For CA FOUNDATION

PAPER 2

BUSINESS LAWS

Edition – 3

VOLUME – I

NO NOTEBOOK CONCEPT BOOK

CA CS Amit Tated
FCA, CS, DISA

For C.A. Foundation

Business Laws

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HEARTIEST CONGRATULATIONS TO THE TOPPER

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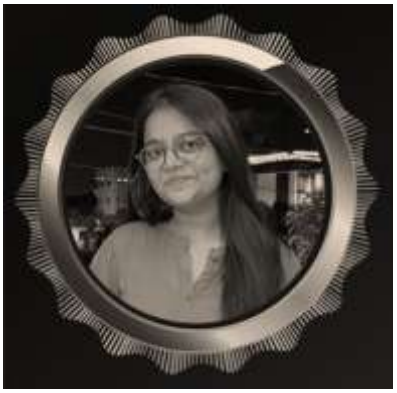
BUSINESS LAW JAN – 2025 RESULT



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Preface

It gives me immense pleasure to present the Third edition of Business Laws. This edition has updated syllabus which is applicable from September 2025 Exams and onwards.

This book has everything which student may require to understand, remember and reproduce Law. The book has been developed keeping in mind the technicality of the subject to bring it at a student's grasping level.

This book will suffice to go with institute language as well as understanding the concept.

In recent exam papers we saw that the questions asked are more practical. Thus, students need to understand the concepts and logical reasoning of the Chapter. Only mugging-up shall not suffice to score in this subject.

For Class Work students can refer Amit Tated YouTube Channel.
(CA CS Amit Tated, CA Amit Tated & Amit Tated Motivates)

Every effort has been made to avoid any errors and omissions in this book. Despite all the efforts we believe some errors might have crept in. The students are welcome to point out any errors / suggestions.

Best wishes,

Amit Tated
(atacademyforca@gmail.com)

March, 2025

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I would like to acknowledge my Parents (Vijay & Shobha), Manish, Allan, Ritesh, Bhavesh & Sumeet for all their support towards my journey of studies, career & experience.

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CHAPTER - 1

INDIAN REGULATORY FRAMEWORK

1. INTRODUCTION

Have you ever wondered why you are studying this subject called law? Is it only because it has been prescribed in the syllabus or is it because you will need this knowledge as a member of the Institute of Chartered Accountants of India?

Awareness of 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.

2. WHAT IS LAW?

3. 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.

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.

4. THE PROCESS OF MAKING A LAW

Types of laws in the Indian Legal System

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

1. Criminal Law
2. Civil Law
3. Common Law
4. Principles of Natural Justice

1. Criminal Law

2. Civil Law

3. **Common Law**

4. **Principles of Natural Justice**

5. **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.

1. **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.

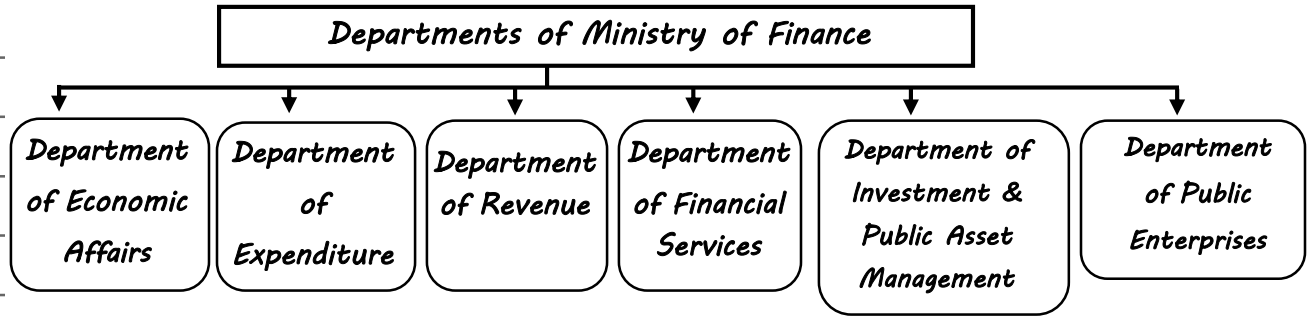
❖ **Constitution of the Ministry of Finance-**

Ministry of Finance

- is the apex controlling authority
- of four Central Civil Services, namely:

- 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

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 Jammu, Kashmir and Ladakh Affairs
- Department of Home
- Department of Official Language
- Department of States

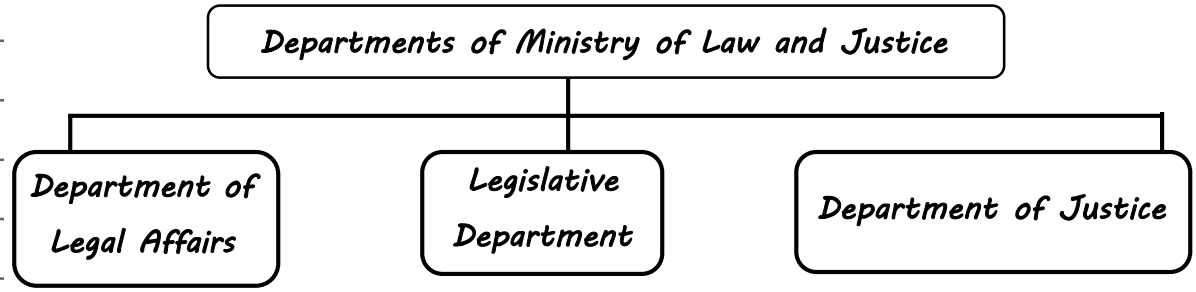
Department of Official Language

- **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 Department of Legal Affairs
  - legislative activities through the Legislative Department
  - 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.



(ii) The Securities and Exchange Board of India (SEBI)

(iii) Reserve Bank of India (RBI)

Reserve Bank of India-

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

6. 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.

(i) Supreme Court

(ii) **High Court**

Which is the oldest High Court in India?

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

(iii) **District Court**

(iv) **Metropolitan Courts**

CHAPTER - 2

UNIT - 1 NATURE OF CONTRACTS

1·1 WHAT IS A CONTRACT?

The term contract is defined under section 2(h) of the Indian Contract Act, 1872 as-

The contract consists of two essential elements:

(i) an agreement, and

(ii) its enforceability by law

(i) Agreement - The term 'agreement' **given in Section 2(e)** of the Act is defined as-

To have an insight into the definition of agreement, we need to understand promise·

Section 2 (b) defines promise as-

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

Where parties have made a binding contract, they created rights and obligations between themselves.

Difference between Agreement and Contract

Basis of differences	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.

1.2 ESSENTIALS OF A VALID CONTRACT

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]	6	-

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.

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.

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)

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.
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.
	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.
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.

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

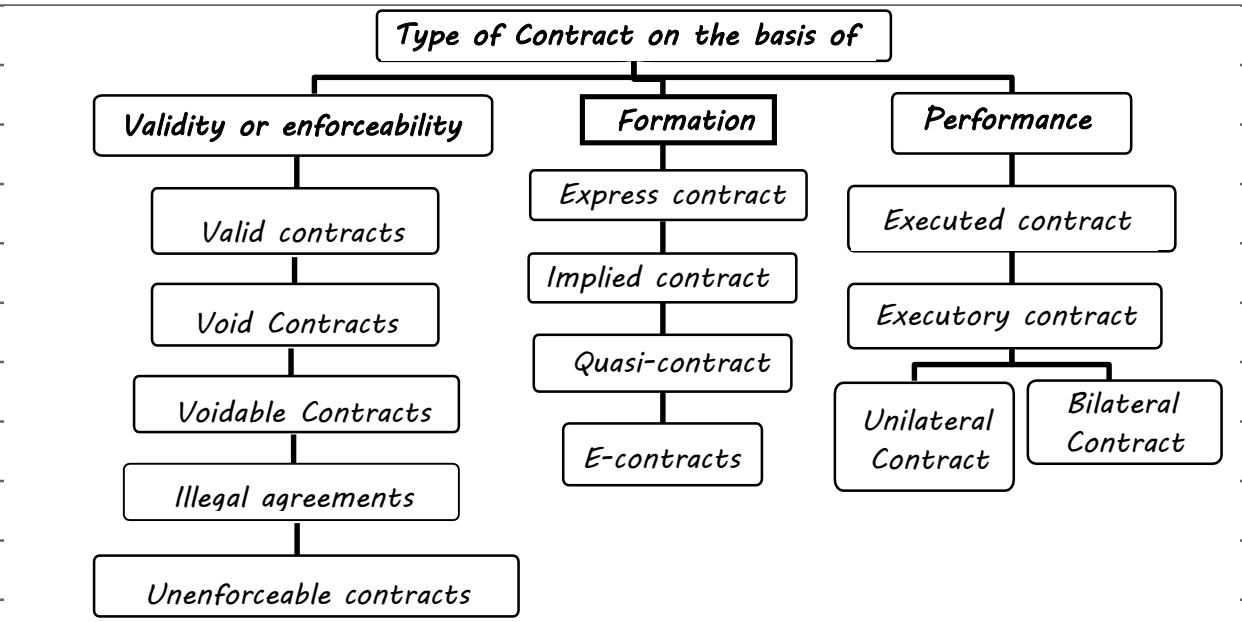
IV. **Consideration:** It is referred to as 'quid pro quo' i.e. 'something in return'. A valuable consideration in the sense of law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

V. **Lawful Consideration and Object:** The consideration and object of the agreement must be lawful.

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.

1.3 TYPES OF CONTRACTS

Now let us discuss various types of contracts.



1.	**On the basis of the validity**
1.	**Valid Contract:**
2.	**Void Contract: Section 2 (j) states as follows:**
3.	**Voidable Contract: Section 2(i) defines that**
	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.
(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.

(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.

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:**

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 are always void.

5. **Unenforceable Contract:**

II. **On the basis of the formation of contract**

1. **Express Contracts:**

2. **Implied Contracts:**

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:**

4. **E-Contracts:**

III. **On the basis of the performance of the contract**

1. **Executed Contract:**

2. **Executory Contract:**

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

(a) **Unilateral Contract:**

(b) **Bilateral Contract:**

1.4 PROPOSAL / OFFER [SECTION 2(a) OF THE INDIAN CONTRACT ACT, 1872]

Definition of Offer/Proposal:

According to Section 2(a) of the Indian Contract Act, 1872,

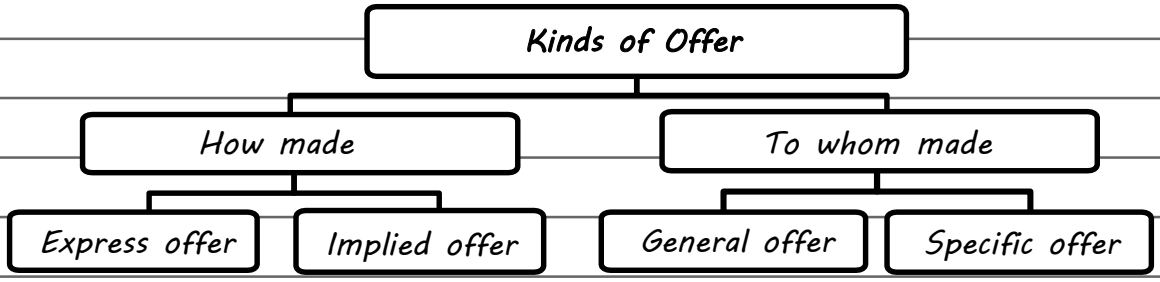
Essentials of a proposal/offer are-

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.

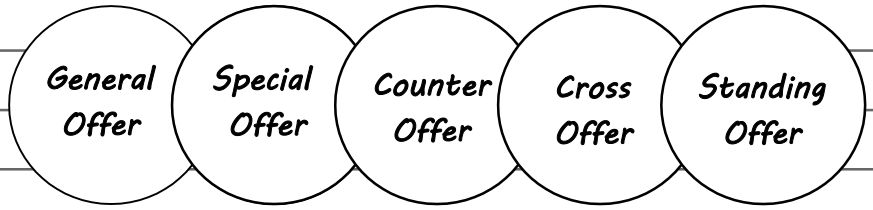
3. The willingness must be expressed with a view to obtain the assent of the other party to whom the offer is made.

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.



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]***

(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.

(d) **Counter offer:** When the offeree offers 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.

(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.

2. **It must be certain, definite and not vague:** If the terms of an offer are vague or indefinite, its acceptance cannot create any contractual relationship.

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 acceptance and does not confer any right on the acceptor.

This can be illustrated by the landmark case of **Lalman Shukla v. GauriDutt**

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.

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.

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.

8. **The offer may be express or implied:** An offer may be made either by words or by conduct.

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.**

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

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

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

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

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 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)
(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.
	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 offers and precedes 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.

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.

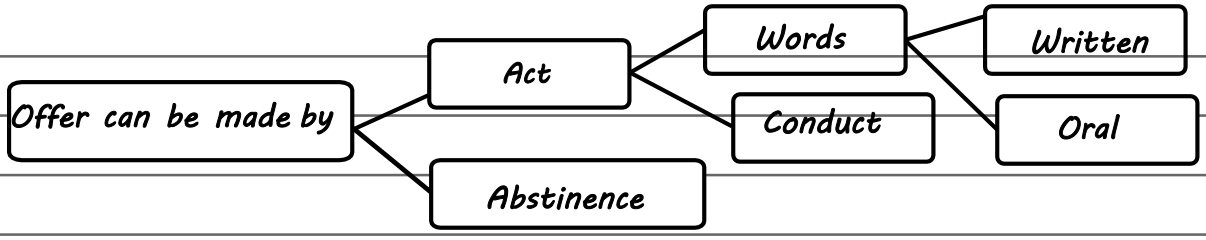
(ii) Display of goods for sale in shop windows.

(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.



1.5 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".

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.

	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 offer, 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 vs. Bahulal AIR 1968 Bombay 294].**
(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 knowledge, 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:

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, Metropolitian 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 ineffective. **[Heyworth vs. Knight [1864] 144 ER 120].**

(4) **Acceptance must be in the prescribed mode:** Where the mode of acceptance is prescribed in the proposal, it must be accepted 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.

(5) **Time:** Acceptance must be given within the specified 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.

(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.

(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.

1.6 COMMUNICATION OF OFFER AND ACCEPTANCE

The Indian Contract Act, 1872 gives a lot of importance to "time" element in deciding when the offer and acceptance is complete.

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".

OFU: 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 sufficient, 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'.

OFU: 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 out 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 acceptance 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.

OFU: 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.

OFU: 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].*

1.7 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.
1.8	**REVOCATION OF OFFER AND ACCEPTANCE**
	If there are specific requirements governing the making of an offer and the acceptance
	of that offer, we also have specific law governing their revocation.
	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.
	As regards revocation of acceptance, if you go by the above example, I can revoke my
	acceptance (of your offer) by a telegram. This revocation of acceptance by me will be
	complete when I dispatch the telegram and against you, it will be complete when it
	reaches you.
	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.

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.

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:**

(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.

CHAPTER - 2

UNIT - 2 CONSIDERATION

2·1 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:

2·2 LEGAL RULES REGARDING CONSIDERATION

(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·

(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.

(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.

(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.

(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.

(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.

(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.

(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.

2.3 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.

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.

(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.

(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.

(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.

(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.

(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.

2.4 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)

(ii)

(iii)

(iv)

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.

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)

(ii)

(iii)

(iv)

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)].

4. **Agency:** According to Section 185 of the Indian Contract Act, 1872, no consideration is necessary 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.

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)

CHAPTER - 2

UNIT - 3 OTHER ESSENTIAL ELEMENTS OF A CONTRACT

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;

(4) it should not have been expressly declared as void by law.

3.1 CAPACITY TO CONTRACT

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)

(B)

(C)

(A) Age of Majority: In India, the age of majority is regulated by the Indian Majority Act, 1875.

Every person domiciled in India shall attain the age of majority on the completion of 18 years of age and not before. 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),***

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.

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).

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.

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.

(i)

(ii)

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 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.

6. **Contract by guardian - how far enforceable:** Though 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 of 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.

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.

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.

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.

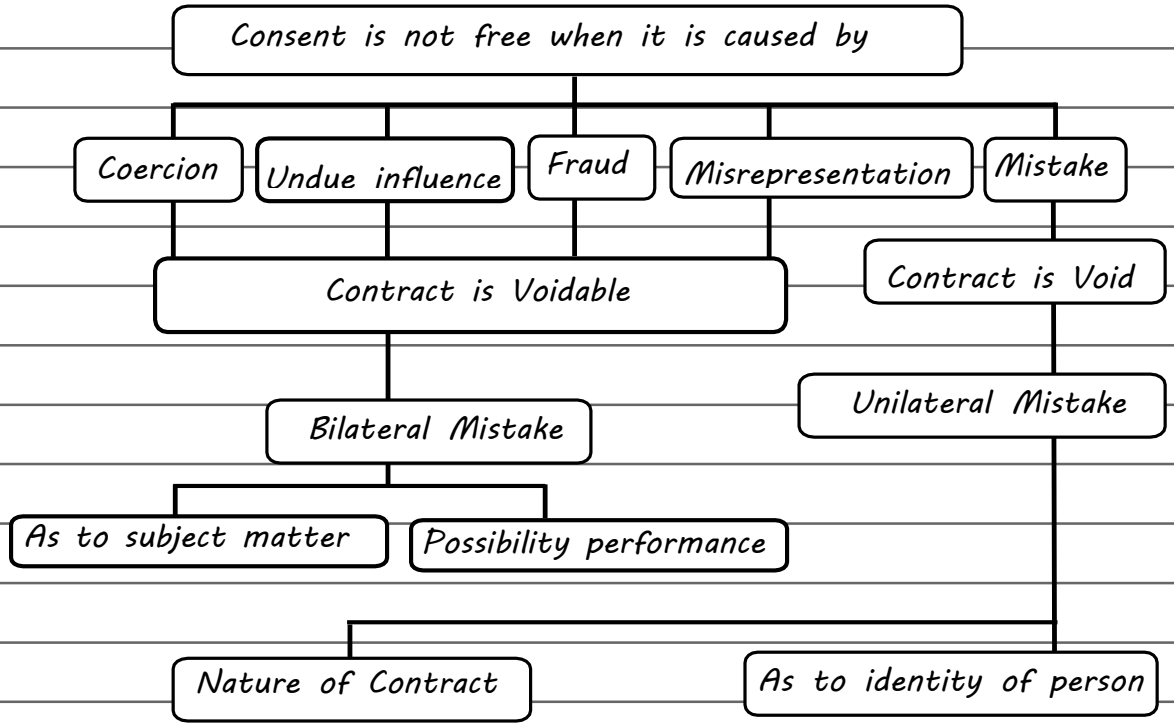
A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

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

(B) **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.

3.2 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·

Definition of 'Free Consent' (Section 14)

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

1·

2·

3·

4·

5·

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, the contract becomes void·

3·3 ELEMENTS VITIATING FREE CONSENT

We shall now explain these elements one by one·

1· Coercion (Section 15)

It is to be noted that 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

(i)

(ii)

Threat to commit suicide – Whether is it coercion?

II. **Undue influence (Section 16)**

According to section 16 of the Indian Contract Act, 1872,

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:**
(b)	**Fiduciary relationship:**
(c)	**Mental distress:**
(d)	**Unconscionable bargains:**
(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.
(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)	
(ii)	
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)	
(2)	
(3)	
(4)	
(5)	
	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.

(b) When silence is equal to speech.

(2) The representation must be related to a fact.

(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.

(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)

(2)

(3)

	Exception: In the following cases, contract is not voidable:
(i)	
(ii)	
(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.
	OFU: 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.
	OFU: '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.

OFU: 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, B finds the mare to be unsound. The representation made by A is a misrepresentation.

OFU: 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.	There is no such intention to deceive the other party.
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.

(V)	**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.
(A)	**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.
(ii)	**Mistake of foreign law:** Such a mistake is treated as mistake of fact and the agreement in such a case is void.
(B)	**Mistake of fact:** Mistake of fact are of two types – (i) Bilateral Mistake, (ii) Unilateral Mistake
(i)	**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.
(ii)	**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.
3.4	**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.

(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.

(iii) **When it is fraudulent:** Agreements which are entered into to promote fraud are void.

(iv) 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.

(v) **When consideration is immoral:** The following are the examples of agreements where the object or consideration is unlawful, being 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.

(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·

(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.

(5) **Agreements tending to create monopolies:** Agreements having for their object the establishment of monopolies are opposed to public policy and therefore void.

(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.

(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."

3.5 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 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.
(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.

(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.
	Essentials of a Wager
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6.	
	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.
	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.

CHAPTER - 2

UNIT - 4 PERFORMANCE OF CONTRACT

4·1 PERFORMANCE OF CONTRACT

Meaning: "Performance of Contract" means fulfilment of obligations to the contract· According to Section 37,

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·

(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·

4·2 CONDITIONS TO BE SATISFIED FOR A VALID TENDER OR ATTEMPTED PERFORMANCE

(i)

(ii)

(iii)

(iv)

4.3 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.

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.

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.

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.

4.4 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.

4.5 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.

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.

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.

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, & after the death of the last survivor, with the representatives of all jointly".

4.6 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 at which the promise ought to be performed.

(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.

(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.

4.7 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**

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

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

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

(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, & 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.

(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.

(2) If unknown to the parties: Where both the promisor and the promisee are ignorant of the impossibility of performance, the contract is void.

(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.

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

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

4.8 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):

(ii) Application of payment where debt to be discharged is not indicated (Section 60):

(iii) Application of payment where neither party appropriates (Section 61):

4.9 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.

(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.

(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".

Analysis of Section 64

(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."

Analysis of Section 65

(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.

4.10 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
(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.
(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)	
(b)	
(c)	
(d)	
(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.
(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.
(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)
(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.

CHAPTER - 2

UNIT - 5 BREACH OF CONTRACT AND ITS REMEDIES

We have so far seen how a contract is made, the essential of a valid contract and also how a contract is to be performed as well as how a contract may be put an end. We shall now discuss about the breach of contract and also the mode in which compensation for breach of contract is estimated.

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

5.1 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.

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.

5.2 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.**

(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

Remedies Available

- ❖
- ❖
- ❖
- ❖
- ❖

5.3 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.

Damages

- ❖ General/Ordinary
- ❖ Special
- ❖ Vindictive or Exemplary
- ❖ Nominal
- ❖ Damages for deterioration caused by delay

❖ Pre-fixed damages

(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 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).**

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.

OFU: A agrees to sell to B bags of rice at ₹ 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.

OFU: '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 received 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).

5.4 PENALTY AND LIQUIDATED DAMAGES (SECTION 74)

The parties to a contract may provide beforehand, 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.
	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:**
(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 restitutory. 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)	
(b)	

(c)

(d)

(e)

(f)

OFU: 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.

OFU: 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:**

(iv) **Suit for injunction:**

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.

CHAPTER - 2

UNIT - 6 CONTINGENT AND QUASI CONTRACTS

6·1 CONTINGENT CONTRACTS

Definition of 'Contingent Contract' (Section 31)

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"·

OFU: 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·

OFU: 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·

(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·

(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.

(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.

6.2 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".

(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".

(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".

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.

(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".

(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.

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.

6.3 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".

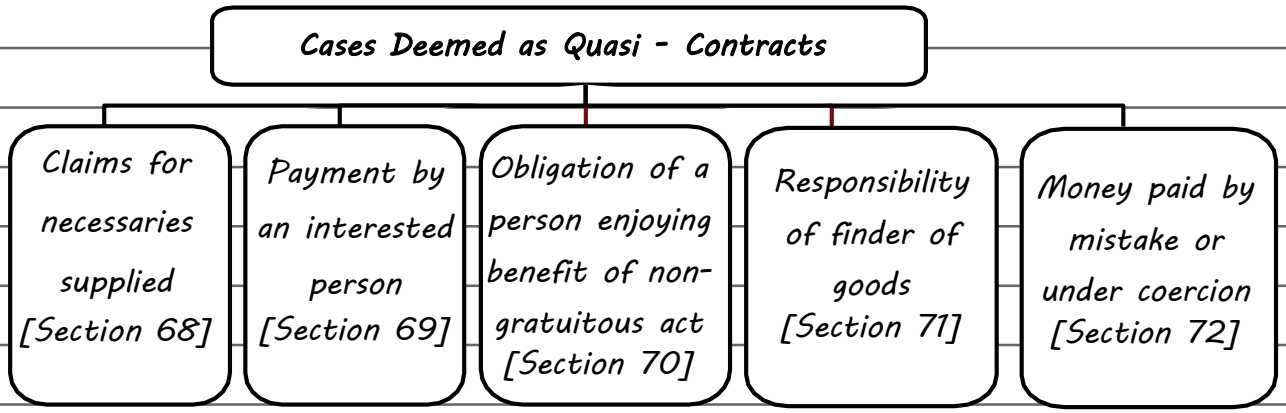
These relations are called as quasi-contractual obligations. In India it is also called as 'certain relation resembling those created by contracts.

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.



Under the provisions of the Indian Contract Act, the relationship of quasi contract is deemed to have come to exist in five different circumstances which we shall presently dilate upon. But it may be noted that in none of these cases there comes into

existence any contract between the parties in the real sense. Due to peculiar circumstances in which they are placed, the law imposes in each of these cases the contractual liability.

(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.

(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.

(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)	that he had done the act or had delivered the thing lawfully;
(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]***
(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.
	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.

(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]**

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**

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]**.

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

CHAPTER - 2

UNIT - 7 CONTRACT OF INEMNITY AND GUARANTEE

7·1 CONTRACT OF INDEMNITY

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·"

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"·

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.

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.

7.2 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

Surety- person who gives the guarantee

Principal debtor- person in respect of whose default the guarantee is given

Creditor- person to whom the gurantee is given

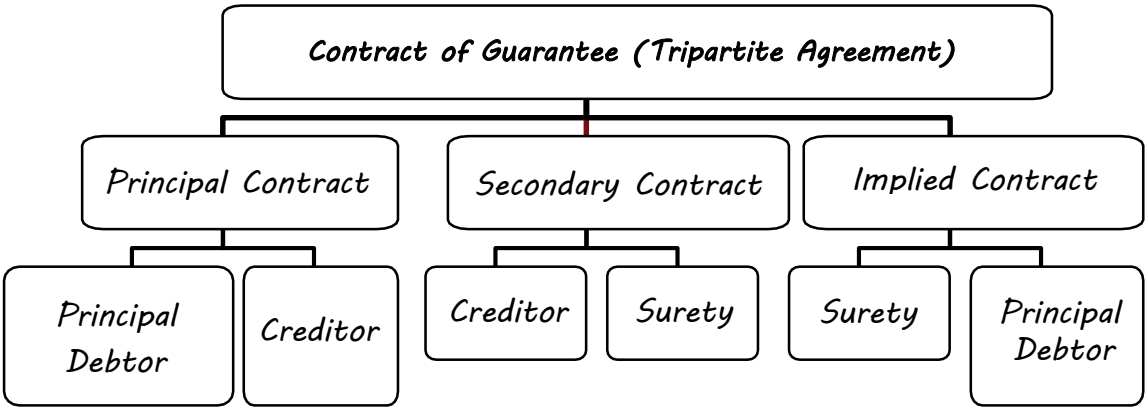
A contract of guarantee is a tripartite agreement between principal debtor, creditor and surety. There are, in effect three contracts

(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.

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).

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.

7.3 TYPES OF GUARANTEES

Guarantee may be classified under two categories:

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.

Case Study: 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.

7.4 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.

7.5 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.

7·6 LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT

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)

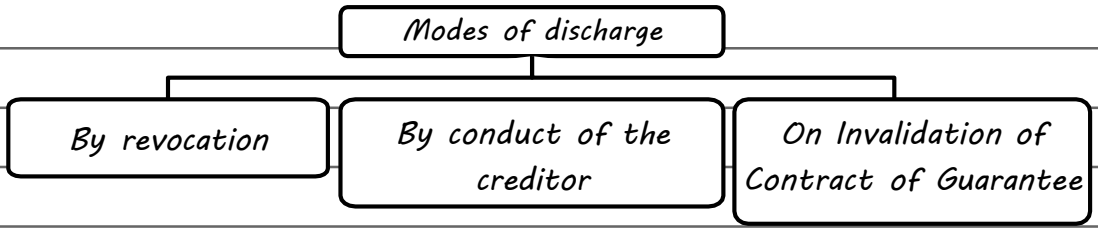
7·7 DISCHARGE OF A SURETY

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.
(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.
(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.
	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.
(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.
(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.
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.

(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]
	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.
(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.
(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.
7.8	**RIGHTS OF A SURETY**
	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.

(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.

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.

(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.

(c) **Right to share reduction:** The surety has right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

OFU: '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·
	OFU: 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·
	OFU: 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·
	OFU: 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·

OFU: 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.

OFU: 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.

CHAPTER - 2

UNIT - 8 BAILMENT AND PLEDGE

8·1 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·

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 in 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.

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. **<u>On the basis of benefit, bailment can be classified into three types:</u>**

a. For the exclusive benefit of bailor

b. For the exclusive benefit of bailee

c. For mutual benefit of bailor and bailee

2. **<u>On the basis of reward, bailment can be classified into two types:</u>**

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

8.2 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.

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.

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 incurred 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.
(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 expire 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.
8.3	**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.
	Case Study: 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.
	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 dear the expense of separation or division and any damage arising from the mixture (Section 156).
	OFU: 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).

OFU: 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 baile 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]

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.

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.

8·4	**RIGHTS OF A BAILOR**
	Rights of Bailor: The following are the rights of bailor:-
(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·
	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 & 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·
8·5	**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·
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.
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)
8.6	**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.
8.7	**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.
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.
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 the nature of goods which makes it impossible to be used for the purpose of bailment.
8.8	**FINDER OF LOST GOODS**
	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
(2)	when the lawful charges of the finder in respect of the thing found amount to two-thirds of its value.
8.9	**RIGHT OF LIEN**
	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.
	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.

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.

8.10 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.

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.

(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 can 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.
8.11	**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.

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.

8.12 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.

CHAPTER - 2

UNIT - 9 AGENCY

A relationship of agency is established when one party (agent) is authorized by another party (principal) to act on his/her behalf. Such relationships are initiated when one party desires to extend his/her activities beyond his/her present limits or capacity. In modern life, it would be impossible for a man to do everything by himself. Thus, he needs agents, to perform activities. A relationship of agency is commonly visible in all business transactions. These include hiring employees or retaining the services of other professionals such as an attorney, design professional, software developer etc. An agent has the potential to form contracts on behalf of the principal and in doing so, will bind the principal. As a result, the relationship of agency is one of trust and confidence and an agent must perform his/her activities in a capable and conscientious manner. The law of agency is contained in sections 182 to 238 of the Indian Contract Act, 1872.

9.1 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.

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.

9.2 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.

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.

9.3 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 & 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·
1·	**Definitions of express and implied authority [Section 187]**
	Express Authority: An authority is said to be express when it is given by words, spoken or written·
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·
	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·
b·	**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.
	***OFU:** 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 ratifies 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.*
	***OFU:** 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) purchases 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.*

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.

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.

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.

9.4 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.
(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.
9.5	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 delegate and a delegate cannot further delegate. This is based on the Latin principle **"delegatus non potest delegare"**.
♦	Principal – delegates act / work
♦	Agent – further delegates
♦	Sub-Agent
	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.

9.6 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.

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.

9.7 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.

Sr. 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 & 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 for 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.

9.8 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.

(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.
(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)
(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 & 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.

(ix)	**Duty not to use any confidential information received in the course of agency against the principal·**
9·9	**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]·
(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.
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.
	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.
(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.

9·10 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 contract 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·

(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·

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·

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 obligation were within the scope of the agent's authority.

(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.

(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 has 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.

9.11 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.

(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 he 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.

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.

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.

b. **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.

9·12 REVOCATION OF AUTHORITY

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:

- Revocation
- Renunciation by agents
- Completion of business
- Death of Principal or the agent
- Principal or agent becoming of unsound mind
- Insolvency of principal
- Expiry of time

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]

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·

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 of 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 agent 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."

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.*

OFU: *A, at Chennai, by letter directs B to sell for him some cotton lying in a warehouse in Mumbai, & 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.*

OFU: *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 - 3

UNIT - 1 FORMATION OF THE CONTRACT OF THE SALE

INTRODUCTION

Sale of goods is one of the specific forms of contracts recognized and regulated by law in India. Sale is a typical bargain between the buyer and the seller. The Sale of Goods Act, 1930 allows the parties to modify the provisions of the law by express stipulations. However, in some cases, this freedom is severely restricted.

Sale of Goods Act, 1930 is an Act to define and amend the law relating to the sale of goods.

1.1 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 expressions used but not defined in the Sales of Goods Act, 1930 and defined in the Indian Contract Act, 1872 have the meanings assigned to them in that 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.

1.2 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 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)].*
(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.

(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.

(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.

(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.

(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)
	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)].
(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)]
	OFU: 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.
(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.
(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.

(I) **Quality of goods** includes their state or condition. **[Section 2(12)]**

1.3 SALE AND AGREEMENT TO SELL (SECTION 4)

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)]**

Contract of sale

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.

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.

1.4 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.

1·5 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.
1.6	**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.
1.7	**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.
(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.

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.

1.8 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.

CHAPTER - 3

UNIT - 2 CONDITIONS & WARRANTIES

2·1 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·

2·2 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)]

OFU: 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)]

OFU: 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·

2·3 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·

(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·

2·4 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 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·

OFU: 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·

OFU: 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·

OFU: 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·

OFU: 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 & 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,

OFU: 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·

OFU: 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.
	OFU: 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.

	OFU: '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.
	OFU: '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 of 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.
	OFU: 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.

OFU: A bought a black velvet cloth from C and found it to be damaged by white ants. Held, the condition as to merchantability was broken.

(vii) **Condition as to wholesomeness:** 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.

OFU: 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.

OFU: 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.

OFU: 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.

2.5 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).

OFU: 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".

OFU: 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)].

	OFU: 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.
	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.
	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)].

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.

CHAPTER - 3

UNIT - 3 TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

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.

3.1 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:
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.
	OFU: 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.

OFU: 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.

OFU: 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.
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.

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.

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.

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)
	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).
3.2	**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
	OFU: 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.
	OFU: 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.

3·3 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·

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.
(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)**.
(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)]**.
(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 dispose 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)]**.
	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.
	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.
(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]
(iii)	A sale by pawnee can convey a good title to the buyer [Section 176 of the Indian Contract Act, 1872]
3.4	**PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31 - 44)**
	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)**
(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)]
(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)**
(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)**
(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.

CHAPTER - 3

UNIT - 4 UNPAID SELLER

4·1 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)]·

4·2 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·
•	Against the goods
•	Where the property in goods has passed to the buyers
•	Where the property in goods has not passed to the buyers
4·3	**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·
	OFU: 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:
(i)	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.
(ii)	Where the buyer or his agent lawfully obtains possession of the goods.
(iii)	Where seller has waived the right of lien.
(iv)	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.)
	OFU: 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]
	OFU: 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.
	Stoppage in transit
	By taking actual possession of goods By giving notice to the carrier not to deliver the goods.
	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).

OFU: A sold certain goods to B of Mumbai and the goods are handed over to railways for transmission to B. In the meantime, 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.

OFU: 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.

4.4 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.

4.5 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.

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.

	OFU: '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 –
(i)	set up against the seller the breach of warranty in diminution or extinction of the price; or
(ii)	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.
4.6	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.

4.7 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 - 4

UNIT - 1 GENERAL NATURE OF A PARTNERSHIP

1·1 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'**·

1·2 ELEMENTS OF PARTNERSHIP

The definition of the partnership contains the following five elements which must co-exist before a partnership can come into existence·

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.

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.

	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'.
1.3	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 proved.
1.	
2.	
3.	

1.4 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.

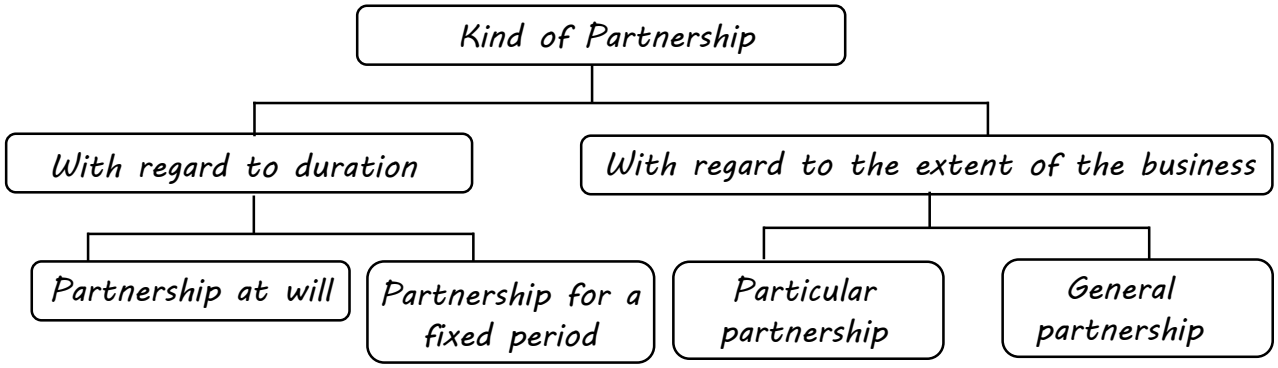
Partnership vs. Association

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	Association evolves out of social cause where there is no necessarily motive to earn and share profits. The intention is

	business for gains, with the intention to share the profits of such a business.	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.

1.5 KINDS OF PARTNERSHIPS

The following chart illustrates the various kinds of partnership:



The various kinds of partnership are discussed below:

1. **Partnership at will according to Section 7 of the Act, partnership at will is a partnership when:**

1.

2.

Where a partnership entered into for a fixed term is continued after the expiry of such term,

A partnership at will may be dissolved by any partner by giving

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:**

4. **General 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.
1.6	**TYPES OF PARTNERS**
	Based on the extent of liability, the different classes of partners are:
	Types of Partners
❖	Active or Ostensible
❖	Nominal
❖	Sub - partner
❖	Outgoing Partner
❖	Sleeping or Dormant
❖	Partner in Profits only
❖	Incoming Partner
❖	Partner by Holding out
	Active or Actual or Ostensible partner:
◈	**It is a**
1.	Who has become a partner by agreement, and
2.	Who actively participates in the Conduct of the partnership
	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:
◈	**It is a**
1.	Who is a partner by agreement, and
2.	Who does not actively take part in the conduct of the partnership business.
	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 invest in the firm nor
	takes part in the conduct of the business. He is, however liable to third parties for all
	acts of the firm.
❖	Lend his name to the firm
❖	Without having any real interest in firm
❖	Not entitled to share the profits
❖	Does not take part in the conduct of the business
❖	Liable to third parties 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.
✓	Entitled to share the profits only
✓	Not liable for the losses
✓	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.
	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.

- When a person represent himself, or
- Knowingly permits himself,
- To be represented as a partner in a firm (when in fact he is not)
- He is liable, like a partner in the firm
- To anyone who on the faith of such representation has given credit to the firm.

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.

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.

CHAPTER - 4

UNIT - 2 RELATIONS OF PARTNERS

2.1 RELATION OF PARTNERS TO ONE ANOTHER

The Partnership Act contains various provisions regulating the relationship between partners.

1. GENERAL DUTIES OF PARTNERS (SECTION 9):

2. DUTY TO INDEMNIFY FOR LOSS CAUSED BY FRAUD (SECTION 10):

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.
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 and copy any of the books of the firm.

(i) **Right to take part in the conduct of the Business [Section 12(a)]:**

OFU: 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, ect·

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)]:**

(iii) **Right of access to books [Section 12 (d)]:**

(iv) **Right of legal heirs/ representatives/ their duly authorised agents [Section 12(e)]:**

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 capital 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)]:**

(ii) Right to share Profits [Section 13 (b)]:

(iii) Interest on Capital [Section 13 (c)]:

(iv) *Interest on advances [Section 13 (d)]:*

(v) *Right to be indemnified [Section 13 (e)]:*

(vi) *Right to indemnify the firm [Section 13 (f)]:*

2·2 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:

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·

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·

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·

2·3· **PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16)**

According to section 16, subject to contract between the partners,-

(a)

(b)

2·4 **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,

	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 reconstituted 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.
2.5	RELATION OF PARTNERS TO THIRD PARTIES
1.	PARTNER TO BE AGENT OF THE FIRM (SECTION 18):
	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.
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".

(2) In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to-

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.

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 the 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.
	If partnership be of a general commercial nature,
(i)	he may pledge of 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.
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.

2.6 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.

2.7 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.

2.8 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):

2. LIABILITY OF THE FIRM FOR WRONGFUL ACTS OF A PARTNER (SECTION 26):

3. LIABILITY OF FIRM FOR MISAPPLICATION BY PARTNERS (SECTION 27):

2·9	**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·
2·10	**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 and it can be 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)	

(ii)	
(iii)	
(i)	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)	
(b)	
(c)	
(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 the 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 regards 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)

(ii)

(b) **When he elects not to become a partner:**

(i)

(ii)

(iii)

2·11 **LEGAL CONSEQUENCES OF PARTNER COMING IN AND GOING OUT (SECTION 31 – 35)**

Any change in the relation of partners will result in reconstitution of 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 the 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 liable 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 is 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.

	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.
(iii)	**EXPULSION OF A PARTNER (SECTION 33):**
(i)	
(ii)	
(iii)	
	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:
❖	The expulsion must be in the interest of the partnership.
❖	The partner to be expelled is served with a notice.
❖	He is given an opportunity of being heard.
	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.
(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 date on which the order of adjudication is made.

EFFECTS OF INSOLVENCY

- The insolvent partner cannot be continued as a partner.
- He will be ceased to be a partner from the very date on which the order of adjudication is made.
- The estate of the insolvent partner is not laible for the acts of the firm done after the date of order of adjudication.
- The firm is also not liable for any act of the insolvent partner after the date of the order of adjudication.
- Ordinarily but not invariably, the insolvency of a partner results in dissolution of a firm; but the partners are competent to agree among themselves that the adjudication of a partner as an insolvent will not give rise to dissolution of the firm.

(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 having dealings with the firm.

2·12 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)

(b)

(c)

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·

2·13 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.

2.14 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.

CHAPTER - 4

UNIT - 3 REGISTRATION AND DISSOLUTION OF A FIRM

3·1 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.

3.2 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:

(ii) **No relief to partners for set-off of claim:**

(iii) **Aggrieved partner cannot bring legal action against other partner or the firm:**

(iv) **Third party can sue the firm:**

Exceptions: Non-registration of a firm does not, however effect the following rights:

3·3 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):**

(ii) **Compulsory dissolution (Section 41):**

(iii) **Dissolution on the happening of certain contingencies (Section 42):**

(iv) **Dissolution by notice of partnership at will (Section 43):**

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:**

(b) Permanent incapacity:

(c) Misconduct:

(d) Persistent breach of agreement:

(e) Transfer of interest:

(f) Continuous/Perpetual losses:

(g) Just and equitable grounds:

3·4 **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):**

2· Notices under sub-section (1) may be given by any partner·

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·

	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.
(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 - 5

THE LIMITED LIABILITY PARTNERSHIP ACT, 2008

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.

The First Schedule deals with

The Second Schedule deals with conversion of a

The Third Schedule deals with conversion of a

The Fourth Schedule deals with conversion of

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.

1. LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT

Meaning: A LLP is a new form of legal business entity with limited liability. 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. 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.

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.

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(d)]:** It means a company as defined in clause (20) of section 2 of the Companies Act, 2013 and includes—

(i)

(ii)

(iii)

but does not include—

(i)

(ii)

(iii)

2. **Business [Section 2(e)]:** "Business" includes every trade, profession, service and occupation.

3. **Designated Partner [Section 2(j)]:** "Designated partner" means any partner designated as such pursuant to section 7.

4. **Entity [Section 2(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(l)]:**

OFU: If a LLP has been incorporated on 15th October, 2019, then its financial year may be from

6. **Foreign LLP [section 2(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(n)]:** Limited Liability Partnership means a partnership formed and registered under this Act.

8. **Limited Liability partnership agreement [Section 2(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(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)	
(b)	
(c)	
	Minimum number of partners (Section 6):
(i)	
(ii)	

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.

OFU: 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.

1. **LLP is a 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.
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:
1.	is organized and operates on the basis of an agreement.
2.	Provides flexibility without imposing detailed legal and procedural requirements.
3.	Easy to form
4.	All partners enjoy limited liability
5.	Flexible capital structure
6.	Easy to dissolve

3.	**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)	
(b)	
(c)	Statement to be filed:

(2)	**The incorporation document shall—**
(a)	be in a form as may be prescribed;
(b)	state the name of the LLP;
(c)	state the proposed business of the LLP;
(d)	state the address of the registered office of the LLP;
(e)	state the name and address of each of the persons who are to be partners of the LLP on incorporation;
(f)	state the name and address of the persons who are to be designated partners of the LLP on incorporation;
(g)	contain such other information concerning the proposed LLP as may be prescribed.
(3)	**If a person makes a statement as discussed above which he—**
(a)	knows to be false; or
(b)	does not believe to be true, shall be punishable
	Incorporation by registration (Section 12):
(1)	When the requirements imposed by clauses (b) and (c) of sub-section (1) of section 11 have been complied with, the Registrar shall retain the incorporation document and, unless the requirement imposed by clause (a) of that sub-section has not been complied with, he shall, within a period of 14 days—
(a)	register the incorporation document; and
(b)	give a certificate that the LLP is incorporated by the name specified therein.
(2)	The Registrar may accept the statement delivered under clause (c) of sub-section (1) of section 11 as sufficient evidence that the requirement imposed by clause (a) of that sub-section has been complied with.

(3)	The certificate issued under clause (b) of sub-section (1) shall be signed by the Registrar and authenticated by his official seal.
(4)	The certificate shall be conclusive evidence that the LLP is incorporated by the name specified therein.
	Registered office of LLP and change therein (Section 13):
(1)	Every LLP shall have a registered office to which all communications and notices may be addressed and where they shall be received.
(2)	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.
(3)	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.
(4)	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):
	On registration, a LLP shall, by its name, be capable of
♦	suing and being sued;
♦	acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
♦	having a common seal, if it decides to have one; and
♦	doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.
	Name (Section 15):
(1)	

(2)	
(a)	
(b)	
	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)	
(b)	
(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)	
(b)	

(2)

(3)

4. 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:

	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 partners (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.

8.	**Liability**	Liability of each partner 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 & 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

	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 the LLP.	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 members Maximum – No such limit on the members in the Act. The members 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 - 6

THE COMPANIES ACT, 2013

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.

1. 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

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 member does not even have an insurable interest in the property of the company. The leading case on this point is of Macaura Vs. Northern Assurance Co. Limited (1925):

Fact of the case

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 not insured in the company's name, M could not claim the compensation from insurance company.

II. **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.

III. **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.
IV.	**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.
V.	**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 Company Secretary, wherever the company has appointed a Company Secretary.**

2. CORPORATE VEIL THEORY

(i) **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.

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.

(ii) **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

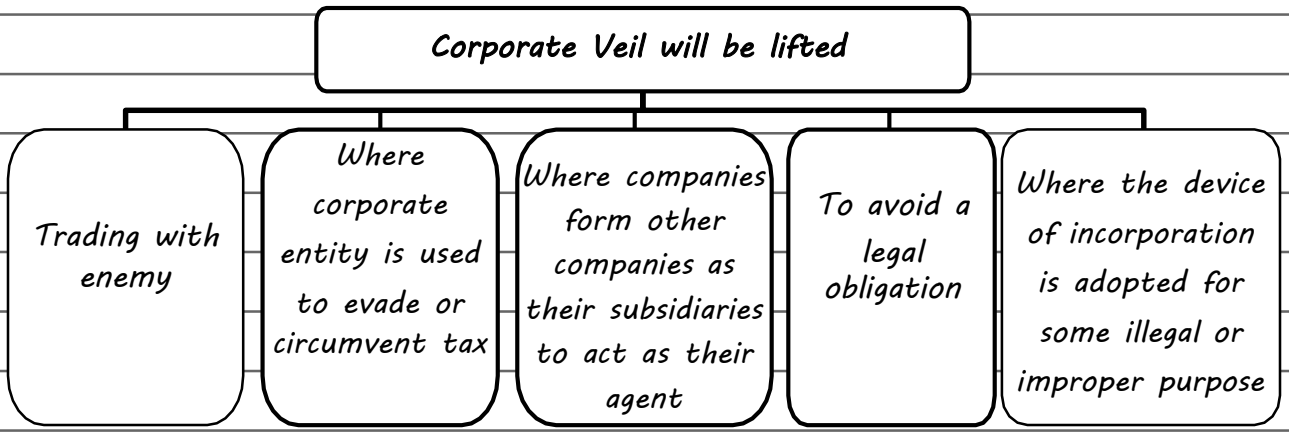
	people of an enemy country. For this purpose, the Court may examine the character of the persons who are really at the helm of affairs of the company.
(2)	**To protect revenue/tax:** In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest 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.

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]**



3. CLASSES OF COMPANIES UNDER THE ACT

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.

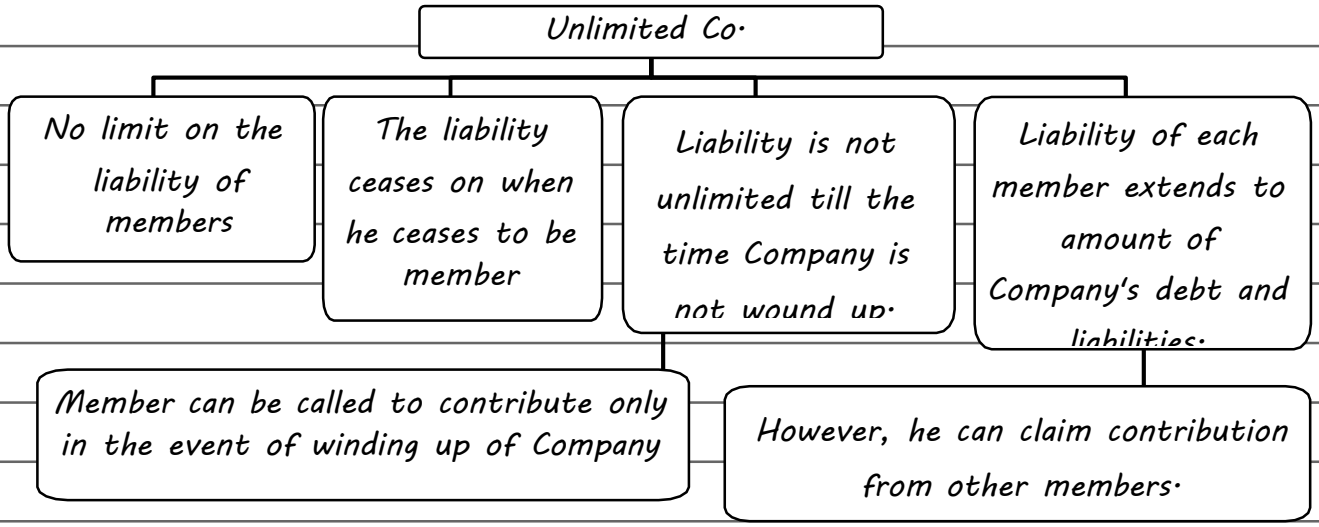
It is clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be held from other sources like endowment, fees, charges, donations, etc.

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.
	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]
(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;
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.

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.
(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 & partly by one or more State Governments, & the section includes a company which is a subsidiary company of such a Government company.
(iv)	**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.
◆	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.
(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.

4. **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.

Public Co.	• 7 or more
Private Co.	• 2 or more
One Person Co.	• One person

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· 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.

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.

5. CLASSIFICATION OF CAPITAL

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.
(e)	**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.
6.	**SHARES**
1.	**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;
(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.
7.	**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 D is 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.
8.	**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.
	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.

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.

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.

9. 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.

10. 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**.

FACTS of the Royal British Bank vs. Turquand

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: *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.*

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.*

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***. 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 - 7

THE NEGOTIABLE INSTRUMENTS ACT, 1881

1. MEANING OF NEGOTIABLE INSTRUMENTS

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.

Type of Negotiable Instrument

1.

2.

3.

(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.

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 number 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.

2. 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 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.

2.

Essential Characteristics of a Promissory Note

a.

b.

c.

d.

e.

f.

g.

h.

3. BILLS OF EXCHANGE

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

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 Colony, Bhopal (M.P.)

Signature
Mr. A

Parties to the bill of exchange

a.

b.

c.

Essential characteristics of bill of exchange

(a)

(b)

(c)

(d)

(e)

(f)

(g)

(h)

Difference between promissory note and bill of exchange

Sr. 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.

4. 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.

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 conditional·

2· **Drawee:** The specific bank on whom cheque is drawn· He makes the payment of the cheque· In case of cheque, drawee is always 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 ned 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·

Note: These two additional features distinguish a cheque from bill· Thus, all cheques are bills while all bills are not cheques·

5. CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

"Bearer instrument" and "order instrument" [Section 13]

Bearer Instrument:

Order Instrument:

"Inland instrument" and "Foreign instrument" [Sections 11 & 12]

"Inland instrument":

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 + drawn upon a person resident in India.	are Inland Instruments

"Foreign 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 On a person residing outside India + payable outside India.	are foreign bills.
	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 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).

OFU: 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%.

Inchoate and Ambiguous Instruments

Inchoate Instrument:

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.

OFU: 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:

6. 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.

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.

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)

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.

7. **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
-

- 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

When section 138 shall be not apply: unless the below given conditions are complied with—

(a) Cheque presented within validity period:

(b) Demand for the payment through the notice:

(c) Failure of drawer to make payment: the drawer of such cheque fails to make the

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.

OFU: 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 hears 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.

8. **PRESENTMENT OF INSTRUMENTS**

Presentment for acceptance [Section 61]

A bill of exchange payable after sight must [if no 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 maker, drawee or acceptor intentionally prevents the presentment of the instrument, 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.
9.	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.