

CHAPTER-2: INDIAN CONTRACT ACT, 1872 [SPECIAL CONTRACT]**UNIT - 7: CONTRACT OF INDEMNITY AND GUARANTEE****CONTRACT OF INDEMNITY****QUS.7.1.1****[SM]**

S asks R to beat T and promises to indemnify R against the consequences. R beats T and is fined Rs. 50,000. Can R claim Rs. 50,000 from S.

ANS.

R cannot claim Rs. 50,000 from S because the object of the agreement was unlawful. A contract of indemnity to be valid must fulfil all the essentials of a valid contract.

QUS.7.1.2**[SM]**

What are the rights of the indemnity-holder when sued?

ANS.

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—

- (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.

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

CONTRACT OF GUARANTEE**QUS.7.2.1****[SM]**

A agrees to sell goods to B on the guarantee of C for the payment of the price of goods in default of B. Is the agreement of guarantee valid in each of the following alternate cases:

Case 1. If A is a Minor

Case 2: If B is a Minor

Case 3: If C is a minor.

ANS.

Case 1: The agreement of guarantee is void because the creditor is incompetent to contract.

Case 2: The agreement of guarantee is valid because the capability of the principal debtor does not affect the validity of the agreement of the guarantee.

Case 3: The agreement of guarantee is void because the surety is incompetent to contract.

QUS.7.2.2**[SM]**

Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid?

ANS.

Section 124 of the Indian Contract Act, 1872 states that "A contract by which one party promises

to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity".

Section 126 of the Indian Contract Act, 1872 states that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default" is called a "contract of guarantee".

The conditions under which the guarantee is invalid or void is provided in section 142, 143 and 144 of the Indian Contract Act. These include:

- (i) Guarantee obtained by means of misrepresentation.
- (ii) Guarantee obtained by means of keeping silence as to material circumstances.
- (iii) When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

QUS.7.2.3

[PEQ-NOV 22-4 MARKS]

Manish, a minor, lost his parents in COVID-19 pandemic. Due to poor financial background Manish was facing difficulties in maintaining his livelihood. He approached Mr. Sohel (a grocery shopkeeper) to supply him grocery items and to wait for some period for receiving his dues. Mr. Sohel did not agree with the proposal; but when Mr. Ganesh, a local person, who is a major, agreed to provide guarantee that he would pay the dues in case Manish fails to pay the amount, Mr. Sohel supplied the required groceries to Manish. After few months when Manish failed to clear his dues, Mr. Sohel approached Mr. Ganesh and asked him to clear the dues of Manish. Mr. Ganesh refused to pay the amount on two grounds; firstly, that there was no consideration in the contract of guarantee and secondly that Manish is a minor and therefore on both the grounds the contract of guarantee is not valid.

Referring to the relevant provisions of the Indian Contract Act, 1872, decide, whether the contention of Mr. Ganesh, (the surety) is tenable? Will your answer differ in case both Manish (the principal debtor) and Mr. Ganesh (the surety) are minors?

ANS.

- (i) Whether the contention of Mr. Ganesh (the Surety) is Tenable?

In the light of the given facts in the question, the guarantee was given by Mr. Ganesh (the surety) to Mr. Sohel that he would pay the dues in case Mr. Manish (the Principal Debtor) fails to pay the amount.

However, later on it was contended by Mr. Ganesh that there was no consideration in the contract of guarantee and also that Manish is a minor and therefore the contract of guarantee is not valid.

As per the provisions of Section 127 of the Indian Contract Act, 1872, anything done, or promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

In the given case, Mr. Ganesh has provided guarantee to Mr. Sohel for the benefit of Mr. Manish which will be treated as sufficient consideration even though there is absence of direct consideration. In other words, a guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor.

Regarding the contention that Manish is a minor and therefore, the contract of guarantee will be invalid is not tenable due to the fact that Mr. Ganesh (surety) and Mr. Sohel (the creditor) are not minors. In other words, the capability of the principal debtor (being a minor) does not affect the validity of the agreement of the guarantee.

In view of the above, it can be concluded that the contention of Mr. Ganesh is not tenable.

(ii) *In case both Manish (the principal debtor) and Mr. Ganesh (the surety) are minors:*

The answer will differ in case both Manish (the principal debtor) and Mr. Ganesh (the surety) are minors. In such a situation, the agreement will be treated as void from inception as the minors cannot give guarantee even with a claim for necessities.

DISCHARGE OF A SURETY

QUS.7.7.1

[SM]

Manoj guarantees for Ranjan, a retail textile merchant, for an amount of Rs. 1,00,000, for which Sharma, the supplier may from time to time supply goods on credit basis to Ranjan during the next 3 months.

After 1 month, Manoj revokes the guarantee, when Sharma had supplied goods on credit for Rs. 40,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether Manoj is discharged from all the liabilities to Sharma for any subsequent credit supply. What would be your answer in case Ranjan makes default in paying back Sharma for the goods already supplied on credit i.e. Rs. 40,000?

ANS.

Discharge of Surety by Revocation: As per section 130 of the Indian Contract Act, 1872, a continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

As per the above provisions, liability of Manoj is discharged with relation to all subsequent credit supplies made by Sharma after revocation of guarantee, because it is a case of continuing guarantee.

However, liability of Manoj for previous transactions (before revocation) i.e. for Rs. 40,000 remains. He is liable for payment of Rs. 40,000 to Sharma because the transaction was already entered into before revocation of guarantee.

QUS.7.7.2

[May 2006] [SM]

Ravi becomes guarantor for Ashok for the amount which may be given to him by Nalin within six months. The maximum limit of the said amount is Rs. 1 lakh. After two months Ravi withdraws his guarantee. Up to the time of revocation of guarantee, Nalin had given to Ashok Rs. 20,000.

(i) Whether Ravi is discharged from his liabilities to Nalin for any subsequent loan.

(ii) Whether Ravi is liable if Ashok fails to pay the amount of Rs. 20,000 to Nalin?

ANS.

Discharge of Surety by Revocation: As per section 130 of the Indian Contract Act, 1872 a specific guarantee cannot be revoked by the surety if the liability has already accrued.

A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into. As per the above provisions.

(i) Yes, Ravi is discharged from all the subsequent loan because it's a case of continuing guarantee.

(ii) Ravi is liable for payment of Rs. 20,000 to Nalin because the transaction has already completed

QUS.7.7.3

[PEQ-Nov. 2002]

'A' stands surety for 'B' for any amount which 'C' may lend to B from time to time during the next three months subject to a maximum of Rs.50,000. One month later A revokes the guarantee, when C had lent to B Rs.5,000. Referring to the provisions of the ICA decide whether 'A' is discharged from all the liabilities to 'C' for any subsequent loan. What would be your answer in case 'B' makes a default in paying back to 'C' the money already borrowed i.e. Rs.5,000?

ANS.

The problem as asked in the question is based on the provisions of the Indian Contract Act 1872, as contained in Section 130 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways:

1. By Notice : A continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor.
2. By death of surety : The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Section 131).

The liability of the surety for previous transactions however remains.

Thus applying the above provisions in the given case, A is discharged from all the liabilities to C for any subsequent loan.

Answer in the second case would differ i.e. A is liable to C for Rs.5,000 on default of B since the loan was taken before the notice of revocation was given to C.

QUS.7.7.4

[SM]

Mr. X, is employed as a cashier on a monthly salary of Rs. 12,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of Rs. 10,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y?

ANS.

According to section 133 of the Indian Contract Act, 1872, 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.

In the instant case, the creditor has made variance (i.e. change in terms) without the consent of surety. Thus, surety is discharged as to the transactions subsequent to the change.

Hence, Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary.

QUS.7.7.5

[SM]

Mr. Chetan was appointed as Site Manager of ABC Constructions Company on a two years' contract at a monthly salary of Rs. 50,000. Mr. Pawan gave a surety in respect of Mr. Chetan's conduct. After six months the company was not in position to pay Rs. 50,000 to Mr. Chetan because of financial constraints. Chetan agreed for a lower salary of Rs.30,000 from the company. This was not communicated to Mr. Pawan. Three months afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's appointment.

ANS.

As per the provisions of Section 133 of the Indian Contract Act, 1872, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change.

In the instant case, Mr. Pawan is liable as a surety for the loss suffered by ABC Constructions company due to misappropriation of cash by Mr. Chetan during the first six months but not for misappropriations committed after the reduction in salary.

Hence, Mr. Pawan, will be liable as a surety for the act of Mr. Chetan before the change in the terms of the contract i.e., during the first six months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Pawan, will discharge Mr. Pawan from all the liabilities towards the act of the Mr. Chetan after such variation.

QUS.7.7.6

[PEQ-NOV.2008]

A gives to C a continuing guarantee to the extent of Rs. 5000 for the vegetables to be supplied by C to B from time to time on credit. Afterwards, B became embarrassed, and without the knowledge of A, B and C contract that C shall continue to supply B with vegetables for ready money, and that the payments shall be applied to the then existing debts between B and C.

Examining the provision of the Indian Contract Act, 1872, decide whether A is liable on his guarantee given to C.

ANS.

The problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 133. The section provides that any variance made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance. In the given problem all the above requirements are fulfilled. Therefore, A is not liable on his guarantee for the vegetable supplied after this new arrangements. The reason for such a discharge is that the surety agreed to be liable for a contract which is no more there and he is not liable on the altered contract because it is different from the contract made by him.

QUS. 7.7.7

The contract of Insurance is not fully covered under the contract of Indemnity.

ANS.

Correct: Contract of Insurance is contract of indemnity, but not fully covered under Indian Contract Act, 1872 as the loss can happen due to any reason, while in the contract of indemnity, under section 124 of the Indian Contract Act, 1872 loss should occur due to conduct of promisor or some other person. Losses due to natural calamities are not covered in this definition as per the Indian Contract Act, 1872.

QUS.7.7.8

[SM]

A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability.

ANS.

According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor by which the principal debtor is discharged or by any act or omission for the creditor the legal consequence of which is the discharge of the principal debtor.

In the given case, B omits to supply the necessary construction material. Hence, C is discharged from his liability.

QUS.7.7.9

[PEQ-NOV.2006]

Explaining the provisions of the Indian Contract Act, 1872, answer the following:

C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability?

ANS.

According to Section 136 of the ICA, 1872, 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. In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence A is not discharged.

QUS.7.7.10

[PEQ-NOV. 2008]

B owes C a debt guaranteed by A. C does not sue B for a year after the debt has become payable. In the meantime, B becomes insolvent. Is A discharged? Decide with reference to the provisions of the Indian Contract Act, 1872.

ANS.

Discharge of surety : The problem is based on the provisions of Section 137 of the Indian Contract Act, 1872 relating to discharge of surety. The section states that mere forbearance on the part of the creditor to sue the principal debtor and/or to enforce any other remedy against him would not, in the absence of any provision in the guarantee to the contrary, discharge the surety. In view of these provisions, A is not discharged from his liability as a surety.

QUS.7.7.11

[PEQ-JUN24-7 MARKS]

R owns an electronics store. P visited the store to buy a water purifier priced at Rs.54,000/-He specifically requested R for a purifier with a copper filter. As P wanted to buy the purifier on credit, with the intention of paying in 9 equal monthly instalments, R demands a guarantor for the transaction. S (a friend of P) came forward and gave the guarantee for payment of water purifier. R sold P, a water purifier of a specific brand. P made payment for 4 monthly instalments and after that became insolvent. Explain with reference to the Indian Contract Act 1872, the liability of S as a guarantor to pay the balance price of water purifier to R.

What will be your answer, if R sold the water purifier misrepresenting it as having a copper filter, while it actually has a normal filter? Neither P nor S was aware of this fact and upon discovering the truth, P refused to pay the price. In response to P's refusal, R filed the suit against S, the guarantor. Explain with reference to the Indian Contract Act 1872, whether S is liable to pay the balance price of water purifier to R?

RIGHTS OF A SURETY

QUS.7.8.1

'C' advances to 'B', Rs. 2,00,000 on the guarantee of 'A'. 'C' has also taken a further security for the same borrowing by mortgage of B's furniture worth Rs. 2,00,000 without knowledge of 'A'. C' cancels the mortgage. After 6 months 'B' becomes insolvent and 'C'

'sues 'A' his guarantee. Decide the liability of 'A' if the market value of furniture is worth Rs. 80,000, under the Indian Contract Act, 1872.

ANS.

Surety's right to benefit of creditor's securities: According to section 141 of the Indian Contract Act, 1872, 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.

In the instant case, C advances to B, Rs. 2,00,000 rupees on the guarantee of A. C has also taken a further security for Rs. 2,00,000 by mortgage of B's furniture without knowledge of A.

C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture i.e. Rs. 80,000 and will remain liable for balance Rs.1,20,000.

QUS.7.8.2

[SM]

Mr. D was in urgent need of money amounting to Rs. 5,00,000. He asked Mr. K for the money. Mr. K lent the money on the sureties of A, B and N without any contract between them in case of default in repayment of money by D to K. D makes default in payment. B refused to contribute, examine whether B can escape liability?

ANS.

Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872): Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that "when two or more persons are co-sureties for the same debt, or duty, either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor".

Accordingly, on the default of D in payment, B cannot escape from his liability. All the three sureties A, B and N are liable to pay equally, in absence of any contract between them.

QUS.7.8.3

[PEQ-JUN24-6 MARKS]

Explain in brief with reference to the provisions of The Indian Contract Act, 1872, what are the rights enjoyed by Surety against the Creditor, the Principal Debtor and Co-Sureties?

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. 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 is called
(a) Surety contract (b) Simple contract
(c) Contract of indemnity (d) None of above
2. X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. This is called:
(a) Contract of indemnity (b) Contract of Guarantee
(c) Quasi Contract (d) None of the above
3. Section 124 to 125, of the Contract Act, deals with:
(a) Contracts of indemnity (b) Contracts of guarantee
(c) Both (a) and (b) (d) None of above
4. Where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of-
(a) Indemnity (b) Guarantee
(c) Wagering (d) None of the above
5. A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. Whether-
(a) A is liable for the price of the four sacks.
(b) A is not liable for the price of the four sacks.
(c) A is liable for the price of the two sacks only.
(d) A is liable for the price of the one sack only.
6. X gives guarantee to the extent of Rs. 50,000 for the loans given from time to time by A to B. A gave a loan of Rs. 10,000 to B. Afterwards, X gives notice of revocation. Which is the correct option?
(a) X is discharged from all liability to A for any loan granted.
(b) X is liable to A for Rs. 10,000 on default of B.
(c) X is liable to A for Rs. 50,000 on default of B.
(d) X is liable to A for Rs. 40,000 on default of B.
7. The guarantee is valid even if _____ is incompetent to contract:
(a) Principal Debtor (b) Surety
(c) Both a & b (d) None of these
8. Section 143 of the Contract Act 1872 deals with
(a) Guarantee obtained by free consent (b) Guarantee obtained by fraud
(c) Guarantee obtained by concealment (d) None of above

9. A surety has a right of indemnity and right of subrogation against _____
 (a) Principal Debtor (b) Creditor
 (c) Co-Sureties (d) All of these
10. In contract of guarantee for whom guarantee given is called
 (a) Surety holder (b) Principal debtor
 (c) Both (a) and (b) (d) None of above

Answers to MCQs

1.	(c)	2.	(a)	3.	(a)	4.	(b)	5.	(b)
6.	(b)	7.	(a)	8.	(c)	9.	(a)	10.	(b)

General Questions

- Q.1** If a variance in terms of contract between principal debtor and a creditor is made without the consent of surety, it cannot absolutely discharge the surety's liability. (2 marks)
Ans. Incorrect : As per Section 133, surety's liability will be discharged if any variance is made without his consent in terms of contract between the principal debtors and the creditor.
- Q.2** A surety is discharged from his liability where there is failure of consideration between the creditor and the principal debtor, in a contract of guarantee. (2 marks)
Ans. Correct : According to the provision of the Indian Contract Act, one of the essential elements of a valid contract is the presence of consideration. Thus, the surety will be discharged, in a contract of guarantee where there is a failure of consideration between the creditor and the principal debtor.
- Q.3** Guarantee obtained by concealment of material facts is invalid. (2 marks)
Ans. Correct : According to Section 143, when a guarantee is obtained by the creditor by means of keeping silence regarding some material part of circumstances relating to the contract, the contract is invalid.
- Q.4** Any variance made without the surety's consent in the terms of the contract, discharges the surety as to transactions subsequent to variation. (2 marks)
Ans. Correct : According to Section 133, any variance made without the consent of the surety in terms of the contract between the principal debtors and the creditor, the surety is discharged as to transactions subsequent to the variation. Surety's interest is always cared by the court. The duty of good faith is imposed upon the creditor. When the contract of guarantee is formed.
- Q.5** A Contract of guarantee is a tripartite contract. (2 marks)
Ans. Correct : There are three contracts in the contracts of guarantee, one between the principal debtor and the creditor, second between the principal debtor and the surety and third between the surety and the creditor.
- Q.6** A contract of guarantee is required to be in writing. (2 marks)
Ans Incorrect : Section 126 of the Indian Contract Act, 1872 states that a guarantee may be either oral or written. Thus, it is not important that the contract of guarantee must be expressed in writing.

- Q.7 Release by the creditor of any one co-surety, discharges the other co-sureties. (2 marks)**
Ans. Incorrect : According to Section 138 of the Indian Contract Act, 1872 a release by the creditor of any one co-surety will not discharge the other co-securities nor absolve the released co surety from his responsibility to other.
- Q.8 In the absence of any provision in the contract of guarantee in the contract, forbearance on the part of creditor to sue the principal debtor does not discharge the surety. (2 marks)**
Ans. Correct : Under Section 137 of the Indian Contract Act, 1872 "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.
- Q.9 A 'Contract of indemnity is not a 'Contingent contract'. (2 marks)**
Ans. Incorrect : A contract of indemnity is a type of contingent contract. Because, in these contracts, the performance depends upon the happening or non-happening of certain event that is loss is caused by the conduct of the promisor of any other person.
- Q.10 In a contract of guarantee, forbearance by the creditor to sue the Principal Debtor discharges the surety. (1 mark)**
Ans. False : As per sec 137 of the Indian Contract Act, 1872, the surety would not be discharged by mere for bearance on the part of the creditor to sue the Principal Debtor.
- Q.11 The contract of Insurance is not fully covered under the contract of Indemnity.**
Ans. Correct : Contract of Insurance is contract of indemnity, but not fully covered under Indian Contract Act, 1872 as the loss can happen due to any reason, while in the contract of indemnity, under section 124 of the Indian Contract Act ,1872 loss should occur due to conduct of promisor or some other person. Losses due to natural calamities are not covered in this definition as per the Indian Contract Act, 1872.

CHAPTER-2: INDIAN CONTRACT ACT, 1872 [SPECIAL CONTRACT]

UNIT-8: BAILMENT AND PLEDGE

WHAT IS BAILMENT?

QUS.8.1.1

[SM]

State the essential elements of a contract of bailment.

ANS.

Essential elements of a contract of bailment: Section 148 of the Indian Contract Act, 1872 defines the term 'Bailment'. A 'bailment' is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The essential elements of the contract of the bailment are:

- (i) **Delivery of goods**—The essence of bailment is delivery of goods by one person to another.
- (ii) **Bailment is a contract**—In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, the goods shall be returned to the bailor.
- (iii) **Return of goods in specific**—The goods are delivered for some purpose and it is agreed that the specific goods shall be returned.
- (iv) **Ownership of goods**—In a bailment, it is only the possession of goods which is transferred, and the bailor continues to be the owner of the goods.
- (v) **Property must be movable**—Bailment is only for movable goods and never for immovable goods or money.

QUS.8.1.2

[SM]

Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:

- (i) V parks his car at a parking lot, locks it, and keeps the keys with himself.
- (ii) Seizure of goods by customs authorities.

ANS.

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.

For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it. There must be a transfer in ownership of the goods.

- (i) No. Mere custody of goods does not mean possession. In the given case, since the keys of the car are with V, Section 148, of the Indian Contract Act, 1872 shall not be applicable.
- (ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists and section 148 is applicable.

QUS.8.1.3

[SM]

Mrs. A delivered her old silver jewellery to Mr. Y a Goldsmith, for the purpose of making new a silver bowl out of it. Every evening she used to receive the unfinished good (silver bowl) to put it into box kept at Mr. Y's Shop. She kept the key of that box with herself. One night, the silver bowl was stolen from that box. Was there a contract of bailment? Whether the possession of the goods (actual or constructive) delivered, constitute contract of bailment or not?

ANS.

Section 148 of Indian Contract Act 1872 defines 'Bailment' as the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them.

According to Section 149 of the Indian Contract Act, 1872, the delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf. Thus, delivery is necessary to constitute bailment.

Thus, the mere keeping of the box at Y's shop, when A herself took away the key cannot amount to delivery as per the meaning of delivery given in the provision in section 149. Therefore, in this case there is no contract of bailment as Mrs. A did not deliver the complete possession of the good by keeping the keys with herself.

QUS.8.1.4

[PEQ-JUNE.09]

A, the bailor, pledges a cinema projector and other accessories with Cine Association Co-operative Bank Limited, the bailee, for a loan. A requests the bank to allow the pledged goods to remain in his possession and promises to hold the same in trust for the bailee and also further promises to handover the possession of the same to the bank whenever demanded. Examining the provisions of the Indian Contract Act, 1872 decide, whether a valid contract of pledge has been made between A, the bailor and Bank, the Bailee?

ANS.

Delivery to Pawnee under Indian Contract Act, 1872: The problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 149 (delivery to bailee and pledge). The Section provides that the delivery of the goods to the bailee may be made by actual or constructive delivery or delivery by attornment to the bank. In such a case there is change in the legal character of the possession of goods though not in the actual or physical custody. Though the bailor continues to be in possession of the goods, it is the possession of the bailee. In the given problem the delivery of the goods is constructive i.e. delivery by attornment to the bailee (pawnee) and the possession of the goods by A, the bailor is construed as possession by bailee/pawnee, the Bank. A constructive pledge comes into existence as soon as the pawnor, without actually delivering the goods, promises to deliver them on demand. The transaction was, therefore, a valid pledge. On this point, the decision given by the Andhra Pradesh High Court in Bank of Chittur Ltd. vs. Narasimhulu is relevant.

DUTIES OF A BAILOR

QUS.8.2.1

[SM]

A hires a carriage from B and agrees to pay Rs.500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Discuss the liability of B.

ANS.

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that 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. Accordingly, applying the above provisions in the given case, B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

DUTIES OF A BAILEE**QUS.8.3.1****[SM]**

A bails his jewellery with B on the condition to safeguard it in a bank's safe locker. However, B kept it in safe locker at his residence, where he usually keeps his own jewellery. After a month all jewellery was lost in a religious riot. A filed a suit against B for recovery. Referring to provisions of the Indian Contract Act, 1872, state whether A will succeed.

ANS.

According to section 152 of the Indian Contract Act, 1872, 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.

Here, A and B agreed to keep the jewellery at the Bank's safe locker and not at the latter's residence (i.e. B's residence).

Thus, B is liable to compensate A for his negligence to keep jewellery at his (B's) residence.

QUS.8.3.2**[SM]**

Amar bailed 50 kg of high quality sugar to Srijith, who owned a kirana shop, promising to give Rs. 200 at the time of taking back the bailed goods. Srijith's employee, unaware of this, mixed the 50 kg of sugar belonging to Amar with the sugar in the shop and packaged it for sale when Srijith was away. This came to light only when Amar came asking for the sugar he had bailed with Srijith, as the price of the specific quality of sugar had trebled. What is the remedy available to Amar?

ANS.

According to section 157 of the Contract Act, 1872, 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 deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

In the given question, Srijith's employee mixed high quality sugar bailed by Amar and then packaged it for sale. The sugars when mixed cannot be separated. As Srijith's employee has mixed the two kinds of sugar, he (Srijith) must compensate Amar for the loss of his sugar.

QUS.8.3.3**[SM]**

R gives his umbrella to M during raining season to be used for two days during Examinations. M keeps the umbrella for a week. While going to R's house to return the umbrella, M accidentally slips and the umbrella is badly damaged. Who bear the loss and why?

ANS.

M shall have to bear the loss since he failed to return the umbrella within the stipulated time and Section 161 clearly says that where a bailee fails to return the goods within the agreed time, he shall be responsible to the bailor for any loss, destruction or deterioration of the goods from that time notwithstanding the exercise of reasonable care on his part.

QUS.8.3.4**[PEQ-NOV.22-4 MARKS]**

Kartik took his AC to Pratik, an electrician, for repair. Even after numerous follow ups by Kartik, Pratik didn't return the AC in reasonable time even after repair. In the meantime, Pratik's electric shop caught fire because of short circuit and AC was destroyed. Decide, whether Pratik will be held liable under the provisions of the Indian Contract Act, 1872.

ANS.

The legal provisions which dealt with the return of goods under the Indian Contract Act, 1872 (the Act) is covered in Sections 160 and 161 of the Act, whereby, it is the duty of bailee to return, or deliver according to the bailor's directions, the goods bailed without demand, as soon as the time for which they were bailed, has expired, or the purpose for which they were bailed has been accomplished.

Further, Section 161 of the Act clearly says that where a bailee fails to return the goods as per term given under Section 160, within the agreed time, he shall be responsible to the bailor for any loss, destruction or deterioration of the goods from that time notwithstanding the exercise of reasonable care on his part.

In the instant case, Pratik did not return the AC in reasonable time even after repair, in spite of numerous follow ups by Kartik.

In the light of the said provision, Pratik shall be held liable for the destruction of goods (i.e. AC) on his failure to return to Kartik within the reasonable time.

QUS.8.3.5

[PEQ-NOV.03]

Sunil delivered his car to Mahesh for repairs Mahesh completed the work, but did not return the car to Sunil within reasonable time, though Sunil repeatedly reminded Mahesh for the return of car. In the meantime a big fire occurred in the neighborhood and the car was destroyed. Decide whether Mahesh can be held liable under the provisions of ICA.

ANS.

The problem asked in the question is based on the provisions of section 160 and 161 of the Indian Contract Act 1872. Accordingly, it is the duty of the bailee to return or deliver the goods bailed according to the bailor's directions, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed for any loss, destruction of the goods from that time (Section 161), notwithstanding the exercise of reasonable care on his part.

Therefore, applying the above provisions in the given case, Mahesh is liable for the loss, although he was not negligent, but because of his failure to deliver the car within a reasonable time (Shaw & Co. v. Symmons & Sons).

QUS.8.3.6

[PEQ-NOV.2008]

M lends a sum of Rs.5,000 to B, on the security of two shares of a Limited Company on 1stApril 2007. On 15thJune, 2007, the company issued two bonus shares. B returns the loan amount of Rs.5,000 with interest but M returns only two shares which were pledged and refuses to give the two bonus shares. Advise B in the light of the provisions of ICA.

ANS.

Bailee's duties and Liabilities: The problem as asked in the question is based on the provisions of Section 163(4) of the Indian Contract Act,1872.

As per the section, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed." Applying the provisions to the given case, the bonus shares are an increase on the shares pledged by B to M. So M is liable to return the shares along with the bonus shares and hence B the bailor, is entitled to them also (Motilal v Bai Mani).

RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY)

QUS.8.6.1

[PEQ-MAY.2008]

Ravi sent a consignment of goods worth Rs.60,000 by railway and got railway receipt. He obtained an advance of Rs. 30,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for Rs. 60,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

OR

X sent a consignment of mobile phones worth Rs.60,000 to Y and obtained a railway receipt therefore. Later, he borrowed a loan of Rs.40,000 from Star Bank and endorsed the railway receipt in favour of the Bank as security. In transit the consignment of mobile phones was lost. The Bank files a suit against the railway for a claim of Rs.60,000, the value of the consignment. The railway contended that the Bank is entitled to recover the amount of loan i.e. 40,000 only. Examining the provisions of the Indian Contract Act, 1872, decide whether the contention of the railway is valid.

[PEQ-NOV.10]

OR

X sent a consignment of goods worth Rs. 2,90,000 by railway and got railway receipt for the same. He obtained an advance of Rs. 2,60,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security for the advance. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for Rs. 2,90,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

[Nov 2014, 5 MARKS]

ANS:

Rights of Bailee: As per Sections 180 and 181 of the Indian Contract Act, 1872 the deposit of railway receipts with the bank as security against an advance constitutes a pledge. As a pledge, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In *Moorvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment.

However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of Rs.60,000 against Railway.

FINDER OF LOST GOODS

QUS.8.8.1

[SM]

What are the rights available to the finder of lost goods under Section 168 and Section 169 of the Indian Contract Act, 1872.

ANS.

As per the provisions of section 168 and 169 of the Indian Contract Act, 1872,

- (i) The finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner. But 'finder of lost goods' can ask for reimbursement for expenditure incurred for preserving the goods and also for searching the true owner. If the real owner refuses to pay compensation, the 'finder'

cannot sue but retain the goods so found.

Further, where the real owner has announced any reward, the finder is entitled to receive the reward. The right to collect the reward is a primary and a superior right even more than the right to seek reimbursement of expenditure.

- (ii) The finder though has no right to sell the goods found in the normal course; he may sell the goods if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:
 - (a) when the article is in danger of perishing and losing the greater part of the value or
 - (b) when the lawful charges of the finder amounts to two-third or more of the value of the article found.

PLEDGE BY NON-OWNERS

QUS.8.11.1

[SM]

Srushti acquired valuable diamond at a very low price by a voidable contract under the provisions of the Indian Contract Act, 1872. The voidable contract was not rescinded. Srushti pledged the diamond with Mr. VK. Is this a valid pledge under the Indian Contract Act, 1872?

ANS.

Pledge by person in possession under voidable contract (Section 178A of the Indian Contract Act, 1872): When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, 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.

Therefore, the pledge of diamond by Srushti with Mr. VK is valid.

DISTINCTION BETWEEN BAILMENT AND PLEDGE

QUS.8.12.1

[SM]

Give differences between Bailment and Pledge.

QUS.8.12.2

[PEQ-MAY 2013-8 MARKS]

State the essential elements of a contract of Bailment. Distinguish between the "Contract of Bailment" and "Contract of Pledge"

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Bailment means _____
 (a) temporary delivery of goods. (b) permanent delivery of goods.
 (c) partly delivery of goods. (d) None
2. Which is not essential element of contract of bailment _____
 (a) doing contract. (b) Purchase of goods.
 (c) delivery of goods. (d) return of goods in specific time.
3. In the contract of bailment the person to whom goods is delivered, called _____
 (a) seller (b) bailee (c) bailor (d) agent
4. Bailee should care the goods as per _____
 (a) as a man of ordinary prudence (b) as owner
 (c) as principal (d) as a servant
5. Lien means _____
 (a) to retain goods in his possession (b) rights to sell the goods.
 (c) right to purchase the goods. (d) right to destroy the goods.
6. In case there are two or more joint owners of the goods, the Bailee has to deliver them back to _____, in the absence of any agreement to the contrary :
 (a) Any of the Joint owners.
 (b) Such joint owner for which all the joint owners have consented.
 (c) All the Joint owners collectively.
 (d) None of these.
7. A finder of goods is subject to the same responsibility as that of a _____
 (a) bailee (b) bailor (c) surety (d) purchaser
8. The bailment of goods as security for payment of a debt is called _____
 (a) pledge (b) bailment (c) mortgage (d) none of these
9. What is an essential element of a valid pledge?
 (a) Delivery of goods (b) Delivery of bills
 (c) Price (d) None of these
10. The pledge is a contract of _____
 (a) bailment (b) agency (c) guarantee (d) mortgage

Answers to MCQs

1.	(a)	2.	(b)	3.	(b)	4.	(a)	5.	(a)
6.	(a)	7.	(a)	8.	(a)	9.	(a)	10.	(a)

General Questions

- Q.1 Placing of ornaments in a bank locker is a contract of bailment. (2 marks)**
Ans. Incorrect: Placing of ornament in a bank locker is not a contract of bailment. It is simply a contract of hiring in which the bank locker is hired. The ornaments are never delivered to the bank. The lockers key's are always with the hirer in bailment under section 148 only the possession of goods are changed. The ownership of the ornament remain with the owner not with the bank is which it is kept.
- Q.2 In a bailment there is a transfer of possessory right for ever. (2 marks)**
Ans. Incorrect: According to section 148 of the Indian Contract Act, 1872, there is no transfer of possessory right forever. The delivery is intended for a temporary purpose. There will be no contract of bailment if the whole property is transferred and things delivered are not specifically returned or accounted for.
- Q.3 A bailment is the delivery of goods by one person to another for some purpose. (2 marks)**
Ans. Correct : The first important feature of bailment is that the goods must be given to the bailee for whatever is the purpose of bailment. Once this done, bailment take, place irrespective of the way in which it happens. The second important feature of the bailment is that the good must be returned in reference with the direction of persons delivering them.
- Q.4 Bailee can retain the goods bailed until he has been paidlawful charges. (2 marks)**
Ans. Correct : According to Section 170, of Indian Contract Act, 1872, if bailee has used labour or skill in respect of goods bailed he becomes liable to receive remuneration in the absence of a contract to the contrary. If the bailor is unwilling to pay for the services, the bailee possess the right to retain the goods bailed until he receives his remuneration. This is called particular lien of the bailee.
- Q.5 A bailee need not return accretion to the goods to the bailor on the completion of the Contract of Bailment. (2 marks)**
Ans. Incorrect : It is the responsibility of the bailee to deliver to the bailor any accretion or profit accruing from the goods bailed.
- Q.6 A contract of bailment becomes void, if the bailee does any act with regard to the goods bailed, which is inconsistent with the conditions of bailment. (2 marks)**
Ans. Incorrect : If the bailee does any act with regard to the goods bailed, inconsistent with the condition of bailment the contract of bailment becomes voidable at the consent of the bailor (Section 153 of the Indian Contract Act) Thus, when an option is given to the bailor, the contract of bailment is not said to be void. It becomes voidable.
- Q.7 Deposit of money in a Bank Amounts to Bailment.**
Ans. No. Money does not covered in the definition of goods under sales of Goods Act, 1930.
- Q.8 A pledge of documents of title to goods by a mercantile agent is a valid pledge. (1 mark)**
Ans. True : As per sec 148 of the Indian contract Act, 1872, a pledge by mercantile agent will be valid if the agent is in possession of goods or documents of title to the goods and if such possession is with the opinion of the owner.

Q.9 If the pawnor makes a default in the payment of debts, or performance of duty, as agreed, the pawnee has a right to sell the thing pledged for which no reasonable notice of sale is required.

Ans. Incorrect : As per section 176 of the Indian Contract Act, 1872 as contained in section 176, if the pawnor makes any default in payment of the debt or performance of duty as agreed, the pawnee has a right to sell the thing pledged on giving the pawnor reasonable notice of the sale. A sale made by the pawnee without giving a reasonable notice is void.

Q.10 Bailee has no right to mix the goods bailed with his own goods without the consent of the bailor.

Ans. Correct.

Q.11 Depositing of ornaments in a bank locker is a bailment.

Ans. Incorrect : 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. So the ornaments are still in possession of the owner though kept in a locker at the bank.

CHAPTER-2: INDIAN CONTRACT ACT, 1872 [SPECIAL CONTRACT]**UNIT-9: AGENCY****APPOINTMENT AND AUTHORITY OF AGENTS****QUS.9.2.1**

Every person has a right to employ an agent lawfully.

[2 marks]

ANS.

Incorrect : A person who has contracting power can lawfully employ an agent. Section 183 states that the person who is major and is of a sound mind can employ an agent.

QUS.9.2.2

[SM]

A appoints M, a minor, as his agent to sell his watch for cash at a price not less than Rs.700. M sells it to D for Rs. 350. Is the sale valid? Explain the legal position of M and D, referring to the provisions of the Indian Contract Act, 1872.

ANS.

According to the provisions of Section 184 of the Indian Contract Act, 1872, as between the principal and a third person, any person, even a minor may become an agent. But no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal. Thus, if a person who is not competent to contract is appointed as an agent, the principal is liable to the third party for the acts of the agent. Thus, in the given case, D gets a good title to the watch. M is not liable to A for his negligence in the performance of his duties.

QUS.9.2.3

No consideration is necessary to create an agency.

ANS.

Correct : No consideration is necessary to create an agency. Unlike other regular contract, a contract of agency does not need consideration. As per section 185 of the Indian contract Act, 1872, the relationship between principal and agent need not be supported by consideration.

CREATION OF AGENCY**QUS.9.3.1**

[SM]

State with reason whether the following statement is correct or incorrect:

Ratification of agency is valid even if knowledge of the principal is materially defective.

ANS.

Incorrect: Section 198 of the Indian Contract Act, 1872 provides that for a valid ratification, the person who ratifies the already performed act must be without defect and have clear knowledge of the facts of the case. If the principal's knowledge is materially defective, the ratification is not valid and hence no agency.

QUS.9.3.2

[SM]

R is the wife of P. She purchased sarees on credit from Nalli. Nalli demanded the amount from P. P refused. Nalli filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Nalli would succeed.

ANS.

The position of husband and wife is special and significant case of implied authority. According to the Indian Contract Act 1872, where the husband and wife are living together in a domestic establishment of their own, the wife shall have an implied authority to pledge the credit of her husband for necessaries. However, the implied authority can be challenged by the husband only in the following circumstances.

- (1) The husband has expressly forbidden the wife from borrowing money or buying goods on credit.
- (2) The articles purchased did not constitute necessities.
- (3) Husband had given sufficient funds to the wife for purchasing the articles she needed to the knowledge of the seller.
- (4) The creditor had been expressly told not to give credit to the wife.

Further, where the wife lives apart from husband without any of her fault, she shall have an implied authority to bind the husband for necessaries, if he does not provide for her maintenance.

Since, none of the above criteria is being fulfilled; Nalli would be successful in recovering its money.

EXTENT OF AGENT'S AUTHORITY**QUS.9.4.1****[SM]**

Rahul, a transporter was entrusted with the duty of transporting tomatoes from a rural farm to a city by Aswin. Due to heavy rains, Rahul was stranded for more than two days. Rahul sold the tomatoes below the market rate in the nearby market where he was stranded fearing that the tomatoes may perish. Can Aswin recover the loss from Rahul on the ground that Rahul had acted beyond his authority?

ANS.

Agent's authority in an emergency (Section 189 of the Indian Contract Act, 1872): 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.

In the instant case, Rahul, the agent, was handling perishable goods like 'tomatoes' and can decide the time, date and place of sale, not necessarily as per instructions of the Aswin, the principal, with the intention of protecting Aswin from losses.

Here, Rahul acts in an emergency as a man of ordinary prudence, so Aswin will not succeed against him for recovering the loss.

SUB-AGENTS**QUS.9.5.1****[SM]**

Comment on the statement 'Principal is not always bound by the acts of a sub-agent'.

ANS.

The statement is correct. Normally, a sub-agent is not appointed, since it is a delegation of power by an agent given to him by his principal. The governing principle is, a delegate cannot delegate'. (Latin version of this principle is, "**delegates non potest delegare**"). However, there are certain circumstances where an agent can appoint sub-agent.

In case of proper appointment of a sub-agent, by virtue of Section 192 of the Indian Contract Act, 1872 the principal is bound by and is held responsible for the acts of the sub-agent. Their relationship is treated to be as if the sub-agent is appointed by the principal himself.

However, if a sub-agent is not properly appointed, the principal shall not be bound by the acts of the sub-agent. Under the circumstances the agent appointing the sub-agent shall be bound by these acts and he (the agent) shall be bound to the principal for the acts of the sub-agent.

SUBSTITUTED AGENT

QUS. 9.6.1

Azar consigned electronic goods for sale to Aziz. Aziz employed Rahim a reputed auctioneer to sell the goods consigned to him through auction. Aziz authorized Rahim to receive the proceeds and transfer those proceeds once in 45 days. Rahim sold goods on auction for Rs.2,00,000 but before transferring the proceeds of the auction, became insolvent. Assess the liability of Aziz according to the provisions of the Indian Contract Act, 1872.

ANS.

According to section 195 of the Contract Act, 1872, in selecting an agent (substituted) 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.

Thus, while selecting a "substituted agent" the agent is bound to exercise same amount of diligence as a man of ordinary prudence and if he does so he will not be responsible for acts or negligence of the substituted agent.

Hence, if Aziz has exercised same amount of diligence as a man of ordinary prudence would, he shall not be responsible to Azar for the proceeds of the auction.

DUTIES AND OBLIGATIONS OF AN AGENT

QUS.9.8.1

[SM]

ABC Ltd. sells its products through some agents and it is not the custom in their business to sell the products on credit. Mr. Pintu, one of the agents sold goods of ABC Ltd. to M/s. Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. ABC Ltd. sued Mr. Pintu for compensation towards the loss caused due to sale of products to M/s. Parul Pvt. Ltd. Will ABC Ltd. succeed in its claim?

Ans.

To conduct the business of agency according to the principal's directions (Section 211 of the Indian Contract Act, 1872): 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 custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

In the present case, Mr. Pintu, one of the agents, sold goods of ABC Ltd. to M/s Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. Also, it is not the custom in ABC Ltd. to sell the products on credit.

Hence, Mr. Pintu must make good the loss to ABC Ltd.

QUS.9.8.2

[PEQ-NOV-05] [SM]

Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for Rs. 20 lakhs in the name of a nominee and then purchased it himself for Rs. 24 lakhs. He then sold the same house to Mr. Ahuja for Rs. 26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh. Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain.

ANS.

The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read with Section 216. The two sections provide that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

- (1) repudiate the transaction, if the case shows, either that the agent has dishonestly concealed any material fact from him, or that the dealings of the agent have been disadvantageous to him.
- (2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. Ahuja is entitled to recover Rs. 6 lakhs from Mr. Singh being the amount of profit earned by Mr. Singh out of the transaction.

QUS.9.8.3

[PEQ-MAY-08]

P appoints A as his agent to sell his estate. A, on looking over the estate before selling it, finds the existence of a good quality Granite-Mine on the estate, which is unknown to P. A buys the estate himself after informing P that he (A) wishes to buy the estate for himself but conceals the existence of Granite-Mine. P allows A to buy the estate, in ignorance of the existence of Mine. State giving reasons in brief the rights of P, the principal, against A, the agent. What would be your answer if A had informed P about the existence of Mine before he purchased the estate, but after two months, he sold the estate at a profit of Rs.1 lac?

ANS.

Agent's duty to disclose all material circumstances & his duty not to deal on his own account without principal's consent. (Sections 215 and 216 of the Indian Contract Act, 1872) : The problem is based on Sections 215 & 216 of the Indian Contract Act, 1872. According to Section 215, if an agent deals on his own account in the business of the agency, without obtaining the consent of his principal and without acquainting him with all material circumstances, then the principal may repudiate the transaction. On the other hand, Section 216 provides that: if an agent, without the knowledge of his principal, acts on his own account in the business of the agency, then the principal may claim any benefit which may have accrued to the agent from such a transaction.

Hence in the first instance, though P had given his consent to A permitting the latter to act on his own account in the business of agency, P may still repudiate the sale as the existence of the mine, a material circumstance, had not been disclosed to him.

In the second instance, P had knowledge that A was acting on his own account and also that the mine was in existence; hence P cannot repudiate the transaction under Section 215. Also, under Section 216, he cannot claim any benefit from A as he had knowledge that A was acting on his own account in the business of the agency.

QUS.9.8.4

[PEQ- MAY 2016]

Mr. A Alwar engaged Mr. S as his agent to buy a house. Mr. S bought a house for Rs.40 lakhs in the name of a nominee and then purchased it himself for Rs.44 lakhs. He then sold the same house to Mr. A for Rs. 46 lakhs. Mr. A later comes to know about the mischief of Mr. S and tries to recover the excess amount paid to Mr. S. Is he entitled to recover any amount form Mr. S? If so, how much? Explain.

ANS.

Provision : The relationship of a Principal and his agent is of mutual trust and confidence. As per Sec.215 of the Indian Contract Act, 1872, the agent must not deal on his own account.

Where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

1. Repudiate the transaction, if the case shows, either that the agent has dishonestly any material fact from his, or that the dealings of the agent have been disadvantages to him.
2. Claim from the agent any benefit, which may have resulted to him from the transaction.

Present Case:

Mr. S, an agent of Mr. Alwar was appointed to buy a house for Mr. Alwar. However, the bought a house for Rs.40 lakhs in the name of a nominee and then purchased it himself for Rs.44 lakhs. He then sold the same house to Mr. Alwar for Rs.46 lakhs. Later Mr. Alwar came to know about the mischief of Mr. S. Hence, based on provision of Sec. 215 (read with Sec.216), Mr. Alwar is entitled to recover Rs.6 lakhs from Mr. S, being the amount of profit earned by Mr. S out of the said transaction.

REVOCAION OF AUTHORITY

QUS.9.12.1

[2 MARKS]

In a contract of agency the principal cannot revoke the authority given to the agent after the authority has been partly exercised by him, for obligations arising in the course of agency.

ANS.

Correct : Section 204 of the Indian Contract Act, 1872, states that the principal cannot revoke the authority given to the agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency.

QUS.9.12.2

[5M]

Bhupendra borrowed a sum of Rs. 3 lacs from Atul. Bhupendra appointed Atul as his agent to sell his land and authorized him to appropriate the amount of loan out of the sale proceeds. Afterward, Bhupendra revoked the agency.

Decide under the provisions of the Indian Contract Act, 1872 whether the revocation of the said agency by Bhupendra is lawful.

ANS.

According to Section 202 of the Indian Contract Act, 1872 an agency becomes irrevocable where the agent has himself an interest in the property which forms the subject-matter of the agency, and such an agency cannot, in the absence of an express provision in the contract, be terminated to the prejudice of such interest.

In the instant case, the rule of agency coupled with interest applies and does not come to an end even on death, insanity or the insolvency of the principal.

Thus, when Bhupendra appointed Atul as his agent to sell his land and authorized him to appropriate the amount of loan out of the sale proceeds, interest was created in favor of Atul and the said agency is not revocable. The revocation of agency by Bhupendra is not lawful.

QUS.9.12.3

[PEQ-MAY 2014-5 Marks]

Sunil borrowed a sum of Rs.3 lakh from Rajendra. Sunil appointed Rajendra as his agent to sell his land and authorized him to appropriate the amount of loan out of the sale proceeds. Afterwards, Sunil revoked the agency. Decide under the provisions of the Indian Contract Act, 1872 whether the revocation of the said agency by Sunil is lawful?

ANS.

The given problem is based on the provision relating to "Agency coupled with interest" According to section 202 of Indian Contract Act, 1872 an agency becomes irrevocable where the agent has himself an interest in the property which forms the subject matter of the agency and such agency cannot, in the absence of an express provision in the contract, be terminated to the prejudice of such interest.

In the instant case, the rule of agency coupled with interest applies and does not come to an end even on death, insanity or the insolvency of the principal.

Thus when Sunil appointed Rajendra as his agent to sell his land and authorized him to appropriate the amount of loan out of the sale proceeds, interest was created in favour of Rajendra and that said agency is not revocable. The revocation of agency by Sunil is not lawful.

QUS.9.12.4

[PEQ-NOV 22-4 MARKS]

Mr. X owes Mr. Y Rs. 50,000. He (Mr. X) afterwards appoints Mr. Y as his agent to sell his Flat at Bangalore and after paying himself (i.e., Mr. Y) what is due to him, hand over the balance to Mr. X. Examine, as per the provisions of the Indian Contract Act, 1872, can Mr. X revoke his authority delegated to Mr. Y?

ANS.

According to Section 202 of the Indian Contract Act, 1872 an agency becomes irrevocable where the agent has himself an interest in the property which forms the subject-matter of the agency, and such an agency cannot, in the absence of an express provision in the contract, be terminated to the prejudice of such interest.

In the given question, Mr. X owed to Mr. Y Rs. 50,000.

When Mr. X appointed Mr. Y as his agent to sell his Flat and authorized him to appropriate the amount due to Mr. X out of the sale proceeds, interest was created in favor of Mr. Y and the said agency is not revocable. Thus, Mr. X cannot revoke his authority delegated to Mr. Y.

Note: The answer to the above question can also be given as per Section 203, section 204 and section 206 as follows:

Revocation of authority under the Indian Contract Act, 1872: 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)

When the principal, having justification to do so, revokes the authority, he must give reasonable notice of such revocation to the agent, otherwise, he would be liable to pay compensation for any damage caused to the agent (Section 206).

Hence, Mr. X can revoke his authority delegated to Mr. Y if Mr. Y has not exercised any authority towards the act authorized by Mr. X and no obligation arises out of it.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. A person employed to do any act and represent is called _____
 (a) agent (b) principal (c) owner (d) servant
2. Who can become an agent?
 (a) Both Minor & Adult (b) Minor
 (c) Adult person (d) Dead person
3. To create an agency, which is not required?
 (a) Principal (b) consideration (c) agent (d) third party
4. _____ is a person employed by, and acting under the control of original agent in the business of agency
 (a) A substituted agent (b) A sub agent
 (c) A mercantile agent (d) An universal agent
5. A substituted agent acts on behalf of _____
 (a) Principal (b) Sub-agent (c) Agent (d) None of these
6. The power given to agent is _____
 (a) reasonable & unreasonable (b) expressed & implied
 (c) legal & illegal (d) all above
7. On whose insolvency the agency is terminated?
 (a) Sub agent (b) Agent (c) Principal (d) Del-credere
8. Under which circumstances agent become personally responsible?
 (a) beyond authority (b) fraudulent transactions
 (c) fraud (d) All of above
9. It is the duty of the agent to protect and preserve the interest on behalf of the principal's representative in case of _____
 (a) Death of the principal (b) Insolvency of the principal
 (c) Both (a) & (b) (d) None of these
10. Agent should not to deal on his own account without first obtaining the consent of the principal, otherwise the principal may—
 (a) repudiate the transaction,
 (b) claim from the agent any benefit which may have resulted to him from the transaction,
 (c) Either (a) or (b)
 (d) Both (a) & (b)

Answers to MCQs

1.	(a)	2.	(a)	3.	(b)	4.	(b)	5.	(a)
6.	(b)	7.	(c)	8.	(d)	9.	(c)	10.	(d)

General Questions

Q.1 In case an agent exceeds his authority and the acts done by him are subsequently ratified by the principal, the ratification relates back from the date when the agent had acted upon. (2 marks)

Ans. Correct

Q.2 An "Agency coupled with Interest" may be terminated, at the instance of principal, at any time.

Ans. Incorrect : Agency coupled with interest cannot be terminated except where there is an express provision to cause prejudice to the interest of the agent. Again, an agency coupled with interest does not come to an end on the death, insanity or the insolvency of the principal.

Q.3 Agency coupled with interest is irrevocable.

Ans. Correct : Agency coupled with interest cannot be terminated except where there is an express provision to cause prejudice to the interest of the agent. Again, an agency coupled with interest does not come to an end on the death, insanity or the insolvency of the principal.

Q.4 Ramesh instructed Suresh, a transporter, to send a consignment of apples to Mumbai. After covering half the distance, Suresh found that the apples will perish before reaching Mumbai. He sold the same at half the market price. Ramesh sued Suresh. Will he succeed?

Ans. An agent has the authority in an emergency to do all such acts as a man of ordinary prudence would do for protecting his principal from losses which the principal would have done under similar circumstances.

A typical case is where the 'agent' handling perishable goods like 'apples' can decide the time, date and place of sale, not necessarily as per instructions of the principal, with the intention of protecting the principal from losses. Here the agent acts in an emergency and acts as a man of ordinary prudence. In the given case Suresh had acted in an emergency situation and Ramesh will not succeed against him.

Q.5 R is the wife of P. She purchased some sarees on Credit from Q. Q demanded the amount from P. P refused. Q filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Q would succeed? PEQ-MAY 2008

OR

K is the wife of A. She purchased a sarees on credit from B. B demanded the amount from A. A refused to make payment. B filed a suit against A for the same amount. Decide in the light of provisions of the Indian contract Act, 1872 whether B would succeed.

PEQ-MAY.2013-4 MARKS

Ans. Problem on Agency : Problem as asked in the question is based on the provisions related with the modes of creation of agency relationship under the Indian Contract Act, 1872. Agency may be created by a legal presumption; in a case of cohabitation by a married woman (i.e. wife is considered as an implied agent, of her husband). If wife lives with her husband, there is a legal presumption that a wife has authority to pledge her husband's credit for necessities. But the legal presumption can be rebutted in the following cases:

- (i) Where the goods purchased on credit are not necessities.
- (ii) Where the wife is given sufficient money for purchasing necessities.
- (iii) Where the wife is forbidden from purchasing anything on credit or contracting debts.
- (iv) Where the trader has been expressly warned not to give credit to his wife.

If the wife lives apart for no fault on her part, wife has authority to pledge her husband's credit

for necessities. This legal presumption can be rebutted (not applicable) only in cases (iii) and (iv). Applying the above conditions in the given case 'Q' will succeed. He could recover the said amount from 'P' if sarees purchased by 'R' are necessities for her.

- Q.6** R of New Delhi sends his agent M to purchase certain goods from Global Enterprise, Mumbai on credit for him. Later, R pays the amount for the goods purchased. On another occasion, he again sends M to purchase goods, but this time pays sufficient cash to M for the purpose. M, however again purchases the goods from Global Enterprises but on credit and soon thereafter he dies. Global Enterprise files a suit against R for recovery of the said amount. Decide whether Global Enterprise would be given any relief by the Court under the provisions of the Indian Contract Act, 1872. PEQ-NOV.09

Ans.

R is liable to Global Enterprise for goods Purchased by M	<ul style="list-style-type: none"> - Since the principal is bound to third parties for all such acts of the agent as are within the scope of authority of the agent; - Since on a previous occasion, purchase of goods by M on behalf of R, and subsequent payment for such goods by R, established that it was within the scope of authority of M to purchase goods on credit on behalf of R.
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CHAPTER-7 :THE NEGOTIABLE INSTRUMENTS ACT, 1881**BILLS OF EXCHANGE****QUE.3.1****[PEQ-MAY-1996]**

Explain the characteristics of a Promissory Note, Mr. X promises by way of a Promissory note to pay Mr. Y his partner a sum of Rs. 10,000 in the event of the latter's retirement from the partnership firm. Decide giving reasons for your answer whether the Promissory note in the above case is a valid Promissory note.

ANS.

Characteristics of PN - Refer notes. (writing, signed, parties, unconditional, stamped, certain amount, certain parties)

In the given case promissory note is not valid, since it is conditional (dependent upon retirement of a partner)

QUE.3.2**[PEQ-NOV-1997]**

Mr. X executes a Promissory note in the following form: "I promise to pay a sum of Rs.10,000 after three months". Decide, with reasons whether the promissory note in the above case is a valid promissory note.

ANS.

Although the amount is certain but the name of payee is not certain, therefore It is a not a valid promissory note.

QUE.3.3**[PEQ-NOV-2000]**

Explain the essential elements of a Promissory note. State, giving reasons, whether the following instruments are valid Promissory notes:

- i) X promises to pay Y, by a Promissory note, a sum of Rs. 5,000, fifteen days after the death of B.
- ii) X promises to pay Y, by a Promissory note, Rs. 500 and all other sums, which shall be due.

ANS.

Essential Elements of a Promissory Note: - Refer notes.

In the case number 1, the payment to be made is fifteen days after the death of B. Though the date of death is uncertain, it is certain that B shall die. Therefore the instrument is valid.

In the second case- the sum payable is not certain within the meaning of Section 4 of the Negotiable Instruments Act, 1881- Hence the Promissory Note is not a valid one.

QUE.3.4**[PEQ-NOV 2002]**

Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following Promissory Notes:

- i) I owe you a sum of Rs. 1000 'A' tells 'B'.
- ii) 'X' promises to pay 'Y' a sum of Rs 10,000, six months after 'Y's marriage with 'Z'.

ANS.

Write definition of Promissory Note (Sec.4).

- (i) It is not a promissory note, because there is no promise to pay. It is just an acknowledgement of debt.

- (ii) It is also not a valid promissory note because it is based on uncertain event (marriage) i.e. conditional.

QUE.3.5

[PEQ-NOV-2007]

What are the essential elements of a "Promissory note" under the Negotiable Instruments Act, 1881 ? Whether the following notes may be considered as valid Promissory notes :

- (i) "I promise to pay Rs.5000 or Rs.7000 to Mr. Ram".
 (ii) I promise to pay to Mohan Rs.500, if he secures 60% marks in the examination.
 (iii) I promise to pay Rs.3000 to Ravi after 15 days of the death of A.

ANS.

PN - Essential Elements - Refer notes.

- i) It is not a valid promissory note
- Since the amount payable is not certain.
- ii) It is not a valid promissory note
- Since the promise is conditional (Since it is not certain that Mohan would secure 60% marks in examination).
- iii) It is valid promissory note
- Since the promise is not conditional (Since it is dependent upon death of A, which is certain to happen, although the time of its happening is not certain.)

QUE.3.6

[PEQ-NOV-20-3MARKS]

- (i) Are the following instruments signed by Mr. Honest is valid promissory Notes? Give the reasons.

- (a) I promise to pay D's son Rs. 10000 for value received (D has two sons)
 (b) I promise to pay Rs.5000/- on demand at my convenience

- (ii) Who is the competent authority to issue a promissory note 'payable to bearer'?

Your answers shall be in accordance with the provisions of the Negotiable Instruments Act, 1881.

ANS.

- (i) Promissory Note: Write definition sec. 4.
 (a) This is not a valid promissory note as D has two sons and it is not specified in the promissory note that which son of D is the payee.
 (b) This is not a valid promissory note as details of the payee are not mentioned in it and it is not an unconditional undertaking.
 (ii) A promissory note cannot be made payable to the bearer (Section 31 of Reserve Bank of India Act, 1934). Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.

QUE.3.7

Discuss with reasons, whether the following persons can be called as a 'Holder' under the Negotiable Instrument Act, 1881:

- (i) X who obtains a cheque drawn by Y by way of gift.
 (ii) A, the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.
 (iii) M, who finds a cheque payable to bearer, on the road and retains it.
 (iv) B, the agent of C, is entrusted (custody) with an Instrument without endorsement by C, who is the payee.
 (v) B, who steals a blank cheque of A and forges A's signature.

ANS.

Holder (S-8 of the Negotiable Instrument Act, 1881) : 'Holder' he must be entitled not only to the possession and to receive or recover the amount due thereon from the parties thereto.

- (i) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.
- (ii) No, he is not a 'holder' because to be called as a holder he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.
- (iii) No, M is not a holder of the instrument though he is in possession of the cheque, but he is not entitled to the possession of it in his own name.
- (iv) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.
- (v) No, B is not a holder because he is in wrongful possession of the instrument.

QUE.3.8

[MTP-NOV-21-4 MARKS]

Discuss with reasons, whether the following persons can be called as a 'holder' under the Negotiable Instruments Act, 1881:

- (1) Megha, who finds a cheque payable to bearer, on the road and retains it.
- (2) Bob, who steals a blank cheque of Alpa and forges Alpa's signature.

ANS.

Write Sec. 8 i.e. Holder.

On applying the above provision in the given cases-

- (1) No, Megha is not a holder of the Instrument though she is in possession of the cheque, so is not entitled to the possession of it in his own name.
- (2) No, Bob is not a holder because he is in wrongful possession of the instrument.

CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

QUE.5.1

[PEQ-NOV.20-4 MARKS]

State with reasons whether each of the following instruments is an Inland Instrument or a Foreign Instrument as per The Negotiable Instruments Act, 1881:

- (i) Ram draws a Bill of Exchange in Delhi upon Shyam a resident of Jaipur and accepted to be payable in Thailand after 90 days of acceptance.
- (ii) Ramesh draws a Bill of Exchange in Mumbai upon Suresh a resident of Australia and accepted to be payable in Chennai after 30 days of sight.
- (iii) Ajay draws a Bill of Exchange in California upon Vijay a resident of Jodhpur and accepted to be payable in Kanpur after 6 months of acceptance.
- (iv) Mukesh draws a Bill of Exchange in Lucknow upon Dinesh a resident of China and accepted to be payable in China after 45 days of acceptance.

ANS.

Write "Inland instrument" and "Foreign instrument" - Sections 11 & 12

Following are the answers as to the nature of the Instruments:

- (i) In first case, Bill is drawn in Delhi by Ram on a person (Shyam), a resident of Jaipur (though accepted to be payable in Thailand after 90 days) is an Inland instrument.
- (ii) In second case, Ramesh draws a bill in Mumbai on Suresh resident of Australia and accepted to be payable in Chennai after 30 days of sight, is an Inland instrument.

- (iii) In third case, Ajay draws a bill in California (which is situated outside India) and accepted to be payable in India (Kanpur), drawn upon Vijay, a person resident in India (Jodhpur), therefore the Instrument is a Foreign instrument.
- (iv) In fourth case, the said instrument is a Foreign instrument as the bill is drawn in India by Mukesh upon Dinesh, the person resident outside India (China) and also payable outside India (China) after 45 days of acceptance.

QUE.5.2.

Explain the provisions of the law relating to 'ambiguous' and 'inchoate' instruments under the negotiable instruments act, 1881.

'A' signs as maker, a blank stamped paper and gives it to 'B', and authorizes him to fill it as a note for Rs. 500, to secure an advance which 'C' is to make to B. B fraudulently fills it up as a note for Rs. 2000, payable to 'C', who has in good faith advanced Rs. 2000. Decide, with reasons, whether C is entitled to recover the amount, and if so, up to what extent? (8)

Answer :

Ambiguous Instrument :- Write S-17 completely.

Inchoate Instruments : Write Section 20 completely.

Problem: According to Section 20, when a person signs and delivers to another a paper stamped, in accordance with the law relating to the instrument then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby permits prima-facie authority to the holder to complete the instrument for any amount mentioned therein and not exceeding the amount covered by the stamps. The person who signed the instrument will be liable for it. A person other than holder in due course is not authorised to recover anything in excess of the amount intended by him to be paid.

In the given problem, C is entitled to recover Rs.2,000/- from 'A' because 'C' has obtained it as a holder in due course. A can not plead against C that B has fraudulently filled up excess amount. But the sum ought not to exceed the amount covered by the stamp

QUE.5.3.

A owes a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due payable by him. B fill up fraudulently the amount larger than the amount due, payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. Referring to the provisions of the Negotiable Instruments Act, 1881, discuss the rights of B and C.

ANS.

Write Inchoate instrument (S-20)

- i) B is entitled to recover only such amount as was intended to be paid by A.

Since a holder to whom an inchoate instrument is delivered is entitled to receive only such amount as was intended to be paid by the person delivering an inchoate instrument.

- ii) C is entitled to recover the whole amount of cheque

Since a holder in due course is entitled to receive whole of the amount of the negotiable instrument (upto the amount covered in stamp)

NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

QUE.6.1

[SM]

M drew a cheque amounting to Rs. 2 lakh payable to N and subsequently delivered to him. After receipt of cheque N indorsed the same to C but kept it in his safe locker. After sometime, N died, and P found the cheque in N's safe locker. Does this amount to Indorsement under the Negotiable Instruments Act, 1881?

ANS.

No, P does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. (Section 48, the Negotiable Instruments Act, 1881)

QUE.6.2.

[RTP-MAY-22]

'Anjum' drew a cheque for Rs. 20,000 payable to 'Babloo' and delivered it to him. 'Babloo' indorsed the cheque in favour of 'Rehansh' but kept it in his table drawer. Subsequently, 'Babloo' died, and cheque was found by 'Rehansh' in 'Babloo's table drawer. 'Rehansh' filed the suit for the recovery of cheque. Whether 'Rehansh' can recover cheque under the provisions of the Negotiable Instrument Act 1881?

ANS.

According to section 48 of the Negotiable Instrument Act 1881, a promissory note, bill of exchange or cheque payable to order, is negotiable by the holder by indorsement and delivery thereof.

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. [Sec. 57]. In the given case, cheque was indorsed properly but not delivered to indorsee i.e. 'Rehansh', Therefore, 'Rehansh' is not eligible to claim the payment of cheque.

QUE.6.3.

[SM]

M owes money to N. Therefore, he makes a promissory note for the amount in favor of N, for safety of transmission he cuts the note in half and posts one half to N. He then changes his mind and calls upon N to return the half of the note which he had sent. N requires M to send the other half of the promissory note. Decide how rights of the parties are to be adjusted.

ANS.

The question arising in this problem is whether the making of promissory note is complete when one half of the note was delivered to N. Under Section 46 of the N.I. Act, 1881, the making of a Promissory Note (P/N) is completed by delivery, actual or constructive. Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole. So, the claim of N to have the other half of the P/N sent to him is not maintainable.

M is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the P/N.

QUE.6.4.

[PEQ-NOV-22-3 MARKS]

Mr. A made endorsement of a bill of exchange amounting Rs.50,000 to Mr. B. But, before the same could be delivered to Mr. B, Mr. A passed away. Mr. S, son of Mr. A, who was the only legal representative of Mr. A approached Mr. B and informed him about his father's death. Now, Mr. S is willing to complete the instrument which was executed by his deceased father. Referring to the relevant provisions of the Negotiable Instruments Act, 1881, decide, whether Mr. S can complete the instrument in the above scenario?

ANS.

According to Section 57 of the Negotiable Instruments Act, 1881, the legal representative of a deceased person cannot negotiate by delivery only, a promissory note, bill of exchange or cheque payable to order and indorsed by the deceased but not delivered. An agent can complete the instrument if he is authorized by the principal to do so. But, a legal representative is not an agent of the deceased.

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.

Therefore, a legal representative cannot complete the instrument if the instrument was executed by the deceased but could not be delivered because of his death.

Hence, in the said case, Mr. S, son of Mr. A (the deceased) cannot complete the instrument which was executed by Mr. A but could not be delivered to Mr. B, because of his death.

DISHONOUR OF CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS [SECTION 138 TO 142]

QUE.7.1

[SM]

Bholenath drew a cheque in favour of Surendar. After having issued the cheque; Bholenath requested Surendar not to present the cheque for payment and gave a stop payment request to the bank in respect of the cheque issued to Surendar. Decide, under the provisions of the Negotiable Instruments Act, 1881 whether the said acts of Bholenath constitute an offence?

ANS.

As per the facts stated in the question, Bholenath (drawer) after having issued the cheque, informs Surendar (drawee) not to present the cheque for payment and as well gave a stop payment request to the bank in respect of the cheque issued to Surendar.

Section 138 of the Negotiable Instruments Act, 1881, is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person out of that account for the discharge in whole or in part of any debt or liability, is informed by the bank unpaid either because of insufficiency of funds to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

Once a cheque is issued by the drawer, a presumption under Section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under Section 138.

Also, Section 140 of the Negotiable Instruments Act, 1881, specifies absolute liability of the drawer of the cheque for commission of an offence under the section 138 of the Act. Section 140 states that it shall not be a defence in a prosecution for 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.

Accordingly, the act of Bholenath, i.e., his request of stop payment constitutes an offence under the provisions of the Negotiable Instruments Act, 1881.

QUE.7.2.

A finance company after having issued a cheque in favour of a depositor informs the depositor not to present the cheque as well as informs the bank to stop payment.

Examine with reference to the provisions of the Negotiable instruments Act whether it is an offence under the Act.

ANS.

This question is based on S-138 of Negotiable Instruments Act, 1881.

- Write S-138.
- In the case of Modi Cements Ltd. Vs. Kuchil Kumar Nandi, it was held that stop payment is equivalent to insufficiency of fund. The object of Section 138 to 142 of the Act is to promote the efficiency of the banking operations and to ensure credibility in transacting business through cheques.
- As per Section 138 if a person issues a cheque to discharge the liability and the same is dishonoured due to insufficient of fund then such a person shall be deemed to have committed an offence u/s 138.
- Therefore, Finance company shall be liable under section 138.

QUE.7.3

[PEQ-NOV 2006]

J, a shareholder of a Company purchased for his personal use certain goods from a mall (Departmental Store) on credit. He sent a cheque drawn on the Company's account to the mall (Departmental Store) towards the full payment of the bills. The cheque was dishonoured by the Company's Bank. J, the shareholder of the company was neither a director nor a person in-charge of the company. Examining the provisions of the Negotiable Instrument Act, 1881 state whether J has committed an offence under Sec. 138 of the Act and decide whether he (J) can be held liable for the payment, for the goods purchased from the Mall (Departmental Store).

ANS.

- According to Section 138 of the Negotiable Instruments Act, 1881 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 his account for discharging any debt or liability, and if it is dishonoured by banker on sufficient grounds, such person shall be deemed to have committed an offence and be punished with imprisonment for a term which may extend to two year or with fine which may extend to twice the amount of the cheque or with both.
- Further as per sec. 141, if the person committing an offence is a company or a person incharge of and responsible to the company for the conduct of the business of the company then he as well as the company shall be deemed guilty of offence and shall be liable to be proceeded against and punished accordingly.

- In the present case, J, a shareholder of company has drawn a cheque on the company's account towards full payment of goods purchased from a Mall (Departmental Store).
- Although cheque was drawn on company's account but company is not guilty of offence as cheque was issued by J who is neither director nor person in charge of company.
- Moreover, J is not the drawer of cheque, which was dishonoured and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, J could not be said to have committed an offence under section 138.
- But J is liable for the payment of goods purchased from the Mall.
- Conclusion : Neither company nor J shall be liable u/s 138.

QUE.7.4

PQR Limited received a cheque for Rs. 50,000 from its customer Mr. LML after a week company came to know that the proceeds were not credited to the account of PQR Limited due to some defects as informed by the Banker. What according to you are the possible effects?

ANS.

According to Sec. 138-142 of the Negotiable Instruments Act, Bouncing of Cheque is a Criminal Offence. In case of Bouncing of Cheque the drawer may be punished with an imprisonment upto 2 years or with a fine upto twice the amount of the cheque or with both.

The following conditions must be satisfied for aforesaid punishments:-

1. The cheque should have been dishonoured, due to insufficiency of funds.
2. The cheque was issued to discharge a liability.
3. The cheque should have been presented within its validity period i.e. 3 months.
4. The holder in due course of the cheque should have been given notice demanding payment within 30 days.
5. The drawer is liable only if he fails to make the payment within 15 days of such notice period.
6. The payee or holder in due course of the cheque dishonoured, should have made a complaint within one month of cause of action arising out of Sec. 138.

Therefore, if PQR Ltd. follow above steps then it may sue u/s 138 on Mr. LML.

QUE.7.5.

V makes a gift of Rs.10000 to W through a cheque issued in favour of W. Later he (V) informs W not to present the cheque for payment and informs the bank also to stop payment. Examining the provisions of the Negotiable Instruments Act, 1881, decide whether V's above acts constitute an offence.

ANS.

Same as qu. 7.4

Since in the present case, the cheque has been issued by V as a gift to W, and not for discharge a legal liability, therefore, Drawer is not liable.

QUE.7.6

A promoter who has borrowed a loan on behalf of company, who is neither a director nor a person-in-charge, sent a cheque from the companies account to discharge its legal liability. Subsequently the cheque was dishonoured and the complaint was lodged against him. Does he is liable for an offence under section 138?

ANS.

- According to Section 138 of the Negotiable Instruments Act, 1881 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 his account for discharging any debt or liability, and if it is dishonoured by banker on sufficient grounds, such person shall be deemed to have committed an offence and be punished with imprisonment for a term which may extend to two year or with fine which may extend to twice the amount of the cheque or with both.
- Further as per sec. 141, if the person committing an offence is a company or a person incharge of and responsible to the company for the conduct of the business of the company then he as well as the company shall be deemed guilty of offence and shall be liable to be proceeded against and punished accordingly.
- However, in this case, the promoter is neither a director nor a person-in-charge of the company and is not connected with the day-to-day affairs of the company and had neither opened nor is operating the bank account of the company.
- Moreover, the Promoter is not the drawer of cheque, which was dishonoured and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company.
- Therefore, the Promoter has not committed an offence under section 138.
- Conclusion : Neither company nor Promoter shall be liable u/s 138.

QUE.7.7

A cheque was dishonoured at the first instance and the payee did not initiate action. The cheque was presented for payment for the second time and again it was dishonoured. State in this connection whether the payee can subsequently initiate prosecution for dishonour of cheque.

ANS.

Write sec. 138 - 7 Points.

Supreme Court held that if cheque is dishonoured at the first instance but payee did not initiate action and cheque is presented for the second time and again dishonoured then the fresh right to file suit u/s 138 arises. Hence the payee can sue by complying the time limits of sec. 138.

QUE.7.8**[PEQ-JULY-21-3 MARKS]**

Mr. Harsha donated Rs.50,000 to an NGO by cheque for sponsoring the education of one child for one year. Later on he found that the NGO was a fraud and did not engage in philanthropic activities.

He gave a "stop payment" instruction to his bankers and the cheque was not honoured by the bank as per his instruction.

The NGO has sent a demand notice and threatened to file a case against Harsha. Advise Mr. Harsha about the course of action available under the Negotiable Instruments Act, 1881.

ANS.

In the given instance, Mr. Harsha donated Rs. 50,000 to NGO by cheque for sponsoring child education for 1 year. On founding that NGO was fraud, Mr. Harsha instructed bankers for stop payment. In lieu of that, NGO sent a demand notice and threatened to file a case against him.

Section 138 of the Negotiable Instruments Act, 1881 deals with dishonor of cheque which is issued for the discharge, in whole or in part, of any debt or other liability.

However, any cheque given as gift or donation, or as a security or in discharge of a mere moral obligation, would be considered outside the purview of section 138.

Here the cheque is given as a donation for the sponsoring child education for 1 year and is not legally enforceable debt or other liability on Mr. Harsha. Therefore, he is not liable for the donated amount which is not honoured by the bank to the NGO.

QUE.7.9**[PEQ-JUNE-2024-7 MARKS]**

Mr. Y issued a cheque for Rs. 10,000 to Mr. Z which was dishonoured by the bank because Y did not have enough funds in his account and has no authority to overdraw. Examine as per the provisions of the Negotiable Instruments Act, 1881 whether -

- (i) Mr. Y is liable for dishonour of cheque, if yes, what are the consequences for such an offence?
- (ii) What would be your answer if Y issued a cheque as a donation to Mr. Z?

PRESENTMENT OF INSTRUMENTS**QUE.8.1****[PEQ-JUNE-2024-7 MARKS]**

A promissory note, payable at a certain period after sight, must be presented to the maker thereof for payment. Under which scenarios presentment for payment is not necessary and the instrument is dishonoured at the due date for presentment according to the provisions of The Negotiable Instrument Act, 1881?

TEST YOUR KNOWLEDGE**Multiple Choice Questions**

1. A negotiable instrument is an instrument which is freely transferable from one person to another by:

(a) Simple delivery	(b) Indorsement and delivery
(c) Indorsement	(d) Registered post
2. An instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note, is called as:

(a) bearer instrument	(b) Ambiguous instrument
(c) Order instrument	(d) Inland instrument
3. As per Negotiable Instruments Act, 1881, Negotiable Instruments means:

(a) Promissory Note	(b) Bills of Exchange
(c) Cheque	(d) All the above
4. How many parties in Bills of exchange:

(a) 2	(b) 3	(c) 4	(d) 5
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5. On which of the followings, even not defined in Negotiable Instruments Act 1881, provisions of Act are applicable:

(a) Hundies	(b) Treasury Bills
(c) Bearer Debentures	(d) All of the above

6. Which is not the essential characteristic of Bill of exchange:
- Must be in writing
 - Must contain an express promise to pay
 - Instrument must be signed
 - Must be stamped
7. Which is not an Inland Instrument:
- P/N made in India + payable in India + drawn upon person resident in India
 - P/N made in India + payable in India + drawn upon person resident outside India
 - P/N made in India + payable outside India + drawn upon person resident in India
 - P/N made in India + payable outside India + drawn upon person resident outside India
8. Negotiable Instrument which can be treated either P/N or BOE, is known as:
- Inland Instrument
 - Inchoate Instrument
 - Ambiguous Instrument
 - Foreign Instrument
9. Order Instrument can be negotiated by:
- By delivery only
 - By endorsement only
 - By endorsement & delivery
 - None of above
10. Where any cheque drawn by a person is dishonoured due to insufficiency of funds, such person shall be punished with:
- imprisonment for a term which may extend to two years,
 - with fine which may extend to twice the amount of the cheque,
 - imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of the cheque, or with both,
 - No punishment

Answers to MCQs

1.	(b)	2.	(b)	3.	(d)	4.	(b)	5.	(d)
6.	(b)	7.	(d)	8.	(c)	9.	(c)	10.	(c)