his shop. ABC offers Rs 2,00,000 to XYZ for shifting the same away from 1 km of ABC's shop. Here, consideration is given for abstaining XYZ from opening his shop nearby.

3. Consideration must be at the **desire of the promisor.**
4. Consideration **may move** from **promisee** or any **other person.**
5. Consideration may be **past, present or future.**

Thus, from above it can be concluded that:

Consideration = Promise / Performance that parties exchange with each other.

Legal Rules Regarding Consideration

Form of consideration = Some benefit, right or profit to one party / some detriment, loss, or forbearance to the other

(i) **Consideration must move at the desire of the promisor:** Consideration must be **offered by the promisee or the third party** at the **desire** or request of the **promisor**. This implies "return" element of consideration. Contract of marriage in consideration of promise of settlement is enforceable.

An act done at the **desire of a third party** is **not a consideration.**

Case Law: Durga Prasad Vs. Baldeo

Facts: In Durga Prasad Vs. Baldeo, D (defendant) promised to pay to P (plaintiff) a certain commission on articles which would be sold through their agency in a market. Market was constructed by P at the desire of the C (Collector), and not at the desire of the D. D was not bound to pay as it was without consideration and hence void.

Example 5:

R saves S's goods from fire without being asked to do so. R cannot demand any reward for his services, as the act being done voluntary.

(ii) **Consideration may move from promisee or any other person:** In India, consideration may **proceed from the promisee** or any **other person** who is **not** a party to the contract. The definition of consideration as given in Section 2(d) makes that proposition clear. According to the definition, when at the desire of the promisor, the promisee or any other person does something such an act is consideration. In other words, there **can be a stranger** to a consideration but **not stranger to a contract.**

Case Law: Chinnayya Vs. Ramayya (1882)

Facts: An old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed a writing in favour of the brother agreeing to pay annuity. The daughter did not, however, pay the annuity and the uncle sued to recover it. It was held that there was sufficient consideration for the uncle to recover the money from the daughter.

(iii) **Executed and executory consideration:** A consideration which consists **in the performance of an act** is said to be **executed**. When it consists **in a promise**, it is said to be **executory**. The promise by one party may be the consideration for an act by some other party, and vice versa.

Example 6:

A pays ₹ 5,000 to B and B promises to deliver to him a certain quantity of wheat within a month. In this case, A pays the amount, whereas B merely makes a promise. Therefore, the consideration paid by A is executed, whereas the consideration promised by B is executory.

(iv) **Consideration may be past, present or future:** The words "has done or abstained from doing" [as contained in Section 2(d)] are a recognition of the doctrine of past consideration. In order to support a promise, a **past** consideration must move by a previous request. It is a general principle that consideration is given and accepted in exchange for the promise. The consideration, if **past**, may be the **motive** but **cannot** be the **real consideration** of a **subsequent promise**. But in the event of the **services** being rendered in the **past** at the **request** or the **desire of the promisor**, the **subsequent promise** is regarded as an **admission** that the **past consideration** was not **gratuitous**.

Example 7:

'A' performed some services to 'B' at his desire. After a week, 'B' promises to compensate 'A' for the work done by him. It is said to be past consideration and A can sue B for recovering the promised money

Example 8:

A cash sale of goods is an example of present consideration. The consideration is immediately made against delivery of goods.

(v) **Consideration need not be adequate:** Consideration **need not** to be of any **particular value**. It **need not** be approximately of **equal value** with the promise for which it is exchanged but it **must be something** which the **law** would regard as having **some value**. **Something in return need not be equal to something given.** It can be considered a bad bargain of the party.

It may be noted in this context that Explanation 2 to Section 25 states that an agreement to which the **consent** of the promisor is **freely given** is **not void** merely because the consideration is **inadequate**.

But as an exception if it is shockingly less and the other party alleges that his consent was **not free** than this inadequate consideration can be **taken as an evidence** in support of this allegation.

Example 9:

X promises to sell a house worth ₹ 60 lacs for ₹ 10 lacs only, the adequacy of the price in itself shall not render the transaction void, unless the party pleads that transaction takes place under coercion, undue influence or fraud.

(vi) **Performance of what one is legally bound to perform:** The performance of an act by a person **who is legally bound to perform** the same **cannot** be **consideration** for a contract. Hence, a promise to pay money to a witness is void, for it is without consideration. Hence, such a contract is void for want of consideration. **Similarly**, an agreement by a client to pay to his counsel after the latter has been engaged, a certain sum over and above the fee, in the event of success of the case would be void, since it is without consideration.

Example 10:

A promise to pay ₹ 2,000 to a doctor over the fees is invalid as it is the duty of a doctor to give a treatment for his normal fees.

But where a person promises to do more that he is legally bound to do or such a promise provided it is **not opposed to public policy**, is a **good consideration**. It should not be vague or uncertain.

(vii) **Consideration must be real and not illusory:** Consideration must be **real** and must **not be illusory**. It must be something to which the **law attaches some value**. If it is legally or physically **impossible** it is **not considered valid consideration.**

Example 11:

A man promises to discover treasure by magic, bringing the dead person to live again. This transaction can be said to be void as it is illusory.

(viii) **Consideration must not be unlawful, immoral, or opposed to public policy**. **Only presence** of consideration is **not sufficient** it must be **lawful**. Anything which is **immoral or opposed to public policy** also **cannot** be valued as **valid consideration.**

Example 12:

ABC Ltd. promises to give job to Mr. X in a Government bank against payment of ₹ 50,000 is void as the promise is opposed to public policy.

❒ SUIT BY A THIRD PARTY TO A CONTRACT

- Though under the Indian Contract Act, 1872, the consideration for an agreement **may proceed from a third party,** the **third party cannot sue** on contract. Only a person who is **party to a contract can sue** on it.
- Thus, the concept of stranger to consideration is a valid and is different from stranger to a contract.

Example 13:

P who is indebted to Q, sells his property to R and R promises to pay off the debt amount to Q. If R fails to pay, then in such situation Q has no right to sue, as R is a stranger to contract.

The aforesaid rule, that **stranger to a contract cannot sue is** known as a "**doctrine of privity of contract",** is however, subject to certain **exceptions**. In other words, even a stranger to a contract may enforce a claim in the following cases:

1. In the case of trust, a **beneficiary** can enforce his right under the trust, though he was **not a party to the contract between the settler and the trustee**.
2. In the case of a family settlement, if the **terms** of the settlement are reduced into **writing, the members** of family who originally had **not been parties to the settlement** may **enforce** the agreement.

Example 14:

Two brothers X and Y agreed to pay an allowance of ₹ 20,000 to mother on partition of joint properties. But later they denied to abide by it. Held their mother although stranger to contract can require their sons for such allowance in the court of law.

3. In the case of certain marriage contracts/arrangements, a **provision** may be made for the **benefit** of a person, he may **file the suit** though he is not a **party** to the agreement.

Example 15:

Mr. X's wife deserted him for ill-treating her. Mr. X promised his wife's father Mr. Puri that he will treat her properly or else pay her monthly allowance. But she was again ill-treated by her husband. Held, she has all right to sue Mr. X against the contract made between Mr. X and Mr. Puri even though she was stranger to contract.

4. In the case of assignment of a contract, when the **benefit** under a contract has been **assigned, the assignee can enforce** the contract but such assignment should **not involve any personal skill.**

Example 16:

Mr. Ankit Sharma has assigned his insurance policy to his son. Now son can claim even if he was not a party to contract.

5. **Acknowledgement or estoppel** – where the **promisor** by his conduct **acknowledges** himself as an **agent of the third party,** it would result into a **binding obligation** towards third party.

Example 17:

If L gives to M ₹ 20,000 to be given to N, and M informs N that he is holding the money for him, but afterwards M refuses to pay the money. N will be entitled to recover the same from the former i.e. M.

6. In the case of **covenant running with the land,** the person who **purchases land** with notice that the **owner** of land is bound by certain duties affecting land, the **covenant affecting** the land may be **enforced by the successor** of the seller.

Example 18:

One owner of the land having two land adjacent to each other. One was agricultural land. He sold the other land containing a condition that it can never be used for Industrial purpose so as to protect the other agricultural land from pollution. Such condition is attached with the land so who so ever is the successor of land has to abide by it. Such are called restrictive covenants and all successor are bind to it.

7. **Contracts entered into through an agent**: The **principal can enforce** the contracts entered by his agent **where the agent has acted within the scope** of his authority and in the name of the principal.

Example 19:

Prashant appoints Abhinav as his agent to sell his house. Abhinav sells house to Tarun. Now Prashant has right to recover the price from Tarun.

❒ VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION

- The general rule is that an agreement made **without consideration is void** (Section 25). In every valid contract, consideration is very important. A contract may only be **enforceable** when **consideration is there.** However, the Indian Contract Act contains **certain exceptions** to this rule. In the following cases, the agreement though made without consideration, will be valid and enforceable.

1. Natural Love and Affection

Conditions to be fulfilled under section 25(1)

(i) It must be made out of **natural love and affection** between the parties.

(ii) Parties must stand in **near relationship** to each other.

(iii) It must be in **writing**.

(iv) It must also be **registered** under the law.

A written and registered agreement based on natural love and affection between the parties standing in near relation (e.g., husband and wife) to each other is enforceable even without consideration.

Example 20:

A husband, by a registered agreement promised to pay his earnings to his wife. Held the agreement though without consideration, was valid.

Example 21:

A out of natural love and affection promises to give his newly wedded daughter- in -law a golden necklace worth ₹ 5,00,000. 'A' made the promise in writing and signed it and registered. The agreement is valid.

2. Compensation for past Voluntary Services

A **promise to compensate**, wholly or in part, a person who has already voluntarily done something for the promisor, is **enforceable** under Section 25(2). In order that a promise to pay for the past voluntary services be binding, the following **essential factors** must exist:

(i) The **services** should have been rendered **voluntarily**.

(ii) The services must have been rendered **for the promisor.**

(iii) The **promisor** must be in **existence** at the time when **services were rendered.**

(iv) The **promisor** must have **intended** to **compensate** the promisee.

Example 22:

P finds R's wallet and gives it to him. R promises to give P ₹ 10,000. This is a valid contract.

Example 23:

Mr. X had helped his nephew Mr. Y to fight a case in the court of law using his knowledge and intellect. After Mr. Y won the case, he promised Mr. X to pay Rs. 10,000. Held, this is a valid contract as it is compensation to past services.

3. Promise to Pay time Barred Debt

Where a **promise in writing signed** by the person making it or by his authorised agent, is made to pay a debt **barred by limitation** it is **valid** without consideration [Section 25(3)].

Example 24:

A is indebted to C for ₹ 60,000 but the debt is barred by the Limitation Act. A sign a written promise now to pay ₹ 50,000 in final settlement of the debt. This is a contract without consideration, but enforceable for ₹ 50,000 only.

4. Agency

According to Section 185 of the Indian Contract Act, 1872, **no consideration is necessar**y to create an agency.

5. Completed Gift

In case of completed gifts, the rule no consideration no contract does not apply. Explanation (1) to Section 25 states "nothing in this section shall affect the validity as between the donor and donee, of any gift actually made." Thus, **gifts do not require any consideration**.

6. Bailment

No consideration is required to affect the contract of **bailment**. Section 148 of the Indian Contract Act, 1872, defines bailment as the delivery of goods from one person to another for some purpose. This delivery is made upon a contract that post accomplishment of the purpose, the goods will either be returned or disposed of, according to the directions of the person delivering them. **No consideration is required** to affect a contract of bailment.

Example 25:

Mr. A hand over the keys of his godown to Mr. Y as Mr. Y had deposited his goods in the same. Mr. Y gets possession of godown but not the ownership. As soon as Mr. Y lifts his goods from godown he is liable to hand over the keys back to Mr. A.

7. Charity

If a **promisee undertakes** the **liability** on the promise of the person to contribute to **charity**, there the contract shall be **valid. (Kadarnath v. Gorie Mohammad)**

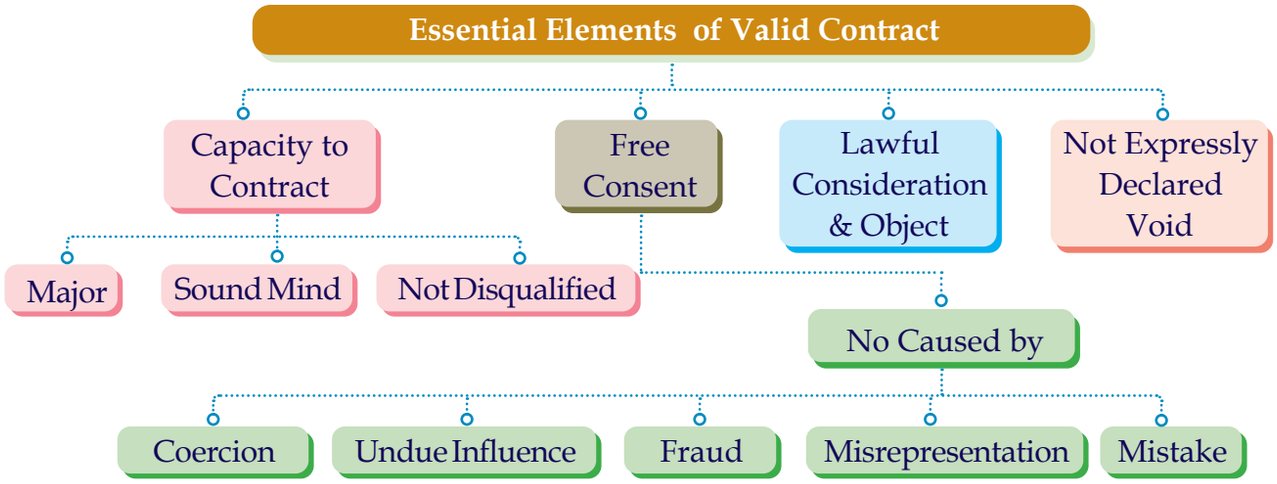
Example 26:

Mr. G promised Mr. K, the secretary of committee of temple to donate ₹ 1,00,000 for renovation of that temple. On the faith of his promise, secretary has incurred some cost for renovation. Now secretary can claim from Mr. G even the contract was without consideration.

UNIT 03 OTHER ESSENTIAL ELEMENTS OF A CONTRACT

TABLE OF THE CONTENTS FOR THE CHAPTER

- CAPACITY TO CONTRACT 48
- FREE CONSENT 52
- ELEMENTS VITIATING FREE CONSENT 53
- LEGALITY OF OBJECT AND CONSIDERATION 60
- VOID AGREEMENTS 64



- Section 10 of the Indian Contract Act, 1872 provides that an agreement in order **to be a contract**, **must satisfy** the following **conditions:**
  1. the parties must be **competent to contract;**
  2. it must be made by the **free consent** of the parties;
  3. it must be made for a **lawful consideration** and with a **lawful object;**

CAPACITY TO CONTRACT

It should not have been **expressly declared as void by law**.

Meaning

- Capacity refers to the **competence** of the parties **to make a contract.** It is one of the essential elements to form a valid contract.

Who is competent **to contract (Section 11)**

Every person is **competent** to contract **who-**

(a) has attained the age of **majority,**

(b) is of **sound mind** and

(c) is **not disqualified from contracting by any law** to which he is subject.

(a) Age of majority

The age of **majority being 18 years,** a person **less than that age** even by a day would be **minor** for the purpose of contracting.

Law Relating to Minor's Agreement/Position of Minor

1. **A contract made with or by a minor is void ab-initio:** A minor is **not competent** to contract and **any agreement** with or by a minor is **void from the very beginning.**

In the leading case of **Mohori Bibi vs. Dharmo Das Ghose (1903)**, "Mr. D a minor, mortgaged his house for Rs. 20,000 to money lender, but the mortgagee i.e. money lender has paid him Rs. 8,000. Subsequently the minor had filed a suit for cancellation of contract. **Held the contract is void** as Mr. D is minor and therefore he is not liable to pay anything to lender."

2. **No ratification after attaining majority:** A minor **cannot ratify** the agreement **on attaining majority** as the **original agreement is void ab initio** and a void agreement can **never be ratified.**

Example 1:

X, a minor makes a promissory note in favour of Y. On attaining majority, he cannot ratify it and if he makes a new promissory note in place of old one, here the new promissory note which he executed after attaining majority is also void being without consideration.

3. **Minor can be a beneficiary or can take benefit out of a contract:** Though a minor is **not competent** to contract, **nothing** in the Contract Act **prevents** the minor from **making the other party bound** to him. Thus, a **promissory note duly executed in favour of a minor is not void** and can be **sued** upon by him, because he though incompetent to contract, may yet **accept a benefit**.

A minor **cannot become partner** in a partnership firm. However, he may with the **consent of all** the partners, be **admitted** to the **benefits** of partnership (Section 30 of the Indian Partnership Act, 1932).

Example 2:

A mortgage was executed in favour of a minor. Held, he can get a decree for the enforcement of the mortgage.

4. **A minor can always plead minority:** A minor can **always plead minority** and is **not stopped** to do so even where he has taken any **loan** or entered into any contract **by falsely representing** that he was **major. Rule of estoppel cannot be applied** against a minor. It means he can be allowed to plea his minority in defence.

Example 3:

A, a minor has falsely induced himself as major and contracted with Mr. X for loan of ₹ 20,000. When Mr. X asked for the repayment A denied to pay. He pleaded that he was a minor so cannot enter into any contract. Held, A cannot be held liable for repayment of amount. However, if he has not spent the same, he may be asked to repay it but the minor shall not be liable for any amount which he has already spent even though he received the same by fraud. Thus, a minor can always plead minority and is not estopped from doing so even where he had produced a loan or entered into some other contract by falsely representing that he was of full age, when in reality he was a minor.

5. **Liability for necessaries:** The case of **necessaries supplied** to a minor **or** to any **other person** whom **such minor is legally bound to support** is governed by **section 68** of the Indian Contract Act. A claim for necessaries supplied to a minor is **enforceable** by law. But a minor is **not liable** for any price that he may **promise** and **never** for **more than** the **value of the necessaries**. There is **no personal liability** of the minor, but only his **property is liable.**

To render **minor's estate liable** for necessaries **two conditions must be satisfied.**

(a) The contract must be for the **goods reasonably necessary** for his **support in the station in life.**

(b) The minor must **not have already** a **sufficient supply** of these necessaries.

Necessaries mean those things that are **essentially needed** by a minor. They **cannot include luxuries** or costly or **unnecessary articles**. Necessaries extend **to all such things** as **reasonable persons would supply to an infant** in that **class of society** to which the infant belongs. Expenses on minor's **education, on funeral** ceremonies come within the scope of the word **'necessaries'.**

The whole question turns upon the minor's status in life. Utility rather than ornament is the criterion.

Example 4:

Shruti being a minor purchased a laptop for her online classes of ₹ 70,000 on credit from a shop. But her assets could pay only ₹ 20,000. The shop keeper could not hold Shruti personally liable and could recover only amount recoverable through her assets i.e. upto ₹ 20,000.

6. **Contract by guardian - how far enforceable: T**hough a minor's agreement is void, his **guardian can,** under certain circumstances enter into a valid contract **on minor's behalf**. Where the guardian makes a **contract for the minor**, which is **within his competence** and which is for the **benefit of the minor**, there will be **valid contract** which the **minor can enforce.**

But **all contracts** made by guardian on behalf of a minor **are not valid.** For **instance,** the guardian of a minor has no power to bind the minor by a contact for the **purchase** of **immovable Property.** But a contract entered into by a **certified guardian** (appointed by the Court) of a minor, with the **sanction of the court** for the sale of the minor's property, may be **enforced** by either party to the contract.

7. **No specific performance:** A minor's agreement being absolutely void, there can be **no question of the specific performance o**f such an agreement.
8. **No insolvency:** A minor **cannot be declared insolvent** as he is incapable of contracting debts and dues are **payable** from the **personal properties** of minor and he shall **never be held personally liable.**
9. **Partnership:** A minor being **incompetent to contract cannot be a partner** in a partnership firm, but under Section 30 of the Indian Partnership Act, he **can be admitted** to the **benefits** of partnership.
10. **Minor can be an agent:** A minor can **act as an agent.** But **he will not be liable** to his principal for his acts. A minor can **draw, deliver and endorse negotiable instruments** without himself being **liable.**

Example 5:

A minor can have an account in the bank. He can draw a cheque for his purchases. But he shall not be liable for cheque bounces nor can he be sued under court of law for any fraud done from his account.

11. **Minor cannot bind parent or guardian: In the absence of authority,** express or implied, **an infant** is **not capable** of **binding** his parent or guardian, **even for necessaries.** The **parents** will be held **liable** only when the **child** is acting as an **agent** for parents.

Example 6:

Richa a minor entered into contract of buying a scooty from the dealer and mentioned that her parents will be liable for the payment of scooty. The dealer sent a letter to her parents for money. The parents will not be liable for such payment as the contract was entered by a minor in their absence and out of their knowledge.

12. **Joint contract by minor and adult:** In such a case, the **adult** will be **liable** on the contract and not the minor. In Sain Das vs. Ram Chand, where there was a joint purchase by two purchasers, one of them was a minor, it was held that the vendor could enforce the contract against the major purchaser and not the minor.
13. **Surety (Guarantor) for a minor:** In a contract of guarantee when an **adult stands surety** for a minor then **he (adult) is liable** to third party as there is direct **contract** between the surety and the **third party.**

Example 7:

Mr. X guaranteed for the purchase of a mobile phone by Krish, a minor. In case of failure for payment by Krish, Mr. X will be liable to make the payment.

14. **Minor as Shareholder:** A minor, being incompetent to contract **cannot be a shareholder** of the company. If **by mistake** he becomes a member, the **company can rescind** the transaction and **remove his name from register**. But, a minor may, **acting though his lawful guardian become a shareholder** by transfer or transmission of **fully paid shares** to him.
15. **Liability for torts:** A tort is a **civil wrong**. A minor is **liable** in tort **unless** the **tort** in reality is a **breach of contract.** Thus, where a minor **borrowed a horse** for riding only, he was held **liable** when he **lent** the horse to one of his **friends** who **jumped and killed** the horse. Similarly, a minor was held **liable** for his failure to **return certain instruments** which he had **hired and then passed on to a friend.**

(b) Person of sound mind

According to Section 12 of Indian Contract Act, "a person is said to be of **sound mind** for the purposes of making a contract if, at the time when he makes it is **capable** of **understanding** it and of forming a **rational judgement** as to its effect upon his interests."

A person who is **usually** of **unsound** mind, but **occasionally** of **sound** mind, may **make a contract** when he is of **sound mind.**

A person who is **usually** of **sound** mind, but **occasionally** of **unsound** mind, may **not make** a contract when he is of **unsound mind.**

Example 8:

A patient in a lunatic asylum, who is at intervals, of sound mind, may contract during those intervals.

Example 9:

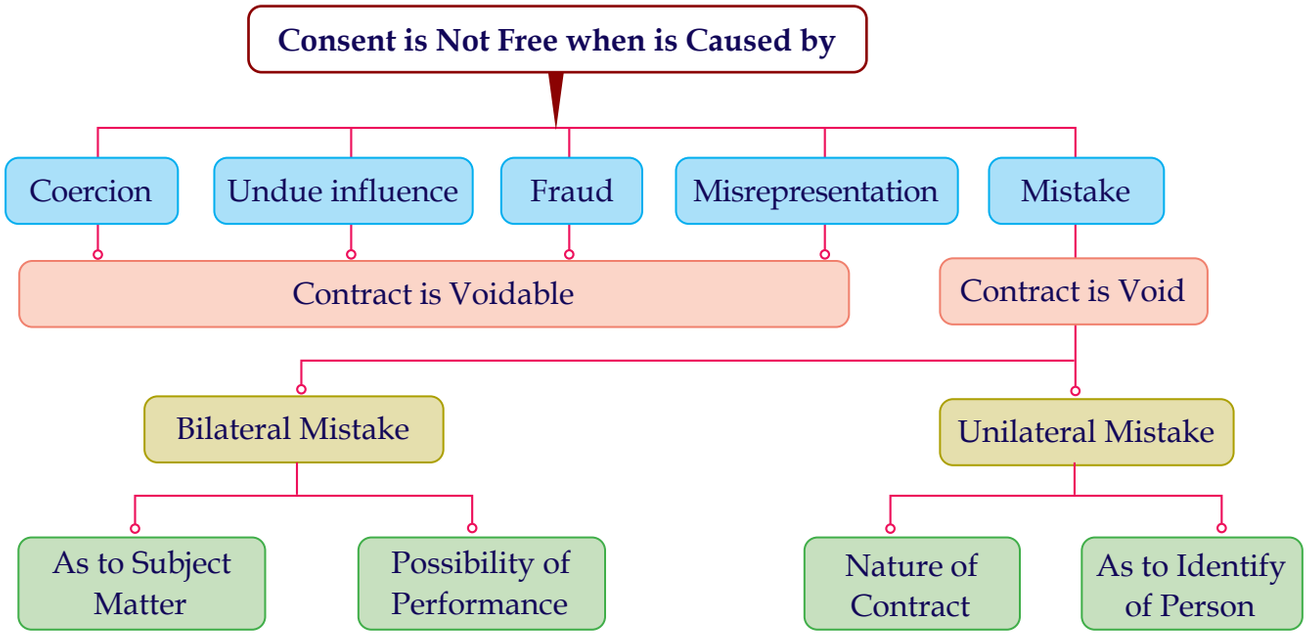
A sane man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgement as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts.

Position of unsound mind person making a contract: A contract by a person who is not of sound mind is void.

(c) Contract by disqualified persons

Besides minors and persons of **unsound mind,** there are also **other persons** who are **disqualified** from contracting, **partially or wholly,** so that the contracts by such person are **void**. Incompetency to contract may **arise from political status, corporate status, legal status**, etc. The following persons **fall in this category:** Foreign Sovereigns and Ambassadors, Alien enemy, Corporations, Convicts, Insolvent etc.

❒ FREE CONSENT



Definition of Consent according to Section 13:

"two or more persons are said to consent when they agree upon the same thing in the same sense."

- Parties are said to have **consented** when they not only agreed upon the **same thing** but also agreed upon that thing in the **same sense**. 'Same thing' must be understood as the whole content of the agreement.

  Consequently, when parties to a contract make some **fundamental error** as to the **nature of the transaction**, or as to the **person** dealt with or as to the **subject-matter** of the agreement, it **cannot be said that they have agreed upon the same thing in the same sense.**

And if they do **not agree** in the **same sense**, there **cannot be consent.** A contract cannot arise in the absence of consent.

- If two persons enter into an apparent contract concerning a particular person or ship, and it turns out that each of them, misled by similarity of name, had a different person or ship in his mind, no contract would exist between them as they were not ad idem, i.e., of the same mind. Again, ambiguity in the terms of an agreement, or an error as to the nature of any transaction or as to the subject-matter of any agreement may prevent the formation of any contract on the ground of absence of consent. In the case of fundamental error, there is really no consent whereas, in the case of mistake, there is no real consent.
- As has been said already, one of the essential elements of a contract is consent and there cannot be a contract without consent. Consent may be **free or not free.** Only **free consent is necessary** for the validity of a contract.

Definition of 'Free Consent' (Section 14)

Consent is said to be **free when** it is **not caused by:**

(a) Coercion, as defined in Section 15; or

(b) Undue Influence, as defined in Section 16; or

(c) Fraud, as defined in Section 17; or

(d) Misrepresentation, as defined in Section 18 or

(e) Mistake, subject to the provisions of Sections 20, 21, and 22.

- When consent to an agreement is **caused by coercion, fraud, misrepresentation, or undue influence,** the agreement is a contract **voidable** at the option of the party whose consent was so caused. When the consent is vitiated by **mistake, t**he contract becomes **void.**

❒ ELEMENTS VITIATING FREE CONSENT

I. Coercion (Section 15)

- "Coercion' is the **committing, or threatening to commit,** any **act forbidden by the Indian Penal Code** or the **unlawful detaining**, or **threatening to detain any property, to the prejudice** of any **person whatever,** with the **intention** of causing any person to **enter into an agreement."**

The section **does not require** that coercion must **proceed from a party to the contract;** nor is it necessary that subject of the coercion must be the other contracting party, it may be **directed against any third person** whatever.

Effects of coercion under section 19 of Indian contract act, 1872

(a) Contract induced by coercion is **voidable** at the option of the party **whose consent was so obtained.**

(b) A person to whom **money has been paid** or anything **delivered** under coercion **must repay or return it. (Section 72)**

- **Threat to commit suicide – Whether is it coercion?**

Suicide though **forbidden by Indian Penal Code** is **not punishable**, as a **dead man cannot be punished.** But Section 15 declares that **committing or threatening to commit** any act forbidden by **Indian Penal Code is coercion.** Hence, a **threat** to commit suicide will be regarded as **coercion.**

Example 10:

Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code.

Example 11:

An agent refused to give books of accounts to the principal unless he frees him from all his liabilities. The principal had to give the release deed. Held, the contract was under coercion by unlawful detaining of the principal's property.

II. Undue influence (Section 16)

According to section 16 of the Indian Contract Act, 1872, "A contract is said to be **induced by 'undue influence'** where the **relations** subsisting between the **parties** are such that **one of the parties** is in a position to **dominate the will** of the **other** and he uses that **position** to obtain an **unfair advantage** over the other".

Example 12:

A having advanced money to his son, B, during his minority, upon B's coming of age obtains, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance. A employs undue influence.

The essential ingredients under this provision are

1. **Relation between the parties:** A person can be **influenced** by the other when a **near relation** between the **two exists.**
2. **Position to dominate the will: Relation** between the parties **exist** in such a manner that **one of them** is in a position to **dominate the will** of the **other.** A person is **deemed** to be in such position in the **following circumstances:**
   (a) **Real and apparent authority:** Where a person holds a **real authority** over the other as in the case of master and servant, doctor and patient and etc.

Example 13:

A father, by reason of his authority over the son can dominate the will of the son.

   (b) **Fiduciary relationship:** Where relation of **trust and confidence** exists between the parties to a contract. Such type of relationship exists between father and son, solicitor and client, husband and wife, creditor and debtor, etc.

Example 14:

By reason of fiduciary relationship, a solicitor can dominate the will of his client and a trustee can dominate the will of the beneficiary.

Example 15:

A spiritual guru induced his devotee to gift to him the whole of his property in return of a promise of salvation of the devotee. Held, the consent of the devotee was given under undue influence. Here, the relationship was fiduciary relationship between Guru and devotee and Guru was in a position to dominate the will of devotee.

(c) **Mental distress:** An undue influence can be **used against a person** to get his consent on a contract where the **mental capacity** of the person is **temporarily or permanently affected** by the reason of mental or bodily distress, illness or of old age.

Example 16:

A doctor is deemed to be in a position to dominate the will of his patient enfeebled by protracted illness.

(d) **Unconscionable bargains:** Where **one** of the **parties** to a contract is in a position to **dominate the will** of the other and the contract is **apparently unconscionable** i.e., unfair, it is **presumed by law** that consent must have been **obtained by undue influence.** Unconscionable bargains are witnessed mostly in money-lending transactions and in gifts.

Example 17:

A, being in debt to B, the money-lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence.

Example 18:

A applies to a banker for a loan at a time when there is a stringency in money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence.

3. **The object must be to take undue advantage:** Where the person is in a **position to influence** the will of the other **in getting consent**, must have the **object to take advantage** of the other.

Example 19:

A teacher asks her daughter to get marry to one of his brilliant students. Both the girl and boy were smart, settled and intelligent. Here the teacher had a relation which can have influence on both of them. But as no undue advantage of such influence was taken such contract of marriage is said to be made by free consent.

4. **Burden of proof:** When a **party** to contract **decides to avoid the contract** on the ground of **undue influence,** he has to **prove that-**
   (a) The **other party** is in **position** to **dominate his will,**
   (b) the other party **actually used** his position to **obtain his consent,**
   (c) transaction is **unfair or unconscionable.**

Effect of undue influence- (Section 19A)

(i) When consent to an agreement is caused by undue influence, the agreement is a contract **voidable** at the **option** of the party whose **consent was so caused.**

(ii) Any such contract may be **set aside** either **absolutely** or, **if** the party who was entitled to avoid it has **received any benefit** thereunder, upon such **terms and conditions** as to the **Court may seem just.**

Example 20:

A, a money lender advances ₹ 1,00,000 to B, an agriculturist, and by undue influence induces B to execute a bond for ₹ 2,00,000 with interest at 6 percent per month. The court may set aside the bond, ordering B to repay ₹ 1,00,000 with such interest as may seem just.

III. Fraud (Section 17)

Definition of fraud under Section 17

'Fraud' **means and includes** any of the **following acts** committed by a party to a contract, or with his connivance, or by his agent, with an **intent to deceive another party** thereto or his agent, or to **induce him** to **enter into the contract:**

1. the **suggestion, as a fact,** of that which is **not true**, by one who **does not believe** it to be **true;**
2. the **active concealment** of a fact by **one having knowledge or belief** of the fact;
3. a **promise made without** any **intention of performing** it;
4. any **other act fitted to deceive;**
5. any such **act or omission** as the **law specially declares** to be **fraudulent.**

The following are the essential elements of the fraud

1. There must be a **representation or assertion** and it must be **false.** However, **silence** may amount to **fraud** or an **active concealment** may amount to **fraud.**

   Whether Silence is fraud or not?

   As per explanation of section 17, silence is fraud in following situations:

   (a) **There is duty to speak.**

Example 21:

A sell, by auction, to B, a horse which A knows to be unsound, A says nothing to B about the unsoundness of the horse. This is not fraud by A.

Example 22:

In the above example, B is A's daughter. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.

   (b) **When silence is equal to speech.**

Example 23:

B says to A –"If you do not deny it, I shall assume that the horse is sound". A says nothing. Here A's silence is equivalent to speech.

2. **The representation must be related to a fact.**

Example 24:

'A' who is about to sell goods says that goods cost him Rs. 50,000. This is statement of fact. But if he says the goods are worth Rs. 50,000, it is a statement of opinion

3. The representation should be **made before the conclusion** of the **contract** with the **intention** to **induce** the other party to act upon it.
4. The representation or statement should be **made with a knowledge** of its **falsity** or **without belief** in its **truth** or recklessly **not caring whether it is true or false.**
5. The **other party** must have been **induced** to **act** upon the **representation or assertion.**

Example 25:

'A' bought shares in a company on the faith of a prospectus which contained an untrue statement that 'B' was a director of the company. 'A' had never heard of 'B' and, therefore, the statement was immaterial from his point of view. A's claim for damages in this case was dismissed because the untrue statement had not induced 'A' to buy the shares.

6. The other party must have **relied upon the representation and** must have been **deceived.**
7. The other party acting on the representation must have **consequently suffered a loss.**

Effect of fraud upon validity of a contract

When the consent to an agreement in caused by the fraud, the contract is voidable at option of the party defrauded and he has the following remedies:

1. He can **rescind the contract** within a **reasonable time.**
2. He can **sue for damages.**
3. He can **insist on the performance** of the contract on the **condition** that he shall be put in the **position** in which he would **have been had** the **representation** made been **true.**

Exception

In the following cases, contract is not voidable:

(i) If the party whose consent was caused by **silence** which amounting to fraud, had the **means of discovering the truth with ordinary diligence.**

(ii) A fraud which **did not cause the consent of the party to agreement.**

IV. Misrepresentation (Section 18)

According to Section 18, there is misrepresentation:

1. **Statement of fact**, which of **false,** would constitute misrepresentation if the **maker believes it to be true** but which is **not justified** by the **information he possesses**;
2. When there is a **breach of duty** by a person **without any intention to deceive** which brings an **advantage to him;**
3. When a **party causes**, **even though done innocently,** the other party to the agreement to **make a mistake** as to the subject matter.

Example 26:

A makes a positive statement to B that C will be made the director of a company. A makes the statement on information derived, not directly from C but from M. B applies for shares on the faith of the statement which turns out to be false. The statement amounts to misrepresentation, because the information received second-hand did not warrant A to make the positive statement to B.

Example 27:

'A' believed the engine of his motor cycle to be in an excellent condition. 'A' without getting it checked in a workshop, told to 'B' that the motor cycle was in excellent condition. On this statement, 'B' bought the motor cycle, whose engine proved to be defective. Here, 'A's statement is misrepresentation as the statement turns out to be false.

Example 28:

A while selling his mare to B, tells him that the mare is thoroughly sound. A genuinely believes the mare to be sound although he has no sufficient ground for the belief. Later on, Blinds the mare to be unsound. The representation made by A is a misrepresentation.

Example 29:

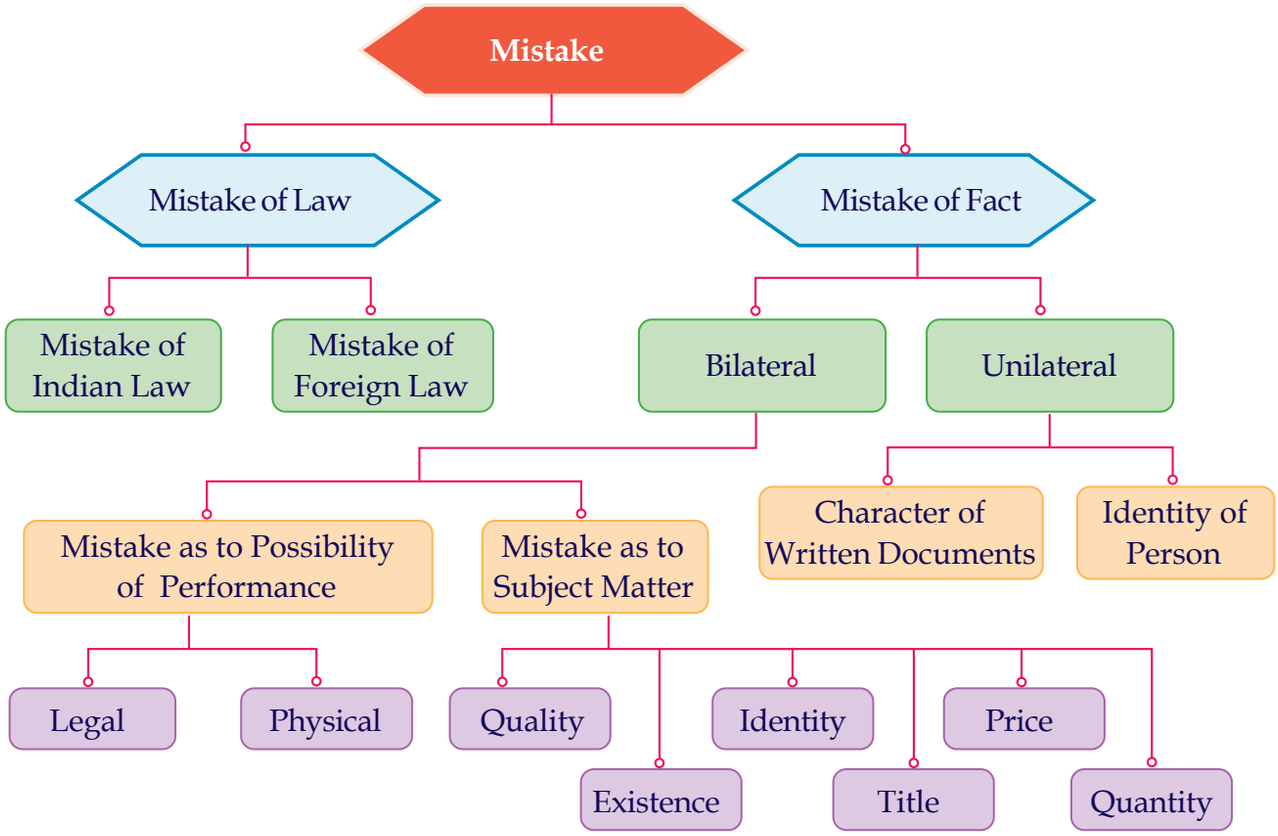
A buy an article thinking that it is worth ₹ 1000 when in fact it is worth only ₹ 500. There has been no misrepresentation on the part of the seller. The contract is valid.

Difference between Coercion and Undue Influence

Basis of Difference	Coercion	Undue Influence
Nature of action	It involves the physical force or threat. The aggrieved party is compelled to make the contract against its will.	It involves moral or mental pressure.
Involvement of criminal action	It involves committing or threatening to commit and act forbidden by Indian Penal Code or detaining or threatening to detain property unlawfully.	No such illegal act is committed or a threat is given.
Relationship between parties	It is not necessary that there must be some sort of relationship between the parties.	Some sort of relationship between the parties is absolutely necessary.
Exercised by whom	Coercion need not proceed from the promisor nor need it be the directed against the promisor. It can be used even by a stranger to the contract.	Undue influence is always exercised between parties to the contract.
Enforceability	The contract is voidable at the option of the party whose consent has been obtained by the coercion.	Where the consent is induced by undue influence, the contract is either voidable or the court may set it aside or enforce it in a modified form.
Position of benefits received	In case of coercion where the contract is rescinded by the aggrieved party, as per Section 64, any benefit received has to be restored back to the other party.	The court has the discretion to direct the aggrieved party to return the benefit in whole or in part or not to give any such directions.

Distinction between Fraud and Misrepresentation

Basis of Difference	Fraud	Misrepresentation
Intention	To deceive the other party by hiding the truth.	To deceive the other party by hiding the truth.
Knowledge of truth	The person making the suggestion believes that the statement as untrue.	The person making the statement believes it to be true, although it is not true.
Rescission of the contract and claim for damages	The injured party can repudiate the contract and claim damages.	The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages.
Means to discover the truth	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.



Mistake

Mistake may be defined as **innocent or erroneous belief** which leads the party to **misunderstand the others**. Mistake may be **either mistake of law** or **mistake of fact.**

Mistake of Law

- Mistake of law is further classified as mistake of Indian law or mistake of foreign law.

(i) Mistake of Indian Law: A person **cannot be allowed** to **get any relief** on the ground that it had **done a particular act in ignorance of law.**

Example 30:

A and B enter into a contract on the erroneous belief that a particular debt is barred by the Indian Law of Limitation. This contract is not voidable.

(ii) **Mistake of foreign law:** Such a mistake is treated as mistake of fact and the agreement in such a case is void.

Mistake of Fact

Mistake of fact are of two types – (i) Bilateral Mistake, (ii) Unilateral Mistake

1. **Bilateral mistake**: Where **both the parties** to an agreement are **under a mistake** as to a **matter of fact essential** to the **agreement**, there is a bilateral mistake. In such a case, the agreement is **void (Section 20).**

Cases of Bilateral Mistakes

(i) Mistake as to the **quality of the subject-matter.**

(ii) Mistake as to the **existence of the subject-matter.**

(iii) Mistake as to the **identity of the subject-matter.**

(iv) Mistake as to the **title of the subject-matter.**

(v) Mistake as to the **price of the subject-matter.**

(vi) Mistake as to the **quantity of the subject-matter.**

2. **Unilateral Mistake**: According to Section 22, a contract is **not voidable** merely because it was caused by **one of the parties** to it being **under a mistake** as to a **matter of fact.**

❒ LEGALITY OF OBJECT AND CONSIDERATION

- **Which considerations and objects are lawful, and those which are not (Section 23):**

Under Section 23 of the Indian Contract Act, in each of the following cases the consideration or object of an agreement is said to be unlawful:

I. When Consideration or Object is Forbidden by Law

Acts forbidden by law are those which are **punishable under any statute** as well as those **prohibited by regulations** or orders made in exercise of the authority conferred by the legislature.

Example 31:

A father had arranged for marriage of his 17 years boy and took dowry from the girl's parents. Such marriage contract cannot take place as in India the minimum age for boy marriage is 21 years and dowry is not permissible in Indian law. Such is not a valid contract as the consideration and object both are forbidden by law.

II. When Consideration or Object are of Such a Nature that if Permitted it would Defeats the Provisions of Law

If the consideration or the object of an agreement is of such a nature that not directly but indirectly, it would **defeat the provisions of the law**, the agreement is **void.**

Example 32:

A's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law.

III. When it is Fraudulent

Agreements which are entered into to **promote fraud are void.**

Example 33:

A, B and C enter into an agreement for the division among them of gains acquired, or to be acquired, by them by fraud. The agreement is void, as its object, viz., acquisition of gains by fraud is unlawful.

VI. The General Term "Injury" means Criminal or Wrongful Harm

In the following examples, the object or consideration is unlawful as it involves **injury to the person or property of another.**

Example 34:

An agreement to print a book in violation of another's copyright is void, as the object is to cause injury to the property of another. It is also void as the object of the agreement is forbidden by the law relating to copyright.

Example 35:

A promises to repay his debt by doing manual labour daily for a special period and agrees to pay interest at an exorbitant rate in case of default. Here A's promise to repay by manual labour is the consideration for the loan, and this consideration is illegal as it imposes what, in substance, amounts to slavery on the part of A. In other words, as the consideration involves injury to the person A, the consideration is illegal. Here, the object too is illegal, as it seeks to impose slavery which is opposed to public policy. Hence, the agreement is void.

V. When Consideration is Immoral

The following are the examples of agreements where the object or consideration is **unlawful,** being **immoral.**

Example 36:

Where P had advanced money to D, a married woman to enable her to obtain a divorce from her husband and D had agreed to marry him as soon as she could obtain the divorce, it was held that P was not entitled to recover the amount, since the agreement had for its object the divorce of D from her husband and the promise of marriage given under these circumstances was against good morals.

Example 37:

A asks B, "If you arrange a girl for marriage with me, I will give Rs. 50,000." Here contract is void as it is immoral.

VI. When Consideration is Opposed to Public Policy

The expression **'public policy'** can be interpreted either in a wide or in a narrow sense. The **freedom to contract** may become illusory, unless the scope of **'public policy' is restricted**. In the name of public policy, freedom of contract is restricted by law only for the good for the community.

Some of the Agreements which are Held to be Opposed to Public Policy are

1. Trading with enemy

Any trade with person **owing allegiance to a Government** at war with India **without the licence** of the Government of India is void, as the object is **opposed to public policy.** Here, the agreement to **trade** offends **against the public policy** by tending to prejudice the interest of the State in times of war.

Example 38:

India entered in war like situation with China. Mr. A from India entered into contract with China for import of toys. Such contract is void as China is alien enemy of India. The contract if made before such war like situation may be suspended or dissolved. Like India felt apps like tik tok and PUBG will provide some internal information of the country, hence such apps were banned and any contract with them were dissolved.

2. Stifling prosecution

An agreement to stifle prosecution i.e. "an agreement to **present proceedings already instituted** from **running their normal course using force"** tends to be a perversion or an abuse of justice; therefore, such an agreement is void. The principle is that one should not make a trade of felony. The compromise of any public offence is generally illegal.

Under the **Indian Criminal Procedure Code**, there is, however, a **statutory list** of **compoundable offences** and an **agreement** to **drop proceeding** relating to such offences **with or without** the **permission of the Court,** as the case may be, in consideration the accused promising to do something for the complainant, is **not opposed to public policy**. Thus, where A agrees to sell certain land to B in consideration of B abstaining from taking criminal proceeding against A with respect to an offence which is compoundable, the agreement is not opposed to public policy. But, it is otherwise, if the offence is uncompoundable.

3. Maintenance and champerty

Maintenance is an **agreement** in which a person promises to **maintain suit** in which he has **no interest.**

Example 39:

A offer B ₹ 2000, if he sues C for a case which they could have settled mutually under provisions of law, just to annoy C. Such agreement is maintenance agreement.

Champerty is an **agreement** in which a person **agrees to assist** another in litigation in exchange of a **promise to hand over** a portion of the **proceeds** of the action.

Example 40:

A agrees to pay expenses to B if he sues C and B agrees to pay half of the amount received from result of such suit. This is an agreement of champerty. The agreement for supplying funds by way of Maintenance or Champerty is valid unless

(a) It is **unreasonable** so as to be **unjust to other party** or

(b) It is made by a **malicious motive** like that of gambling in litigation or oppressing other party by encouraging unrighteous suits and **not with the bonafide object** of assisting a claim believed to be just.

4. Trafficking relating to public offices and titles

An agreement to trafficking in public office is **opposed to public policy,** as it **interferes with** the **appointment** of a person **best qualified** for **the service of the public.** Public policy requires that there should be **no money consideration** for the **appointment** to an office in which the **public is interested.** The following are the **examples** of agreements that are void; since they are tantamount to sale of public offices.

1. An agreement to pay money to a **public servant** in order to induce him to **retire** from his office so that **another person may secure the appointment** is void.
2. An agreement to procure **a public recognition** like Padma Vibhushan for reward is void.

Example 41:

Harish paid ₹ 15000 to the officer to give his son the job in the Forest department of India. On failure by officer he couldn't recover the amount as such contract amounts to trafficking in public office which is opposed to public policy.

5. Agreements tending to create monopolies

Agreements having for their object the establishment of monopolies are opposed to public policy and therefore void.

Example 42:

XYZ and ABC were only the manufactures of oxygen cylinders in West Bengal. They both entered into contract of supplying the same at very high rates and enjoy the monopoly rates during the covid period in the country. Such contract is opposed to public policy as they intended to create monopolies.

6. Marriage brokerage agreements

An agreement to negotiate marriage **for reward**, which is known as a marriage brokerage contract, **is void,** as it is opposed to public policy. For instance, an agreement to pay money to a person hired to procure a wife is opposed to public policy and therefore void.

Note: **Marriage bureau only provides information** and **doesn't negotiate marriage for reward**, therefore, it is not covered under this point.

7. Interference with the course of justice

An agreement whose object is to **induce any judicial officer of the State** to **act partially or corruptly is void**, as it is **opposed to public policy;** so also is an agreement by A to reward B, who is an intended witness in a suit against A in consideration of B's absenting himself from the trial. For the same reasons, an agreement which contemplates the use of under-hand means to influence legislation is void.

8. Interest against obligation

The following are examples of agreement that are void as they tend to create an interest against obligation. The object of such agreements is opposed to public policy.

1. An agreement by an agent to receive without his principal's consent compensation from another for the performance of his agency is invalid.
2. A, who is the manager of a firm, agrees to pass a contract to X if X pays to A ₹ 200,000 privately; the agreement is void.

9. Consideration unlawful in part

By virtue of Section 24, if any part of **a single consideration** for **one or more objects,** or any **one or any part** of any one of **several considerations** for a **single object, is unlawful,** the agreement is **void."**

This section is an obvious consequence of the general principle of Section 23. There is **no promise** for a **lawful consideration** if there is **anything illegal** in a consideration which **must be taken as a whole.** The general rule is that where the **legal part** of a contract can be **severed from the illegal part,** the **bad part** may be **rejected** and the **good one** can be **retained.** But where the **illegal part cannot be severed**, the contract is **altogether void.**

❒ VOID AGREEMENTS

Expressly Declared Void Agreements

1	Made by incompetent parties (Section 11)	6	Agreement in restraint of marriage (Section 26)
2	Agreements made under Bilateral mistake of fact (Section 20)	7	Agreements in restraint of trade (Section 27)
3	Agreements the consideration or object of which is unlawful (Section 23)	8	Agreement in restraint of legal proceedings (Section 28)
4	Agreement the consideration or object of which is unlawful in parts (Section 24)	9	Agreement the meaning of which is uncertain (Section 29)
5	Agreements made BUSINESS LAWS without consideration (Section 25)	10	Wagering Agreement (Section 30)
	[Refer Unit 2]	11	Agreements to do impossible Acts (Section 56)

1. Agreement in restraint of marriage (Section 26)

Every agreement in restraint of marriage of any person **other than a minor, is void**. So, if a person, being a **major, agrees** for **good consideration not to marry,** the promise is not binding and considered as **void agreement.**

2. Agreement in restraint of trade (Section 27)

An agreement by which any person is **restrained from exercising a lawful profession, trade or business** of any kind, is to that extent **void.** But this rule is subject to the following exceptions, namely, where a person **sells the goodwill** of a business and **agrees** with the **buyer to refrain** from carrying on a **similar business,** within **specified local limits**, so long as the buyer or his successor in interest carries on a like business therein, such an agreement is valid (goodwill is the advantage enjoyed by a business on account of public patronage and encouragement from habitual customers). The **local limits** within which the seller of the goodwill agrees not to carry on similar business must be **reasonable**. Under Section 36 of the Indian Partnership Act, 1932 if an outgoing partner makes an agreement with the continuing partners that he will not carry on any business similar to that of the firm **within a specified period or within specified local limits,** such an agreement, thought in restraint of trade, will be **valid**, if the restrictions imposed are reasonable. Similarly, under Section 11 of that Act an **agreement between partners not to carry on competing business** during the continuance of partnership is **valid.**

But an **agreement of service** by which an **employee binds himself,** during the **term** of his agreement, **not to compete** with his **employer** is **not in restraint of trade.**

Example 43:

B, a physician and surgeon, employs A as an assistant for a term of three years and A agrees not to practice as a surgeon and physician during these three years. The agreement is valid and A can be restrained by an injunction if he starts independent practice during this period.

Example 44:

An agreement by a manufacturer to sell during a certain period his entire production to a wholesale merchant is not in restraint of trade.

Example 45:

Agreement among the sellers of a particular commodity not to sell the commodity for less than a fixed price to maintain the quality of the product, is not an agreement in restraint of trade.

3. Agreement in restraint of legal proceedings (Section 28)

An agreement in restraint of legal proceeding is the one by which **any party** thereto is **restricted absolutely** from enforcing his **rights** under a contract **through a Court** or which **abridges the usual period** for starting **legal proceedings.** A contract of this nature is **void.**

However, there are certain exceptions to the above rule:

(i) A contract by which the **parties agree** that any **dispute** between them in respect of **any subject** shall be referred to **arbitration** and that only the **amount awarded** in such arbitration shall be **recoverable** is a **valid contract.**

(ii) Similarly, a contract by which the **parties agree to refer to arbitration** any question between them which has **already arisen** or which may arise in **future, is valid;** but such a contract **must be in writing.**

4. Agreement – the meaning of which is uncertain (Section 29)

An agreement, the meaning of which is not certain, is void, but where the meaning thereof is capable of being made certain, the agreement is valid.

Example 46:

A agrees to sell B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. But the agreement would be valid if A was dealer only in coconut oil; because in such a case its meaning would be capable of being made certain.

5. Wagering agreement (Section 30)

An **agreement by way of a wager** is **void**. It is an agreement **involving payment** of a sum of money **upon the determination** of an **uncertain event**. The **essence** of a wager is that **each side should stand to win or lose,** depending on the way an **uncertain event takes place** in reference to which the chance is taken and in the occurrence of which neither of the parties has legitimate interest.

Example 47:

A agrees to pay ₹ 50,000 to B if it rains, and B promises to pay a like amount to A if it does not rain, the agreement will be by way of wager. But if one of the parties has control over the event, agreement is not a wager.

Essentials of a Wager

1. There must be a **promise to pay money or money's worth.**
2. Promise must be **conditional** on an event happening or not happening.
3. There must be **uncertainty of event.**
4. There must be **two parties**, each party must stand to **win or lose.**
5. There must be **common intention** to **bet** at the timing of making such agreement.
6. Parties should have **no interest** in the event **except for stake.**

Transactions Similar to Wager (Gambling)

(i) Lottery transactions

A lottery is a **game of chance** and **not of skill or knowledge**. Where the **prime motive** of participant is **gambling**, the transaction amounts to a wager. Even if the lottery is **sanctioned by the Government** of India it is a **wagering** transaction. The **only effect** of such sanction is that the **person responsible** for running the lottery will **not be punished under the Indian Penal Code. Lotteries are illegal** and even **collateral transactions** to it are tainted with **illegality** (Section 294A of Indian Penal Code).

(ii) Crossword puzzles and competitions

Crossword puzzles in which **prizes depend** upon the **correspondence** of the competitor's solution with a **previously prepared solution** kept with the **editor of a newspaper** is a **lottery** and therefore, **a wagering transaction.**

Case Law: State of Bombay Vs. R.M.D. Chamarbangwala AIR (1957)

Facts: A crossword puzzle was given in magazine. Abovementioned clause was stated in the magazine. A solved his crossword puzzle and his solution corresponded with previously prepared solution kept with the editor. Held, this was a game of chance and therefore a lottery (wagering transaction).

Crossword puzzles, picture competitions and athletic competitions where **prizes are awarded** on the **basis of skill and intelligence** are the **games of skill** and hence such **competitions are valid.** According to the Prize Competition Act, 1955 prize competitions in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.

(iii) Speculative transactions

An **agreement** or a **share market transaction** where the parties **intend to settle the difference** between the **contract price** and the **market price** of certain goods or shares on a specified day, is a **gambling and hence void.**

(iv) Horse Race transactions

A **horse race competition** where prize payable to the bet winner is **less than ₹ 500, is a wager.**

Example 48:

A and B enter into an agreement in which A promises to pay ₹ 2,00,000 provided 'Chetak' wins the horse race competition. This is not a wagering transaction.

However, Section 30 is not applicable in an agreement to contribute toward plate, prize or sum of money of the value of ₹ 500 or above to be awarded to the winner of a horse race.

Transactions Resembling with Wagering Transaction but are not Void

(i) Chit fund

Chit fund does not come within the scope of wager (Section 30). In case of a chit fund, a **certain number of persons decide** to **contribute** a fixed sum for a **specified period** and at the **end of a month,** the **amount** so contributed is **paid** to the **lucky winner** of the lucky draw.

(ii) Commercial transactions or share market transactions

In these transactions in which **delivery of goods or shares** is **intended** to be given or taken, **do not amount to wagers.**

(iii) Games of skill and athletic competition

Crossword puzzles, picture competitions and **athletic competitions** where prizes are awarded on the **basis of skill and intelligence** are the games of skill and hence such competition are **valid.** According to the Prize Competition Act, 1955 prize competition in **games of skill** are not wagers provided the **prize money does not exceed ₹ 1,000.**

(iv) A contract of insurance

A contract of insurance is a **type of contingent contract** and is **valid** under law and these contracts are **different from wagering agreements.**

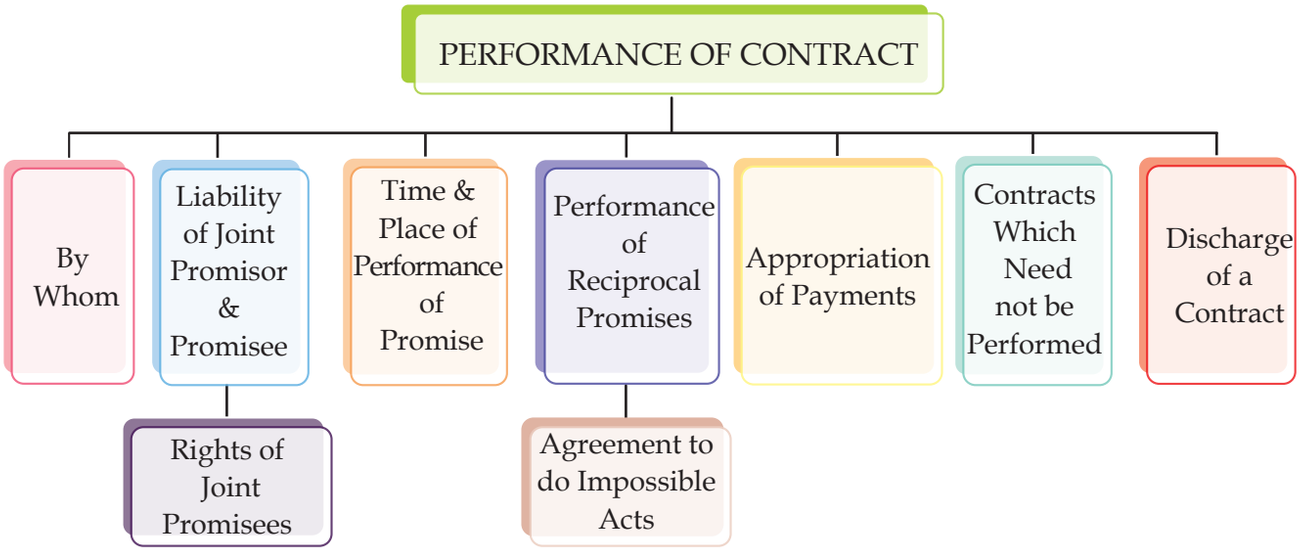
Distinction between Contract of Insurance and Wagering Agreement

	Basis	Contracts of Insurance	Wagering Agreement
1	**Meaning**	It is a contract to indemnify the loss.	It is a promise to pay money or money's worth on the happening or non-happening of an uncertain event.
2	**Consideration**	The crux of insurance contract is the mutual consideration (premium and compensation amount).	There is no consideration between the two parties. There is just gambling for money.
3	**Insurable Interest**	Insured party has insurable interest in the life or property sought to be insured.	There is no property in case of wagering agreement. There is betting on other's life and properties.
4	**Contract of Indemnity**	Except life insurance, the contract of insurance indemnifies the insured person against loss.	Loser has to pay the fixed amount on the happening of uncertain event.
5	**Enforceability**	It is valid and enforceable	It is void and unenforceable agreement.
6	**Premium**	Calculation of premium is based on scientific and actuarial calculation of risks.	No such logical calculations are required in case of wagering agreement.
7	**Public Welfare**	They are beneficial to the society.	They have been regarded as against the public welfare.

UNIT 04 PERFORMANCE OF CONTRACT

TABLE OF THE CONTENTS FOR THE CHAPTER

- PERFORMANCE OF CONTRACT 69
- CONDITIONS TO BE SATISFIED FOR A VALID TENDER OR ATTEMPTED PERFORMANCE 70
- BY WHOM A CONTRACT MAY BE PERFORMED (SECTION 40, 41 AND 42) 71
- DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT 72
- LIABILITY OF JOINT PROMISOR & PROMISEE 72
- TIME AND PLACE FOR PERFORMANCE OF THE PROMISE 74
- PERFORMANCE OF RECIPROCAL PROMISE 75
- APPROPRIATION OF PAYMENTS 79
- CONTRACTS, WHICH NEED NOT BE PERFORMED - WITH THE CONSENT OF BOTH THE PARTIES 79
- DISCHARGE OF A CONTRACT 82



PERFORMANCE OF CONTRACT

Meaning

"Performance of Contract" means **fulfilment of obligations** to the contract. According to Section 37, the parties to a contract must **either perform**, or **offer to perform**, their respective promises **unless** such performance is **dispensed** with **or excused** under the provisions of the Contract Act or of any other law.

Types

On the basis of Section 37, "Performance of Contract" may be **actual or attempted**.

(a) Actual performance

Where a party to a contract has done what he had undertaken to do or either of the parties has fulfilled their obligations under the contract within the time and in the manner prescribed.

Example 1:

X borrows ₹ 5,00,000 from Y with a promise to be paid after 1 month. X repays the amount on the due date. This is actual performance.

(b) Offer to perform or attempted performance or tender of performance

It may happen sometimes, when the **performance becomes due**, the promisor **offers** to perform his obligation **but the promisee refuses to accept** the performance.

Example 2:

A promises to deliver certain goods to B. A takes the goods to the appointed place during business hours but B refuses to take the delivery of goods. This is an attempted performance as A the promisor has done what he was required to do under the contract.

❒ CONDITIONS TO BE SATISFIED FOR A VALID TENDER OR ATTEMPTED PERFORMANCE

(i) **It must be unconditional.**

Example 3:

A offers to B to repay only the principal amount of the loan. This is not a valid tender since the whole amount of principal and interest is not offered.

(ii) **It must be made at proper time and place.**

Example 4:

If the promisor wants to deliver the goods at 2 a.m., this is not a valid tender unless it was so agreed.

(iii) **Reasonable opportunity to examine goods.**

Example 5:

A contract's to deliver B at his warehouse 1000 Kgs of wheat on certain date. A must bring the wheat to B's warehouse on the appointed day, under such circumstances that B may have reasonable opportunity of satisfying himself that the thing offered is wheat of the quality contracted for, and that there are 1000 Kgs.

(iv) **It must be for whole obligation.**

Example 6:

X, a singer enters into a contract with Y, the manager of a theatre to sing at his theatres two nights in every week during the next two months, and Y engaged to pay her ₹ 10,000 for each night's performance. On the sixth night, X willfully absents herself from the theatre. Y is at liberty to put an end to the contract.

Example 7:

A promises to deliver 100 bales of cotton on a certain day. On the agreed day and place 'A' offers to deliver 80 bales only. This is not a valid tender.

❒ BY WHOM A CONTRACT MAY BE PERFORMED (SECTION 40, 41 AND 42)

The promise under a contract may be performed, as the circumstances may permit, by the promisor himself, or by his agent or his legal representative.

1. Promisor Himself

If there is something in the contract to show that it was the **intention** of the parties that the **promise** should be performed by the **promisor himself**, such promise must be performed by the promisor. This means contracts which involve the **exercise of personal skill or diligence**, **or** which are founded on **personal confidence** between the parties must be performed by the **promisor himself**.

Example 8:

A promises to paint a picture for B and this must be performed by the promisor himself.

2. Agent

Where **personal consideration is not the foundation** of a contract, the promisor or his representative may **employ a competent person** to perform it.

3. Legal Representatives

A contract which involves the **use of personal skill or** is founded on **personal consideration** comes to an **end on the death** of the promisor. As regards **any other contract** the **legal representatives** of the deceased promisor are **bound** to perform it unless a contrary intention appears from the contract (Section 37, para 2). But their **liability** under a contract is **limited** to the value of the property they **inherit** from the deceased.

Example 9:

A promises to B to pay ₹ 100,000 on delivery of certain goods. A may perform this promise either himself or causing someone else to pay the money to B. If A dies before the time appointed for payment, his representative must pay the money or employ some other person to pay the money. If B dies before the time appointed for the delivery of goods, B's representative shall be bound to deliver the goods to A and A is bound to pay ₹ 100,000 to B's representative.

Example 10:

A promises to paint a picture for B for a certain price. A is bound to perform the promise himself. He cannot ask some other painter to paint the picture on his behalf. If A dies before painting the picture, the contract cannot be enforced either by A's representative or by B.

4. Third Persons

Effect of accepting performance from third person- Section 41: When a **promisee accepts** performance of the promise **from a third person**, he **cannot afterwards enforce** it **against the promisor**. That is,

performance by a stranger, if accepted by the promisee, this results in discharging the promisor, although the latter has **neither authorised not ratified** the act of the third party.

Example 11:

A received certain goods from B promising to pay ₹ 100,000/-. Later on, A expressed his inability to make payment. C, who is known to A, pays ₹ 60,000/- to B on behalf of A. However, A was not aware of the payment. Now B is intending to sue A for the amount of ₹ 100,000/-. Therefore, in the present instance, B can sue only for the balance amount i.e., ₹ 40,000/- and not for the whole amount.

5. Joint Promisors (Section 42)

When **two or more persons** have made a joint promise, then unless a contrary intention appears by the contract, **all such persons must jointly fulfil** the promise. If **any** of them **dies**, his **legal representatives** must, **jointly with the surviving** promisors, **fulfil** the promise. If **all** of them **die**, the **legal representatives of all** of them must fulfil the promise jointly.

Example 12:

'A', 'B' and 'C' jointly promised to pay ₹ 6,00,000 to 'D'. Here 'A', 'B' and 'C' must jointly perform the promise. If 'A' dies before performance, then his legal representatives must jointly with 'B' and 'C' perform the promise, and so on. And if all the three (i.e. 'A', 'B' and 'C') die before performance, then the legal representatives of all must jointly perform the promise.

❒ DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT

Distinction between two legal concepts, viz., succession and assignment may be noted carefully. When the **benefits** of a contract are **succeeded** to by **process of law**, then both **burden and benefits** attaching to the contract, may sometimes **devolve on the legal heir**. Suppose, a son succeeds to the estate of his father after his death, he will be liable to pay the debts and liabilities of his father owed during his life-time. But if the debts owed by his father exceed the value of the estate inherited by the son then he would not be called upon to pay the excess. In other words, the **liability** of the son will be **limited** to the extent of the **property inherited** by him.

In the matter of assignment, however the **benefit** of a contract can **only** be assigned but **not** the **liabilities** thereunder. This is because when **liability is assigned**, a **third party gets involved therein**. Thus, a **debtor cannot relieve** himself of his liability to creditor by **assigning to someone** else his obligation to repay the debt.

On the other hand, if a creditor assigns the benefit of a promise, he thereby entitles the assignee to realise the debt from the debtor but where the **benefit is coupled with a liability** or when a **personal consideration** has entered into the making of the contract then the **benefit cannot be assigned**.

❒ LIABILITY OF JOINT PROMISOR & PROMISEE

Devolution of Joint Liabilities (Section 42)

If two or more persons have made a joint promise, ordinarily **all** of them during their life time must **jointly fulfil** the promise. After **death of any one** of them, his **legal representative jointly with the**

survivor or survivors should do so. After the **death of the last** survivor the **legal representatives of all** the original co-promisors must **fulfil** the promise.

Example 13:

X, Y and Z who had jointly borrowed money must, during their life-time jointly repay the debt. Upon the death of X his representative, say, S along with Y and Z should jointly repay the debt and so on. If in an accident all the borrowers X, Y and Z dies then their legal representatives must fulfil the promise and repay the borrowed amount. This rule is applicable only if the contract reveals no contrary intention.

We have seen that **Section 42 deals with voluntary discharge of obligations by joint promisors.** But if they do not discharge their obligation on their own volition, what will happen? This is what Section 43 resolves.

Any one of Joint Promisors may be Compelled to Perform – Section 43

When two or more persons make a joint promise, the **promisee may**, in the **absence** of **express** agreement to the contrary, **compel any one or more** of such joint promisors to **perform the whole** of the promise.

Each Promisor May Compel Contribution

Each of two or more joint promisors may **compel** every other joint promisor to **contribute equally** with himself to the performance of the promise, **unless a contrary intention** appears from the contract.

In other words, if one of the joint promisors is made to perform the whole contract, he can call for a contribution from others.

Sharing of Loss by Default in Contribution

If any one of two or more joint promisors makes **default** in such contribution, the **remaining joint promisors** must bear the loss arising from such default in **equal shares**.

Explanation to Section 43

Nothing in this section shall prevent a surety from recovering, from his principal, payments made by the surety on behalf of the principal, or entitle the principal to recover anything from the surety on account of payment made by the principal.

Example 14:

A, B and C jointly promise to pay D ₹ 3,00,000. D may compel either A or B or C to pay him ₹ 3,00,000.

Example 15:

A, B and C are under a joint promise to pay D ₹ 3,00,000. C is unable to pay anything A is compelled to pay the whole. A is entitled to receive ₹ 1,50,000 from B.

Example 16:

X, Y and Z jointly promise to pay ₹ 6,000 to A. A may compel either X or Y or Z to pay the amount. If Z is compelled to pay the whole amount; X is insolvent but his assets are sufficient to pay one-half of his debts. Z is entitled to receive ₹ 1,000 from X's estate and ₹ 2,500 from Y.

We thus observe that the effect of Section 43 is to make the **liability** in the event of a joint contract, **both joint & several**, in so far as the promisee may, in the absence of a contract to the contrary, compel anyone or more of the joint promisors to perform the whole of the promise.

Effect of Release of One Joint Promisor- Section 44

The effect of release of one of the joint promisors is dealt with in Section 44 which is stated below:

Where **two or more persons** have made a **joint promise, a release of one** of such joint promisors by the promisee **does not discharge** the **other** joint promisor or joint promisors, **neither** does it **free the joint promisors so released** from **responsibility to the other** joint promisor or promisors.

Example 17:

'A', 'B' and 'C' jointly promised to pay ₹ 9,00,000 to 'D'. 'D' released 'A' from liability. In this case, the release of 'A' does not discharge 'B' and 'C' from their liability. They remain liable to pay the entire amount of ₹ 9,00,000 to 'D'. And though 'A' is not liable to pay to 'D', but he remains liable to pay to 'B' and 'C' i.e. he is liable to make the contribution to the other joint promisors.

Rights of Joint Promisees

The law relating to Devolution of joint rights is contained in Section 45 which is reproduced below:

"When a person has made a promise to two or more persons jointly, then **unless a contrary intention** appears from the contract, the right to **claim performance** rests, as between him and them, with them during their joint lives, and **after the death** of any of them, with the **representative** of such deceased person **jointly with the survivor** or survivors, and after the **death of the last** survivor, with the **representatives of all** jointly".

Example 18:

A, in consideration of ₹ 5,00,000 rupees lent to him by B and C, promises B and C jointly to repay them that sum with interest on a specified day but B dies. In such a case right to demand payment shall rest with B's legal representatives, jointly with C during C's life-time, and after the death of C, with the legal representatives of B and C jointly.

❒ TIME AND PLACE FOR PERFORMANCE OF THE PROMISE

The law on the subject is contained in Sections 46 to 50 explained below:

(i) **Time for performance of promise, where no application is to be made and no time is specified - Section 46**

Where, by the contract, a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a **reasonable time**.

Explanation to Section 46 - The expression reasonable time is to be interpreted having regard to the facts and circumstances of a particular case.

(ii) **Time and place for performance of promise, where time is specified and no application to be made – Section 47**

When a promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promise, the promisor may perform it at **any time** during the **usual hours of business**, on such day and the place where the promise **ought to be performed.**

Example 19:

If the delivery of goods is offered say after 8.30 pm, the promisee may refuse to accept delivery, for the usual business hours are over. Moreover, the delivery must be made at the usual place of business.

(iii) **Application for performance on certain day to be at proper time and place – Section 48**

When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it **without application** by the promisee, it is the **duty of the promisee to apply** for performance at a **proper place** and within the usual **hours of business**.

Explanation to Section 48 states that the question "what is a proper time and place" is, in each particular case, a question of fact.

(iv) **Place for the performance of promise, where no application to be made and no place fixed for performance - Section 49**

When a promise is to be performed without application by the promisee, and no place is fixed for the performance of it, it is the **duty of the promisor** to apply to the promisee **to appoint a reasonable place** for the performance of the promise, and to **perform it** at such a place.

Example 20:

A undertakes to deliver a thousand maunds of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

(v) **Performance in manner or at time prescribed or sanctioned by promisee - Section 50**

The performance of any promise may be **made in any such manner**, or at **any time** which the **promisee prescribes** or sanctions.

❒ PERFORMANCE OF RECIPROCAL PROMISE

The law on the subject is contained in Sections 51 to 58. The provisions thereof are summarized below:

(i) **Promisor not bound to perform, unless reciprocal promisee ready and willing to perform- Section 51**

When a contract consists of **reciprocal promises** to be **simultaneously performed**, **no** promisor **needs to perform** his promise **unless the promisee is ready and willing** to perform his reciprocal promise.

Example 21:

A and B contract that A shall deliver the goods to B to be paid for by B on delivery. A need not deliver the goods, unless B is ready and willing to pay for the goods on delivery.

(ii) **Order of performance of reciprocal promises- Section 52**

When the **order** of performance of the reciprocal promises is **expressly fixed** by the contract, they shall be **performed in that order**; and where the order is **not** expressly **fixed** by the contract, they shall be **performed** in that order which the **nature of the transaction requires**.

Example 22:

A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.

(iii) **Liability of party preventing event on which the contract is to take effect – Section 53**

When a contract contains reciprocal promises, and **one party** to the contract **prevents** the other from **performing** his promise, the contract becomes **voidable** at the option of the party **so prevented**; and he is entitled to **compensation from the other** party for any loss he may sustain in consequence of the non- performance of the contract.

Example 23:

A and B contract that B shall execute some work for A for a thousand rupees. B is ready and willing to execute the work accordingly, but A prevents him from doing so. The contract is voidable at the option of B; and if he elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.

Example 24:

In a contract for the sale of standing timber, the seller is to cut and cord it, whereupon buyer is to take it away and pay for it. The seller cords only a part of the timber and neglects to cord the rest. In that event the buyer may avoid the contract and claim compensation from the seller for any loss which he may have sustained for the non-performance of the contract.

(iv) **Effect of default as to that promise which should be first performed, in contract consisting of reciprocal promises (Section 54)**

Section 54 applies when the promises are **reciprocal and dependent**. If the **promisor** who has to **perform** his promise **before** the **performance** of the **other's promise fails** to perform it, he **cannot claim performance** of the other's promise, and is **also liable for compensation** for his non- performance.

Example 25:

A hires B's ship to take in and convey, from Kolkata to the Mauritius, a cargo to be provided by A, B receiving a certain freight for its conveyance. A does not provide any cargo for the ship. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non performance of the contract.

Example 26:

A hires B to make a shoe rack. A will supply the plywood, fevicol and other items required for making the shoe rack. B arrived on the appointed day and time but A could not arrange for the required materials. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non-performance of the contract.

(v) **Effects of Failure to Perform at a Time Fixed in a Contract in which Time is Essential (Section 55)**

The law on the subject is contained in Section 55 which is reproduced below:

"When a party to a contract **promises to do** certain thing **at or before the specified time,** and **fails** to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes **voidable** at the option of the promisee, if the **intention** of the parties was that time should be of **essence of the contract**".

Effect of such failure when time is not essential

If it was not the intention of the parties that time should be of essence of the contract, the contract **does not become voidable** by the failure to do such thing at or before the specified time; but the promisee is entitled to **compensation** from the promisor for any **loss occasioned** to him by such failure.

Effect of acceptance of performance at time other than agreed upon:

If, in case of a contract **voidable** on account of the **promisor's failure** to perform his promise at the time agreed, the **promisee accepts** performance of such promise **at any time other than agreed**, the promisee **cannot claim compensation** for any loss occasioned **by the non-performance** of the promise at the time agreed, **unless,** at the time of **acceptance**, he gives **notice** to the promisor of his **intention** to do so.

(vi) **Agreement to do Impossible Act (Section 56)**

The impossibility of performance may be of the two **types**, namely (a) **initial** impossibility, and (b) **subsequent** impossibility.

A. Initial Impossibility (Impossibility Existing at the Time of Contract)

When the parties agree upon doing of something which is obviously **impossible in itself** the agreement would be **void**. Impossible in itself means impossible in the nature of things. The **fact** of impossibility **may be** and may **not be known** to the parties.

Example 27:

'A', a Hindu, who was already married, contracted to marry 'B', a Hindu girl. According to law, 'A' being married, could not marry 'B'. In this case, 'A' must make compensation to 'B' for the loss caused to her by the non-performance of the contract.

1. If known to the parties

It would be observed that an **agreement constituted**, quite **unknown** to the parties, may be **impossible** of being performed and hence **void**.

Example 28:

B promises to pay a sum of ₹ 5,00,000 if he is able to swim across the Indian Ocean from Mumbai to Aden within a week. In this case, there is no real agreement, since both the parties are quite certain in their mind that the act is impossible of achievement. Therefore, the agreement, being impossible in itself, is void.

2. If unknown to the parties

Where **both** the promisor and the promisee are **ignorant** of the impossibility of performance, the contract is **void**.

Example 29:

A contracted B to sell his brown horse for ₹ 2,50,000 both unaware that the horse was dead a day before the agreement.

3. If known to the promisor only

Where at the time of entering into a contract, the **promisor alone knows** about the impossibility of performance, **or even** if he **does not know** though he should have **known** it with **reasonable diligence**, the promisee is entitled to **claim compensation** for any loss he suffered on account of non performance.

B. Subsequent or Supervening Impossibility (Becomes Impossible after Entering into Contract)

When performance of promise become **impossible or illegal** by occurrence of an **unexpected event** or a change of **circumstances** beyond the contemplation of parties, the contract becomes **void** e.g. change in law etc. In other words, sometimes, the **performance** of a contract is **quite possible** when it is **made. But subsequently**, some event **happens** which renders the performance **impossible or unlawful**. **Such impossibility is called the subsequent or supervening. It is also called the post-contractual impossibility.** The effect of such impossibility is that it makes the contract **void**, and the **parties are discharged** from further performance of the contract.

Example 30:

'A' and 'B' contracted to marry each other. Before the time fixed for the marriage, 'A' became mad. In this case, the contract becomes void due to subsequent impossibility, and thus discharged

(viii) **Reciprocal promise to do certain things that are legal, and also some other things that are illegal- Section 57**

Where persons reciprocally promise, first to do certain things which are legal and secondly, under specified circumstances, to do certain other things which are illegal, the **first set** of promises is a **valid** contract, but the **second** is a **void** agreement.

Example 31:

A and B agree that A will sell a house to B for ₹ 50,00,000 and also that if B uses it as a gambling house, he will pay a further sum of ₹ 75,00,000. The first set of reciprocal promises, i.e. to sell the house and to pay ₹ 50,00,000 for it, constitutes a valid contract. But the object of the second, being unlawful, is void.

(viii) **'Alternative promise' one branch being illegal- Section 58**

The law on this point is contained in Section 58 which says that "In the case of the alternative promise, one branch of which is legal and the other illegal, the **legal** branch alone can be **enforced**".

Example 32:

A and B agree that A shall pay B ₹ 1,00,000, for which B shall afterwards deliver to A either rice or smuggled opium. This is a valid contract to deliver rice, and a void agreement as to the opium.

❒ APPROPRIATION OF PAYMENTS

Sometimes, a **debtor owes several debts to the same creditor** and makes **payment**, which is **not sufficient** to discharge all the debts. In such cases, the payment is appropriated (i.e. adjusted against the debts) as per Section 59 to 61 of the Indian Contract Act.

I. Application of Payment where Debt to be Discharged is Indicated (Section 59)

Where a debtor, owing several distinct debts to one person, makes a payment to him **either with express intimation or** under **circumstances implying** that the payment is to be **applied to** the discharge of **some particular debt**, the payment, if accepted, must be **applied accordingly.**

II. Application of Payment where Debt to be Discharged is not Indicated (Section 60)

Where the debtor has **omitted** to intimate **and** there are **no other circumstances** indicating to which debt the payment is to be applied the creditor may apply it at his **discretion** to any **lawful debt** actually due and payable to him from the debtor, where its **recovery is or is not barred by the law** in force for the time being as to the limitation of suits. However, he **cannot apply** the payment to the **disputed** debt.

III. Application of Payment where Neither Party Appropriates (Section 61)

Where **neither party** makes any appropriation, the payment shall be applied in discharge of the debts **in order of time**, whether they **are or are not barred by the law** in force for the time being as to the limitation of suits. If the debts are of **equal standing**, the payments shall be applied in discharge of each **proportionately**.

❒ CONTRACTS, WHICH NEED NOT BE PERFORMED – WITH THE CONSENT OF BOTH THE PARTIES

Under this heading, we shall discuss the principles of Novation, Rescission and Alteration. The law is contained in Sections 62 to 67 of the Contract Act.

I. Effect of Novation, Rescission, and Alteration of Contract (Section 62)

"If the parties to a contract agree to **substitute a new contract** for it, or to **rescind** or **alter** it, the **original** contract **need not be performed**".

Analysis of Section 62

(a) Effect of novation

The parties to a contract may **substitute a new** contract **for the old**. If they do so, it will be a case of novation. On novation, the **old** contract **is discharged** and consequently it **need not be performed**. Thus, it is a case where there being a contract in existence some **new** contract **is substituted for it either** between the **same** parties **or** between **different parties** the consideration mutually being the discharge of old contract. Novation can take place only by **mutual agreement** between the parties.

Example 33:

A owes B ₹ 100,000. A, B and C agree that C will pay B and he will accept ₹ 100,000 from C in lieu of the sum due from A. A's liability thereby shall come to an end, and the old contract between A and B will be substituted by the new contract between B and C.

(b) Effect of rescission

A contract is also discharged by rescission. When the parties to a contract agree to **rescind** it, the contract need **not be performed**. In the case of rescission, **only** the **old** contract is **cancelled** and **no new** contract **comes to exist** in its place. It is needless to point out that novation also involves rescission. Both in novation and in rescission, the contract is **discharged by mutual agreement**.

(c) Effect of alteration of contract

As in the case of novation and rescission, so also in a case where the parties to a contract **agree to alter it**, the original contract is **rescinded**, with the result that it need **not be performed**. In other words, a contract is also discharged by alteration. The **terms** of contract may be **so altered** by mutual agreement that the alteration may have the **effect of substituting** a **new contract** for the **old one**. In other words, the **distinction** between novation and alteration is **very slender**.

Novation and Alteration

The law pertaining to novation and alteration is contained in Sections 62 to 67 of the Indian Contract Act. In both these cases the original contract need not be performed. Still there is a difference between these two.

1. Novation means **substitution** of an **existing** contract with a **new one**. Novation may be made by **changing** in the **terms** of the contract or there may be a **change** in the **contracting parties**. But in case of **alteration** the **terms** of the contract may be **altered** by **mutual agreement** by the **contracting parties** but the **parties** to the contract will remain the **same**.
2. In case of **novation** there is altogether a **substitution of new** contract **in place** of the **old** contract. But in case of **alteration** it is **not essential to substitute** a new contract in place of the **old** contract. In **alteration**, there may be a **change in some** of the terms and conditions of the original agreement.

II. Promisee may Waive or Remit Performance of Promise (Section 63)

"Every promisee may **dispense** with or **remit**, **wholly or in part**, the **performance** of the promise made to him, **or may extend** the **time** for such performance or may **accept** instead of it **any satisfaction** which he thinks fit". In other words, a contract may be **discharged by remission**.

Example 34:

A owes B ₹ 5,00,000. A pays to B, and B accepts, in satisfaction of the whole debt, ₹ 2,00,000 paid at the time and place at which the ₹ 5,00,000 were payable. The whole debt is discharged.

III. Restoration of Benefit under a Voidable Contract (Section 64)

The law on the subject is "When a person at whose option a contract is **voidable rescinds it**, the **other** party thereto **need not perform** any promise therein contained in **which he is the promisor**. The **party rescinding** avoidable contract shall, if he has **received any benefit** thereunder from

another party to such contract, **restore such benefit**, so far as may be, to the person from whom it was received".

Example 35:

An insurance company may rescind a policy on the ground that material fact has not been disclosed. When it does so, the premium collected by it in respect of the policy reduced by the amount of expenses incurred by it in this connection must be repaid to the policy holder.

(iv) Obligations of Person who has Received Advantage under Void Agreement or Contract that Becomes void (Section 65)

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

Example 36:

A pays B ₹ 1,00,000, in consideration of B's promising to marry C, A's daughter. C is dead at the time of the promise. The agreement is void, but B must repay A ₹ 1,00,000.

Case Law: In a case, the plaintiff hired a godown from the defendant for twelve months and paid the whole of the rent in advance. After about seven months the godown was destroyed by fire, without any fault or negligence on the part of the plaintiff and the plaintiff claimed a refund of a proportionate amount of the rent. Held, the plaintiff was entitled to recover the rent for the unexpired term, of the contract.

The Act requires that a party must give back whatever he has received under the contract. The benefit to be restored under this section must be benefit received under the contract (and not any other amount). A agrees to sell land to B for ₹ 400,000. B pays to A ₹ 40,000 as a deposit at the time of the contract, the amount to be forfeited by A if B does not complete the sale within a specified period. B fails to complete the sale within the specified period, nor is he ready and willing to complete the sale within a reasonable time after the expiry of that period. A is entitled to rescind the contract and to retain the deposit. The deposit is not a benefit received under the contract, it is a security that the purchaser would fulfil his contract and is ancillary to the contract for the sale of the land.

V. Communication of Rescission (Section 66)

You have noticed that a contract **voidable** at the option of one of the parties can be **rescinded**; but **rescission** must be **communicated** to the other party in the **same manner** as a proposal is **communicated** under Section 4 of the Contract Act. Similarly, a rescission may be **revoked** in the **same manner** as a **proposal** is revoked.

VI. Effects of Neglect of Promisee to Afford Promisor Reasonable Facilities for Performance (Section 67)

If any **promisee neglects or refuses** to **afford** the promisor **reasonable facilities** for the performance of his promise, the promisor is **excused** by such neglect or refusal as to any **non-performance** caused thereby.

Example 37:

If an apprentice refuses to learn, the teacher cannot be held liable for not teaching.

Example 38:

A contracts with B to repair B's house. B neglects or refuses to appoint out to A the places in which his house requires repair. A is excused for the non performance of the contract, if it is caused by such neglect or refusal.

❒ DISCHARGE OF A CONTRACT

A contract is discharged when the obligations created by it come to an end. A contract may be discharged in any one of the following ways:

I. Discharge by Performance

It takes place when the parties to the contract **fulfil their obligations** arising under the contract within the **time and in the manner** prescribed. Discharge by performance may be

1. **Actual** performance; or
2. **Attempted performance**.

Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement. When the promisor offers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance or tender.

Example 39:

A contracts to sell his car to B on the agreed price. As soon as the car is delivered to B and B pays the agreed price for it, the contract comes to an end by performance.

Example 40:

A contracted to supply certain quantity of timber to B. B made the supply of timber at appointed time and place but A refused to accept the delivery. This is called as attempted performance.

II. Discharge by Mutual Agreement

Section 62 of the Indian Contract Act provides if the parties to a contract **agree to substitute a new** contract for it, or to **rescind or remit** or **alter it**, the original contract need not be performed. The principles of Novation, Rescission, Alteration and Remission are already discussed.

Example 41:

A owes B ₹ 1,00,000. A enters into an agreement with B and mortgage his (A's), estates for ₹ 50,000 in place of the debt of ₹ 1,00,000. This is a new contract and extinguishes the old.

Example 42:

A owes B ₹ 5,00,000. A pays to B ₹ 3,00,000 who accepts it in full satisfaction of the debt. The whole is discharged.

III. Discharge by Impossibility of Performance

The impossibility may **exist from the very start**. In that case, it would be **impossibility ab initio**. Alternatively, it may **supervene**. Supervening impossibility may take place owing to:

(a) An **unforeseen change in law**;

(b) The destruction of the **subject-matter essential** to that performance;

(c) The **non-existence or non-occurrence** of particular state of things, which was **naturally contemplated for performing** the contract, as a result of some personal incapacity like dangerous malady;

(d) The **declaration of a war** (Section 56).

Example 43:

A agrees with B to discover a treasure by magic. The agreement is void due to initial impossibility.

Example 44:

A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.

Example 45:

A contracts to act at a theatre for six months in consideration of a sum paid in advance by B. On several occasions A is too ill to act. The contract to act on those occasions becomes void.

Example 46:

X agrees to sell his horse to Y for ₹ 5,000 but the horse died in an accident. Here, it become impossible to perform the contract due to destruction of the subject. Thus, a valid contract changes into void contract because of impossibility of performance.

IV. Discharge by Lapse of Time

A contract should be **performed** within a **specified period** as prescribed by the Limitation Act, 1963. If it is **not performed** and if **no action is taken** by the promisee within the specified period of limitation, he is **deprived of remedy** at law.

Example 47:

If a creditor does not file a suit against the buyer for recovery of the price within three years, the debt becomes time-barred and hence irrecoverable.

V. Discharge by Operation of Law

A contract may be **discharged by operation** of law which includes by **death** of the promisor, by **insolvency** etc.

VI. Discharge by Breach of Contract

Breach of contract may be **actual** breach of contract or **anticipatory** breach of contract. If one party defaults in performing his part of the contract on the due date, he is said to have committed breach thereof. When on the other hand, a person repudiates a contract before the stipulated time for its performance has arrived, he is deemed to have committed anticipatory breach. If one of the parties to a contract breaks the promise the party injured thereby, has not only a right of action for damages but he is also discharged from performing his part of the contract.

Example 48:

A contracted with B to supply 100 kgs of rice on 1st June. But A failed to deliver the same on said date. This is actual breach of contract. If time is not essential essence of contract B can give him another date for supply of goods and he will not be liable to claim for any damages if prior notice for the same is not given to A while giving another date.

VII. Promisee may Waive or Remit Performance of Promise

Every promisee may **dispense** with or **remit**, **wholly or in part**, the **performance** of the promise made to him, **or may extend** the time for such performance **or may accept** instead of it **any satisfaction** which he thinks fit. In other words, a contract may be discharged by remission. (Section 63)

Example 49:

A owes B ₹ 5,00,000. C pays to B ₹ 1,00,000 and B accepts them, in satisfaction of his claim on A. This payment is a discharge of the whole claim.

VIII. Effects of Neglect of Promisee to Afford Promisor Reasonable Facilities for Performance

If any **promisee neglects or refuses to afford** the promisor **reasonable facilities** for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby. (Section 67)

IX. Merger of Rights

Sometimes, the **inferior** rights **and the superior rights coincide** and meet in one and the same person. In **such cases, the inferior** rights **merge into the superior** rights. On **merger**, the **inferior** rights **vanish** and are not required to be enforced.

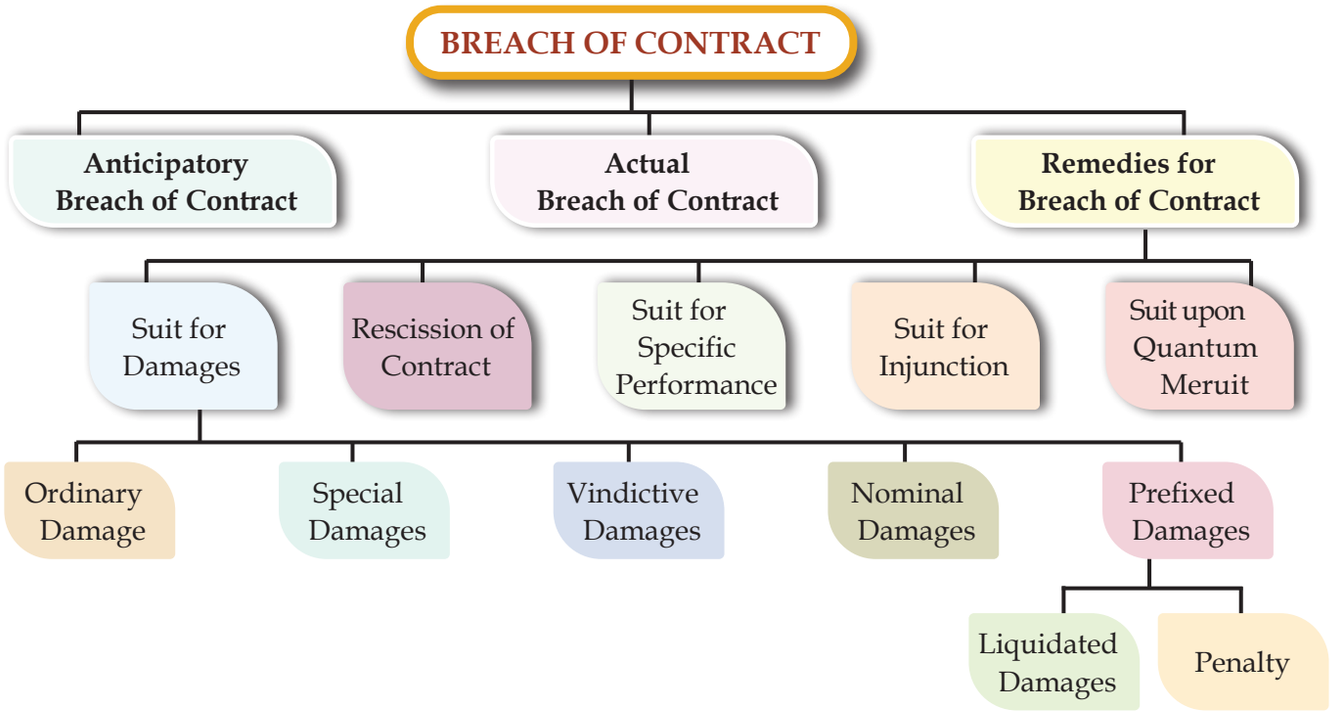
Example 50:

A took a land on lease from B. Subsequently, A purchases that very land. Now, A becomes the owner of the land and the ownership rights being superior to rights of a lessee, the earlier contract of lease stands terminated.

UNIT 05 BREACH OF CONTRACT AND ITS REMEDIES

TABLE OF THE CONTENTS FOR THE CHAPTER

- ANTICIPATORY BREACH OF CONTRACT 85
- ACTUAL BREACH OF CONTRACT 86
- SUIT FOR DAMAGES 87
- PENALTY AND LIQUIDATED DAMAGES (SECTION 74) 89



- Breach means **failure of a party to perform** his or her **obligation** under a contract. Breach of contract may arise in two ways:
  (1) **Actual breach** of contract
  (2) **Anticipatory** breach of contract

ANTICIPATORY BREACH OF CONTRACT

- An anticipatory breach of contract is a breach of contract **occurring before** the **time** fixed for performance has **arrived**. When the promisor **refuses altogether** to perform his promise **and** signifies his **unwillingness** even **before** the **time** for performance has arrived, it is **called** Anticipatory Breach.
- Anticipatory breach of a contract may take either of the following **two ways**:
  (a) Expressly by words **spoken or written**, and
  (b) Impliedly by the **conduct** of one of the parties.

Example 1:

Where A contracts with B on 15th July, 2022 to supply 10 bales of cotton for a specified sum on 14th August, 2022 and on 30th July informs B, that he will not be able to supply the said cotton on 14th August, 2022, there is an express rejection of the contract.

Example 2:

Where A agrees to sell his white horse to B for ₹ 50,000/- on 10th of August, 2022, but he sells this horse to C on 1st of August, 2022, the anticipatory breach has occurred by the conduct of the promisor.

Section 39 of the Indian Contract Act deals with anticipatory breach of contract and provides as follows:

"When a party to a contract has refused to perform or disable himself from performing, his promise in its entirety, the promisee may put an **end to the contract, unless** he has **signified**, but words or conduct, his acquiescence in its continuance."

Effect of Anticipatory Breach

The **promisee is excused** from performance or from further performance. Further he gets an **option**:

1. To either **treat** the contract as "**rescinded and sue** the other party for damages from breach of contract **immediately without waiting** until the due date of performance;

OR

2. He may **elect not to rescind** but to **treat** the contract as still **operative** and **wait** for the time of performance and then hold the other party responsible for the consequences of non-performance. But in **this case,** he will keep the **contract alive for the benefit of the other** party as well as his own, and the **guilty** party, if he so decides on re-consideration, may **still perform** his part of the contract and can **also take advantage** of any **supervening impossibility** which may have the effect of discharging the contract.

❒ ACTUAL BREACH OF CONTRACT

- In contrast to anticipatory breach, it is a case of **refusal to perform** the promise **on** the **scheduled date.** The parties to a lawful contract are **bound to perform** their respective promises. But when **one of the parties breaks** the contract **by refusing** to perform his promise, he is said to have **committed** a breach. In that case, the other party to the contract obtains a right of action against the one who has refused to perform his promise.
- Actual breach of contract may be committed-

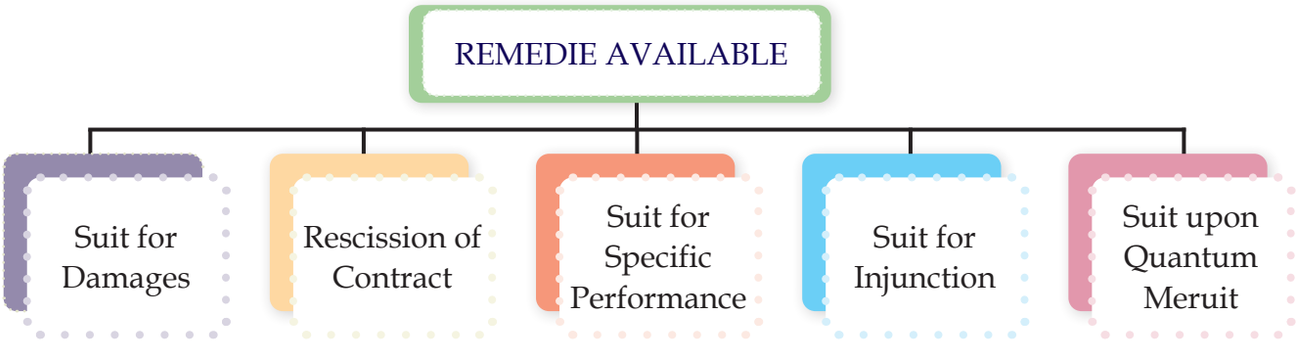
  (A) **At the time when the performance of the contract is due.**

Example 3:

A agrees to deliver 100 bags of sugar to B on 1st February 2022. On the said day, he failed to supply 100 bags of sugar to B. This is actual breach of contract. The breach has been committed by A at the time when the performance becomes due.

(B) **During the performance of the contract:** Actual breach of contract also occurs when during the performance of the contract, **one party fails** or **refuses** to perform his obligation under it by express or implied act.

Remedies for Breach of Contract



❒ SUIT FOR DAMAGES

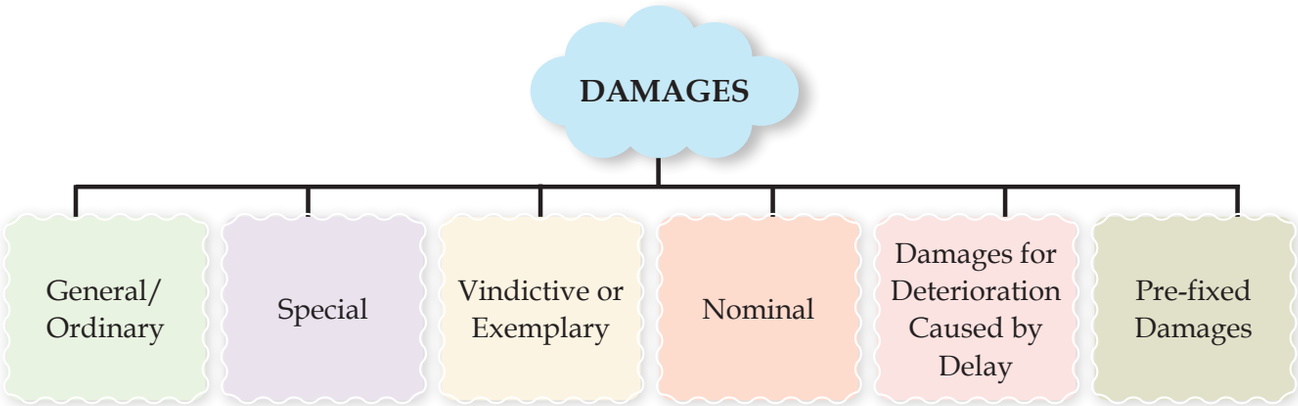
The Act in Section 73, has laid down the rules as to how the amount of compensation is to be determined. On the breach of the contract, the **party who suffers** from such a breach is entitled to **receive**, from the party who has broken the contract, **compensation** for any **loss or damage** caused to him by breach.

Compensation can be claimed **for** any loss or damage which **naturally arises** in the **usual course** of events.

A compensation can also be claimed for any loss or damage which the **party knew** when they entered into the contract, as **likely to result** from the breach.

That is to say, **special** damage can be claimed **only** on a **previous notice**. But the **party suffering** from the breach is bound to **take reasonable steps** to minimise the loss.

No compensation is payable for any **remote or indirect loss.**



I. Ordinary Damages

When a **contract** has been **broken**, the party who **suffers** by such breach is **entitled** to receive, from the party who has broken the contract, **compensation** for any loss or damage cause to him thereby, which **naturally arose** in the usual course of things from such breach, **or** which the **parties know**, when they made the contract, to be likely two to result from the breach of it.

Such compensation is **not to be given** for any **remote and indirect** loss or damage sustained by reasons of the breach. (Section 73 of the Contract Act and the rule in Hadley vs. Baxendale).

Case Law: HADLEY Vs. BAXENDALE

Facts: The crankshaft of P's flour mill had broken. He gives it to D, a common carrier who promised to deliver it to the foundry in 2 days where the new shaft was to be made. The mill stopped working, D delayed the delivery of the crankshaft so the mill remained idle for another 5 days. P received the repaired crankshaft 7 days later than he would have otherwise received. Consequently, P sued D for damages not only for the delay in the delivering the broken part but also for loss of profits suffered by the mill for not having been worked. The count held that P was entitled only to **ordinary damages** and D was not liable for the loss of profits because the only information given by P to D was that the article to be carried was the broken shaft of a mill and it was not made known to them that the delay would result in loss of profits.

Example 4:

A agrees to sell to B bags of rice ₹ 5,000 per bag, delivery to be given after two months. On the date of delivery, the price of rice goes up to ₹ 5,500 per bag. A refuse to deliver the bags to B. B can claim from A ₹ 500 as ordinary damages arising directly from the breach.

II. Special Damages

Where a **party** to a contract **receives a notice of special circumstances affecting** the **contract**, he will be **liable** not only for **damages arising naturally** and directly from the breach but **also for special damages**.

Example 5:

'A' delivered a machine to 'B', a common carrier, to be conveyed to 'A's mill without delay. 'A' also informed 'B' that his mill was stopped for want of the machine. 'B' unreasonably delayed the delivery of the machine, and in consequence 'A' lost a profitable contract with the Government. In this case, 'A' is entitled to receive from 'B', by way of compensation, the average amount of profit, which would have been made by running the mill during the period of delay. But he cannot recover the loss sustained due to the loss of the Government contract, as 'A's contract with the Government was not brought to the notice of 'B'.

III. Vindictive or Exemplary Damages

These damages may be **awarded only in two cases:**

(a) For **breach of promise to marry** because it causes **injury** to his or her **feelings**; and

(b) For wrongful dishonour by a banker of his customer's cheque because in this case the injury due to **wrongful dishonour to the drawer** of cheque is so heavy that it causes loss of credit and reputation to him. A business man whose **credit has suffered** will get exemplary damages even if he has **sustained no pecuniary loss**. But a **non-trader cannot** get heavy damages in the like circumstances, **unless** the damages are alleged and **proved** as special damages. (Gibbons v West Minister Bank)

IV. Nominal Damages

Nominal damages are **awarded** where the **plaintiff has proved** that there has been a **breach** of contract but he **has not in fact suffered any real damage**. It is awarded just to **establish the right to decree** for the breach of contract. The **amount** may be a **rupee or even 10 paise.**

V. Damages for Deterioration Caused By Delay

In the case of deterioration caused to goods by delay, damages can be **recovered from carrier even without notice.** The word 'deterioration' **not only** implies **physical damages** to the goods **but** it may **also** mean loss of **special opportunity for sale.**

VI. Pre-Fixed Damages

Sometimes, parties to a contract **stipulate** at the **time** of its **formation** that on a breach of contract by any of them, a **certain amount** will be payable as damage. It may amount to **either liquidated** damages (i.e., a reasonable estimate of the likely loss in case of breach) **or a penalty** (i.e., an amount arbitrarily fixed as the damages payable). Section 74 provides that if a sum is named in a contract as the amount to be paid in case of a breach, the **aggrieved party** is entitled to receive from the **party at fault** a **reasonable compensation not exceeding** the **amount** so named (Section 74).

Example 6:

If the penalty provided by the contract is ₹ 1,00,000 and the actual loss because of breach is ₹ 70,000, only ₹ 70,000 shall be available as damages, i.e., the amount of actual loss and not the amount stipulated. But if the loss is, say, ₹ 1,50,000, then only, ₹ 1,00,000 shall be recoverable.

Example 7:

X promised Y, a priest, to pay ₹ 10,000 as charity. The priest on X's promise incurred certain liabilities towards the repairing of the temple to the extent of Rs. 7,500. Y, the priest, can recover from X ₹ 7,500.

❒ PENALTY AND LIQUIDATED DAMAGES (SECTION 74)

- The parties to a contract may **provide** before hand, the amount of **compensation** payable in case of failure to perform the contract. In such cases, the question arises whether the courts will accept this figure as the measure of damage.
- **English Law:** According to English law, the sum so fixed in the contract may be interpreted either as **liquidated damages or as a penalty.**
- If the sum fixed in the contract represents a **genuine pre-estimate** by the parties of the loss, which would be caused by a future breach of the contract it is liquidated damages. It is an assessment of the amount which in the **opinion of the parties will compensate** for the breach. Such a clause is effective and the amount is recoverable. But where the sum fixed in the contract is **unreasonable and is used to force** the other party to **perform** the contract; it is penalty. Such a clause of **disregarded** and the injured party **cannot recover more than the actual loss.**
- **Indian Law:** Indian law makes no distinction between 'penalty 'and liquidated damages'. The Courts in India award only a reasonable compensation not exceeding the sum so mentioned in the contract. Section 74 of the Contract Act lays down if the parties have fixed what the

damages will be, the courts will never allow more. But the court may allow less. A decree is to be passed only for **reasonable compensation not exceeding** the sum named by the parties. Thus, Section 74 entitles a person complaining of breach of contract to get reasonable compensation and does not entitle him to realise anything by way of penalty.

- **Exception:** Where any person gives any **bond to the Central or State government** for the **performance** of any **public duty** or act in which the public are **interested**, on breach of the condition of any such instrument, he shall be **liable to pay the whole sum mentioned** therein.

Example 8:

A contracts with B, that if A practices as a surgeon in Kolkata, he will pay B ₹ 50,000. A practice as a surgeon at Kolkata, B is entitled to such compensation not exceeding ₹ 50,000 as the court considers reasonable.

Example 9:

A borrows ₹ 10,000 from B and gives him a bond for ₹ 20,000 payable by five yearly instalments of ₹ 4,000 with a stipulation that in default of payment, the whole shall become due. This is a stipulation by way of penalty.

Example 10:

A undertakes to repay B, a loan of ₹ 10,000 by five equal monthly instalments with a stipulation that in default of payment of any instalment, the whole shall become due. This stipulation is not by way of penalty and the contract may be enforced according to its terms.

Distinction Between Liquidated Damages and Penalty

Penalty and liquidated damages have one thing in **common** that both are **payable on the occurrence of a breach** of contract. It is very **difficult to draw a clear line of distinction** between the two but certain principles as laid down below may be helpful.

1. If the sum payable is **so large** as to be far in **excess** of the **probable damage** on breach, it is certainly a **penalty**.
2. Where a sum is expressed to be **payable on a certain date** and a **further sum** in the event of **default** being made, the **latter** sum is a **penalty** because mere delay in payment is unlikely to cause damage.
3. The **expression** used by the parties is **not final**. The **court** must find out whether the **sum fixed** in the contract is in truth a **penalty or liquidated damages**. If the sum fixed is **extravagant or exorbitant**, the court will regard it is as a **penalty even if,** it is **termed** as **liquidated** damages in the contract.
4. The **essence** of a penalty is payment of money stipulated as a **terrorem** of the offending party. The essence of liquidated damages is a **genuine pre-estimate of the damage.**
5. **English law** makes a **distinction** between liquidated damages and penalty, but **no such** distinction is followed in **India**. The **courts** in India must **ascertain the actual loss** and **award** the same which amount must **not**, however, **exceed** the **sum so fixed** in the **contract**. The courts have not to bother about the distinction but to award **reasonable compensation** not exceeding the sum so fixed.

Besides Claiming Damages as a Remedy for the Breach of Contract, the Following Remedies are also Available

(i) Rescission of contract

When a contract is **broken by one party**, the **other party** may treat the contract as **rescinded**. In such a case, he is **absolved of all his obligations** under the contract and is entitled to **compensation** for any damages that he might have suffered.

Example 11:

A promises B to deliver 50 bags of cement on a certain day. B agrees to pay the amount on receipt of the goods. A failed to deliver the cement on the appointed day. B is discharged from his liability to pay the price.

(ii) Quantum meruit

Where one person has rendered service to another in circumstances which indicate an understanding between them that it is to be paid for although no particular remuneration has been fixed, the law will infer a promise to pay. Quantum Meruit i.e. as much as the party doing the service has deserved. It covers a case where the party injured by the breach had at time of breach done part but not all of the work which he is bound to do under the contract and seeks to be compensated for the value of the work done. For the application of this doctrine, two conditions must be fulfilled:

1. It is only available if the **original contract has been discharged.**
2. The **claim** must be **brought by a party not in default.**

The object of allowing a claim on quantum meruit is to **recompensate** the party or person **for value of work** which he has **done**. **Damages** are **compensatory** in nature while **quantum merit is statutory**. It is but **reasonable compensation awarded** on implication of a contract to remunerate. Where a person orders only 12 bottles of a whiskey from a wine merchant but also receives 2 bottles of brandy, and the purchaser accepts them, the purchaser must pay a reasonable price for the brandy.

The claim for quantum meruit arises in the following cases

(a) When an **agreement** is discovered **to be void** or when a contract **becomes void.**

(b) When something is **done without any intention** to do so **gratuitously**.

(c) Where there is an **express or implied contract** to render **services** but there is **no agreement as to remuneration.**

(d) When one party **abandons or refuses** to perform the contract.

(e) Where a contract is **divisible** and the party **not in default has enjoyed the benefit of part performance**.

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

Example 12:

X wrongfully revoked Y's (his agent) authority before Y could complete his duties. Held, Y could recover, as a quantum meruit, for the work he had done and the expenses he had incurred in the course of his duties as an agent.

Example 13:

A agrees to deliver 100 bales of cottons to B at a price of ₹ 1000 per bale. The cotton bales were to be delivered in two instalments of 50 each. A delivered the first instalment but failed to supply the second. B must pay for 50 bags.

(iii) Suit for specific performance

Where **damages** are **not an adequate remedy** in the case of breach of contract, the court may in its **discretion** on a suit for specific performance **direct party in breach**, to carry out his **promise** according to the **terms** of the contract.

(iv) Suit for injunction

Where a party to a contract is **negating the terms** of a contract, the **court may** by issuing an **'injunction orders', restrain** him from doing what he **promised not to do.**

Example 14:

N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer. Held, she could be restrained by an injunction.

Example 15:

A, a singer, agreed with B to perform at his theatre for two months, on a condition that during that period, he would not perform anywhere. In this case, B could move to the Court for grant of injunction restraining A from performing in other places.

Party rightfully rescinding contract, entitled to compensation (Section 75)

A person who **rightfully rescinds** a contract is entitled to **compensation** for any damage which he has **sustained** through **non-fulfilment** of the contract.

Example 16:

A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹ 10000 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non fulfilment of the contract.

UNIT 06 CONTINGENT AND QUASI CONTRACTS

TABLE OF THE CONTENTS FOR THE CHAPTER

- CONTINGENT CONTRACTS 93
- RULES RELATING TO ENFORCEMENT 94
- QUASI CONTRACTS 96

CONTINGENT CONTRACTS

- A contract may be **absolute** or a **contingent**. An **Absolute** contract is one where the **promisor undertakes** to **perform** the contract in any **event without any condition**.

Definition of 'Contingent Contract' (Section 31)

"A contract to do or not to do something, if some event, collateral to such contract, does or does not happen".

Contracts of **Insurance**, **indemnity** and **guarantee** fall under this category.

Example 1:

A contracts to pay B ₹ 10,00,000 if B's house is burnt. This is a contingent contract.

Example 2:

A makes a contract with B to buy his house for ₹ 50,00,000 if he is able to secure to bank loan for that amount. The contract is contingent contract.

Meaning of collateral Event: Pollock and Mulla defined collateral event as "an event which is **neither a performance directly promised** as part of the contract, **nor** the whole of the **consideration** for a promise".

Example 3:

A contracts to pay B ₹ 10,00,000 if B's house is burnt. This is a contingent contract. Here the burning of the B's house is neither a performance promised as part of the contract nor it is the consideration obtained from B. The liability of A arises only on the happening of the collateral event

Example 4:

A agrees to transfer his property to B if her wife C dies. This is a contingent contract because the property can be transferred only when C dies.

Essentials of a Contingent Contract

(a) The **performance** of a contingent contract would **depend** upon the **happening or non-happening** of some event or condition. The condition may be precedent or subsequent.

Example 5:

'A' promises to pay ₹ 50,000 to 'B' if it rains on first of the next month.

(b) **The event referred to as collateral to the contract.** The event is **not part** of the contract. The event should be **neither performance** promised **nor a consideration** for a promise.

Thus (i) where A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards, the contract is a conditional contract and not contingent; because the event on which B's obligation is made to depend is part of the promise itself and not a collateral event. (ii) Similarly, where A promises to pay B ₹ 1,00,000 if he marries C, it is not a contingent contract. (iii) 'A' agreed to construct a swimming pool for 'B' for ₹ 20,00,000. And 'B' agreed to make the payment only on the completion of the swimming pool. It is not a contingent contract as the event (i.e. construction of the swimming pool) is directly connected with the contract.

(c) **The contingent event should not be a mere 'will' of the promisor.** The **event** should be **contingent** in addition to being the will of the promisor.

Example 6:

If A promises to pay B ₹ 100,000, if he so chooses, it is not a contingent contract. (In fact, it is not a contract at all). However, where the event is within the promisor's will but not merely his will, it may be contingent contract.

Example 7:

If A promises to pay B ₹ 100,000 if it rains on 1st April and A leave Delhi for Mumbai on a particular day, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but raining is not merely his will.

(d) The event must be **uncertain**. Where the event is **certain or bound** to happen, the contract is due to be performed, then it is a **not contingent** contract.

Example 8:

'A' agreed to sell his agricultural land to 'B' after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfilment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.

❒ RULES RELATING TO ENFORCEMENT

- The rules relating to enforcement of a contingent contract are laid down in sections 32, 33, 34, 35 and 36 of the Act.

(a) **Enforcement of contracts contingent on an event happening:**

Section 32 says that "where a contingent contract is made to do or not to do anything if an **uncertain future event happens,** it **cannot** be **enforced** by law **unless** and until that event has **happened**. If the event becomes **impossible**, such contracts become **void**".

Example 9:

A contracts to pay B a sum of money when B marries C. C dies without being married to B. The Contract becomes void.

(b) **Enforcement of contracts contingent on an event not happening:** Section 33 says that "Where a contingent contract is made to do or not do anything if an uncertain future event **does not happen,** it can be **enforced** only when the happening of that event becomes **impossible and not before**".

Example 10:

Where 'P' agrees to pay 'Q' a sum of money if a particular ship does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.

Where A agrees to pay sum of money to B if certain ship does not return however the ship returns back. Here the contract becomes void.

(c) **A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does something to make the 'event' or 'conduct' as impossible of happening.**

Section 34 says that "if a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to have become impossible when such person does anything which renders it impossible that he should so act within any definite time or otherwise than under further contingencies".

Example 11:

Where 'A' agrees to pay 'B' a sum of money if 'B' marries 'C'. 'C' marries 'D'. This act of 'C' has rendered the event of 'B' marrying 'C' as impossible; it is though possible if there is divorce between 'C' and 'D'.

In Frost V. Knight, the defendant promised to marry the plaintiff on the death of his father. While the father was still alive, he married another woman. It was held that it had become impossible that he should marry the plaintiff and she was entitled to sue him for the breach of the contract.

(d) **Contingent on happening of specified event within the fixed time:** Section 35 says that Contingent contracts to do or not to do anything, if a specified uncertain event **happens within a fixed time**, becomes void if, at the **expiration** of time fixed, such event has **not happened,** or if, before the time fixed, such event becomes **impossible**.

Example 12:

A promises to pay B a sum of money if certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

(e) **Contingent on specified event not happening within fixed time:** Section 35 also says that - "Contingent contracts to do or not to do anything, if a specified uncertain event **does not**

happen within **a fixed time**, may be **enforced** by law when the time fixed has **expired**, and such event has **not happened** or before the time fixed has expired, if it becomes **certain** that such event **will not happen**".

Example 13:

A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

(f) **Contingent on an impossible event (Section 36):** Contingent agreements to do or not to do anything, if an impossible event happens are **void**, whether the impossibility of the event is **known or not** to the parties to the agreement at the time when it is made.

Example 14:

'A' agrees to pay 'B' ₹ one lakh if sun rises in the west next morning. This is an impossible event and hence void

Example 15:

X agrees to pay Y ₹ 1,00,000 if two straight lines should enclose a space. The agreement is void.

Difference between a Contingent Contract and a Wagering Contract

Basis of Difference	Contingent Contract	Wagering Contract
Meaning	A contingent contract is a contract to do or not to do something with reference to a collateral event happening or not happening.	A wagering agreement is a promise to give money or money's worth with reference to an uncertain event happening or not happening.
Reciprocal promises	Contingent contract may not contain reciprocal promises.	A wagering agreement consists of reciprocal promises.
Uncertain event	In a contingent contract, the event is collateral.	In a wagering contract, the uncertain event is the core factor.
Nature of contract	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.
Interest of contracting parties	Contracting parties have interest in the subject matter in contingent contract.	The contracting parties have no interest in the subject matter.
Doctrine of mutuality of lose and gain	Contingent contract is not based on doctrine of mutuality of lose and gain.	A wagering contract is a game, losing and gaining alone matters.
Effect of contract	Contingent contract is valid.	A wagering agreement is void.

❒ QUASI CONTRACTS

- A **valid contract** must contain certain **essential elements**, such as offer and acceptance, capacity to contract, consideration and free consent.

  But sometimes the **law implies** a promise imposing **obligations** on one party and conferring right in favour of the other even when there is no offer, no acceptance, no genuine consent,

lawful consideration, etc. and in fact neither agreement nor promise. Such cases are not contract in the strict sense, but the **Court recognises** them as **relations resembling those of contracts** and enforces them as if they were contracts. Hence the term **Quasi –contracts** (i.e. resembling a contract). Even **in the absence** of a contract, certain social relationships give rise to certain specific obligations to be performed by certain persons. These are known as quasi contracts as they **create same obligations** as in the case of regular contract.

- Quasi contracts are based on principles of equity, justice and good conscience.
- A quasi or constructive contract rest upon the maxims, "No man must grow rich out of another person's loss".

Example 16:

T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

Example 17:

A pays some money to B by mistake. It is really due to C. B must refund the money to A.

Example 18:

A fruit parcel is delivered under a mistake to R who consumes the fruits thinking them as birthday present. R must return the parcel or pay for the fruits. Although there is no agreement between R and the true owner, yet he is bound to pay as the law regards it a Quasi-contract.

These relations are called as quasi-contractual obligations. In India it is also called as 'certain relation resembling those created by contracts.

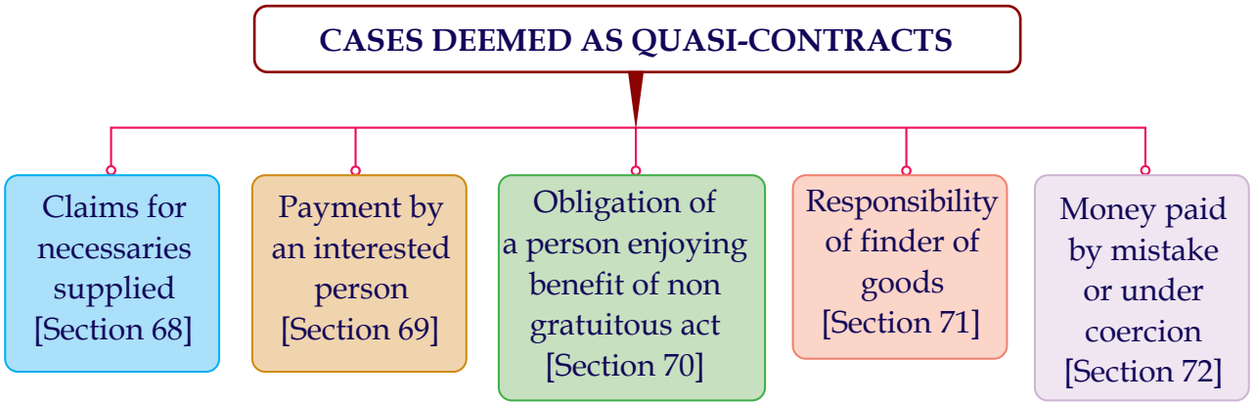
Salient Features of Quasi Contracts

(a) In the first place, such a right is **always** a **right to money** and generally, though not always, to a **liquidated sum** of money.

(b) Secondly, it **does not arise from any agreement** of the parties concerned, but is **imposed by the law**; and

(c) Thirdly, it is a right which is **available not against all the world**, but **against** a **particular person** or persons only, so that in this respect it resembles a contractual right.

Cases Deemed as Quasi Contract



(a) **Claim for necessaries supplied to persons incapable of contracting (Section 68):** If a person, **incapable** of entering into a **contract, or** anyone whom he is **legally bound to support**, is supplied by another person with **necessaries** suited to his **condition in life,** the person who has furnished such supplies is **entitled to be reimbursed** from the property of such incapable person.

Example 19:

A supplies B, a lunatic, or a minor, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property.

To establish his claim, the **supplier must prove** not only that the goods were **supplied** to the person who was **minor or a lunatic** but also that they were **suitable to his actual requirements** at the time of the sale and delivery.

(b) Payment by an interested person (Section 69): A person who is **interested in the payment** of money **which another is bound by law to pay,** and who therefore pays it, is **entitled to be reimbursed** by the other.

Example 20:

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

(c) Obligation of person enjoying benefits of non-gratuitous act (Section 70): In term of section 70 of the Act "where a person **lawfully does anything** for another person, **or delivers** anything to him **not intending** to do so **gratuitously** and such other person **enjoys the benefit** thereof, the latter is bound to pay compensation to the former in respect of, or to restore, the thing so done or delivered".

It thus follows that for a suit to succeed, the plaintiff must prove:

(i) It thus follows that for a suit to succeed, the plaintiff must prove:

(ii) That he did not do so gratuitously; and

(iii) That the other person enjoyed the benefit.

The above can be illustrated by a case law where 'K' a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in the meantime government went on appeal. The appeal was decided in favour of the government and 'K' was directed to return the salary paid to him during the period of reinstatement. [Shyam Lal vs. State of U.P. A.I.R (1968) 130]

Example 21:

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

(d) Responsibility of finder of goods (Section 71): 'A person who **finds goods belonging** to another and **takes** them into his **custody** is subject to same **responsibility** as if he were a **bailee'**.

Thus, a **finder** of lost goods has:

(i) to take **proper care** of the property as man of **ordinary prudence** would take

(ii) **no right to appropriate** the goods and

(iii) to **restore** the goods if the **owner** is found.

Case Law: Hollins Vs. Howler L. R. & H. L.

Facts: In Hollins vs. Howler L. R. & H. L., 'H' picked up a diamond on the floor of 'F's shop and handed over the same to 'F' to keep till the owner was found. In spite of the best efforts, the true owner could not be traced. After the lapse of some weeks, 'H' tendered to 'F' the lawful expenses incurred by him and requested to return the diamond to him. 'F' refused to do so. Held, 'F' must return the diamond to 'H' as he was entitled to retain the goods found against everybody except the true owner.

Example 22:

'P' a customer in 'D's shop puts down a brooch worn on her coat and forgets to pick it up and one of 'D's assistants finds it and puts it in a drawer over the weekend. On Monday, it was discovered to be missing. 'D' was held to be liable in the absence of ordinary care which a prudent man would have taken.

(e) Money paid by mistake or under coercion (Section 72): "A **person** to whom **money** has been **paid** or anything **delivered by mistake** or under **coercion**, must **repay or return** it".

Every kind of payment of money or delivery of goods for every type of 'mistake' is **recoverable**. **[Shivprasad Vs Sirish Chandra A.I.R. 1949 P.C. 297]**

Example 23:

A payment of municipal tax made under mistaken belief or because of mis-understanding of the terms of lease can be recovered from municipal authorities. The above law was affirmed by Supreme Court in cases of Sales tax officer vs. Kanhaiyalal A. I. R. 1959 S. C. 835

Case Law: Seth Khanjelek Vs. National Bank of India 1954

Facts: Similarly, any money paid by coercion is also recoverable. The word coercion is not necessarily governed by section 15 of the Act. The word is interpreted to mean and include oppression, extortion, or such other means [Seth Khanjelek vs National Bank of India].

Case Law: Trikamdas Vs. Bombay Municipal Corporation A. I. R. 1954

Facts: In a case where 'T' was traveling without ticket in a tram car and on checking he was asked to pay ₹ 5/- as penalty to compound transaction. T filed a suit against the corporation for recovery on the ground that it was extorted from him. The suit was decreed in his favour. [Trikamdas vs. Bombay Municipal Corporation A. I. R. 1954]

In all the above cases the contractual liability arose without any agreement between the parties.

Difference between Quasi Contracts and Contracts

Basis of Distinction	Quasi- Contract	Contract
Essential for the valid contract	The essentials for the formation of a valid contract are absent	The essentials for the formation of a valid contract are present.
Obligation	Imposed by law	Created by the consent of the parties

UNIT 07 CONTRACT OF INDEMNITY AND GUARANTEE

TABLE OF THE CONTENTS FOR THE CHAPTER

- CONTRACT OF INDEMNITY 101
- CONTRACT OF GUARANTEE 103
- TYPES OF GUARANTEES 105
- NATURE AND EXTENT OF SURETY'S LIABILITY [SECTION 128] 107
- LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT 107
- DISCHARGE OF A SURETY 107
- RIGHTS OF A SURETY 111

- Contract of Indemnity and Guarantee are the specific types of contracts provided under sections 124 to 147 of the Indian Contract Act, 1872. In addition to the specific provisions (i.e. Section 124 to Section 147 of the Indian Contract Act, 1872), the general principles of contracts are also applicable to such contracts. Even though both the contracts are modes of compensation based on similar principles, they differ considerably in several aspects.

CONTRACT OF INDEMNITY

In this unit, the law relating to indemnity and guarantee are discussed in detail.

The term "Indemnity" literally means "**Security against loss**" or "**to make good the loss**" or "to **compensate** the party who has **suffered some loss**".

The term "Contract of Indemnity" is defined under Section 124 of the Indian Contract Act, 1872. It is "a contract by which **one party promises** to **save** the other from **loss** caused to him by the **conduct** of the **promisor himself**, or by the conduct of **any other person**."

Example 1:

Mr. X contracts with the Government to return to India after completing his studies (which were funded by the Government) at University of Cambridge and to serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

Parties

(a) The party who **promises to indemnify**/ save the other party from loss- **"indemnifier"**,

(b) The party who is **promised to be saved** against the loss- "**indemnified**" or "**indemnity holder**".

Example 2:

A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ₹ 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Example 3:

X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighboring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.

However, the above **definition** of indemnity **restricts the scope** of contracts of indemnity in as much as it covers **only the loss caused by**:

(i) the conduct of the **promisor himself,** or

(ii) the conduct of **any other person**.

Thus, loss occasioned by **an accident not caused by any person, or an act of God/ natural event, is not covered.**

In case of Gajanan Moreshwar v/s Moreshwar Madan (1942), decision is taken on the basis of **English Law.** As per English Law, Indemnity means promise to **save another harmless from** the **loss**. Here it **covers every loss** whether due to **negligence** of promisee **or by natural calamity** or **by accident.**

Mode of Contract of Indemnity

A contract of indemnity like any other contract may be express or implied.

(a) A contract of indemnity is said to be **express** when a person **expressly promises** to compensate the other from loss.

(b) A contract of indemnity is said to be **implied** when it is to be **inferred from the conduct** of the parties or from the **circumstances** of the case.

A **contract of indemnity** is like any other contract and must fulfil **all the essentials** of a **valid contract**.

Example 4:

A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined ₹ 1000, B cannot claim this amount from A because the object of the agreement is unlawful.

A contract of **Fire** Insurance or **Marine** Insurance is **always** a contract of **indemnity.** But there is **no contract of indemnity** in case of contract of **Life Insurance.**

Rights of Indemnity-holder when sued (Section 125): The **promisee** in a contract of indemnity, acting **within the scope of his authority,** is entitled to **recover** from the promisor/indemnifier—

(a) **all damages** which he may be **compelled to pay** in any suit

(b) **all costs** which he may have been **compelled to pay** in **bringing/ defending** the suit and

(c) **all sums** which he may have **paid** under the **terms of any compromise** of suit.

When does the Liability of an Indemnifier Commence

Although the Indian Contract Act, 1872, is **silent on the time** of commencement of liability of indemnifier, however, on the basis of **judicial pronouncements** it can be stated that the liability of an indemnifier **commences** as soon as the **liability** of the **indemnity-holder becomes absolute and certain.** This principle has been followed by the courts in several cases.

Example 5:

A promises to compensate X for any loss that he may suffer by filling a suit against Y. The court orders X to pay Y damages of ₹ 10000. As the loss has become certain, X may claim the amount of loss from A and pass it to Y

❒ CONTRACT OF GUARANTEE

- "Contract of guarantee", "surety", "principal debtor" and "creditor" [Section 126]
  - **Contract of guarantee:** A contract of guarantee is a contract to **perform** the promise **made or discharge** the liability, of a **third person** in case of **his default.**
  - Three parties are involved in a contract of guarantee
    1. **Surety-** person who **gives the guarantee**
    2. **Principal debtor-** person in respect of whose default the **guarantee is given**
    3. **Creditor-** person **to whom** the guarantee is given

Example 6:

When A requests B to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he (A) will himself pay to B, there is a contract of guarantee.

Here, B is the creditor, C the principal debtor and A the surety.

Example 7:

X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y, and agrees that if Y fails to pay he will. In case of Y's failure to pay, the car showroom will recover its money from X.

This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

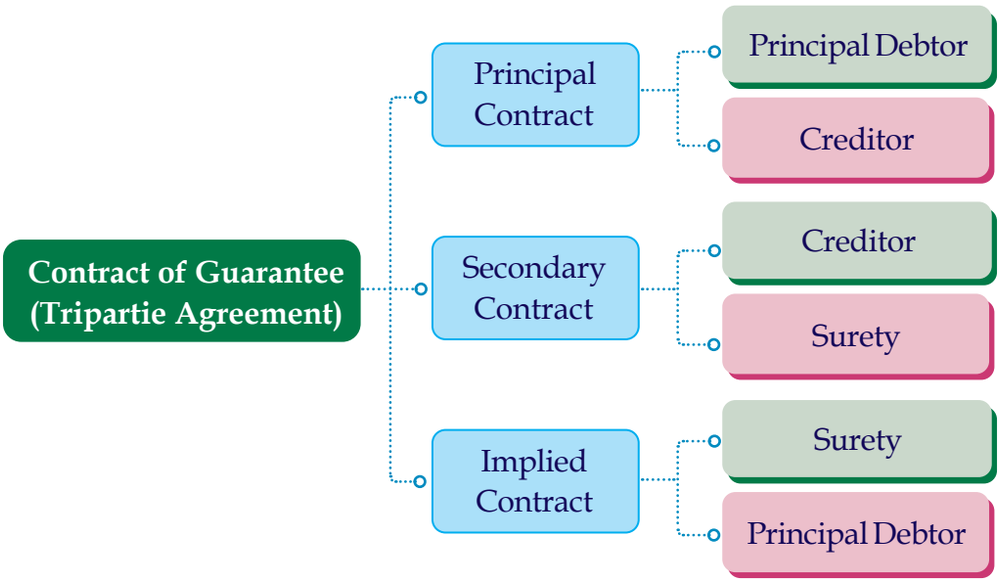
A contract of guarantee is a **tripartite agreement** between principal debtor, creditor and surety. There are, in effect three contracts

(i) A **principal contract** between the **principal debtor and the creditor.**

(ii) A **secondary** contract between the **creditor and the surety.**

(iii) An **implied contract** between the **surety and the principal debtor** whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.



Essential Features of a Guarantee

The following are the requisites of a valid guarantee:-

1. Purpose

The purpose of a guarantee being to **secure the payment** of a debt, the existence of **recoverable debt** is necessary. If there is **no principal debt**, there can be **no valid guarantee.**

2. Consideration

Like every other contract, a contract of guarantee should also be **supported by some consideration.** A guarantee **without** consideration is **void,** but there is **no need for a direct consideration** between the **surety and the creditor.**

As per Section 127 consideration **received by the principal debtor** is **sufficient consideration** to the surety for giving the guarantee, but **past consideration is no consideration** for the contract of guarantee. Even if the **principal debtor is incompetent** to contract, the guarantee is **valid.** But, if **surety is incompetent** to contract, the guarantee is **void.**

Example 8:

B requests A to sell and deliver to him goods on credit. A agrees to do so provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A 's promise to deliver the goods. As per Section 127, there is a sufficient consideration for C's promise. Therefore, the guarantee is valid.

Example 9:

A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

3. Existence of a liability

There must be an **existing liability** or a **promise** whose **performance is guaranteed.** Such liability or promise must be **enforceable by law.** The liability must be legally enforceable and **not time barred.**

4. No misrepresentation or concealment (Section 142 and 143)

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

Any guarantee which the **creditor has obtained** by means of **keeping silence** as to material circumstances, is **invalid** (section 143).

Example 10:

A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C, with his previous conduct. B afterwards make default. The guarantee is invalid.

Example 11:

A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay rupee five per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

5. Writing not necessary

Section 126 expressly declares that a guarantee may be **either oral or written.**

6. Joining of the other co-sureties (Section 144)

Where a **person gives a guarantee** upon a contract that the **creditor shall not act** upon it **until another person has joined** in it as co-surety, the **guarantee is not valid** if that **other person does not join.** That implies, the **guarantee** by a surety is **not valid** if a **condition is imposed** by a surety that **some other person** must also **join as a co-surety**, but such other person **does not join** as a co-surety.

❒ TYPES OF GUARANTEES

Guarantee may be classified under two categories:

A. Specific Guarantee

A guarantee which extends to a **single debt/ specific transaction** is called a specific guarantee. The surety's liability **comes to an end** when the guaranteed debt is **duly discharged** or the promise is **duly performed.**

Example 12:

A guarantees payment to B of the price of the five bags of rice to be delivered by B to C and to be paid for in a month. B delivers five bags to C. C pays for them. This is a contract for specific guarantee because A intended to guarantee only for the payment of price of the first five bags of rice to be delivered one time [Kay v Groves]

B. Continuing Guarantee [Section 129]

A guarantee which **extends** to a **series of transaction** is called a continuing guarantee. A surety's liability **continues until** the **revocation** of the guarantee.

The essence of continuing guarantee is that it applies not to a specific number of transactions but to **any number of transactions** and makes the **surety liable** for the **unpaid balance** at the **end of the guarantee.**

Example 13:

On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5thof every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.

Example 14:

A guarantees payment to B, a tea-dealer, to the amount of ₹ 10,000, for any tea he may from time-to-time supply to C. B supplies C with tea to above the value of ₹ 10,000, and C pays B for it. Afterwards B supplies C with tea to the value of ₹ 20,000. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of ₹ 10,000.

Distinction between a contract of indemnity and a contract of guarantee

Point of Distinction	Contract of Indemnity	Contract of Guarantee
Number of party/parties to the contract	There are only two parties namely the indemnifier [promisor] and the indemnified [promisee]	There are three parties- creditor, principal debtor and surety.
Nature of liability	The liability of the indemnifier is primary and unconditional.	The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor.
Time of liability	The liability of the indemnifier arises only on the happening of a contingency.	The liability arises only on the non-performance of an existing promise or non-payment of an existing debt.
Time to Act	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
Right to sue third party	Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.

Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	All parties must be competent to contract.	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

❒ NATURE AND EXTENT OF SURETY'S LIABILITY [SECTION 128]

(i) The liability of the surety is **co-extensive** with that of the principal debtor **unless it is otherwise provided** by the contract. [Section 128]

(ii) Liability of surety is of **secondary nature** as he is **liable only on default** of principal debtor.

(iii) Where a **debtor cannot be held liable** on account of **any defect** in the document, the **liability of the surety** also **ceases.**

(iv) A **creditor may choose** to **proceed** against a **surety first, unless** there is **an agreement** to the contrary.

❒ LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT

Example 15:

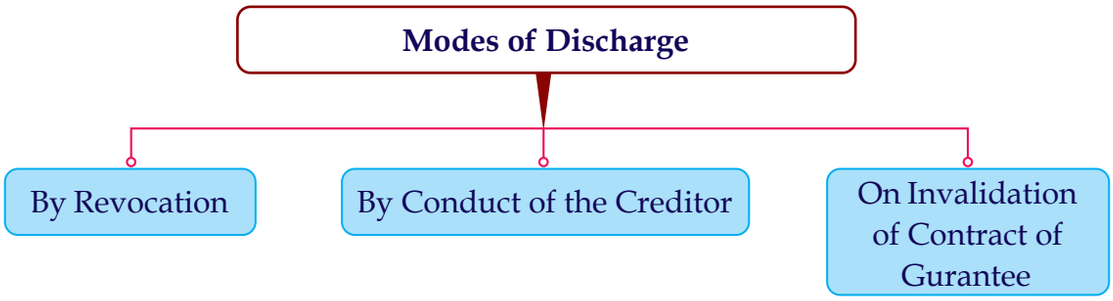
A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

- Where **two persons** contract with a **third person** to undertake a certain liability, and **also contract with each other** that **one of them** shall be **liable only** on the **default** of the other, the third person not being a party to such contract, the **liability** of each of such two persons to the **third person** under the first contract is **not affected** by the existence of the second contract, although such third person may have been **aware** of its existence. (Section 132)

Example 16:

A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

❒ DISCHARGE OF A SURETY



- A surety is said to be **discharged** when his liability as **surety comes to an end.** The various modes of discharge of surety are discussed below:
  (i) By revocation of the contract of guarantee.
  (ii) By the conduct of the creditor, or
  (iii) By the invalidation of the contract of guarantee.

By Revocation of the Contract of Guarantee

(a) **Revocation of continuing guarantee by Notice (Section 130):** The continuing guarantee may **at any time** be revoked by the surety **as to future transactions by notice** to the **creditors. Once** the guarantee is **revoked**, the **surety is not liable** for any **future transaction** however he is **liable for all the transactions** that happened **before the notice** was given.

A **specific** guarantee can be **revoked** only if **liability** to principal debtor **has not accrued.**

Example 17:

Arun promises to pay Rama for all groceries bought by Carol for a period of 12 months if Carol fails to pay. In the next three months, Carol buys ₹ 2000/- worth of groceries. After 3 months, Arun revokes the guarantee by giving a notice to Rama. Carol further purchases ₹ 1000 of groceries. Carol fails to pay. Arun is not liable for ₹ 1000/- of purchase that was made after the notice but he is liable for ₹ 2000/- of purchase made before the notice.

(b) **Revocation of continuing guarantee by surety's death (Section 131):** In the absence of any contract to the contrary, the **death of surety** operates as a **revocation of a continuing guarantee** as to the **future transactions** taking place **after the death** of surety. However, the **surety's estate** remains **liable** for the **past transactions** which have already taken place before the death of the surety.

Example 18:

'S' guarantees 'C' for the transaction to be done between 'C' & 'P' for next month. After 5 days 'S' died. Now guarantee is revoked for future transactions but 'S's estate is still liable for transactions done during previous five days.

(c) **By novation [Section 62]:** The surety **under original contract** is **discharged** if a **fresh contract is entered** into either **between** the **same parties** or between the **other parties**, the consideration being the **mutual discharge** of the **old** contract.

Example 19:

'S' guarantees 'C' for the payment of the supply of wheat to be done by 'C' & 'P' for next month. After 5 days, the contract is changed. Now 'S' guarantees 'C' for the payment of the supply of rice to be done by 'C' & 'P' for rest of next month. Here, guarantee is revoked for supply of wheat. But 'S' is still liable for supply of wheat done during previous five days.

By Conduct of the Creditor

(a) **By variance in terms of contract (Section 133):** Where there is any **variance in the terms** of contract between the **principal debtor and creditor without surety's consent**, it would **discharge the surety in respect of all transactions** taking place **subsequent** to such variance.

Example 20:

A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent and is not liable to make good this loss.

(b) **By release or discharge of principal debtor (Section 134):** The surety is **discharged if the creditor:**

(i) **enters** into a **fresh/ new contract** with principal debtor; by which the **principal debtor is released**, or

(ii) does any **act or omission**, **the legal consequence** of which is the **discharge** of the principal debtor.

Example 21:

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

Example 22:

A gives a guarantee to C for goods to be delivered to B. Later on, B contracts with C to assign his property to C in lieu of the debt. B is discharged of his liability and A is discharged of his liability.

(c) **Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135]:** A contract **between** the **creditor and the principal debtor,** by which the **creditor** makes a **composition** with, or promises to **give time** to, or promises **not to sue,** the principal debtor, **discharges the surety**, **unless** the surety **assents** to such contract.

(i) **Composition:** If the creditor makes a **composition** with the principal debtor, **without consulting** the surety, the **latter is discharged**. Composition inevitably involves **variation of the original** contract, and, therefore, the surety is discharged.

(ii) **Promise to give time:** When the **time for the payment** of the guaranteed debt **comes**, the surety has the **right** to require the **principal debtor** to **pay off** the debt. Accordingly, it is one of the **duties** of the creditor towards the surety **not to allow** the **principal debtor more time** for payment.

(iii) **Promise not to sue:** If the **creditor** under an agreement with the **principal debtor promises not to sue him, the surety is discharged.** The main reason is that the surety **is entitled at any time to require the creditor** to call upon the principal debtor to pay off the **debt** when it is **due and this right is positively violated** when the creditor promises not to sue the principal debtor.

Cases where Surety not Discharged

(i) **Surety not discharged when agreement made with third person to give time to principal debtor [Section 136]:** Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

Example 23:

C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

(ii) **Creditor's forbearance to sue does not discharge surety [Section 137]: Mere forbearance** on the part of the creditor **to sue** the principal debtor **or to enforce** any other remedy against him **does not** in the absence of any provision in the guarantee to the contrary, **discharge** the surety.

Example 24:

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

(d) **Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139]:** If the creditor **does any act** which is **inconsistent** with the **rights of the surety** or **omits to do** any act which his **duty to the surety requires** him to do, and the **eventual remedy** of the surety himself against the principal debtor is **thereby impaired**, the surety is **discharged.**

In a case before the Supreme Court of India, "A bank granted a loan on the security of the stock in the godown. The loan was also guaranteed by the surety. The goods were lost from the godown on account of the negligence of the bank officials. The surety was discharged to the extent of the value of the stock so lost." [State bank of Saurashtra V Chitranjan Rangnath Raja (1980) 4 SCC 516]

Example 25:

A puts M as apprentice to B and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

By the invalidation of the contract of guarantee

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

Example 26:

'C' sells AC to 'P' on misrepresenting that it is made of copper while it is made of aluminum. 'S' guarantees for the same as surety without the knowledge of fact that it is made of aluminum. Here, 'S' will not be liable.

(b) **Guarantee obtained by concealment [Section 143]:** Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Example 27:

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

Example 28:

A guarantees to C payment for iron to be supplied by him to B for the amount of ₹ 2,00,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

(c) **Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144):** Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

❒ RIGHTS OF A SURETY

Example 29:

'S1' guarantees 'C' for payment to be done by 'P' to 'C' on the condition that 'S1' will be liable only if 'S2' joins him for such guarantee. 'S2' does not give his consent. Here, 'S1' will not be liable.

The surety enjoys the following rights against the creditor:

A. Rights against the creditor.
B. Rights against the principal debtor.
C. Rights against co-sureties.

Right Against the Principal Debtor

(a) **Rights of subrogation [Section 140]:** Where, a **guaranteed debt** has **become due,** or default of the principal debtor to perform a guaranteed duty has taken place, the **surety, upon payment or performance** of all that he is liable for, is **invested** with **all the rights** which the **creditor had against** the principal debtor.

This right is known as **right of subrogation**. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the **surety steps into the shoes of the creditor.**

Example 30:

'Raju' has taken a housing loan from Canara Bank. 'Pappu' has given guarantee for repayment of such loan. Besides, there was a condition that if 'Raju' does not repay the loan within time, the bank can auction his property by giving 15 days notice to 'Raju'. On due date 'Raju' does not repay, hence Pappu being a surety has to repay the loan. Now 'Pappu' can take the house from bank and has a right to auction the house by giving 15 days notice to 'Raju'.

(b) **Implied promise to indemnify surety [Section 145]:** In every contract of guarantee there is an **implied promise** by the principal debtor to **indemnify the surety**. The **surety is entitled** to

recover from the principal debtor **whatever sum** he has **rightfully paid** under the guarantee, **but not sums which he paid wrongfully.**

Example 31:

B is indebted to C and A is surety for the debt. Upon default, C sues A. A defends the suit on reasonable grounds but is compelled to pay the amount. A is entitled to recover from B the cost as well as the principal debt.

In the same case above, if A did not have reasonable grounds for defence, A would still be entitled to recover principal debt from B but not any other costs.

Right Against the Creditor

(a) **Surety's right to benefit of creditor's securities [Section 141]:** A surety is entitled to the **benefit of every security which** the **creditor has against the principal debtor** at the time when the **contract of suretyship is entered** into, **whether the surety knows** of the existence of such security **or not**; and, if the **creditor loses,** or, **without the consent** of the surety, **parts** with such security, the surety is **discharged** to the extent of the **value of the security.**

Example 32:

C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) **Right to set off:** If the **creditor sues** the surety, for payment of principal debtor's liability, the **surety** may have the **benefit of the set off,** if any, that the **principal debtor** had against the creditor

Example 33:

'X' took a loan of ₹ 50,000 from 'Y' which was guaranteed by 'Z'. There was one another contract between 'X' and 'Y' in which 'Y' had to pay ₹ 10,000 to 'X'. On default by 'X', 'Y' filed suit against 'Z'. Now 'Z' is liable to pay ₹ 40,000 (₹ 50,000 – ₹ 10,000).

(c) **Right to share reduction:** The surety has **right to claim proportionate reduction** in his liability if the **principal debtor becomes insolvent.**

Example 34:

'X' took a loan of ₹ 50,000 from 'Y' which was Guaranteed by 'Z'. 'X' became insolvent and only 25% is realised from his property against liabilities. Now 'Y' will receive ₹ 12,500 from 'X' and Now 'Z' is liable to pay ₹ 37,500 (₹ 50,000 – ₹ 12,500).

Rights against co-sureties

"Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties"

(a) **Co-sureties liable to contribute equally (Section 146):** Unless otherwise agreed, each surety is liable to contribute equally for **discharge of whole debt or part** of the debt **remains unpaid by debtor**

Example 35:

A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.

Example 36:

A, B and C are sureties to D for the sum of 1,00,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one- half. E makes default in payment. As between the sureties, A is liable to pay 25,000 rupees, B 25,000 rupees, and C 50,000 rupees.

(b) **Liability of co-sureties bound in different sums (Section 147):** The principal **of equal contribution** is, however, subject to the **maximum limit fixed** by a surety to his liability. Co-sureties who **are bound in different sums** are liable **to pay equally** as far as the **limits** of their **respective obligations permit.**

Example 37:

A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.

Example 38:

A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.

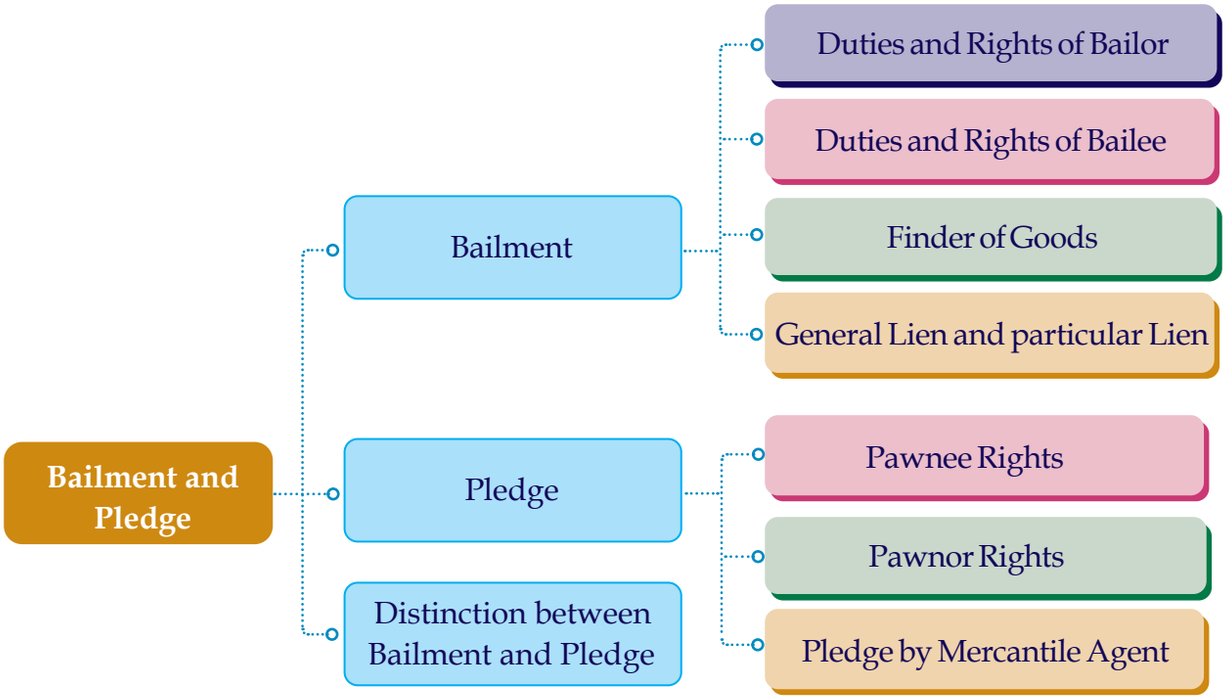
Example 39:

A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.

UNIT 08 BAILMENT AND PLEDGE

TABLE OF THE CONTENTS FOR THE CHAPTER

- WHAT IS BAILMENT 114
- DUTIES OF A BAILOR 116
- DUTIES OF A BAILEE 118
- RIGHTS OF A BAILOR 120
- RIGHTS OF A BAILEE 121
- RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY) 122
- TERMINATION OF BAILMENT 122
- FINDER OF LOST GOODS 123
- RIGHT OF LIEN 123
- PLEDGE 125
- PLEDGE BY NON-OWNERS 127



WHAT IS BAILMENT

- The word "Bailment" has been derived from the French word "ballier" which means **"to deliver".** Bailment etymologically means '**handing over**' or '**change of possession**'
- As per Section 148 of the Act, bailment is the **delivery of goods** by one person to another **for some purpose,** upon a contract, that the **goods shall,** when the **purpose is accomplished**, be **returned** or otherwise **disposed** of according to the **directions** of the person delivering them.

Parties to Bailment

(a) **Bailor:** The person **delivering** the goods.

(b) **Bailee:** The person **to whom** the goods are delivered.

Example 1:

Where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

Example 2:

X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is contract for bailment.

Example 3:

Goods given to a friend for his own use, without any charge.

Example 4:

X delivers goods to blue dart for carriage.

Essential Elements

The essential elements of a contract of bailment are –

(a) **Contract:** Bailment is based upon a contract. The contract may be **express or implied**. **No consideration** is **necessary** to create a valid contract of bailment.

(b) **Delivery of goods:** It involves the **delivery of goods** from one person to another **for some purposes.** Bailment is **only for moveable goods** and **never for immovable goods** or money. The delivery of the possession of goods is of the following kinds:

(i) **Actual Delivery:** When goods are **physically handed** over to the bailee **by the bailor.** Eg: delivery of a car for repair to workshop

(ii) **Constructive Delivery:** Where delivery is made by **doing anything** that has the effect of **putting goods i**n the **possession** of the **bailee** or of any **person authorized** to hold them on his behalf. Eg: Delivery of the key of car to a workshop dealer for repair of the car.

(c) **Purpose:** The goods are delivered for **some purpose.** The purpose may be **express or implied.**

(d) **Possession:** In bailment, possession of goods changes. **Change of possession** can happen by **physical delivery or by any action** which has the effect of placing the goods in the possession of bailee. The change of possession does not lead to change of ownership. In bailment, bailor continues to be the owner of goods. Where a person is in **custody without possession** he does **not become a bailee.**

Example 5:

For example, servant of a master who is in custody of goods of the master does not become a bailee.

Similarly, depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in possession of the owner though kept in a locker at the bank.

(e) **Return of goods:** Bailee is obliged to **return the goods** physically to the bailor. The goods should be returned in the **same form** as given or may be **altered as per bailor's direction**. It should be noted that **exchange** of goods should **not be allowed**. The bailee cannot deliver some other goods, even **not those of higher value.**

Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Types of Bailment

1. On the basis of benefit, bailment can be classified into three types

(a) For the **exclusive benefit of bailor:**

Example 6:

The delivery of some valuables to a neighbour for safe custody, without charge.

(b) For the **exclusive benefit of bailee:**

Example 7:

The lending of a bicycle to a friend for his use, without charge.

(c) For **mutual benefit** of bailor and bailee:

Example 8:

Giving of a watch for repair.

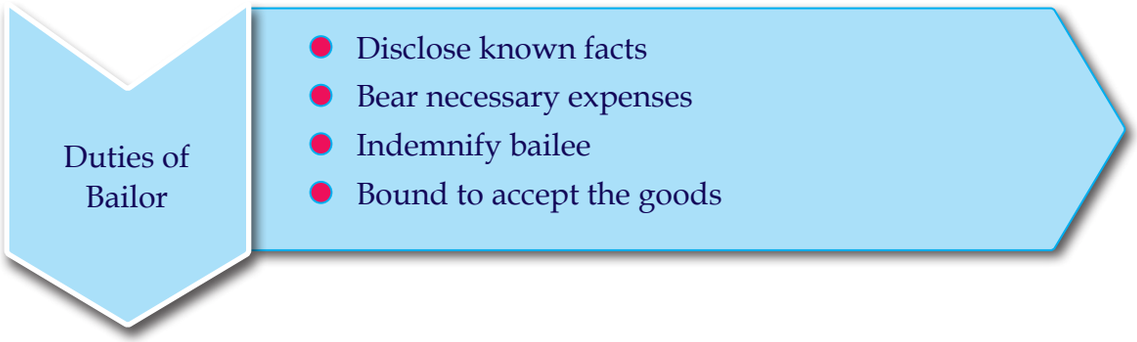
2. On the basis of reward, bailment can be classified into two types

(a) **Gratuitous Bailment:** The word gratuitous means **free of charge.** So, a gratuitous bailment is one when the **provider of service** does it **gratuitously** i.e. free of charge. Such bailment would be either for the **exclusive benefits** of bailor or bailee.

(b) **Non-Gratuitous Bailment:** Non gratuitous bailment means where **both the parties** get **some benefit** i.e. bailment for the benefit of both bailor & bailee

❒ DUTIES OF A BAILOR

Duties of Bailor: The duties of bailor are spelt out in a number of Sections [Section 150, 158, 159, 164]. These are categorized under the following headings:



These are enumerated hereunder:

I. Bailor's Duty to Disclose Faults in Goods Bailed [Section 150]

(a) **In case of gratuitous bailment:** The bailor is **bound to disclose** to the bailee **faults** in the goods bailed, of which the **bailor is aware**, and which **materially interfere** with the use of them, or expose the bailee to **extraordinary risks;** and if he **does not make such disclosure**, he is **responsible for damage** arising to the bailee directly from such faults.

Example 9:

A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

(b) **In case of non- gratuitous bailment:** If the goods are **bailed for hire**, the bailor is responsible for such **damage**, whether he **was or was not aware** of the existence of such faults in the goods bailed.

Example 10:

A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

Case Law: Hyman & Wife Vs. Nye & Sons (1881)

Facts: In Hyman & Wife v. Nye & Sons (1881), A hired from B a carriage along with a pair of horses and a driver for a specific journey. During the journey a bolt in the under-part of the carriage broke away. As a result of this, the carriage became upset and A was injured. It was held that B was liable to pay damages to A for the injury sustained by him. The court observed that it was the bailor's duty to supply a carriage fit for the purpose for which it was hired.

Sometimes, the **goods bailed** are of **dangerous nature** (e.g., explosives). In such cases it is the **duty** of the bailor **to disclose the nature of goods**. [Great Northern Ry' case (1932)]

II. Duty to Pay Necessary Expenses [Section 158]

(a) **In case of Gratuitous bailment:** Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration (gratuitous bailment), the **bailor shall repay** to the bailee the **necessary expenses i**ncurred by him **and any extraordinary expenses** incurred by him for the purpose of the bailment.

(b) **In case of non-gratuitous** bailment the bailor is liable to pay the **extraordinary expenses** incurred by the bailee.

Example 11:

A hired a taxi from B for the purpose of going to Gurgaon from Noida. During the journey, a major defect occurred in the engine. A had to pay ₹ 5000 as repair charges. These are the extraordinary expenses and it is the bailor's duty to bear such expenses. However, the usual and ordinary expenses for petrol, toll tax etc. are to be borne by the bailee itself.

III. Duty to Indemnify the Bailee for Premature Termination [Section 159]

The bailor must **compensate the bailee** for the **loss or damage** suffered by the bailee that is **in excess of the benefit received,** where he had lent the goods **gratuitously** and decides to **terminate** the bailment **before the expiry** of the period of bailment.

IV. Bailor's Responsibility to Bailee [Section 164]

The bailor is responsible to the bailee for the following:

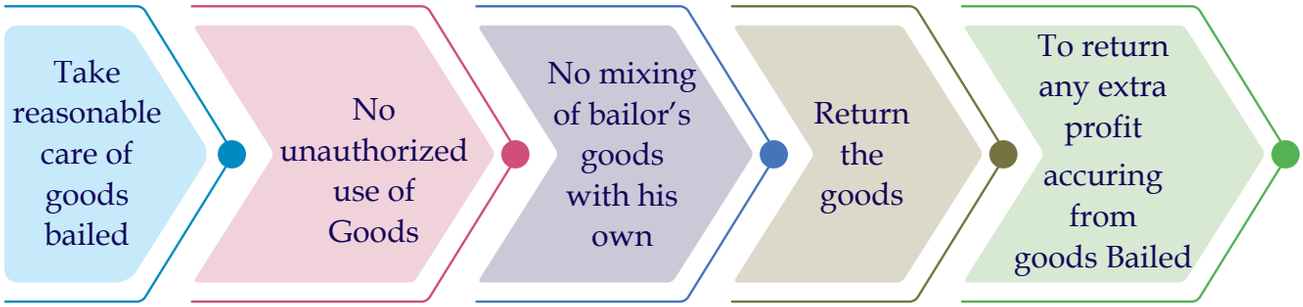
(a) **Indemnify for any loss** which the bailee may sustain by reason that the **bailor was not entitled** to make the bailment, or to **receive back** the goods or to **give directions,** respecting them (defective title in goods).

(b) It is the duty of the bailor **to receive back the goods** when the bailee **returns** them **after the time** of bailment has **expired or the purpose** of bailment has been **accomplished**. If the bailor **refuses** to take delivery of goods when it is offered at the proper time the **bailee can claim compensation for all necessary expenses** incurred for the **safe custody.**

Example 12:

X delivered his car to S for five days for safe keeping. However, X did not take back the car for one month. In this case, S can claim the necessary expenses incurred by him for the custody of the car.

❒ DUTIES OF A BAILEE



1. Take Reasonable Care of the Goods (Section 151 & 152)

In all cases of bailment, the bailee is bound to **take as much care** of the goods bailed to him as a **man of ordinary prudence** would, **under similar circumstances,** take care of his **own goods** of the same bulk, quality and value, as the goods bailed.

Example 13:

If X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss caused on account of riot.

Example 14:

A deposited his goods in B's warehouse. On account of unprecedented floods, a part of the goods were damaged. It was held that, B is not liable for the loss (Shanti Lal V. Takechand).

Exception: Bailee when not liable for loss, etc., of thing bailed [Section 152]: The bailee, **in the absence of any special contract**, is **not responsible for the loss**, **destruction or deterioration of the thing bailed**, if he **has taken reasonable care** as required under section 151.

2. Not to make Inconsistent use of Goods (section 153 & 154)

As per Section 154, if the bailee **makes any use** of the goods bailed, which is **not according to the terms** and conditions of the bailment, he is liable **to compensate the bailor** for any loss or destruction of goods.

Example 15:

A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

Example 16:

'A' hires a horse in Kolkata from B expressly to march to Varanasi. 'A' rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'A' is liable to make compensation to B for the injury to the horse.

As per Section 153, a contract of bailment is **voidable** at the option of the **bailor**, if the bailee does not use the goods according to the terms and conditions of bailment.

3. Not to Mix the Goods (Section 155, 156 and 157)

(i) If the Bailee, **mixes the goods** bailed **with his own goods**, with the **consent of the bailor, both** the parties shall have an **interest in proportion** to their **respective shares** in the mixture thus produced (Section 155).

(ii) If the bailee, **without the consent of the bailor**, **mixes the goods** bailed with his own goods and the goods **can be separated or divided**, the **property** in the goods remains in the **parties respectively;** but the **bailee is bound to bear** the **expense of separation** or division and **any damage** arising from the mixture (Section 156).

Example 17:

A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark; A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

(iii) If the bailee, **without the consent** of the bailor **mixes the goods** of the bailor with his own goods in such a **manner** that it is **impossible to separate** the goods bailed from the other goods and to **deliver them back**, the **bailor is entitled to be compensated** by the bailee for **loss** of the goods (Section 157).

Example 18:

A bails a barrel of Cape flour worth ₹ 4500 to B. B, without A's consent, mixes the flour with country flour of his own, worth only ₹ 2500 a barrel. B must compensate A for the loss of his flour.

4. Return the Goods (Section 160 & 161)

It is the duty of bailee to **return, or deliver** according to the bailor's **directions,** the goods bailed **without demand,** as soon as the time for which they were bailed, has **expired**, or the **purpose** for which they were bailed has been **accomplished.** [Section 160]

If, by the **default** of the bailee, the **goods are not returned, delivered or tendered** at the proper time, he is **responsible** to the bailor **for any loss, destruction or deterioration** of the goods from that time. [Section 161]

Example 19:

X delivered books to Y to be bound. Y promised to return the books within a reasonable time. X pressed for the return of the book. But Y, failed to deliver them back even after the expiry of reasonable time. Subsequently the books were burnt in an accidental fire at the premises of Y. In this case Y was held liable for the loss.

5. Return an Accretion from the Goods [Section 163]

In the **absence of any contract to the contrary,** the **bailee** is bound to **deliver** to the bailor, or according to his **directions,** any **increase** or **profit** which may have **accrued** from the goods bailed.

Example 20:

A leaves a cow in the custody of B. The cow gives birth to a calf. B is bound to deliver the calf along with the cow, to A.

6. Not to setup Adverse Title

Bailee must **not set up a title adverse** to that of the bailor. He must **hold the goods on behalf** of and for the bailor. He **cannot deny** the **title** of the bailor.

❒ RIGHTS OF A BAILOR

Rights of Bailor: The following are the rights of bailor:-

- Right to terminate the bailment
- Right to demand back the goods at any time
- Right to file a suit against any wrong dore
- Right to file a suit for enforcement of duties imposed upon a bailee.
- Right to claim compensation

(i) **Right to terminate the bailment [Section 153]:** A contract of bailment is **voidable** at the option of the bailor, if the **bailee does** any act with regard to the goods bailed, **inconsistent** with the conditions of the bailment.

(ii) **Right to demand back the goods (Section 159):** When the goods are lent **gratuitously**, the bailor **can demand** back the goods at **any time even before the expiry** of the **time fixed or** the **achievement of** the **object.**

Example 21:

A, while going out of station delivered his ornaments to B for safe custody for one month. But A returned to station after one week. He may demand the return of his ornaments even though the time of one month has not expired.

However, due to the premature return of the goods, if the bailee suffers any loss, which is more than the benefit actually obtained by him from the use of the goods bailed, the bailor has to compensate the bailee.

(iii) **Right to file a suit against a wrong doer** [Section 180 and section 181] (discussed in next pages)

(iv) **Right to sue the bailee:** The bailor has a right to sue the bailee **for enforcing all the liabilities and duties** of him.

(v) **Right to compensation:** If any **damage** is caused to the goods bailed because of the **unauthorized use** of the goods or unauthorized **mixing** of the goods, the bailor has a right to claim **compensation** for the same.

❒ RIGHTS OF A BAILEE

Rights of bailee: The following are the rights of the bailee:

1. **Right to Deliver the Goods to any one of the joint bailors [Section 165]:** If **several joint owners** bailed the goods, the bailee has a right to deliver them to **any one of the joint owners unless** there was a **contract to the contrary.**

Example 22:

A, B and C are the joint owners of a harvesting combine. They delivered it on hire to D for one month. After the expiry of one month, D may return the "combine" to any one of the joint owners namely, A, B or C.

2. **Right to indemnity (Section 166):** Bailee is entitled to be indemnified by the bailor for **any loss arising** to him by reasons that the **bailor was not entitled** to make the **bailment** or to **receive back** the goods or to **give directions** in respect to them. If the bailor has **no title** to the goods, and the **bailee in good faith, delivers them back** to, or according to the **directions** of the bailor, the bailee **shall not be responsible** to the owner in respect of such delivery. Bailee can also **claim all the necessary expenses** incurred by him for the purpose of gratuitous bailment.
3. **Right to claim compensation in case of faulty goods (Section 150):** A bailee is entitled to **receive compensation** from the bailor or any loss caused to him **due to the failure** of the bailor to **disclose any faults** in the goods known to him. If the bailment is for **hire, the bailor will be liable** to compensate even though he was **not aware of** the existence of such **faults.**
4. **Right to claim necessary expenses (Section 158):** In case of **gratuitous bailment,** the bailor shall **repay to the bailee the necessary expenses** incurred by him **and any extraordinary expenses** incurred by him for the purpose of the bailment.

5. **Right to Apply to Court to Decide the Title to the Goods [Section 167]:** If the goods bailed are **claimed by the person other than the bailor**, the **bailee** may **apply** to the court **to stop its delivery** and to **decide the title** to the goods.

Example 23:

A, a dealer in T.V. delivered a T.V. to B for using in summer vacation. Subsequently, C claimed that the T.V. belonged to him as it was delivered only for repairs, to A and thus, B should deliver it to him. In this case, B may apply to the Court to decide the question of ownership of the T.V. so that he may deliver it to the right owner.

6. **Right of particular lien for payment of services [Section 170]:** (Discussed in next pages)
7. **Right of general lien (Sec. 171):** (Discussed in next pages)

❒ RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY)

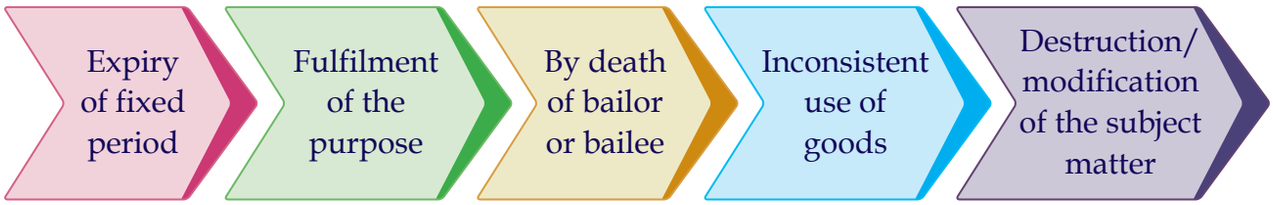
Suit by Bailor & Bailee Against Wrong Doers [Section 180]

If a **third person wrongfully deprives** the bailee of the **use or possession** of the goods bailed, or does them **any injury,** the bailee is entitled to **use such remedies** as the **owner might have used** in the like case if no bailment had been made; and either the **bailor or the bailee** may bring a **suit against a third person** for such deprivation or injury.

Apportionment of Relief or Compensation Obtained by Such Suits [Section 181]

Whatever is obtained by way of **relief or compensation** in any such suit shall, as between the bailor and the bailee, **be dealt** with according to their **respective interests.**

❒ TERMINATION OF BAILMENT



A contract of bailment shall terminate in the following circumstances:

1. **On expiry of stipulated period:** If the **goods** were given for a **stipulated period,** the contract of bailment shall **terminate after the expiry** of such period.

Example 24:

X gives his motorcycle to Y for a month. The bailment terminates after 1 month.

2. **On fulfillment of the purpose:** If the goods were **delivered for a specific purpose**, a bailment shall **terminate on the fulfillment** of that purpose.

Example 25:

X hires certain tents and crockery on marriage of his daughter. The bailment terminates after marriage.

3. **By Notice:**
   (a) Where the **bailee acts in a manner** which is **inconsistent** with the terms of the bailment, **the bailor** can always **terminate** the contract of bailment by giving a **notice to the bailee.**
   (b) A **gratuitous** bailment can be terminated by the bailor at **any time** by giving a notice to the bailee. However, the termination should **not cause loss to the bailee in excess of the benefit derived** by him. In case the **loss exceeds the benefit** derived by the bailee, the bailor must **compensate** the bailee for such a loss (Sec. 159).
4. **By death:** A **gratuitous** bailment terminates upon the **death of either** the bailor or the bailee.
5. **Destruction of the subject matter:** A bailment is **terminated** if the **subject matter** of the bailment is **destroyed** or there is a **change** is in the **nature of goods** which makes it **impossible** to be used for the purpose of bailment.

❒ FINDER OF LOST GOODS

Example 26:

X gives his cycle to Y on hire. Cycle damaged beyond repairs. Bailment ends.

Right of finder of lost goods- may sue for specific reward offered [Section 168]: A person **who finds some goods** which **do not belong to him,** is **called** the finder of the goods. It is the **duty of the finder** of goods to **find the true owner and surrender** the goods to him. However, the finder of goods has **no right to sue** the owner **for compensation** for **trouble and expense voluntarily** incurred by him in finding the owner and **preserving the goods** found. But he has a **right to retain** the goods against the owner **until he receives** such **compensation;** and, where the owner has offered a **specific reward** on the lost goods, the **finder may sue** the owner for such reward, and **may retain** the goods until then.

When finder of thing commonly on sale may sell it [Section 169]: When a thing which is commonly the subject of sale if lost, if the **owner cannot with reasonable diligence be found**, or if **he refuses,** upon demand, **to pay** the lawful charges of the finder, the **finder may sell** it –

1. When the **thing is in danger of perishing** or of **losing the greater part of its value**, or when the **lawful charges** of the finder in respect of the thing found **amount to two thirds of its value.**

❒ RIGHT OF LIEN

Lien is the right of a person

- **to retain the goods** belonging to another
- **until** his **claim is satisfied** or
- some **debt** due to him is **repaid.**

Types of Lien

Lien may be of two types:

(a) Particular Lien
(b) General Lien

Particular lien

It is a right to retain **only the particular goods** in respect of which the **claim is due.**

Section 170 provides, where the **bailee** has, in accordance with the purpose of the bailment, rendered any **service involving the exercise of labour or skill** in respect of the goods bailed, he has, in the **absence of a contract to the contrary,** a **right to retain** such goods until he **receives due remuneration** for the services he has rendered in respect of them.

Example 27:

'A' gives cloth to 'B', a tailor, to make into a coat. 'B' is entitled to retain the coat until he is paid.

Example 28:

If in the above example, 'B' takes 15 days time to make the coat, right of lien will be applicable after 15 days.

Example 29:

A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

General lien

It is a right to **retain** the goods **not only for demands** arising out of the goods retained **but for a general balance** of account in favour of **certain persons** (in the **absence** of a **contract** to the contrary). Section 171 provides this right is available to **Bankers, factors, wharfingers, policy brokers** and **attorneys** of law.

Example 30:

'A' borrows ₹ 500/- from the bank without security and subsequently again borrows another ₹ 1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned ₹ 1000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

Under the right of general lien the goods **cannot be sold** but can only be **retained for dues.** The right of lien can be **waived through a contract.**

Difference between Bailee's General and Particular Lien

General Lien	Particular Lien
Section **171** of the Indian Contract Act, 1872 confer on Bailee the right of General Lien.	Section **170** of the Indian Contract Act, 1872 confers on the Bailee, the right of particular lien.
General lien alludes to the right to **keep possession** of goods **belonging to other against general balance** of account.	Particular lien **implies a right** of the bailee to **retain specific goods** bailed for **non-payment** of amount.
A general lien is **not automatic** but is **recognized** through on **agreement**. It is exercised by the bailee only by name.	It is **automatic.**

It can be exercised **against goods** even **without involvement of labor or skill.**	It comes into play only **when some labor or skill is involved has been expended on the goods, resulting** in an increase in value of goods.
Only such persons as are specified under section 171, e.g., **Bankers, factors, wharfingers, policy brokers** etc. are entitled to general lien.	**Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc. are entitled** to particular lien.

❒ PLEDGE

"Pledge", "pawnor" and "pawnee" defined [Section 172]: The **bailment** of goods as security **for payment** of a **debt or performance** of a promise is called "pledge". The **bailor** is in this case called the "**pawnor".** The **bailee** is called the **"pawnee".**

Section 172 to 182 of the Indian Contract Act, 1872 deal with the contract of pledge.

Example 31:

A lends money to B against the security of jewellery deposited by B with him. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor/ pledger and A is a pawnee/ pledgee.

Essentials of Contract of Pledge

Since **pledge is a special kind of bailment**, therefore **all the essentials of bailment** are also the **essentials of the pledge.** Apart from that, the other essentials of the pledge are:

- There shall be a bailment for Security against payment or performance of the promise
- The subject matter of pledge is goods
- Goods pledged for shall be in existence
- There shall be the delivery of goods from pledger to pledgee

Rights of a Pawnee/ Pledgee

Rights of Pawnee can be classified as under the following headings:

(a) **Right to retain the pledged goods [Section 173]:** The **pawnee may retain** the goods pledged, not only for **payment of the debt or the performance of the promise**, but for the interest, of the debt, and **all necessary expenses** incurred by him in respect of the possession or for the preservation of the goods pledged.

Example 32:

Where 'M' pledges stock of goods for certain loan from a bank, the bank has a right to retain the stock not only for adjustment of the loan but also for payment of interest.

(b) **Right to retention of subsequent debts [Section 174]:** The Pawnee can **retain** the goods pledged for any **debt or promise other than** the debt or promise for which they are pledged. But he can exercise this right only when there is a contract to this effect. i.e. a right to retain goods for subsequent debts can be exercised only when it has been provided for in a contract to this effect.

(c) **Pawnee's right to extraordinary expenses incurred [Section 175]:** The pawnee is entitled to **receive** from the pawnor **extraordinary expenses** incurred by him for the preservation of the goods pledged. For such expenses, however, he **does not have** the right to **retain** the goods, but he c**an sue the pawnor** for such expenses.

(d) **Pawnee's right where pawnor makes default [Section 176]:** If the **pawnor** makes **default in payment** of the **debt, or performance**, at the stipulated time of the promise, in respect of which the goods were pledged, the **pawnee has the following rights:**

(i) the pawnee may bring a **suit against the pawnor** upon the debt or promise, and retain the goods pledged as a **collateral security**; or

(ii) he may **sell the thing pledged** on giving the **pawnor reasonable notice** of the sale.

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

Rights of a Pawnor

As the bailor of goods, pawnor has **all the rights of the bailor.** Along with that he also has the right of redemption to the pledged goods which is enumerated under section 177 of the Act.

Right to redeem [Section 177]: If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes **default in payment of the debt or performance of the promise** at the stipulated time, he **may redeem the goods pledged** at any subsequent time **before the actual sale** of them; but he must, in that case, **pay, in addition, any expenses** which have **arisen** from his default.

Note: Redemption means to recover back the goods by making of the payment of debt or performance of promise.

Duties of the Pawnee

Pawnee has the following duties:

(a) Duty to take **reasonable care** of the pledged goods.

(b) Duty **not to make unauthorized use** of pledged goods.

(c) Duty to **return** the goods when the debt has been **repaid or the promise** has been **performed.**

(d) Duty **not to mix** his own goods with goods pledged.

(e) Duty **not** to do any act which is **inconsistent with the terms** of the pledge.

(f) Duty to **return accretion** to the goods, if any.

Duties of a Pawnor

Pawnor has the following duties:

(a) The pawnor is liable to **pay the debt or perform the promise** as the case may be.

(b) It is the duty of the pawnor to **compensate the pawnee** for any **extraordinary expenses** incurred by him for preserving the goods pawned.

(c) It is the duty of the pawnor to **disclose all the faults** which may put the **pawnee under extraordinary risks.**

(d) If **loss occurs** to the pawnee due to defect in pawnor's title to the goods, the pawnor must **indemnify the pawnee.**

(e) If the **pawnee sells** the good due to **default by the pawnor**, the **pawnor** must **pay the deficit.**

❒ PLEDGE BY NON-OWNERS

Ordinarily, it is the owner of the goods, or any person authorized by him in that behalf, who can pledge the goods. But in order to facilitate mercantile transactions, the law has recognised certain exceptions. These exceptions are for bonafide pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left.

(a) **Pledge by mercantile agent [Section 178]: A mercantile agent,** who is in the **possession of goods** or **document of title**, with the **consent of owner**, can pledge them while **acting in the ordinary course** of business as a Mercantile Agent.

Such Pledge shall be **valid** as if were made with the **authority** of the owner of goods. **Provided, Pawnee** acted in **good faith** and had **no notice** that **Pawnor has no authority** to pledge.

(b) **Pledge by person in possession under voidable contract [Section 178A]:** When the **pawnor** has **obtained possession** of the goods pledged by him under a **contract voidable** under section 19 or section 19A (contracts where consent has been obtained by fraud, coercion, misrepresentation, undue influence), but the **contract** has **not been rescinded** at the time of the pledge, the pawnee acquires a **good title** to the goods, provided he acts in **good faith and without notice** of the pawnor's defect of title.

(c) **Pledge where pawnor has only a limited interest [Section 179]:** Where a **person pledges goods** in which he has **only a limited interest** i.e. pawnor is **not the absolute owner** of goods, the **pledge is valid** to the **extent** of that interest.

Example 33:

Mr. X finds a defective mobile phone lying on the road. He picks it up, gets it repaired for ₹ 5000. He later pledges the mobile phone for ₹ 2,000. The true owner can recover the mobile phone only on paying ₹ 5,000.

Example 34:

'A' pledges his jewellery worth ₹ 1,00,000 with 'B' for a advance of ₹ 70,000. 'B' pledges the same for ₹ 90,000 with 'C'. Now this pledge is valid upto ₹ 70,000 plus interest due thereon.

(d) **Pledge by a co-owner in possession:** Where the goods are **owned by many person** and with the **consent of other owners**, the goods are left in the possession of **one of the co-owners**. Such a co-owner may make a **valid pledge** of the goods **in his possession.**

(e) **Pledge by seller or buyer in possession:** A seller, in whose possession, the **goods have been left after sale or** a **buyer** who with the **consent of the seller, obtains possession** of the goods, **before sale**, can make a **valid pledge,** provided the pawnee acts in **good faith** and he has **no knowledge** of the defect in title of the pawnor.

Example 35:

A buys a cycle from B. But leaves the cycle with the seller. B then pledges the cycle with C, who does not know of sale to A, and acted in good faith. This is valid pledge.

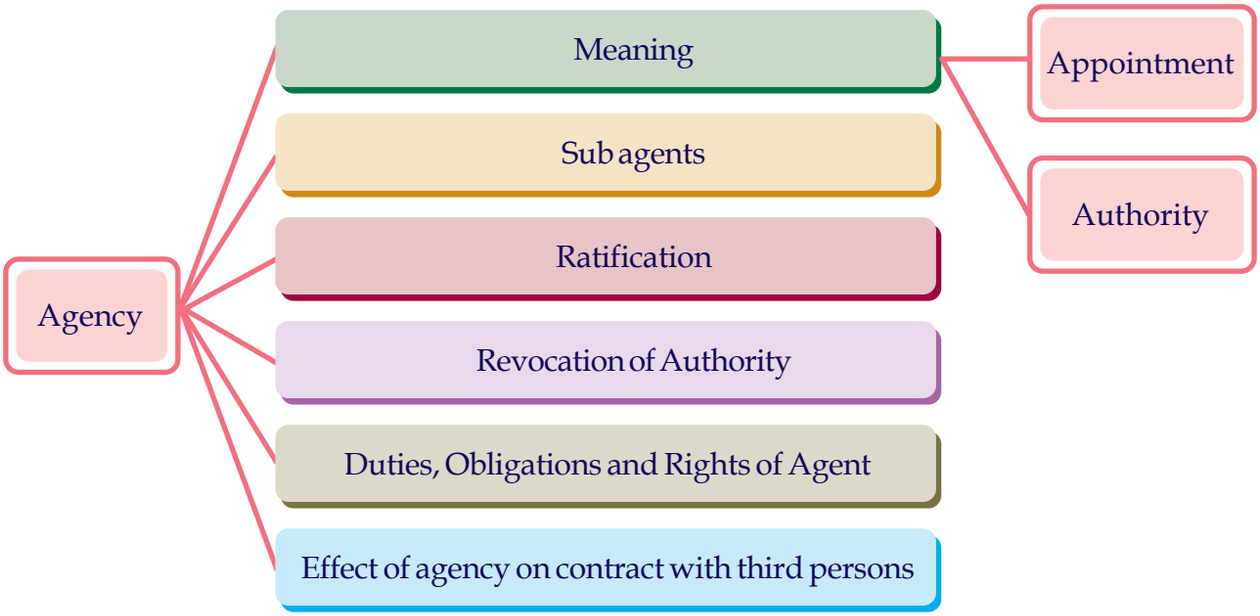
Distinction between Bailment and Pledge

Basis of Distinction	Bailment	Pledge
Meaning	Transfer of goods by one person to another for some specific purpose is known as bailment.	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.
Parties	The person delivering the goods under a contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee".	The person who delivers the good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "pawnee".
Purpose	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods).	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise.
Consideration	The bailment may be made for consideration or without consideration.	Pledge is always made for a consideration.
Right to sell the goods	The bailee has no right to sell the goods even if the charges of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed.	The pawnee has right to sell the goods if the pawnor fails to redeem the goods.
Right to use of goods	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledgee or Pawnee cannot use the goods pledged.

UNIT 09 AGENCY

TABLE OF THE CONTENTS FOR THE CHAPTER

- WHAT IS AGENCY? 129
- APPOINTMENT AND AUTHORITY OF AGENTS 130
- CREATION OF AGENCY 130
- EXTENT OF AGENT'S AUTHORITY 134
- SUB-AGENTS 135
- SUBSTITUTED AGENT 136
- DUTIES AND OBLIGATIONS OF AN AGENT 137
- RIGHTS OF AN AGENT 140
- PRINCIPAL'S LIABILITY TO THIRD PARTIES 142
- PERSONAL LIABILITY OF AGENT TO THIRD PARTIES 144



WHAT IS AGENCY?

The **Indian Contract Act,** 1872 **does not define** the word 'Agency'. However, section **182** of the Indian Contract Act, 1872 defines Agent and Principal as:

Agent means a person employed to do any act for another or to represent another in dealing with the third persons and

The **principal** means a person **for whom** such act is done or who is so represented.

The Indian Contract Act, 1872

Test of Agency

(a) Whether the person has the **capacity to bind** the principal and **make him answerable** to the third party.

(b) Whether he can **establish privity of contract** between the **principal and third parties**.

If the answer to these questions is in affirmative (Yes), then there is a relationship of agency.

Thus, 'Agency' is a comprehensive word used to describe the relationship between one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim "Qui facit per alium, facit per se" i.e., he who **acts through an agent is himself acting.**

Qul faclt per allum, faclt per

❒ APPOINTMENT AND AUTHORITY OF AGENTS

Who may employ an agent: According to Section 183, "**any person** who has attained **majority** according to the law to which he is subject, and who is of **sound mind**, may employ an agent." Thus, a **minor** or a person of **unsound mind cannot** appoint an agent.

Person qualified to appoint agent must be
- Major
- Sound mind

Who may be an Agent

According to Section 184 of the Act **any person** may become an **agent** i.e. even a **minor** or a person of **unsound mind** may become an agent and the principal shall be bound by his acts. But as a rule of **caution**, a **minor** or a person of **unsound mind** should **not be appointed** as an agent because he is **incompetent** to contract and in case of **his misconduct or negligence, the principal** shall **not** be able to **proceed against him**.

Example 1:

P appoints Q, a minor, to sell his car for not less than ₹ 2,50,000. Q sells it for ₹ 2,00,000. P will be held bound by the transaction and further shall have no right against Q for claiming the compensation for having not obeyed the instructions, since Q is a minor and a contract with a minor is 'void-ab-initio'.

Consideration not necessary: According to Section 185, **no consideration is necessary** to create an agency. The **acceptance of the office** of an agent is regarded as a **sufficient consideration** for the appointment.

❒ CREATION OF AGENCY

In the words of Desai J, of the Supreme Court of India "The **relation** of agency arises **whenever one person** called the **agent has the authority** to act on **behalf of another** called the **principal** and **consents** to act. The relationship has genesis in a contract".

The **relationship** of the principal and the agent may be **created in any** of the following ways –

The authority may be express or implied: According to Section 186, the authority of an agent may be express or implied.

Definitions of Express and Implied Authority [Section 187]

1. Express authority

An authority is said to be express when it is given by words, **spoken or written.**

Example 2:

A is residing in Delhi and he has a house in Kolkata. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.

Example 3:

If a customer of a bank wishes to transact his banking business through an agent, the bank will require written evidence of the appointment of the agent and will normally ask to see the registered power of attorney appointing the agent.

2. Implied authority

An authority is said to be implied when it is to be inferred from the **circumstances** of the case, **conduct** of the parties and things spoken or written, or in the ordinary course of dealing, may be **accounted** from the **circumstances** of the case.

If a person realises rent and gives it to the landlord, he impliedly acts for the landlord as an agent.

Example 4:

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

Implied Agency includes

(a) **Agency by Estoppel [Section 237]:** Where the principal by his **conduct** or **statement willfully induces another person** to **believe** that a **certain person** is his **agent**, he is **subsequently** prevented or **estopped** from **denying the fact** of agency.

According to section 237 of the Contract Act, an agency by **estoppel** may be **created** when **following essentials** are fulfilled:

1. the principal must have made a **representation**;
2. the representation may be **express or implied**;
3. The representation must state that the **agent has an authority** to do certain act although really he has **no authority**;
4. The principal must have **induced** the **third person** by such representation; and
5. The third person must have **believed** the representation **and made the contract** on the belief of such representation.

Example 5:

A consigns goods to B for sale and gives him instructions not to sell below a fixed price. C being ignorant of B's instruction enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract. A cannot plead that he had given instructions to B to not sell the goods below certain price. An agency by estoppel is, consequently, deemed between A and B.

Example 6:

If Piyal (the principal) has for several months permitted Sunil to buy goods on credit from Prasad and has paid for the goods bought by Sunil, Piyal cannot later refuse to pay Prasad who had supplied goods on credit to Sunil in the belief that he was Piyal's agent and was buying the goods on behalf of Piyal. Piyal is estopped from now asserting that Sunil is not his agent because on earlier occasions he permitted Prasad to believe that Sunil was his agent and Prasad had acted in that belief.

(c) **Agency by Necessity:** An agency of necessity arises **due to some emergent circumstances.** In emergency a person is **authorised** to do **what he cannot do in ordinary** circumstances. Thus, where an agent is authorised to do certain act, and while doing such an act, an emergency arises, he **acquires** an **extra-ordinary** or **special authority** to **prevent** his principal from **loss**.

Example 7:

Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire and save the farm from destruction during Raja's absence from the country.

3. Agency by operation of law

When **law treats** one person as an **agent** of other. For example, a partner is the agent of the firm for the purposes of the business of the firm.

4. Rights of person as to acts done for him without his authority, effect of ratification [Section 196]

Where **acts are done** by one person on behalf of another, **but without his knowledge** or **authority**, he may elect to **ratify or to disown** such acts. If **he ratifie**s them, the **same effects** will follow as if they had been **performed** by his **authority**. In simple words, "Ratification" means **approving a previous act** or transaction. Ratification may be **express or implied** by the conduct of the person on whose **behalf** the **act was done**.

Example 8:

X who is Y's agent has on 10th January 2022 purchases goods from Z on credit without Y's permission. After the purchase, on 20th January 2022, Y tells X that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit. Y's subsequent statement on 20th January 2022 amounts to a ratification of the agent's (X's) purchase of goods on 10th January 2022.

Essentials of a valid ratification

(a) **Ratification may be expressed or Implied [Section 197]: Ratification** may be **expressed** or may be **implied** in the conduct of the person on whose behalf the acts are done.

Example 9:

A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A.

Example 10:

A, without B's authority, lends B's money to C. Afterwards B accepts interests on the money from C. B's conduct implies a ratification of the loan.

(b) **Knowledge requisite for valid ratification [Section 198]: No valid ratification** can be made by a person **whose knowledge** of the **facts** of the case is **materially defective**.

Example 11:

A has an authority from P to buy certain goods at the market rate. He buys at a higher rate but P accepts the purchase. Afterwards P comes to know that the goods purchased by A for P belonged to A himself. The ratification is not binding on P.

(c) **The whole transaction must be ratified [Section 199]:** There can be **ratification** of an act in **entirely or its rejection in entirely.** The principal **cannot ratify a part** of the transaction which is **beneficial to him** and **reject the rest.**

(d) **Ratification cannot injure third person [Section 200]:** When the **interest** of **third parties** is **affected**, the principle of ratification **does not apply**. Ratification **cannot relate back** to the **date of contract** if third party has in the **intervening time acquired rights.**

Example 12:

A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

Example 13:

A holds a lease from B, terminable on three months' notice. C, an unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

(e) Ratification within reasonable time: Ratification must be **made within a reasonable period** of time.

(f) Communication of Ratification: Ratification must be **communicated to the other party**.

(g) Act to be **ratified** must be valid: Act to be ratified should not be **void or illegal**, for e.g. payment of dividend out of capital, forgery of signatures, any other criminal offence, or anything which is not permitted under law.

❒ EXTENT OF AGENT'S AUTHORITY

The agent's authority is governed by two principles, namely (a) in normal circumstances and (b) in emergency.

A. Agent's Authority in Normal Circumstances [Section 188]

An agent having an authority to **do an act** has authority to do **every lawful thing** which is **necessary** in order to do such act.

An agent having an authority to carry on a **business** has authority to do **every lawful thing necessary** for the **purpose**, or **usually done** in the course, of **conducting** such business.

Example 14:

A is employed by B, residing in London, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt and may give a valid discharge for the same.

Example 15:

A constitutes B as his agent to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on the business.

B. Agent's Authority in an Emergency [Section 189]

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

To constitute a **valid agency** in an **emergency**, following **conditions** must be satisfied.

(i) Agent should **not** be a in a **position** or have any **opportunity to communicate** with his **principal** within the time available.

(ii) There should have been **actual and definite commercial necessity** for the agent to act promptly.

(iii) the agent should have acted **bonafide** and for **the benefit of the principal**.

(iv) the agent should have **adopted** the **most reasonable and practicable course** under the circumstances, and

(v) the agent must have been in **possession of the goods** belonging to his principal and which are the subject of contract.

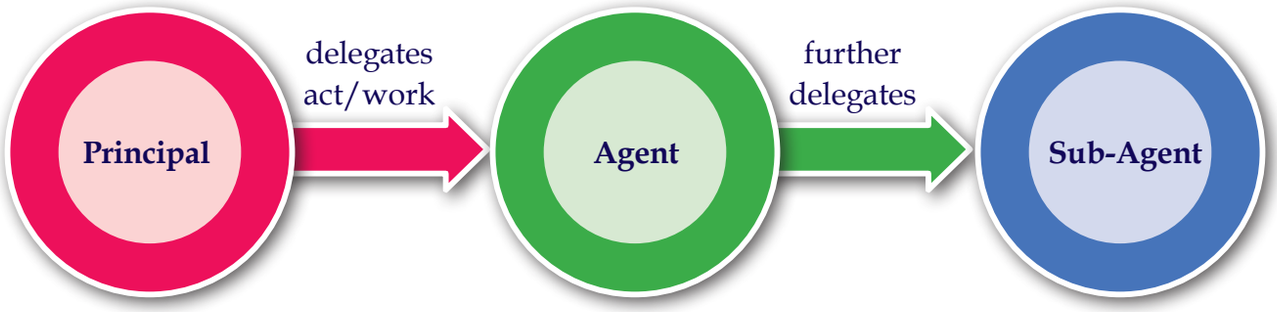
Example 16:

An agent who has authority for sale of goods may repair it if necessary.

Example 17:

A consigns perishable goods to B at Srinagar, with directions to send them immediately to C at Tamandu. B may sell the good if they begin to perish before reaching its destination.

❒ SUB-AGENTS



When Agent Cannot Delegate [Section 190]

An agent **cannot lawfully employ** another to perform acts which he has **expressly or impliedly undertaken** to perform **personally, unless** by the **ordinary custom** of trade a sub-agent may, or from the **nature** of the agency, a sub agent must, be **employed**.

"Sub-agent" Defined [Section 191]

A "Sub-agent" is a **person employed** by, and **acting** under the **control** of, the **original** agent in the business of the agency.

Analysis: Sub agency refers to case where an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a **delegatee** and a **delegatee cannot further delegate**. This is based on the Latin principle "**delegatus non potest delegare".**

Delegatus Non Potest Delegare

A contract of agency is of a **fiduciary character.** It is based on the **confidence** reposed by the principal in the agent and that is why a **delegatee cannot further delegate.**

Exception where an Agent can Appoint Sub-agent

1. The appointment of a sub agent would be **valid** if the **terms** of appointment **originally contemplated** it.
2. Sometimes **customs** of the trade may provide for **appointment** of sub agents.

   In both these cases the sub agent would be treated as the agent of the principal.
3. Where in the **course** of the agent's employment, **unforeseen emergency** arise making it necessary for him **to delegate the authority** that was given to him by the principal.

Representation of Principal by Sub-agent Properly Appointed [Section 192]

Where a sub-agent is **properly appointed,**

1. **Principal is liable** to third parties for the **acts of the sub-agent.**
2. **Agents responsibility for sub agents:** The **agent is responsible** to the principal for the **acts** of the **sub-agent.**
3. **Sub-agents liability to principal:** The **sub-agent is responsible** for his acts to the **agent**, but **not to the principal**, **except** in case of **fraud or willful wrong.**

Agent's Responsibility for Sub-agent Appointed without Authority [Section 193]

Where an **agent, without having authority** to do so, has appointed a **person** to act as a sub-agent,

1. the **agent is responsible** for his acts **both to the principal** and to **third persons;**
2. the **principal** is responsible for the acts of the **sub agent,**
3. the **sub agent** is **not responsible** to the principal at all. He is **answerable only** to the **agent**.

Example 18:

A, a carrier, agreed to carry 60 bags of cotton waste from Morvi to Bhavnagar by a truck. A asked B, another carrier, to carry the goods. The goods were damaged in transit. Held, A was liable even though it was proved that B was the carrier.

❒ SUBSTITUTED AGENT

Substituted Agent is a **person appointed by the agent** to act for the principal, in the business of agency, with the **knowledge and consent** of the principal. Substituted agents are **not sub agents**. They are **agents of the principal.**

Relation between Principal and Person Duly Appointed by Agent to act in Business of Agency [Section 194]

Where an agent, holding an **express or implied authority** to name **another person** to act for the principal in the business of the agency, has **named another person** accordingly, such person is **not a sub-agent**, but an **agent of the principal** for such part of the business of the agency as is entrusted to him.

Example 19:

A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub agent, but is A's agent for the conduct of the sale.

Example 20:

A authorizes B, a merchant in Kolkata, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co. for the recovery of the money. D is not a sub-agent, but is a solicitor for A.

Agent's Duty in Naming Such Person [Section 195]

In **selecting such agent** for his principal, an agent is bound to **exercise the same amount** of **discretion** as a man of **ordinary prudence** would exercise in his **own case**; and, if he does this, he is **not responsible** to the principal for the **acts or negligence** of the agent so selected.

Example 21:

A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

Example 22:

A consigns goods to B, a merchant, for sale. B in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

Difference between a Sub-agent and a Substituted Agent

Both a sub-agent and a substituted agent are appointed by the agent. But, however, the following are the points of distinction between the two.

S.No.	Sub Agent	Substituted Agent
1	A sub-agent does his **work** under the **control** and **directions** of agent.	A substituted agent works under the instructions of the principal.
2	The agent not only appoints a sub agent but also **delegates** to him a part of his own duties.	The agent does not delegate any part of his task to a substituted agent.
3	There is no **privity of contract** between the principal and the sub agent.	Privity of contract is established between a principal and a substituted agent.
4	The sub-agent is **responsible** to the agent alone and is not generally responsible to the principal.	A substituted agent is responsible to the principal and not to the original agent who appointed him
5	The agent is **responsible** to the principal for the acts of the sub agent.	The agent is not responsible to the principal for the acts of the substituted agent.
6	The sub-agent has **no right of action** against the principal remuneration due to him.	The substituted agent can sue the principal for remuneration due to him.
7	Sub-agents may be improperly **appointed.**	Substituted agents can never be improperly appointed.
8	The agent remains **liable for the acts** of the sub-agent as long as the sub agency continues.	The agent's duty ends once he has named the substituted agent.

❒ DUTIES AND OBLIGATIONS OF AN AGENT

I. Duty to follow Instructions or Customs

According to Section 211 an agent is bound to **conduct the business** of his principal according to the **direction given by the principal,** or, in the **absence** of any such directions, according to the **customs** which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts **otherwise** and any loss is sustained by the Principal, he must **indemnify him**, and, if any **profit accrues**, he must **account for it.**

Example 23:

A, an agent is engaged for managing the business of B, in which it is a custom to invest money at hand for interest. If A omits to make such investment he must indemnify B for the losses i.e. for the interest B would have obtained for such investment.

Example 24:

B, a broker, in whose business it is not the custom to sell on credit, sells goods of A on credit to C. C, before payment, becomes insolvent. B will have to indemnify A for the losses.

II. Duty of Reasonable Care and Skill

According to section 212, an agent is bound to **conduct the business** of the principal with as much **skill** as is **generally possessed** by persons engaged in **similar business, unless** the **principal** has notice of his **want of skill.**

The agent is always **bound to act** with **reasonable diligence**, and to use such skill as he possesses; and to make **compensation** to his principal in respect of the **direct consequences** of his own neglect, **want of skill or misconduct**, but **not in respect** of loss of damage which are **indirectly** or remotely caused by such **neglect**, want of skill or misconduct.

Example 25:

A, a merchant in Kolkata, has an agent, B, in London, to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss- e.g. by variation of rate of exchange-but not further.

Example 26:

A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. A must compensate his principal for the loss sustained by him.

Example 27:

A, an insurance-broker, employed by B to effect an insurance on a ship, omits to see that the "usual clauses" are inserted in the policy. The ship is afterwards lost. In consequence of the omission nothing can be recovered from the underwriters. A is bound to make good the loss to B.

Example 28:

A, a merchant in England, directs B, his agent at Mumbai, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

III. Duty to Render Proper Accounts [Section 213]

An agent is bound to **render proper accounts** to his principal on demand. Rendering accounts does not **mean** showing the accounts but the accounts supported by vouchers. (Anandprasad vs. Dwarkanath)

IV. Agent's Duty to Communicate with Principal [Section 214]

It is the duty of an agent, in cases of **difficulty**, to use **all reasonable diligence** in communicating with his principal, and **in seeking to obtain his instructions.**

V. Duty not to Deal on his own Account

Agent should **not deal** on his **own account without** first obtaining the **consent** of the principal, **otherwise** the **principal may** –

(a) **repudiate** the transaction, (Section 215)

(b) **claim** from the agent **any benefit** which may have **resulted** to him from the transaction. (Section 216)

Example 29:

A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

Example 30:

A directs B to sell A's estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allow B to buy, in ignorance of the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either repudiate or accept the sale at his option.

Example 31:

A directs B, his agent, to buy a certain house for him. B tells A it cannot be bought and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.

VI. Duty not to Make Secret Profits

It is the duty of an agent **not to make any secret profit** in the business of agency. His relationship with the principal is of **fiduciary nature** and this requires **absolute good faith** in the conduct of agency.

Secret Profit means any **advantage obtained** by the agent **over and above** his agreed remuneration and which he **would not have been able to make** but for his position as agent.

VII. Duty not to Delegate

According to section 190, an agent **cannot lawfully employ** to perform acts which he has **expressly or impliedly undertaken to perform personally, unless** by the ordinary **custom** of trade a sub-agent may, or, from the nature of agency, a sub- agent, must be employed.

VIII. Agent's Duty to Pay Sums Received for Principal [Section 218]

Subject to such **deductions**, the agent is bound to **pay to his principal all sums received** on his account.

XI. Duty not to use any confidential information received in the course of agency against the principal.

❒ RIGHTS OF AN AGENT

I. Right of Retain out of Sums Received on Principal's Account [Section 217]

This section empowers the agent to **retain**, out of any sums received on account of the principal in the business of the agency for the following **payments**:

(a) **all moneys due to himself** in respect of **advances** made.

(b) in respect of **expenses properly incurred** by him in **conducting** such business.

(c) such remuneration as may be **payable** to him for **acting as agent.**

The right can be **exercised on any sums** received on account of the principal in the business of agency.

II. Right to Remuneration [Section 219]

The agent in the **normal course** is entitled for **remuneration** as per the contract. In the **absence** of any agreed amount of **remuneration**, he is entitled for usual remuneration which is **customary** in the business. However, an agent who is **guilty of misconduct** in the business of the agency is not entitled **to any remuneration** in respect of **that part** of the business which he has **misconducted** [Section 220].

Example 32:

A employs B to recover ₹ 1,00,000 from C, and invest it in securities that give good returns. B recovers the amount and lays out ₹ 90,000 on good securities but lays out ₹ 10,000 on securities which he ought to provide poor returns, whereby A loses ₹ 2,000. B is entitled to remuneration for recovering the ₹ 1,00,000 and for investing the ₹ 90,000. He is not entitled to any remuneration for investing the ₹ 10,000, and he must indemnify A for ₹ 2000.

Example 33:

A employs B to recover ₹ 1,00,000 from C. Because of B's misconduct the money is not recovered. B is entitled to no remuneration for his services and must make good the loss.

III. Agent's Lien on Principal's Property [Section 221]

In the **absence of any contract** to the contrary, an agent is **entitled to retain the goods**, **papers** and **other property**, whether movable or immovable, of the principal received by him, **until the amount due** to himself for **commission**, **disbursement and services** in respect of the same has been **paid or accounted** for him.

The conditions of this right are:

(a) The agent should be **lawfully entitled** to **receive** from the principal a **sum of money** by way of **commission** earned or **disbursement** made or **services rendered** in the proper execution of the business of agency.

(b) The **property** over which the lien is to be exercised should **belong to the principal** and it should have been **received** by the agent in his **capacity and during the course** of his ordinary duties as an agent. If the agent obtains **possession of the property by unlawful means**, he **cannot exercise particular lien.**

The agent's right to lien is lost in the following cases:

(a) When the **possession** of the property is **lost**.

(b) When the **agent waives** his right. Waiver may arise out of **agreement express or implied.**

(c) The agent's lien is **subject to a contract** to the contrary.

IV. Right to Indemnity

(a) **Right of indemnification for lawful acts [Section 222]:** The principal is **bound to indemnify the agent** against **all consequences of lawful acts** done in exercise of his authority.

Example 34:

'A' residing in Delhi appoints 'B' from Mumbai as an agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But A fails to send the merchandise to B and B faces litigations for non- performance. Here, A is bound to protect B against the litigations and all costs, expenses arising of that.

(b) **Right of indemnification against acts done in good faith [Section 223]:** Where the **agent acts in good faith** on the **instruction of principal**, agent is entitled for indemnification of any loss or damage **from the principal.**

Example 35:

Where P appoints A as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to P and if third parties sue A for this act, A is entitled for reimbursement and indemnification for such act done in good faith.

However, the **agent cannot claim any reimbursement or indemnification** for any loss etc. **arising** out of **acts done** by him in violation of any **penal laws of the country.**

(c) **Non-liability of employer of agent to do a criminal act:** According to section 224, where one person **employs another** to do an act which is criminal, the **employer is not liable** to the agent, either upon an **express or an implied** promise, to indemnify him **against the consequences** of that act.

Example 36:

A employs B to beat C and agrees to indemnify him against all consequences of the act. B thereupon beats C and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

Example 37:

B, the proprietor of a newspaper, publishes, at A's request, a libel upon C in the paper, and A agrees to indemnify B against the consequences of the publication, and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages, and also incurs expenses. A is not liable to indemnify B.

V. Right to Compensation for Injury Caused by Principal's Neglect [Section 225]

Section 225 provides that the **principal must compensate** his agent in respect of **injury caused** to such agent due to **principal's neglect** or want of **skill**. Thus, every principal **owes** to his agent **the duty of care**, and not to expose him to unreasonable risks.

Example 38:

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

❒ PRINCIPAL'S LIABILITY TO THIRD PARTIES

An agent does all acts on behalf of the principal but **incurs no personal liability**. The liability remains that of the **principal unless there is a contract** to the contrary. This is because there is **no privity of contract** and passing of **consideration** between the **agent and third party**. An **agent also cannot personally enforce** contracts entered into by him on behalf of the principal.

(i) **Principal's liability for the Acts of the Agent [Section 226]:** Principal **liable** for the acts of agents which are **within the scope** of his authority.

Example 39:

A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set off against that claim a debt due to himself from B.

Example 40:

A, being B's agent with authority to receive money on his behalf, receives from C, a sum of money due to B. C is discharged of his · obligation to pay the sum in question to B.

(ii) **Principal's liability when agent exceeds authority [Section 227]:** When an **agent does more** than he is authorised to do, and when the **part** of what he does, which is within his authority, can be **separated** from the part which is **beyond his authority**, so much only of what he does as is within his authority is binding as **between him and his principal.**

Example 41:

A, being owner of a ship and cargo, authorizes B to procure an insurance for ₹ 4,00,000 on the ship. B procures a policy for ₹ 4,00,000 on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

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

Example 42:

A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of ₹ 6,00,000. A may repudiate the whole transaction.

Example 43:

A authorizes B to draw bills to the extent ₹ 200 each. B draws bills in the name of A for ₹ 1,000 each. A may repudiate the whole transaction.

Exception: Liability of principal inducing belief that agent's unauthorized acts were authorized [Section 237]: When an **agent has, without authority, done acts** or incurred **obligations** to third persons on behalf of his principal, the **principal is bound** by such acts or obligations, if he has by his **words or conduct induced such third persons** to believe that such **acts and obligations** were **within the scope** of the agent's authority.

Example 44:

A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

Example 45:

A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A. The sale is good.

(iii) **Consequences of notice given to agent [Section 229]:** Any **notice given** to or **information obtained** by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the **same legal consequence** as if it had been **given to or obtained by the principal.**

Example 46:

A is employed by B to buy from C certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C against the price of the goods. Thus, the knowledge of the agent is treated as the knowledge of the principal.

(iv) **Principal's liability for the agent's fraud, misrepresentation or torts [Section 238]:** **Misrepresentations** made, or **frauds** committed, by agents acting in the **course** of their business for their **principals**, have the **same effect** on agreements made by such agents as if such misrepresentations or frauds had been made, or committed, by the principals; but misrepresentations made, or frauds committed, by agents, in matters which **do not fall** within their **authority**, do **not affect their principals.**

Example 47:

A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

Example 48:

A, the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended consignor.

❒ PERSONAL LIABILITY OF AGENT TO THIRD PARTIES

Agent Cannot Personally Enforce, nor be Bound by, Contracts on behalf of Principal [Section 230]

In the absence of any contract to that effect, an **agent cannot personally enforce** contracts entered into by him on behalf of his principal, nor is he personally bound by them. He can neither sue nor be sued on contracts made by him on his principal's behalf.

Exceptions

In the following **exceptional cases,** the agent is presumed to have agreed to be personally bound:

1. Where the contract is **made by an agent** for the sale or purchase of goods for **a merchant resident abroad/foreign principal:** – When an **agent** has entered into a contract for the sale or purchase of goods on behalf of a **principal resident abroad**, the **presumption** is that the agent undertakes to be **personally liable** for the performances of such contract.
2. Where the agent **does not disclose** the **name of his principal or undisclosed principal;** (Principal unnamed): when the agent does not disclose the name of the principal then there arises a presumption that he **himself undertakes to be personally liable.**
3. **Non-existent or incompetent principal:** Where the principal, though disclosed, **cannot be sued**, the agent is presumed to be **personally liable.**

Example 49:

An agent who contracts for a minor, the minor being not liable, the agent becomes personally liable. This result, may not, however, follow where the other party already knows that the principal is a minor.

4. Pretended agent – if **the agent pretends** but is **not** an **actual agent**, and the principal **does not rectify** the act but disowns it, the **pretended agent** will be **himself liable** (Section 235).
5. When agent exceeds authority- When the agent **exceeds his authority**, **misleads** the third person in believing that the **agent** has the **requisite authority** in doing the act, then **the agent** can be made **liable personally** for the breach **of warranty of authority.**

Rights of third Parties

(i) Rights of parties to a contract made by undisclosed agent [Section 231]

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

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

Example 50:

SS bought for himself a ticket of IPL match at Wankahde Stadium through AB because on personal grounds Stadium management would not have issued the ticket to SS. Stadium management may repudiate the contract and refuse SS to enter the stadium.

(ii) Performance of contract with agent supposed to be principal [Section 232]

When **agent does not disclosed** that he is acting as an **agent** and the **principal requires** the **performance** of the contract then the **principal can obtain** such performance subject to the **rights and obligations** subsisting between the **agent and the other party** to the contract.

Example 51:

A, who owes 50,000 rupees to B, sells 1,00,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

(iii) Option to third person- sue the agent or the principal

(a) Right of person dealing with agent personally liable [Section 233]: In cases where the **agent is personally liable, a person dealing** with him may hold **either him** or **his principal**, or **both** of them, **liable**.

Example 52:

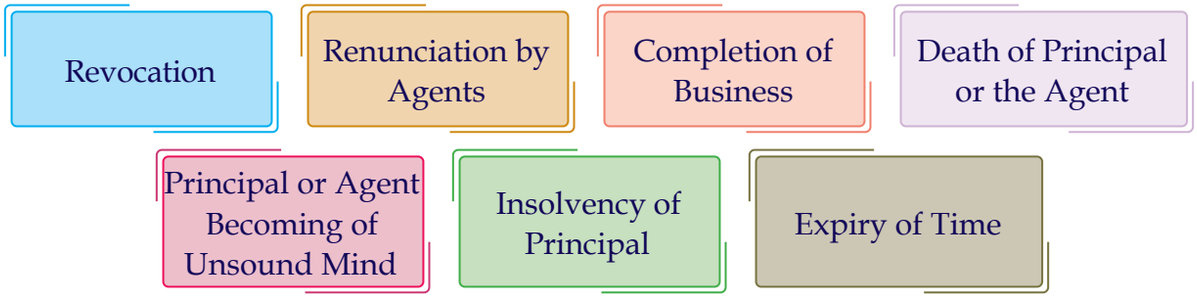
A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable [Section 234]: When a person who has made a **contract with an agent** induces the

agent to **act upon** the belief that the **principal only will be held liable,** or induces the **principal to act** upon the belief that the **agent only will be held liable**, he **cannot afterwards hold liable the agent** or **principal respectively**.

Termination of Agency [Section 201]

Termination of agency means **putting an end** to the **legal relationship** between principal and agent. Section 201 provides for the following modes of termination:



(a) Revocation

An agency may be terminated **by the principal** revoking the **authority of the agent.** Principal may revoke the authority given to his agent **at any time before** the **authority** has been **exercised** so as to bind the principal [Section 203]. However, the principal **cannot revoke the authority** given to his agent after the authority has been **partly exercised** so far as regards such acts and obligations as arise for acts already done in the agency. [Section 204]

Example 53:

A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

Example 54:

A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in A's name, and so as not to render himself personally liable for the price. A can revoke B's authority to pay for the cotton.

Compensation for revocation by principal [Section 205]: If there is premature revocation of agency without sufficient cause, the principal must compensate the agent, for such revocation.

Notice of revocation [Section 206]: When the principal, having justification to do so, **revokes the authority,** he must give **reasonable notice** of such revocation to the agent, otherwise, he can be **liable to pay** compensation for **any damage caused** to the agent (Section 206).

Revocation and renunciation may be expressed or implied [Section 207]: Revocation of agency may be **expressed or implied** in the conduct of the principal.

Example 55:

A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

(b) Renunciation by agent [Section 206]

An **agent may renounce** the business of agency in the **same manner** in which the principal has the right of revocation. In the first place, if the agency is for a **fixed period**, the agent would have to **compensate** the principal for **any premature renunciation** without **sufficient cause.** [Section 205] Secondly, a **reasonable notice** of renunciation is **necessary**. **Length** of notice (time period of notice) is to be **determined** by the **same principles** which apply to revocation by the principal. If the a**gent renounces without proper notice,** he shall have to **make good any damage** thereby resulting to the principal. [Section 206]

(c) Completion of business

An agency is automatically and by operation of law terminated when its business is completed. Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed

(d) Death or insanity

An agency is determined **automatically** on the **death or insanity** of the **principal or the agent. Winding up** of a company or **dissolution of partnership** has the **same effect.** Act done by agent **before death** would remain **binding**.

(e) Principal's insolvency

An agency ends on the principal being adjudicated insolvent.

(f) On expiry of time

Where an agent has been appointed for a fixed term, the expiration of the term puts an end to the agency, whether the purpose of agency has been accomplished or not. An agency comes to an automatic end on expiry of its term.

When the Agency is Irrevocable?

When the agent is **personally interested** in the subject matter of agency the agency becomes **irrevocable**. Section 202 states that "where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the **absence** of an **express contract,** be terminated to the prejudice of such interest."

Example 56:

A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

Example 57:

A consigns 1000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself, out of the price, the amount of his own advances. A cannot revoke this authority, nor it is terminated by his insanity or death.

Effects of Termination [Section 208]

When termination of agent's authority takes effect as to agent, and as to third persons [Section 208]: The termination of the authority of an agent **does not**, so far as regards the agent, **take effect before** it becomes **known to him,** or, so far as regards **third persons, before it becomes known to them.**

Example 58:

A directs B to sell goods for him and agrees to give B five per cent commission on the price fetched by the goods. A afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it sells the goods for ₹ 1,00,000. The sale is binding on A, and B is entitled to ₹ 5,000 as his commission.

Example 59:

A, at Chennai, by letter directs B to sell for him some cotton lying in a warehouse in Mumbai, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C's payment is good as against A.

Example 60:

A directs B, his agent, to pay certain money to C. A dies, and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

Agent's duty on termination of agency by principal's death or insanity [Section 209]: When an **agency is terminated** by the **principal dying** or becoming of **unsound mind,** the agent is bound to take on behalf of the representatives of his **late principal**, **all reasonable steps** for the **protection and preservation** of the **interests entrusted** to him.

Termination of Sub-agent's Authority [Section 210]

The **termination** of the authority of an **agent** causes the termination (subject to the rules herein contained regarding the termination of an agent's authority) of the **authority** of **all sub-agents** appointed by him.

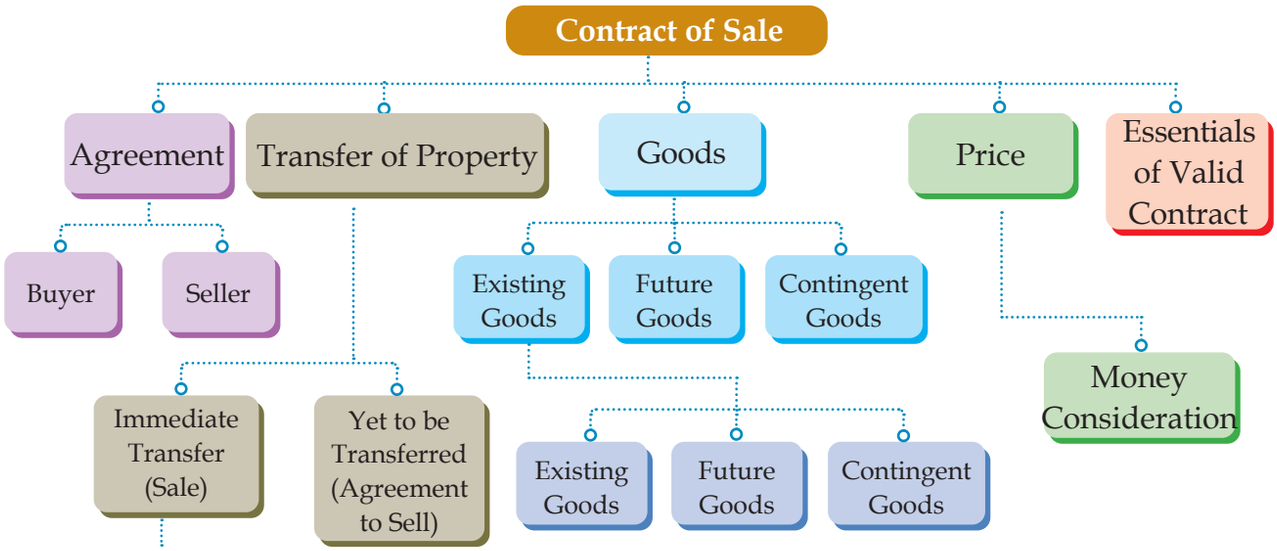
CHAPTER

03 The Sale of Goods Act, 1930

UNIT 01 FORMATION OF THE CONTRACT OF SALE

TABLE OF CONTENTS FOR THE CHAPTER

INTRODUCTION	149
SCOPE OF THE ACT	150
DEFINITIONS	150
SALE AND AGREEMENT TO SELL (SECTION 4)	155
DISTINCTION BETWEEN SALE AND AN AGREEMENT TO SELL	156
SALE DISTINGUISHED FROM OTHER SIMILAR CONTRACTS	157
CONTRACT OF SALE HOW MADE (SECTION 5)	159
SUBJECT MATTER OF CONTRACT OF SALE	159
ASCERTAINMENT OF PRICE (SECTION 9 & 10)	160



INTRODUCTION

- The Sale of Goods Act, 1930 deals with the laws relating to sale of goods in India. Before the Sale of Goods Act, 1930, all the provisions relating to sale of goods was covered under the Chapter VII of Indian Contract Act, 1872. A strong need was felt to have an independent Sale

of Goods Act and consequently a new act called the Sale of Goods Act, 1930 was passed. The Act came into force from **1st July 1930** and extends to **whole of India**.

- Sale is a typical bargain between the buyer and the seller. Sale of Goods Act, 1930 is an Act to **define and amend** the **law** relating to the **sale of goods.**

SCOPE OF THE ACT

- The provisions of the Act are applicable to the contracts related to the sale of goods which means movable properties. The Act is not applicable for the sale of immovable properties like land, fields, shop or house etc. For immovable property, Transfer of Property Act, 1882 is applicable. Sale of Goods Act, 1930 deals only with movable property.
- The general provisions of the Indian Contract Act, 1872 apply to a Contract of Sale of Goods as far as they are not inconsistent with the express provisions of the Sale of Goods Act.
- The customs and usages will bind both the parties if these are reasonable and are known to the parties at the time of entering the contract of sale.

DEFINITIONS

The Sale of Goods Act, 1930 defines the terms which have been frequently used in the Act, which are as follows:

A. Buyer and Seller

'Buyer' means a person who **buys or agrees to buy goods** [Section 2(1)].

'Seller' means a person who **sells or agrees to sell goods** [Section 2(13)]. The two terms, 'buyer' and 'seller' are complementary and represent the two parties to a contract of sale of goods. Both the terms are, however, used in a sense wider than their common meaning. Not only the person who buys but also the one who agrees to buy is a buyer. Similarly, a 'seller' means not only a person who sells but also a person who agrees to sell.

B. Goods and other Related Terms

Goods
Means every kind of movable property

Other than
Actionable claims
Money in circulation

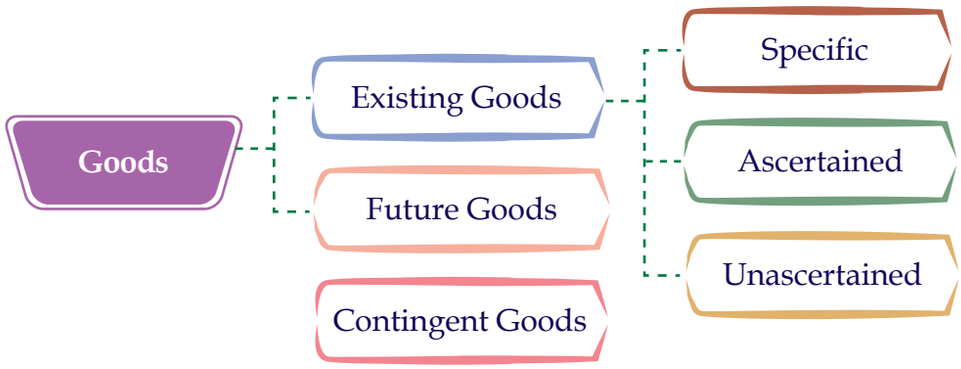
Also includes
Stock & Shares
Growing crops
Grass, and
Things attached to or forming part of land which agreed to be severed

"Goods" means **every kind of movable property other than actionable claims and money;** and **includes stock and shares, growing crops, grass, and things attached** to or forming part of the land, which are agreed to be **severed/ separated** from the land **before sale** or **under the contract of sale**. [Section 2(7)]

'Actionable claims' are claims, which can be **enforced** only by an **action or suit,** e.g., debt. A **debt** is **not** a **movable property or goods**. Even the Fixed Deposit Receipts **(FDR) are considered as goods** under Section 176 of the Indian Contract Act read with Section 2(7) of the Sales of Goods Act.

"Goods" **include both tangible** goods and **intangible** goods like goodwill, copyrights, patents, trademarks etc. Stock and shares, gas, steam, water, electricity and decree of the court are also considered to be goods.

Classification of goods



(i) Existing goods

Are such goods which are **in existence at the time** of the contract of **sale**, i.e., those owned or possessed or acquired by the seller at the time of contract of sale (Section 6).

The existing goods may be of following kinds:

(a) **Specific goods mean** goods **identified and agreed** upon **at** the time a contract of **sale** is made [Section 2(14)].

Example 1:

Any specified and finally decided goods like a Samsung Galaxy S7 Edge, Whirlpool washing machine of 7 kg etc.

Example 2:

'A' had five cars of different models. He agreed to sell his 'Santro' car to 'B' and 'B' agreed to purchase the same 'Santro' car. In this case, the sale is for specific goods as the car has been identified and agreed at the time of the contract of sale.

(b) **Ascertained Goods** are those goods which are identified **in accordance** with the **agreement after the contract** of sale **is made.** This term is not defined in the Act but has been judicially interpreted. In actual practice, the term 'ascertained goods' is used in the same sense as 'specific goods.' When **out of a lot** or out of large quantity **of unascertained** goods, the **number** or quantity contracted for is **identified**, such identified goods are **called ascertained goods.**

Example 3:

A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside. On selection, the goods become ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract. It may be noted that before the ascertainment of the goods, the contract was for the sale of unascertained goods.

(c) **Unascertained goods** are the goods which are **not specifically identified** or ascertained at the **time of making of the contract.** They are **indicated** or defined **only by description or sample.**

Example 4:

If A agrees to sell to B one packet of salt out of the lot of one hundred packets lying in his shop, it is a sale of unascertained goods because it is not known which packet is to be delivered. As soon as a particular packet is separated from the lot, it becomes ascertained or specific goods.

Example 5:

X has ten horses. He promises to sell one of them but does not specify which horse he will sell. It is a contract of sale of unascertained goods.

(ii) Future goods

Means goods **to be manufactured or produced or acquired** by the seller **after** making the contract of sale [Section 2(6)].

A contract for the sale of future goods is **always an agreement to sell**. It is never actual sale because a person cannot transfer what is not in existence.

Example 6:

1,000 quintals of potatoes to be grown on A's field is an example of agreement to sell.

Example 7:

P agrees to sell to Q all the milk that his cow may yield during the coming year. This is a contract for the sale of future goods.

Example 8:

T agrees to sell to S all the oranges which will be produced in his garden this year. It is contract of sale of future goods, amounting to 'an agreement to sell.

(iii) Contingent goods

The acquisition of goods which depends upon an **uncertain contingency** (uncertain event) are called 'contingent goods' [Section 6(2)].

Contingent goods also operate as **'an agreement to sell'** and not a 'sale' so far as the question of passing of property to the buyer is concerned. In other words, like the future goods, in the case of contingent goods also, the **property does not pass** to the buyer **at the time of making the contract.**

Example 9:

A agrees to sell to B a Picasso painting provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

Example 10:

P contracts to sell 50 pieces of particular article provided the ship which is bringing them reaches the port safely. This is an agreement for the sale of contingent goods.

C. Delivery – Its Forms and Derivatives

Delivery means **voluntary transfer** of **possession** from **one** person **to another** [Section 2(2)]. As a general rule, delivery of goods may be made by **doing anything,** which has the **effect of putting** the goods in the **possession of** the **buyer, or** any **person authorized** to hold them on his behalf.

Forms of delivery: Following are the kinds of delivery for transfer of possession:

Delivery of Goods

Voluntary transfer of possession by one person to another

Actual delivery	Constructive delivery	Symbolic delivery

(i) Actual delivery

When the goods are **physically delivered** to the buyer. Actual delivery takes place when the seller transfers the **physical possession** of the goods to the **buyer** or to a **third person authorised** to hold goods on behalf of the buyer. This is the most common method of delivery.

(ii) Constructive delivery

When transfer of goods is effected **without any change** in the **custody** or **actual possession** of the thing as in the case of **delivery by attornment (acknowledgement)**

Example 11:

Where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request.

Constructive delivery takes place when a **person in possession** of the goods belonging to the seller **acknowledges to the buyer** that he **holds** the goods on **buyer's behalf.**

(iii) Symbolic delivery

When there is a delivery of a **thing in token** of a **transfer** of **something else**, i.e., delivery of goods in the course of transit may be made by **handing over documents of title** to goods, like bill of lading or railway receipt or delivery orders or the key of a warehouse containing the goods is handed over to buyer. Where **actual delivery is not possible,** there may be **delivery** of the **means** of getting possession of the goods.

Goods are said to be in a deliverable state when they are in such a condition that the buyer would, under the contract, be bound to take delivery of them [Section 2(3)].

Example 12:

When A contracts to sell timber and make bundles thereof, the goods will be in a deliverable state after A has put the goods in such a condition.

D. Document of Title to Goods

Includes bill of lading, dock-warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt, multimodal transport document, warrant or order for the delivery of goods and any other document used in the ordinary course of business as **proof of the possession** or control of goods or is for authorizing or purporting to authorize, **either by endorsement or by delivery**, the possessor of the document to transfer or receive goods thereby represented. [Section 2(4)]

Example 13:

Bill of lading, dock warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, warrant, an order of delivery of goods.

The list is only illustrative and not exhaustive. Any other document which has the above characteristics also will fall under the same category. Though a bill of lading is a document of title, a mate's receipt is not; it is regarded at law as merely an acknowledgement for the receipt of goods. A document amounts to a document of title only where it shows an **unconditional undertaking** to **deliver** the goods to the **holder** of the document.

However, there is a **difference** between a **'document showing title'** and **'document of title'.** A **share certificate** is a 'document' **showing title** but not a document of title. It merely **shows** that the **person named** in the share certificate is **entitled** to the **share represented** by it, but it **does not allow** that person to **transfer** the share mentioned therein **by mere endorsement** on the back of the certificate **and the delivery** of the certificate.

E. Mercantile Agent [Section 2(9)]

It means an agent who in the customary course of business has, as such agent, authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of the goods. Mercantile agent can borrow money by pledging the goods.

Example 14:

Such kind of agents are auctioneers or brokers, etc.

F. Property [Section 2(11)]

'Property' here means 'ownership' or general property. In every contract of sale, the ownership of goods must be transferred by the seller to the buyer, or there should be an agreement by the seller to transfer the ownership to the buyer. It means the general property (right of ownership-in-goods) and not merely a special property.

The property in the goods means the general property i.e., all ownership right of the goods. Note that the 'general property' in goods is to be distinguished from a 'special property'. It is quite possible that the general property in a thing may be in one person and a special property in the same thing may be in another e.g., when an article is pledged, the special property gets transferred and not the general property. The general property in a thing may be transferred, subject to the special property continuing to remain with another person i.e., the pledgee who has a right to retain the goods pledged till payment of the stipulated dues.

Example 15:

If A who owns certain goods pledges them to B, A has general property in the goods, whereas B has special property or interest in the goods to the extent of the amount of advance he has made. In case A fails to repay the amount borrowed on pledging the goods, then B may sell his goods but not otherwise.

G. Insolvent [Section 2(8)]

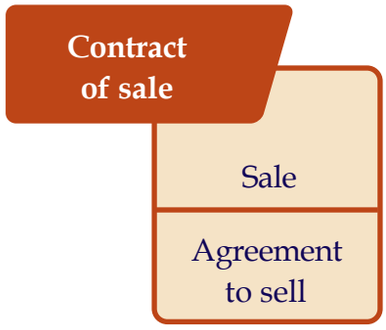
A person is said to be insolvent when he ceases to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not.

H. Price [Section 2(10)]

Price means the money consideration for a sale of goods. It is the value of goods expressed in monetary terms. It is the essential requirement to make a contract of sale of goods.

❒ SALE AND AGREEMENT TO SELL (SECTION 4)

Quality of goods includes their state or condition. [Section 2(12)]



According to section 4(1), "A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price". There may be a contract of sale between one part-owner and another.

A contract of sale may be absolute or conditional. [Section 4(2)]

Where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, it is called an agreement to sell. [Section 4(3)]

An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred. [Section 4(4)]

Sale

In Sale, the property in goods is transferred from seller to the buyer immediately. The term sale is defined in the Section 4(3) of the Sale of Goods Act, 1930 as – "where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale."

Agreement to Sell

In an agreement to sell, the ownership of the goods is not transferred immediately. It is intending to transfer at a future date upon the completion of certain conditions thereon. The term is defined in Section 4(3) of the Sale of Goods Act, 1930, as – "where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, it is called an agreement to sell."

Thus, whether a contract of sale of goods is an absolute sale or an agreement to sell, depends on the fact whether it contemplates immediate transfer from the seller to the buyer or the transfer is to take place at a future date.

Example 16:

X agrees with Y on 10th October, 2022 that he will sell his car to Y on 10th November, 2022 for a sum of ₹ 7 lakhs. It is an agreement to sell.

When Agreement to Sell Becomes Sale

An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

The **following elements must co-exist** so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930:

(i) There must be **at least two parties,** the **seller** and the **buyer** and the two must be **different persons**. A person cannot be both the seller and the buyer and sell his goods to himself.

(ii) The **subject matter** of the contract must necessarily be **goods** covering only **movable property.** It may be **either existing goods**, owned or possessed by the seller **or future** goods.

(iii) A **price in money** (**not in kind**) should be **paid or promised**. But there is **nothing** to prevent the **consideration** from being **partly in money and partly** in kind.

(iv) A **transfer** of property in goods **from seller to the buyer** must take place. The contract of sale is **made by** an **offer** to buy or sell goods for a price by one party and the **acceptance** of such offer by other.

(v) A contract of sale may be **absolute or conditional.**

(vi) All **other essential elements** of a valid contract **must be present** in the contract of sale, e.g. free consent of parties, competency of parties, legality of object and consideration etc.

❒ DISTINCTION BETWEEN SALE AND AN AGREEMENT TO SELL

The differences between the two are as follows:

Basis of Difference	Sale	Agreement to Sell
Transfer of property	The property in the goods passes to the buyer immediately.	Property in the goods passes to the buyer on future date or on fulfilment of some condition.
Nature of contract	It is an executed contract i.e. contract for which consideration has been paid.	It is an executory contract i.e. contract for which consideration is to be paid at a future date.
Remedies for breach	The seller can sue the buyer for the price of the goods because of the passing of the property therein to the buyer.	The aggrieved party can sue for damages only and not for the price, unless the price was payable at a stated date.
Liability of parties	A subsequent loss or destruction of the goods is the liability of the buyer.	Such loss or destruction is the liability of the seller.
Burden of risk	Risk of loss is that of buyer since risk follows ownership.	Risk of loss is that of seller.

Nature of rights	Creates Jus in rem means right against the whole world.	Creates Jus in personam means rights against a particular party to the contract
Right of resale	The seller cannot resell the goods.	The seller may sell the goods since ownership is with the seller.
In case of insolvency of seller	The official assignee will not be able to take over the goods but will recover the price from the buyer.	The official assignee will acquire control over the goods but the price will not be recoverable.
In case of insolvency of buyer	The official assignee will have control over the goods.	The official assignee will not have any control over the goods.

❒ SALE DISTINGUISHED FROM OTHER SIMILAR CONTRACTS

I. Sale and Hire Purchase

Contract of sale resembles with contracts of hire purchase very closely, and indeed the real object of a contract of hire purchase is the sale of the goods ultimately.

Hire purchase agreements are governed by the Hire-purchase Act, 1972. Term "hire purchase agreement" means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which –

(a) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and

(b) The property in the goods is to pass to such person on the payment of the last of such instalments, and

(c) Such person has a right to terminate the agreement at any time before the property so passes;

Nonetheless, a sale has to be distinguished from a hire purchase as their legal incidents are quite different.

The main points of distinction between the 'sale' and 'hire-purchase' are as follows:

Basis of Difference	Sale	Hire-Purchase
Time of passing property	Property in the goods is transferred to the buyer immediately at the time of contract.	The property in goods passes to the hirer upon payment of the last instalment.
Position of the party	The position of the buyer is that of the owner of the goods.	The position of the hirer is that of a bailee till he pays the last instalment.

Termination of contract	The buyer cannot terminate the contract and is bound to pay the price of the goods.	The hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining instalments.
Burden of Risk of insolvency of the buyer	The seller takes the risk of any loss resulting from the insolvency of the buyer.	The owner takes no such risk, for if the hirer fails to pay an instalment, the owner has right to take back the goods.
Transfer of title	The buyer can pass a good title to a bona fide purchaser from him.	The hirer cannot pass any title even to a bona fide purchaser until he pays the last instalment.
Resale	The buyer in sale can resell the goods.	The hire purchaser cannot resell unless he has paid all the instalments.

II. Sale and Bailment

A 'bailment' is the delivery of goods for some specific purpose under a contract on the condition that the same goods are to be returned when the purpose is accomplished to the bailor or are to be disposed of according to the directions of the bailor. Provisions related to bailment are regulated by the Indian Contract Act, 1872.

The difference between bailment and sale may be clearly understood by studying the following:

Basis of Difference	Sale	Bailment
Transfer of property	The property in goods is transferred from the seller to the buyer. So, it is transfer of general property.	There is only transfer of possession of goods from the bailor to the bailee for any of the reasons like safe custody, carriage etc. So, it is transfer of special property.
Return of goods	The return of goods in contract of sale is not possible.	The bailee must return the goods to the bailor on the accomplishment of the purpose for which the bailment was made.
Consideration	The consideration is the price in terms of money.	The consideration may be gratuitous or non-gratuitous.

III. Sale and Contract for Work and Labour

A contract of sale of goods is one in which some goods are sold or are to be sold for a price. But where no goods are sold, and there is only the doing or rendering of some work of labour, then the contract is only of work and labour and not of sale of goods.

Example 17:

Where gold is supplied to a goldsmith for preparing an ornament or when an artist is asked to paint a picture. Here, the basic substance of the contract is the exercise of skill and labour, therefore it is contract for work and labour.

❒ CONTRACT OF SALE HOW MADE (SECTION 5)

According to Section 5(1), A contract of sale may be made in any of the following modes:

(i) Contract of sale is made by an **offer to buy or sell goods** for **a price and acceptance** of such offer.

(ii) There may be **immediate delivery** of the goods; or

(iii) There may be **immediate payment** of price, but it may be agreed that the **delivery** is to be made at **some future date**; or

(iv) There may be **immediate delivery** of the goods and an **immediate payment** of price; or

(v) It may be agreed that the **delivery or payment** or both are to be made in **instalments**; or

(vi) It may be agreed that the **delivery or payment** or both are to be made at **some future date.**

Example 18:

R agrees to deliver his old motorcycle valued at ₹ 55,000 to S in exchange for a new motorcycle and agrees to pay the difference in cash, it is a Contract of Sale

❒ SUBJECT MATTER OF CONTRACT OF SALE

Existing or Future Goods (Section 6)

1. The goods **which form** the subject matter of a contract of sale may be **either existing goods** that are acquired, owned or possessed by the seller, or **future goods.**
2. There may be a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen.

Example 19:

A contracts for sale of certain cloth to be manufactured by a certain mill is a valid contract. Such contacts are called contingent contracts.

3. There may be a contract of sale, where the seller purports to effect a present sale of future goods, such contract operates as an agreement to sell the goods.

Goods Perishing before Making of Contract (Section 7)

Where there is a contract for the **sale of specific goods**, the contract is **void** if the **goods without** the **knowledge of the seller** have, at the **time** when the contract was **made**, **perished** or become so **damaged** that they **no longer answer** to their **description given** in the contract.

Example 20:

A agrees to sell B 50 bags of wheat stored in the A's godown. Due to water logging, all the goods stored in the godown were destroyed. At the time of agreement, neither parties were aware of the fact. The agreement is void.

Goods Perishing before Sale but After Agreement to Sell (Section 8)

Where there is an **agreement to sell specific goods,** and **subsequently the goods without any fault** on the **part of the seller or buyer perish or become so damaged** that they **no longer answer** to their **description** in the agreement before the **risk passes** to the buyer, the agreement is thereby **avoided** or becomes **void**.

Perishing of Future Goods

If the future goods are **specific, the destruction of such goods** will amount to **supervening impossibility** and the contract shall become **void**.

Example 21:

A agrees to sell B 100 tons of tomatoes grown on his land next year. But the crop failed due to some disease in plants and A could only deliver 80 tons of tomatoes to B. It was held A was not liable as the performance of contract became impossible due to supervening impossibility.

❒ ASCERTAINMENT OF PRICE (SECTION 9 & 10)

Ascertainment of Price (Section 9)

'Price' means the **monetary consideration** for sale of **goods** [Section 2 (10)]. By virtue of Section 9, the price in the contract of sale may be-

1. **fixed by the contract**, or
2. agreed to be **fixed in a manner** provided by the **contract**, e.g., by a valuer, or
3. **determined** by the **course of dealings** between the parties.

Agreement to Sell at Valuation (Section 10)

Section 10 provides for the determination of price by a third party.

1. Where there is an **agreement to sell goods** on the terms that **price** has to be **fixed by the third party** and he **either does not or cannot make such valuation,** the agreement will be **void**.
2. In case the third party is **prevented by the default of either party** from fixing the price, the **party** at **fault** will be **liable to the damages** to the **other party** who is **not at fault.**
3. However, a **buyer** who has **received and appropriated** the goods must pay a **reasonable price** for them in any eventuality.

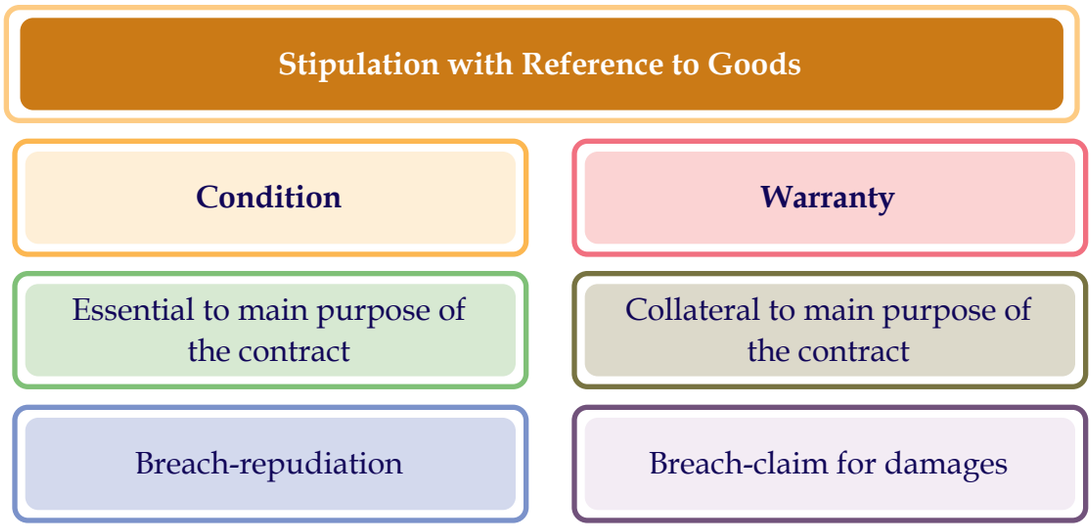
Example 22:

P is having two bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price. As such P ask S to return the bike already delivered while S claims for the delivery of the second bike too. In the given instance, buyer S shall pay reasonable price to P for the bike already taken. As regards the Second bike, the contract can be avoided as the third party Q refuses to fix the price.

UNIT 02 CONDITIONS & WARRANTIES

TABLE OF THE CONTENTS FOR THE CHAPTER

- STIPULATION AS TO TIME (SECTION 11) 161
- INTRODUCTION - CONDITIONS AND WARRANTIES 161
- WHEN CONDITION IS TO BE TREATED AS WARRANTY (SECTION 13) 163
- EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES (SECTION 14-17) 164
- CAVEAT EMPTOR 169



STIPULATION AS TO TIME (SECTION 11)

As regard to time for the payment of price, unless a different intention appears from the terms of contract, stipulation as regard this, is not deemed to be of the essence of a contract of sale. But delivery of goods must be made without delay. Whether or not such a stipulation is of the essence of a contract depends on the terms agreed upon.

Price for goods may be fixed by the contract or may be agreed to be fixed later on in a specific manner. Stipulation as to time of delivery are **usually** the **essence** of the contract.

INTRODUCTION - CONDITIONS AND WARRANTIES

At the time of selling the goods, a **seller** usually makes certain **statements** or representations with a view to **induce the intending buyer to purchase** the goods. Such representations are generally about the nature and quality of goods, and about their fitness for buyer's purpose.

When these statements or representations do not **form a part of the contract** of sale, they are not relevant and have no legal effects on the contract. But when these form part of the contract of sale and the buyer relies upon them, they are relevant and have legal effects on the contract of sale.

A representation which forms a part of the contract of sale and affects the contract, is called a stipulation. However, every stipulation is not of equal importance. Some of these may be very vital while others may be of somewhat lesser significance. The more significant stipulations contained in a contract of sale of goods have been called as "Conditions", while the less significant stipulation have been given the name "Warranties".

Condition and Warranty (Section 12)

A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty. [Sub-section (1)]

"A **condition** is a stipulation **essential to the main purpose** of the contract, the **breach** of which gives rise to a right to **treat the contract as repudiated**". [Sub-section (2)]

Example 1:

P wants to purchase a car from Q, which can have a mileage of 20 km/litre. Q pointing at a particular vehicle says "This car will suit you." Later P buys the car but finds out later on that this car only has a top mileage of 15 km/ litre. This amounts to a breach of condition because the seller made the stipulation which forms the essence of the contract. In this case, the mileage was a stipulation that was essential to the main purpose of the contract and hence its breach is a breach of condition.

"A **warranty** is a **stipulation collateral to the main purpose of the contract**, the **breach** of which gives rise to a claim for damages but not to a right to reject the goods and **treat the contract as repudiated**". [Sub-section (3)].

Whether a stipulation in a contract of sale is a condition or a warranty **depends** in each case on the **construction** of the contract. A stipulation **may be a condition**, though **called a warranty** in the contract. [Sub-section (4)]

Example 2:

Ram consults Shyam, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Shyam suggests 'Maruti' and Ram accordingly buys it from Shyam. The car turns out to be unfit for touring purposes. Here, the term that the 'car should be suitable for touring purposes' is a condition of the contract. It is so vital that its non fulfilment defeats the very purpose for which Ram purchases the car. Ram is therefore entitled to reject the car and have refund of the price.

Let us assume, Ram buys a new Maruti car from the show room and the car is guaranteed against any manufacturing defect under normal usage for a period of one year from the date of original purchase and in the event of any manufacturing defect there is a warranty for replacement of defective part if it cannot be properly repaired. After six months, Ram finds that the horn of the car is not working, here in this case he cannot terminate the contract. The manufacturer can either get it repaired or replaced it with a new horn. Ram gets a right to claim for damages, if any, suffered by him but not the right of repudiation.

Difference between Conditions and Warranties

The following are important differences between conditions and warranties.

Point of Differences	Condition	Warranty
Meaning	A condition is a stipulation essential to the main purpose of the contract.	A warranty is a stipulation collateral to the main purpose of the contract.

Right in case of breach	The aggrieved party can repudiate the contract or claim damages or both in the case of breach of condition.	The aggrieved party can claim only damages in case of breach of warranty.
Conversion of stipulations	A breach of condition may be treated as a breach of warranty.	A breach of warranty cannot be treated as a breach of condition.

❒ WHEN CONDITION IS TO BE TREATED AS WARRANTY (SECTION 13)

Section 13 specifies cases where a breach of condition be treated as a breach of warranty. As a result of which the buyer loses his right to rescind the contract and **can claim damages only.**

In the following cases, a contract is **not avoided** even on account of a **breach** of a condition:

(i) Where the buyer **altogether waives** the **performance** of the condition. A **party may** for his **own benefit, waive** a stipulation. It should be a **voluntary waiver** by buyer.

(ii) Where the buyer **elects to treat the breach** of the conditions, as **one of a warranty**. That is to say, he may **claim only damages** instead of repudiating the contract. Here, the buyer has not waived the condition but **decided to treat it as a warranty**.

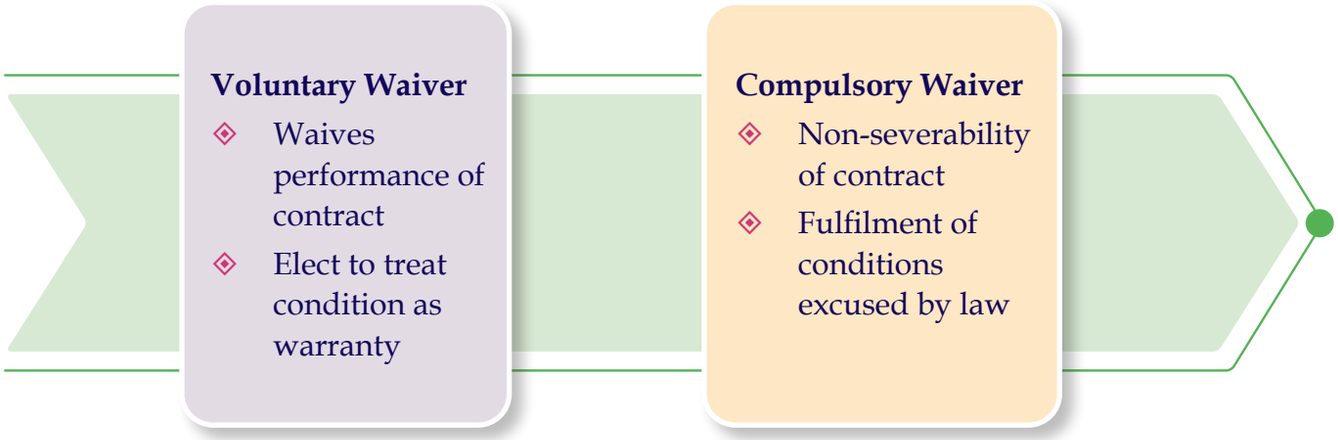
Example 3:

A agrees to supply B 10 bags of first quality sugar @ ₹ 625 per bag but supplies only second quality sugar, the price of which is ₹ 600 per bag. There is a breach of condition and the buyer can reject the goods. But if the buyer so elects, he may treat it as a breach of warranty, hence he may accept the second quality sugar and claim damages @ ₹ 25 per bag.

(iii) Where the contract is **non-severable** and the buyer has **accepted either the whole** goods or any **part thereof**. For Eg. If basmati rice and lower quality rice mixed together, the contract becomes non severable.

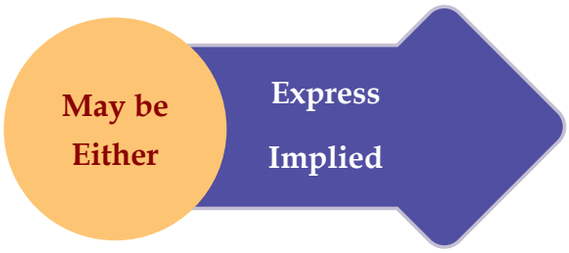
(iv) Where the **fulfilment** of any **condition or warranty** is **excused by law** by reason of **impossibility or otherwise**.

Waiver of conditions



❒ EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES (SECTION 14-17)

Condition and Warranty



'Conditions' and 'Warranties' may be **either express or implied**. They are "express" when the terms of the contract expressly state them. They are implied when, not being expressly provided for. Implied conditions are incorporated by law in the contract of sale.

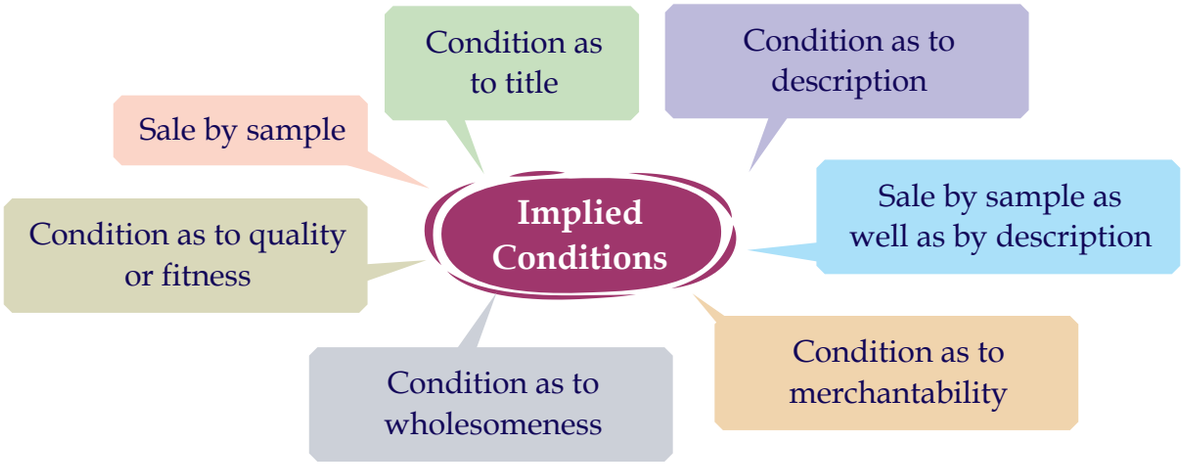
Express Conditions

are those, which **are agreed upon between the parties at** the time of contract and are expressly provided in the contract.

Implied Conditions

on the other hand, are those, which **are presumed by law to be present** in the contract. It should be noted that an implied condition may be negated or waived by an express agreement.

Following conditions are implied in a contract of sale of goods unless the circumstances of the contract show a different intention.



(i) Condition as to title [Section 14(a)]

In every contract of sale, unless there is an agreement to the contrary, the first implied condition on the part of the seller is that

(a) in case of a **sale**, he has a **right to sell the goods**, and

(b) in the case of an **agreement to sell,** he will have the **right to sell the goods** at the time when the property is to pass.

In simple words, the condition implied is that the seller has the right to sell the goods (means he should be the real owner) at the time when the property is to pass. If the **seller's title/ownership**

turns out to be defective, the buyer must return the goods to the **true owner** and **recover the price** from the seller.

Example 4:

A purchased a tractor from B who had no title to it. After 2 months, the true owner spotted the tractor and demanded it from A. Held that A was bound to hand over the tractor to its true owner and that A could sue B, the seller without title, for the recovery of the purchase price.

Example 5:

If A sells to B tins of condensed milk labelled 'C.D.F. brand', and this is proved to be an infringement of N Company's trade mark, it will be a breach of implied condition that A had the right to sell. B in such a case will be entitled to reject the goods or take off the labels, and claim damages for the reduced value. If the seller has no title and the buyer has to make over the goods to the true owner, he will be entitled to refund of the price.

(ii) Sale by description [Section 15]

Where there is a contract of sale of goods by description, there is an **implied condition** that the goods shall **correspond** with the **description**. This rule is based on the **principle** that "if you **contract to sell peas**, you **cannot compel** the buyer to **take beans**." The **buyer is not bound to accept and pay** for the goods which are **not in accordance** with the **description of goods.**

Thus, it has to be determined whether the buyer has undertaken to purchase the goods by their description, i.e., whether the description was essential for identifying the goods where the buyer had agreed to purchase. If that is required and the **goods** tendered **do not correspond** with the **description**, it would be **breach** of **condition** entitling the buyer to **reject** the goods.

It is a condition which goes to the root of the contract and the **breach** of it entitles the buyer **to reject** the goods **whether** the **buyer** is able to **inspect them or not.**

Example 6:

A at Kolkata sells to B twelve bags of "waste silk" on its way from Murshidabad to Kolkata. There is an implied condition that the silk shall be such as is known in the market as "Waste Silk". If it not, B is entitled to reject the goods.

Example 7:

A ship was contracted to be sold as "copper-fastened vessel" but actually it was only partly copper-fastened. Held that goods did not correspond to description and hence could be returned or if buyer took the goods, he could claim damages for breach.

The Act, however, does not define 'description'.

(i) where the class or kind to which the goods belong has been specified, e.g., 'Egyptian cotton', "java sugar", etc., defining the category of good

(ii) where the goods have been described by certain characteristics essential to their identification, e.g., jute bales of specified shipment, steel of specific dimension, etc.

It may be noted that the description in these cases assumes that form of a statement or representation as regards the identity of particular goods by reference to the place of origin or mode of packing, etc. Whether or not such a statement or representation is essential to the identity of the goods is a question of fact depending, in each case, on the construction of the contract.

(iii) Sale by sample [Section 17]

In a contract of sale by sample, there is an implied condition that

(a) the **bulk shall correspond** with the **sample in quality**;

(b) the **buyer** shall have a **reasonable opportunity** of comparing the **bulk with the sample,**

Example 8:

In a case of sale by sample of two parcels of wheat, the seller allowed the buyer an inspection of the smaller parcel but not of the larger parcel. In this case, it was held that the buyer was entitled to refuse to take the parcels of wheat.

(c) the **goods** shall be **free from** any **defect** rendering them **un-merchantable**, which would **not** be **apparent** on **reasonable examination** of the sample. This condition is applicable only with regard to defects, which could not be discovered by an ordinary examination of the goods. If the **defects are latent,** then the **buyer can avoid** the contract. This simply means that the goods shall be **free** from any latent defect i.e. a **hidden defect.**

Example 9:

A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of the price plus damages.

(iv) Sale by sample as well as by description [Section 15]

Where the goods are sold by sample as well as by description the implied condition is that the **bulk** of the goods supplied shall **correspond both with the sample** and the description. In case the goods correspond with the sample but **do not tally** with **description** or **vice versa** or both, the **buyer can repudiate** the contract.

Example 10:

A agreed with B to sell certain oil described as refined sunflower oil, warranted only equal to sample. The goods tendered were equal to sample but contained a mixture of hemp oil along with sunflower oil. Hence, B can reject the goods because the goods were as per sample but do not correspond to the description.

(v) Condition as to quality or fitness [Section 16(1)]

Ordinarily, there is no implied condition as to the quality or fitness of the goods sold for any particular purpose.

However, the condition as to the reasonable fitness of goods for a particular purpose may be **implied** if the buyer had made known to the seller the purpose of his purchase and relied upon the skill and judgment of the seller to select the best goods and the seller has ordinarily been dealing in those goods. This implied condition will not apply if the goods have been sold under a trademark or a patent name.

There is **implied** condition of the part of the seller that the goods supplied shall be reasonably fit for the purpose for which the buyer wants them, provided the **following conditions** are fulfilled:

(a) The buyer should have made **known** to the **seller the particular purpose** for which goods are **required**.

(b) The buyer should **rely on the skill and judgement** of the seller.

(c) The goods must be of a **description dealt** in by the **seller, whether** he be a **manufacturer or not.**

In some cases, the purpose may be ascertained from the conduct of the parties or form the nature of the goods sold. Where the goods can be used for only one purpose, the buyer need not tell the seller the purpose for which he requires the goods.

Example 11:

'A' bought a set of false teeth from 'B', a dentist. But the set was not fit for 'A's mouth. 'A' rejected the set of teeth and claimed the refund of price. It was held that 'A' was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled.

Example 12:

'A' went to 'B's shop and asked for a 'Merrit' sewing machine. 'B' gave 'A' the same and 'A' paid the price. 'A' relied on the trade name of the machine rather than on the skill and judgement of the seller 'B'. In this case, there is no implied condition as to fitness of the machine for buyer's particular purpose.

As a general rule, it is the **duty of the buyer** to **examine** the goods **thoroughly before** he **buys** them in order to satisfy himself that the goods will be **suitable for his purpose** for which he is buying them. This is known as **rule of caveat emptor** which means "**Let the buyer beware**".

(vi) Condition as to merchantability [Section 16(2)]

Where goods are **bought by description** from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an **implied condition** that the goods shall be of **merchantable quality**.

There are **two requirements** for this condition to apply:

(a) Goods should be **bought by description.**

(b) The **seller** should be a **dealer in goods o**f that description.

Provided that, if the **buyer has examined the goods,** there shall be **no implied condition as regards** defects which such examination **ought to have revealed.**

The expression "merchantable quality", though not defined, nevertheless connotes goods of **such a quality and in such a condition** a man of **ordinary prudence** would **accept** them as goods of that description. It does not imply any legal right or legal title to sell.

Example 13:

If a person orders motor horns from a manufacturer of horns, and the horns supplied are scratched and damaged owing to bad packing, he is entitled to reject them as unmerchantable.

Example 14:

A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

(vii) Condition as to wholesomenes

In the case of **eatables and provisions,** in addition to the implied condition as to merchantability, there is **another implied condition** that the goods shall be **wholesome**.

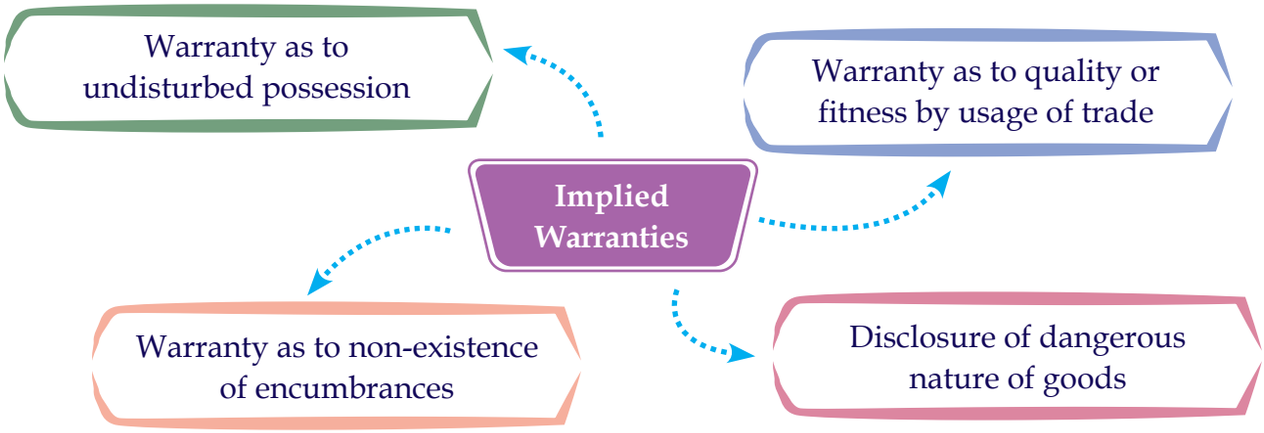
Example 15:

A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

Implied Warranties

It is a **warranty** which the **law implies** into the contract of **sale**. In other words, it is the stipulation which has not been included in the contract of sale in express words. But the law **presumes** that the **parties** have **incorporated** it into their contract. It will be interesting to know that implied warranties are read into every contract of sale **unless they are expressly excluded** by the express agreement of the parties.

These may also be excluded by the course of dealings between the parties or by usage of trade (Section 62).



The examination of Sections 14 and 16 of the Sale of Goods Act, 1930 discloses the following implied warranties:

1. Warranty as to undisturbed possession [Section 14(b)]

An implied warranty that the **buyer** shall have and **enjoy quiet possession of the goods**. That is to say, if the buyer having got **possession** of the goods, is **later on disturbed** in his possession, he is entitled to **sue the seller** for the **breach** of the warranty.

Example 16:

X buys a laptop from Y. After the purchase, X spends some money on its repair and uses it for some time. Unknown to the parties, it turns out that the laptop was stolen and was taken from X and delivered to its rightful owner. Y shall be held responsible for a breach and X is entitled to damages of not only the price but also the cost of repairs.

2. Warranty as to non-existence of encumbrances [Section 14(c)]

An implied warranty that the goods shall be **free from any charge or encumbrance** in favour of any **third party not declared or known to the buyer before** or at the **time the contract** is entered into.

Example 17:

A pledges his car with C for a loan of ₹ 15,0000 and promises him to give its possession the next day. A, then sells the car immediately to B, who purchased it on good faith, without knowing the fact. B, may either ask A to clear the loan or himself may pay the money and then, file a suit against A for recovery of the money with interest.

3. Warranty as to quality or fitness by usage of trade [Section 16(3)]

An implied warranty as to **quality or fitness** for a **particular purpose** may be **annexed** or **attached** by the **usage of trade.**

Regarding implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied, the rule is **'let the buyer beware'** i.e., the **seller** is under **no duty to reveal unflattering truths** about the **goods** sold, but this rule has certain **exceptions**.

4. Disclosure of dangerous nature of goods

Where the **goods are dangerous** in **nature** and the **buyer is ignorant** of the danger, the **seller** must **warn** the buyer of the **probable danger**. If there is a breach of warranty, the seller **may be liable in damages.**

❒ CAVEAT EMPTOR

In case of sale of goods, the doctrine 'Caveat Emptor' **means 'let the buyer beware'.** When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. If the goods turn out to be defective, he cannot hold the seller liable. The **seller is in no way responsible** for the **bad selection** of the buyer. The seller is **not bound to disclose the defects** in the goods which he is selling.

It is the **duty of the buyer** to **satisfy himself before buying** the goods that the goods will serve the purpose for which they are being bought. If the goods turn out to be **defective** or **do not serve his purpose** or if he **depends** on **his own skill or judgment, the buyer cannot hold the seller responsible.**

The rule of Caveat Emptor is laid down in the Section 16, which states that, "subject to the provisions of this Act or of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale".

Following are the conditions to be satisfied:

- if the buyer had made known to the seller the purpose of his purchase, and

- the buyer relied on the seller's skill and judgement, and
- seller's business to supply goods of that description (Section 16).

Example 18:

A sold pigs to B. These pigs being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy. The rule of the law being "Caveat Emptor".

Example 19:

A purchases a horse from B. A needed the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the carriage. Caveat emptor rule applies here and so A can neither reject the horse nor can claim compensation from B.

Exceptions

The doctrine of Caveat Emptor is, however, subject to the following exceptions:

1. Fitness as to quality or use

Where the **buyer makes known** to the **seller** the particular **purpose** for which the **goods** are **required**, so as to **show** that he **relies** on the **seller's skill or judgment** and the **goods are of a description** which is in the **course of seller's business** to supply, it is the **duty** of **the seller to supply** such goods as are **reasonably fit** for **that purpose** [Section 16 (1)].

Example 20:

An order was placed for some trucks to be used for heavy traffic in a hilly country. The trucks supplied by the seller were unfit for this purpose and broke down. There is a breach of condition as to fitness.

Case Law: Priest vs. Last

Facts: In Priest vs. Last, P, a draper, purchased a hot water bottle from a retail chemist, P asked the chemist if it would stand boiling water. The Chemist told him that the bottle was meant to hold hot water. The bottle burst when hot water was poured into it and injured his wife. It was held that the chemist shall be liable to pay damages to P, as he knew that the bottle was purchased for the purpose of being used as a hot water bottle.

Where the article can be used for only one particular purpose, the buyer need not tell the seller the purpose for which he required the goods. But where the article can be used for a number of purposes, the buyer should tell the seller the purpose for which he requires the goods, if he wants to make the seller responsible.

Case Laws: Bombay Burma Trading Corporation Ltd.

Facts: In Bombay Burma Trading Corporation Ltd. vs. Aga Muhammad, timber was purchased for the express purpose of using it as railways sleepers and when it was found to be unfit for the purpose, the Court held that the contract could be avoided.

2. Goods purchased under patent or brand name

In case where the **goods are purchased** under its **patent name or brand name,** there is **no implied condition** that the goods shall be **fit for any particular purpose** [Section 16(1)]. Here, the buyer is **relying on the particular brand name.**

3. Goods sold by description

Where the goods are sold by description there is an implied condition that the **goods shall correspond with the description** [Section 15]. **If it is not so, then seller is responsible.**

4. Goods of merchantable quality

Where the goods are bought by description from a seller who deals in goods of that description there is an implied condition that the goods shall be of merchantable quality. The rule of Caveat Emptor is not applicable for latent defects. But where the **buyer has examined the goods,** this **rule shall apply** if the **defects** were such which **ought to have not been revealed by ordinary examination** [Section 16(2)].

5. Sale by sample

Where the goods are bought by sample, this **rule of Caveat Emptor does not apply** if the **bulk does not correspond** with the **sample** [Section 17].

6. Goods by sample as well as description

Where the goods are bought by sample as well as description, the rule of Caveat Emptor is not applicable in case the goods do not correspond with both the sample and description or either of the condition [Section 15].

7. Trade usage

An **implied warranty or condition as to quality or fitness** for a **particular purpose** may be **annexed by the usage** of trade and if the **seller deviates** from that, this rule of **Caveat Emptor is not applicable** [Section 16(3)].

Example 21:

In readymade garment business, there is an implied condition by usage of trade that the garments shall be reasonably fit on the buyer.

8. Seller actively conceals a defect or is guilty of fraud

Where the seller **sells the goods by making some misrepresentation or fraud** and the **buyer relies** on it or when the **seller actively conceals** some **defect** in the goods so that the same **could not be discovered** by the buyer on a **reasonable examination,** then the rule of Caveat Emptor will **not apply.** In such a case the buyer has a **right to avoid the contract** and **claim damages.**

UNIT 03 TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

TABLE OF THE CONTENTS FOR THE CHAPTER

❒ INTRODUCTION	172
❒ PASSING OF PROPERTY (SECTIONS 18 – 26)	172
❒ RISK PRIMA FACIE PASSES WITH PROPERTY (SECTION 26)	177
❒ TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27 – 30)	178
❒ PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31 – 44)	181

A contract of sale of goods involves transfer of ownership in three stages:

❒ INTRODUCTION

Sale of goods involves **transfer of ownership** of property from seller to buyer. It is essential to determine the time at which the ownership passes from the seller to the buyer.

Importance of the Time of Transfer

The general rule is that **risk** prima facie **passes** with the **property**. In case where goods are **lost or damaged,** the **burden of loss** will be borne by the person who is the **owner** at the time when the goods are lost or damaged. Where the goods are **damaged** by the act of the **third party**, it is the **owner** who can **take action**. Suit for price by the seller can be filed only when the property has passed to the buyer.

❒ PASSING OF PROPERTY (SECTIONS 18 – 26)

Passing or transfer of **property** constitutes the most important element and factor to decide legal rights and liabilities of sellers and buyers. **Passing of property** implies **passing of ownership**. If the **property** has **passed to the buyer**, the **risk** in the goods sold is that of **buyer** and **not of seller**, **though** the goods may **still** be in the **seller's possession.**

The rules regarding transfer of property in goods from the seller to the buyer depend on two basic factors:

(a) **Identification of Goods:** Section 18 provides that where there is a contract of safe for **unascertained** goods, the **property in goods cannot pass** to the buyer **unless and until** the goods are **ascertained**. The buyer can get the **ownership right** on the goods **only when** the goods are **specific and ascertained**.

(b) **Intentions of Parties:** The property in goods is **transferred** to the buyer at such **time** as the **parties** to the contract **intend it to be transferred.** [section 19(1)]

Section 19(2) further provides that for the purpose of ascertaining the **intention** of the parties **regard** shall be:

(i) To the **terms** of the contract

(ii) To the **conduct** of the parties and

(iii) To the **circumstances** of the case

The primary rules determining the passing of property from seller to buyer are as follows:

Passing of Property

- Specific or Ascertained Goods
- Passing of Unascertained Goods
- Goods sent on approval or "on sale or return"
- Transfer of property in case of reservation of right to disposal.

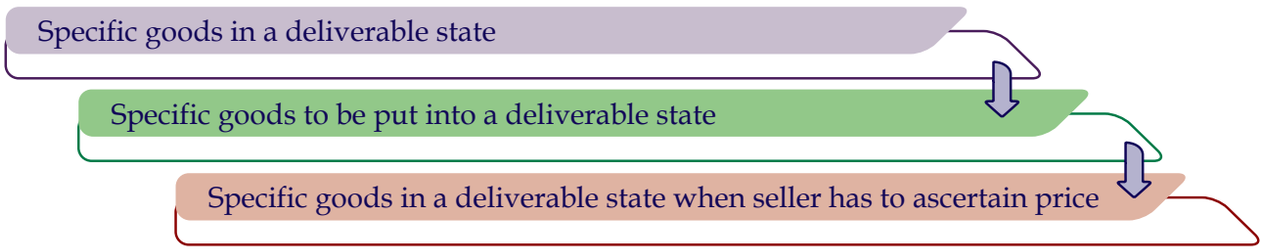
A. Property (Specific or ascertained goods) Passes When Intended to Pass (Section 19)

Where there is a contract for the sale of specific or ascertained goods, the property in them is **transferred** to the buyer at such **time** as the **parties to the contract intend** it to be **transferred**. [sub-section (1)]

For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the **circumstances of the case.** [sub-section (2)]

Unless a different **intention** appears, the rules contained in Sections 20 to 24 are rules for ascertaining the intention of the parties as to the **time** at which the **property** in the goods is to pass to the buyer. [sub-section (3)]

Stages of goods while passing of property



1. Specific goods in a deliverable state (Section 20)

Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the **contract is made**, and it is **immaterial** whether the time of **payment** of the price **or the time of delivery** of the goods, or both, is postponed. Here, the **condition** is goods must be **ready for delivery.**

Example 1:

X goes into a shop and buys a television and asks the shopkeeper for its home delivery. The shopkeeper agrees to do it. The television immediately becomes the property of X.

2. Specific goods to be put into a deliverable state (Section 21)

Where there is a contract for the sale of specific goods and the **seller is bound** to do **something** to the goods for the purpose of putting them into a deliverable state, the property **does not pass until** such **thing is done** and the buyer has **notice thereof.**

Example 2:

Peter buys a laptop from an electronics store and asks for a home delivery. The shopkeeper agrees to it. However, the laptop does not have a Windows operating system installed. The shopkeeper promises to install it and call Peter before making the delivery. In this case, the property transfers to Peter only after the shopkeeper has installed the OS making the laptop ready for delivery and intimated the buyer about it.

3. Specific goods in a deliverable state, when the seller has to do anything thereto in order to ascertain price (Section 22)

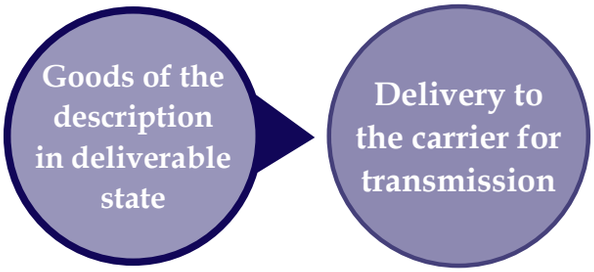
Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property **does not pass** until such **act or thing is done and** the **buyer has notice thereof.**

Example 3:

A sold carpets to the Company which were required to be laid. The carpet was delivered to the company's premises but was stolen before it could be laid. It was held that the carpet was not in deliverable state as it was not laid, which was part of the contract and hence, the property had not passed to the buyer company.

B. Unascertained Goods

Where there is a contract for the sale of unascertained goods, **no property** in the goods is **transferred** to the buyer **unless and until** the goods are **ascertained**. [Section 18]



The **rules** in respect **of passing** of property of unascertained goods are as follows:

1. Sale of unascertained goods by description and appropriation [Section 23(1)]

Appropriation of goods **involves selection** of goods with the **intention** of using them in **performance** of the contract and with the **mutual consent of the seller and the buyer.**

The essentials are:

(a) There is a contract for the **sale of unascertained or future goods.**

(b) The goods should **conform to the description and quality** stated in the contract.

(c) The goods must be in a **deliverable state.**

(d) The goods must be **unconditionally** (as distinguished from an intention to appropriate) **appropriated** to the contract either by delivery to the buyer or his agent or the carrier.

(e) The appropriation must be made by:

(i) the **seller with the assent of the buyer**; or

(ii) the **buyer with the assent of the seller.**

(f) The assent may be **express or implied.**

(g) The assent may be given either before or after appropriation.

2. Delivery of the goods to the carrier [Section 23(2)]

Where, in pursuance of the contract, the **seller delivers** the goods to the **buyer or to a carrier or other bailee** (whether named by the buyer or not) for the purpose of **transmission** to the buyer, and **does not reserve** the **right of disposal,** he is deemed to have **unconditionally appropriated** the goods to the contract.

Example 4:

A bill of lading of railway parcel is made out in the name of the buyer and is sent to him, the ownership in the goods passes from the seller to the buyer. In case the goods are subjected to accidental loss or by theft, the seller will not be liable.

Example 5:

M places an order for book with a book seller in Mumbai. He asks him to send the book by courier. Payment of the book was to be made by cheque. The seller sends the book by courier. The book is lost in the way. The seller wants the buyer to bear the loss. According to Section 23(2), it is an unconditional appropriation of goods because of which buyer M has become the owner of the goods. Therefore, he will bear the risk of loss of the book in the way.

C. Goods Sent on Approval or "On Sale Or Return" (Section 24)

When goods are **delivered** to the buyer on **approval** or "**on sale or return**" or other similar terms, the property therein **passes** to the buyer-

(a) when he **signifies his approval or acceptance** to the seller or does any **other act** adopting the **transaction;**

(b) if he **does not signify** his approval or acceptance to the seller **but retains** the goods **without giving notice** of rejection, then, if a **time** has been **fixed for the return** of the goods, on the **expiration** of such time, and, if **no time** has been **fixed**, on the **expiration** of a **reasonable time;** or

(c) he **does something** to the good which is **equivalent to accepting the goods** e.g. he pledges or sells the goods.

Example 6:

P brought a musical instrument from a musical shop on a condition that he will purchase it, if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument. The ownership is transferred when he has decided to purchase the instrument as his own.

A buyer under a contract on the basis of **'sale or return'** is deemed to have **exercised his option** when he **does any act** exercising **domination** over the **goods** showing an unequivocal intention to buy, example, if he pledges the goods with a third party. **Failure or inability** to return the goods to the seller **does not necessarily imply selection** to buy.

Example 7:

'A' delivered some jewellery to 'B' on sale or return basis. 'B' pledged the jewellery with 'C'. It was held that the ownership of the jewellery had been transferred to 'B' as he had adopted the transaction by pledging the jewellery with 'C'. In this case, 'A' has no right against 'C'. He can only recover the price of the jewellery from 'B'.

Example 8:

A sends to B a water motor on approval or return in March, 2020. B to return it after trial in August, 2020. The water motor has not been returned within a reasonable time, and therefore, A is not bound to accept it and B must pay the price.

Sale for cash only or return

It may be noted that where the goods have been **delivered** by a person on **"sale or return"** on the terms that the **goods** were to **remain the property** of the **seller** till they are **paid for,** the property therein **does not pass to the buyer** until the **terms are complied** with, i.e., cash is paid for.

Example 9:

'A' delivered his jewellery to 'B' on sale for cash only or return basis. It was expressly provided in the contract that the jewellery shall remain 'A's property until the price is paid. Before the payment of the price, 'B' pledged the jewellery with 'C'. It was held that at the time of pledge, the ownership was not transferred to 'B'. Thus, the pledge was not valid and 'A' could recover the jewellery from 'C'.

D. Reservation of Right of Disposal (Section 25)

This section **preserves the right of disposal** of goods to secure that the price is paid before the property in goods passes to the buyer.

Where there is contract of sale of specific goods or where the goods have been subsequently appropriated to the contract, the seller may, by the **terms** of the contract or appropriation, as the case may be, **reserve the right to dispose** of the goods, **until certain conditions** have been **fulfilled**. In such a case in spite of the fact that the goods have already been delivered to the buyer or to a carrier or other bailee for the purpose of transmitting the same to the buyer, the **property** therein **will not pass** to the buyer till the **condition imposed**, if any, by the seller has been **fulfilled**. (sub-section 1)

Example 10:

X sends furniture to a company by a truck and instructs the driver not to deliver the furniture to the company until the payment is made by company to him. The property passes only when the payment is made.

Circumstances under which the right to disposal may be reserved

In the following circumstances, seller is presumed to have reserved the right of disposal:

1. If the goods are **shipped or delivered** to a **railway administration for carriage and** by the bill of lading or **railway receipt**, as the case may be, the goods are **deliverable to the order of the seller or his agent**, then the seller will be **prima facie deemed** to have **reserved** to the right of disposal. (sub section 2)
2. Where the **seller draws a bill** on the buyer for the price and **sends to him the bill of exchange together** with the **bill of lading** or (as the case may be) the **railway receipt** to **secure acceptance** or payment thereof, the buyer must **return the bill of lading**, if he **does not accept or pay** the bill.

   And if he **wrongfully retains** the bill of lading or the railway receipt, the **property** in the goods **does not pass to him**. (sub section 3)

   It should be noted that Section 25 deals with "conditional appropriation" as distinguished from 'unconditional appropriation' dealt with under Section 23 (2).

❒ RISK PRIMA FACIE PASSES WITH PROPERTY (SECTION 26)

According to section 26, "**unless otherwise agreed,** the goods remain at the **seller's risk until the property** therein is **transferred** to the buyer, but when the property therein is **transferred to the buyer**, the goods are at the **buyer's risk** whether **delivery** has been **made or not".**

However, Section 26 also lays down an exception to the rule that 'risk follows ownership.' It provides that where **delivery** of the goods has been **delayed** through the **fault** of **either buyer or seller**, the goods are at the **risk of the party in fault** as regards any loss which **might not have occurred** but for such fault.

Thus, in ordinary circumstances, risk is borne by the buyer only when the property in the goods passes over to him. However, the parties may by special agreement stipulate that 'risk' will pass sometime after or before the 'property' has passed.

Risk Prima Facie Passes with Ownership

The owner of goods must bear the loss or damage of goods **unless otherwise is agreed** to. Under Section 26 of the Sale of Goods Act, unless otherwise agreed, the goods remain at the **seller's risk until property** therein has **passed** to the buyer. After that event they are at the **buyer's risk**, whether **delivery** has been **made or not.**

Seller's risk-until the property passes to the buyer

Buyer's risk-after the property passes from the seller

Example 11:

A bids for an antique painting at a sale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the antique which gets damaged. The loss will have to be borne by the seller, because the ownership of goods has not yet passed from the seller to the buyer.

The aforesaid rule is, however, subject to two qualifications:

(i) If **delivery** has been **delayed** by the **fault of the seller or the buyer**, the goods shall be at the **risk of the party in default,** as regards loss which **might not have arisen** but **for** the **default**.

(ii) The **duties and liabilities** of the seller or the buyer as **bailee** of goods for the other party **remain unaffected** even when the risk has passed generally.

Example 12:

A contracted to sell 100 bales of cotton to B to be delivered in February. B took the delivery of the part of the cotton but made a default in accepting the remaining bales. Consequently, the cotton becomes unfit for use. The loss will have to be borne by the buyer. It should, however, be remembered that the general rule shall not affect the duties or liabilities of either seller or buyer as a bailee of goods for the other, even when the risk has passed. It is their duty to take care of the goods as a man of ordinary prudence would have done.

As noted above, the risk (i.e., the liability to bear the loss in case property is destroyed, damaged or deteriorated) passes with ownership. The parties may, however, agree to the contrary. For instance, the parties may agree that risk will pass sometime after or before the property has passed from the seller to the buyer.

❒ TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27 – 30)

Sale by person not the owner (Section 27): In general, the seller can sell only such goods of which he is the absolute owner. But sometimes a person may sell goods of which he is not the owner, then the question arises as to what is the position of the buyer who has bought the goods by paying price. The general rule regarding the transfer of title is that the **seller cannot transfer** a **better title** to the buyer for goods **than he himself has**. If the **seller is not the owner** of goods, then the **buyer also** will **not become the owner** i.e. the title of the buyer shall be the same as that of the seller. This rule is expressed in the Latin maxim "**Nemo dat quod non habet**" which means that **no one can give what he has not got.**

Example 13:

If A sells some stolen goods to B, who buys them in good faith, B will get no title to that and the true owner has a right to get back his goods from B.

Example 14:

P, the hirer of vehicle under a hire purchase agreement, sells them to Q. Q, though a bona fide purchaser, does not acquire the ownership in the vehicle. At the most he acquires the same right as that of the hirer.

If this rule is enforced rigidly then the innocent buyers may be put to loss in many cases. Therefore, to protect the interests of innocent buyers, a number of exceptions have been provided to this rule.

Exceptions

In the following cases, a non-owner can convey better title to the bona fide purchaser of goods for value.

1. Sale by a mercantile agent

A sale made by a mercantile agent of the goods for document of title to goods would pass a **good title** to the buyer in the **following circumstances;** namely;

(a) If he was in **possession** of the goods **or documents with the consent** of the owner;

(b) If the **sale was made** by him when **acting** in the **ordinary course** of business as a **mercantile agent**; and

(c) If the buyer **had acted in good faith** and has at the **time of the contract** of sale, **no notice** of the fact that the **seller had no authority to sell** (Proviso to Section 27).

Mercantile Agent means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)].

2. Sale by one of the joint owners (Section 28)

If one of several **joint owners** of goods has the **sole possession** of goods by **permission** of the **co-owners**, the **property** in the goods is **transferred** to any person who buys them from such joint owner in **good faith** and has **not** at the time of the contract of sale **notice** that the **seller has no authority to sell.**

Example 15:

A, B, and C are three brothers and joint owners of a T.V and VCR and with the consent of B and C, the VCR and T.V was kept in possession of A. A sells the T.V and VCR to P who buys it in good faith and without notice that A had no authority to sell. P gets a good title to VCR and T.V.

3. Sale by a person in possession under voidable contract

A buyer would **acquire a good title** to the goods sold to him by a seller who had obtained possession of the goods under a **contract** voidable on the ground of coercion, fraud, misrepresentation or undue influence provided that the contract **had not been rescinded until the time of the sale (Section 29)**.

Example 16:

X fraudulently obtains a diamond ring from Y. This contract is voidable at the option of Y. But before the contract could be terminated, X sells the ring to Z, an innocent purchaser. Z gets the good title and Y cannot recover the ring from Z even if the contract is subsequently set aside.

4. Sale by one who has already sold the goods but continues in possession thereof

If a person has sold goods but continues to be in possession of them or of the documents of title to them, he may **sell them to a third person**, and if such person **obtains the delivery** thereof in

good faith and **without notice** of the previous sale, he would have **good title** to them, although the property in the goods had passed to the first buyer earlier. A **pledge** or other **disposition** of the goods or **documents of title** by the seller in possession are **equally valid** [Section 30(1)].

Example 17:

During IPL matches, P buys a TV set from R. R agrees to deliver the same to P after some days. In meanwhile R sells the same to S, at a higher price, who buys in good faith and without knowledge about the previous sale. S gets a good title.

5. Sale by buyer obtaining possession before the property in the goods has vested in him

Where a **buyer with the consent of the seller obtains possession** of the goods **before the property** in them **has passed to him,** he may **sell, pledge or otherwise dispos**e of the goods to a **third person**, and if **such person obtains delivery** of the goods in **good faith** and **without notice** of the lien or other right of the original seller in respect of the goods, he would get a **good title** to them [Section 30(2)].

Example 18:

Furniture was delivered to B under an agreement that price was to be paid in two instalments, the furniture to become property of B on payment of second instalment. B sold the furniture before second instalment was paid. It was held that the buyer acquired a good title. (Lee Vs Butler)

However, a person in possession of goods under a **'hire-purchase' agreement** which gives him only an option to buy is **not covered** within the section unless it amounts to a sale.

Example 19:

A took a car from B on this condition that A would pay a monthly instalment of ₹ 5,000 as hire charges with an option to purchase it by payment of ₹ 1,00,000 in 24 instalments.

After the payment of few instalments, A sold the car to C. B can recover the car from C since A had neither bought the car, nor had agreed to buy the car. He had only an option to buy the car.

6. Effect of estoppel

Where the **owner** is **estopped** by the conduct **from denying the seller's authority to sell,** the transferee will get a **good title** as against the **true owner**. But before a good title by estoppel can be made, it must be shown that the true owner had actively suffered or held out the other person in question as the true owner or as a person authorized to sell the goods.

Example 20:

'A' said to 'B', a buyer, in the presence of 'C' that he (A) is the owner of the horse. But 'C' remained silent though the horse belonged to him. 'B' bought the horse from 'A'. Here the buyer (B) will get a valid title to the horse even though the seller (A) had no title to the horse. In this case, 'C', by his own conduct, is prevented from denying 'A's authority to sell the horse. Here, 'C's silence has induced 'B' to believe that 'A' is the owner of the horse.

7. Sale by an unpaid seller

Where an unpaid seller who had exercised his **right of lien or stoppage in transit resells the goods**, the buyer acquires a **good title** to the goods as against the **original buyer** [Section 54 (3)].

8. Sale under the provisions of other acts

(i) Sale by an **Official Receiver or Liquidator** of the Company will give the **purchaser a valid title.**

(ii) Purchase of goods from a **finder of goods** will get a **valid title** under circumstances [Section 169 of the Indian Contract Act, 1872]

❒ PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31 – 44)

A sale by **pawnee** can convey a **good title to the buyer** [Section 176 of the Indian Contract Act, 1872]

The performance of a contract of sale implies delivery of goods by the seller and acceptance of the delivery of goods and payment of price for them by the buyer in accordance of the terms of the contract.

Definition of Delivery [Section 2(2)]

Delivery means voluntary transfer of possession from one person to another. For delivery, **physical** possession is **not important**. The buyer should be placed in a position so that he **can exercise his right over** the goods.

Thus, if the possession is **taken through unfair means,** there is **no delivery** of the goods. Delivery of goods sold may be made by doing anything which the parties agree, shall be treated as delivery or putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.

Delivery of Goods is of Three Types

(a) **Actual Delivery**

(b) **Symbolic delivery**

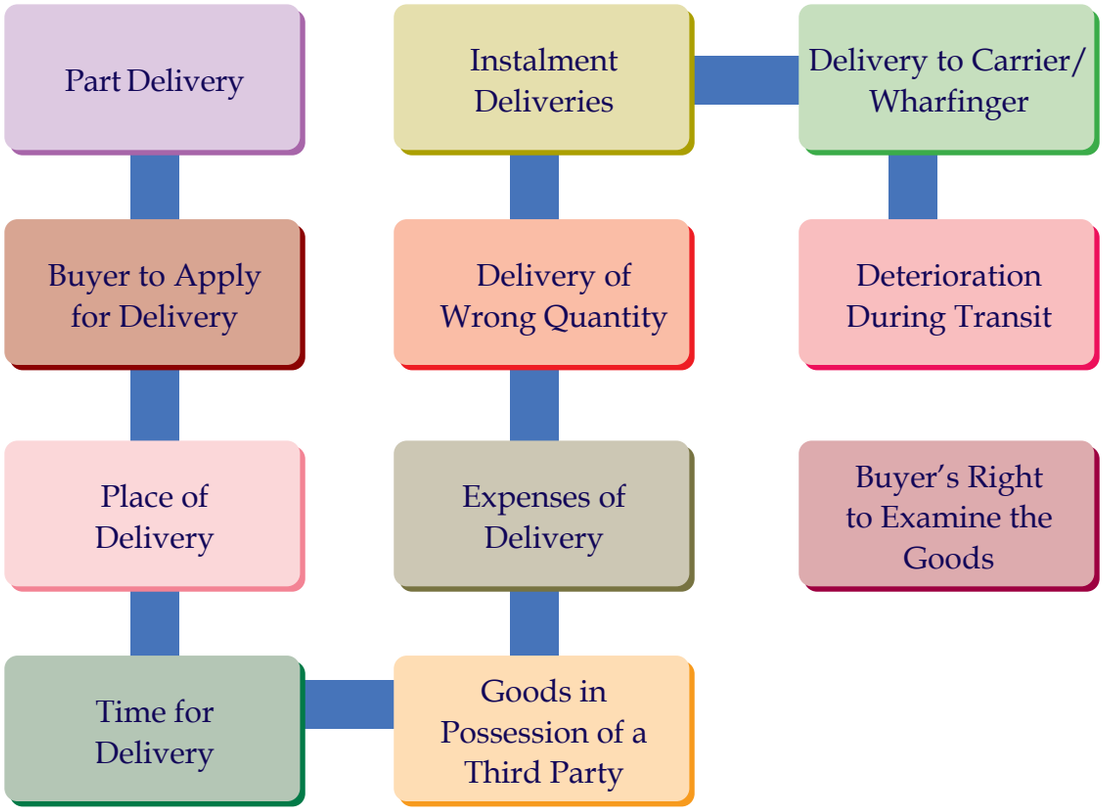
(c) **Constructive Delivery**

Duties of seller and buyer (Section 31): It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale.

Payment and delivery are concurrent conditions (Section 32): Unless otherwise agreed, **delivery** of the goods and **payment** of the price are **concurrent conditions**, that is to say, the seller shall be **ready and willing** to give possession of the goods to the buyer in **exchange for the price,** and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.

Rules Regarding Delivery of Goods (Section 33-41)

The Sale of good Act, 1930 prescribes the following rules of delivery of goods:



(i) Delivery (Section 33)

Delivery of goods sold may be made by **doing anything** which the **parties agree** shall be treated as delivery **or** which has the **effect of putting the goods in the possession** of the **buyer or of any person authorised** to hold them on his behalf.

(ii) Effect of part delivery

A **delivery of part of goods, in progress** of the delivery of the **whole** has the **same effect**, for the purpose of **passing the property** in such goods, as a delivery of the whole; but a delivery of **part** of the goods, with an **intention** of **severing it from the whole, does not operate** as a delivery of the **remainder**. (Section 34)

Example 21:

Certain goods lying at wharf were sold in a lot. The seller instructed the wharfinger to deliver them to the buyer who had paid for them and the buyer, thereafter, accepted them and took away part. Held, there was delivery of the whole.

(iii) Buyer to apply for delivery

Apart from any express contract, the seller of goods is **not bound to deliver** them until the **buyer applies** for delivery. (Section 35)

(iv) Place of delivery

Whether it is for the **buyer to take possession** of the goods or for the **seller to send** them to the

buyer is a **question depending** in each case on the contract, **express or implied,** between the parties. Apart from any such contract,

- goods sold are to be **delivered** at the **place** at which they are **at the time of the sale,** and
- goods **agreed to be sold** are to be **delivered** at the place at which they are **at the time of** the **agreement to sell** or
- if goods are **not then in existence**, at the **place** at which they are **manufactured or produced.** [Section 36(1)]

(v) Time of delivery

Where under the contract of sale, the seller is bound to **send the goods to the buyer**, but **no time for sending them is fixed**, the seller is bound to **send them within a reasonable time**. [Section 36(2)]

(vi) Goods in possession of a third party

Where the goods at the time of sale are in possession of a third person, there is **no delivery unless and until such third person acknowledges** to the buyer that he holds the goods on his behalf. Provided that nothing in this section shall affect the operation of the issue or transfer of any document of title to goods. [Section 36(3)]

(vii) Time for tender of delivery

Demand or tender of delivery may be treated as **ineffectual unless** made at a **reasonable hour**. What is reasonable hour is a **question of fact.** [Section 36(4)].

(viii) Expenses for delivery

The **expenses** of and **incidental to putting** the goods into a **deliverable state** must be **borne** by the **seller** in the **absence** of a contract to the contrary. [Section 36(5)].

(ix) Delivery of wrong quantity [Section 37]

Where the seller **delivers** to the buyer a **quantity** of goods **less** than he contracted to sell, the **buyer may reject** them, but if the **buyer accepts** the goods so delivered he shall **pay** for them at the **contract rate**. [Sub section (1)]

Where the seller delivers to the buyer a **quantity** of goods **larger** than he contracted to sell, the buyer may **accept** the goods **included** in the contract and **reject the rest**, or he may **reject the whole**. If the buyer **accepts the whole** of the goods so delivered, he shall **pay** for them at the **contract rate.** [Sub-section (2)]

Where the **seller delivers** to the buyer the goods he contracted to sell **mixed** with goods of a **different description** not included in the contract, the **buyer may accept** the goods which are **in accordance** with the contract and **reject**, **or** may **reject the whole**. [Sub section (3)]

The provisions of this section are subject to any usage of trade, special agreement or course of dealing between the parties. [Sub-section (4)]

Example 22:

A agrees to sell 100 quintals of wheat to B at ₹ 1,000 per quintal. A delivers 1,100 quintals. B may reject the whole lot or accept only 1,000 quintals and reject the rest or accept the whole lot and pay for them at the contract of sale.

(x) Instalment deliveries

Unless otherwise **agreed**, the buyer is **not bound to accept** delivery in **instalments**. The rights and liabilities in cases of delivery by instalments and payments thereon may be determined by the parties of contract. (Section 38)

Example 23:

There was sale of 100 tons of paper to be shipped in November. The seller shipped 80 tons in November and 20 tons in December. The buyer was entitled to reject the whole 100 tons.

(xi) Delivery to carrier

Subject to the **terms** of contract, the delivery of the goods **to the carrier for transmission** to the buyer, is **prima facie deemed** to be **delivery** to the **buyer**. [Section 39(1)]

(xii) Deterioration during transit

Where goods are delivered at a distant place, the **liability for deterioration** necessarily **incidental** to the course of transit will **fall on the buyer**, though the seller **agrees to deliver at his own risk.** (Section 40)

Example 24:

P sold to Q a certain quantity of iron rods which were to be sent by proper vessel. It was rusted before it reached the buyer. The rust of the rod was so minimal and was not effecting the merchantable quality and the deterioration was not necessarily incidental to its transmission. It was held that Q was bound to accept the goods.

(xiii) Buyer's right to examine the goods

Where goods are delivered to the buyer, who has **not previously examined** them, he is entitled to a **reasonable opportunity** of examining them in order to **ascertain** whether they are in **conformity** with the contract. Unless otherwise agreed, the seller is **bound**, on request, **to afford** the buyer a **reasonable opportunity** of examining the goods. (Section 41)

Rule Related to Acceptance of Delivery of Goods (Section 42)

Acceptance is deemed to take place when the buyer:

(a) **intimates** to the seller that he had **accepted** the goods; or

(b) does **any act** to the **goods**, which is **inconsistent** with the **ownership** of the seller; or

(c) **retains** the goods after the lapse of a **reasonable time**, **without intimating** to the seller that he has rejected them.

Buyer not Bound to Return Rejected Goods (Section 43)

Unless otherwise agreed, where goods are **delivered** to the buyer **and he refuses** to accept them, having the **right so to do**, he is **not bound to return** them to the seller, but it is **sufficient** if he **intimates** to the seller that he refuses to accept them.

Liability of Buyer for Neglecting or Refusing Delivery of Goods (Section 44)

When the seller is **ready and willing** to deliver the goods and **requests the buyer to take delivery**,

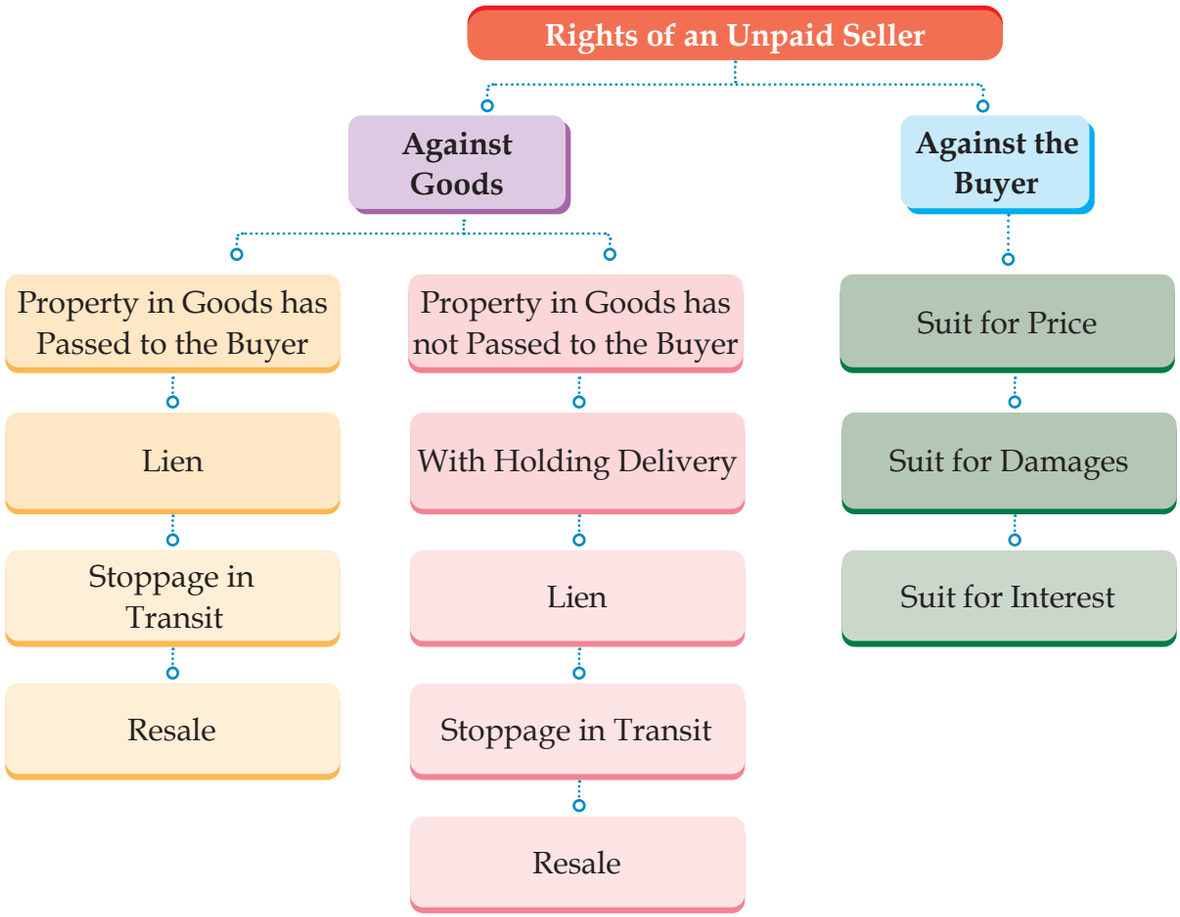
and the **buyer does not** within a **reasonable time** after such request take delivery of the goods, he is **liable to the seller** for any **loss occasioned** by his **neglect or refusal** to take delivery and also for a **reasonable charge** for the **care and custody** of the goods.

Provided further that **nothing** in this section **shall affect the rights** of the seller where the **neglect or refusal** of the buyer to take delivery amounts to a **repudiation** of the **contract.**

UNIT 04 UNPAID SELLER

TABLE OF THE CONTENTS FOR THE CHAPTER

- UNPAID SELLER 186
- RIGHTS OF AN UNPAID SELLER 187
- RIGHT OF UNPAID SELLER AGAINST THE GOODS 188
- RIGHTS OF UNPAID SELLER AGAINST THE BUYER (SECTIONS 55-61) 192
- REMEDIES OF BUYER AGAINST THE SELLER 193
- AUCTION SALE (SECTION 64) 195
- INCLUSION OF INCREASED OR DECREASED TAXES IN CONTRACT OF SALE (SECTION 64A) 196



UNPAID SELLER

A contract comprises of reciprocal promises. In a contract of sale, if seller is under an obligation to deliver goods, buyer has to pay for it. In case buyer fails or refuses to pay, the seller, as an unpaid seller, shall have certain rights.

According to Section 45(1) of the Sale of Goods Act, 1930, the seller of goods is deemed to be an **'Unpaid Seller' when-**

(a) The **whole of the price** has **not been paid or tendered and the seller** had an **immediate right of action** for the price.

(b) When a **bill of exchange or other negotiable instrument** has been **received as conditional payment**, and the **condition** on which it was received has **not been fulfilled** by reason of the dishonour of the instrument or otherwise.

The term **'seller' here includes** any person who is in the **position of a seller**, as, for instance, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price [Section 45(2)].

Example 1:

X sold certain goods to Y for ₹ 50,000. Y paid ₹ 40,000 but fails to pay the balance. X is an unpaid seller.

Example 2:

P sold some goods to R for ₹ 60,000 and received a cheque for a full price. On presentment, the cheque was dishonoured by the bank. P is an unpaid seller.

❒ RIGHTS OF AN UNPAID SELLER

Unpaid seller's right (Section 46): Subject to the provisions of this Act and of any law for the time being in force, notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of goods, as such, has by implication of law-

(a) a **lien on the goods** for the price while he is in possession of them;

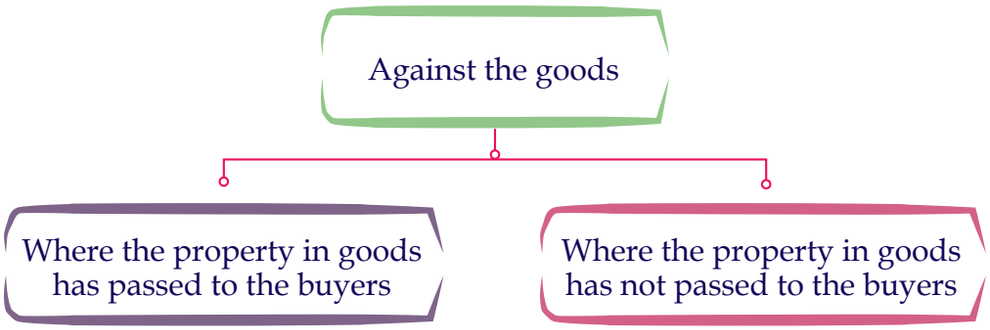
(b) in case of the insolvency of the buyer a right of **stopping the goods in transit** after he has parted with the possession of them;

(c) a **right of re-sale** as limited by this Act. [Sub-section (1)]

Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer. [Sub-section (2)]

An unpaid seller has been expressly given the rights against the goods as well as the buyer personally which are discussed as under:

(a) **Rights of an unpaid seller against the goods:** The right of unpaid seller against goods can be categorized under two headings.



❒ RIGHT OF UNPAID SELLER AGAINST THE GOODS

The unpaid seller has the following rights against the goods:

1. Seller's Lien (Section 47)

Rights of lien: An unpaid seller has a **right of lien on the goods** for the **price** while he is in **possession, until** the **payment or tender** of the price of such goods. It is the right to **retain the possession** of the goods and **refusal** to deliver them to the buyer **until the price** due in respect of them is **paid or tendered.**

The unpaid seller's lien is a possessory lien i.e. the lien can be **exercised** as long as the seller remains in **possession of the goods.**

Exercise of right of lien: This right can be exercised by him in the **following cases** only:

(a) where goods have been **sold without any stipulation of credit**; (i.e., on cash sale)

(b) where goods have been **sold on credit but the term of credit has expired;** or

(c) where the **buyer becomes insolvent.**

Example 3:

A sold certain goods to B for a price ₹ 50,000 and allowed him to pay the price within one month. B becomes insolvent during this period of credit. A, the unpaid seller, can exercise his right of lien.

Seller may exercise his right of lien even where he is in possession of the goods as agent or bailee for the buyer.

The term insolvent refers to "a person is said to be insolvent who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not".

Part Delivery (Section 48): Where an unpaid seller has made **part delivery** of the goods, he may **exercise his right of lien on the remainder**, **unless** such part delivery has been **made** under such **circumstances** as to show an **agreement** to **waive** the lien.

Termination of Lien (Section 49): The unpaid seller **loses his right** of lien under the following circumstances:

(a) When he **delivers the goods** to a **carrier or other bailee** for the **purpose of transmission** to the buyer **without reserving** the right of **disposal** of the goods.

(b) Where the **buyer or** his **agent lawfully obtains possession** of the goods.

(c) Where **seller has waived** the right of lien.

(d) **By Estoppel** i.e., where the seller so conducts himself that he leads third parties to believe that the lien does not exist.

Exception: The unpaid seller of the goods, having a lien thereon, does **not lose** his lien by reason only that he has **obtained a decree** for the **price** of the goods. (This means even if the seller has taken a price for the goods under a court case, he can still exercise his right to lien on those goods.)

Example 4:

A, sold a car to B for ₹ 1,00,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now A cannot exercise the right of lien.

2. Right of Stoppage in Transit (Section 50 to 52)

Meaning of right of stoppage in transit (Section 50): The right of stoppage in transit means the right of **stopping the goods** while they are in **transit**, to **regain the possession** and to **retain** them till the **full price is paid.**

When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right of asking the carrier to return the goods back, or not to deliver the goods to the buyer.

This right is the **extension** of the right of lien because it entitles the seller to **regain possession** even **when** the seller has **parted** with the possession of the goods.

However, the right of stoppage in transit is exercised **only when** the following **conditions** are **fulfilled:**

(a) The seller must be **unpaid.**

(b) He must have **parted** with the **possession** of goods.

(c) The goods are **in transit.**

(d) The buyer **has become insolvent.**

(e) The **right is subject** to **provisions** of the Act. [Section 50]

Example 5:

A of Mumbai sold certain goods to B of Delhi. He delivered the goods to C, a common carrier for the purpose of transmission of these goods to B. Before the goods could reach him, B became insolvent and A came to know about it. A can stop the goods in transit by giving a notice of it to C.

Duration of transit (Section 51): The goods are deemed to be in course of transit from the **time** when they are **delivered to a carrier** or other **bailee for the purpose of transmission** to the buyer, until the buyer or his **agent** on that behalf **takes delivery** of them from such **carrier or other bailee.**

When does the transit come to an end?

The right of stoppage in transit is **lost** when transit **comes to an end.** Transit comes to an end in the **following cases:**

When the buyer or other bailee **obtains delivery.**

Buyer obtains delivery **before the arrival of goods at destination.** It is also called interception by the buyer which can be **with or without the consent** of the carrier.

Where the carrier or other bailee **acknowledges** to the buyer or his agent that **he holds the goods** as soon as the goods are loaded on the ship, unless the seller has **reserved the right of disposal** of the goods.

If the carrier **wrongfully refuses** to deliver the goods to the buyer.

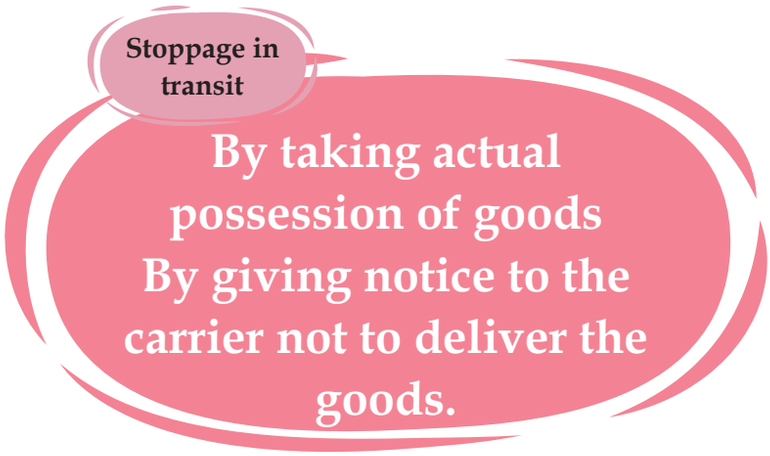
Where goods are **delivered to the carrier hired** by the buyer, the **transit comes to an end.**

Where the **part delivery** of the goods has been made to the buyer, the transit will come to an **end for the remaining** goods which are yet in the course of transmission.

Where the goods are **delivered to a ship chartered by the buyer**, the transit comes to an end. [section 51]

How stoppage in transit is effected (Section 52):

1. The unpaid seller may exercise his right of stoppage in transit either by taking **actual possession** of the goods, or by **giving notice** of his claim to the **carrier** or other bailee in whose **possession** the **goods are**. Such notice may be **given either** to the person in actual **possession** of the goods **or to his principal.** In the latter case, the notice, to be **effectual,** shall be given at such time and in such circumstances, that the **principal,** by the exercise of reasonable diligence, may **communicate** it to his servant or **agent** in **time to prevent a delivery to the buyer.**
2. When notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall re-deliver the goods to, or according to the directions of, the seller. The expenses of such re-delivery shall be borne by the seller.



Distinction between Right of Lien and Right of Stoppage in Transit

(i) The **essence** of a right of lien is to **retain possession** whereas the **right of stoppage** in transit is right to **regain possession.**

(ii) Seller should be in **possession** of goods under lien while in **stoppage in transit** (i) seller should have **parted with the possession** (ii) **possession** should be with a **carrier** & (iii) **buyer** has **not acquired** the **possession.**

(iii) Right of lien can be **exercised** even when the **buyer is not insolvent** but it is **not** the **case** with **right of stoppage in transit.**

(iv) Right of stoppage in transit **begins** when the **right of lien ends.** Thus, the **end** of the **right of lien** is the **starting point** of the right of **stoppage in transit.**

(v) Right of lien comes to an **end** as soon as the **goods go out of the possession** of the seller but the right of stopping in **transit comes** to an **end** as soon as the **goods are delivered** to the **buyer.**

Sometimes it is said that right of stopping the goods in transit is nothing but an extension of right of lien.

Effects of sub-sale or pledge by buyer (Section 53): The right of **lien** or stoppage in **transit is not affected** by the buyer selling or pledging the goods **unless** the seller has **assented to it.** This is based on the principle that a **second buyer cannot stand** in a **better position** than his seller. (The first buyer).

Example 6:

A sold certain goods to B of Mumbai and the goods are handed over to railways for transmission to B. In the mean time, B sold these goods to C for consideration. B becomes insolvent. A can still exercise his right of stoppage in transit. Here we assume that seller did not give his assent for sub sale, therefore he can still exercise his right of stoppage in transit.

The right of stoppage is **defeated** if the buyer has **transferred the document of title or pledges** the goods to a **sub-buyer** in **good faith** and for **consideration.**

Exceptions where Unpaid Seller's Right of Lien and Stoppage in Transit are Defeated

(a) When the seller has **assented to the sale, mortgage** or other **disposition** of the goods made by the buyer.

Example 7:

A entered into a contract to sell cartons in possession of a wharfinger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now B sold goods to C and C duly paid to B. But anyhow B failed to make the payment to A. A wanted to exercise his right of lien and ordered the wharfinger not to make delivery to C. Held that the seller had assented to the resale of the goods by the buyer to the sub-buyers. As a result, A's right to lien is defeated (Mount D. F. Ltd. vs Jay & Jay (Provisions) Co. Ltd).

(b) When a **document of title** to goods has been **transferred** to the buyer and the **buyer transfers** the documents to a person who has **bought goods in good faith and for value** i.e. for price, then, the proviso of sub-section (1) stipulates as follows:

(i) If the last-mentioned transfer is by way of **sale**, right of lien or stoppage in transit is **defeated**, or

(ii) If the **last mentioned transfer** is by way of **pledge**, unpaid seller's right of lien or stoppage only be **exercised, subject to the rights of the pledgee**.

However, the **pledgee may be required by the unpaid seller** to **use** in the **first instance**, **other goods** or securities of the pledger **available** to him to **satisfy his claims. [Sub section (2)].**

Effect of stoppage: The contract of sale is **not rescinded** when the seller **exercises** his right of **stoppage in transit**. The contract **still remains in force** and the buyer can **ask for delivery** of goods on **payment of price.**

Right of re-sale [Section 54]: The right of resale is a very valuable right given to an unpaid seller. In the absence of this right, the unpaid seller's other rights against the goods that is lien and the stoppage in transit would not have been of much use because these rights only entitled the unpaid seller to retain the goods until paid by the buyer.

The unpaid seller can exercise the right to re-sell the goods under the following conditions:

(i) **Where the goods are of a perishable nature:** In such a case, the **buyer need not be informed** of the **intention of resale.**

(ii) **Where he gives notice to the buyer of his intention to re-sell the goods:** If after the receipt of such notice the **buyer fails within a reasonable time** to pay or tender the price, the **seller may resell** the goods.

It may be noted that in such cases, on the resale of the goods, the seller is also entitled to:

(a) **Recover the difference** between the **contract price and resale price**, from the original buyer, as damages.

(b) **Retain the profit** if the **resale price is higher** than the contract price.

It may also be noted that the seller can recover damages and retain the profits only when the goods are resold after **giving the notice of resale** to the buyer. Thus, if the goods are resold by the seller **without giving any notice** to the buyer, the seller **cannot recover the loss** suffered on resale. Moreover, if there is any **profit on resale**, he must **return it to the original buyer,** i.e. he cannot keep such surplus with him [Section 54(2)].

(iii) **Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods:** The subsequent buyer acquires the good title thereof as against the original buyer, despite the fact that the notice of re-sale has not been given by the seller to the original buyer.

(iv) **A re-sale by the seller where a right of re-sale is expressly reserved in a contract of sale:** Sometimes, it is expressly agreed between the seller and the buyer that in case the **buyer makes default in payment** of the price, the **seller will resell** the goods to some other person. In such cases, the seller is said to have **reserved his right of resale**, and he may resell the goods on buyer's default.

It may be noted that in such cases, the seller is not required to give notice of resale. He is **entitled to recover damages** from the original buyer **even if no notice of resale is given.**

(v) **Where the property in goods has not passed to the buyer:** The unpaid seller has **in addition** to his remedies a **right of withholding delivery of the goods**. This right is similar to lien and is called **"quasi-lien".** This is the **additional right** used in case of **agreement to sell.**

❒ RIGHTS OF UNPAID SELLER AGAINST THE BUYER (SECTIONS 55-61)

Rights of unpaid seller against the buyer personally: An unpaid seller can enforce certain rights against the goods as well as **against the buyer personally.** Rights of unpaid seller against the buyer are otherwise known as seller's remedies for breach of contract of sale. The rights of the seller against the buyer personally are called **rights in personam** and are **in addition to his rights against the goods.**

The right against the buyer are as follows:

1. Suit for Price (Section 55)

(a) Where under a contract of **sale,** the property in the goods has **passed to the buyer** and the buyer **wrongfully neglects** or **refuses** to pay for the goods according to the **terms** of the contract, the seller may **sue him for the price** of the goods. [Section 55(1)] (This is the case of contract of sale)

(b) Where under a contract of sale, the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the **property in the goods has not passed** and the **goods have not been appropriated** to the contract. [Section 55(2)]. (This is the case of agreement to sell)

2. Suit for Damages for Non-Acceptance (Section 56)

Where the buyer **wrongfully neglects or refuses** to accept and pay for the goods, the seller may **sue him** for **damages for non-acceptance**. As regards measure of damages, Section 73 of the Indian Contract Act, 1872 applies in this case.

3. Repudiation of Contract before due Date (Section 60)

Where the **buyer repudiates** the contract **before the date of delivery,** the seller may **treat** the contract as **rescinded** and **sue damages** for the breach. This is known as the 'rule of anticipatory breach of contract'.

4. Suit for Interest [Section 61]

Where there is **specific agreement** between the seller and the buyer as to **interest on the price** of the goods from the **date** on which **payment becomes due,** the seller may **recover interest** from the buyer. If, however, there is **no specific agreement** to this effect, the seller may **charge** interest on the price when it **becomes due** from such day as he may **notify to the buyer.**

In the **absence** of a contract to the contrary, the Court may **award interest** to the seller in a suit by him at such rate as it **thinks fit** on the amount of the price from the date of the **tender** of the goods or from the **date** on which the **price was payable.**

❒ REMEDIES OF BUYER AGAINST THE SELLER

Breach of Contract by Seller

Breach of contract by seller, where he-
◈ Fails to deliver the goods at the time or in manner prescribed
◈ Repudiates the contract
◈ Deliver non-conforming goods and buyer rejects and revokes acceptance

If the **seller commits a breach** of contract, the buyer gets the following rights against the seller:

Rights of Buyer

- Damages for non-delivery
- Suit for specific performance
- Suit for breach of warranty
- Suit for anticipatory breach
- Suit for interest

1. Damages for Non-Delivery [Section 57]

Where the **seller wrongfully neglects or refuses** to deliver the goods to the buyer, the **buyer may** sue the **seller for damages** for non-delivery.

Example 8:

A' a shoe manufacturer, agreed to sell 100 pairs of shoes to 'B' at the rate of ₹ 10,500 per pair. 'A' knew that 'B' wanted the shoes for the purpose of further reselling them to 'C' at the rate of ₹ 11,000/- per pair. On the due date of delivery, 'A' failed to deliver the shoes to 'B'. In consequence, 'B' could not perform his contract with 'C' for the supply of 100 pairs of shoes. In this case, 'B' can recover damages from 'A' at the rate of ₹ 500/- per pair (the difference between the contract price and resale price).

2. Suit for Specific Performance (Section 58)

Where the seller commits of breach of the contract of sale, the buyer can **appeal to the court** for **specific performance**. The court can **order** for specific performance only when the goods are **ascertained or specific.**

This remedy is allowed by the court subject to **these conditions:**

(a) The contract must be for the sale of **specific and ascertained goods.**

(b) The **power of the court** to order specific performance is **subject to provisions** of **Specific Relief Act of 1963.**

(c) It **empowers the court** to order specific performance where **damages** would **not be an adequate remedy.**

(d) It will be **granted as remedy** if goods are of **special nature or are unique.**

Example 9:

'A' agreed to sell a rare painting of Mughal period to 'B'. But on the due date of delivery, 'A' refused to sell the same. In this case, 'B' may file a suit against 'A' for obtaining an order from the Court to compel 'A' to perform the contract (i.e. to deliver the painting to 'B' at the agreed price).

3. Suit for Breach of Warranty (Section 59)

Where there is **breach of warranty** on the part of the seller, or where the **buyer elects to treat breach of condition** as breach of **warranty,** the buyer is **not entitled to reject** the goods only on the basis of such breach of warranty. But he may -

set up against the seller the **breach** of warranty in **diminution or extinction** of the price; or

sue the seller for **damages** for breach of warranty.

4. Repudiation of Contract before due Date (Section 60)

Where **either party** to a contract of sale **repudiates** the contract **before the date of delivery,** the other **may** either **treat** the contract as **subsisting** and **wait** till the **date of delivery**, or he may **treat** the contract as **rescinded** and **sue for damages** for the breach.

5. Suit for Interest

1. Nothing in this Act shall affect the right of the **seller** or the buyer to **recover interest** or special damages, in any case where by law **interest** or **special damages may be recoverable**, or to recover the money paid where the consideration for the payment of it **has failed**.
2. In the **absence of a contract to the contrary,** the court may **award** interest at **such rate** as it **thinks fit** on the amount of the price to the buyer in a suit filed by him for the refund of the price (in a case of a breach of the contract on the part of the seller) from the date on which the **payment was made**.

Example 10:

In case of a sale of cigarettes which turned out to be mildewed and unfit for consumption, damages were awarded on the basis of the difference between the contract price and the price released.

Example 11:

In case of absence of transfer of title or registration, the purchaser cannot claim damages for breach of conditions and warranties relating to sale.

❒ AUCTION SALE (SECTION 64)

An 'Auction Sale' is a mode of **selling property** by inviting **bids publicly** and the property is **sold to the highest bidder.** An **auctioneer is an agent** governed by the **Law of Agency.** When he sells, he is only the agent of the seller. He may, however, **sell his own property** as the principal and **need not disclose** the fact that he is so selling.

Legal Rules of Auction Sale

Section 64 of the Sale of Goods Act, 1930 provides following rules to regulate the sale by auction:

(a) **Where goods are sold in lots:** Where goods are put up for sale in lots, **each lot** is prima facie **deemed** to be subject of a **separate contract of sale.**

(b) **Completion of the contract of sale:** The sale is **complete** when the **auctioneer announces** its **completion by the fall of hammer** or in any **other customary manner**. **Until** such **announcement** is made, any **bidder may retract** from his bid.

(c) **Right to bid may be reserved:** Right to bid may be **reserved expressly** by or on behalf of the **seller** and where such a right is expressly reserved, but not otherwise, the seller or **any one person** on his behalf may **bid at the auction.**

(d) **Where the sale is not notified by the seller:** Where the **sale is not notified** to be subject to a right to bid on behalf of the seller, it shall **not be lawful** for the seller to **bid himself** or to **employ any person** to **bid at such sale, or** for the **auctioneer** knowingly to **take any bid** from the seller or any such person; and **any sale contravening** this rule may be **treated as fraudulent** by the buyer.

(e) **Reserved price:** The sale may be **notified** to be subject to a **reserve or upset price**; and

(f) **Pretended bidding:** If the seller makes use of **pretended bidding to raise the price**, the sale is **voidable** at the option of the buyer.

Example 12:

P sold a car by auction. It was knocked down to Q who was only allowed to take it away on giving a cheque for the price and signing an agreement that ownership should not pass until the cheque was cleared. In the meanwhile till the cheque was cleared, Q sold the car to R. It was held that the property was passed on the fall of the hammer and therefore R had a good title to the car. Both sale and sub sale are valid in favour of Q and R respectively.

❒ INCLUSION OF INCREASED OR DECREASED TAXES IN CONTRACT OF SALE (SECTION 64A)

Where after a **contract** has been **made but before** it has been **performed**, **tax revision** takes place. Where tax is **being imposed, increased, decreased or remitted** in respect of any goods without any stipulations to the payment of tax, the parties would become **entitled to read** just the price of the goods accordingly. **Following taxes** are applied on the sale or purchase of goods:

- Any **duty of customs or excise** on goods,
- Any tax on the **sale or purchase** of goods

The buyer would have to **pay the increased price** where the **tax increases** and may derive the **benefit of reduction** if taxes are curtailed. Thus, seller may add the increased taxes in the price. The **effect** of provision can, however, is **excluded** by an **agreement** to the contrary. It is open to the parties to stipulate anything regard to taxation.

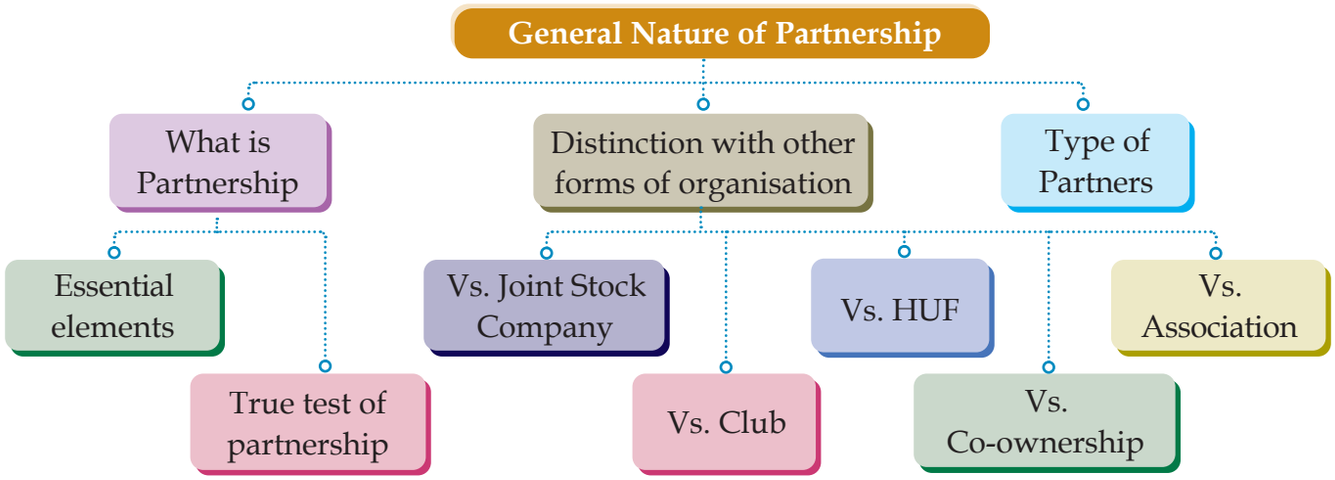
CHAPTER

04 The Indian Partnership Act, 1932

UNIT 01 GENERAL NATURE OF A PARTNERSHIP

TABLE OF CONTENTS FOR THE CHAPTER

- DEFINITION OF 'PARTNERSHIP', 'PARTNER', 'FIRM' AND 'FIRM NAME' (SECTION 4) 197
- TRUE TEST OF PARTNERSHIP 200
- PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANISATION 201
- KINDS OF PARTNERSHIPS 205
- TYPES OF PARTNERS 206



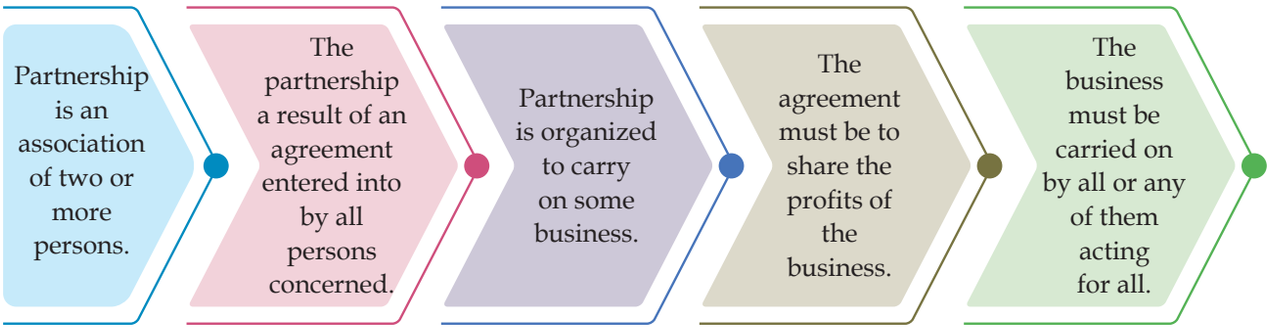
❒ DEFINITION OF 'PARTNERSHIP', 'PARTNER', 'FIRM' AND 'FIRM NAME' (SECTION 4)

'Partnership' is the **relation between persons** who have agreed to **share the profits** of a **business carried** on by **all or any of them acting for all.**

Persons who have entered into **partnership with one another** are called individually **'partners'** and **collectively 'a firm'**, and the **name** under which their business is carried on is called the **'firm name'.**

Elements of Partnership

The definition of the partnership contains the following five elements which must co-exist before a partnership can come into existence.



We shall now discuss the aforestated elements one by one.

1. Association of Two or More Persons

Partnership is an **association of 2 or more persons**. Again, only persons **recognized by law** can **enter into an agreement** of partnership. Therefore, a firm, since it is not a person recognized in the eyes of law cannot be a partner. Again, a **minor cannot be a partner** in a firm, but with the **consent of all** the partners, may be **admitted to the benefits** of partnership.

The partnership Act is **silent** about the maximum number of partners but section 464 of the Companies Act, 2013 has now **put a limit of 50 partners** in any association/partnership firm.

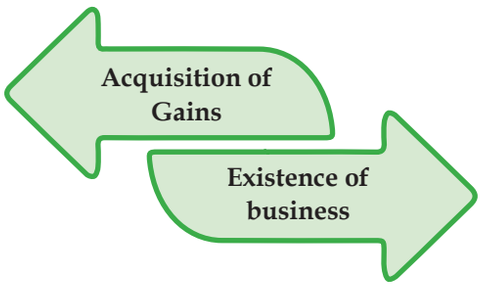
2. Agreement

It may be observed that partnership must be the **result of an agreement** between two or more persons. There must be an agreement entered into by all the persons concerned. This element relates to **voluntary contractual nature of partnership.** Thus, the nature of the partnership is voluntary and contractual.

An agreement from which relationship of Partnership arises may be **express**. It may also be **implied** from the act done by partners and from a consistent course of conduct being followed, showing mutual understanding between them. It may be **oral or in writing**.

3. Business

In this context, we will consider two propositions. First, there must exist a **business.** For the purpose, the term 'business' includes every trade, occupation and profession. The existence of business is essential. Secondly, the motive of the business is the **"acquisition of gains"** which leads to the formation of partnership. Therefore, there can be **no partnership** where there is **no intention** to carry on the business and to share the profit thereof.



4. Agreement to Share Profits

The **sharing** of profits is an **essential feature** of partnership. There can be no partnership **where only one of the partners is entitled to the whole of the profits** of the business. Partners must agree to share the profits in any manner they choose.

But an agreement to **share losses is not an essential** element. It is open to one or more partners to agree to **share all the losses.** However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio.

Example 1:

Co-owners who share amongst themselves the rent derived from a piece of land are not partners, because there does not exist any business.

Example 2:

No charitable institution or club may be floated in partnership [A joint stock company may, however, be floated for non-economic purposes].

Example 3:

X and Y buy certain bales of cotton which they agree to sell on their joint account and to share the profits equally. In these circumstances, X and Y are partners in respect of such cotton business.

5. Business Carried on by All or any of them Acting for All

The business must be **carried on by all the** partners or **by anyone** or more of the partners **acting for all**. This is the **cardinal principle of the partnership** Law. In other words, there should be a **binding contract of mutual agency** between the partners.

An act of one partner in the course of the business of the firm is in fact an **act of all partners.** Each partner carrying on the business is the **principal as well as the agent** for all the other partners. He is an agent in so far as he **can bind** the other partners by his acts and he is a principal to the extent that **he is bound by** the act of other partners.

It may be noted that the **true test** of partnership is **mutual agency rather than sharing of profits.** If the element of mutual agency is absent, then there will be no partnership.

Example 4:

A, B and C are partners in ABC Associates, a partnership firm. If A made certain purchases for the purpose of business from Mr. K, then Mr. K can recover the money from A, B or C as all partners are liable for any act done on behalf of firm.

Case Law: In KD Kamath & Co.

The Supreme Court has held that the **two essential conditions** to be satisfied are that:

1. there should be an **agreement to share the profits** as well as **the losses** of business; and
2. **the business** must be **carried on by all or any of them acting for all**, within the meaning of the definition of 'partnership' under section 4.

The fact that the **exclusive power and control**, by agreement of the parties, is **vested in one partner** or the further circumstance that only one partner can operate the bank accounts or **borrow on behalf of the firm** are **not destructive** of the theory of partnership provided the **two essential conditions, mentioned earlier, are satisfied.**

Note:- The 'Partnership Agreement' is also known as 'Partnership Deed'.

❒ TRUE TEST OF PARTNERSHIP

Mode of determining existence of partnership (Section 6): In determining whether a group of persons is or is not a firm, or whether a person is or not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.

For determining the existence of partnership, it must be proved.

1. There was an **agreement** between all the persons concerned;
2. The agreement was to **share the profits** of a **business** and
3. The business was carried on **by all or any of them acting for all.**

1. Agreement

Partnership is created **by agreement and not by status** (Section 5). The **relation** of partnership **arises** from **contract** and **not from status**; and in particular, the members of a **Hindu Undivided family** carrying on a **family business** as such, or a **Burmese Buddhist husband and wife** carrying on **business** as such are **not partners** in such business.

2. Sharing of Profit

The sharing of profits or of **gross returns arising from property** by persons holding a joint or common interest in that property **does not of itself** make such persons **partners.**

The receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not of itself make him a partner with the persons carrying on the business; and in particular, the receipt of such share or payment-

(a) by a **lender of money** to persons engaged or about to engage in any business,

(b) by a **servant or agent** as remuneration,

(c) by a **widow or child** of a deceased partner, as annuity, or

(d) by a **previous owner or part owner** of the business, as **consideration for** the sale of the **goodwill** or share thereof, does not of itself make the receiver a partner with the persons carrying on the business.

As discussed earlier, **sharing of profit** is an **essential element** to constitute a partnership. **But, it is only** a **prima facie evidence** and **not conclusive evidence**, in that regard. The sharing of profits or of gross returns accruing from property by persons holding joint or common interest in the property would not by itself make such persons partners. Although the right to participate in profits is a strong test of partnership, and there may be cases where, upon a simple participation in profits, there is a partnership, yet whether the relation does or does not exist must depend upon the whole contract between the parties.

Where there is an express agreement between partners to share the profit of a business and the business is being carried on by all or any of them acting for all, there will be no difficulty in the light of provisions of Section 4, in determining the existence or otherwise of partnership.

But the task becomes difficult when either there is no specific agreement or the agreement is such as does not specifically speak of partnership. In such a case for testing the existence or otherwise of partnership relation, Section 6 has to be referred.

According to **Section 6**, regard must be had to the **real relation between the parties** as shown by all relevant facts taken together. The rule is easily stated and is clear but its application is difficult. Cumulative effect of all relevant facts such as written or verbal agreement, real intention and conduct of the parties, other surrounding circumstances etc., are to be considered while deciding the relationship between the parties and ascertaining the existence of partnership.

3. Agency

Existence of **Mutual Agency** which is the **cardinal principle** of partnership law, is very much helpful in reaching a conclusion in this regard. Each partner carrying on the business is the **principal as well as an agent of other partners.** So, the **act of one partner** done on behalf of firm, **binds all the** partners. If the **elements of mutual agency** relationship exist between the parties constituting a group formed with a view to **earn profits** by running a business, a partnership **may be deemed to exist.**

Existence of Mutual Agency which is the cardinal principle of partnership law, is very much helpful in reaching a conclusion in this regard. **Each partner carrying on the business is the principal as well as an agent of other partners.** So, the act of one partner done on behalf of firm, binds all the partners. If the elements of mutual agency relationship exist between the parties constituting a group formed with a view to earn profits by running a business, a partnership may be deemed to exist.

Case Law: Santiranjan Das Gupta Vs. Dasyran Murzamull (Supreme Court)

In Santiranjan Das Gupta Vs. Dasyran Murzamull, following factors weighed upon the **Supreme Court to reach the conclusion** that there is no partnership between the parties:

(a) Parties **have not retained any record of terms and conditions** of partnership.

(b) Partnership business has **maintained no accounts of its own,** which would be **open to inspection** by both parties.

(c) **No account** of the partnership was **opened with any bank.**

(d) **No written intimation** was conveyed to the **Deputy Director of Procurement** with respect to the newly created partnership.

❒ PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANISATION

Partnership Vs. Joint Stock Company

Basis	Partnership	Joint Stock Company
Legal status	A firm is **not legal entity** i.e. it has no legal personality distinct from the personalities of its constituent members.	A company is a **separate legal entity** distinct from its members (Salomon v. Salomon).
Agency	In a firm, every **partner is an agent of the other partners** as well as of the **firm**.	In a company, a **member is not an agent of the other members** or of the company, his actions do not bind either.

Distribution of profits	The profits of the firm **must be distributed among the partners** according to the terms of the partnership deed.	There is **no such compulsion** to distribute its profits among its members. Some portion of the profits, but generally not the entire profit, become distributable among the shareholders only when dividends are declared.
Extent of liability	In a partnership, **the liability of the partners is unlimited.** This means that each partner is liable for debts of a firm incurred in the course of the business of the firm and these debts can be recovered from his private property, if the joint estate is insufficient to meet them wholly.	In a company limited by shares, the **liability of a shareholder is limited** to the amount, if any, unpaid on his shares, but in the case of a guarantee company, the liability is limited to the amount for which he has agreed to be liable. However, there may be companies where the liability of members is unlimited.
Property	The **firm's property** is that which is the **"joint estate" of all the partners** as distinguished from the 'separate' estate of any of them and it does not belong to a body distinct in law from its members.	In a company, **its property is separate from that of its members** who can receive it back only in the form of dividends or refund of capital.
Transfer of shares	A **share in a partnership cannot be transferred** without the consent of all the partners.	In a company **a shareholder may transfer his shares**, subject to the provisions contained in its Articles. In the case of public limited companies whose shares are quoted on the stock exchange, the transfer is usually unrestricted.
Management	In the absence of an express agreement to the contrary, **all the partners are entitled to participate in the management.**	**Members** of a company are **not entitled to take part in the management** unless they are appointed as directors, in which case they may participate. Members, however, enjoy the right of attending general meeting and voting where they can decide certain questions such as election of directors, appointment of auditors, etc.
Registration	**Registration is not compulsory** in the case of partnership.	A company cannot come into existence **unless it is registered** under the companies Act, 2013.
Winding up	A partnership firm **can be dissolved at any time** if all the partners agree.	A company, being a legal person is either **wind up by the National Company Law Tribunal** or its name is struck of by the Registrar of companies.

Number of membership	According to section 464 of the companies Act, 2013, the number of partners in any association shall **not exceed 100**. However, the Rule given under the companies (Miscellaneous) Rules, 2014 restrict the present limit to 50.	A **private company** may have as many **as 200 members** but not less than two and a **public company** may have **any number of members** but not less than seven. A private company can also be formed by one person known as one person company.
Duration of existence	Unless there is a contract to the contrary, death, retirement or insolvency of a partner results in the dissolution of the firm.	A company enjoys a **perpetual succession.**

Partnership Vs. Club

Basis of Difference	Partnership	Club
Definition	It is an **association of persons** formed for **earning profits** from a business carried on by all or any one of them acting for all.	A club is an association of persons formed with the **object not of earning profit,** but of promoting some beneficial purposes such as improvement of health or providing recreation for the members, etc.
Relationship	Persons forming a partnership are **called partners** and a partner is an agent for other partners.	Persons forming a club are called **members.** A member of a club is not the agent of other members.
Interest in the property	Partner **has interest in the property** of the firm.	A member of a club **has no interest in the property** of the club.
Dissolution	A **change in the partners** of the firm **affect its existence.**	A change in the membership of a club **does not affect its existence.**

Partnership Vs. Hindu Undivided Family

Basis of Difference	Partnership	Joint Hindu Family
Mode of creation	Partnership is created necessarily by an **agreement.**	The right in the joint family is **created by status** means its creation by birth in the family.
Death of a member	**Death** of a partner ordinarily **leads to the dissolution** of partnership.	The death of a member in the Hindu undivided family **does not give rise to dissolution** of the family business.
Management	All the partners are **equally entitled to take part** in the partnership **business.**	The **right of management** of joint family business generally **vests in the Karta,** the governing male member or female member of the family.
Authority to bind	**Every partner can**, by his act, **bind the firm.**	**The Karta or the manager**, has the **authority to contract** for the family business and the other members in the family.

Liability	In a partnership, **the liability of a partner is unlimited.**	In a Hindu undivided family, only the **liability of the Karta is unlimited**, and the other coparcener are liable only to the extent of their share in the profits of the family business.
Calling for accounts on closure	A **partner can bring a suit** against the firm for accounts, provided he also seeks the dissolution of the firm.	On the separation of the joint family, a **member is not entitled to ask for account** of the family business.
Governing Law	A partnership is governed by the **Indian Partnership Act, 1932.**	A Joint Hindu Family business is governed by **the Hindu Law.**
Minor's capacity	In a partnership, **a minor cannot become a partner,** though he can be admitted to the benefits of partnership, only with the consent of all the partners.	In Hindu undivided family business, a **minor becomes a member of the ancestral business by the incidence of birth**. He does not have to wait for attaining majority.
Continuity	A firm subject to a contract between the partners gets **dissolved by death or insolvency** of a partner.	A Joint Hindu family has the continuity till it is divided. The status of Joint Hindu family is **not thereby affected by the death of a member.**
Number of Members	In case of Partnership number of members **should not exceed 50.**	Members of HUF who carry on a business **may be unlimited in number.**
Share in the business	In a partnership, each partner has a **defined share** by virtue of an agreement between the partners.	In a HUF, no coparceners has a definite share. His **interest is a fluctuating one**. It is capable of being enlarged by deaths in the family diminished by births in the family.

Partnership Vs. Co-Ownership or Joint Ownership i.e. the Relation which Subsists between Persons who own Property Jointly or in Common

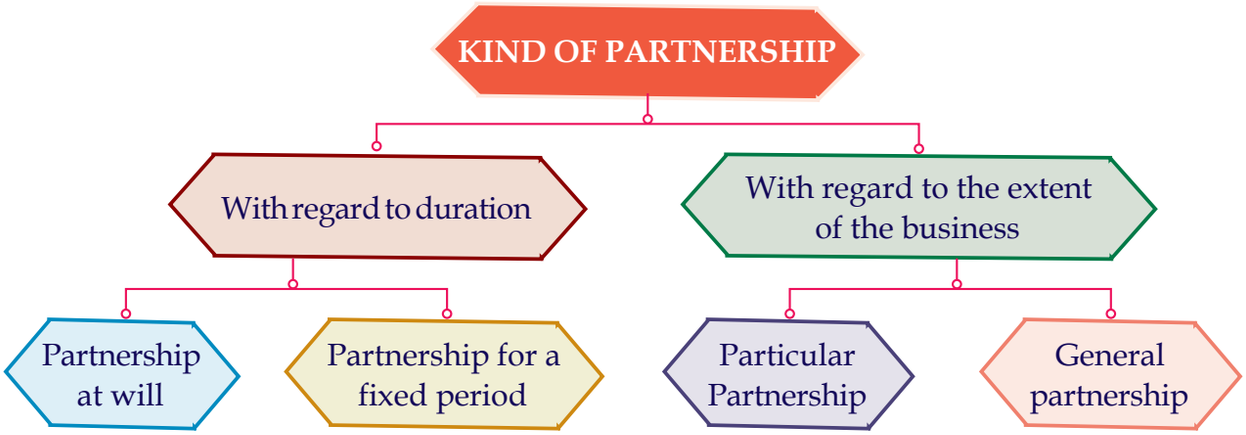
Basis of Difference	Partnership	Co-ownership
Formation	Partnership always arises **out of a contract, express or implied.**	Co-ownership **may arise either from agreement or by the operation of law,** such as by inheritance.
Implied agency	A **partner is the agent** of the other partners.	A **co-owner is not the agent** of other co-owners.
Nature of interest	There is **community of interest** which means that profits and losses must have to be shared.	**Co-ownership does not necessarily** involve **sharing of profits and losses.**
Transfer of interest	A share in the partnership is **transferred only by the consent of other partners**.	A co-owner may transfer his interest or rights in the property **without the consent of other co owners**.

Partnership vs. Association

Basis of Difference	Partnership	Association
Meaning	Partnership means and involves setting up **relation of agency between two or more persons** who have entered into a business for gains, with the intention to share the profits of such a business.	Association **evolves out of social cause** and there is no necessarily motive to earn and share profits. The intention is not to enter in a business for gains.
Examples	Partnership to run a business and **earn profit** thereon.	Members of charitable society or religious association or an improvement scheme or building corporation or a **mutual insurance society or a trade protection association.**

❒ KINDS OF PARTNERSHIPS

The following chart illustrates the various kinds of partnership:



1. Partnership at will According to Section 7 of the Act, Partnership at will is a Partnership when

1. **no fixed period has been agreed** upon for **the duration** of the partnership; and
2. there is **no provision made** as to the **determination** of the partnership.

These two conditions must be satisfied before a partnership can be regarded as a partnership at will. But, where there is **an agreement between the partners either for the duration** of the partnership or for the determination of the partnership, the partnership is **not partnership at will.**

Where a partnership **entered into for a fixed term is continued after** the **expiry of such term**, it is to be **treated** as having become a **partnership at will.**

A partnership at will **may be dissolved by any partner** by giving **notice in writing to all** the other partners of his **intention to dissolve the same.**

2. Partnership for a Fixed Period

Where a **provision is made** by a contract for the **duration of the partnership**, the partnership is called 'partnership for a fixed period'. It is a partnership **created for a particular period of time**. Such a partnership comes to an **end on the expiry of the fixed period.**

3. Particular Partnership

A partnership **may be organized** for the **prosecution of a single adventure as well as for the conduct of a continuous business**. Where **a person becomes a partner with another** person in any **particular adventure** or undertaking the partnership is called **'particular partnership'.**

A partnership, constituted for **a single adventure or undertaking** is, subject to any agreement, **dissolved** by the completion **of the adventure or undertaking**.

4. General Partnership

Where a partnership is constituted with respect to the **business in general**, it is called a general partnership. A general partnership is **different from a particular partnership.** In the case of a **particular partnership**, the **liability of the partners extends only to that particular adventure** or undertaking, but it is not so in the case of general partnership. **General partnership is different from limited liability partnership.**

Partnership Deed

Partnership is the **result of an agreement**. **No particular formalities** are required for an agreement of partnership. It may be **in writing or formed verbally**. But it is **desirable** to have the partnership agreement in **writing to avoid future disputes**. **The document in writing containing the various terms and conditions as to the relationship of the partners to each other is called the 'partnership deed'**. It should be **drafted with care and be stamped** according to the provisions of the Stamp Act, 1899. Where the partnership **comprises immovable property**, the instrument of partnership must be in **writing, stamped and registered under the Registration Act.**

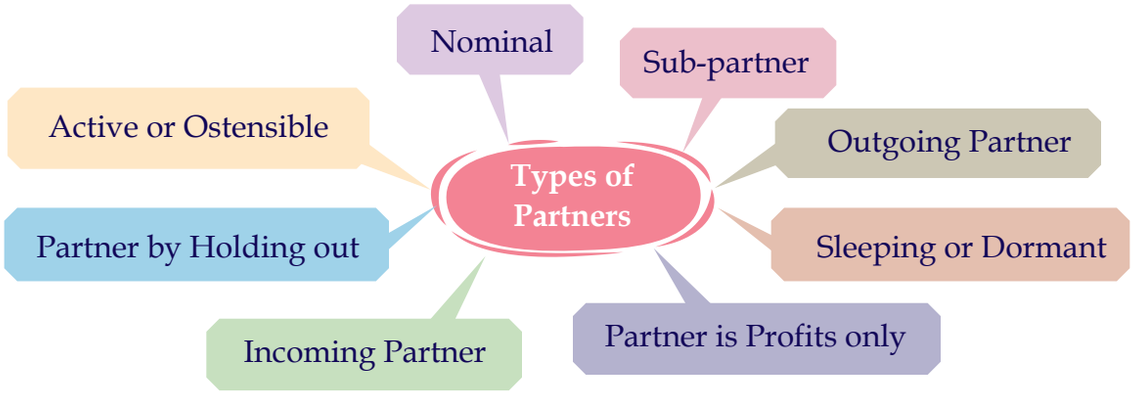
Partnership deed may contain the following information:-

1. **Name** of the partnership **firm.**
2. **Names** of **all the partners.**
3. **Nature and place of the business** of the firm.
4. **Date of commencement** of partnership.
5. **Duration** of the partnership firm.
6. **Capital contribution** of each partner.
7. **Profit Sharing ratio** of the partners.
8. **Admission and Retirement** of a partner.
9. **Rates of interest on Capital, Drawings and loans.**
10. Provisions for **settlement of accounts in the case of dissolution of the firm.**
11. Provisions for **Salaries or commissions**, payable to the partners, if any.
12. Provisions for **expulsion of a partner** in case of gross breach of duty or fraud.

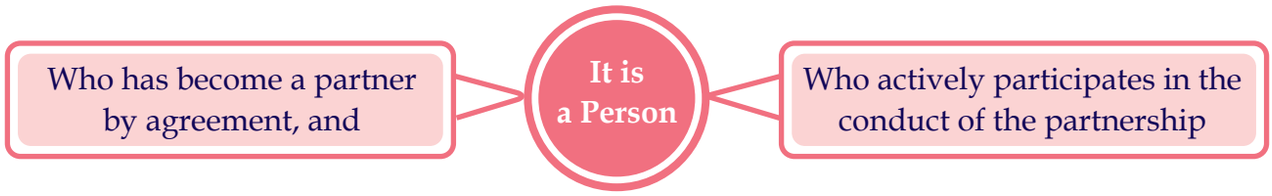
A partnership firm may **add or delete** any provision according to the needs of the firm.

❒ TYPES OF PARTNERS

Based on the extent of liability, the different classes of partners are:

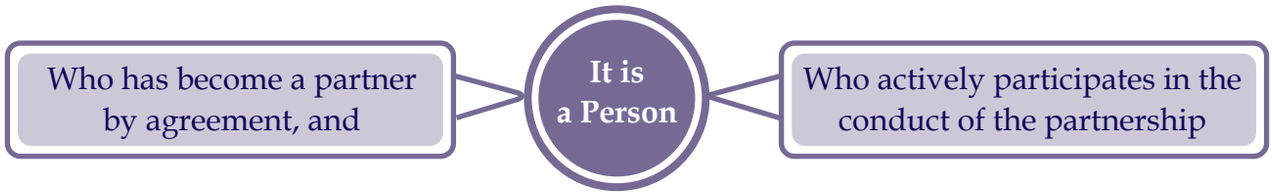


Active or Actual or Ostensible Partner



He acts as an **agent of other partners for all** acts done in the **ordinary course of business**. In the event of **his retirement,** he must give a **public notice** in order to **absolve himself** of liabilities for **acts of other partners done after his retirement**.

Sleeping or Dormant Partner



They are called as **'sleeping' or 'dormant' partners.** They **share profits and losses** and are **liable to the third parties** for all acts of the firm. They are, however **not required to give public notice of their retirement** from the firm.

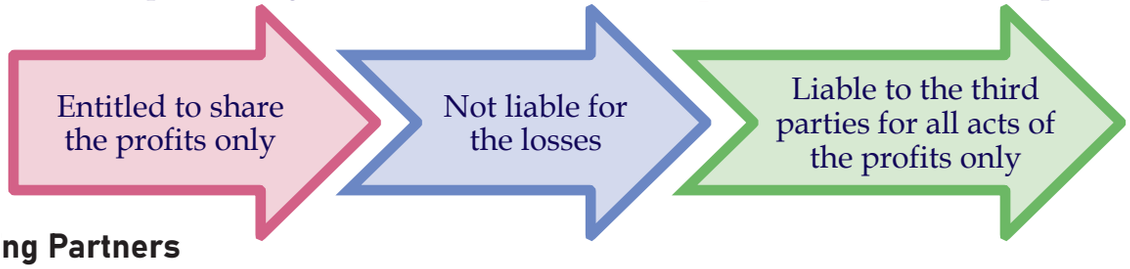
Nominal Partner

A person **who lends his name** to the firm, **without having** any **real interest** in it, is called a nominal partner.

He is **not entitled to share the profits of the firm**. **Neither he invests in the firm nor takes part in the conduct of the business.** He is, b for all acts of the firm.

Partner in Profits Only

A partner who is entitled to **share the profits only without being liable for the losses** is known as the partner for profits only and **also liable to the third parties** for all acts of the profits only.



Incoming Partners

A person who is **admitted as a partner into an already existing firm** with the **consent of all the existing partners** is called as **"incoming partner".** Such a partner is not liable for any act of the firm **done before his admission** as a partner.

Example 5:

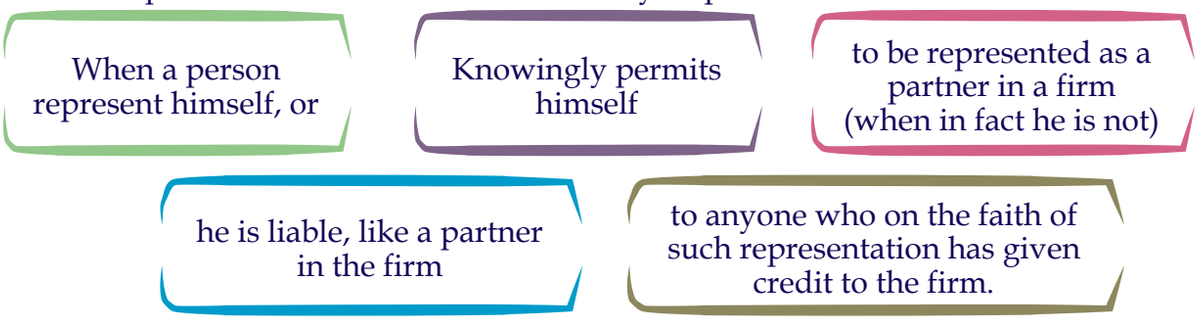
Mr. A joined as a partner on 10th September, 2021 in a firm MNQ Associates which was existing from 10th July, 2017. Mr. A will not be liable for any acts of the firm done before his date of joining i.e. 10th September, 2021

Outgoing Partner

A partner who **leaves** a firm in which the **rest of the partners continue to carry on business** is called a retiring or outgoing partner. Such a partner remains **liable to third parties** for all acts of the firm **until public notice is given** of his retirement.

Partner by Holding out (Section 28)

Partnership by holding out is also known as partnership by estoppel. Where a man **holds himself out as a partner**, or **allows others** to do it, he is then **stopped from denying the character** he has **assumed** and upon the **faith** of which **creditors** may be presumed to have **acted.**



A person may himself, **by his words or conduct have induced others to believe** that he is a partner or he may have allowed others to represent him as a partner. The result in both the cases is identical.

Example 6:

X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. After expiry of credit period, Z did not get amount of T.V sets sold to the partnership firm. Z filed a suit against X and A for the recovery of price. Here, in the given case, A, the Manager is also liable for the price because he becomes a partner by holding out (Section 28, Indian Partnership Act, 1932).

It is only the **person to whom** the **representation** has been **made** and who has **acted thereon** that has **right to enforce liability** arising out of '**holding out'.**

You must also note that for the purpose of fixing liability on a person who has, by representation, led another to act, it is **not necessary** to show that he was actuated by a **fraudulent intention.**

The rule given in Section 28 is **also applicable to a former partner** who has **retired** from the firm **without giving proper public notice** of his retirement. In such cases a person who, even subsequent to the retirement, give credit to the firm on the belief that he was a partner, will be entitled to hold him liable.

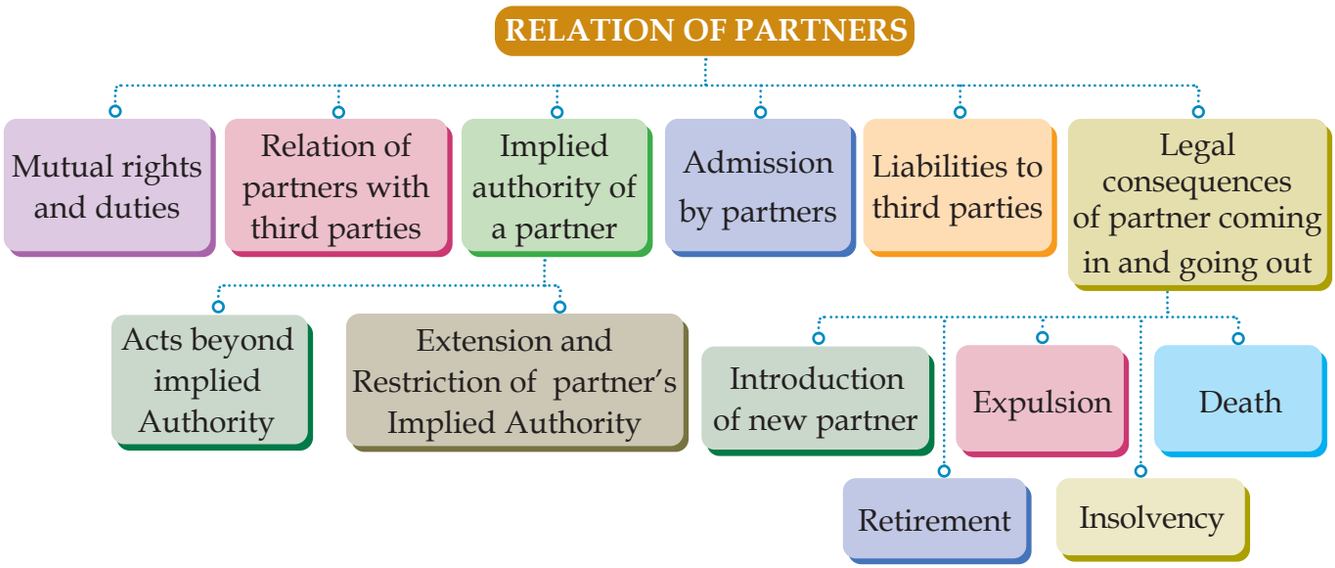
Example 7:

A partnership firm consisting of P, Q, R and S. S retires from the firm without giving public notice and his name continues to be used on letterheads. Here, S is liable as a partner by holding out to creditors who have lent on the faith of his being a partner.

UNIT 02 RELATIONS OF PARTNERS

TABLE OF CONTENTS FOR THE CHAPTER

- RELATION OF PARTNERS TO ONE ANOTHER 211
- PARTNERSHIP PROPERTY (SECTION 14) 214
- PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16) 215
- RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM (SECTION 17) 216
- RELATION OF PARTNERS TO THIRD PARTIES 216
- EFFECT OF ADMISSIONS BY A PARTNER (SECTION 23) 218
- EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24) 219
- LIABILITY TO THIRD PARTIES (SECTION 25 TO 27) 219
- RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29) 221
- MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30) 221
- LEGAL CONSEQUENCES OF PARTNER COMING IN AND GOING OUT (SECTION 31 – 35) 222
- RIGHTS OF OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS (SECTION 36) 226
- RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT (SECTION 37) 226
- REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38) 226



❒ RELATION OF PARTNERS TO ONE ANOTHER

The Partnership Act contains various provisions regulating the relationship between partners.

1. General Duties of Partners (Section 9)

The partners should **carry business** of the firm to the **greatest common advantages** and later, they should render to any partner or his legal representatives **full information** of all things affecting the firm. A partner must observe the utmost **good faith** in his dealings with the other partners.

All the partners are **bound to render accounts to each other** but where some of the accounts are kept by one of them, **prima facie** he would be the proper person to explain and give **full information** about them.

Example 1:

In a transaction between partners for the sale and purchase of a share in the business, if one of them is better acquainted with the accounts than the other, it is his duty to disclose all material facts.

2. Duty to Indemnify for Loss Caused by Fraud (Section 10)

The partner, committing fraud in the conduct of the business of the firm, must **make good the loss** sustained by the firm by **his misconduct** and the **amount so brought** in the partnership should be **divided** between the partners.

An act of a partner imputable to the firm or the principles of agency, which is a **fraud on his co-partners,** entitles the co-partners as between themselves, to throw the **whole of the consequences upon him**.

3. Determination of Rights and Duties of Partners by Contract between the Partners (Section 11)

1. Subject to the provisions of this Act, the mutual rights and duties of the partners of a firm may be **determined by contract** between the partners, and such contract **may be express or may be implied** by a course of dealing.

   Such contract may be **varied by consent of all** the partners, and such consent may be express or may be implied by a course of dealing.

2. **Agreements in restraint of trade**- Notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such **contracts may provide** that a partner **shall not carry on any business other than that of the firm while he is a partner**.

Partnership is a relation eminently depending on the consent of the parties, not only for its existence, but for the terms of the agreement in all things consistent with its essential nature and purpose; and an agreement to become partners in the first instance, or to vary the terms at any time, need not be manifested in any particular form.

4. The Conduct of the Business (Section 12)

Subject to contract between the partners-.

(a) every partner has a **right to take part in the conduct** of the **business;**

(b) every partner is bound to **attend diligently to his duties** in the conduct of the business;

(c) any **difference** arising as to **ordinary matters** connected with the business may be **decided by majority of the partners,** and every partner shall have the right to express his opinion before the matter is decided, but **no change may be made in the nature of the business without the consent of all partners**; and

(d) every partner has a **right to have access to and to inspect and copy** any of the **books of the firm.**

(e) in the event of the **death of a partner, his heirs or legal representatives** or their duly authorised agents **shall have a right of access to** and **to inspect the copy** of any of the **books** of the **firm.**

(i) **Right to take part in the conduct of the Business [Section 12(a)]:** Every partner has the **right to take part in the business of the firm.** This is because partnership business is a business of the partners and their management powers are generally **co-extensive.**

Example 2:

Now suppose this management power of the particular partner is interfered with and he has been wrongfully precluded from participating therein. Can the Court interfere in these circumstances? The answer is in the affirmative. The Court can, and will, by injunction, restrain other partners from doing so. It may be noted in this connection that a partner who has been wrongfully deprived of the right of participation in the management has also other remedies, e.g., a suit for dissolution, a suit for accounts without seeking dissolution, etc.

The above mentioned provisions of law will be applicable only if there is no contract to the contrary between the partners. It is quite common to find a term in partnership agreements, which gives only limited power of management to a partner or a term that the management of the partnership will remain with one or more of the partners to the exclusion of others. In such a case, the Court will normally be unwilling to interpose with the management with such partner or partners, unless it is clearly made out that something was done illegally or in breach of the trust reposed in such partners.

(ii) **Right to be consulted [section 12(c)]:** Where **any difference arises** between the partners with regard to the business of the firm, **it shall be determined by the views of the majority of them,** and **every partner** shall have the **right to express** his opinion before the matter is decided. But **no change in the nature of the business of the firm can be made without the consent of all the partners.** This means that in **routine matters,** the **opinion of the majority of the partners** will prevail. Of course, the **majority must act in good faith** and every partner must be **consulted** as far as practicable.

It may be mentioned that the aforesaid majority rule will not apply where there is a **change in the nature of the firm** itself. In such a case, the **unanimous consent** of the partners is needed.

(iii) **Right of access to books [Section 12(d)]:** Every partner whether active or sleeping is entitled to **have access to any of the books of the firm** and to inspect and take out of copy thereof. The right must, however, be exercised bona fide.

(iv) **Right of legal heirs/ representatives/ their duly authorised agents [Section 12(e)]:** In the event of the death of a partner, **his heirs or legal representatives or their duly authorised agents shall have a right of access to** and to inspect and copy any of the **books of the firm.**

5. Mutual Rights and Liabilities (Section 13)

Subject to contract between the partners-

(a) a partner is **not entitled to receive remuneration** for taking part in the conduct of the business;

(b) the partners are **entitled to share equally in the profits** earned, and shall contribute **equally to the losses** sustained by the firm;

(c) **where** a partner is **entitled to interest on the capita**l subscribed by him such interest shall be **payable only out of profits;**

(d) a partner making, for the purposes of the business, **any payment or advance** beyond the amount of capital he has agreed to subscribe, **is entitled to interest thereon at the rate of six percent per annum;**

(e) the firm shall indemnify a partner in respect of payments made and liabilities incurred by him-

  (i) in the **ordinary and proper conduct of the business**, and

  (ii) in doing such act, **in an emergency**, for the purposes of protecting the firm from loss, as would be done by a person of **ordinary prudence, in his own case,** under **similar circumstances;**

(f) a partner shall **indemnify the firm for any loss caused to it by his wilful neglect** in the conduct of business of the firm.

(i) Right to remuneration [Section 13(a)]

No partner is entitled to receive any remuneration in addition to his share in the profits of the firm for taking part in the business of the firm. But this rule can always be **varied by an express agreement, or by a course of dealings,** in which event the partner will be entitled to remuneration. Thus, a partner can claim remuneration even in the absence of a contract, when such **remuneration is payable under the continued usage of the firm**. In other words, where **it is customary to pay** remuneration to a partner for conducting the business of the firm, he **can claim** it **even in the absence of a contract** for the payment of the same.

(ii) Right to share profits [Section 13(b)]

Partners are entitled to **share equally in the profits earned** and so contribute **equally to the losses sustained** by the firm. The amount of a partner's share must be ascertained by enquiring **whether there is any agreement** in that behalf between the partners. **If there is no agreement then you should make a presumption of equality** and the burden of proving that the shares are unequal, will lie on the party alleging the same.

There is **no connection between** the proportion in which the partners shall share the **profits** and the proportion in which they have contributed towards the **capital** of the firm.

(iii) Interest on capital [Section 13(c)]

The following elements must be there before a partner can be entitled to interest on moneys brought by him in the partnership business: (i) **an express agreement** to that effect, or **practice of the particular partnership** or (ii) any **trade custom** to that effect; or (iii) a **statutory provision** which entitles him to such interest.

(iv) Interest on advances [Section 13(d)]

Suppose a **partner makes an advance** to the firm in addition to the amount of capital to be contributed by him, in such a case, the partner is **entitled to claim interest thereon @ 6% per annum**. While interest on capital account ceases to run on dissolution, the interest on advances **keep running** even after dissolution and **up to the date of payment.**

(v) Right to be indemnified [Section 13(e)]

Every partner has the right to be **indemnified by the firm in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business** of the firm as well as in the performance of an act **in an emergency** for protecting the firm from any loss, if the payments, liability and act are such **as a prudent man** would make, incur or perform in his **own case, under similar circumstances.**

(vi) Right to indemnify the firm [Section 13(f)]

A partner must indemnify the firm **for any loss** caused to it **by wilful neglect** in the conduct of the business of the firm.

❒ PARTNERSHIP PROPERTY (SECTION 14)

1. The Property of the Firm (Section 14)

The expression 'property of the firm', also referred to as **'partnership property', 'partnership assets', 'joint stock', 'common stock' or 'joint estate',** denotes all property, rights and interests to which the firm, that is, all partners collectively, may be entitled. The property which is **deemed** as **belonging to the firm**, in the absence of any agreement between the partners showing contrary intention, is comprised of the following items:

(i) all **property**, **rights and interests which partners may have brought** into the common stock as their contribution to the common **business;**

(ii) all the **property, rights and interest acquired or purchased by or for the firm**, or for the purposes and in the course of the **business of the firm**; and

(iii) **Goodwill** of the business.

The determination of the question whether **a particular property is or is not 'property'** of the **firm** ultimately depends on the **real intention or agreement** of the partners. Thus, the mere fact that the **property of a partner** is **being used** for the purposes of the firm shall **not by itself make it partnership property,** unless it is intended to be treated as such. Partners may, by an agreement at any time, **convert the property of any partner or partners** (and such conversion, if made in good faith, would be effectual between the partners and against the creditors of the firm) or the **separate property of any partner into a partnership property.**

Goodwill

Section 14 specifically lays down that the goodwill of a business is subject to a contract between the partners, to be regarded as 'property' of the 'firm'. But this Section does not define the term Goodwill.

'Goodwill' is a concept which is very easy to understand but difficult to define. Goodwill may be defined as the **value of the reputation of a business** house in respect of **profits expected** in future **over and above the normal level of profits** earned by undertaking belonging to the same class of business.

When a partnership firm is **dissolved every partner has a right**, in the absence of any agreement to the contrary, to have the **goodwill of business sold** for the benefit of all the partners.

Goodwill is a part of the property of the firm. **It can be sold separately or along with the other properties of the firm.** Any partner may upon the sale of the goodwill of a firm, make an agreement with the buyer that **such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits** and notwithstanding anything contained in Section 27 of the Indian Contract Act, 1872. Such **agreement shall be valid** if the **restrictions** imposed are **reasonable.**

Property of a partner

Where the property is exclusively belonging to a person, it does not become a property of the partnership merely because it is used for the business of the partnership, such property will become property of the partnership if there is an agreement.

2. Application of the Property of the Firm (Section 15)

Section 15 provides that the property of the firm shall be **held and used exclusively** for the **purpose of the firm.** In partnership, there is a **community of interest** which all the partners take in the property of the firm. But that **does not mean** than during the subsistence of the partnership, a particular **partner has any proprietary interest** in the **assets of the firm**. Every partner of the firm has a **right to get his share of profits** till the firm subsists and he has also a **right to see** that all the **assets** of the partnership are **applied** to and **used for the purpose of partnership business.**

❒ PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16)

According to section 16, subject to contract between the partners,-

(a) **If a partner derives any profit for himself from any transaction of the firm,** or from the **use of the property** or **business connection** of the firm or the **firm name**, he **shall account for that profit** and **pay it** to the firm;

(b) If a partner **carries on any business of the same nature as and competing** with that of the firm, he shall account for and **pay to the firm all profits made by him** in that business.

Example 3:

A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. It was held that A was bound to account to the firm for the profit so made by him. This rule, however, is subject to a contract between partners.

Example 4:

A, B, C and D started a business in partnership for importing salt from foreign ports and selling it at Chittagong. A struck certain transactions in salt on his own account, which were found to be of the same nature as the business carried on by the partnership. It was held that A was liable to account to the firm for profits of the business so made by him. This rule is also subject to a contract between the partners.

❒ RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM (SECTION 17)

Before going into rights and duties, we should first know how a change may take place in the constitution of the firm. It may occur in one of the four ways, namely,

- Where a new partner or partners come is
- Where some partner or partners go out, i.e., by death or retirement
- Where the partnership concerned carries on business other than the business for which it was originally formed
- Where the partnership business is carried out on after the expiry of the term fixed for the purpose.

According to section 17, subject to contract between the partners-

A. After a Change in the Firm

Where a change occurs in the **constitution of a firm,** the **mutual rights and duties** of the partners in the r**econstituted firm remain the same** as they were immediately before the change, as far as may be;

B. After the Expiry of the Term of the Firm

Where a firm constituted for a **fixed term** continues to **carry on business** after the **expiry of that term**, the **mutual rights and duties of the partners remain the same** as they were before the expiry, so far as they may be consistent with the incidents of partnership at will; and

C. Where Additional Undertakings are Carried out

where a firm constituted to carry out one or more adventures or undertakings carries out other adventures or undertakings are the same as those in respect of the original adventures or undertakings.

❒ RELATION OF PARTNERS TO THIRD PARTIES

1. Partner to be an Agent of the Firm (Section 18)

You may recall that a partnership is the relationship between the partners who have agreed to share the profits of the business carried on by all or any of them acting for all (Section 4). This definition suggests that any of the partners can be the agent of the others.

Section 18 clarifies this position by providing that, subject to the provisions of the Act, a partner is the **agent of the firm** for the **purpose of the business** of the firm. The partner indeed virtually **embraces the character of both a principal and an agent. So as far as he** acts for himself and in his own interest in the common concern of the partnership, he may properly be **deemed a principal** and so far as **he acts for his partners,** he may properly be deemed as an **agent.**

The principal **distinction between him and a mere agent** is that **he has a community of interest with other partners in the whole property and business and liabilities of partnership,** whereas a**n agent as such has no interest in either.**

The rule that a partner is the agent of the firm for the purpose of the business of the firm cannot be applied to all transactions and dealings between the partners themselves. It is applicable only to the act done by partners for the purpose of the business of the firm.

2. Implied Authority of Partner as Agent of the Firm (Section 19)

Subject to the provisions of section 22, **the act of a partner** which is done to carry on, in the **usual way,** business of the kind carried on by the firm, **binds the firm.**

The authority of a partner to bind the firm conferred by this section is called his **"implied authority".**

In the **absence** of any **usage or custom** of trade to the contrary, the implied authority of **a partner does not empower him to-**

(a) **Submit a dispute** relating to the business of the firm to **arbitration;**
(b) **open a banking account** on behalf of the firm in his **own name**;
(c) **compromise or relinquish any claim or portion of a claim** by the firm;
(d) **withdraw a suit or proceedings** filed on behalf of the firm;
(e) **admit any liability in a suit** or proceedings against the firm;
(f) **acquire immovable property** on behalf of the firm;
(g) **transfer immovable property** belonging to the firm; and
(h) **enter into partnership** on behalf of the firm.

Mode of doing act to bind firm (Section 22)

In order to **bind a firm,** an **act or instrument** done or executed by a partner or other person on behalf of the firm shall be done or **executed** in the firm **name,** or in any other manner expressing or implying an **intention to bind** the firm.

At the very outset, you should understand what is meant by **"implied authority"**. You have just read that every partner is an agent of the firm for the purpose of the business thereof. Consequently, as between the partners and the outside world (whatever may be their private arrangements between themselves), each partner is agent of every other in every matter connected with the partnership business; his acts bind the firm.

Sections 19(1) and 22 deal with the implied authority of a partner. The impact of these Sections is that the act of a partner **which is done to carry on, in the usual way,** business of the kind carried on by the firm binds the firm, provided that the act is **done in the firm name,** or any manner expressing or implying an **intention to bind t**he firm. Such an authority of a partner to bind the firm is called his implied authority. It is however subject to the following restrictions:

1. **The act done must relate to the usual business** of the firm, that is, the act done by the partner must be **within the scope of his authority** and related to the normal business of the firm.
2. The act is such as is done for **normal conduct of business of the firm**. The usual way of carrying on the business will depend on the nature and circumstances of each particular case [Section 19(1)].
3. The act to be done **in the name of the firm** or in any other manner expressing or **implying an intention to bind the firm** (Section 22).

   Thus, a partner has implied authority to bind the firm by all acts done by him in all matters connected with the partnership business and which are done in the **usual way** and are not in their nature beyond the scope of partnership. You must remember that an implied authority of a partner may **differ in different kinds of business.**

Example 5:

X, a partner in a firm of solicitors, borrows money and executes a promissory note in the name of firm without authority. The other partners are not liable on the note, as it is not part of the ordinary business of a solicitor to draw, accept, or endorse negotiable instruments; however, it may be usual for one partner of firm of bankers to draw, accept or endorse a bill of exchange on behalf of the firm.

If partnership be of a **general commercial nature,**

(i) **he may pledge or sell** the partnership property;

(ii) he may **buy goods** on account of the partnership;

(iii) he may **borrow money, contract debts** and pay debts on account of the partnership;

(iv) he **may draw, make, sign, endorse, transfer, negotiate and procure to be discounted, Promissory notes, bills of exchange, cheques** and other negotiable papers in the name and on account of the partnership.

Section 19(2) contains the acts which are beyond the implied authority of the partners.

3. Extension and Restriction of Partners' Implied Authority (Section 20)

The implied authority of a partner may be **extended or restricted by contract** between the partners. Under the following conditions, the restrictions imposed on the implied authority of a partner by agreement shall be **effective against a third party:**

1. The **third party knows about the restrictions,** and
2. The third party **does not know that he is dealing with a partner** in a firm.

Example 6:

A, a partner, borrows from B ₹ 1,000 in the name of the firm but in excess of his authority, and utilizes the same in paying off the debts of the firm. Here, the fact that the firm has contracted debts suggests that it is a trading firm, and as such it is within the implied authority of A to borrow money for the business of the firm. This implied authority, as you have noticed, may be restricted by an agreement between him and other partners. Now if B, the lender, is unaware of this restriction imposed on A, the firm will be liable to repay the money to B. On the contrary, B's awareness as to this restriction will absolve the firm of its liability to repay the amount to B.

It may be noted that the above-mentioned extension or restriction is only possible with the **consent of all the partners**. Any **one partner**, or **even a majority** of the partners, **cannot restrict or extend** the implied authority.

4. Partner's Authority in an Emergency (Section 21)

According to section 21, a partner has authority, in an emergency, to **do all such acts** for the **purpose of protecting** the firm from loss as would be done by a person of **ordinary prudence**, in his own case, acting under **similar circumstances,** and such acts bind the firm.

❒ EFFECT OF ADMISSIONS BY A PARTNER (SECTION 23)

Partners, as agents of each other can make **binding admissions** but only in relation to partnership transaction and in the **ordinary course** of business. An admission or representation by a partner **will not however, bind the firm** if his authority on the point is **limited** and the **other party knows of the restriction**. The section speaks of admissions and representations being evidenced against the firm. That is to say, **they will affect the firm when tendered by third parties; they may not have the same effect in case of disputes between the partners themselves.**

Example 7:

X and Y are partners in a firm dealing in spare parts of different brands of motorcycle bikes. Z purchases a spare part for his Yamaha motorcycle after being told by X that the spare part is suitable for his motorcycle. Y is ignorant about this transaction. The spare part proves to be unsuitable for the motorcycle and it is damaged. X and Y both are responsible to Z for his loss.

❒ EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24)

The **notice to a partner, who habitually acts in business of the firm**, on matters **relating to the affairs** of the firm, **operates as a notice to the firm** except in the case of a **fraud** on the firm committed by or with the consent of that partner. Thus, the notice to **one is equivalent to the notice to the rest of the partners** of the firm, just as a notice to an agent is notice to his principal. This notice must be **actual and not constructive**. It must be received **by a working partner** and **not by a sleeping partner**. It must further relate to the **firm's business**. Only then it would constitute a notice to the firm.

Example 8:

P, Q, and R are partners in a business for purchase and sale of second hand goods. R purchases a second hand car on behalf of the firm from S. In the course of dealings with S, he comes to know that the car is a stolen one and it actually belongs to X. P and Q are ignorant about it. All the partners are liable to X, the real owner.

The only exception would lie in the **case of fraud**, whether **active or tacit.**

Example 9:

A, a partner who actively participates in the management of the business of the firm, bought for his firm, certain goods, while he knew of a particular defect in the goods. His knowledge as regards the defect, ordinarily, would be construed as the knowledge of the firm, though the other partners in fact were not aware of the defect. But because A had, in league with his seller, conspired to conceal the defect from the other partners, the rule would be inoperative and the other partners would be entitled to reject the goods, upon detection by them of the defect.

❒ LIABILITY TO THIRD PARTIES (SECTION 25 TO 27)

The question of liability of partners to third parties may be considered under different heads. These are as follows:

1. Liability of a Partner for Acts of the Firm (Section 25)

The partners are **jointly and severally responsible to third parties** for all acts which come under the **scope of their express or implied authority.** This is because that all the acts done within the scope of authority are the acts done **towards the business of the firm.**

The expression **'act of firm' connotes any act or omission by all the partners or by any partner or agent of the firm**, which gives rise to a **right enforceable by or against the firm.** Again, in order to bring a case under Section 25, it is necessary that the act of the firm, in respect of which liability is brought to be enforced against a party, must have been **done while he was a partner.**

Example 10:

Certain persons were found to have been partners in a firm when the acts constituting an infringement of a trademark by the firm took place, it was held that they were liable for **damages arising out of the alleged infringement**, it being **immaterial** that the **damages arose after the dissolution of the firm.**

2. Liability of the Firm for Wrongful Acts of a Partner (Section 26)

The **firm is liable to the same extent** as the **partner** for **any loss or injury** caused to a **third party** by the **wrongful acts of a partner**, if they are done by the partner while acting:

(a) **in the ordinary course of the business** of the firm

(b) with the **authority of the partners.**

If the act in question can be regarded as authorized and as falling within either of the categories mentioned in Section 26, the fact that the **method employed by the partner** in doing it was unauthorized or wrongful would **not affect the question.** Furthermore, **all the partners in a firm** are liable to a third party for loss or injury caused to him by the negligent act of a partner acting in the ordinary course of the business.

Example 11:

One of the two partners in coal mine acted as a manager was guilty of personal negligence in omitting to have the shaft of the mine properly fenced. As a result thereof, an injury was caused to a workman. The other partner was also held responsible for the same.

3. Liability of Firm for Misapplication by Partners (Section 27)

It may be observed that the workings of the two clauses of Section 27 is designed to bring out clearly an important point of distinction between the two categories of cases of misapplication of money by partners.

Clause (a) covers the case where a partner **acts within his authority** and due to his authority as partner, he **receives money or property** belonging to a **third party** and **misapplies** that money or property. For this provision to the attracted, **it is not necessary that the money should have actually come into the custody of the firm.**

On the other hand, the provision of clause (b) would be attracted when such money or property has **come into the custody** of the firm and it is misapplied by any of the partners.

The **firm would be liable in both the cases**.

If **receipt** of money by one partner is **not within the scope of his apparent authority**, his receipt **cannot be regarded as a receipt by the firm** and the **other partners will not be liable**, unless the money received comes into their possession or under their control.

Example 12:

A, B, and C are partners of a place for car parking. P stands his car in the parking place but A sold out the car to a stranger. For this liability, the firm is liable for the acts of A.

❒ RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29)

A **share** in a partnership is **transferable** like any other property, but as the partnership relationship is based on **mutual confidence**, the **assignee of a partner's interest** by sale, mortgage or otherwise **cannot enjoy the same rights and privileges** as the original partner.

The rights of such a transferee are as follows:

I. During the **continuance** of partnership, such transferee is **not entitled:**

(a) to **interfere** with the conduct of the business,

(b) to **require** accounts, or

(c) to **inspect books** of the firm.

He is **only entitled to receive the share of the profits** of the transferring partner and he is **bound to accept** the profits as agreed to by the partners, i.e., he cannot challenge the accounts.

II. On the **dissolution** of the firm or on the **retirement** of the transferring partner, the transferee will be entitled, against the remaining partners:

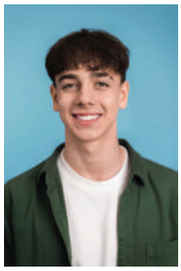
(a) **to receive the share** of the assets of the firm to which the transferring partner was entitled, and

(b) for the purpose of **ascertaining the share,**

he is entitled to an **account** as from the **date of the dissolution.**

By virtue of Section 31, which we will discuss hereinafter, no person can be introduced as a partner in a firm without the consent of all the partners. A partner cannot by transferring his own interest, make anybody else a partner in his place, unless the other partners agree to accept that person as a partner. At the same time, a partner is not debarred from transferring his interest. A partner's interest in the partnership can be regarded as an existing interest and tangible property which can be assigned.

❒ MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30)



You have observed that a minor **cannot be bound** by a contract because a minor's contract is void and not merely voidable. Therefore, a **minor cannot become a partner** in a firm because partnership is founded on a contract. Though a minor cannot be a partner in a firm, he can nonetheless be **admitted to the benefits** of partnership under Section 30 of the Act. In other words, he can be validly given a share in the partnership profits. When this has been done with the **consent of all the partners** then the rights and liabilities of such a partner will be governed under Section 30 as follows:

1. Rights

(i) A minor partner has a right to his **agreed share** of the profits and of the firm.

(ii) He can have **access to, inspect and copy the accounts** of the firm.

(iii) He **can sue** the partners for accounts or for **payment of his share** but only when **severing his connection** with the firm, and not otherwise.

(iv) On attaining **majority,** he may **within 6 months elect** to **become a** partner or **not to become a partner**. If he elects to become a partner, then he is **entitled to the share** to which he was entitled as a minor. If he **does not,** then his share is **not liable** for any acts of the firm **after the date of the public notice** served to that effect.

2. Liabilities

(i) Before attaining majority

(a) The liability of the minor is confined only to the **extent of his share** in the **profits and the property** of the firm.

(b) Minor has **no personal liability** for the debts of the firm incurred during his minority.

(c) Minor **cannot be declared insolvent**, but if the **firm is declared insolvent** his **share in the firm vests in the Official Receiver/**Assignee (which means minor can recover his share in the firm on proportionate basis from official receiver/assignee)

(ii) After attaining majority

Within 6 months of his attaining majority or on his **obtaining knowledge that he had been admitted to the benefits** of partnership, **whichever date is later,** the minor partner **has to decide** whether he shall **remain a partner or leave t**he firm.

Where he has elected not to **become partner**, he may give public notice that he has elected not to become partner and such notice shall determine his position with regard to the firm If **he fails to give such notice** he shall become a partner in the firm on the expiry of the said six months.

(a) When he becomes partner

If the minor becomes a partner on his own willingness or by his failure to give the public notice within specified time, his rights and liabilities as given in Section 30(7) are as follows:

(i) He **becomes personally liable** to third parties for **all acts of the firm** done **since** he was **admitted to the benefits** of partnership.

(ii) His **share in the property** and the profits of the firm **remains the same** to which he was entitled as a minor.

(b) When he elects not to become a partner

(i) His **rights and liabilities continue** to be those of a minor **up to the date** of giving **public notice.**

(ii) His **share shall not be liable** for any acts of the firm done **after the date of the notice.**

(iii) He shall be entitled to **sue the partners** for his share of the property and profits. It may be noted that such minor shall **give notice** to the Registrar that **he has or has not become a partner.**

❒ LEGAL CONSEQUENCES OF PARTNER COMING IN AND GOING OUT (SECTION 31 – 35)

Any **change in the relation** of partners will result in **reconstitution o**f the partnership firm. Thus, on admission of a new partner or retirement of a partner or expulsion of the partner, or on insolvency of a partner etc. a firm will be reconstituted:

I. Introduction of a Partner (Section 31)

As we have studied earlier, subject to a contract between partners and to the provisions regarding minors in a firm, **no new partners** can be introduced into a firm **without the consent of all** the existing partners.

Rights and liabilities of new partner

The liabilities of the new partner **ordinarily** commence from the date **when he is admitted as a partner, unless he agrees** to be liable for obligations incurred by the firm **prior to the date**. The **new firm**, including the new partner who joins it, may agree to assume **liability for the existing debts** of the old firm, and **creditors** may agree to **accept t**he new firm as their debtor and discharge the old partners. The **creditor's consent is necessary** in every case to make the transaction operative. **Novation** is the technical term in a contract for substituted liability, of course, not confined only to case of partnership.

But a **mere agreement amongst partners cannot operate as Novation.** Thus, an agreement between the **partners and the incoming partner** that he shall be l**iable** for existing debts **will not ipso facto give creditors of the firm any right against him.**

In case of partnership of two partners

This section does not apply to a partnership of two partners which is automatically dissolved by the death of one of them.

Ii. Retirement of a partner (Section 32)

1. A partner may retire:
   (a) with the **consent of all** the other partners;
   (b) in accordance with an **express agreement** by the partners; or
   (c) where the partnership is at will, by giving **notice in writing to all** the other partners of **his intention** to retire.
2. A retiring partner may be **discharged from any liability** to any third party for acts of the firm **done before his retirement** by an **agreement** made by him with such **third party** and the **partners of the reconstituted firm**, and such agreement may be implied by a course of dealing between the third party and the reconstituted firm after he had knowledge of the retirement.
3. Notwithstanding the retirement of a partner from a firm, he and the partners **continue to be liable** as partners to third parties for any act done by any of them which would have been an act of the firm if done before the retirement, **until public notice is given of the retirement:**

   Provided that a **retired partner i**s not liable to any third party who deals with the firm without knowing that he was a partner.
4. Notices under sub-section (3) may be given by the retired partner or by any partner of the reconstituted firm.

Case Law: In Vishnu Chandra Vs. Chandrika Prasad [Supreme Court]

The Supreme Court in Vishnu Chandra Vs. Chandrika Prasad, held that the expression 'if any partner wants to dissociate from the partnership business', in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from the partnership. The expression clearly indicated that in the event of retirement, the partnership business will not come to an end.

Example 13:

Mere **retirement of a partner**, who was the **tenant of the premises** in which the partnership business was carried out, would **not result in assignment of the tenancy rights** in **favour of the remaining partners** even though the retiring partner ceases to have any right, title or interest in the business as such.

III. Expulsion of a Partner (Section 33)

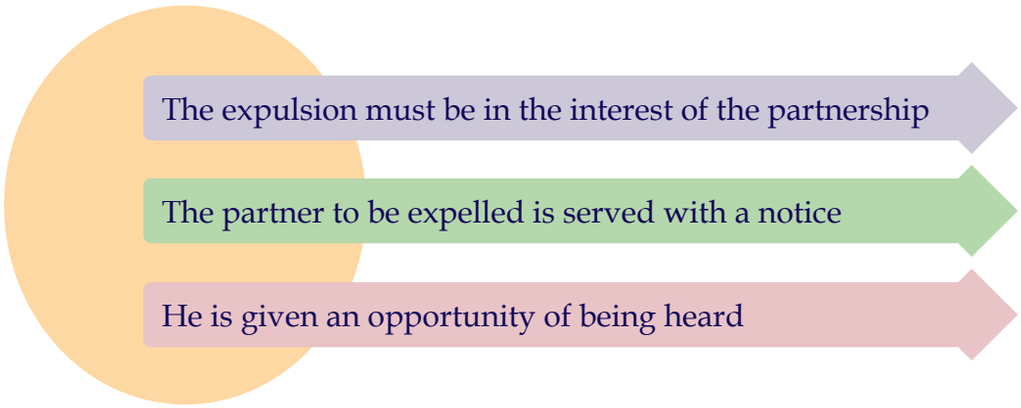
(i) the **power** of expulsion must have **existed in a contract** between the partners;

(ii) the power has been **exercised by a majority** of the partners; and

(iii) it has been exercised i**n good faith.**

If **all** these conditions are **not present**, the **expulsion is not deemed to be in bona fide** interest of the business of the firm.

The test of good faith as required under Section 33(1) includes three things:



If a partner is **otherwise expelled,** the expulsion is **null and void.**

It may be noted that under the Act, the expulsion of partners does not necessarily result in dissolution of the firm. The invalid expulsion of a partner does not put an end to the partnership even if the partnership is at will and it will be deemed to continue as before.

Example 14:

A, B and C are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly. A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C. Considering the provisions of Indian Partnership Act, 1932 state whether they can expel a partner from the firm?

A partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by contract between the partners. It is, thus, essential that:

(i) the power of expulsion must have existed in a contract between the partners;

(ii) the power has been exercised by a majority of the partners; and

(iii) it has been exercised in good faith.

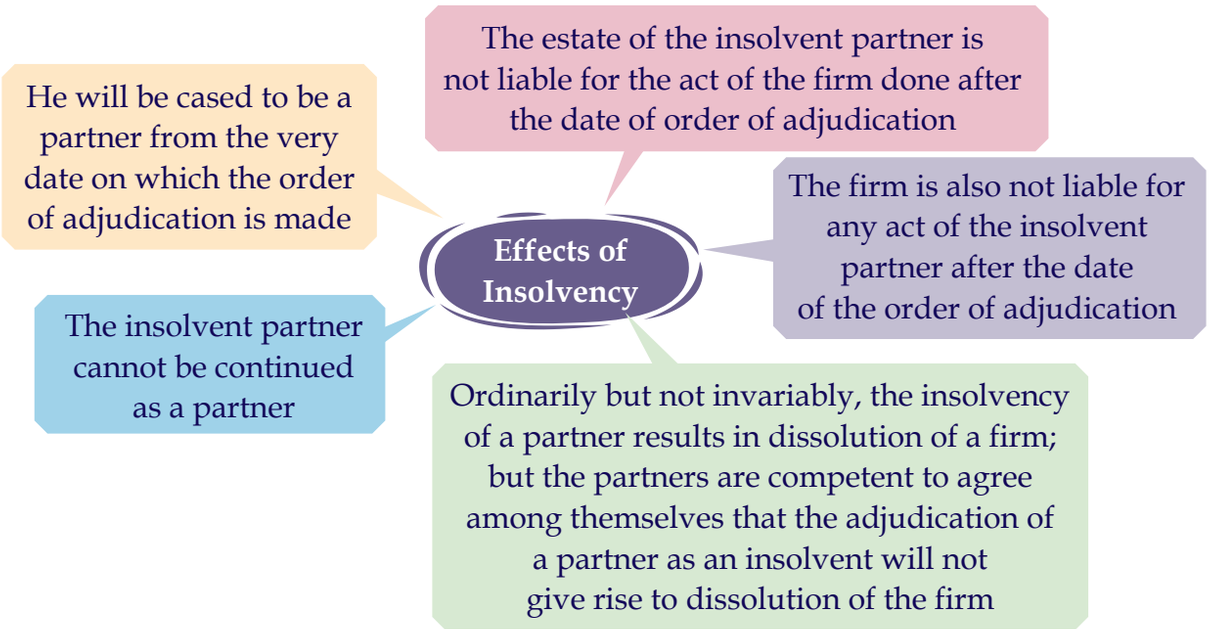
If all these conditions are not present, the expulsion is not deemed to be in bonafide interest of the business of the firm.

Thus, according to the test of good faith as required under Section 33(1), expulsion of Partner B is not valid.

In this context, you should also remember that provisions of Sections 32 (2), (3) and (4) which we have just discussed, will be equally applicable to an expelled partner as if he was a retired partner.

IV. Insolvency of a Partner (Section 34)

1. Where a partner in a firm is adjudicated as an insolvent he **ceases to be a partner** on the **date** on which the **order of adjudication is made**, whether or not the firm is hereby dissolved.
2. Where under a contract between the partners the firm is not dissolved by the adjudication of a partner as an insolvent, the **estate** of a partner so adjudicated is **not liable** for any act of the firm and the firm is not liable for any act of the insolvent, **done after the dat**e on which the **order of adjudication is made.**



V. Liability of Estate of Deceased Partner (Section 35)

Ordinarily, the **effect of the death** of a partner is the **dissolution** of the partnership, but the rule in regard to the dissolution of the partnership, by death of partner is subject to a contract between the parties and the partners are **competent to agree** that the death of one will not have the effect of dissolving the partnership as regards the surviving partners unless the firm consists of only two partners. In order that the **estate of the deceased** partner may be **absolved** from **liability** for the **future obligations** of the firm, it is **not necessary** to give any **notice either to the public** or the persons h**aving dealings with the firm.**

Example 15:

X was a partner in a firm. The firm ordered goods in X's lifetime; but the delivery of the goods was made after X's death. In such a case, X's estate would not be liable for the debt; a creditor can have only a personal decree against the surviving partners and a decree against the partnership assets in the hands of those partners. A suit for goods sold and delivered would not lie against the representatives of the deceased partner. This is because there was no debt due in respect of the goods in X's lifetime.

❒ RIGHTS OF OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS (SECTION 36)

An **outgoing partner** may carry on **business competing** with that of the firm and he may **advertise such business**, but subject to contract to the contrary, he **may not,-**

(a) **use the firm name,**

(b) **represent himself** as carrying on the **business of the firm** or

(c) **solicit the custom** of persons who were **dealing** with the firm **before he ceased** to be a partner.

Agreement in restraint of trade

A partner may make an **agreement** with his partners that on ceasing to be a partner he will **not carry on any business similar to that of the firm** within a **specified period or within specified local limits** and, notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such agreement **shall be valid** if the restrictions imposed are reasonable.

❒ RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS (SECTION 37)

According to section 37, Where any member of a firm **has died or otherwise ceased** to be partner, and the **surviving or continuing partners carry on the business** of the firm with the property of the firm **without any final settlement of accounts** as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the **outgoing partner or his estate** is **entitled** at the option of himself or his representatives to such **share of the profits made since he ceased** to be a partner as may be attributable to the **use of his share of the property** of the firm or to **interest at the rate of six per cent** per annum on the amount of **his share in the property** of the firm:

Provided that whereby contract between the partners, an **option is given** to surviving or continuing partners to **purchase** the interest of a deceased or outgoing partner, and that **option is duly exercised,** the estate of the deceased partner, or the **outgoing partner or his estate**, as the case may be, is **not entitled to any further or other share of profits;** but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.

Example 16:

A, B and C are partners in a manufacture of machinery. A is entitled to three eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. A's estate is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

Example 17:

A, B and C are partners. C retires after selling his share in the partnership firm. A and B fail to pay the value of the share to C as agreed to. The value of the share of C on the date of his retirement from the firm would be pure debt from the date on which he ceased to be a partner as per the agreement entered between the parties. C is entitled to recover the same with interest.

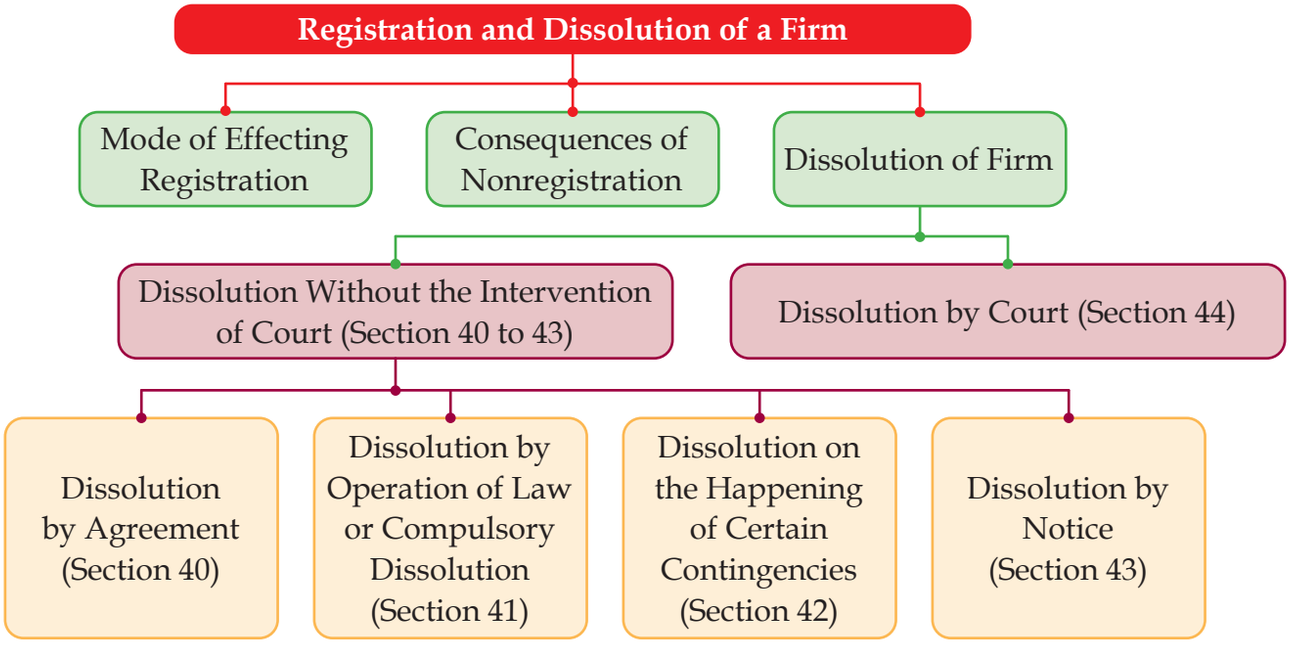
❒ REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38)

According to section 38, a **continuing guarantee** given to a firm or to third party in respect of the transaction of a firm is, in the absence of an agreement to the contrary, **revoked** as to **future transactions** from **the date of any change** in the constitution of the firm.

UNIT 03 REGISTRATION AND DISSOLUTION OF A FIRM

TABLE OF CONTENTS FOR THE CHAPTER

- REGISTRATION OF FIRMS 227
- CONSEQUENCES OF NON-REGISTRATION (SECTION 69) 228
- DISSOLUTION OF FIRM (SECTIONS 39 - 47) 229
- CONSEQUENCES OF DISSOLUTION (SECTIONS 45 - 55) 233



REGISTRATION OF FIRMS

APPLICATION FOR REGISTRATION (SECTION 58): (1) The **registration** of a firm may be effected at **any time** by sending by **post or delivering** to the Registrar of the area in which **any place of business** of the firm is situated or proposed to be situated, **a statement** in the prescribed form and accompanied by the prescribed fee, stating-

(a) **The firm's name**

(b) **The place or principal place** of business of the firm,

(c) The names of any **other places** where the firm carries on **business,**

(d) The date when **each partner joined** the firm,

(e) The names in **full and permanent addresses** of the partners, and

(f) The **duration** of the firm.

The **statement** shall be **signed** by **all the partners,** or by **their agents** specially authorised in this behalf.

1. **Each person signing** the statement shall also **verify** it in the manner prescribed.
2. A **firm name shall not contain** any of the following words, namely.

Note: 'Crown', Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or words expressing or implying the sanction, approval or patronage of Government **except** when the **State Government** signifies its **consent** to the use of such words as part of the firm-name by order in writing.

REGISTRATION (SECTION 59): When the Registrar is **satisfied** that the provisions of Section 58 have been duly complied with, he shall **record an entry** of the statement in a Register called the Register of Firms and shall **file the statement.** Then he shall issue a **certificate of Registration**. However, registration is **deemed to be completed** as soon as an application in the **prescribed form** with the **prescribed fee** and necessary **details** concerning the particulars of partnership is **delivered to the Registrar**. The recording of an **entry in the register of firms** is a **routine duty** of Registrar.

Registration **may also be effected even after a suit has been filed** by the firm but in that case it is **necessary to withdraw the suit first** and get the firm registered and then file a **fresh suit**.

LATE REGISTRATION ON PAYMENT OF PENALTY (SECTION 59A-1): If the statement in respect of any firm is not sent or delivered to the Registrar within the time specified in sub section (1A) of section 58, then the firm may be registered on payment, to the Registrar, of a penalty of one hundred rupees per year of delay or a part thereof.

❒ CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

Under the English Law, the registration of firms is compulsory. Therefore, there is a penalty for non-registration of firms. But the Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration. However, under Section 69, non-registration of partnership gives rise to a number of disabilities which we shall presently discuss. Although registration of firms is **not compulsory,** yet the **consequences** or disabilities of non-registration have a **persuasive pressure** for their registration. These disabilities briefly are as follows:

(i) No suit in a civil court by firm or other co-partners against third party: **The firm or any other person** on its behalf cannot bring an **action against the third party** for breach of contract entered into by the firm, unless the firm is **registered** and the **persons suing** are or have been **shown in the register** of firms **as partners** in the firm. In other words, a registered firm can only file a suit against a third party and the persons suing have been in the register of firms as partners in the firm.

(ii) No relief to partners for set-off of claim: If an **action is brought** against the firm by a third party, then **neither the firm nor the partner** can claim any set-off, if the suit be **valued** for **more than ₹ 100** or pursue other proceedings to enforce the rights arising from any contract.

(iii) Aggrieved partner cannot bring legal action against other partner or the firm: A **partner** of an **unregistered firm** (or any other person on his behalf) **is precluded from bringing legal action against** the **firm** or any person alleged to be or to have been a **partner** in the firm. But, such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.

(iv) Third party can sue the firm: In case of an unregistered firm, an action can be brought **against** the **firm by a third party**.

Exceptions: Non-registration of a firm does not, however effect the following rights:

1. The right of **third parties to sue** the **firm** or **any partner**.
2. The right of **partners to sue** for the **dissolution** of the firm or for the **settlement** of the accounts of a dissolved firm, or for **realization** of the property of a dissolved firm.

3. The power of an **Official Assignees,** Receiver of Court to **release the property** of the **insolvent** partner and to bring an action.
4. The right to **sue or claim a set-off** if the **value** of suit does **not exceed ₹ 100** in value.
5. The right to **suit** and proceeding instituted **by legal representatives** or **heirs** of the deceased partner of a firm **for accounts** of the firm or to **realise the property** of the firm.

Example 1:

A & Co. is registered as a partnership firm in 2017 with A, B and C partners. In 2018, A dies. In 2019, B and C sue X in the name and on behalf of A & Co. without fresh registration. Now the first question for our consideration is whether the suit is maintainable.

As regards the question whether in the case of a registered firm (whose business was carried on after its dissolution by death of one of the partners), a suit can be filed by the remaining partners in respect of any subsequent dealings or transactions without notifying to the Registrar of Firms, the changes in the constitution of the firm, it was decided that the remaining partners should sue in respect of such subsequent dealings or transactions even though the firm was not registered again after such dissolution and no notice of the partner was given to the Registrar.

The test applied in these cases was whether the plaintiff satisfied the only two requirements of Section 69 (2) of the Act namely,

(i) the suit must be **instituted by** or on **behalf** of the **firm** which had **been registered**;

(ii) **the person suing** had been shown as **partner** in the register of firms. In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.

Now, in the above example, what difference would it make, if in 2019 B and C had taken a new partner, D, and then filed a suit against X without fresh registration?

Where a **new partner is introduced**, the fact is to be **notified to Registrar** who shall make a **record** of the notice in the entry relating to the firm **in the Register of firms**. Therefore, the firm cannot sue as D's (new partner's) name has not been entered in the register of firms. It was pointed out that in the second requirement, the phrase "person suing" means persons in the sense of individuals whose names appear in the register as partners and who must be all partners in the firm at the date of the suit.

❒ DISSOLUTION OF FIRM (SECTIONS 39 - 47)

According to Section 39 of the Indian Partnership Act, 1932, the **dissolution of partnership between all partners** of a firm is **called** the **'dissolution of the firm'**.

Thus, the dissolution of firm **means the discontinuation** of the **legal relation** existing **between** all the **partners** of the firm. But when only one or more partners retires or becomes incapacitated from acting as a partner due to death, insolvency or insanity, the partnership, i.e. the relationship between such a partner and other is dissolved, but the rest may decide to continue. In such cases, there is in practice, no dissolution of the firm. The particular partner goes out, but the remaining partners carry on the business of the firm, it is called dissolution of partnership. In the case of dissolution of the firm, on the other hand, the whole firm is dissolved. The partnership terminates as between each and every partner of the firm.

Dissolution of Firm Vs. Dissolution of Partnership

S. No.	Basis of Difference	Dissolution of Firm	Dissolution of Partnership
1	**Continuation of business**	It involves discontinuation of business in partnership.	It does not affect continuation of business. It involves only reconstitution of the firm.
2	**Winding up**	It involves winding up of the firm and requires realization of assets and settlement of liabilities.	It involves only reconstitution and requires only revaluation of assets and liabilities of the firm.
3	**Order of court**	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
4	**Scope**	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.
5	**Final closure of books**	It involves final closure of books of the firm.	It does not involve final closure of the books of the firm.

Modes of Dissolution of a firm (Sections 40-44)

The dissolution of partnership firm may be in any of the following ways:

1. **DISSOLUTION WITHOUT THE ORDER OF THE COURT OR VOLUNTARY DISSOLUTION:**

   It consists of following four types:

   (i) Dissolution by Agreement (Section 40):

   Section 40 gives right to the partners to dissolve the partnership by agreement with the **consent of all the partners** or in accordance with a contract between the partners. 'Contract between the partners' means a contract already made.

   (ii) Compulsory dissolution (Section 41):

   A firm is compulsorily dissolved

   - **by the adjudication** of **all** the **partners** or of all the partners but one as insolvent; or
   - by the happening of any **event** which makes it **unlawful for** the business of the firm to be carried on **or** for the **partners** to carry it on in **partnership**.

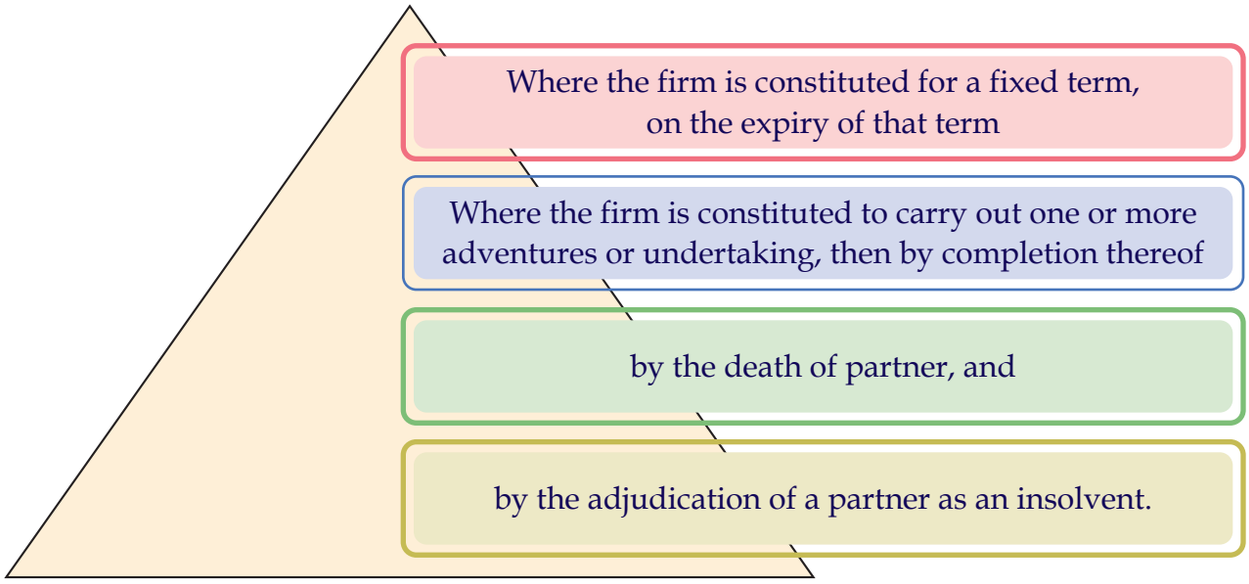
   However, when more than one **separate adventure or undertaking** is carried on by the firm, the **illegality of one or more** shall **not** of itself **cause** the **dissolution** of the firm in respect of its **lawful adventures** and undertakings.

Example 2:

A firm is carrying on the business of trading a particular chemical and a law is passed which bans on the trading of such a particular chemical. The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.

   (iii) Dissolution on the happening of certain contingencies (Section 42):

   Subject to contract between the partners, a firm can be dissolved on the happening of any of the following contingencies-



(iv) Dissolution by notice of partnership at will (Section 43):

1. Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing **to all the other** partners of his **intention** to dissolve the firm.
2. In case **date is mentioned** in the Notice: The firm is dissolved as from the **date mentioned** in the notice as the date of dissolution, or in case **no date** is so mentioned, as from the **date of the communication** of the notice.

2. DISSOLUTION BY THE COURT (SECTION 44):

Court may, at the suit of the partner, dissolve a firm on any of the following ground:

(a) Insanity/unsound mind: Where a partner **(not a sleeping partner)** has become of unsound mind, the court may dissolve the firm on a suit of the other partners or by the next friend of the insane partner. **Temporary sickness** is no ground for dissolution of firm.

Example 3:

A, B and C are partners in a firm. A has severe infection and got typhoid. Due to this, he was not able to conduct business for few weeks. This kind of illness cannot be treated as the ground for dissolution.

(b) Permanent incapacity: When a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner, then the court may dissolve the firm. Such permanent incapacity may result from physical disability or illness etc.

(c) Misconduct: Where a partner, other than the partner suing, is guilty of conduct which is likely to **affect prejudicially** the carrying on of business, the court may order for dissolution of the firm, by giving regard to the nature of business. It is **not necessary** that **misconduct** must **relate to the conduct of the business**. The important point is the **adverse effect** of misconduct on the business. In each case nature of business will decide whether an act is misconduct or not.

(d) Persistent breach of agreement: Where a partner other than the partner suing, **wilfully or persistently** commits breach of agreements relating to the **management** of the affairs of the firm or the **conduct** of its **business**, or otherwise so conduct himself in matters relating to the business that it is **not** reasonably **practicable** for other partners to carry on

the business in partnership with him, then the court may dissolve the firm at the **instance** of any of the partners. Following comes in to category of breach of contract:

- Embezzlement,
- Keeping erroneous accounts
- Holding more cash than allowed
- Refusal to show accounts despite repeated request etc.

Example 4:

If one of the partners keeps erroneous accounts and omits to enter receipts or if there is continued quarrels between the partners or there is such a state of things that destroys the mutual confidence of partners, the court may order for dissolution of the firm.

(e) Transfer of interest: Where a partner other than the partner suing, has transferred the whole of his interest in the firm to a third party or has allowed his share to be charged or sold by the court, in the recovery of arrears of land revenue due by the partner, the court may dissolve the firm at the instance of any other partner.

(f) Continuous/Perpetual losses: Where the business of the firm **cannot be carried** on except at a **loss** in future also, the court may order for its dissolution.

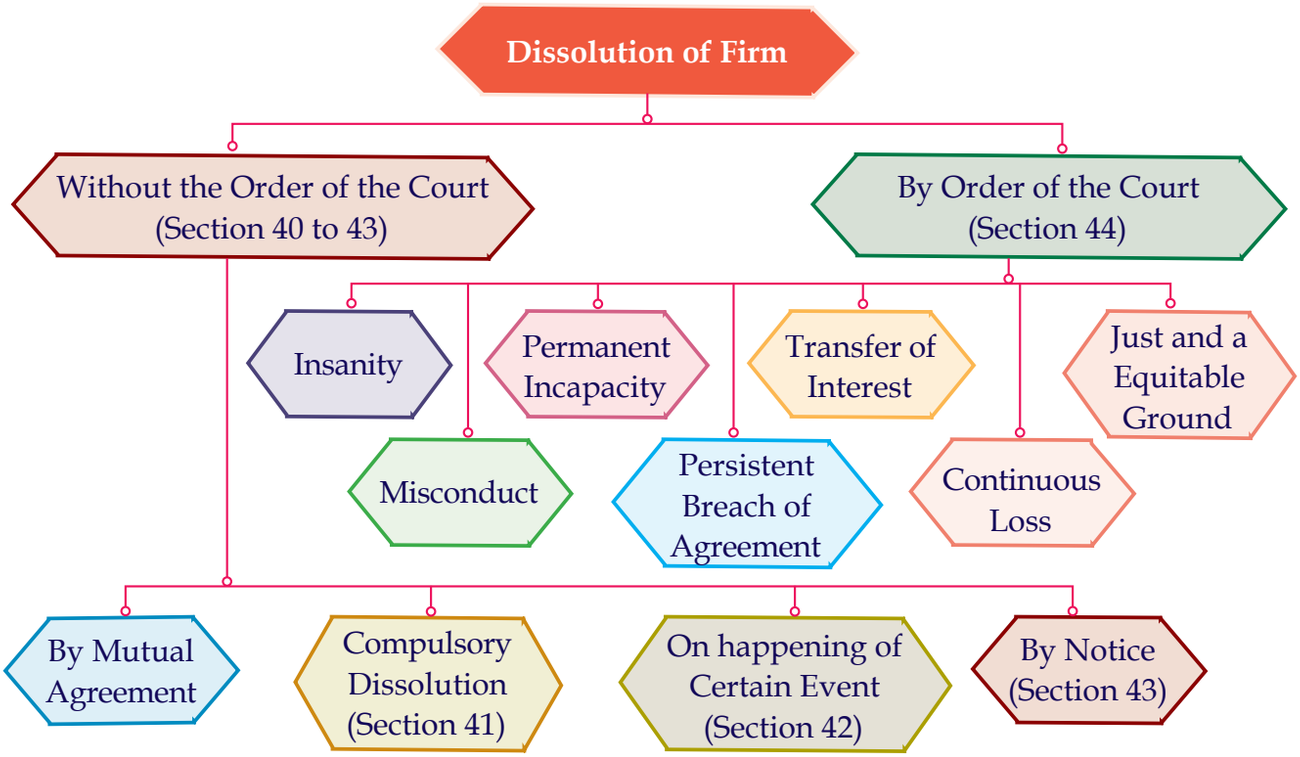
(g) Just and equitable grounds: Where the court considers any other ground to be just and equitable for the dissolution of the firm, it may dissolve a firm. The following are the cases for the just and equitable grounds-

(i) **Deadlock** in the management.

(ii) Where the partners are **not in talking** terms between them.

(iii) Loss of **substratum**.

(iv) **Gambling** by a partner on a stock exchange.



❒ CONSEQUENCES OF DISSOLUTION (SECTIONS 45 - 55)

Consequent to the dissolution of a partnership firm, the partners have certain rights and liabilities, as are discussed:

(a) Liability for acts of partners done after dissolution (Section 45):

Section 45 has two fold objectives-

1. It seeks to **protect third parties** dealing with the firm who had no notice of prior dissolution and
2. It also seeks to **protect partners** of a dissolved firm from liability **towards third parties**.

Example 5:

X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution. In such a case, Y also would be liable for the amount because no public notice was given.

However, there are exceptions to the rule stated in above example i.e. even where notice of dissolution has not been given, there will be **no liability** for subsequent acts **in the case of:**

(a) the estate of a **deceased partner**,

(b) an **insolvent** partner, or

(c) a **dormant partner,** i.e., a partner who was not known as a partner to the person dealing with the firm.

(b) Right of partners to have business wound up after dissolution (Section 46): On the dissolution of a firm every **partner** or his **representative** is entitled, as against all the other partners or their representative, to have the **property** of the firm **applied in** payment of the **debts and liabilities of the firm**, and to have the **surplus distributed** among the partners or their representatives according to their **rights**.

(c) Continuing authority of partners for purposes of winding up (Section 47): After the dissolution of a firm the **authority** of each partner to **bind** the firm, and the other mutual rights and obligations of the partners, **continue** notwithstanding the dissolution, so far as may be necessary **to wind up the affairs** of the firm and to **complete transactions begun but unfinished** at the time of the dissolution, but not otherwise:

Provided that the **firm** is in **no case bound** by the acts of a partner who has been **adjudicated insolvent;** but this proviso does not affect the liability of **any person** who has after the adjudication **represented himself or knowingly permitted himself** to be represented **as a partner** of the insolvent.

(d) Mode of Settlement of partnership accounts (Section 48): In settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:-

(i) Losses, **including deficiencies** of capital, shall be paid first out of **profits**, next out of **capital**, and, lastly, if necessary, by the **partners individually** in the proportions in which they were entitled to **share profits**;

(ii) The assets of the firm, **including** any sums contributed by the partners to make up **deficiencies** of capital, must be applied in the following manner and order:

(a) in paying the debts of the firm **to third parties**;

(b) in paying to each partner rateably what is **due to him from capital**;

(c) in paying to each partner rateably what is **due to him on account of capital**; and

(d) the residue, if any, shall be **divided** among the partners in the proportions in which they were entitled **to share profits**.

Example 6:

X and Y were partners sharing profits and losses equally and X died. On taking partnership accounts, it transpired that he contributed ₹ 6,60,000 to the capital of the firm and Y only ₹ 40,000. The assets amounted to ₹ 2,00,000. In such situation, the deficiency (₹ 6,60,000 + ₹ 40,000 – ₹ 2,00,000 i.e. ₹ 5,00,000) would have to be shared equally by Y and X's estate.

If in the above example, the agreement provided that on dissolution the surplus assets would be divided between the partners according to their respective interests in the capital and on the dissolution of the firm a deficiency of capital was found, then the assets would be divided between the partners in proportion to their capital with the result that X's estate would be the main loser.

(e) Payment of firm debts and of separate debts (Section 49): Where there are joint debts due from the firm and also separate debts due from any partner:

(i) the property of the **firm** shall be applied in the first instance in payment of the **debts of the firm**, and if there is any surplus, then the share of each **partner** shall be applied to the payment of his **separate debts** or paid to him;

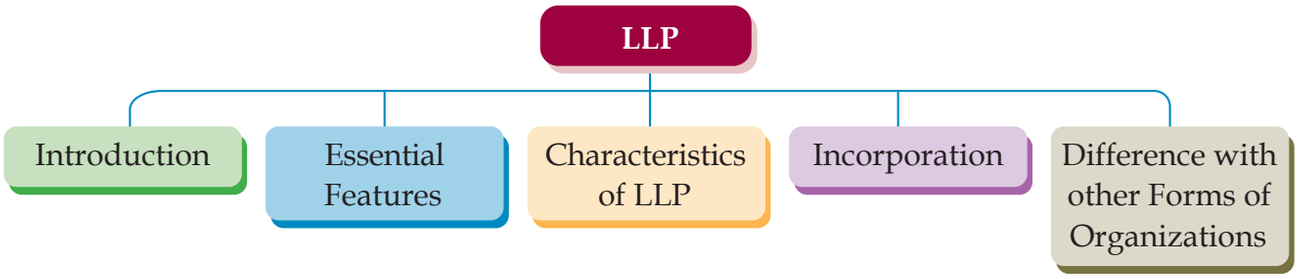
(ii) the **separate property** of any partner shall be applied first in the payment of his **separate debts** and **surplus**, if any, in the payment of **debts of the firm**.

CHAPTER

05 The Limited Liability Partnership Act, 2008

TABLE OF CONTENTS FOR THE CHAPTER

- INTRODUCTION 235
- LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT 236
- IMPORTANT DEFINITIONS 237
- CHARACTERISTICS OF LLP 239
- INCORPORATION OF LLP 242
- EFFECT OF REGISTRATION (SECTION 14) 243
- DIFFERENCES WITH OTHER FORMS OF ORGANISATION 244



INTRODUCTION

The Ministry of Law and Justice on 9th January 2007 notified the Limited Liability Partnership Act, 2008.

The Parliament passed the Limited Liability Partnership Bill on 12th December, 2008 and the President of India has assented the Bill on 7th January, 2009 and called as the Limited Liability Partnership Act, 2008.

The LLP Act, 2008 is applicable to the whole of India.

This Act have been **enacted to make provisions for the formation and regulation of Limited Liability Partnerships** and for matters connected there with or incidental thereto.

The LLP Act, 2008 has **81 sections** and **4 schedules.**

(i) The **First Schedule** deals with **mutual rights and duties** of partners, as well Limited Liability Partnership and its partners where there is **absence of a formal agreement** with respect to them.

(ii) The **Second** Schedule deals with conversion of **a firm into LLP.**

(iii) The **Third** Schedule deals with conversion of a **private company into LLP.**

(iv) The **Fourth** Schedule deals with conversion **of unlisted public company into LLP.**

- The **Ministry of Corporate Affairs and the Registrar of Companies (ROC)** are entrusted with the task of **administrating** the LLP Act, 2008. The **Central Government** has the **authority to frame the Rules** with regard to the LLP Act, 2008, and can **amend** them by notifications in the Official Gazette, from time to time.
- It is also to be noted that the **Indian Partnership Act, 1932 is not applicable** to LLPs.
- The Limited Liability Act, 2008 has been amended through the Limited Liability Partnership (Amendment) Act, 2021 dated 13th August, 2021.

Need of new form of Limited Liability Partnership

The lawmakers envisaged the need for bringing out a new legislation for creation of the Limited Liability Partnership to meet with the contemporary growth of the Indian economy. A need has been felt for a new corporate form that would provide an alternative to the traditional partnership with unlimited personal liability on the one hand and the statute-based governance structure of the limited liability company on the other hand. In order to enable professional expertise and entrepreneurial initiative and combine, organize and operate in flexible, innovative and efficient manner, the LLP Act, 2008 was enacted.

Thus, LLP as a form of business organization is an alternative corporate business vehicle. It provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form enables entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP is a suitable vehicle for small enterprises and for investment by venture capital.

❒ LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT

Meaning:

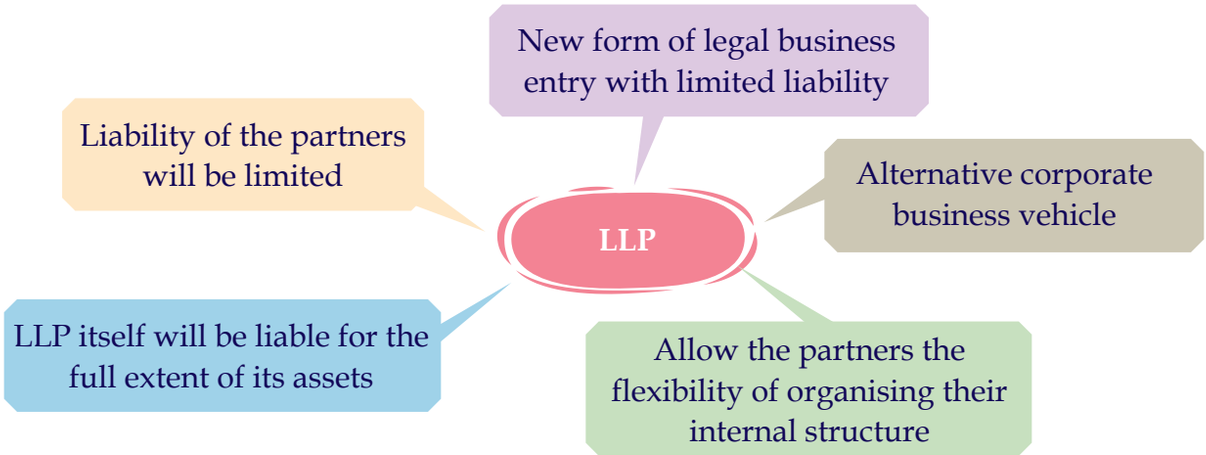
(i) A LLP is a **new form** of legal business entity with limited liability.

(ii) **It is an alternative corporate business vehicle** that not only gives the benefits of limited liability at **low compliance** cost but allows its partners the **flexibility** of organising their **internal structure** as a traditional partnership.

(iii) The LLP is a **separate legal entity** and, while the LLP itself will be **liable** for the **full extent of its assets, the liability** of the **partners** will be **limited.**

(iv) LLP as **a separate legal entity** and business organisation is an alternative corporate business form that gives the **benefits of limited liability** of a company and the **flexibility of a partnership.**

(v) **Since LLP contains elements of both** 'a corporate structure' as well as 'a partnership firm structure' LLP is called a **hybrid** between a **company and a partnership.**



❒ IMPORTANT DEFINITIONS

1. Body Corporate [(Section 2(1)(d)]

It means a company as **defined in clause (20) of section 2** of the Companies Act, 2013 and **includes**

(i) a Limited Liability Partnership **registered under this Act;**

(ii) a Limited Liability Partnership **incorporated outside India;** and

(iii) a **company incorporated outside India,**

but **does not include**

(i) a **corporation sole;**

(ii) a **co-operative society** registered under any law for the time being in force; and

(iii) any **other body corporate (not being a company** as defined in **clause (20)** of section 2 of the Companies Act, 2013 or **a limited liability partnership** as **defined in this Act),** which the **Central Government** may, by **notification** in the Official Gazette, **specify** in this behalf.

2. Business [Section 2(1)(e)]

"Business" **includes** every trade, profession, service and occupation except any activity which the Central Government may, by notification, exclude.

3. Designated Partner [Section 2(1)(j)]

"Designated partner" means any partner designated as such pursuant to section 7.

4. Entity [Section 2(1)(k)]

"Entity" means any body corporate and includes, for the purposes of sections 18, 46, 47, 48, 49, 50, 52 and 53, a firm setup under the Indian Partnership Act, 1932.

5. Financial Year [Section 2(1)(l)]

"Financial year", in relation to a LLP, **means** the **period** from **the 1st day of April** of a year to the **31st day of March of the following year.**

However, in the case of a LLP **incorporated after** the **30th day of September** of a year, the financial year may end on the 31st day of March of the year **next following that year.**

Example 1:

If a LLP has been incorporated on 15th October, 2019, then its financial year may be from 15th October, 2019 to 31st March, 2021.

The **Income Tax** department has prescribed uniform financial year from 1st April to 31st March of next year. In keeping with the Income tax law, the financial year for LLP should **always be** from **1st April to 31st March each year.**

6. Foreign LLP [Section 2(1)(m)]

It means a LLP **formed, incorporated or registered outside India** which establishes **a place of business within India.**

7. Limited Liability Partnership [Section 2(1)(n)]

Limited Liability Partnership means a partnership **formed and registered** under this Act.

8. Limited Liability Partnership Agreement [Section 2(1)(o)]

It means any **written agreement** between the **partners** of the LLP or between the **LLP and its partners** which determines the **mutual rights and duties** of the partners and their rights and duties **in relation to that LLP.**

9. Partner [Section 2(1)(q)]

Partner, in relation to a LLP, means any person who **becomes a partner** in the LLP in **accordance** with the LLP **agreement.**

10. Small Limited Liability Partnership [Section 2(1)(ta)]

It means a Limited Liability Partnership:

(i) the **contribution** of which, **does not exceed twenty-five lakh rupees** or such **higher** amount, **not exceeding five crore rupees,** as may be **prescribed;** and

(ii) the **turnover** of which, as per the **Statement of Accounts and Solvency** for the **immediately preceding financial year, does not exceed forty lakh rupees** or such **higher** amount, **not exceeding fifty crore rupees,** as may be **prescribed;**

Or

(iii) which meets **such other requirements** as may be **prescribed,** and fulfils such **terms and conditions** as may be **prescribed.**

Non-applicability of the Indian Partnership Act, 1932 (Section 4)

Save as **otherwise provided,** the provisions of the Indian Partnership Act, 1932 shall **not apply** to a LLP.

Partners (Section 5)

Any **individual or body corporate** may be a partner in a LLP. However, an **individual** shall **not be capable** of becoming a partner of a LLP, if –

(a) he has been found to be of **unsound mind** by a Court of competent jurisdiction and the **finding is in force;**

(b) he is an **undischarged insolvent;** or

(c) he has **applied to be adjudicated as an insolvent** and his **application is pending.**

Minimum Number of Partners (Section 6)

(i) Every LLP shall have **at least two partners**

(ii) If at **any time** the **number** of partners of a LLP is **reduced below two** and the **LLP carries on** business for **more than six months** while the number is so reduced, the **person,** who is the **only partner** of the LLP during the time that it so carries on business **after those six months** and has the knowledge of the **fact** that it is carrying on business with **him alone,** shall be **liable personally** for the obligations of the **LLP** incurred **during that period.**

Designated Partners (Section 7)

(i) Every LLP shall have **at least two designated partners** who are individuals and **at least one** of them shall be a **resident in India.**

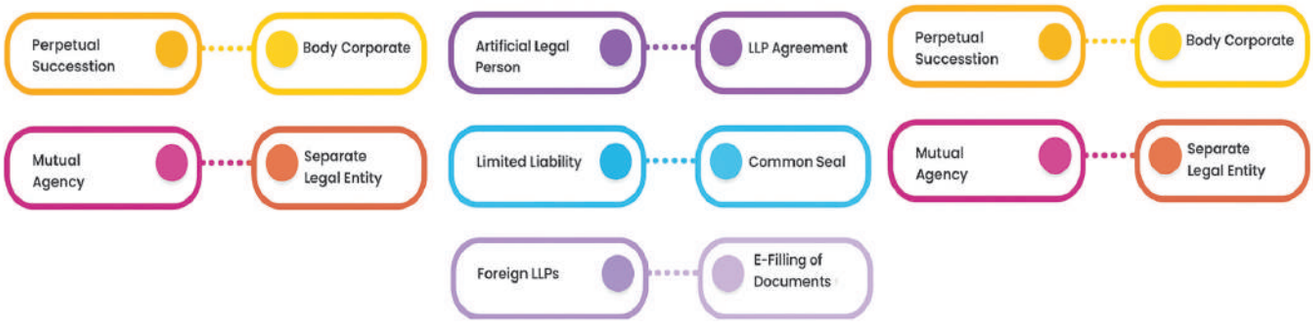
(ii) If in LLP, **all the partners are bodies corporate** or in which one or more partners **are individuals and bodies corporate, at least two individuals** who are **partners** of such LLP or **nominees** of such bodies corporate shall **act as designated partners.**

(iii) Resident in India: For the purposes of this section, the term resident in India means a person who has **stayed in India** for a period of **not less than 120 days during the financial year.**

Example 2:

There is an LLP by the name Indian Helicopters LLP having 5 partners namely Mr. A (Non resident), Mr. B (Non Resident) Ms. C (resident), Ms. D (resident) and Ms. E (resident). In this case, at least 2 should be named as Designated Partner out of which 1 should be resident. Hence, if Mr. A and Mr. B are designated then it will not serve the purpose. One of the designated partners should be there out of Ms. C, Ms. D and Ms. E.

❐ CHARACTERISTIC OF LLP



1. Body Corporate

Section 2(1)(d) of the LLP Act, 2008 provides that a LLP is a body **corporate formed and incorporated under this Act** and is a legal entity **separate** from that of **its partners** and shall have **perpetual succession.** Therefore, **any change** in the partners of a LLP **shall not affect** the existence, rights or liabilities of the LLP.

Section 3 of LLP Act provides that a LLP is a **body corporate formed and incorporated** under this Act and is a legal entity separate from that of its partners.

2. Perpetual Succession

The LLP can **continue** its existence **irrespective of changes in partners**. Death, insanity, retirement or insolvency of partners has **no impact** on the existence of LLP. It is **capable** of entering into contracts and **holding property** in its own name.

3. Separate Legal Entity

The LLP as a separate legal entity, is liable to the **full extent of its assets** but **liability** of the partners is **limited** to their **agreed contribution** in the LLP. In other words, **creditors of LLP** shall be the **creditors of LLP alone.**

4. Mutual Agency

No partner is liable on account of the independent or un authorized actions of other partners, thus **individual partners are shielded from joint liability** created by another partner's wrongful business decisions or misconduct. In other words, **all partners** will be the **agents of the LLP alone.** No one partner can bind the other partner by his acts.

5. LLP Agreement

Mutual rights and duties of the partners within a LLP are **governed** by **an agreement** between the partners. The LLP Act, 2008 provides **flexibility to partner** to **devise the agreement** as per their **choice.** In the **absence** of any such agreement, the mutual rights and duties shall be governed by the provisions of the **LLP Act, 2008.**

6. Artificial Legal Person

A LLP is an artificial legal person because it is **created by a legal process** and is **clothed** with all **rights of an individual.** It can **do everything** which any natural person can do, **except** of course that, it cannot be sent to jail, cannot take an oath, cannot marry or get divorce nor can it practice a learned profession like CA or Medicine. A LLP is **invisible, intangible, immortal** (it can be dissolved by law alone) but **not fictitious** because it really exists.

7. Common Seal

A LLP being an artificial person can **act** through its **partners and designated** partners. LLP **may have** a common seal, if it decides to have one [Section 14(c)]. Thus, it is **not mandatory** for a LLP to have a common seal. It shall remain under the **custody** of some **responsible official** and it shall be **affixed** in the **presence** of **at least 2 designated partners** of the LLP.

8. Limited Liability

Every partner of a LLP is, **for the purpose of the business of LLP, the agent of the LLP,** but **not of other partners.** The liability of the partners will be **limited** to their **agreed contribution** in the LLP. Such contribution may be of **tangible or intangible** nature or both.

Example 3:

The professionals like Engineering consultants, Legal Advisors and Accounting Professional are afraid of entering into business due to unlimited liability. Hence the LLP partnership Act provides an avenue for these professionals to Limited Liability Partnership firms which restricts their liability to the agreed amount. This has encouraged Professionals to form LLP.

9. Management of Business

The **partners** in the LLP are **entitled to manage** the business of LLP. But only the **designated partners** are responsible for **legal compliances.**

10. Minimum and Maximum Number of Partners

Every LLP shall have **least two partners** and shall also have **at least 2 individuals** as **designated partners,** of whom **at least one** shall be **resident in India.** There is **no maximum limit** on the partners in LLP.

11. Business for Profit Only

The **essential requirement** for forming LLP is carrying on a **lawful business** with a view **to earn profit.** Thus, LLP **cannot** be formed for **charitable or non-economic purpose.**

12. Investigation

The Central Government shall have powers to investigate the affairs of an LLP by appointment of competence authority for the purpose.

13. Compromise or Arrangement

Any compromise or agreements including merger and amalgamation of LLPs shall be in accordance with the provisions of the LLP Act, 2008.

14. Conversion into LLP

A firm, private company or an unlisted public company would be allowed to be converted into LLP in accordance with the provisions of LLP Act, 2008.

15. E-Filling of Documents

Every form or application of document required to be filed or delivered under the act and rules made thereunder, shall be filed in computer readable electronic form on its website www.mca.gov.in and authenticated by a partner or designated partner of LLP by the use of electronic or digital signature.

16. Foreign LLPs

Section 2(1)(m) defines foreign Limited Liability Partnership "as a Limited Liability Partnership **formed, incorporated**, or **registered outside India** which established as **place of business within India**". Foreign LLP can **become a partner** in an Indian LLP.

Advantages of LLP form

LLP form is a form of business model which:

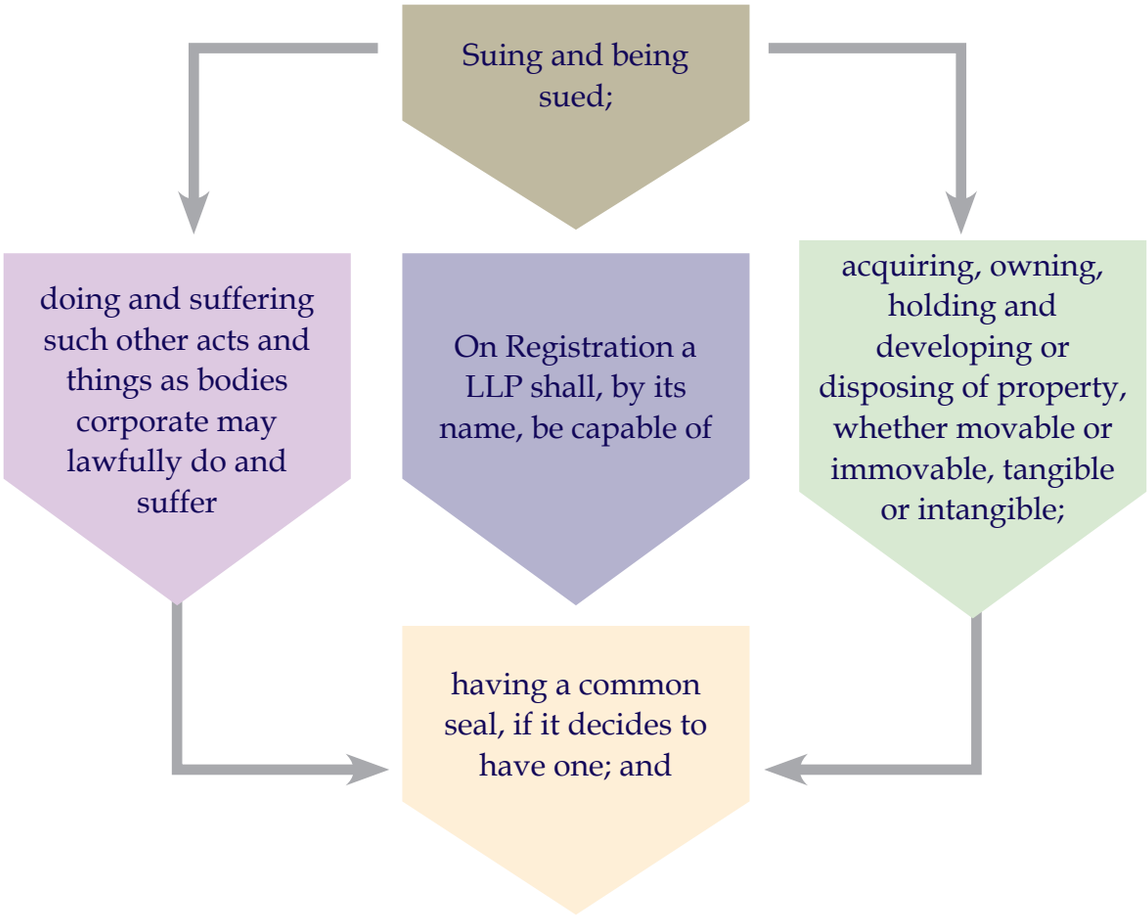
- Is organized and operates on the basis of **an agreement**
- Provides **flexibility** without imposing detailed legal and procedural requirements
- **Easy to form**
- All **partners** enjoy **limited liability**
- Flexible **capital structure**
- **Easy to dissolve**

❒ INCORPORATION OF LLP

Incorporation document (Section 11): The most important document needed for registration is the incorporation document.

1. **For a LLP to be incorporated:**
   (a) **two or more persons** associated for carrying on a **lawful business** with a view to **profit** shall **subscribe their names** to an **incorporation document;**
   (b) the incorporation document shall be filed in such **manner** and with **such fees,** as may be **prescribed** with the **Registrar of the State** in which the registered **office of** the LLP is **to be situated;** and
   (c) **Statement to be filed:**
   - there shall be filed along **with the incorporation document,** a statement in the prescribed **form,**
   - A document may be **served on a LLP or a partner or designated partner** thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed, at the **registered office** and any other address specifically declared by the LLP for the purpose in such form and manner as may be prescribed.
   - A LLP may change the place of its **registered office** and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.
   - If the LLP **contravenes** any provisions of this section, the LLP and its every partner shall be **liable to a penalty** of ₹ 500 for each day during which the default continues, subject to a maximum of ₹ 50,000 for the LLP and its every partner.

❒ EFFECT OF REGISTRATION (SECTION 14)



Name (Section 15)

1. **Every limited liability partnership** shall have **either** the words **"limited liability partnership"** or the **acronym** "LLP" as the **last words of** its name.
2. **No LLP** shall be **registered** by a name which, in the **opinion of the Central Government** is–
   (a) **undesirable;** or
   (b) **identical** or **too nearly resembles** to that of any **other LLP** or a **company** or a **registered trade mark** of any other person under the Trade Marks Act, 1999.

Reservation of Name (Section 16)

1. A **person** may apply in such form **and manner** and accompanied by such fee as may be prescribed to the **Registrar** for the **reservation** of a name set out in the application as –
   (a) the name of a **proposed LLP;** or
   (b) the name to which a LLP proposes to change its name.
2. Upon **receipt** of an application under sub-section (1) and on **payment of the prescribed fee,** the **Registrar may, if he is satisfied,** subject to the rules prescribed by the Central Government in the matter, that the name to be reserved is not one which may be rejected on any ground referred to in sub-section (2) of section 15, **reserve** the name for a **period of 3 months** from the date of **intimation by the Registrar.**

Change of Name of LLP (Section 17)

1. Notwithstanding anything contained in sections 15 and 16, if through inadvertence or otherwise, a LLP, on **its first registration** or **on its registration** by a new body corporate, its **registered name,** is registered by a name which **is identical** with or **too nearly resembles** to:

   (a) that of any other LLP or a company; or

   (b) a registered **trade mark** of a proprietor under the Trade Marks Act, 1999, as is likely to be mistaken for it,

   then on **an application** of such LLP or **proprietor** referred to in clauses (a) and (b) respectively or a **company**,

   the **Central Government may direct** that such LLP to **change its name or new name** within a period of 3 months from the **date of issue** of such direction.

   It is further provided that an **application of the proprietor** of the registered **trade marks** shall be **maintainable** within a period of 3 years from the **date of incorporation** or registration or change of name of the LLP under this Act.

2. Where a **LLP changes its name or obtains a new name** under sub-section (1), it shall within a **period of 15 days** from the date of such change, **give notice** of the change to **Registrar along** with the **order of the Central Government,** who shall carry out necessary changes in the certificate of incorporation and **within 30 days** of such change in the certificate of incorporation, such LLP shall **change its name in the LLP agreement.**

3. If the LLP is in default in complying with any direction given under sub-section (1), the **Central Government shall allot a new name** to the LLP in such manner as may be prescribed and the **Registrar shall enter** the new name in the **register of LLP** in place of the old name and **issue a fresh certificate** of incorporation with new name, which the LLP shall use thereafter.

   Nothing contained in this sub-section shall **prevent a LLP** from subsequently changing its **name in accordance** with the provisions of section 16.

❒ DIFFERENCES WITH OTHER FORMS OF ORGANISATION

Distinction between LLP and Partnership Firm

The points of distinction between a Limited Liability Partnership and partnership firm are tabulated as follows:

S.No	Basis	LLP	Partnership firm
1	**Regulating Act**	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
2	**Body corporate**	It is a body corporate.	It is not a body corporate.
3	**Separate legal entity**	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4	**Creation**	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.

5	**Registration**	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary. Only the registered partnership firm can sue the third parties.
6	**Perpetual succession**	The death, insanity, retirement or insolvency of the partner(s) does not affect its existence of LLP. Partners may join or leave but its existence continues forever.	The death, insanity, retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7	**Name**	Name of the LLP to contain the word Limited Liability Partnership (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8	**Liability**	Liability of each partner is limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.
9	**Mutual agency**	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10	**Designated partners**	At least two designated partners and atleast one of them shall be resident in India.	There is no provision for such partners under the Partnership Act, 1932.
11	**Common seal**	It may have its common seal as its official signatures.	There is no such concept in partnership.
12	**Legal compliances**	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13	**Annual filing of documents**	LLP is required to file: (i) Annual statement of accounts (ii) Statement of solvency (iii) Annual return with the registration of LLP every year.	Partnership firm is not required to file any annual document with the registrar of firms.
14	**Foreign partnership**	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
15	**Minor as partner**	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

Distinction between LLP and Limited Liability Company

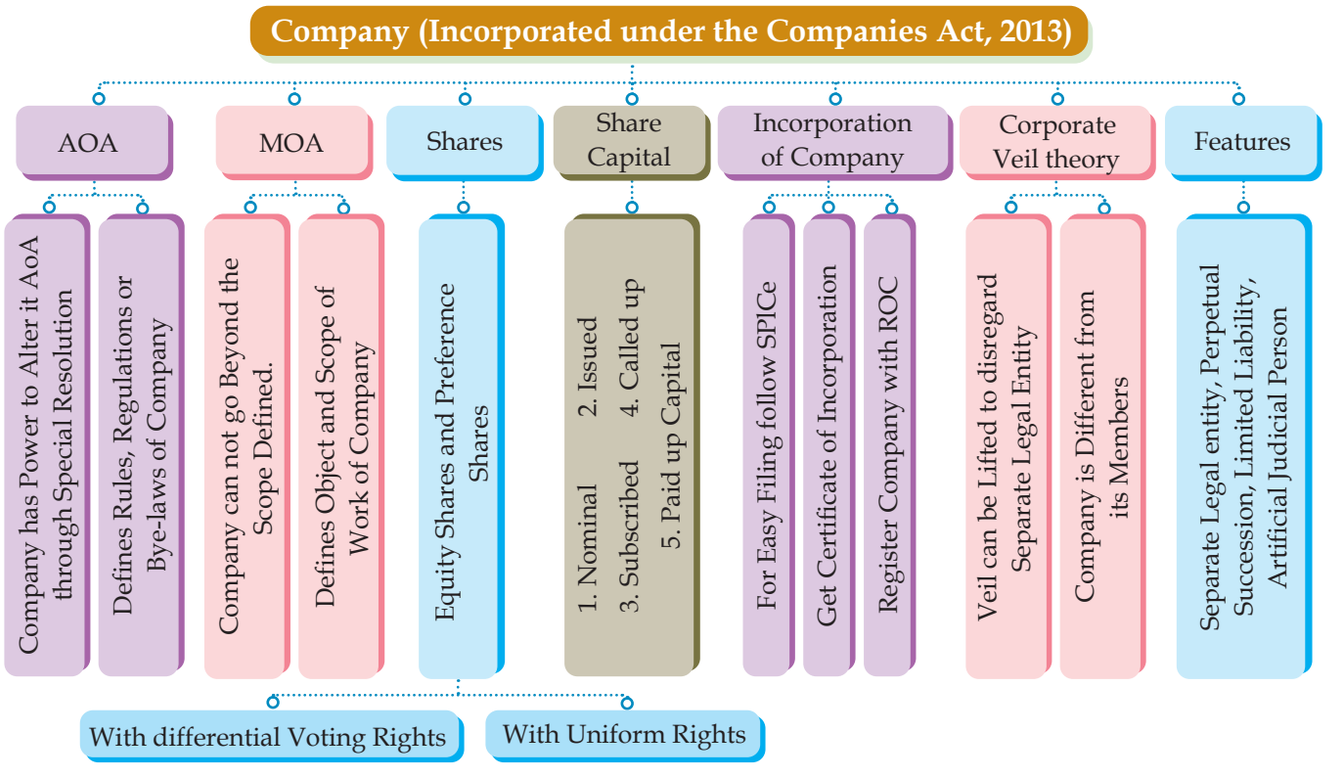
S. No.	Basis	LLP	Limited Liability Company
1	**Regulating Act**	The LLP Act, 2008.	The Companies Act, 2013.
2	**Members/Partners**	The persons who contribute to LLP are known as partners of theLLP.	The persons who invest the money in the shares are known as members of the company.
3	**Internal governance structure**	The internal governance structure of a LLP is governed by contract agreement between the partners.	The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).
4	**Name**	Name of the LLP to contain the word "Limited Liability Partnership" or "LLP" as suffix.	Name of the public company to contain the word "limited" and Pvt. Co. to contain the word "Private limited" as suffix.
5	**No. of members/ partners**	Minimum – 2 partners Maximum– No such limit on the partners in the Act. The partners of the LLP can be individuals/or body corporate through the nominees.	**Private company:** Minimum – 2 members Maximum 200 members **Public company:** Minimum – 7 members Maximum – No such limit on the members. Members can be organizations, trusts, another business form or individuals.
6	**Liability of members/ partners**	Liability of a partners is limited to the extent of agreed contribution except in case of willful fraud.	Liability of a member is limited to the amount unpaid on the shares held by them.
7	**Management**	The business of the company is managed by the partners including the designated partners authorized in the agreement.	The affairs of the company are managed by board of directors elected by the shareholders.
8	**Minimum number of directors/designated partners**	Minimum 2 designated partners.	Pvt. Co. – 2 directors Public co. – 3 directors

CHAPTER

06 The Companies Act, 2013

TABLE OF CONTENTS FOR THE CHAPTER

- INTRODUCTION 248
- COMPANY: MEANING AND ITS FEATURES 248
- CORPORATE VEIL THEORY 251
- CLASSES OF COMPANIES UNDER THE ACT 254
- MODE OF REGISTRATION/INCORPORATION OF COMPANY 264
- CLASSIFICATION OF CAPITAL 268
- SHARES 269
- MEMORANDUM OF ASSOCIATION 270
- DOCTRINE OF ULTRA VIRES 273
- ARTICLES OF ASSOCIATION 274
- DOCTRINE OF INDOOR MANAGEMENT 276



INTRODUCTION

The Companies Act, 2013 was enacted to **consolidate and amend the law relating to the companies.** The Companies Act, 2013 was **preceded by** the Companies Act, 1956.

Due to changes in the national and international economic environment and to facilitate expansion and growth of our economy, the Central Government decided to replace the Companies Act, 1956 with a new legislation. The Companies Act, **2013 contains 470 sections and seven schedules.** The entire Act has been **divided into 29 chapters.** A substantial part of this Act is in the form of Companies Rules. The Companies Act, 2013 **aims to** improve corporate governance, simplify regulations, strengthen the interests of minority investors and for the first time legislates the role of whistle-blowers and provisions relating to class action suit. Thus, this enactment seeks to make our corporate regulations more contemporary.

Applicability of the Companies Act, 2013:

The provisions of the Act shall apply to

- **Companies incorporated under this Act** or under any **previous company law.**
- **Insurance companies** (except where the provisions of the said Act are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999)
- **Banking companies** (except where the provisions of the said Act are inconsistent with the provisions of the Banking Regulation Act, 1949)
- Companies engaged in the **generation or supply of electricity** (except where the **provisions of the above Act are inconsistent** with the provisions of the Electricity Act, 2003)
- Any other company governed by any **special Act** for the time being in force.
- Such **body corporate** which are incorporated by any Act for time being in force, and as the **Central Government may by notification specify** in this behalf.

COMPANY: MEANING AND ITS FEATURES

Meaning: According to **Chief Justice Marshall,** "a corporation is an artificial being, invisible, intangible, existing only in contemplation of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as accidental to its very existence.

In the words of **professor Haney,** "A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal." This definition sums up the meaning as well as the features of a company succinctly.

However, the Act defines the term company a bit **differently.**

Section 2(20) of the Companies Act, 2013 defines the term 'company'. **"Company means a company incorporated under this Act or under any previous company law".** As we shall progress under the chapter, the meaning of the term company will be understood by the students.

Features of a Company

Separate Legal Entity
- Legally separate from the members

Perpetual succession
- Change in members does not affect existence of Company

Limited Liability
- Liability of Company is different from liability of members

Artificial Juridicial Person
- Company can act through human agency only
- Company can contract, sue and be sued in its own name

We have seen the definition given to company from a layman's point of view and legal point of view. But the company form of organization has certain distinctive features that help us to understand the realms of a company. Following are the **main features:**

1. Separate legal entity

There are distinctive features between different forms of organisations and the most striking feature in the company form of organisation vis à-vis the other forms of business organisations is that it acquires a unique character of being a separate legal entity. In other words, **when a company is registered**, it is **clothed** with a **legal personality**. It comes to have almost the **same rights and powers** as a human being. Its **existence is distinct and separate** from that of its members. A company **can own** property, have bank account, raise loans, incur liabilities and enter into contracts.

(a) It is **at law,** a person which is **different from** the **subscribers** to the memorandum of association. It's **personality is distinct** and separate from the personality of **those who compose it.**

(b) **Even members can contract** with company, **acquire** right against it or **incur** liability to it. For the **debts** of the company, only its **creditors can sue** it and not its members.

A company is capable of **owning, enjoying and disposing of property in its own name.** Although the **capital and assets are contributed** by the shareholders, the **company** becomes the **owner** of its capital and assets. The **shareholders** are **not the private or joint owners** of the company's property.

A member does not even have an insurable interest in the property of the company. The leading course case on this point is of Macaura Vs. Northern Assurance Co. Limited (1925):

Case Law: Macaura Vs. Northern Assurance Co. Limited (1925)

Facts: Macaura (M) was the holder of nearly all (except one) shares of a timber company. He was also a major creditor of the company. M insured the company's timber in his own name. The timber was lost in a fire. M claimed insurance compensation. Held, the insurance company was not liable to him as no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest in them. Hence in this case, since the timber was insured in the company's name, M could not claim the compensation from insurance company.

2. Perpetual succession

Members may **die or change**, but the **company goes on till it is wound up** on the grounds specified by the Act. The **shares** of the company **may change hands infinitely** but that **does not affect** the existence of the company. Since a company is an artificial person **created by law,** law alone can **bring an end** to its life. Its **existence** is **not affected** by the **death** or **insolvency** of its members.

Example 1:

Many companies in India are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence. There was a company which has 7 members and all of them died in an aircraft. Despite this the company still exists unlike partnership form of business.

3. Limited liability

The liability of a member depends upon the kind of company of which he is a member. We know that company is a separate legal entity which is distinct from its members.

(i) Thus, in the case of a **limited liability company**, the debts of the company in totality do not become the debts of the shareholders. The liability of the members of the company is **limited to** the **extent of the nominal value** of shares held by them. In **no case** can the shareholders be **asked to pay** anything more than the unpaid value of their shares.

(ii) In the case of a **company limited by guarantee**, the members are liable only to the extent of the amount **guaranteed** by them and that too **only when** the company goes into **liquidation**.

(iii) However, if it is an **unlimited company**, the liability of its members is **unlimited as well**.

4. Artificial legal person

1. A company is an artificial person as it is created by a **process other than natural birth.** It is legal or judicial as it is **created by law**. It is a **person** since it is **clothed** with all the rights of an individual.
2. Further, the company being a **separate legal entity can** own property, have banking account, raise loans, incur liabilities and enter into contracts. **Even members can** contract with company, acquire right against it or incur liability to it. It can **sue and be sued** in its own name. It can **do everything** which any natural person can do **except** be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.
3. As the company is an artificial person, it can **act only through** some human agency, viz., directors. The directors cannot control affairs of the company and act as its agency, but they are **not the "agents" of the members** of the company. The **directors can** either on their **own** or through the **common seal** (of the company) can authenticate its formal acts.
4. Thus, a company is called an artificial legal person.

5. Common seal

A company being an artificial person is **not bestowed with a body** of a natural being. Therefore, it **works through** the agency of **human beings.** Common seal is the **official signature** of a company, which is **affixed by the officers and employees of the company on its every document**. The common seal is a seal used by a corporation as the **symbol of its incorporation**.

The **Companies (Amendment) Act, 2015** has made the common seal **optional** by omitting the words "and a common seal" from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. Rational for this amendment is that common seal is seen as a relic of medieval times. Even in the U.K., common seal has been made optional since 2006. This amendment provides that the **documents** which need to be **authenticated** by a common seal will be **required** to be so done, **only if the company opts to have a common seal**. In case a company **does not have a common seal**, the authorization shall be made by **two directors or** by a **director and the**

❒ CORPORATE VEIL THEORY

Company Secretary, wherever the company has **appointed a Company Secretary.**

1. Corporate Veil

Corporate Veil refers to a legal concept whereby the **company is identified separately** from the **members** of the company.

The term Corporate Veil refers to the concept that **members of a company are shielded** from **liability** connected to the **company's actions.** If the company incurs any **debts or contravenes** any laws, the corporate veil concept implies that **members should not be liable for those errors**. In other words, they enjoy corporate insulation.

Thus, the **shareholders are protected** from the acts of the company.

Case Law: Salomon Vs. Salomon and Co Ltd.

Facts: The **Salomon Vs. Salomon and Co Ltd.** laid down the foundation of the concept of corporate veil or independent corporate personality.

In Salomon vs. Salomon & Co. Ltd. the **House of Lords** laid down that a company is a person distinct and **separate from its members.** In this case one Salomon incorporated a company named "**Salomon & Co. Ltd**.", with seven subscribers consisting of himself, his wife, four sons and one daughter. This company took over the personal business assets of Salomon for £ 38,782 and in turn, Salomon took 20,000 shares of £ 1 each, debentures worth £ 10,000 of the company with charge on the company's assets and the balance in cash. His wife, daughter and four sons took up one £ 1 share each. Subsequently, the company went into liquidation due to general trade depression. The unsecured creditors to the tune of £ 7,000 contended that Salomon could not be treated as a secured creditor of the company, in respect of the debentures held by him, as he was the managing director of one-man company, which was not different from Salomon and the cloak of the company was a mere sham and fraud. It was held by Lord Mac Naughten:

"The Company is at law a **different person altogether from the subscribers** to the memorandum, and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers, and the same hands receive the profits, the company is **not** in law the **agent of the subscribers or trustees** for them. Nor are the subscribers, as members, liable, in any shape or form, except to the extent and in the manner provided by the Act."

Thus, this case clearly established that company has its own existence and as a result, a shareholder **cannot be held liable** for the acts of the company **even though** he holds virtually the **entire share capital**. The whole law of corporation is in fact based on this theory of separate corporate entity.

Now, the question may arise whether this Veil of Corporate Personality can even be lifted or pierced.

Before going into this question, one should first try to understand the meaning of the phrase "lifting the veil". It means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade. Where the **Courts ignore** the **company** and **concern** themselves **directly** with the **members** or managers, the **corporate veil** may be said to have been **lifted**. Only in appropriate **circumstances**, the Courts are willing to **lift the corporate veil** and that too, when questions of control are involved rather than merely a question of ownership.

2. Lifting of Corporate Veil

The following are the cases where company law **disregards** the principle of corporate personality or the principle that the company is a legal entity **distinct and separate** from its shareholders or members:

1. To determine the character of the company i.e.

to find out whether co-enemy or friend: In the law relating to trading with the enemy where the test of control is adopted. The leading case in this point is Daimler Co. Ltd. vs. Continental Tyre & Rubber Co., if the **public interest** is **not likely to be in jeopardy,** the Court may **not be willing** to **crack** the corporate shell. But it may rend the veil for ascertaining whether a company is an enemy company. It is true that, unlike a natural person, a company **does not have mind or conscience**; therefore, **it cannot be a friend or foe**. It may, **however**, be **characterised** as an **enemy** company, if its **affairs** are under the **control of people** of an enemy country. For this **purpose**, the Court may **examine** the **character of the persons** who are **really** at the helm of **affairs** of the company.

2. To protect revenue/tax

In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue. [S. Berendsen Ltd. vs. Commissioner of Inland Revenue]

(i) Where corporate entity is used to **evade or circumvent tax, the Court** can **disregard** the corporate entity [Juggilal vs. Commissioner of Income Tax AIR (SC)].

(ii) In **[Dinshaw Maneckjee Petit],** it was held that the company was not a genuine company at all but merely the assessee himself disguised under the legal entity of a limited company. The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan. The **Court** decided that the private companies were a **sham** and the **corporate veil was lifted** to decide the **real owner of the income.**

3. To avoid a legal obligation

Where it was found that the **sole purpose** for the **formation** of the company was to use it as a **device to reduce** the **amount** to be paid by way of **bonus to workmen**, the **Supreme Court** upheld the piercing of the veil to **look at the real transaction** (The **Workmen Employed in Associated**

Rubber Industries Limited, Bhavnagar vs. The Associated Rubber Industries Ltd., Bhavnagar and another).

Workmen of Associated Rubber Industry Ltd., v. Associated Rubber Industry Ltd.: The facts of the case are that "A Limited" purchased shares of "B Limited" by investing a sum of ₹ 4,50,000. The dividend in respect of these shares was shown in the profit and loss account of the company, year after year. It was taken into account for the purpose of calculating the bonus payable to workmen of the company. Sometime in 1968, the company transferred the shares of B Limited, to C Limited a subsidiary, wholly owned by it. Thus, the dividend income did not find place in the Profit & Loss Account of A Ltd., with the result that the surplus available for the purpose for payment of bonus to the workmen got reduced.

Here a company created a subsidiary and transferred to it, its investment holdings in a bid to reduce its liability to pay bonus to its workers. Thus, the **Supreme Court** brushed aside the **separate existence** of the **subsidiary company**. The new company so formed had no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company and serving no purpose except to reduce the gross profit of the principal company so as to reduce the amount paid as bonus to workmen.

4. Formation of subsidiaries to act as agents

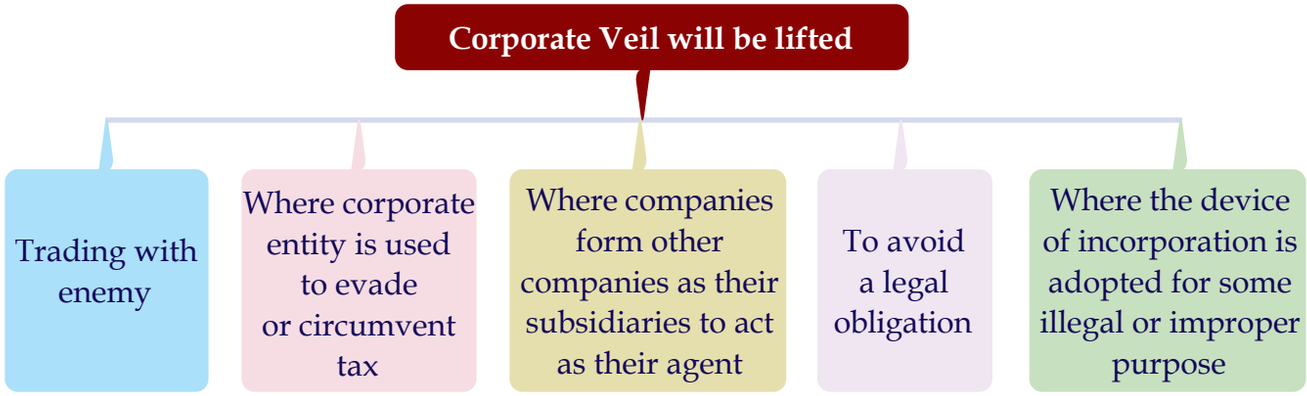
A **company** may sometimes be regarded as an **agent** or **trustee** of its **members, or** of **another company**, and may therefore be deemed to have **lost its individuality** in favour of its **principal**. Here the **principal will be held liable** for the acts of that company.

Case Law: Merchandise Transport Limited vs. British Transport Commission (1982)

Facts: In the case of **Merchandise Transport Limited vs. British Transport Commission (1982),** a transport company wanted to obtain licences for its vehicles but could not do so if applied in its own name. It, therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the **parent and the subsidiary** were **one commercial unit** and the **application** for licences was **rejected**.

5. Company formed for fraud/improper conduct or to defeat law

Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations. **[Gilford Motor Co. vs. Horne]**



❒ CLASSES OF COMPANIES UNDER THE ACT

The growth of the economy and increase in the complexity of business operation in the corporate world has led to the emergence of different forms of corporate organizations. To regulate them, the Companies Act, 2013 has broadly classified the companies into various classes.

A company may be incorporated as a one-person company, private company or a public company, depending upon the number of members joining it. Again, it may either be an unlimited company, or may be limited by shares or by guarantee or by both. On the basis of control, companies can be classified as associate company, holding company and subsidiary company. Some other forms of classification of companies are foreign company, government company, small company, dormant company, nidhi company and company formed for charitable objects.

Companies may be classified into various classes on the following basis:

1. On the Basis of Liability

(a) Company limited by shares

Section 2(22) of the Companies Act, 2013, defines that **when** the **liability** of the **members** of a company is **limited by its memorandum of association** to the **amount (if any) unpaid** on the shares held by them, it is **known as** a company limited by shares.

It thus implies that for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings. His **separate property cannot** be encompassed to **meet the company's debt.**

It may be worthwhile to know that though a shareholder is a co-owner of the company, he is **not a co-owner** of the company's assets. The **ownership** of the **assets remains** with the company, **because** of its **nature** as a **legal person**. The extent of the **rights and duties** of a shareholder as co-owner is **measured by his shareholdings**.

(b) Company limited by guarantee

Section 2(21) of the Companies Act, 2013 defines it as the company having the **liability** of its members **limited by the memorandum to** such **amount** as the **members** may respectively **undertake** by the **memorandum** to **contribute to the assets** of the company in the **event of its being wound up.**

Thus, the liability of the member of a guarantee company **is limited upto a** stipulated sum mentioned in the memorandum. Members **cannot** be called upon to **contribute beyond** that stipulated sum.

The **common features** between a 'guarantee company' and 'the company having share capital' are legal personality and limited liability. In the latter case, the member's liability is limited by the amount remaining unpaid on the share, which each member holds. Both of them have to state in their memorandum that the members' liability is limited.

However, the **point of distinction** between these two types of companies is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the latter case, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

It is clear from the definition of the guarantee company that it **does not raise** its **initial working funds** from its **members**. Therefore, such a company may be **useful** only where **no working funds**

are **needed or** where these funds can be held **from other sources** like endowment, fees, charges, donations, etc.

Case Law: Narendra Kumar Agarwal vs. Saroj Maloo

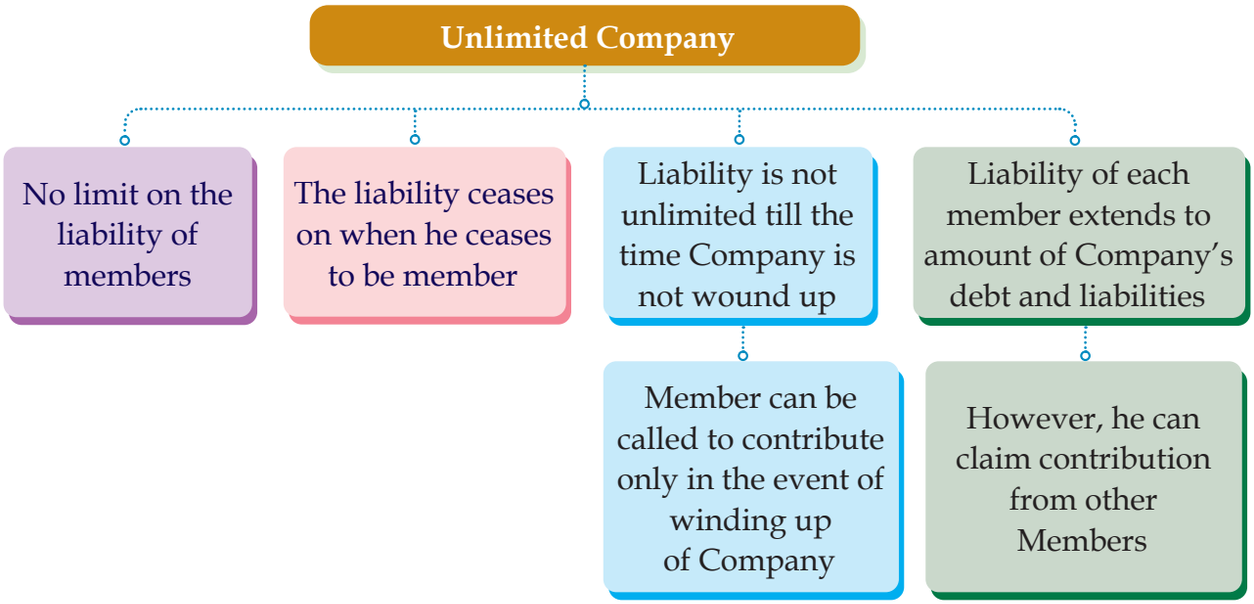
Facts: In Narendra Kumar Agarwal vs. Saroj Maloo,

The **Supreme Court** has laid down that the **right of a guarantee company** to **refuse to accept** the **transfer** by a member of his interest in the company is on a **different footing** than that of a **company limited by shares.** The **membership** of a guarantee company **may carry privileges** much **different from** those of **ordinary shareholders**.

(c) Unlimited company

Section 2(92) of the Companies Act, 2013 defines unlimited company as a company **not having any limit** on the liability of its members.

In such a company, the liability of a member **ceases when he ceases to be a member**. The liability of each member **extends to the whole amount** of the company's **debts and liabilities** but he will be entitled to claim contribution from other members. In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share. So long as the company is a **going concern** the liability on the shares is the only liability which **can be enforced by the company.** The **creditors** can institute **proceedings** for winding up of the company for their claims. The **official liquidator** may **call the members** for their **contribution** towards the liabilities and debts of the company, which can be unlimited.



2. On the Basis of Members

(a) One person company

The Companies Act, 2013 introduced a new class of companies which can be incorporated by a single person.

Section 2(62) of the Companies Act, 2013 defines one person company (OPC) as a **company which has only one person as a member**.

One person company has been introduced to encourage entrepreneurship and corporatization of business. OPC differs from sole proprietary concern in an aspect that OPC is a separate legal entity with a limited liability of the member whereas in the case of sole proprietary, the liability of owner is not restricted and it extends to the owner's entire assets constituting of official and personal.

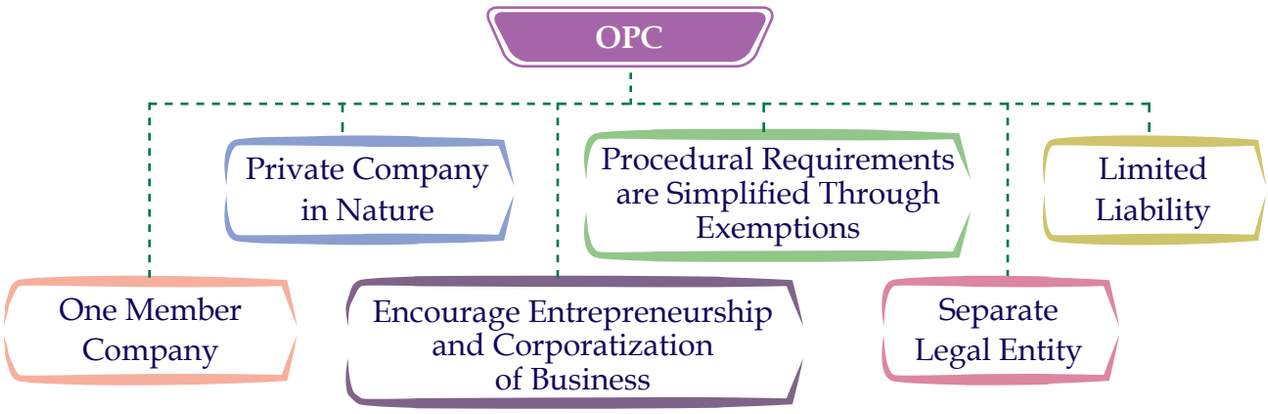
The procedural requirements of an OPC are simplified through exemptions provided under the Act in comparison to the other forms of companies.

According to section 3(1)(c) of the Companies Act, 2013, OPC is a private limited company with the **minimum paid up share capital as may be prescribed** and **having one member**.

OPC (One Person Company) - significant points

- Only one person as member.
- Minimum paid up capital – no limit prescribed.
- The **memorandum** of OPC shall **indicate** the **name** of the **other person**, who shall, in the **event of the subscriber's death** or **his incapacity to contract,** become the **member** of the company.
- The **other person** whose name is given in the memorandum shall give his **prior written consent** in prescribed **form** and the same shall be **filed with Registrar** of companies at the **time of incorporation** of the company along with its e-memorandum and e-articles.
- Such other person may be given the **right to withdraw** his consent.
- The **member** of OPC may at **any time change the name** of such other person by giving **notice to the company** and the **company shall intimate** the same to the **Registrar**.
- Any such change in the name of the person shall **not be deemed** to be an **alteration of the memorandum.**
- Only a **natural person** who is an **Indian citizen** whether resident in India or otherwise and has **stayed in India** for a period of **not less than 120 days** during the **immediately preceding financial year**
  - shall be eligible to incorporate a OPC;
  - shall be a nominee for the sole member of a OPC.
- **No person** shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
- No minor shall become **member or nominee** of the OPC or can hold **share with beneficial interest**.
- Such Company **cannot be incorporated** or **converted into a company under section 8** of the Act. Though it **may be converted to private or public** companies in certain cases.
- Such Company **cannot carry out** Non-Banking Financial Investment activities including **investment in securities of any body corporate.**

Here the member can be the sole member and director.



(b) Private company [Section 2(68)]

"Private company" means a company having a **minimum paid-up share capital as may be prescribed**, and which **by its articles,** -

(i) restricts the **right to transfer** its shares;

(ii) except in case of One Person Company, limits the **number of its members to two hundred**:

Provided that where **two or more persons** hold **one or more shares** in a company **jointly**, they shall, for the purposes of **this clause**, be treated as a **single member**:

Provided further that—

(a) persons who are **in the employment** of the company; and

(b) persons who, having been **formerly in the employment** of the company, were **members** of the company while in that employment **and have continued** to be **members after the employment ceased**,

shall **not be included** in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company;

Private company - significant points

- **No minimum paid-up** capital requirement.
- Minimum **number of members – 2 (except if private company is an OPC, where it will be 1).**
- Maximum number of members – 200, excluding present employee-cum-members and erstwhile employee-cum-members.
- Right to transfer shares restricted.
- **Prohibition** on invitation to subscribe to securities of the company.
- **Small company** is a **private company**.
- **OPC** can be formed only as a **private company**.

Small company

Small company given under the Section 2(85) of the Companies Act, 2013 which **means** a company, **other than a public company**—

(i) **paid-up share** capital of which **does not exceed fifty lakh rupees** or such **higher** amount as may be prescribed which shall not be more than **ten crore** rupees; and

(ii) **turnover** of which as **per profit and loss** account for the **immediately preceding financial year does not exceed two crore rupees** or such **higher** amount as may be prescribed which shall not be more than **one hundred crore rupees**:

Exceptions: This clause shall **not apply** to:

(a) a **holding** company or a **subsidiary** company;

(b) a company registered under **section 8**; or

(c) a company or body corporate governed by any **special Act**.

For the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed rupees four crores and rupees forty crores respectively. [Companies (Specification of definition details) Amendment Rules, 2022, w.e.f. 15th September, 2022]

Small Company –significant points

- A private company
- Paid up capital – not more than ₹ 50 lakhs

Or

Turnover – not more than ₹ 2 crores.

- Should not be – Section 8 company, Holding or a Subsidiary company

(c) Public company [Section 2(71)]

"Public company" **means** a company which –

(i) is not a private company; and

(ii) has a minimum paid-up share capital, as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

Public company - significant points

- Is **not a private company** (Articles do not have the restricting clauses).
- Shares freely transferable.
- No **minimum paid up capital requirement.**
- **Minimum** number of members **– 7**.
- **Maximum** numbers of members **– No limit**.
- **Subsidiary of a public company is deemed** to be a public company.

According to section 3(1)(a), a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company.

3. On the Basis of Control

(a) Holding and subsidiary companies

'Holding and subsidiary' companies are relative terms

A company is a holding company in relation to one or more other companies, means a company of which **such companies are subsidiary companies.** [Section 2(46)]

For the purposes of this clause, the expression **"company" includes any body corporate.**

Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company **in which the holding company –**

(i) **controls** the **composition** of the **Board** of Directors; **or**

(ii) exercises or controls **more than one-half of the total voting power** either at its **own or together** with one or more of its subsidiary companies.

Provided that such class or classes of holding companies as may be prescribed shall **not have layers** of subsidiaries beyond such numbers as may be prescribed.

For the purposes of this section:

I. a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

II. the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

III. the expression "company" includes any body corporate;

IV. "layer" in relation to a holding company means its subsidiary or subsidiaries.

Example 2:

A will be subsidiary of B, if B controls the composition of the Board of Directors of A, i.e., if B can, without the consent or approval of any other person, appoint or remove a majority of directors of A.

Example 3:

A will be subsidiary of B, if B holds more than 50% of the share capital of A.

Example 4:

B is a subsidiary of A and C is a subsidiary of B. In such a case, C will be the subsidiary of A. In the like manner, if D is a subsidiary of C, D will be subsidiary of B as well as of A and so on.

Status of private company, which is subsidiary to public company: In view of Section 2(71) of the Companies Act, 2013 a **Private company**, which is **subsidiary of a public company** shall be **deemed to be public company** for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.

(b) Associate company [Section 2(6)]

In relation to another company, means a company in which that **other company has a significant influence**, but which is **not a subsidiary** company of the company having such **influence and includes a joint venture company**.

Explanation. — For the purpose of this clause:

(a) the expression "significant influence" means **control of at least twenty per cent of total voting power**, or control of or **participation** in **business decisions** under an agreement;

(b) the expression "joint venture" means a **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights **to the net assets** of the arrangement.

4. On the Basis of Access to Capital

(a) Listed company

As per the definition given in the section 2(52) of the Companies Act, 2013, it is a company which has **any of its securities listed** on **any recognised stock exchange**.

Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in **consultation with the Securities and Exchange Board,** shall **not be considered** as listed companies.

Whereas the word securities as per the section 2(81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

Example 5:

Scan Steel Rods Limited is a Public Limited Company whose shares are listed in the Stock Exchange, Kolkata. Hence Scan Steel Rods Limited is a Listed Company. The reason for calling it "Listed" is because the company and the Stock Exchange have signed a Listing Agreement for trading of shares in the capital market.

(b) Unlisted company means

company **other than listed** company.

5. Other Companies

(a) Government company [Section 2(45)]

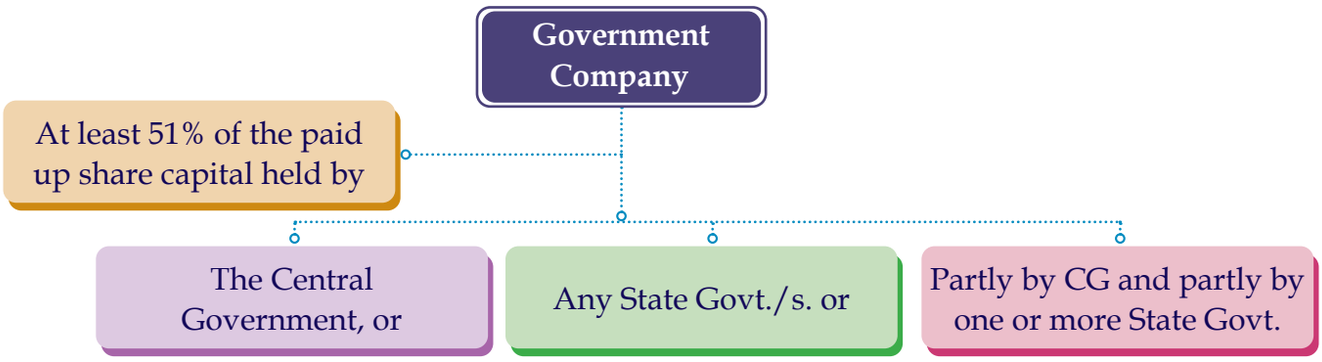
Government Company means any company in which **not less than 51% of the paid-up share capital** is held by:

(i) the **Central** Government, or

(ii) by any **State** Government or Governments, or

(iii) **partly by the Central Government** and partly by **one or more State** Governments, and the section **includes** a company which is a **subsidiary** company of such a Government company.

Explanation: For the purposes of this clause, the **"paid up share capital"** shall be construed as "total voting power", where shares with differential voting rights have been issued.



(b) Foreign company [Section 2(42)]

It means any **company or body corporate incorporated outside India** which –

(i) has a **place of business in India** whether by itself or through an agent, physically or through electronic mode; **and**

(ii) conducts any **business activity in India** in any other manner.

(c) Formation of companies with charitable objects etc. (Section 8 company)

Section 8 of the Companies Act, 2013 **deals with** the **formation** of companies which are formed to

- promote the **charitable objects** of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.
- Such company intends to apply its **profit** in
- promoting its objects and
- **prohibiting the payment** of any **dividend** to its members.

Examples of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

Power of Central government to issue the license:

(i) Section 8 allows the **Central Government to register** such person or association of persons as a company **with limited liability without the addition** of words **'Limited' or 'Private limited'** to its name, by issuing licence on such **conditions as it deems fit**.

(ii) The **registrar shall on application** register such person or association of persons as a company under this section.

(iii) On registration the company shall enjoy same **privileges and obligations as** of a limited company.

Revocation of license: The **Central Government may by order revoke** the licence of the company where the company **contravenes any of the requirements or the conditions** of this sections subject to which a **licence is issued** or where the **affairs** of the company are **conducted fraudulently**, or **violative** of the **objects** of the company or **prejudicial** to public interest, and **on revocation** the Registrar shall **put 'Limited' or 'Private Limited'** against the company's name in the register. But **before such revocation**, the Central Government must give it a **written notice** of its intention to revoke the licence and **opportunity** to be heard in the matter.

Order of the Central Government: Where a licence is revoked then the **Central Government may, in the public interest** order that the company registered under this section should be **amalgamated** with another company registered under this section having similar objects, to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order, or the company be **wound up.**

Penalty/punishment in contravention: If a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees **and the directors and every officer of the** company who is in default shall be **punishable with fine** which shall not **be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees**.

Provided that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.

Section 8 Company- Significant points

- Formed for the promotion of commerce, art, science, religion, charity, protection of environment, sports, etc.
- Requirement of minimum share capital does not apply.
- Uses its profits for the promotion of the objective for which it is formed.
- Does not declare dividend to members.
- Operates under a special licence from Central Government.
- Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.
- Licence revoked if conditions contravened.
- On revocation, Central Government may direct it to
  - Converts its status and change its name
  - Wind – up
  - Amalgamate with another company having similar object.
- Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- Requirement of minimum number of directors, independent directors etc. does not apply.
- Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- A **partnership firm can be a member of Section 8 company.**

Formation
- To promote Charitable objects

Application of profits
- To promote its objects
- No payment of dividends out of profits

Type of Co.
- Limited Liability
- Without the addition of words "Ltd" or "Pvt Ltd."

How status is granted
- The CG can grant such status
- However, CG has delegated the power to grant licence to ROC

Revocation of licence
- CG may revoke licence
  - If conditions of section 8 are contravented, or
  - Affairs of the company are conducted fraudulently, or prejudicial to public interest

Effect of revocation of licence
- Co has to use words "Ltd" or "Pvt Ltd."

(d) Dormant company (Section 455)

Where a company is **formed and registered** under this Act for a **future project** or to hold an **asset or intellectual property** and has **no significant accounting transaction, such** a company or an **inactive company** may make an **application to the Registrar** in such manner as may be prescribed for obtaining the **status** of a dormant company.

"**Inactive company**" means a company which has **not** been carrying on any **business or operation**, or has **not** made any **significant accounting transaction** during the **last two financial years,** or has **not filed financial statements and annual returns during the last two financial years.**

"Significant accounting transaction" means **any transaction other than**-

(i) payment of **fees** by a company **to the Registrar**;

(ii) payments made by it to **fulfil the requirements** of **this Act** or any **other law;**

(iii) **allotment of shares** to fulfil the **requirements** of this Act; **and**

(iv) payments for **maintenance of its office and records.**

(e) Meaning of nidhi companies [Section 406(1) of the companies act, 2013]

In this section, "Nidhi" or "Mutual Benefit Society" means a company which the **Central Government may, by notification** in the Official Gazette, **declare** to be a Nidhi or Mutual Benefit Society, as the case may be. Nidhi Companies are created mainly for **cultivating the habit of thrift and savings** amongst its members.

(f) Public financial institutions (PFI)

By virtue of Section 2(72) of the Companies Act, 2013, the **following institutions** are to be regarded as public financial institutions:

(i) the **Life Insurance Corporation** of India, established under the Life Insurance Corporation Act, 1956;

(ii) the **Infrastructure Development Finance** Company Limited,

(iii) specified company referred to in the **Unit Trust of India** (Transfer of Undertaking and Repeal) Act, 2002;

(iv) institutions **notified by the Central Government** under section 4A(2) of the Companies Act, **1956 so repealed** under section 465 of this Act;

(v) such other institution as may be **notified** by the Central Government in **consultation with the Reserve Bank of India**:

Conditions for an institution to be notified as PFI: No institution shall be so notified **unless** –

A. It has been **established or constituted** by or under any **Central or State Act other than this Act** or the previous Companies Law; or

B. **Not less than fifty-one per cent of the paid-up share capital** is held or controlled by the **Central Government** or by any **State Government** or Governments or **partly by the Central Government** and **partly by** one or more **State** Governments.

Conditions for an institution to be notified as PFI

- Established or constituted by or under any Central or State Act
- At least 51% of the paid-up share capital is held/controlled by the CG or by any State Govt./s or partly by the CG and partly by one or more State Govts.

❒ MODE OF REGISTRATION/INCORPORATION OF COMPANY

Promoters

The Companies Act, 2013 defines the term "Promoter" under section 2(69) which means a person-

(a) who has been **named as such** in a prospectus or is **identified** by the company in the **annual return** referred to in section 92; **or**

(b) who has **control** over **the affairs** of the company, **directly or indirectly** whether as a **shareholder, director or otherwise;** or

(c) in accordance with whose **advice, directions, or instructions** the **Board of Directors of the company is accustomed to act.**

In simple terms we can say,

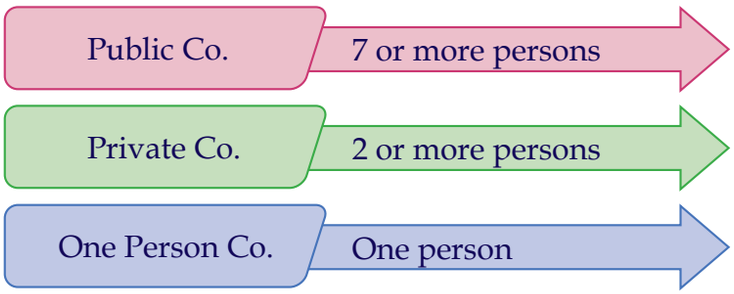
- Persons who **form** the company are known as promoters.
- It is they who **conceive the idea** of forming the company.
- They take **all necessary steps** for its registration.
- It should, however, be noted that persons acting **only in a professional capacity** e.g., the solicitor, banker, accountant etc. are **not** regarded as promoters.

Formation of Company

Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company.

In the case of a **public company**, any **7 or more persons** can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration.

In the same way, **2 or more persons can form a private company** and **one person can form one person company**.



Incorporation of Company

Section 7 of the Companies Act, 2013 provides for the **procedure** to be followed for **incorporation** of a company.

1. **Filing of the documents** and information with the registrar: For the registration of the company following documents and information are required to be filed with the **registrar within whose jurisdiction** the registered office of the company is proposed to be situated-
   - the **memorandum and articles** of the company duly **signed by all** the subscribers to the memorandum.
   - a **declaration** by person who is **engaged in the formation** of the company (an advocate, a chartered accountant, cost accountant or company secretary in practice), **and** by a person **named in the articles** (director, manager or secretary of the company), that **all** the **requirements** of this **Act** and the **rules** made thereunder in respect of registration and matters precedent or incidental thereto have been **complied with.**
   - a **declaration** from **each of the subscribers** to the memorandum and from persons named as the **first directors**, if any, in the articles stating that-
     - he is **not convicted** of any **offence** in connection with the **promotion, formation** or **management** of any company, or
     - he has **not been found guilty** of any **fraud or misfeasance or of any breach of duty** to any company under this Act or any previous company law during the **last five years**,
     - and that **all the documents** filed with the Registrar for registration of the company contain information that is **correct and complete** and **true to the best of his knowledge and belief;**
   - the **address for correspondence** till its registered office is established;
   - the **particulars (names, including surnames or family names, residential address, nationality) of every subscriber** to the memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
   - the **particulars (names, including surnames or family names, the Director Identification Number, residential address, nationality) of the persons mentioned in the articles as the subscribers** to the Memorandum and such other particulars including proof of identity as may be prescribed; and
   - the **particulars of the interests of the persons mentioned in the articles as the first directors** of the company in other firms or bodies corporate along **with their consent** to act as directors of the company in such form and manner as may be prescribed.
   - **Particulars** provided in this provision **shall be** of the **individual subscriber** and **not of the professional** engaged in the incorporation of the **company [The Companies (Incorporation)** Rules, 2014].
2. **Issue of certificate of incorporation** on registration: The Registrar on the basis of documents and information filed, shall **register all the documents** and information in the register and **issue** a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

3. **Allotment of Corporate Identity Number (CIN):** On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a **distinct identity** for the company and which shall also be included in the certificate.
4. **Maintenance of copies of all documents and information:** The company shall **maintain and preserve at its registered office copies** of all documents and information as **originally filed, till its dissolution** under this Act.
5. Furnishing of false or incorrect information or suppression of material fact **at the time of incorporation** (i.e. at the time of Incorporation): If **any person** furnishes any **false or incorrect** particulars of any information or **suppresses any material information**, of which he is **aware** in any of the documents filed with the Registrar in relation to the registration of a company, he shall be **liable for action** for **fraud under section 447.**
6. Company **already incorporated** by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation): Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated **by furnishing any false or incorrect information** or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the **promoters**, the persons named as the **first directors** of the company and the persons **making declaration** under this section shall each be **liable** for action for fraud under section **447**.
7. **Order of the Tribunal:** Where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the **Tribunal may**, on an **application** made to it, on being **satisfied** that the situation so warrants,-
   (a) pass **such orders**, as it may **think fit, for regulation** of the **management** of the company **including changes,** if any, in its **memorandum and articles**, in **public interest** or in the **interest** of the **company** and its **members and creditors;** or
   (b) direct that **liability** of the **members** shall be **unlimited**; or
   (c) direct **removal of the name** of the company **from** the **register** of companies; or
   (d) pass an **order for the winding up** of the company; or
   (e) pass such **other orders** as it may **deem fit**:

Provided that **before** making any order,—

- the company shall be given a reasonable **opportunity** of being heard in the matter; and
- the Tribunal shall take into **consideration the transactions entered** into by the company, including the obligations, if any, contracted or payment of any liability.

Simplified Proforma for Incorporating Company Electronically (SPICe)

The Ministry of Corporate Affairs has taken various initiatives for **ease of business**. In a step towards easy setting up of business, MCA has **simplified the process** of filing of forms for incorporation of a company through Simplified Proforma for incorporating company electronically.

Effect of Registration

Section 9 of the Companies Act, 2013 provides for the effect of registration of a company.

According to Section 9, **from the date of incorporation (mentioned in the certificate** of incorporation), the subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a **body corporate** by the name contained in the memorandum. Such a registered company shall be **capable** of exercising all the functions of an incorporated company under this Act and having **perpetual succession** with power to **acquire, hold and dispose** of property, both movable and immovable, tangible and intangible, to **contract** and to **sue** and be sued, by the said name.

From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators; and there comes into existence a **binding contract** between the **company and its members** as evidenced by the Memorandum and Articles of Association [Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala]. It has perpetual existence until it is dissolved by liquidation or struck out of the register. A shareholder who buys shares, does not buy any interest in the property of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.

A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the legal person begins to function as an entity. A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members [State Trading Corporation of India vs. Commercial Tax Officer].

It may be noted that under the provisions of the Act, a company may **purchase shares of another** company and thus become a controlling company. However, merely because a company purchases all shares of another company it will not serve as a means of putting **an end to the corporate** character of another company and each company is a separate juristic entity [Spencer & Co. Ltd. Madras vs. CWT Madras].

As has been stated above, the law recognizes such a company as a juristic person separate and distinct from its members. The mere fact that the **entire share capital has been contributed by the Central Government** and **all** its shares are **held by the President** of India and other officers of the Central Government **does not make any difference** in the position of registered company and it **does not make** a company an **agent** either of the President or the Central Government [Heavy Electrical Union vs. State of Bihar].

Effect of Memorandum and Articles

As per Section 10 of the Companies Act, 2013, where the memorandum and articles when registered, shall **bind the company and the members** thereof to the same extent as if they **respectively had been signed** by the company and by each member, and an agreement to **observe all** the provisions of the memorandum and of the articles. **All monies payable** by any member to the company under the memorandum or articles shall be a **debt due from him** to the company.

❒ CLASSIFICATION OF CAPITAL

The term Capital has A variety of meanings. It means one thing to economists; another to accountants and still another to businessmen and lawyers. In relation to a company **limited by shares,** the word **capital** means **share-capital**, i.e., the capital or figure in terms of so many **rupees divided into shares of fixed amount**. In other words, the **contributions** of persons to the **common stock** of the company form the capital of the company. The **proportion** of the capital to which **each member is entitled**, is his **share**. A share is **not a sum of money;** it is rather an **interest measured by a sum of money and made up of various rights contained in the contract**.

In the domain of Company Law, the term 'capital' is used in the following senses:

A. Nominal or Authorised or Registered Capital

This form of capital has been defined in section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is **authorised by the memorandum** of a company to be the **maximum amount** of share capital of the company. Thus, it is the sum stated in the memorandum as the capital of the company with which it is **to be registered being the maximum amount** which it is authorised to raise by issuing shares, and upon **which it pays the stamp duty**. It is **usually fixed at the amount**, which, it is estimated, the company will need, **including the working capital and reserve capital**, if any.

B. Issued Capital

Section 2(50) of the Companies Act, 2013 defines "issued capital" which means such capital as the **company issues from time to time for subscription**. It is that **part of authorised capital** which is offered by the company for subscription and **includes** the shares allotted for **consideration other than cash**.

Schedule III to the Companies Act, 2013, makes it **obligatory for a company to disclose** its issued capital in the **balance sheet.**

C. Subscribed Capital

Section 2(86) of the Companies Act, 2013 defines "subscribed capital" as such part of the capital which is for the time being **subscribed by the members** of a company.

It is the **nominal amount** of shares **taken up** by the public. Where any notice, advertisement or other official **communication or any business letter, bill head or letter paper of a company** states the **authorised capital, the subscribed and paid-up capital** must also be stated in equally conspicuous characters. A default in this regard will make the company and every officer who is in default liable to pay penalty extending ₹ 10,000 and ₹ 5,000 respectively. [Section 60].

D. Called-up Capital

Section 2(15) of the Companies Act, 2013 defines "called-up capital" as such part of the capital, which has **been called for payment**. It is the **total amount called up on the shares issued.**

Paid-up Capital

is the total amount **paid or credited** as **paid up** on shares issued. It is equal to **called up capital less calls in arrears.**

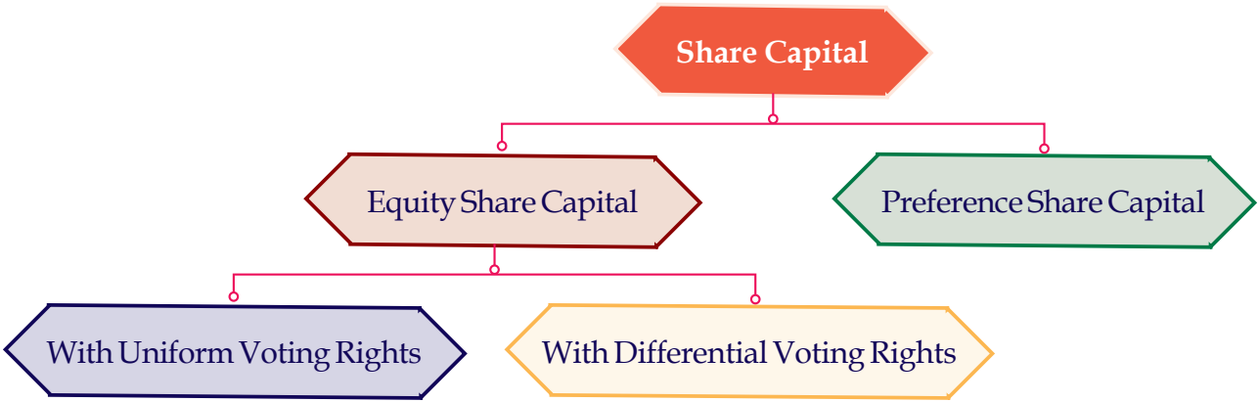
❒ SHARES

I. Nature of Shares

Section 2(84) of the Companies Act, 2013 defines the term 'share' which **means** a share in the **share capital of a company and includes stock.** A share thus represents such **proportion** of the interest of the shareholders as the **amount paid up** thereon bears to the **total capital payable** to the company. It is a measure of the interest in the company's assets to which a person holding a share is entitled.

Share is an interest in the company

Farwell Justice, in Borland Trustees vs. Steel Bors. & Co. Ltd. observed that "a share is **not a sum of money but is an interest measured** by a sum of money and made up of **various rights** contained in the contract, including the right to a sum of money of a more or less amount". You should note that the shareholders are not, in the eyes of law, part owners of the undertaking. The undertaking is somewhat different from the totality of the shareholders. The **rights and obligations** attaching to a share are those **prescribed by the memorandum and the articles of a company.** It must, however, be remembered that a shareholder has not only contractual rights against the company, but also certain other rights which accrue to him according to the provisions of the Companies Act.



Shares are a movable property

According to section 44 of the Companies Act, 2013, the shares or debentures or other interests of any member in a company shall be movable property transferable in the manner provided by the articles of the company.

Shares shall be numbered: Section 45 provides, every share in a company having a share capital, shall be **distinguished by its distinctive number.** This implies that **every share shall be numbered.**

However, this shall **not apply** to a share **held by a person** whose **name is entered as holder of beneficial interest in such share in the records of a depository.**

II. Kinds of Share Capital

Section 43 of the Companies Act, 2013 provides the kinds of share capital. According to the provision the share capital of a company limited by shares shall be of **two kinds, namely:**

(i) Equity share capital

1. **with voting rights**; or
2. **with differential rights** as to dividend, voting or otherwise in accordance with prescribed rules;

Example 6:

It is to be noted that, Tata Motors in 2008 introduced equity shares with differential voting rights called 'A' equity shares in its rights issue. In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares. Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting. Other companies which have issued equity shares with differential voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others.

(ii) Preference share capital

However, this Act shall not affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

According to explanation to section 43:

1. **"Equity share capital",** with reference to any company limited by shares, means all share capital which is not preference share capital;
2. **"Preference share capital",** with reference to any company limited by shares, means that part of the issued share capital of the company which **carries** or would carry a **preferential right** with respect to-
   (a) **payment of dividend**, either as a **fixed amount** or an amount **calculated at a fixed rate,** which may either be **free of or subject to income-tax**; and
   (b) **repayment,** in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a **preferential right** to the payment of any fixed **premium** or premium on any fixed scale, **specified** in the **memorandum or articles** of the company;

   Exception: In case of private company - **Section 43 shall not apply where memorandum or articles of association of the private** company so provides.

❒ MEMORANDUM OF ASSOCIATION

The Memorandum of Association of company is in fact its **charter**; it defines its **constitution and the scope** of the **powers** of the company with which it has been established under the Act. It is the **very foundation** on which the whole edifice of the **company is built.**

Object of Registering a Memorandum of Association

- It contains the **object** for which the company is **formed** and therefore identifies the **possible scope** of its operations **beyond which its actions cannot go.**
- It **enables shareholders, creditors** and all those who **deal with company** to know what its **powers are and what activities** it can engage in.

A memorandum is a **public document** under Section 399 of the Companies Act, 2013. Consequently, every person **entering into a contract** with the company is **presumed** to have the **knowledge** of the conditions contained therein.

The shareholders must **know the purposes** for which his **money can be used** by the company and **what risks he is taking** in making the investment.

A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum. If it does so, it would be ultra vires the company and void.

As per Section 4, Memorandum of a company shall be drawn up in such form as is given in Tables A, B, C, D and E in Schedule I of the Companies Act, 2013.

Table A is a form for memorandum of association of a company limited by **shares**.

Table B is a form for memorandum of association of a company limited by **guarantee** and **not having a share capital.**

Table C is a form for memorandum of association of a company limited by **guarantee** and **having a share capital**.

Table Dis a form for memorandum of association of an **unlimited** company.

Table E is a form for memorandum of association of an **unlimited** company and **having share capital**.

The memorandum and articles of a company must be as **closed to model forms,** as possible, depending upon the circumstances.

Content of the Memorandum

The memorandum of a company shall state:

(a) the name of the company **(Name Clause)** with the **last word "Limited" in the case of a public limited company,** or the last words **"Private Limited"** in the case of a **private limited company.** This clause **is not applicable** on the companies formed under **section 8** of the Act.

The name including phrase 'Electoral Trust' may be allowed for Registration of companies to be formed under section 8 of the Act, in accordance with the Electoral Trusts Scheme, 2013 notified by the Central Board of Direct Taxes (CBDT). For the Companies under section 8 of the Act, the name shall include the words foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust and the like etc. **[The Companies (Incorporation) Rules, 2014]**.

As per MCA notification dated 5th June, 2015, a Government company's name must end with the word "Limited". In the case of One Person Company, the words "**One Person Company**", should be included **below** its name.

(b) the **State** in which the **registered office** of the company **(Registered Office clause) is to be situated;**

(c) the **objects** for which the company is **proposed to be incorporated** and any **matter considered necessary** in furtherance thereof **(Object clause);**

If any company has **changed its activities** which are **not reflected in its name**, it shall **change its name** in **line with its activities** within a period of **six months** from the **change** of **activities** after complying with all the provisions as applicable to change of name.

(d) the **liability of members** of the company **(Liability clause),** whether **limited or unlimited**, and also state, -

- **in the case of a company limited by shares**, that the liability of its members is limited to the amount **unpaid**, if any, on the shares held by them; and
- **in the case of a company limited by guarantee**, the amount up to which each member **undertakes to contribute** –
  - to **the assets of the company in the event of its being wound-up** while he **is a member** or within **one year after he ceases** to be a member for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted **before he ceases to be a member**, as the case may be; and
  - to the **costs, charges and expenses** of winding-up and for **adjustment of the rights of the contributories** among themselves;

(e) the amount of **authorized capital (Capital Clause) divided** into share of **fixed amounts** and the **number of shares** with the subscribers to the memorandum have agreed to take, **indicated opposite their names**, which shall **not be less than one share**. A company not having share capital need not have this clause.

(f) the **detail of the subscribers** to be formed into a company. The Memorandum shall **conclude with the association clause.** Every subscriber to the Memorandum shall **take atleast one share**, and shall **write against his name**, the **number** of **shares taken** by him.

In the case of OPC, the **name of the person** who, in the **event of death** of the subscriber, shall **become the member** of the company.

The memorandum must be **printed**, **divided into paragraphs**, **numbered consecutively**, and **signed** by at least **seven** persons (**two** in the case of a **private** company and **one** in the case of **One Person Company**) in the **presence** of at least one witness, who will **attest** the signatures. The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation etc., must also be entered.

It is to be noted that a company being a legal person can through its agent, subscribe to the memorandum. However, a minor cannot be a signatory to the memorandum as he is not competent to contract. The guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.

The above clauses of the Memorandum are called compulsory clauses, or "Conditions". In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

The Memorandum of Association of a company **cannot contain anything contrary** to the provisions of the **Companies Act.** If it does, the same shall be devoid of any legal effect. Similarly, all **other documents** of the company must **comply** with the provisions of the **Memorandum**.

❒ DOCTRINE OF ULTRA VIRES

Doctrine of ultra vires: The meaning of the term ultra vires is simply **"beyond (their) powers"**. The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further. In consequence, any act done or a contract made by the company which travels beyond the powers **not only of** the **directors but also of the company** is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The **impact** of the doctrine of ultra vires is that a company can **neither be sued on an ultra vires** transaction, nor can it sue on it. Since the **memorandum** is a **"public document"**, it is **open to public** inspection. Therefore, when one deals with a company one **is deemed to** know about the powers of the company. If **in spite of** this you enter into a transaction which is ultra vires the company, you **cannot enforce** it against the company.

Example 7:

If you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company, then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is ultra vires the company **being void, cannot be ratified** by the shareholders of the company. Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, **the shareholders can ratify it**; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

The leading case through which this doctrine was enunciated is that of **Ashbury Railway Carriage and Iron Company Limited v. Riche-(1875).**

The facts of the case are:

The main objects of a company were:

(a) To make, sell or lend on hire, railway carriages and wagons;

(b) To carry on the business of mechanical engineers and general contractors.

(c) To purchase, lease, sell and work mines.

(d) To purchase and sell as merchants or agents, coal, timber, metals etc.

The directors of the company entered into a contract with Riche, for financing the construction of a railway line in Belgium, and the company further ratified this act of the directors by passing a

special resolution. The company however, repudiated the contract as being ultra vires. And Riche brought an action for damages for breach of contract. His contention was that the contract was well within the meaning of the word general contractors and hence within its powers. Moreover, it had been ratified by a majority of shareholders. However, it was held by the Court that the contract was null and void. It said that the terms general contractors was associated with mechanical engineers, i.e. it had to be read in connection with the company's main business. If, the term general contractor's was not so interpreted, it would authorize the making of contracts of any kind and every description, for example, marine and fire insurance.

An ultra vires contract can never be made binding on the company. It cannot become "Intravires" by reasons of estoppel, acquiescence, Lapse of time, delay or ratification.

The whole position regarding the doctrine of ultra vires can be summed up as:

(i) When an act is performed, which though legal in itself, is not authorized by the object clause of the memorandum, or by the statute, it is said to be ultravires the company, and hence null and void.

(ii) An act which is ultravires, the company cannot be ratified even by the unanimous consent of all the shareholders.

(iii) An act which is ultravires the directors, but intravires the company can be ratified by the members of the company through a resolution passed at a general meeting.

(iv) If an act is ultravires the Articles, it can be ratified by altering the Articles by a Special Resolution at a general meeting.

However, the disadvantages of this doctrine outweigh its main advantage, namely to provide protection to the shareholders and creditors. Although it may be useful to members in restraining the activities of the directors, **it is only a nuisance in so far as it prevents the company from changing its activities in a direction which is agreed by all.** Again, the purpose of doctrine of ultravires has been defeated as now the object clause can be easily altered, by passing just a special resolution of the shareholders.

❒ ARTICLES OF ASSOCIATION

The articles of association of a company are its **rules and regulations**, which are framed to **manage its internal affairs.** Just as the memorandum contains the fundamental conditions upon which the company is allowed to be incorporated, so also the articles are the internal regulations of the company **(Guiness vs. Land Corporation of Ireland).** These general functions of the articles have been aptly summed up by Lord Cairns in Ashbury Carriage Co. vs. Riches as follows: "The articles **play a part subsidiary** to memorandum of association. They accept the memorandum as the charter of incorporation, and so accepting it the articles proceed to define the duties, the rights and powers of the governing body as between themselves and the company and the **mode and form** in which the **business** of the company is to be **carried on**, and the mode and form in which changes in the internal regulation of the company may from time to time be made."

The **document** containing the **articles** of association of a company (the **Magna Carta**) is **a business document**; hence it has to be **construed strictly.** It **regulates domestic management** of a company and **creates certain rights and obligations** between the **members and the company** [S.S. Rajkumar vs. Perfect Castings (P) Ltd.].

The articles of association are in fact the **bye-laws** of the company according to which **director and other officers** are **required to perform** their functions as regards the **management of the company, its accounts and audit**. It is important therefore that the auditor should study them and, while doing so he should note the provisions therein in respect of relevant matters.

Section 5 of the Companies Act, 2013 Seeks to Provide the Contents and Model of Articles of Association. The Section Lays the Following Law

1. Contains regulations

The articles of a company shall contain the **regulations for management** of the company.

2. Inclusion of matters

The articles shall also contain such **matters**, as are **prescribed** under the rules. However, a company may also include such **additional matters** in its articles as may be **considered necessary** for its management.

3. Contain provisions for entrenchment

The articles **may** contain provisions for entrenchment (to protect something) to the effect that **specified provisions of the articles may be altered** only if **conditions or procedures** as that are **more restrictive than those applicable in the case of a special resolution**, are met or **complied** with.

4. Manner of inclusion of the entrenchment provision

The provisions for entrenchment shall only be made **either on formation** of a company, or by an **amendment** in the **articles** agreed to **by all** the members of the company in the case of a **private** company and by a **special resolution** in the case of a **public company.**

5. Notice to the registrar of the entrenchment provision

Where the articles contain provisions for entrenchment, whether made on **formation or by amendment**, the company shall give **notice to the Registrar** of such provisions in such form and manner as may be prescribed.

6. Forms of articles

The articles of a company shall be in respective forms specified in Tables, **F, G, H, I and J** in Schedule I as may be applicable to such company.

7. Model articles

A company may **adopt all or any** of the regulations contained in the **model articles applicable** to such company.

8. Company registered after the commencement of this act

In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

The following are the key Differences between the Memorandum of Association vs. Articles of Association

1. Objectives

Memorandum of Association **defines and delimits the objectives of the** company whereas the Articles of association lays down the **rules and regulations for the internal management** of the company. Articles determine how the **objectives** of the company are **to be achieved.**

2. Relationship

Memorandum defines the **relationship** of the company with the **outside world** and Articles define the relationship between the **company and its members.**

3. Alteration

Memorandum of association can be **altered** only under **certain circumstances** and in the **manner provided** for in the Act. In **most cases permission of the Regional Director, or the Tribunal** is required. The articles can be altered simply by passing a **special resolution**.

4. Ultra vires

Acts done by the company **beyond the scope** of the memorandum are **ultra-vires and void**. These **cannot be ratified even** by the **unanimous consent of all the shareholders**. The acts **ultra-vires the articles** can be ratified by a **special resolution** of the shareholders, provided they are **not beyond** the provisions of the **memorandum**.

❒ DOCTRINE OF INDOOR MANAGEMENT

Doctrine of Constructive Notice

Section 399 of the Companies Act, 2013 provides that **any person can inspect** by electronic means any document kept by the Registrar, or make a **record** of the same, or get a **copy** or extracts of any document, including certificate of incorporation of any company, on **payment** of **prescribed fees**.

The memorandum and articles of association of a company when registered with Registrar of Companies, become public documents, and they are available for inspection to any person, on the payment of a nominal fees. In other words, Section 399 confers the right of inspection to all. It is therefore, the **duty** of **every person dealing** with a company to **inspect** its documents and **make sure** that his contract is in **conformity with their provisions** but whether a **person reads them or not**, it will be presumed that he knows the contents of the documents. This kind of presumed/ implied notice is called constructive notice.

By constructive notice is meant:

(i) Whether a person reads the documents or not, he is **presumed to have knowledge** of the contents of the documents. He is not only presumed to have read the documents but also **understood** them in their **true perspective**, and

(ii) Every person dealing with the company not only has the constructive notice of the memorandum and articles, but also of all the other related documents, such as Special Resolutions etc., which are required to be registered with the Registrar.

Thus, if a person **enters into a contract which** is **beyond the powers** of the company as defined in the memorandum, **or outside the authority** of directors as per memorandum or articles, he **cannot acquire any rights** under the contract against the company.

Doctrine of Indoor Management

The Doctrine of Indoor Management is **the exception to the doctrine** of constructive notice. The aforesaid doctrine of constructive notice does in **no sense** mean that **outsiders are deemed** to have **notice of the internal affairs** of the company. For instance, if an act is **authorised by the articles or memorandum**, an outsider is entitled to assume that **all the detailed formalities** for doing that act have **been observed**. This can be explained with the help of a landmark case The Royal British Bank vs. Turquand. This is the doctrine of indoor management popularly known as Turquand Rule.

Case Law: Royal British Bank vs. Turquand

Facts: Mr. Turquand was the official manager (liquidator) of the insolvent Cameron's Coalbrook Steam, Coal and Swansea and Loughor Railway Company. It was incorporated under the Joint Stock Companies Act, 1844. The company had given a bond for £ 2,000 to the Royal British Bank, which secured the company's drawings on its current account. The bond was under the company's seal, signed by two directors and the secretary. When the company was sued, it alleged that under its registered deed of settlement (the articles of association), directors only had power to borrow up to an amount authorized by a company resolution. A resolution had been passed but not specifying how much the directors could borrow.

Held, it was decided that the bond was valid, so the Royal British Bank could enforce the terms. He said the bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed. Articles of association were registered with Companies House, so there was **constructive notice**. But the **bank could not be deemed** to know which ordinary resolutions passed, because these were **not registrable**. The **bond was valid** because there was no requirement to look into the company's internal workings. This is the indoor management rule, that the company's indoor affairs are the company's problem.

Exceptions to the Doctrine of Indoor Management

Thus, you will notice that the aforementioned rule of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required.

The above-mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

(a) Actual or constructive knowledge of irregularity

The rule **does not protect** any person when the person dealing with the company **has notice**, whether **actual or constructive**, of the irregularity.

Case Law: Howard vs. Patent Ivory Manufacturing Co.

Facts: In Howard vs. Patent Ivory Manufacturing Co. where the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

Case Law: Morris v Kansseen

Likewise, in Morris v Kansseen, a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

(b) Suspicion of irregularity

The doctrine in **no way**, **rewards** those who **behave negligently**. Where the person dealing with the company is **put upon an inquiry**, for example, where the transaction is unusual or not in the ordinary course of business, it is the **duty of the outsider** to make the **necessary enquiry**.

The protection of the "Turquand Rule" is also not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. Suspicion should arise, for example, from the fact that an officer is purporting to act in matter, which is apparently outside the scope of his authority. Where, for example, as in the case of **Anand Bihari Lal vs. Dinshaw & Co**. the plaintiff accepted a transfer of a company's property from its accountant, the transfer was held void. The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property.

Similarly, in the case of Haughton & Co. v. Nothard, Lowe & Wills Ltd. where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said that it was something so unusual "that the plaintiff were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it". Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf".

(c) Forgery

The doctrine of indoor management **applies only to irregularities** which might otherwise affect a **transaction** but it **cannot apply to forgery** which must be regarded as **nullity**.

Forgery may in circumstances exclude the 'Turquand Rule'. The only clear illustration is found in the Ruben v Great Fingall Consolidated.

Case Law: Ruben v Great Fingall Consolidated

Facts: In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.

The plaintiff contended that whether the signature were genuine or forged was apart of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has **never been extended** to cover such a **complete forgery**.

CHAPTER

07 The Negotiable Instruments Act, 1881

TABLE OF CONTENTS FOR THE CHAPTER

- INTRODUCTION 279
- MEANING OF NEGOTIABLE INSTRUMENTS 280
- PROMISSORY NOTE 281
- BILLS OF EXCHANGE 283
- DIFFERENCE BETWEEN PROMISSORY NOTE AND BILL OF EXCHANGE 286
- CHEQUE [SECTION 6] 286
- CLASSFICATION OF NEGOTIABLE INSTRUMENTS 288
- NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS 292
- DELIVERY WHEN EFFECTIVE BETWEEN THE PARTIES 293
- DISHONOUR OF CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS [SECTION 138 TO 142] 294
- PRESENTMENT OF INSTRUMENTS 295
- RULES OF COMPENSATION 298

INTRODUCTION

The law relating to negotiable instruments is the law of the commercial world which was enacted to facilitate the activities in trade and commerce making provision for giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, the trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry with it the bulk of the currency in force. The source of Indian law relating to such instruments is admittedly the English Common Law.

The main objective of the Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods.

The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. This is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques. The Act applies to the whole of India, but nothing herein contained affects the Reserve Bank of India Act, 1934, (section 21 which provides the Bank to have the right to transact Government business in India), or affects any local usage relating to any instrument in an oriental language.

Provided that such usages may be excluded by any words in the body of the instrument, which indicate an intention that the legal relations of the parties thereto shall be governed by this Act; and it shall **come into force** on the **first day of March, 1882.**

The provisions of this Act are also applicable to Hundis, unless there is a local usage to the contrary. Other native instruments like Treasury Bills, Bearer Debentures, Railway Receipts, Delivery Orders, Bill of Lading etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

Recent developments: The Act was amended several times. Following are the significant amendments made in the Negotiable Instruments Act, 1881 (N.I. Act):

- The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, **2002;**
- The Negotiable Instruments (Amendment) Act, **2015,** and

MEANING OF NEGOTIABLE INSTRUMENTS

The Negotiable Instruments (Amendment) Act, 2018.

Negotiable Instruments is an instrument (the word instrument means a document) which is **freely transferable** (by customs of trade) from one person to another by **mere delivery** or by **indorsement and delivery**. The **property** in such an instrument pass to a **bonafide transferee for value**.

The Act **does not define** the term 'Negotiable Instruments'. However, **Section 13** of the Act provides for only **three kinds** of negotiable instruments namely **bills of exchange, promissory notes and cheques**, payable either to order or bearer.

It is to be noted that Hundies, Treasury Bills, Bearer Debentures, Railway Receipts, Delivery Orders, Bill of Lading etc. are also considered as negotiable instruments either by mercantile custom or usage.

Types of Negotiable Instrument

- Promissory Note
- Bill of Exchange
- Cheque

1. A negotiable instrument is payable to order when:
   (a) It is expressed to be so payable
   (b) When it is expressed to be payable to a specified person and does not contain words prohibiting its transfer. (i.e. it is transferrable by indorsement and delivery)
2. A negotiable instrument is payable to bearer when:
   (a) When it is expressed to be so payable e.g. pay bearer
   (b) When the only or last indorsement (indorsement means signing of the instrument) on the instrument is an indorsement in blank i.e., the person who possesses it can demand payment. For example,. A cheque made payable to specified person and that cheque is endorsed by signing on the back of the cheque by that specified person.

Essential Characteristics of Negotiable Instruments

1. It is necessarily in **writing**.
2. It should be **signed**.

3. It is **freely transferable** from one person to another.
4. Holder's title is **free from defects.**
5. It can be **transferred any numbe**r of times till its satisfaction.
6. Every negotiable instrument must contain an unconditional promise or order to pay money. The promise or order to pay must consist of **money only**.
7. The **sum** payable, the **time** of payment, the **payee,** must be **certain**.
8. The instrument should be **delivered**. Mere drawing of instrument does not create liability.

Characteristics							
written	signed	transferable	title free from defects	can be transferred number of times	uncon-ditional promise/ order to pay	certainty of sum payable, time of payment and the payee	delivered

❒ PROMISSORY NOTE

Meaning

According to section 4 of the NI Act, 1881, "A 'promissory note' is an **instrument in writing** (not being a bank-note or a currency-note) containing an **unconditional undertaking signed** by the **maker**, to pay a certain **sum of money** only to, or to the order of, a certain person, or to the bearer of the instrument."

Specimen of Bill of Exchange

Specimen of Promissory Note

₹10,000 Lucknow
April 10, 2022

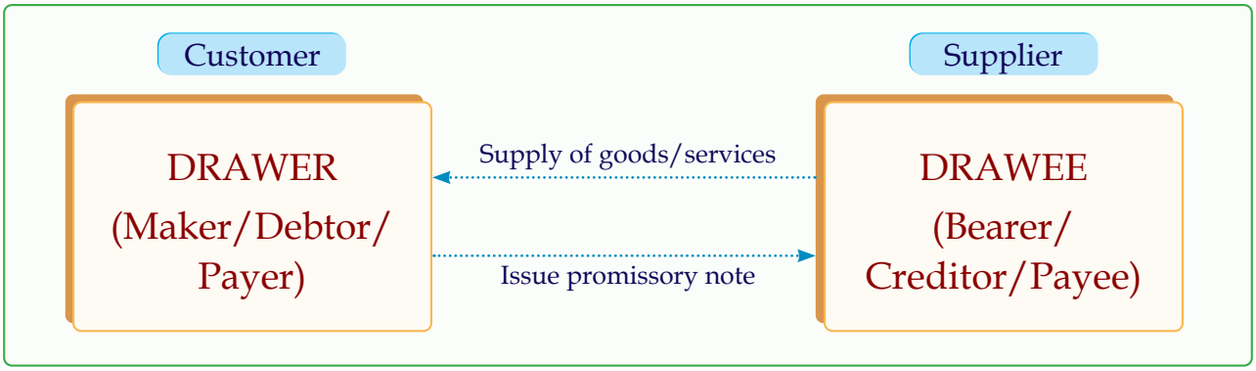
Three months after date, I promise to pay Shri Ramesh (Payee) or to his order the sum of Rupees Ten Thousand, for value received.

Stamp
Sd/-
Ram

To,
Shri Ramesh,
B-20, Green Park,
Mumbai
(Maker)

Parties to Promissory Note

1. Maker: The person **who makes** the promise to pay is called the Maker. He is the **debtor and must sign** the instrument.
2. Payee: Payee is the person to **whom the amount on the note is payable**.



Essential Characteristics of a Promissory Note

(a) In **writing**- An oral promise to pay is not sufficient.

(b) There must be **an express promise** to pay. Mere **acknowledgment** of debt is **insufficient**.

Example 1:

Example 1: I acknowledge myself to be indebted to B in ₹1,000, to be paid on demand, for value received. (Valid promissory note as the promise to pay is definite)

Example 2:

Mr. B, I.O.U ₹1,000." – Invalid promissory note as there is no promise to pay. It is just an acknowledgement of debt.

(c) The promise to pay should be **definite and unconditional.** Therefore, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event, are not promissory notes. However, the promise to pay may be subject to a **condition**, which according to the **ordinary experience of mankind, is bound to happen**.

Example 3:

I promise to pay B ₹500 seven days after my marriage with C. (the promissory note is invalid as marriage with C may or may not happen.)

Example 4:

I promise to pay B ₹500 on D's death- as the death of D is certain, promise in unconditional. Thus, the promissory note is valid.

Example 5:

I promise to pay B ₹500 on D's death, provided D leaves me enough to pay that sum. Invalid promissory note as promise is dependent on D's leaving behind money which is not certain.

(d) A promissory note must be **signed by the make**r otherwise it is incomplete and ineffective.

(e) Promise to pay **money only.**

Example 6:

I promise to pay B ₹500 and to deliver to him my black horse on 1st January next. It is not a valid promissory note, as the promisor needs to deliver its black horse which is not money.

(f) Promise to pay a **certain sum**.

Example 7:

"I promise to pay B ₹500 and all other sums which shall be due to him."- Promissory note invalid as the amount payable is not certain.

But sometimes, the language of a promissory note is such that the amount payable can be **easily ascertained**. In such cases, the promissory note will be valid.

Example 8:

"I promise to pay B ₹500 along with simple interest at the rate of 12% per annum.

(g) The **maker and payee** must be **certain, definite and differen**t persons. A promissory note **cannot be made payable to the bearer** [Section 31 of the Bank of India Act, 1934 **(RBI Act)**]. **Only the Reserve Bank** or the **Central** Government **can** make or **issue** a promissory note 'payable to bearer'.

❒ BILLS OF EXCHANGE

Stamping: A promissory note must be properly **stamped** in accordance with the provisions of the Indian Stamp Act and such stamp must be duly **cancelled** by maker's signatures or initials on such stamp or otherwise.

A "bill of exchange" is an instrument in **writing** containing an **unconditional order**, **signed** by the maker, **directing** a certain person to pay a certain sum of **money only** to, or to the order of, a certain person or to the bearer of the instrument.

Specimen of Bill of Exchange

Specimen of Promissory Note

Mr. A (Drawer)
48, MP Nagar, Bhopal (M.P.)
April 10, 2022

₹10,000

Four months after date, pay to Mr. B (Payee) a sum of Rupees Ten Thousand, for value received.

To,
Mr. C (Drawee),
576, Arera Colonym Bhopal (M.P.)

Signature
Mr. A

Specimen of Promissory Note

Mr. A (Drawer)
48, MP Nagar, Bhopal (M.P.)
April 10, 2022

₹10,000
Four months after date, pay to Mr. B (Payee) a sum of Rupees Ten Thousand, for value received.

To,
Mr. C (Drawee),
576, Arera Colonym Bhopal (M.P.)

Signature
Mr. A

Parties to the Bill of Exchange

(a) **Drawer**: The **maker** of a bill of exchange.

(b) **Drawee:** The **person directed** by the drawer **to pay** is called the 'drawee'. He is the person **on whom** the bill is **drawn. On acceptance** of the bill, he is called an **acceptor** and is **liable** for the payment of the bill. His liability is **primary and unconditional.**

(c) **Payee:** The person named in the instrument, to **whom** or to **whose order the money** is, by the instrument, directed to be **paid**.

Essential Characteristics of Bill of Exchange

(a) It must be in **writing**.

(b) Must contain an **express order** to pay.

(c) The order to pay must be **definite and unconditional.**

(d) The drawer must **sign** the instrument.

(e) **Drawer, drawee, and payee** must be **certain**. All these three parties may **not necessarily** be three different persons. **One can play the role of two**. But there must be two distinct persons in any case. As per Section 31 of RBI Act, 1934, a **bill of exchange cannot be made payable to bearer on demand**.

Example 9:

"On demand pay to the bearer the sum of rupees five hundred, for value received." It is invalid BOE.

However, a bill of exchange payable on demand, in which **name of the payee** is **mentioned, is valid**.

Example 10:

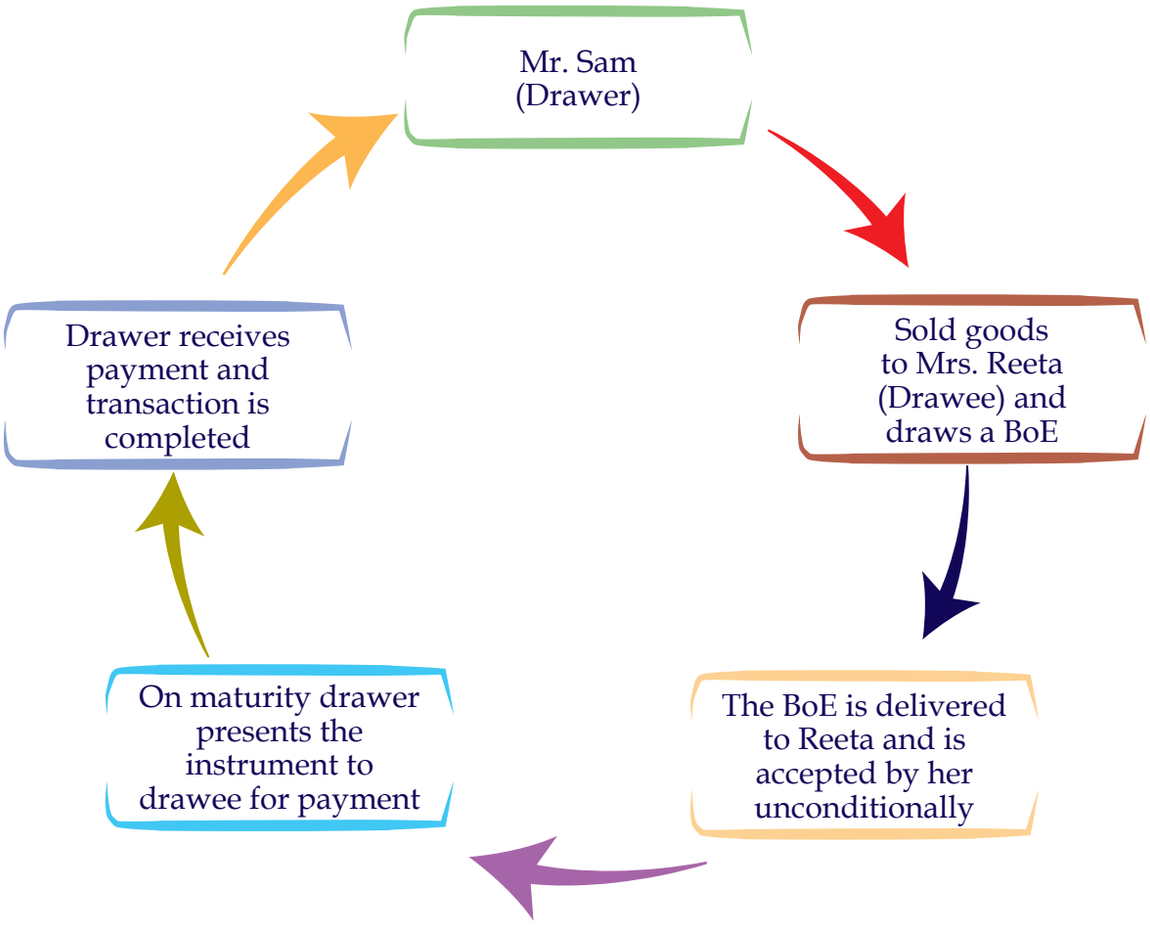
"On demand pay to A or order the sum of rupees five hundred for value received." It is valid BOE.

(f) The sum must be certain.

(g) The order must be to pay **money only**.

(h) It must be **stamped**.

Process of Bill of Exchange



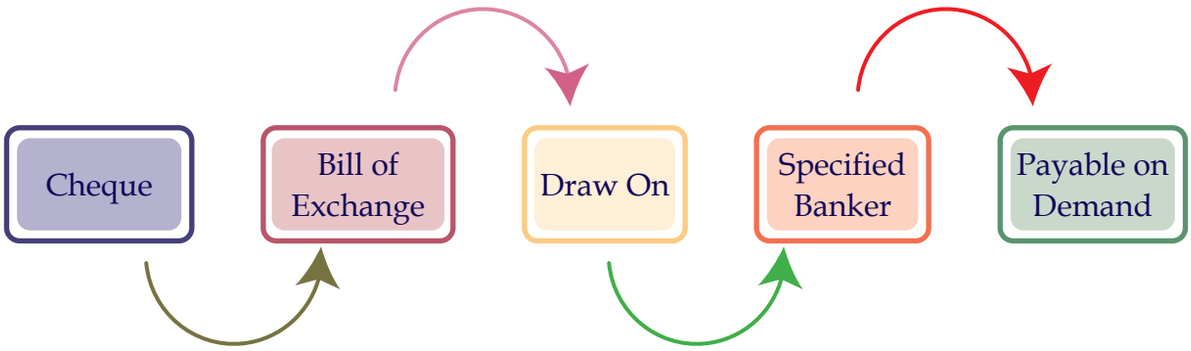
In above image, firstly the seller sold goods to the buyer/customer and then draws a bill of exchange on him. The Bill of exchange is delivered by the buyer who accepts it without any condition. On maturity of bill of exchange, the buyer will pay the amount due to the payee. (The payee may be the drawer himself or a third party.)

❒ DIFFERENCE BETWEEN PROMISSORY NOTE AND BILL OF EXCHANGE

S. No	Basis	Promissory Note	Bill of Exchange
1.	Definition	"A Promissory Note" is an instrument in **writing** (not being a banknote or a currency-note) containing an **unconditional undertaking signed by** the **maker**, to **pay** a certain sum of **money only** to, or to the order of, a certain person, or to the bearer of the instrument.	"A bill of exchange" is an instrument in **writing** containing an **unconditional order**, **signed by** the **maker**, **directing** a certain person to pay a certain sum of **money only** to, or to the order of a certain person or to the bearer of the instrument.
2.	Nature of Instrument	In a promissory note, there is a promise to **pay money.**	In a bill of exchange, there is an **order for making payment**.
3.	Parties	In a promissory note, there are only **2 parties** namely: (i) the maker and (ii) the payee	In a bill of exchange, there are **3 parties** which are as under: (i) the drawer (ii) the drawee (iii) the payee
4.	Acceptance	A promissory note **does not require** any acceptance, as it is signed by the person who is liable to pay.	A bills of exchange **needs** acceptance from the drawee.
5.	Payable to bearer	A promissory note **cannot** be made payable to **bearer**.	On the other hand, a bill of exchange **can be** drawn payable to bearer. **However**, it cannot be payable to **bearer on demand**.

❒ CHEQUE [SECTION 6]

A "cheque" is a **bill of exchange** drawn on a **specified banker** and not expressed to be payable otherwise than on **demand** and it **includes** the **electronic image of a truncated cheque and** a cheque in the **electronic form.**



Payable on demand means- It should be payable whenever the holder **chooses to present it** to the drawee (the banker).

The expression "Banker" includes any person acting as a banker and any post office saving bank [Section 3]

Explanation I: For the purposes of this section, the expressions-

(a) Cheque in the electronic form-means a cheque **drawn in electronic form by** using any computer resource, and **signed in** a secure system **with a digital signature** (with/without biometric signature) and asymmetric crypto system or electronic signature, as the case may be;

Note- For the purposes of this section, the expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have the same meanings respectively assigned to them in the Information Technology Act, 2000.

(b) "a truncated cheque" means a **cheque which is truncated** during a clearing cycle, **either** by the **clearing house** or by the bank **whether paying or receiving payment**, immediately **on generation of an electronic image for transmission, substituting** the **further physical movement** of the cheque **in writing**.

Explanation II: For the purposes of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India.

Explanation III: For the purposes of this section, the expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have the same meanings respectively assigned to them in the Information Technology Act, 2000.

A combined reading of sections 5 and 6 tells us that a bill of exchange is a negotiable instrument in writing containing an instruction to a third party to pay a stated sum of money at a designated future date or on demand. Whereas a cheque is also a bill of exchange but is drawn on a banker and payable on demand.

Specimen of Cheque

Specimen of Cheque

Date: .....

Pay.....

a sum of Rupees .....₹

A/C No. 12345678910

ABC Bank

622, Vijay Nagar, Indore (M.P.)

Signature

01212 1125864 000053 38

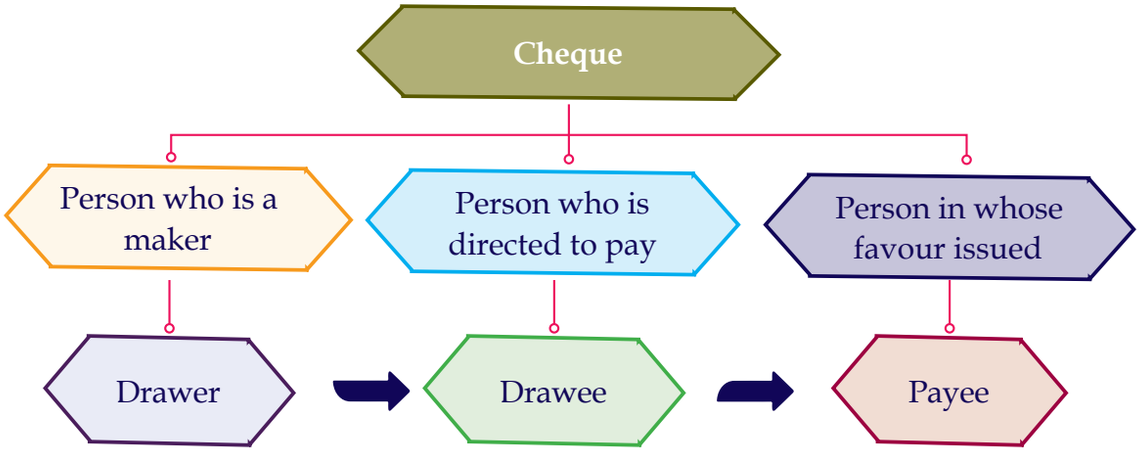
Parties to Cheque

1. **Drawer:** The person **who draws** a cheque i.e., makes the cheque (Debtor). His liability is **primary and conditiona**l.

2. **Drawee:** The specific bank **on whom cheque is drawn**. He **makes the payment** of the cheque. In case of **cheque, Drawee is always a banker**.

   "drawee in case of need" — When in the **bill or** in any **indorsement** thereon, the **name** of any person is given in **addition to the drawee** to be **resorted to in case of need** such person is called a "drawee in case of need".

3. **Payee:** The person **named in the instrument** (i.e., the person in whose favour cheque is issued), **to whom** or to **whose order** the money is, by the instrument, **directed to be paid,** is called the **payee**. The payee **may** be the **drawer himself or a third party.**



Essential Characteristics of a Cheque

According to the definition of cheque under section 6, a cheque is a species of bill of exchange. Thus, it should fulfil:

(a) **all** the essential **characteristics** of a **bill of exchange**

(b) Must be **drawn on** a specified banker.

(c) It must be **payable on** demand.

❒ CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

"Bearer Instrument" and "Order Instrument" [Section 13]

Bearer instrument

It is an instrument where the **name of the payee is blank** or where the name of payee is **specified with the words "or bearer"** or where the **last endorsement is blank.** Such instrument can be **negotiated by mere delivery.**

Order instrument

It is an instrument which is **payable to a person** or Payable to a **person or his order** or Payable to order of a person or where **the last indorsement is in full**, such instrument can be **negotiated by indorsement and delivery**.

Bearer Instrument	Order Instrument
name of the payee is blank or	payable to a person, or
name of payee is specified with the words "or bearer" or	Payable to a person /his order, or
the last indorsement is blank	Payable to order of a person, or
negotiated by mere delivery	the last indorsement is in full,
	negotiated by indorsement and delivery

"Inland Instrument" and "Foreign Instrument" [Sections 11 & 12]

"Inland instrument"

A promissory note, bill of exchange or cheque **drawn or made in India and made payable in, or drawn upon any person resident in India** shall be deemed to be an inland instrument.

Example 11:

(i) A promissory note made in Kolkata and payable in Mumbai.

(ii) A bill drawn in Varanasi on a person resident in Jodhpur (although it is stated to be payable in Singapore)

(iii) A, a resident of Agra, drew (i.e., made) a bill of exchange in Agra on B, a merchant in New York. And B accepted the bill of exchange as payable in Delhi. It is an inland bill of exchange. In this case, the bill of exchange was drawn in India and also payable in India.

(iv) A, resident of Mumbai, drew a bill of exchange in Mumbai on B, a merchant in Mathura. And B accepted the bill of exchange as payable in London. It is also an inland bill of exchange. In this case, the bill of exchange was drawn in India on a person resident in India. It is immaterial that the amount is payable in London.

An inland instrument remains **inland even if it has been endorsed in a foreign country.**

(v) If the bills of exchange mentioned in above two examples, are endorsed in France, they will remain inland bills.

Place Where Instrument is Drawn And Made Payable	Residence of Person on Whom Instrument is Drawn	Nature of Instrument
P/N, BOE, C drawn/made in India	+ Payable in India OR	are Inland Instruments
	+ drawn upon a person resident in India	

"Foreign instrument"

A foreign instrument is one which is **not an inland** instrument. In other words, can be understood as follows:

Place Where Bill is Drawn	Residence of Person on Whom Drawn and Place Where Made Payable	Nature of Instrument
P/N, BOE, C drawn/made outside India	on a person resident in or outside India + made payable in India	are foreign bills.
	on a person residing outside India + payable outside India.	
	on a person residing in India + payable outside India	

Liability of Maker/Drawer of Foreign Bill

In the absence of a contract to the country, the liability of the maker or drawer of a foreign promissory note or bill of exchange or cheque is regulated in all essential matters by the law of the **place where** he **made the instrument**, and the respective liabilities of the acceptor and indorser by the law of the **place** where the **instrument** is **made payable** (Section 134).

Example 12:

A bill of exchange is drawn by A in Berkley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%. The bill is indorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 15%.

Inland Instrument - when B.o.E/P/N Cheque
- draw/made in India
- made payable in/ drawn upon person resident in India

Foreign Instrument - when B.o.E/P/N, Cheque, IS NOT
- Drawn in India
- Made in India
- Made payable in India

Inchoate and Ambiguous Instruments

Inchoate instrument

It means an instrument that is **incomplete in certain respects**. The drawer/maker/acceptor/indorser of a negotiable instrument may **sign and deliver the instrument to another person** in his capacity **leaving the instrument, either wholly blank** or having **written on it the word incomplete**. Such an instrument is called an inchoate instrument and this gives a power to its **holder to make it complete** by writing **any amount either** within **limits specified therein or** within the limits specified **by the stamp's affixed on it**. The principle of this rule of an inchoate instrument is **based on the principle of estoppel**.

Liability on drawing inchoate instrument: The person signing and delivering the inchoate instrument is **liable both** to a holder and holder in due course. However, there is a difference in their respective rights:

The **holder** of such an instrument cannot recover the amount in excess of the amount **intended to be paid by the signor**.

The **holder in due course can**, however, recover **any amount** on such instrument provided it is **covered by the stamp** affixed on the instrument.

Section 20 of the Act reads as "Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount. Provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder".

Example 13:

A person signed a blank acceptance on a bill of exchange and kept it in his drawer. The bill was stolen by X and he filled it up for ₹20,000 and negotiated it to an innocent person for value. It was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument. Further, as a condition of liability, the signer as a maker, drawer, indorser or acceptor must deliver the instrument to another. In the **absence of delivery**, the **signer is not liable.** Furthermore, the paper so signed and delivered must be **stamped** in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.

Ambiguous instrument

Section 17 of the Act, reads as: "Where an instrument may be **construed either as a promissory note or bill of exchange**, the holder may at his **election treat it as eithe**r, and the instrument shall be thenceforward treated accordingly."

Thus, an instrument which is **vague and cannot be clearly identified** either as a bill of exchange, or as a promissory note, is an **ambiguous** instrument. In other words, such an instrument may be

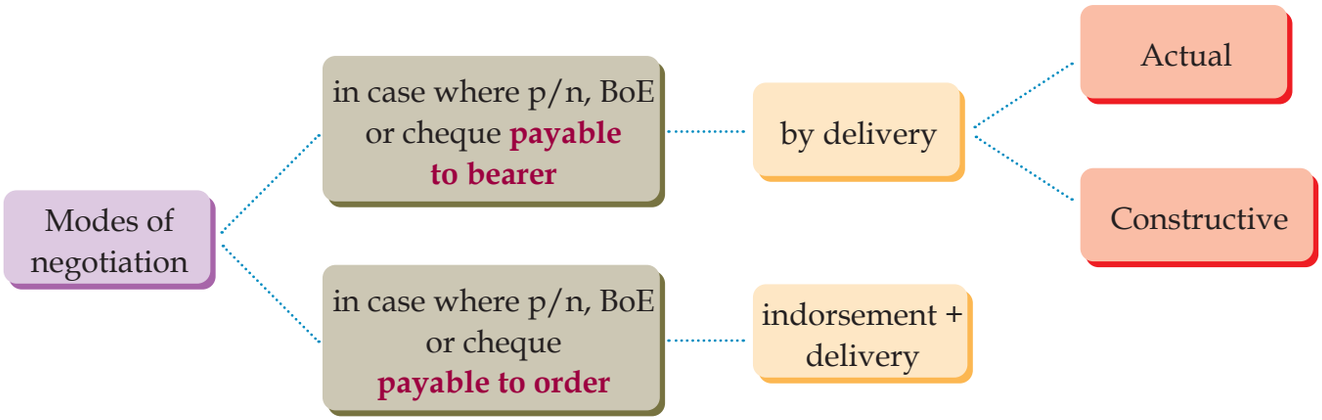
construed either as promissory note, or as a bill of exchange. Section 17 provides that the holder may, at his discretion, treat it as either and the instrument shall thereafter be treated accordingly. Thus, **after exercising** his option, the holder **cannot change** that it is the other kind of instrument.

❒ NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

One of the essential characteristics of a **negotiable instrument** is that it is **freely transferable** from one person to another. The rights in a negotiable instrument can be transferred from one person to another by negotiation.

According to Section 14 of the N.I. Act, when a negotiable instrument is transferred to any person with a view to constitute the person holder thereof, the instrument is deemed to have been negotiated. Thus, there is a **transfer of ownership** of the instrument. Negotiable instruments may be negotiated either by delivery when these are payable to bearer or by indorsement and delivery when these are payable to order.

Modes of Negotiation



(i) A promissory note, bill of exchange or cheque payable to bearer is negotiable by the delivery thereof.

(ii) A promissory note, bill of exchange or cheque payable to order is negotiable by the holder by indorsement and delivery thereof.

Example 14:

X drew a cheque for Rs. 50,000 payable to Y and delivered it to him. Y indorsed the cheque in favour of Z but kept it in his table drawer. Subsequently, Y died, and cheque was found by Z in Y's table drawer. In this case, Z does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him.

Negotiation by Delivery [Section 47]

Subject to the provisions of section 58 [Instrument obtained by **unlawful means** or for unlawful consideration], a promissory note, bill of exchange or cheque **payable to bearer** is negotiable by **delivery** thereof.

Exception: A promissory note, bill of exchange or cheque **delivered on** condition that it **is not to take effect** except in a **certain event** is **not negotiable** (**except** in the hands of a **holder for value** without notice of the condition) **unless such event happens**.

Example 15:

(i) A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

(ii) A, the holder of a negotiable instrument payable to bearer, which is in the hands of A's banker, who is at the time the banker of B, directs the banker to transfer the instrument to B's credit in the banker's account with B. The banker does so, and accordingly now possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

Negotiation by indorsement [section 48]

Subject to the provisions of section 58, a promissory note, bill of exchange or cheque **payable to order**, is negotiable by the **holder** by **indorsement and delivery** thereof.

Importance of Delivery in Negotiation [Section 46]

Delivery of an instrument is **essential** whether the instrument is **payable to bearer or order** for effecting the negotiation. The delivery must be **voluntary**, and the **object** of delivery should be to **pass** the **property** in the instrument to the person to whom it is delivered. The delivery can be, actual or constructive. **Actual** delivery takes place when the instrument changes **hand physically.** Constructive delivery takes place when the instrument is delivered to the **agent, clerk or servant** of the indorsee on his behalf or when the **indorser, after indorsement, holds** the instrument **as an agent** of the indorsee.

Section 46 also lays down that when an instrument is conditionally or for a special purpose only, the **property** in it **does not pass** to the transferee, even though it is indorsed to him, **unless the instrument is negotiated** to a holder in due course.

The contract on a negotiable instrument **until delivery remains incomplete and revocable**. The delivery is **essential** not only at the time of negotiation but **also at the time of making or drawing of negotiable instrument**. The **rights** in the instrument are **not transferred** to the indorsee **unless** after the indorsement the same has been **delivered**. If a person makes the indorsement of instrument but before the same could be delivered to the indorsee the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof. (Section 57)

According to section 57, the legal representative of a deceased person cannot negotiate by delivery only, a promissory note, bill of exchange or cheque payable to order and indorsed by the deceased but not delivered.

A legal representative is **not an agent** of the deceased. Therefore, a legal representative cannot complete the instrument if the instrument was executed by the deceased but could not be delivered because of his death.

❐ DELIVERY WHEN EFFECTIVE BETWEEN THE PARTIES

Negotiation of instruments between the parties	How delivery is to be made
As between parties standing in immediate relation	Delivery to be effectual must be made by the party making, accepting, or endorsing the instrument, or by a person authorized by him in that behalf.

As between such parties and any holder of the instrument other than a holder in due course	It may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

DISHONOUR OF CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS [SECTION 138 TO 142]

Dishonor of Cheque for Insufficiency, etc., of Funds in the Accounts [Section 138]

Where any **cheque drawn** by a person on an **account maintained by him** with a banker:

- for **payment** of any amount of **money**
- **to another** person from that account
- for the **discharge**, in whole or in part, of any **debt or other liability**, [A cheque given as **gift or donation, or as a security or in discharge of a mere moral obligation, or for an illegal consideration**, would be **outside the purview** of this section]
- is **returned** by the bank **unpaid,**
- **either** because of the –
- **amount** of money standing to the **credit** of that **account is insufficient** to honor the cheque, or
- that it **exceeds** the amount **arranged to be paid from that account** by an **agreement** made with that bank,

such person shall be **deemed to have committed an offence** and shall, be **punished** with **imprisonment** for a term which may extend to two years, **or** with **fine** which may extend to twice the amount of the cheque, **or** with **both**.

When section 138 shall be not apply: unless the below given conditions are complied with –

(a) Cheque **presented** within **validity period**: The cheque has been presented to the bank within a period of three months from the date on which it is **drawn or within the period of its validity,** whichever is **earlier**.

(b) **Demand for the payment** through the **notice**: the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer of the cheque**, within 30 days** of the receipt of information by him from the bank **regarding the return of the cheque** as unpaid, and

(c) **Failure of drawer to make payment:** the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, **within fifteen days** of the **receipt** of the **said notice.**

Explanation: For the purpose of this section, "debt or other liability" means a legally **enforceable** debt or other liability.

Therefore we may conclude that **compliant** can be filed **after 45 days** of dishonor of the cheque i.e., 30 days of notice period +15 days of the receipt of the said notice.

Example 16:

X issued a post-dated cheque to Y on the account of discharge of its liability. Further, X instructed to the bank to stop the payment due to unavailability of the adequate amount in the account. Here, in this instance section 138 of the Act is attracted as when a cheque is dishonoured on account of **stop payment instructions** sent by the drawer to his banker **in respect of a post- dated cheque** irrespective of insufficiency of funds in the account. A post-dated cheque is deemed to have been drawn on the date it bears and the three months period for the purposes of section 138 is to be counted from that date. So, X will be liable for dishonour of cheque. Once a cheque is issued by the drawer, a presumption under section 139 must follow.

Penalty: According to Section 138 of the Act, the **dishonour** of cheque is **a criminal offence** and is **punishable** with **imprisonment up to 2 years or fine up to twice the amount of cheque or both.**

Presumption in Favor of Holder [Section 139]

When a cheque is dishonoured, it shall be presumed, unless the contrary is proved, that the **holder** of a cheque **received** the cheque of the nature referred to in section 138 for the **discharge, in whole or in part,** or any debt or other liability.

Presumption prescribed here is a "rebuttable presumption" as the provisions clearly provides that the person issuing the cheque is at liberty to **prove to the contrary**. The effect of this presumption is to place the evidential burden on the accused.

Defence which may not be Allowed in any Prosecution Under Section 138 [Section 140]

It shall not be a defence in a prosecution of an offence under section 138 that the **drawer had no reason to believe** when he issued the cheque that the cheque may be **dishonoured on presentment** for the reasons stated in that section.

❒ PRESENTMENT OF INSTRUMENTS

Presentment for Acceptance [Section 61]

A bill of exchange payable **after sight** must [if n**o time or place is specified** therein for presentment] be presented to the drawee thereof for acceptance [if he can, after reasonable search, be found] by a person entitled to demand acceptance, within a **reasonable time** after it is drawn, and in **business hours** on a **business day**.

In **default** of such presentment, **no party** thereto **is liable** thereon to the person making such default. If the drawee **cannot**, after reasonable search, **be found**, the bill is **dishonoured**.

If the bill is **directed** to the drawee at a **particular place**, it must be presented at **that place**, and if at the due date for presentment he **cannot**, after reasonable search, be **found** there, the bill is **dishonoured**.

Where authorised by **agreement or usage,** a presentment through the **post office** by means of a **registered letter** is sufficient.

Presentment of Promissory Note for Sight [Section 62]

A promissory note, payable at a certain period after sight, must be presented to the maker thereof for sight (if he can after reasonable search be found) by a person entitled to demand payment, within a **reasonable time** after it is made and in **business hours on a business day**.

In **default** of such presentment, **no party** thereto **is liable** thereon to the person making such default.

Drawee's Time for Deliberation [Section 63]

The holder must, if so required by the **drawee** of a bill of exchange presented to him **for acceptance**, allow the drawee **48 hours** (**exclusive of public holidays**) to consider whether he will **accept it.**

Presentment for Payment [Section 64]

Promissory notes, bill of exchange and cheques must be presented for payment to the **maker, acceptor or drawee** thereof respectively, by or on behalf of the holder as hereinafter provided.

In **default** of such presentment, the **other parties** thereto are **not liable** thereon to such holder.

Where authorised by **agreement or usage**, a presentment through the **post office** by means of a **registered letter** is sufficient.

Exception: Where a promissory note is **payable on demand** and is **not** payable **at a specified place, no presentment is necessary** in order to charge the maker thereof.

Notwithstanding anything contained in section 6, where an electronic image of a **truncated cheque is presented for payment**, the **drawee bank** is entitled to demand **any further information** regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the **suspicion** is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further **demand** the presentment of the truncated cheque itself for verification:

Provided that the truncated **cheque** so demanded by the drawee bank shall be **retained** by it, **if** the **payment is made** accordingly.

Hours for Presentment (Section 65)

Presentment for payment must be made during the **usual hours** of business, and, if at a banker's within banking hours.

Presentment for Payment of Instrument Payable after Date or Sight (Section 66)

A promissory note or bill of exchange, made payable at a specified period after date or sight thereof, must be **presented** for payment **at maturity.**

Presentment for Payment of Promissory note Payable by Instalments (Section 67)

A promissory note payable by instalments must be presented for payment on the **third day after the date fixed for payment of each instalment**; and non-payment on such presentment has the same effect as non-payment of a note at maturity.

Presentment for Payment of Instrument Payable at Specified Place and not Elsewhere (Section 68)

A promissory note, bill of exchange or cheque made, drawn or accepted **payable at a specified** place and not elsewhere must, in order to charge any party thereto, be presented for payment at **that place**.

Instrument Payable at Specified Place (Section 69)

A promissory note or bill of exchange made, drawn or accepted **payable at a specified place** must, in order to charge the maker or drawer thereof, be presented for payment **at that place**.

Presentment where no Exclusive Place Specified (Section 70)

A promissory note or bill of exchange, not made payable as mentioned in sections 68 and 69, must be presented for payment at the place of business (if any) or at the usual residence, of the maker, drawee or acceptor thereof, as the case may be.

Presentment when Maker, etc., Has no Known Place of Business or Residence (Section 71)

If the maker, drawee or acceptor of a negotiable instrument has **no known place of business or fixed residence**, and no place is specified in the instrument for presentment for acceptance or payment, such presentment may be made to him in person wherever he **can be found.**

Presentment of Cheque to Charge Drawer (Section 72)

Subject to the provisions of section 84, a cheque must, in order to **charge the drawer**, be presented at the **bank** upon which it is **drawn** before the relation between the drawer and his banker has been altered to the prejudice of the drawer.

Presentment of Cheque to Charge any Other Person (Section 73)

A cheque must, in order to **charge any person** except the drawer, be presented within a **reasonable time after delivery** thereof by such person.

Presentment of Instrument Payable on Demand (Section 74)

Subject to the provisions of section 31, a negotiable instrument payable **on demand** must be presented for payment within a **reasonable time** after it is received by the holder.

Presentment by or to Agent, Representative of Deceased, or Assignee of Insolvent (Section 75)

Presentment for acceptance or payment **may be made to** the duly **authorised agent** of the drawee, maker or acceptor, as the case may be, or, where the drawee, maker or acceptor has died, to his **legal representative**, or, where he has been declared an insolvent, to his **assignee.**

Excuse for Delay in Presentment for Acceptance or Payment (Section 75A)

Delay in presentment for **acceptance or payment** is excused if the delay is caused by circumstances **beyond the control of the holder**, and not imputable to his default, misconduct or negligence. When the cause of the delay **ceases** to operate, presentment must be made within a reasonable time.

When Presentment Unnecessary (Section 76)

No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:

(A)

(i) if the instrument being **payable at his place of business**, he **closes such** place on a business day **during the usual business hours**, or

(ii) if the instrument being payable at his place of business, he closes such place on a **business day during the usual business hours**, or

(iii) if the instrument being payable at some **other specified place, neither he nor any person authorised** to pay it **attends** at such place during the **usual business hours,** or

(iv) if the instrument **not** being payable **at any specified place,** he **cannot** after due search **be found;**

(B) As against any **party sought** to be charged therewith, if he has **engaged to pay notwithstanding non-presentment;**

(C) as against any party if, **after maturity**, with knowledge that the **instrument has not been presented**-

- he makes a **part payment** on account of the amount due on the instrument,
- or **promises** to pay the amount **due thereon** in **whole or in part**,
- or otherwise **waives his right** to take **advantage of any default** in presentment for payment;

(D) As against the drawer, if the drawer **could not suffer damage** from the want of such presentment.

Liability of Banker for Negligently Dealing with Bill Presented for Payment (Section 77)

When a bill of exchange, accepted payable at a specified bank, has been duly presented there for payment and dishonoured, if the **banker so negligently or improperly keeps, deals** with or **delivers back** such bill as to cause **loss to the holder**, he must **compensate** the holder for such loss.

❒ RULES OF COMPENSATION

Rules as to Compensation (Section 117)

The compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:

(a) the holder is entitled to the **amount due upon the instrument**, together **with the expenses properly incurred** in presenting, noting and protesting it;

(b) when the **person charged resides at a place different** from that at which the instrument was **payable**, the holder is entitled to receive such sum at the **current rate of exchange** between the two places;

(c) **an endorser** who, being liable, has paid the **amount due** on the same is entitled to the **amount so paid with interest** at **18% per annum** from **the date of payment** until tender or realisation thereof, together **with all expenses** caused by the dishonour and payment;

(d) when the **person charged** and such **endorser reside** at **different places,** the endorser is entitled to **receive such sum** at the **current rate of exchange** between the two places;

(e) the party entitled to **compensation** may **draw a bill** upon the **party liable to compensate** him, payable at **sight or on demand**, for the **amount due** to him, together **with all expenses properly incurred** by him. Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If **such bill is dishonoured**, the party dishonouring the same is liable to make compensation thereof in the **same manner** as in the case of the **original bill**.