



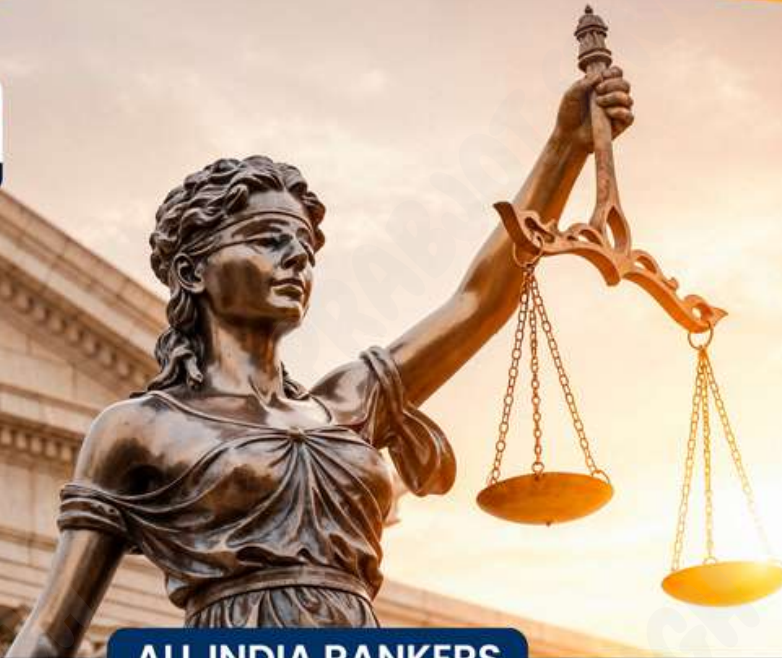
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# Chapter 1

## Indian Regulatory Framework

### WHAT IS LAW?

#### Definition

Law is defined as a set of obligations and duties imposed by the government for securing welfare and providing justice to society.

#### Purpose

A regulatory framework aims to provide uniform rules and regulations that govern the conduct of individuals in both personal and business relationships. Laws are essential to guide conduct, identify violations, and ensure punishment for them.

#### Indian Context

India's legal framework reflects the country's diverse social, political, economic, and cultural aspects.



#### Historical Roots

The "Code of Hammurabi" (1792 BC to 1758 BC) is recognised as the oldest known law in written form, carved on stone slabs in Babylon.

In 450 BC, Rome had the "Twelve Tables," engraved on 12 bronze tablets, considered the first detailed code of any civilization, aimed at protecting public rights and providing remedies for wrongs.

### SOURCES OF LAW IN INDIA

The main sources of law in India are:

#### The Constitution

It is the basis and source for all laws in India.

India is a parliamentary democracy where elected representatives make laws in Parliament or State Assemblies.

The Government of India Act, 1935, was a precursor to the Indian Constitution, defining the government's shift from "unitary" to "federal" and distributing powers between the Centre and States.

The Constitution of India, 1950, provides the framework for the democratic system, protects Fundamental Rights, outlines Fundamental Duties, and defines the powers and duties of both Central and State Governments.

Law-making power is divided between the Central Government and various State Governments, categorized into three lists: Central List, State List, and Joint List.

**Central List:** Matters where only the Central Government can pass laws (e.g., Income Tax).

**State List:** Matters where only State Governments can pass laws.

**Joint List:** Matters where both Central and State Governments can pass laws (e.g., Levy of stamp duty).

### Statutes or Laws

These are laws made by the Parliament and State Assemblies. Laws passed by Parliament can apply to all or part of India, while state legislature laws apply within their respective state borders.

### Precedents or Judicial Decisions

These are decisions of various Courts.

### Established Customs and Usages

In some cases, these also serve as sources of law.



## PROCESS OF MAKING A LAW

The process of making a law in India involves several stages:

### Introduction of a Bill

When a law is proposed in Parliament, it is called a Bill.

### Passage in Lok Sabha

After discussion and debate, the Bill is passed in the Lok Sabha.

### Passage in Rajya Sabha

Subsequently, it must be passed in the Rajya Sabha.

### Presidential Assent

The Bill then needs to obtain the assent of the President of India.

### Notification

Finally, the Government notifies the law in the Official Gazette of India.

### Effective Date

The law becomes applicable from the effective date mentioned in the notification.

### Act of Parliament

Once notified and effective, it is called an Act of Parliament.

## TYPES OF LAWS IN THE INDIAN LEGAL SYSTEM

Laws in the Indian legal system are broadly classified as follows:

### Criminal Law

Concerned with violations of the rule of law or public wrongs and their punishment.

Governed by:

*Indian Penal Code, 1860: Defines the crime, its nature, and punishments.*

*Code of Criminal Procedure, 1973 (CrPC): Defines the exhaustive procedure for executing punishments.*

#### Examples

Murder, rape, theft, fraud, cheating, and assault.

### Civil Law

Deals with disputes between individuals or organizations.

Primarily focuses on dispute resolution rather than punishment.

Civil courts enforce rights and obligations through civil suits.

Governed by: Code of Civil Procedure, 1908 (CPC).

Classifications: Can be further classified into Law of Contract, Family Law, Property Law, and Law of Tort.

#### Examples

Breach of contract, non-delivery of goods, non-payment of dues to a lender or seller, defamation, and disputes between landlord and tenant.

### Common Law

Also known as a judicial precedent or case law.

A judgment delivered by the Supreme Court is binding upon all courts within the territory of India under Article 141 of the Indian Constitution.

### Doctrine of Stare Decisis

This Latin phrase means "to stand by that which is decided" and is the principle supporting common law. It reinforces the obligation of courts to follow principles or judgments established by previous decisions when ruling on similar cases.

### Principles of Natural Justice

Often known as Jus Natural, these deal with certain fundamental principles of justice that go beyond written law.

#### Key Rules:

*Nemo judex in causa sua*: "No one should be made a judge in his own cause" (Rule against Prejudice)

*Audi alteram partem*: "Hear the other party" or "give the other party a fair hearing"

*Reasoned decision.*

A judgment can override or alter a common law but cannot override or change a statute.

## ENFORCING OF LAW

- After a law is passed, it is the job of the executive to enforce it.
- The Central or State Government acts as the enforcing authority, depending on whether it's a Central or State law.
- Government functions are distributed among various ministries, such as the Ministry of Finance, Ministry of Corporate Affairs, Ministry of Home Affairs, and Ministry of Law and Justice.
- These ministries are headed by a minister and managed by officers of various administrative services (civil servants).
- **Example:** the Income Tax Act is enforced by the Ministry of Finance through the Central Board for Direct Taxes, administered by officers of the Indian Revenue Service.

## MAJOR REGULATORY BODIES

India has several key regulatory bodies:

### The Ministry of Finance (Vitta Mantralaya)

The Ministry of Finance (Vitta Mantralaya) is the Government of India's key ministry managing the economy and serving as the Treasury, overseeing crucial areas like taxation, financial legislation, institutions, capital markets, and center-state finances.



Its functions, including the presentation of the eagerly awaited Union Budget—which outlines tax rates and allocations for the coming year—profoundly impact professionals like Chartered Accountants and the general public. This significance is underscored by its status as a preferred portfolio among ministers.

## Constitution of Ministry of Finance

### 1. Ministry Of Finance

1. Is the **apex controlling authority**
2. of four Central Civil Services, namely;
  - a. Indian Revenue Service
  - b. Indian Audit and Accounts Service
  - c. Indian Economic Serviced.
  - d. Indian Civil Accounts Service
3. Also the apex controlling authority of one of the central commerce services namely Indian Cost and Management Accounts Service.

## Departments of Ministry Of Finance

### Departments of Ministry Of Finance

Department of  
Economic  
Affairs

Department of  
Expenditure

Department of  
Revenue

Department of  
Financial  
Services

Department of  
Investment and  
Public Asset  
Management

Department of  
Public  
Enterprises

### (i) Ministry of Corporate Affairs (MCA)

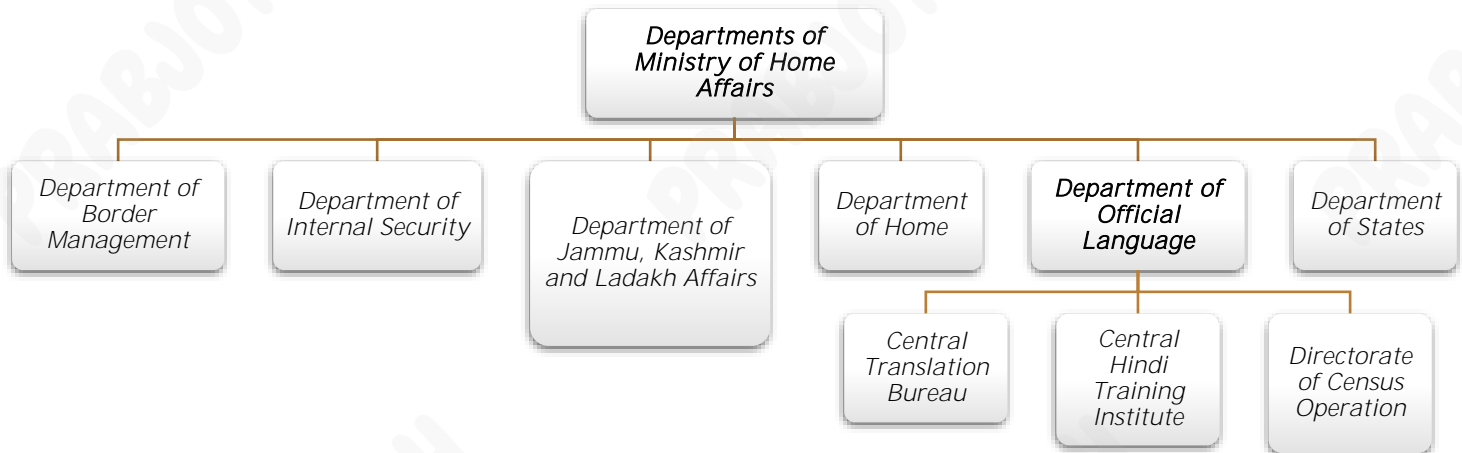
#### Ministry of Corporate Affairs

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

Ministry of Home Affairs (Grah Mantra Laya)

**Ministry of Home Affairs**

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



Ministry of Law and Justice

**Ministry of Law and Justice**

- 1. in the Government of India is a **Cabinet Ministry**
- 2. Deals with the-
  - a. Management of the legal affairs, through the Legislative Department.
  - b. legislative activities through the Department of Legal Affairs.
  - c. administration of justice in India through the Department of Justice.
- 3. The Department of Legal Affairs is concerned with advising the various Ministries of the Central Government while the Legislative Department is concerned with drafting of principal legislation for the Central Government.

**Departments of Ministry of Law and Justice**



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

**The Securities and Exchange Board of India**

- 1. is the regulatory body
- 2. for securities and commodity market in India
- 3. under the ownership of Ministry of Finance within the Government of India.
- 4. It was established on 12 April, 1988 as an executive body and was given statutory powers on 30 January, 1992 through the SEBI Act, 1992.

## (iii) Reserve Bank of India (RBI)

**Reserve Bank of India**

- 1. is India's Central Bank and regulatory body responsible for regulation of the Indian banking system.
- 2. It is under the ownership of Ministry of Finance, Government of India.
- 3. It is responsible for the control, issue and maintaining supply of the Indian rupee.
- 4. It also manages the country's main payment systems and works to promote its economic development.
- 5. Bhartiya Reserve Bank Note Mudran (BRBNM) is a specialised division of RBI through which it prints and mints Indian currency notes (INR) in two of its currency printing presses located in Nashik (Western India) and Dewas (Central India).
- 6. RBI established the National Payments Corporation of India as one of its specialised divisions to regulate the payment and settlement systems in India.
- 7. Deposit Insurance and Credit Guarantee Corporation was established by RBI as one of its specialised divisions for the purpose of providing insurance of deposits and guaranteeing of credit facilities to all Indian banks.

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

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

- 1. is the regulator for overseeing insolvency proceedings and entities like Insolvency Professional Agencies (IPA), Insolvency Professionals (IP) and Information Utilities (IU) in India.
- 2. It was established on 1 October 2016 and given statutory powers through the Insolvency and Bankruptcy Code, which was passed by Lok Sabha on 5th May 2016.
- 3. It covers Individuals, Companies, Limited Liability, Partnerships and Partnership firms. The new code will speed up the resolution process for stressed assets in the country.
- 4. It attempts to simplify the process of insolvency and bankruptcy proceedings.
- 5. It handles the cases using two tribunals like NCLT (National company law tribunal) and Debt recovery tribunal.

## STRUCTURE OF THE INDIAN JUDICIAL SYSTEM

When there is a dispute between citizens or between citizens and the Government, these disputes are resolved by the judiciary. The functions of judiciary system of India are:

1. Regulation of the interpretation of the Acts and Codes,



2. Dispute Resolution,



3. Promotion of fairness among the citizens of the land.

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

## Supreme Court

### Apex Body & Establishment

The apex body of the judiciary in India.

Established on January 26, 1950.

### Chief Justice

The Chief Justice of India is the highest authority, appointed under Article 126.



### Composition

The principal bench initially consisted of seven members, including the Chief Justice of India, and has increased to 34 due to workload.

### Binding Precedent

Its decisions are binding on all High Courts under Article 141 of the Indian Constitution and represent the final word on any matter.

### Relief

Individuals can seek relief by filing a writ petition under Article 32.

## High Court

### Highest State Court

The highest court of appeal in each state and union territory.

### Constitutional Provision

Article 214 of the Indian Constitution mandates a High Court in each state.



### Jurisdiction

Possesses appellate, original, and supervisory jurisdiction (though supervisory power is limited by Article 227).

### Number

There are **twenty-five High Courts in India**, with six states sharing a single High Court.

### Oldest High Court

The **Calcutta High Court**, established on July 2, 1862, is the oldest.

### Binding Nature

Decisions of a High Court are binding within its respective state but are only persuasive in other states.

### Relief

Individuals can seek remedies against fundamental rights violations by filing a writ under **Article 226**.

## District Court

### Hierarchy

Located below the High Courts.

### Civil Matters

The **Courts of District Judge** deal with Civil law matters, such as contractual disputes and claims for damages.

### Criminal Matters

The **Courts of Sessions** deal with Criminal matters.

### Pecuniary Jurisdiction

A civil judge can try suits valuing **not more than Rupees two crore**.

### Territorial Jurisdiction

Determined by the local limits where parties reside or the disputed property is situated.

## Metropolitan Courts

### Establishment

Established in metropolitan cities (**population of ten lakh or more**) in consultation with the High Court.

### Magistrate Powers

A Chief Metropolitan Magistrate has powers equivalent to a Chief Judicial Magistrate, and a Metropolitan Magistrate has powers similar to a Magistrate of the first class.



# Chapter 2

## Unit 1: Nature of Contracts

### WHAT IS A CONTRACT?

A contract is defined under Section 2(h) of the Indian Contract Act, 1872, as "an agreement enforceable by law". This definition highlights two key elements:

An Agreement

Its Enforceability by Law

#### Agreement? [Section 2(E)]

"Every promise and every set of promises, forming the consideration for each other".

#### Promise? [Section 2(B)]

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

An agreement is the result of a proposal (offer) made by one party, which the other party accepts for mutual consideration.

Agreement = Offer / Proposal + Acceptance + Consideration.



Motu (offers): "Fresh samosas! Two for 50 rupees!"

Patlu (accept): "Okay, but only if you throw in an extra green chili chutney!"



Motu said Done!!, Motu gets 50 rupees (consideration from Patlu), and Patlu gets his samosas with extra chutney.

#### Enforceability By Law

For an agreement to become a contract, it must give rise to a legal obligation. This means it must be something the law can enforce.

Contract = Agreement + Enforceability by law



Ramesh: "Hey Suresh, I'm a bit short on cash for my new stock. Could you lend me ₹50,000? I'll return it in two months, with a small interest."

Suresh: "No problem, Ramesh! You're a good friend. Here's the money. Just make sure to pay me back on time."



(Two months pass. Ramesh struggles to repay.)



**Suresh:** "Ramesh, it's been two months. Any updates on the money?"

**Ramesh:** "Oh, Suresh, business has been slow. I really can't pay you back right now. Maybe next month?"



**Suresh (frustrated):** "But you promised! I need that money back."

**Ramesh:** "Well, it was just a friendly gesture, wasn't it? We didn't sign anything."



**Legal outcome:** A friendly loan between Ramesh and Suresh, lacking formal documentation and the intention to create legal relations, would likely be unenforceable in court as a contract.

Some obligations, like maintaining a wife and children or a court order, are status obligations and outside the scope of the Contract Act.

An agreement without it being a contract (like the father-son pocket money example), but you can't have a contract without an agreement.

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

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

## DIFFERENCE BETWEEN AGREEMENT AND CONTRACT

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

## ESSENTIAL ELEMENTS OF A VALID CONTRACT

For an agreement to be a legally enforceable valid contract, it must possess certain essential elements. Some are explicitly mentioned in Section 10 of the Indian Contract Act, 1872, while others are also considered essential by legal interpretation.

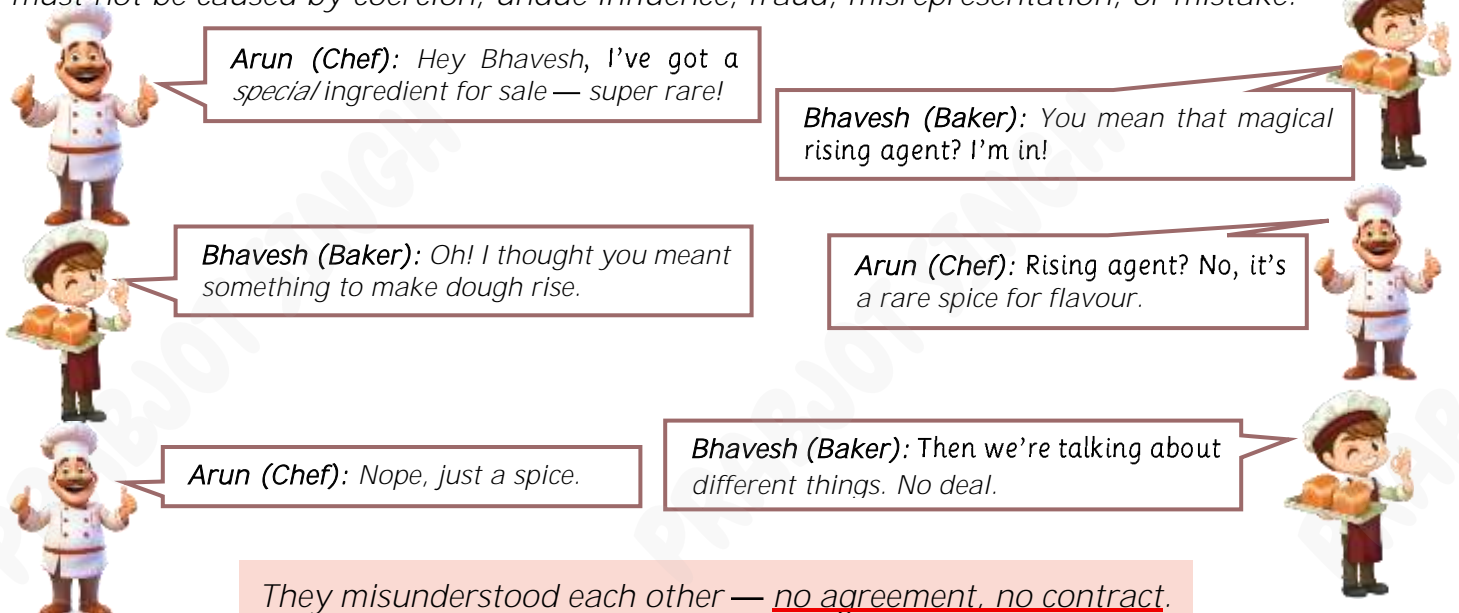
### Elements Given by Section 10:

#### Agreement

Which includes Offer and Acceptance.

#### Free Consent

Parties must agree upon the same thing in the same sense (*consensus ad idem*) and this consent must not be caused by coercion, undue influence, fraud, misrepresentation, or mistake.



**Arun (Chef):** Hey Bhavesh, I've got a *special* ingredient for sale — super rare!

**Bhavesh (Baker):** You mean that magical rising agent? I'm in!

**Bhavesh (Baker):** Oh! I thought you meant something to make dough rise.

**Arun (Chef):** Rising agent? No, it's a rare spice for flavour.

**Arun (Chef):** Nope, just a spice.

**Bhavesh (Baker):** Then we're talking about different things. No deal.

They misunderstood each other — no agreement, no contract.

#### Competency of the Parties

Parties must be legally capable of entering a contract.

➤ Section 11 states that a person is competent if they are:

Of the age of majority (18 years). Minors are incompetent to contract.

Of sound mind (understand the contract's implications). Lunatics, idiots, or intoxicated persons are generally not of sound mind.

Not disqualified from contracting by any law (e.g., alien enemies, foreign sovereigns, or convicts, unless formalities are met).

➤ **Consequence:** Contracts entered into by incompetent persons are not valid.

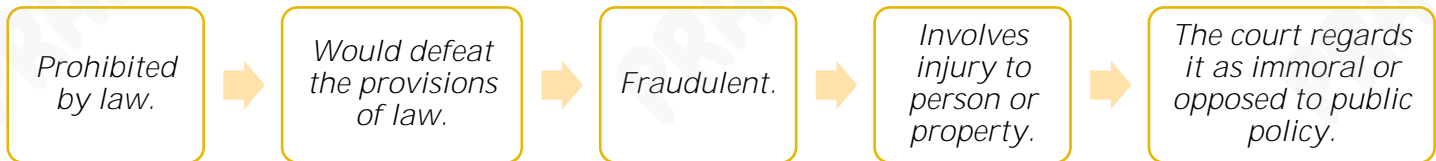
**Lawful Consideration**

Consideration is often referred to as **'quid pro quo'**, meaning **'something in return'**. It can be a right, interest, profit, or benefit for one party, or a forbearance, detriment, loss, or responsibility for the other.

**Lawful Object**

The purpose or object of the agreement must be lawful.

➤ Section 23 states an object is unlawful if it is:



**Example:** An agreement where 'A' promises to drop prosecution against 'B' for robbery in exchange for 'B' restoring stolen goods is void because its object is unlawful.

**Example:** A agrees to sell his house to B for 100 kgs of cocaine. This is an illegal agreement as the consideration (cocaine) is unlawful.

**Not Expressly Declared to be Void**

The agreement must not be one that the law specifically declares to be illegal or void.

**Illegal agreements**

- are those prohibited by law (e.g., threat to commit murder, agreements against public policy).

**Void agreements**

- are those without any legal effects (e.g., agreements in restraint of trade, marriage, legal proceedings).

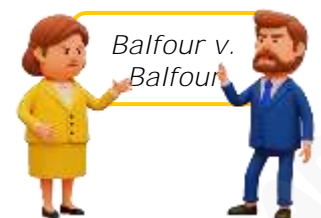
**Elements Not Given by Section 10 But Also Considered Essential:**

**Two Parties**

A contract requires at least two parties – an offeror and an offeree. One cannot contract with oneself.

**Intention to create legal relationship**

Parties must intend for their agreement to create legal consequences. Social or domestic agreements are generally not contracts.



**Example:** A husband agreed to pay to his wife certain amount as maintenance every month while he was abroad. Husband failed to pay the promised amount. Wife sued him for the recovery of the amount. Here, in this case, wife could not recover as it was a social agreement and the parties did not intend to create any legal relations. (*Balfour v. Balfour*)

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

**Pintu-** Hey Chintu, help me move my furniture this weekend? I'll get you pizza!

**Chintu-** Sure! I'm in — as long as there's pizza. (After helping)

**Pintu-** Oh... I kinda forgot. Maybe next time?

**Chintu-** Alright, where's my pizza?

**Pintu-** C'mon, it was just a friendly promise — not a contract.

**Chintu-** Seriously? I helped you move!

Social agreements = no legal obligation.

**Fulfilment of legal formalities**

Some contracts require specific formalities like being in writing or registration (e.g., contracts of insurance, transfer of immovable a property) to be valid and enforceable.

**Certainty of meaning**

The terms of the agreement must be clear, definite, and not vague or indefinite

**Possibility of performance**

The terms of the agreement must be capable of being performed. An agreement to do an impossible act cannot be enforced.

**Dev-** Pay me ₹ 1,000,000 and I'll teach my cat to speak fluent Shakespearean English in a week.

**Sid -** Deal! That would be amazing!

**Dev -** Great. Let the training begin! (A week later)

**Sid -** Well? Can your cat speak?



*Dev- Um... no.*

*Dev - You never paid — and even if you did, this was impossible to begin with.*

*Sid - Then I want my money back!*

*Sid - Right... guess I shouldn't have trusted a cat to speak English*



*Contracts to do the impossible aren't enforceable — even if agreed.*

## TYPES OF CONTRACTS

### On The Basis of Validity or Enforceability

#### Valid Contract

An agreement that is binding and enforceable by law, containing all the essential elements of a valid contract.

**Example:** A asks B if he wants to buy his bike for ₹ 50,000. B agrees to buy the bike. This agreement is enforceable by law. Hence, it is a valid contract.

#### Void Contract (Section 2(j)):

A contract that "ceases to be enforceable by law becomes void when it ceases to be enforceable". It cannot be enforced by a court of law.

- A valid contract can become void due to impossibility of performance or a change in law or circumstances.

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

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

#### Voidable Contract (Section 2(i)):

"An agreement which is enforceable by law at the option of one or more parties thereto, but not at the option of the other or others is a voidable contract".

- This means one party has the legal right to avoid performing their part of the agreement.
- Common situations leading to voidable contracts:

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

**Example:** X promises to sell his scooter to Y for ₹1 Lac, but Y procured X's consent at gunpoint. The contract is voidable at X's option, not Y's. If X accepts it, it becomes valid; if X rescinds, it becomes void.

When one person prevents another from performing their promise.

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

When a party fails to perform work within a specified time (time is of the essence).

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

## DIFFERENCE BETWEEN VOID CONTRACT AND VOIDABLE

Basis	Void Contract	Voidable Contract
Meaning	A Contract ceases to be enforceable by law becomes void when it ceases to be enforceable.	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.
Enforceability	A void contract cannot be enforced at all.	It is enforceable only at the option of aggrieved party and not at the option of other party.
Cause	A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties.	A contract becomes a voidable contract if the consent of a party was not free.
Performance of contract	A void contract cannot be performed.	If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming the performance of the contract.
Rights	A void contract does not grant any legal remedy to any party.	The party whose consent was not free has the right to rescind the contract within a reasonable time. If so rescinded, it becomes a void contract. If it is not rescinded it becomes a valid contract.

### Illegal Agreement

A contract that the law forbids to be made.

Courts will not enforce such contracts, nor any connected (collateral) contracts.

All illegal agreements are void, but not all void agreements are necessarily illegal.

**Example:** R agrees with S to purchase brown sugar (an illegal substance). This is an **illegal agreement**.

## DIFFERENCE BETWEEN VOID AGREEMENT AND ILLEGAL AGREEMENT

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

### Unenforceable Contract

A contract that is good in substance but cannot be sued upon due to some technical defect (e.g., absence in writing, barred by limitation).

**Example:** Bought goods from B in 2018, but no payment was made till 2022. B cannot sue A for payment in 2022 as it is barred by the Limitation Act (after three years).

## On The Basis of the Formation of Contract

### Express Contracts

Terms are expressed by words or in writing.

➤ Section 9: If a proposal or acceptance is made in words, the promise is express.

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

### Implied Contracts

Come into existence by implication, often by action or conduct of parties or course of dealings.

➤ Section 9: Proposal or acceptance made otherwise than in words is implied.

**Example:** A coolie picks up A's luggage at a railway station without being asked, and A allows him. This is an implied contract, and A must pay.

## Implied Contracts

A type of implied contract where terms are *inferred through conduct without words*.

**Example:** Withdrawing cash from an ATM implies acceptance of the bank's terms.

## Quasi-Contract

Not an actual contract, but resembles one. It is created and enforced by law under certain circumstances to impose legal rights and obligations where no real contract exists. There's no intention by parties to make a contract.



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

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

## E-Contracts

Contracts entered into by two or more parties using electronic means like e-mails or electronic data interchange (EDI). Also known as Cyber contracts or mouse click contracts.

## On The Basis of the Performance of the Contract

### Executed Contract

When the act is done or executed, or forbearance is brought on record, meaning both parties have performed their obligations.

**Example:** A grocer sells sugar for cash payment. Both parties have done what they were supposed to do.

**Executory Contract:**

The consideration involves reciprocal promises or obligations that are to be performed in the future.

**Unilateral Contract:**

One-sided, where one party has performed their duty, and the other party's obligation is outstanding.

**Example:** M advertises a reward of ₹50,000 for finding his missing boy. As soon as B traces the boy, an **executed contract** comes into existence for B (who performed), and it remains for M to pay (outstanding obligation), making it a unilateral contract from M's perspective.

**Bilateral Contract**

Where the obligation or promise is outstanding on the part of both parties. Where the obligation or promise is outstanding on the part of both parties.

**Example:** A promises to sell his plot to B for ₹10 lacs, but B pays only ₹2.5 lacs as earnest money and promises the balance next Sunday. A gives possession but promises to execute the sale deed upon full payment. Both have obligations remaining, making it a bilateral contract.

## PROPOSAL / OFFER

A proposal (or offer) is defined in Section 2(a) of the Indian Contract Act, 1872, as: “when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal”.

### Essentials Of a Valid Proposal/Offer

**Willingness to do or not to do**

The offeror must express their readiness to perform (positive act) or refrain from performing (negative act/abstinence) something.

**Example (Positive):** A is willing to sell his goods at a certain price to B.

**Example (Negative/Abstinence):** A asks B not to go to court after their cars collide, promising to pay repair charges. This is an offer of abstinence.

**Intention to Obtain Assent**

The willingness must be expressed specifically to obtain the other party's acceptance or agreement.

**Capable of Creating Legal Relations**

The offer must be made with the intent that, if accepted, it will create legally binding consequences and not just social obligations.

### Certain, Definite, and Not Vague

The terms of the offer must be clear and unambiguous to avoid confusion. If they are vague, acceptance cannot create a contract.

### Communicated to the Offeree

An offer is only complete when it comes to the knowledge of the person to whom it is made. An acceptance made in ignorance of the offer is not valid.

### May be Conditional

An offer can include specific terms and conditions that the offeree must accept entirely.

### Cannot Imply Acceptance from Non-Compliance

An offer can't state that if the offeree doesn't respond by a certain time, the offer will be considered accepted. Silence generally doesn't constitute acceptance.

## CLASSIFICATION OF OFFER

### General offer (Section 8)

An offer made to public at large and hence anyone can accept and do the desired act. The offer can be accepted by anyone who fulfils the conditions, as it is a continuing offer that can be accepted at any time.

*Carlill Vs. Carbolic Smoke Ball Co. (1893)*



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

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

**"Free coffee for anyone who can recite a Shakespearean sonnet by heart!"**

**Customer-** Seriously? So, I just perform, and I get a free coffee?



**Barista-** "Free coffee if you recite a Shakespearean sonnet by heart!" Did you see that sign?

**Barista-** Yep, that's the offer. Recite it, get the coffee. Simple as that.

**Cross offer**

Occur when two parties exchange identical offers in ignorance, without a binding contract as one's offer cannot be considered acceptance of another's offer.



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

**Special/specific offer**

A specific offer is made to a specific or ascertained person and can only be accepted by that specific person.

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



**Counter offer**

A rejection of the original offer, where the offeree offers to qualified acceptance subject to modifications and variations in the original offer terms.



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

**Standing or continuing or open offer**

An open, continuous, or ongoing offer that remains open for acceptance over time, such as tenders for goods supply.

## OFFER VS. INVITATION TO OFFER

An offer is a final expression of willingness to be bound as soon as the other party accepts it. An invitation to offer (or invitation to treat) is merely a circulation of an offer or an attempt to induce offers. The person making the invitation does not intend to be bound immediately but rather invites others to make an offer, which they may then accept or reject. The key distinction lies in the intention to be bound.

### Invitation to Offer

**Example:** A Cloth store displays with price tags. This is an invitation to offer. When a customer picks up a Jeans and T-shirt and takes it to the cashier, the customer is making an offer to buy the Jeans and T-shirt at the displayed price. The cashier (representing the store) can then accept or reject this offer.

### Offer

**Example:** A person holds an "Imitation item sale" sign that says, "All items on this table \$5 each." When you pick up an item from that table, you've accepted their specific offer to sell at that price, and a contract is formed.

## DIFFERENCE BETWEEN OFFER AND INVITATION TO OFFER

Basis	Offer	Invitation to Offer
<b>Meaning</b>	Final expression of willingness by the offeror to be bound by the offer if the other party accepts.	A proposal of terms on which a party is willing to negotiate, inviting the other party to make an offer. It precedes a definite offer.
<b>Intention</b>	The person making the statement intends to be bound as soon as it is accepted.	The person making the statement intends to negotiate further or receive offers, rather than be bound immediately upon another's acceptance of their statement.
<b>Sequence</b>	An offer cannot be an act precedent to an invitation to offer.	An invitation to offer is always an act precedent to an offer.
<b>Result</b>	Acceptance of an offer directly results in a contract.	Acceptance of an invitation to offer does not result in a contract; instead, an offer emerges, which then needs to be accepted to form a contract.

## ACCEPTANCE (SECTION 2(B))

**Definition:** In terms of Section 2(b) of the Act, "When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted. The proposal, when accepted, becomes a promise".

This means the offeree expresses their consent to the proposal.

Accepted proposal becomes a promise.

## Relationship between Offer and Acceptance

Sir William Anson famously observed: "Acceptance is to offer what a lighted match is to a train of gun powder".

The offer (gunpowder) is inert on its own.

The acceptance (lighted match) triggers the contract.

Once accepted, the offer becomes a promise and cannot be withdrawn or revoked. There's a choice to remove the gunpowder (revoke the offer) before the match is applied (acceptance).

## Legal Rules regarding a Valid Acceptance

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

**Specific Offer:** Only the specified person can accept.

**CASE LAW:** *Boulton v. Jones (1857)*

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

**General Offer:** Any person with knowledge of the offer can accept by performing its conditions.

**CASE LAW:** *Carlill v. Carbolic Smoke Ball Co. (1893)*

2. Acceptance must be absolute and unqualified.

Section 7 requires acceptance to be absolute and in a usual/reasonable manner.

Any conditional acceptance or one with modifications is a counter-proposal, not an acceptance.

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

**CASE LAW:** *Neale v. Merret:*

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

CASE LAW: *Union of India v. Bahulal AIR 1968:*

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

### 3. The acceptance must be communicated

A contract is concluded only when acceptance is communicated in a perceptible form.

➤ Mere mental assent is not communication.

CASE LAW: *Brogden v. Metropolitan Railway Co. (1877):*

Facts: B a supplier, sent a draft agreement relating to the supply of coal to the manager of railway Co. viz, Metropolitan railway for his acceptance. The manager wrote the word “Approved” on the same and put the draft agreement in the drawer of the table intending to send it to the company’s solicitors for a formal contract to be drawn up. By an over sight the draft agreement remained in drawer. Held, that there was no contract as the manager had not communicated his acceptance to the supplier, B. Where an offer made by the intended offeree without the knowledge that an offer has been made to him cannot be deemed as an acceptance thereto.

CASE LAW: *(Bhagwandas v. Girdharilal)*

A mere variation in the language not involving any difference in substance would not make the acceptance ineffective.

CASE LAW: *[Heyworth vs. Knight [1864] 144 ER 120].*

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

### 4. Acceptance must be in the prescribed mode

If the offeror prescribes a mode, it must be followed. If not, and the offeror doesn’t object, it’s presumed accepted.

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

### 5. Time

Acceptance must be given within the specified time limit, or if none, within a reasonable time.

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

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

### 6. Mere silence is not acceptance

Acceptance cannot be implied from silence unless previous conduct indicates otherwise.

**CASE LAW:** *Felthouse v. Bindley (1862):*

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

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

### 7. Acceptance by conduct/Implied Acceptance

Section 8 states that performance of the conditions of a proposal or acceptance of consideration constitutes acceptance.

*Example:* A tradesman executes an order by sending goods; the customer's order is an offer accepted by the tradesman's conduct of sending goods.

## COMMUNICATION OF OFFER AND ACCEPTANCE

*When parties are face-to-face  
communication is instantaneous, and revocation issues are minimal.*

*When parties are at a distance  
timing of communication becomes very important.*

### Communication of Offer

Section 4: "The communication of offer is complete when it comes to the knowledge of the person to whom it is made".

**Example:** If A posts an offer letter on March 10, and B receives it on March 12 but reads it on March 15, the offer is communicated on March 15 (when B gains knowledge).

### Communication of Acceptance

Section 3 outlines two modes: by any act or by omission, intended to communicate.

- ➔ **By Act:** Words (written like letters, emails, faxes; or oral like telephone) or positive conduct/signs.
- ➔ **By Omission:** Forbearance or conduct. However, silence generally is not considered communication by omission.

### When is acceptance complete (Section 4)?

**As against the proposer:**

When it is put into a course of transmission to him so as to be out of the power of the acceptor to withdraw the same. (This usually means when the letter is posted correctly).

- The proposer becomes bound even if the letter is delayed or lost.

**As against the Acceptor:**

When it comes to the knowledge of the proposer. (This means when the letter actually reaches the proposer).

- The acceptor is bound only when the letter reaches the proposer.

**Alex (Proposer):** "Just sent you an email! Check your inbox when you get a chance. It's about that rare comic book we talked about."



**Bela (Offeree):** "Oh, cool! I'm just getting to my computer now. Let me open it up... [sound of typing/clicking] ...Aha! 'Offer to sell Rare Comic Book.' Got it! So, you're really letting go of it?"

## Acceptance over Telephone or Telex or Fax

- ➔ For instantaneous communication (telex, telephone, fax, email), the contract is complete when the acceptance is received by the offeror, and the contract is made at the place where acceptance is received.
- ➔ If a call drops or there are disturbances, there may not be a valid contract because acceptance wasn't clearly received.

CASE LAW: *Entores Ltd. v. Miles Far East Corporation*

## Communication of Special Conditions

Sometimes, contracts include special conditions that are conveyed implicitly or on documents like tickets or receipts. Acceptance of these conditions can be tacit, meaning implied by the customer's acceptance of the document or service. However, such terms must be reasonable and reasonable notice of them must be given.

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

When a passenger travels by air, the ticket often contains special conditions printed in fine print or displayed at the airline office. Even if the passenger does not read them, these conditions are considered to have been communicated and accepted.

This was upheld in *Mukul Datta vs. Indian Airlines (1962 AIR Cal 314)*. However, such terms and conditions must be reasonable.

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

CASE LAW: *Lilly White vs. Mannuswamy (1970)*

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

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

## Standard forms of contracts:

A standard form contract can bind a party even if they are unaware of its contents, provided reasonable notice of the terms was given. However, if the document does not clearly indicate special conditions, the acceptor is not bound.

**CASE LAW:** In *[Raipur Transport Co. vs. Ghanshyam (1956 A. Nag. 145)]*,

a carrier who issued limiting conditions after accepting goods was not protected, as the terms were not communicated before the contract.

## COMMUNICATION OF PERFORMANCE

Under Section 4 of the Act, communication of a proposal is complete when it reaches the offeree. Communication of acceptance is complete:

(i) For the proposer – when the acceptance is sent (beyond the acceptor's control).

(ii) For the acceptor – when the acceptance reaches the proposer.

If acceptance is by performing an act, the act must be communicated unless the offer specifies that performance alone constitutes acceptance.

In *Carlill vs. Carbolic Smoke Ball Co.*, the court held Mrs. Carlill entitled to the reward as:

1. The offer contained a definite promise to be bound on performance.
2. An offer can be made to an individual or the public at large.
3. When the offer is in return for an act, performing the act itself amounts to acceptance without separate communication.

## REVOCATION OF OFFER AND ACCEPTANCE

Section 4 defines when communication of revocation is complete:

As against the person who makes it

As against the person to whom it is made

When it is put into a course of transmission so as to be out of their power.

When it comes to their knowledge.

**Example (Revocation of Proposal):** If you revoke your offer by telegram, revocation is complete for you when you dispatch the telegram. For me, it's complete when I receive it.

**Example (Revocation of Acceptance):** If I revoke my acceptance by telegram, revocation is complete for me when I dispatch it. For you, it's complete when you receive it.

### When can a Proposal be Revoked?

An offeror can revoke their offer any time before its acceptance is complete as against the proposer.

**Example:** A proposes to sell his house to B by post. B accepts by post. A may revoke his proposal any time before or at the moment B posts his letter of acceptance, but not afterwards.

#### English Law vs. Indian Law (Contract through post):

- ✓ English Law: Acceptance is irrevocable once the letter is properly posted.
- ✓ Indian Law: Acceptor can revoke acceptance any time before the letter of acceptance reaches the offeror, if the revocation (e.g., by faster telegram) arrives before or at the same time as the letter of acceptance.

### When can an Acceptance be Revoked?

An acceptance can be revoked any time before the communication of acceptance is complete as against the acceptor.

## MODES OF REVOCATION OF OFFER

#### 1. By notice of revocation:

The offeror informs the offeree of withdrawal.

**Example:** A offers goods to B by post. Before B accepts, A gets a higher bid from C, so A revokes the offer to B via telephone and sells to C.

#### 2. By lapse of time:

If acceptance is not given within the specified time, or within a reasonable time if no time is specified.

**CASE LAW: Ramsgate Victoria Hotel Co. vs. Montefiore (1866)**

#### 3. By non-fulfillment of condition precedent:

If the acceptor fails to fulfil a condition required before acceptance.

**Example:** A proposes to sell his house to B for ₹5 lakhs, provided B leases his land to A. If B refuses to lease the land, A's offer is automatically revoked.

#### 4. By death or insanity:

If the fact of death or insanity of the proposer comes to the knowledge of the acceptor before acceptance.

#### 5. By counter offer:

As discussed, a counter-offer rejects the original offer.

#### 6. By the non-acceptance of the offer according to the prescribed or usual mode.

#### 7. By subsequent illegality:

If the object or consideration of the offer becomes illegal after the offer is made but before acceptance.

# Chapter 2

## Unit 2: Consideration

### INTRODUCTION

Consideration is a fundamental element for a valid contract, without which a promise generally cannot be enforced. It is often understood as "quid pro quo", meaning "something in return".

### WHAT IS CONSIDERATION?

Consideration is the PRICE agreed to be paid by the promisee for the obligation of the promisor. It has a "double aspect": CASE LAW: *Misa v. Currie*

Benefit to the promisor

Detriment to the promisee

#### Definition [Section 2(d)]

"When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or abstain from doing something, such an act or abstinence or promise is called consideration for the promise."

#### An Act (Doing Something)

This means performing an action.

**Example:**

**Chef Pankaj:** if I can peel this potato perfectly in 5 seconds, I get a free dessert, right?" Pankaj asked, potato and peeler in hand.



**Chef Sanjay:** Nodded. "That's right, Pankaj. Your speedy peeling is the consideration for that dessert. If you just stand there, no dessert!"

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

#### Abstinence (Abstaining from Doing Something)

This refers to refraining from an action.

**Example:**

**Badmash Babu:** "Hey, Sheela, I'll give you ₹100 if you don't tell the teacher I copied on the test."



**Sharmila Sheela:** "Done. My silence for your ₹100."

A Promise (to do or abstain from doing something)

This means making a commitment for future action or non-action.

**Example:** Lazy Lalit promised Mehnati Maya to paint her fence next week, in exchange for Maya's promise to bake him a cake this weekend. Their mutual promises are the consideration, even though nothing's been done yet.

Forms of Consideration: It can be a promise or performance exchanged between parties. It constitutes some benefit, right, or profit to one party, or some detriment, loss, or forbearance to the other.

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

## LEGAL RULES REGARDING VALID CONSIDERATION

### ◆ Consideration Must Move at the Desire of the Promisor

Consideration must be offered or performed at the request or desire of the promisor, not voluntarily or at the desire of a third party. The "return" element is crucial here.

**CASE LAW:** *Durga Prasad v. Baldeo*.

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

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

### ◆ Consideration May Move from Promisee or Any Other Person

Consideration does not necessarily have to come from the promisee; it can proceed from "any other person" who is not a direct party to the contract. This is explicitly stated in Section 2(d).

**CASE LAW:** *Chinnayya vs. Ramayya*

This implies there can be a "stranger to a consideration," but generally not a "stranger to a contract".

**Example:**

**Mr. Gupta:** Agrees to pay Siya's tuition directly to Elite Academy. What happens if he stops?



Elite Academy: Sue him. Even though the "consideration" – the school fees – is moving from Mr. Gupta, who isn't technically a direct party to the agreement between him and Siya, it's for Siya's benefit.

"Stranger to consideration" can still be part of a contract and enforce it under Indian law.

### Executed and Executory Consideration

#### Executed consideration

Occurs when the consideration is the performance of an act.

#### Executory consideration

occurs when the consideration is a promise to do something in the future.

**Example:** If you pay Pat Rs 500 now to sing "Happy Birthday" off-key immediately, that's an executed deal – payment's done, singing's done, ears ringing! But if you promise Rs 500 next week for Pat to promise to sing at your aunt's next month, both are just promises for future actions. No immediate ringing ears, just anticipated ones!

### Consideration May Be Past, Present, or Future

Consideration can relate to an act that has already been done (past), is being done currently (present), or will be done in the future (future).

→ **Past Consideration:** An act or forbearance that "has done or abstained from doing" before the promise is made. To support a promise, it must have been done at a previous request of the promisor. If services were rendered in the past at the promisor's request, a subsequent promise to compensate is valid.

#### Example:

**Mr. A:** So, I returned my neighbor's parrot "Squawk-zilla" last week, no strings attached.

**Mr. A:** Exactly! Can I actually hold them to that promise?

**Ms. B:** And now, a week later, they've promised you a lifetime supply of birdseed, right?

**Ms. B:** Absolutely! Even though you didn't ask for anything initially, your past act of returning Squawk-zilla is now acknowledged by their subsequent promise. You could sue for that birdseed!

→ **Present Consideration:** Occurs when the act and promise happen simultaneously. Example: A cash sale of goods.

→ **Future Consideration:** Occurs when the consideration is a promise to do or abstain from doing something in the future.

### Consideration Need Not Be Adequate

Consideration in a contract is not necessarily of specific value, but must be considered valuable by the law, and the return may not be equal to the given.

→ Explanation 2 to Section 25 clarifies that an agreement with freely given consent is not void merely due to inadequate consideration.

**Exception:** If the consideration is "shockingly less" and there are allegations of coercion, undue influence, or fraud, the inadequacy can be used as evidence to support such allegations.

**Example:**

**Mr. A:** So, I'm selling my rare "Smelly Socks" comics, worth ₹10,000, to my friend for just ₹10 because I'm moving. Is that even a valid contract?



**Mr. B:** Absolutely! The law generally doesn't care if it's a "bad" deal for you, as long as there's genuine agreement and no coercion. Unless your friend was, say, blackmailing you about your polka dot obsession!

### Consideration Must Be Real and Not Illusory

The consideration must be something that has value in the eyes of the law. It cannot be something that is legally or physically impossible or purely fictional.

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

A contract is "void" if based on an illusory promise or impossibility of performance. Like here promising a pot of gold at a rainbow's end is impossible, making the agreement legally unenforceable from the start.

### Performance of What One is Legally Bound to Perform is Not Consideration

If a person is already legally bound to perform an act, doing that act cannot be considered valid consideration for a new contract.

**Example:**

Raghav offered Udaipur's Inspector Sharma ₹5,000 to recover his stolen rubber chickens. Sharma explained the offer was void because catching criminals is his existing legal duty, making the payment redundant unless it involved an additional, non-obligatory act like juggling flaming swords.



### Consideration Must Not Be Unlawful, Immoral, or Opposed to Public Policy

Even if consideration exists, it must be lawful. Anything that is against the law, morally wrong, or harmful to public interest, cannot be valid consideration.

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

## VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION

The general rule is that an agreement made without consideration is void (Section 25).

"No Consideration, No Contract" – meaning an agreement without consideration is void. However, the Indian Contract Act, 1872, specifies certain circumstances where an agreement can be valid and enforceable even without consideration:

### ◆ Natural Love and Affection [Section 25(1)]

A written and registered agreement made out of natural love and affection between parties standing in a near relation to each other (e.g., husband and wife, father and daughter-in-law) is valid without consideration.

*Example:* Dev promises his wife, Meena, all his earnings via a registered agreement. This agreement is valid due to natural love and affection, even without Meena providing anything "in return." Should Devraj try to pay with something like Monopoly money, Meenakshi could legally demand his actual earnings.



### ◆ Compensation for Past Voluntary Services [Section 25(2)]

A promise to compensate someone, wholly or partly, for something they have voluntarily done for the promisor in the past is enforceable. The services must have been rendered voluntarily for the promisor, who must have been in existence at the time and intended to compensate the promisee.

(i) The services should have been rendered voluntarily.

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

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

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

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

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

### 🔑 Promise to Pay Time-Barred Debt [Section 25(3)]

Where a promise in writing signed by the person making it or by his authorised agent, is made to pay a debt barred by limitation it is valid without consideration.

**Example:** You owe "Forgetful Falguni" ₹50,000 from a loan taken ten years ago, now past the legal time limit to sue. Feeling guilty, you write and sign a promise to pay her ₹30,000 as a final settlement. Even without new consideration, this promise is enforceable. It's like admitting, "Okay, the statute of limitations saved me, but my conscience (and this signed paper) says I still owe you!"



### 🔑 Agency [Section 185]

No consideration is necessary to create an agency.

**Example:** You ask Anil to buy you a giant inflatable flamingo. You don't pay Anil for being your agent, but when Anil buys the flamingo, you're bound by the purchase. Anil's just your faithful flamingo-fetching agent; no "quid pro quo" needed for his role!



### 🔑 Completed Gift [Explanation 1 to Section 25]

The rule "no consideration, no contract" does not apply to gifts that have already been made. A gift, once given, is valid regardless of consideration.

### 🔑 Bailment [Section 148]

A contract of bailment, which involves the delivery of goods for a specific purpose with an agreement for their return or disposal after the purpose is accomplished, does not require consideration.

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

### 🔑 Charity

If a promisee undertakes a liability based on a person's promise to contribute to charity, the contract can be valid.

**CASE LAW:** *Kadarnath v. Gorie Mohammad*.

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

## DOCTRINE OF PRIVACY OF CONTRACT

The concept of stranger to consideration is valid and distinct from stranger to a contract, as only a party to the agreement can sue on it.

The aforesaid rule, that stranger to a contract cannot sue is known as a "doctrine of privity of contract", is however, subject to certain exceptions.

**Example:**

**Friend:** That's right! But if Sunny doesn't pay you, you can't actually sue Sunny directly, even though he made that promise.

**Lender:** Hey, so I heard Balu sold his vintage roller skates to Sunny, and Sunny promised Balu he'd pay off Balu's debt to me.

**Friend:** Because you're a "stranger to the contract" between Balu and Sunny. You weren't a part of their agreement. You'd have to sue Balu instead.

**Lender:** What? Why not? He clearly said he'd pay me!



## EXCEPTIONS TO THE DOCTRINE OF PRIVACY OF CONTRACT

### In the Case of Trust

A beneficiary can enforce their right under a trust, even if they were not a party to the contract between the settler and the trustee.

### In the Case of a Family Settlement

If the settlement terms are written down, family members who were not initially involved can enforce the agreement.

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

### In the Case of Certain Marriage Contracts/Arrangement

A person can file a lawsuit for the benefit of another person who is not a party to the agreement.

**Example:**

**Anil:** Raghav promised his father-in-law Sanjay, that he'd treat his wife, Meena, properly or pay her a monthly allowance. But I hear Raghav's back to his grumpy old self.

**Priya:** That's right. And the interesting thing is, Meena can actually sue Raghav, even though the original promise was made between Raghav and Sanjay. Her well-being was the entire basis of that agreement!



### ◆ In the Case of Assignment of a Contract

The assignee can enforce a contract when the benefit under the contract has been assigned, but this assignment should not involve any personal skill.

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

### ◆ Acknowledgement or Estoppel

If a promisor acknowledges themselves as an agent of a third party, it would result in a binding obligation towards the third party.

**Example:** Lakshmi gives Manoj ₹ 20,000 for Naveen. Manoj tells Naveen he has the money. If Manoj doesn't pay, Naveen can sue him due to Manoj's acknowledgment.

### ◆ In the Case of Covenant Running with the Land

If a purchaser of land is informed of certain land-related duties, the seller's successor can enforce these covenants.

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

### ◆ Contracts Entered Through an Agent

The principal can enforce contracts entered by their agent, provided they have acted within their authority and in the principal's name.

**Example:**

"Priya the Painter" asks "Anjali the Artist" to sell her painting. Anjali sells it to "Chirag the Collector."

**Priya:** "Actually, since Anjali was my agent, you owe me the payment directly!"

**Chirag:** "I made the deal with Anjali, so I'll pay her."



# Chapter 2

## Unit 3: Other Essential Elements of a contract

### CAPACITY TO CONTRACT

**Meaning-** Capacity refers to the competence of the parties to make a contract. It is an essential element for a valid contract.

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

Every person is competent to contract who:

Has **attained the age of majority**.

Is of **sound mind**.

Is **not disqualified from contracting by any law to which they are subject**.

#### Age of Majority

In India, the age of majority is regulated by the Indian Majority Act, 1875.

Every person domiciled in India attains the age of majority upon completion of **18 years of age**. A person younger than 18, even by a day, is considered a minor for contracting purposes.



### LAW RELATING TO MINOR'S AGREEMENT/POSITION OF MINOR

*A contract made with or by a minor is void ab-initio*

A minor is not competent to contract, and any agreement with or by a minor is void from the very beginning.

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

### No ratification after attaining majority

A minor cannot ratify an agreement upon attaining majority, as the original agreement is void ab initio and a void agreement can never be ratified.

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



### Minor can be a beneficiary or can take benefit out of a contract

The Contract Act does not prevent a minor from making the other party bound to them. A promissory note in favor of a minor is not void and can be sued upon by the minor, as they may accept a benefit even if incompetent to contract. A minor cannot become a partner in a partnership firm but may be admitted to the benefits of partnership with the consent of all partners (Section 30 of the Indian Partnership Act, 1932).

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

### A minor can always plead minority:

A minor can always plead minority and is not estopped from doing so, even if they obtained a loan or entered a contract by falsely representing themselves as major. If the minor has not spent the money received by fraud, they may be asked to repay it, but they are not liable for any amount already spent.

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

### Liability for necessities

Governed by Section 68 of the Indian Contract Act.

A claim for necessities supplied to a minor or someone they are legally bound to support is enforceable by law.

A minor is **not personally liable**; only their property is liable.

To render a **minor's estate liable**, two conditions must be satisfied:

- The contract must be for goods reasonably necessary for their support in their station in life
- The minor must not already have a sufficient supply of these necessities.

**Necessaries** mean essential things, excluding luxuries, costly, or unnecessary articles. They include things a reasonable person would supply to an infant in that class of society, such as expenses on education or funeral ceremonies. The criterion is utility, not ornament.

The recoverable amount is limited to the value of necessities, and never more than what the **minor's assets** can cover.

### Contract by guardian - how far enforceable:

A **minor's agreement** is void, but their guardian can, under certain circumstances, enter into a valid contract on the **minor's behalf**.

If the guardian makes a contract for the minor that is within their competence and for the **minor's benefit**, it is a valid contract that the minor can enforce.

However, not all contracts made by guardians are valid; for instance, a guardian generally cannot bind a minor to a contract for the purchase of immovable property.

A contract entered into by a certified guardian (appointed by the Court) with court sanction for the sale of a **minor's property** may be enforced by either party.

### No specific performance

A minor's agreement is absolutely void, so there can be no specific performance of such an agreement.

### No insolvency

A minor cannot be declared insolvent as they are incapable of contracting debts. Dues are payable from the minor's personal properties, but they are never personally liable.

### Partnership

A minor, being incompetent to contract, cannot be a partner in a partnership firm, but can be admitted to the benefits of partnership under Section 30 of the Indian Partnership Act.

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### Minor can be an agent

A minor can act as an agent but will not be liable to their principal for their acts. A minor can draw, deliver, and endorse negotiable instruments without incurring personal liability.

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



### Minor cannot bind parent or guardian

In the absence of express or implied authority, a minor cannot bind their parent or guardian, even for necessities. Parents are liable only if the child acts as their agent.

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



### Joint contract by minor and adult

In such a case, the adult will be liable on the contract, but not the minor.

In **Sain Das vs. Ram Chand**, where there was a joint purchase by two purchasers, one of them was a minor, it was held that the vendor could enforce the contract against the major purchaser and not the minor.

### Surety (Guarantor) for a minor

In a contract of guarantee, if an adult stands surety for a minor, the adult is liable to the third party due to a direct contract between the surety and the third party.

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

### Minor as Shareholder

A minor, being incompetent to contract, cannot be a company shareholder. If a minor mistakenly becomes a member, the company can rescind the transaction and remove their name. However, a minor may, acting through their lawful guardian, become a shareholder by transfer or transmission of fully paid shares.

### Liability for torts

A minor is liable in tort (civil wrong) unless the tort is in reality a breach of contract.

### Person of sound mind (Section 12)

#### Definition

A person is said to be of sound mind for making a contract if, at the time of making it, they are capable of understanding it and forming a rational judgment as to its effect upon their interests.

#### Rules for occasional soundness/unsoundness:

A person usually of unsound mind, but occasionally of sound mind, may contract when they are of sound mind.

A person usually of sound mind, but occasionally of unsound mind, may not contract when they are of unsound mind.

#### Position of unsound mind person making a contract

A contract by a person who is not of sound mind is void.

#### Liability for necessities

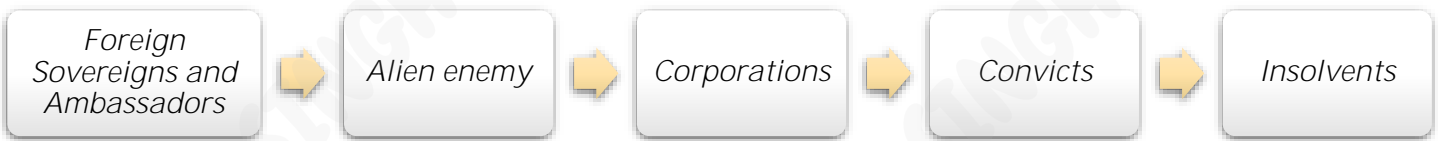
The liability for necessities of life supplied to persons of unsound mind is the same as for minors.



### Contract by disqualified persons

Besides minors and persons of unsound mind, other individuals are disqualified from contracting, either partially or wholly, rendering their contracts void. Incompetency may arise from political, corporate, or legal status.

This category includes:



## FREE CONSENT

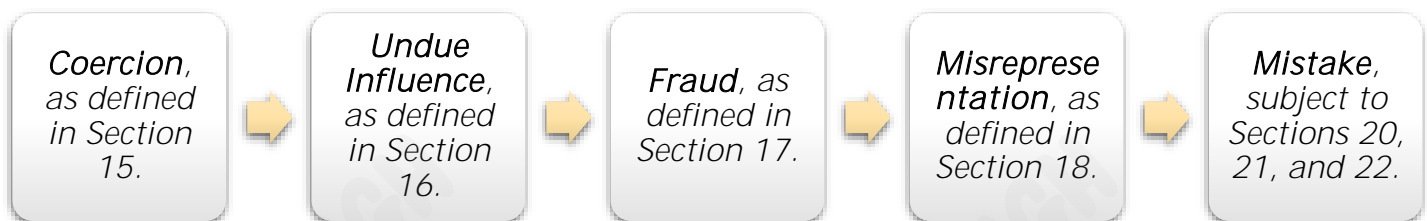
### Definition of Consent (Section 13)

"Two or more persons are said to consent when they **agree upon the same thing in the same sense.**" This is known as 'consensus ad idem'.

'Same thing' refers to the whole content of the agreement.

If parties make a fundamental error as to the nature of the transaction, the person dealt with, or the subject-matter, there is no agreement in the same sense, and thus, no consent. A contract cannot arise in the absence of consent.

### Definition of 'Free Consent' (Section 14)



### Consequences of vitiated consent:

"When consent is caused by coercion, fraud, misrepresentation, or undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused.

When consent is vitiated by mistake, the contract becomes **void**.

## ELEMENTS VITIATING FREE CONSENT

### Coercion (Section 15)

#### Definition:

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

#### Scope:

Coercion need not proceed from a party to the contract, nor is it necessary that the subject of coercion be the other contracting party; it may be directed against any third person.

#### Effects of coercion (Section 19):

"Contract induced by coercion is voidable at the option of the party whose consent was so obtained.

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

#### Threat to commit suicide:

This is regarded as coercion because Section 15 declares that committing or threatening to commit any act forbidden by the Indian Penal Code is coercion.

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



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



**Burden of Proof**

Lies on the aggrieved party.

John: "Barry, about these lawn ornaments... I'm not interested."

John: "Actually, no. A contract signed under threat like that is voidable. So, no deal."

John: "Yep. And I'd like my peace and quiet back."



Barry: "Not interested? But... [starts squeezing accordion ominously] ...I thought we had a deal for peace and quiet?"

Barry: (Accordion wheezes to a halt) "Voidable?"

**Undue Influence (Section 16)**

**Definition:**

A contract is said to be induced by 'undue influence' where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.



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

**Essential ingredients:**

**(1) Relation between the parties:**

A person can be influenced by the other when a near relation between the two exists.

**(2) Position to dominate the will:**

A person is considered in a dominant position in a relationship when they can dominate the will of the other party.

**(a) Real and apparent authority:** a person holds significant authority over another, Eg. master and servant, doctor and patient.

**(b) Fiduciary relationship:** Relation of trust and confidence exists between the parties to a contract. **Example:** father and son, solicitor and client.

**(c) Mental distress:** used to obtain consent for a contract when a person's mental capacity is temporarily or permanently affected due to distress, illness, or old age.

**(d) Unconscionable bargains:** Unconscionable bargains, often seen in money-lending transactions and gifts, are presumed to be unconscionable if one party dominates the other's will, indicating undue influence.

**(3) The object must be to take undue advantage:**

When someone has the power to influence another's will for consent, they must have the intention to exploit the other.

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

#### (4) Burden of proof:

When a party to contract decides to avoid the contract on the ground of undue influence, he has to prove that-

- (a) The other party is in position to dominate his will,
- (b) the other party actually used his position to obtain his consent,
- (c) transaction is unfair or unconscionable.

#### Effect of undue influence- (Section 19A):

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

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

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

#### Fraud (Section 17)

##### Definition:

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

The suggestion, as a fact, of that which is not true, by one who does not believe it to be true.

The active concealment of a fact by one having knowledge or belief of the fact.

A promise made without any intention of performing it.

Any other act fitted to deceive.

Any such act or omission as the law specially declares to be fraudulent.



**Essential elements of fraud:**

There must be a representation or assertion, and it must be false.

The representation must be related to a fact.

The representation should be made before the conclusion of the contract with the intention to induce the other party to act upon it.

The representation or statement should be made with knowledge of its falsity, or without belief in its truth, or recklessly not caring whether it is true or false.

The other party must have been induced to act upon the representation or assertion.

The other party must have relied upon the representation and must have been deceived.

The other party acting on the representation must have consequently suffered a loss.

**Silence as fraud (Explanation to Section 17):**

Silence amounts to fraud in the following situations:

When there is a duty to speak.

When silence is equivalent to speech.

**Effect of Fraud upon validity of a contract:**

When consent is caused by fraud, the contract is voidable at the option of the party defrauded.

**Remedies for the defrauded party:**

They can rescind the contract within a reasonable time.

They can sue for damages.

They can insist on the performance of the contract on the condition that they shall be put in the position they would have been in had the representation been true.

**Exceptions (contract not voidable):**

If the party whose consent was caused by silence amounting to fraud had the means of discovering the truth with ordinary diligence.

If the fraud did not cause the consent of the party to the agreement.

Magician: This magic deck will make you rich—guaranteed!

Magician: Wise choice! The magic begins. (Later)

Magician: Ah... must've vanished with the magic.



Shreya: Seriously? Okay... here's my savings.

Shreya: Nothing happened!

## 🔹 Misrepresentation (Section 18)

### Definition:

Misrepresentation occurs when:

A statement of fact is made, which is false, but the maker believes it to be true even though it is not justified by the information they possess.

There is a breach of duty by a person without any intention to deceive, which brings an advantage to them.

A party, even innocently, causes the other party to the agreement to make a mistake as to the subject matter.

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

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

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

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

**Effect:**

The aggrieved party can avoid or rescind the contract (Section 19).

**Loss of right to rescind:**

The aggrieved party loses the right to rescind if, after becoming aware of the misrepresentation, they take a benefit under the contract or affirm it.

**Exception:**

If consent was caused by misrepresentation, the contract is not voidable if the party whose consent was so caused had the means of discovering the truth with ordinary diligence

Henry: Wait, seriously? That's wild... but kinda cool. I'll take it!  
(Two blocks later, the car dies.)



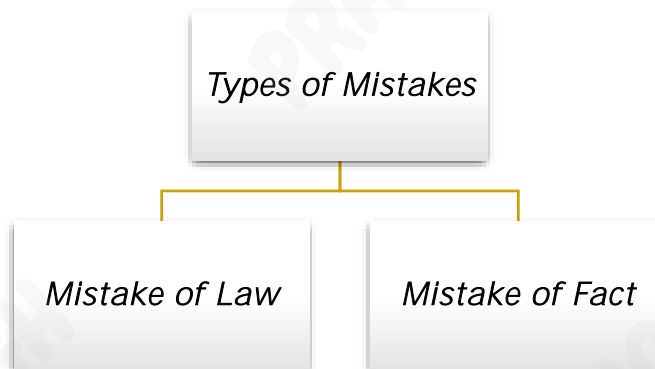
Olivia: You're gonna love this car — the engine's built with alien tech and runs on hopes and dreams!

Olivia: What? My cousin swore it was! I really thought it was true...

Henry: Olivia! The car broke down! This thing isn't alien — it's barely functional!

**Mistake**

Mistake may be defined as an innocent or erroneous belief which leads the party to misunderstand the others.



**Mistake of Law**

**Mistake of Indian Law:** A person cannot get relief on the ground of ignorance of Indian law. Such a contract is **not voidable**.

**Mistake of Foreign Law:** Such a mistake is treated as a mistake of fact, and the agreement in such a case is **void**.

## Mistake of Fact

### Bilateral Mistake:

- ▲ Occurs when both parties to an agreement are under a mistake as to a matter of fact essential to the agreement.
- ▲ In such a case, the agreement is void (Section 20).
- ▲ Cases of Bilateral Mistakes include mistakes as to the:

Quality of the subject-matter.

Existence of the subject-matter.

Identity of the subject-matter.

Title of the subject-matter.

Price of the subject-matter.

Quantity of the subject-matter.

Possibility of performance (legal or physical).

### Unilateral Mistake:

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

However, if a unilateral mistake relates to the identity of the person or the character of a written document, it may prevent contract formation due to absence of consent.



**Jack:** Here's Oinkers! My brilliant little pig — he does tricks!

**Jack:** I meant my prize-winning pot-bellied pig!

**Jiya:** What?! I was expecting a 500-pound farm pig — Sir Ham-a-Lot!

**Jiya:** I wanted a bacon pig, not a circus act!

**Both:** This isn't the pig I agreed to!

## DIFFERENCES & DISTINCTIONS

### ◆ Difference between Coercion and Undue influence:

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

### ◆ Distinction between fraud and misrepresentation:

Basis of difference	Fraud	Misrepresentation
Intention	To deceive the other party by hiding the truth.	There is no such intention to deceive the other party.
Knowledge of truth	The person making the suggestion believes that the statement as untrue.	The person making the statement believes it to be true, although it is not true.
Rescission of the contract and claim for damages	The injured party can repudiate the contract and claim damages.	The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages.

<b>Means to discover the truth</b>	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.
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### ◆ Distinction between Contract of Insurance and Wagering Agreement:

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

## LEGALITY OF OBJECT AND CONSIDERATION (SECTION 23)

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



*When consideration or object is forbidden by law*

Acts forbidden by law include those punishable under any statute or prohibited by regulations or orders issued by legislative authority.

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

*When consideration or object are of such a nature that if permitted it would defeat the provisions of law*

If an agreement's consideration or object would, directly or indirectly, defeat legal provisions, it is void.

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

*When it is fraudulent*

Agreements entered into to promote fraud are void.

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

*When it involves injury to the person or property of another*

"Injury" means criminal or wrongful harm. If the object or consideration causes injury, it is unlawful.

*When consideration is immoral*

Agreements with an immoral object or consideration are unlawful.

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

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

### When consideration is opposed to public policy

This expression restricts freedom of contract for the good of the community. Some agreements considered opposed to public policy include:

Some of the agreements which are held to be opposed to public policy are-

(1) *Trading with enemy:* Trade with allegiant Indian government at war without Indian government license is void as it opposes public policy and prejudices state interests during war.

(2) *Stifling Prosecution:* An agreement to stifle prosecution is void, as it is an abuse of justice. However, under the Indian Criminal Procedure Code, agreements to drop proceedings for compoundable offences are not opposed to public policy.

(3) *Maintenance and Champerty:* Maintenance is an agreement where a person agrees to maintain a suit, they have no interest in.

Champerty is a legal agreement where one party agrees to help another in litigation in exchange for a promise to share a portion of the action's proceeds.

(4) *Trafficking relating to Public Offices and titles:* Public policy prohibits trafficking in public office, as it disrupts the appointment of qualified individuals for public service, requiring no financial consideration for such appointments.

(5) *Agreements tending to create monopolies:* Monopolies-establishing agreements are incompatible with public policy and are therefore void.

(6) *Marriage brokerage agreements:* Marriage brokerage contracts, which involve negotiating marriage for reward, are void as they contradict public policy and are not subject to payment to a procurer.

(7) *Interference with the course of Justice:* An agreement aiming to corrupt or induce a judicial officer is void, as it contradicts public policy and uses underhand means to influence legislation.

(8) *Interest against obligation:* Interference with the course of justice Interest against obligation.

(9) *Consideration Unlawful in Par:* Section 24 states that any part of a single consideration for one or more objects, or any part of several considerations for a single object, is unlawful. Section 23 states that a contract is void if the illegal part cannot be separated from the legal part, resulting in the rejection of the bad part.

## VOID AGREEMENTS

### Agreement in restraint of marriage (Section 26):

Marriage restraint agreements for minors are void, meaning a major's good consideration not to marry is not binding and considered a void agreement.

**Aunt Mildred:** Ryan, you'll get my entire fortune—if you promise never to marry.

**Aunt Mildred:** So Captain Squawk stays your one true love!

**Aunt Mildred:** You'd choose a wife over Squawk?!

**Ryan:** Wait, what? Why?

**Ryan:** Auntie, I'm a grown man. That promise is legally void.

### Agreement in restraint of trade (Section 27):

An agreement restraining a person from exercising a lawful profession, trade, or business is void, except when selling a business's goodwill and agreeing to refrain from similar business within specified limits.

[Section 36(IPA)] allows for restraint of trade agreements if the local limits are reasonable, but not for service agreements requiring employees to avoid competition.

An employee's service agreement, where they agree not to compete with their employer, does not constitute a restraint of trade.

**Gustave:** Yes! They bought my Secret Sauce recipe and now want me to retire... mentally too!

**Gustave:** So I can still cook?

**Gustave:** Perfect. Time to open "Gustave's Bistro" ... right next door!

**Lawyer:** Chef Gustave, I saw the contract. It says you can't cook or even think about food ever again?

**Lawyer:** That clause is ridiculous. It's an unreasonable restraint of trade.

**Lawyer:** Of course! Just don't use the Secret Sauce.

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

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

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

### Agreement in restraint of legal proceedings (Section 28)

An agreement in restraint of legal proceedings restricts a party's rights or abridges the usual legal proceedings period, making the contract void.

#### Exceptions are:

(i) A valid contract is one where parties agree to refer any dispute to arbitration, with only the awarded amount being recoverable.

(ii) A valid contract allows parties to refer to arbitration for any existing or future disputes, but it must be in writing.



**Sam:** Professor Peculiar, this “time machine” is just a washing machine!

**Sam:** That’s absurd!

**Sam:** Nope. That clause is void. You can’t stop me from suing—especially with nonsense like this.

**Professor Peculiar:** Ah, but did you read the contract? No lawsuits—only a synchronized swimming match to settle disputes!

**Professor Peculiar:** Rules are rules. Now grab your swimsuit!

**Professor Peculiar:** Uh-oh... time to disappear into spin cycle!

### Agreement - the meaning of which is uncertain (Section 29)

An agreement is void if its meaning is uncertain, but valid if it can be determined and understood.



**Siya:** “So, Sid, about that shiny thing? I’ll sell it to you for a decent amount. Whatever feels right, you know?”

**Sid:** “Shiny thing? Decent amount? Siya, what is it, and how much is ‘whatever feels right’? This is too vague. This agreement is void for uncertainty!”

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

### Wagering agreement (Section 30):

A wager is void as it involves payment for an uncertain event, with each party having a legitimate interest in winning or losing.

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

### Essentials of a Wager:

*There must be a promise to pay money or money's worth.*

*Promise must be conditional on an event happening or not happening.*

*There must be uncertainty of event*

*There must be two parties each party must stand to win or lose.*

*There must be common intention to bet at the timing of making such agreement*

*Parties should have no interest in the event except for stake*



### Transactions similar to Wager (Gambling)

#### (i) Lottery transactions:

*Lottery is a chance-based game, not a skill or knowledge game, where gambling is the primary motive, even if sanctioned by the government.*

*The sanction only prevents the lottery operator from being punished under Section 294A of the Indian Penal Code, as lottery operations are illegal.*

#### (ii) Crossword Puzzles and Competitions:

*Crossword puzzles with prizes based on competitor's solution matching a newspaper editor's prepared solution are considered a lottery and wagering transaction.*

**CASE LAW: *State of Bombay vs. R.M.D. Chamarhangwala***

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

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

(iii) Speculative transactions:

An agreement or share market transaction where parties aim to settle the difference between contract and market prices on a specific day is considered gambling and void.

(iv) Horse Race Transactions:

Section 30 does not apply to wagers in horse race competitions with a prize payable less than ₹500, or to agreements contributing to a plate prize.

◆ Transactions resembling with wagering transaction but are not void

(i) Chit fund: involves a fixed sum of money contributed by a specific group of people, which is then paid to the lucky winner of a monthly draw.

(ii) Commercial transactions or share market transactions

(iii) Games of skill and Athletic Competition: The Prize Competition Act, 1955, allows games of skill, such as crossword puzzles, picture competitions, and athletic competitions, to be valid as long as the prize money does not exceed ₹1,000.

(iv) A contract of insurance: A contract of insurance is a legal contingent contract, distinct from wagering agreements, and is valid under law.

# Chapter 2

## Unit 4: Performance of Contract

### MEANING OF PERFORMANCE OF CONTRACT

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

**Example:**

A local eccentric, Mr. Sharma, contracted with the town mayor to perform a daily "chicken dance" in the town square for a year. When Mr. Sharma, on the 365th day, completed his final, flamboyant chicken dance, he had actually performed his contractual obligation.



### TYPES OF PERFORMANCE

Based on Section 37, "Performance of Contract", can be of two types:

Actual Performance

Offer to Perform or Tender of Performance

#### Actual Performance

This occurs when a party to a contract has done what they undertook to do or when either of the parties has fulfilled their obligations under the contract within the time and in the manner prescribed.

**Example:**

"Bharat" promised to bake a three-tier, smoke-emitting, fondant-covered dragon cake for his niece's birthday. When he arrived at the party, he had delivered.

**Niece:** "Uncle Bharat, did you really make my dragon cake?"

**Bharat:** "And here it is, complete with smoke! Just as I promised."



#### Offer to Perform / Attempted Performance / Tender of Performance

This happens when the performance becomes due, and the promisor offers to perform their obligation, but the promisee refuses to accept the performance.

**Example:** A furniture manufacturer, "Sharma Furniture", builds a custom dining table for a customer, "Mr. Gupta". Sharma Furniture tries to deliver it during business hours, but Mr. Gupta refuses delivery without a valid reason.

## CONDITIONS FOR A VALID TENDER OR ATTEMPTED PERFORMANCE

For an offer to perform (tender) to be valid, several conditions must be satisfied:

### (i) Unconditional

The offer to perform must not be subject to any conditions.

**Example:** A quirky inventor offered to deliver his "self-stirring coffee mug" to a buyer, but only if the buyer promised to wear a tin foil hat while using it. The buyer refused, as the offer to deliver was not unconditional.

### (ii) Must be Made at Proper Time and Place

The performance must be offered at a reasonable time and the agreed-upon place.

**Example:** A pizza delivery person tried to deliver a pepperoni pizza to a customer at 3:00 AM, ringing their doorbell repeatedly. The customer, understandably annoyed, refused the delivery, stating it was not at a proper time for pizza.



### (iii) Reasonable Opportunity to Examine Goods

The promisee must have a reasonable chance to inspect goods offered for delivery.

**Example:** A collector bought a "genuine antique invisible cloak." When the seller arrived with an empty box and claimed the cloak was inside but invisible, the buyer demanded a reasonable opportunity to examine the "goods," which, of course, wasn't possible, rendering the tender invalid.

### (iv) For Whole Obligation

The offer must be for the entire agreed-upon obligation, not just a part of it.

**Example:** A band was hired to play a full three-hour set at a wedding. When they showed up and only played a single 5-minute song before packing up, the wedding planner pointed out it was not a valid tender because it wasn't the whole obligation.

## BY WHOM A CONTRACT MAY BE PERFORMED (SECTIONS 40, 41, & 42)

### ◆ Promisor himself

If the contract involves the exercise of personal skill or diligence, or is founded on personal confidence between the parties, the promise must be performed by the promisor themselves.

Example:

**Mr. Jatin's Manager:** "Mr. Jatin sends his apologies and his talented parrot, who will perform his routine!"



**Audience Member:** "Where's Mr. Jatin? We came to see him!"

**Audience Member:** "No way! We want Mr. Jatin's unique mime, not a talking parrot!"

Agent

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

Example:

A famous online influencer, "Raj Sharma", contracted to promote a brand of cat food by having a picture of their cat eating it posted. Raj could easily have his assistant take the picture and post it, as personal involvement wasn't key to the contract.



Legal Representatives [Section 37, para 2]

- A contract involving personal skill or personal consideration comes to an end on the death of the promisor.
- For any other contract, the legal representatives of the deceased promisor are bound to perform it, unless a contrary intention appears from the contract. Their liability under a contract is limited to the value of the property they inherit from the deceased.

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

Third Persons [Section 41]

If a promisee accepts performance of the promise from a third person, they cannot afterwards enforce it against the promisor. This results in discharging the promisor, even if the promisor did not authorise or ratify the act.

Example:

**Bharat:** "Hey Jatin, about that \$50 for my lost hamster..."



**Jatin:** "No need, Bharat! Looks like Sheru found him for you."

**Bharat:** "Sheru did? Wow! Well, I can't complain now that he's back. Thanks, Sheru!"

## Joint Promisors [Section 42]

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

**Example:** Three friends, Aisha, Brijesh, and Chitra, jointly promised to dress up as a giant three-headed dragon for the town parade. On the day, Aisha and Brijesh showed up with two dragon heads, but Chitra forgot her head at home. The parade organizers, seeing only two-thirds of a dragon, insisted that all three, as joint promisors, must jointly fulfill the promise of a three-headed dragon.

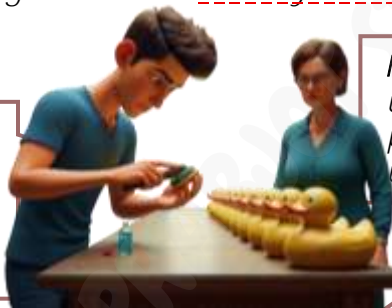
## DISTINCTION BETWEEN SUCCESSION & ASSIGNMENT

### Succession

When contract benefits are succeeded to by process of law, both the burden and benefits attaching to the contract may devolve on the legal heir. The liability of the successor is limited to the extent of the property inherited.

**Example:**

**Rohan:** "Yes, I am. I've been polishing them non-stop, but I can only continue as long as the polish from Uncle's estate lasts. My liability is limited to what I inherited."



**Museum Curator:** "Rohan, your late uncle, Mr. Sharma, promised to polish all our rubber ducks. Are you upholding the contract?"

**Museum Curator:** "So, when the polish runs out... no more shiny ducks?"

**Rohan:** "Precisely. I'm doing my best with what he left me!"

### Assignment

Only the benefit of a contract can be assigned, not the liabilities. A debtor cannot relieve themselves of liability by assigning their obligation. A creditor can assign the benefit of a promise, entitling the assignee to realise the debt from the debtor, but this is not possible if the benefit is coupled with a liability or involves personal consideration.

**Example:**

A famous comedian, Mr. Hasmukh, had a contract to tell jokes at a corporate event. He tried to assign his 'joke-telling' liability to his pet parrot, Mithu, claiming Mithu knew all his best material. The company refused, because while the benefit of hearing jokes might be assigned, the personal consideration of a famous comedian could not be assigned.



## LIABILITY OF JOINT PROMISOR & PROMISEE

### Devolution of Joint Liabilities [Section 42]

Joint promisors must jointly fulfil the promise, and upon death, their legal representatives jointly with survivors, or representatives of all jointly if all die. This rule applies unless a contrary intention is evident in the contract.

**Example:** Three culinary students, Chef Rahul, Chef Gaurav, and Chef Sameer, jointly promised to bake the world's largest cake. If Chef Rahul suddenly disappeared (perhaps chasing a rogue ingredient), Chef Gaurav, Chef Sameer, and Rahul's legal representatives would still be on the hook to jointly fulfill the promise of the largest cake.



### Compelling Performance [Section 43]

The promisee may compel any one or more of such joint promisors to perform the whole of the promise, in the absence of an express agreement to the contrary. This means the liability is joint and several.

### Contribution Among Promisors [Section 43]

Each joint promisor may compel every other joint promisor to contribute equally to the performance of the promise, unless a contrary intention appears from the contract.

### Sharing of Loss by Default [Section 43]

If anyone joint promisor defaults in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

**Example:** If Shankar then refused to pay his share to Priya for the apartment cleaning, Priya and Lakshman would have to bear the loss (or extra burden) from Shankar's default in equal shares, perhaps by Priya cleaning Shankar's room for free, and Lakshman giving her extra "Lakshman-loonies."



### Surety [Explanation to Section 43]

Does not prevent a surety from recovering payments made on behalf of the principal, nor does it allow the principal to recover from the surety for payments made by the principal.

### Effect of Release of One Joint Promisor [Section 44]

Joint promises between two or more individuals are not discharged or freed from responsibility if one person's release does not discharge the other.

*Example:* Two friends jointly sign a lease. The landlord later agrees to release one friend from their direct liability to the landlord.

The other friend remains fully liable to the landlord for the rent. Furthermore, the released friend is still liable to contribute their share to the other friend if that friend ends up paying the full rent.

### ◆ Rights of Joint Promisees [Section 45]

When a promise is made to two or more persons jointly, the right to claim performance rests with them jointly during their joint lives. After the death of any of them, the right rests with the representative of the deceased person jointly with the survivor(s). After the death of the last survivor, it rests with the representatives of all jointly, unless a contrary intention appears from the contract.

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

## TIME AND PLACE FOR PERFORMANCE OF THE PROMISE (SECTIONS 46 TO 50)

### ◆ No application, no time specified [Section 46]

Where the promisor is to perform without application by the promisee and no time is specified, the performance must occur within a reasonable time. "Reasonable time" is interpreted based on the facts and circumstances of each case.

### ◆ Time specified, no application [Section 47]

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

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

### ◆ Application for performance [Section 48]

If a promise is to be performed on a certain day and the promisor has not undertaken to perform without application, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business. "What is a proper time and place" is a question of fact in each case.

**Example:**

Mrs. Sharma: "Mr. Khanna, Buddy's still barking at shadows! I thought you were supposed to calm him by now."



Mr. Khanna: "Mrs. Sharma, I understand your concern. But I can't work my magic unless you bring Buddy to my clinic during our agreed-upon hours. My methods aren't telepathic, you know!"

### ◆ No application, no place fixed [Section 49]

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

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

### ◆ Manner or time prescribed/sanctioned by promisee [Section 50]

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

**Example:** A homeowner hired a painter to paint their house. The homeowner then prescribed that the house be painted entirely and only between 1 AM and 3 AM. The painter, though bewildered, had to perform as sanctioned.



## PERFORMANCE OF RECIPROCAL PROMISES (SECTIONS 51 TO 58)

### ◆ Promisor not bound unless promisee ready and willing [Section 51]

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

**Example:**

Prakash (Baker): "Here's your magnificent wedding cake, Amit! That'll be ₹ 15,000."



Amit (Groom): "Fantastic! Here's the payment." (Hands over a stack of Monopoly money)

Prakash (Baker): "Hold on, Amit! I need real money for this cake, not play money. I can't leave the cake until you're ready to pay with actual currency."

### Order of performance of reciprocal promises [Section 52]

If the order is expressly fixed by the contract, promises are performed in that order. If not expressly fixed, they are performed in the order required by the nature of the transaction.

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

### Liability of party preventing event [Section 53]

If one party to a contract containing reciprocal promises prevents the other from performing their promise, the contract becomes voidable at the option of the prevented party. The prevented party is also entitled to compensation from the other party for any loss sustained due to non-performance.

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

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

### Effect of default as to first-performed promise [Section 54]

When promises are reciprocal and dependent, if the promisor who has to perform first fails, they cannot claim performance of the other's promise and are liable for compensation for their non-performance.

### Effects of Failure to Perform when Time is Essential [Section 55]

A contract becomes voidable if a party fails to fulfill a promise to do something by a specified time, if the intention was for time to be the essence of the contract.

*Effect of such failure when time is not essential*

The contract is not voidable if the parties did not intend for time to be the essence of the contract, but the promisee is entitled to compensation.

### Effect of such failure when time is not essential

If a contract is voidable due to the promisor's failure to fulfill a promise, the promisee cannot claim compensation for loss unless they notify the promisor of their intention.

**Example:** A catering company, "Royal Caterers", promised to deliver a massive ice sculpture of a swan by 6 PM for a summer wedding. If they showed up at midnight with a puddle, the contract was voidable because time was of the essence for a melting ice sculpture.



### Agreement to do Impossible Act [Section 56]

#### Initial Impossibility

An agreement to do something that is obviously impossible in itself is void.

#### If known to both parties

There is no real agreement, hence void.

#### If unknown to both parties

The contract is void.

#### If known to promisor only

The promisee is entitled to claim compensation for any loss suffered due to non-performance.

#### Subsequent or Supervening Impossibility

When performance becomes impossible or illegal after the contract is made due to an unexpected event or change of circumstances (e.g., unforeseen change in law, destruction of subject-matter, non-existence of a particular state of things, personal incapacity, declaration of war), the contract becomes void, and the parties are discharged.

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

### Reciprocal promise - legal & illegal parts [Section 57]

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

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

### Alternative promise - one branch illegal [Section 58]

*In the case of an alternative promise where one branch is legal and the other illegal, the legal branch alone can be enforced.*

*Example: A dubious merchant, Mr. Sharma, offered to pay a client, Mr. Gupta, ₹ 1,000. Mr. Gupta could choose to receive either a rare, legal, antique coin or a bag of clearly counterfeit banknotes. Only the promise to deliver the antique coin is enforceable; the counterfeit banknotes option is illegal.*



## APPROPRIATION OF PAYMENTS

### Debtor indicates [Section 59]

*If the debtor makes a payment with express intimation or implying that it's for a particular debt, the payment, if accepted, must be applied accordingly.*

### Debtor does not indicate [Section 60]

*If the debtor omits to intimate, the creditor may apply it at their discretion to any lawful debt actually due and payable, whether its recovery is time-barred or not. However, the creditor cannot apply the payment to a disputed debt.*

### Neither party appropriates [Section 61]

*If neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are time-barred or not. If debts are of equal standing, payments are applied proportionately.*

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

### Effect of novation, rescission, and alteration [Section 62]

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

#### Novation

*Involves the substitution of an existing contract with a new one, either between the same parties or different parties. The old contract is discharged. Requires mutual agreement.*

#### Rescission

*Occurs when parties agree to cancel the old contract, and no new contract comes into existence in its place. It discharges the contract by mutual agreement.*

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*Example:* A teenager contracted to mow their parents' lawn weekly for an allowance. Mid-summer, both parties, exasperated by the persistent rain, mutually agreed to rescind the mowing contract altogether. The lawn remained a jungle, but the contract was discharged.

### Alteration

Occurs when parties agree to change the terms of the contract. The original contract is rescinded and need not be performed.

### Distinction between Novation and Alteration

Novation always involves the substitution of an entirely new contract, potentially changing parties or terms.

Alteration involves changing some terms of the original agreement, but the parties generally remain the same, and a complete substitution is not essential.

### ◆ Promisee may waive or remit performance of promise (Section 63):

Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to them, or may extend the time for such performance, or may accept any satisfaction they think fit. This discharges the contract by remission.

*Example:* A child owed their parent ten chores. The parent, in a moment of extreme generosity (or exhaustion), decided to waive five of the chores, allowing the child to only perform five.

### ◆ Restoration of Benefit under a Voidable Contract (Section 64):

When a person, at whose option a contract is voidable, rescinds it, the other party need not perform their promise. The party rescinding must restore any benefit received under the contract, as far as possible, to the person from whom it was received.

*Example:* A magician sold an "ancient cursed amulet" to a gullible tourist. When the tourist realized it was just a painted rock and rescinded the contract (making it voidable), the magician was bound to restore the benefit by refunding the tourist's money, even if the "curse" was already broken.



### ◆ Obligations of Person who has Received Advantage under Void Agreement or contract that becomes void (Section 65):

If an agreement is discovered to be void, or a contract becomes void, any person who received an advantage under it is bound to restore it or compensate for it to the person from whom it was received.

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

### Communication of rescission (Section 66):

*Rescission of a voidable contract must be communicated to the other party in the same manner as a proposal under Section 4 of the Contract Act. Similarly, a rescission may be revoked in the same manner as a proposal is revoked.*

### Effects of neglect of promisee to afford promisor reasonable facilities for performance (Section 67):

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

*Example: A professional cat groomer contracted to give a fluffy Persian a lion cut. However, the cat's owner refused to hold the cat still or even provide catnip. The groomer was excused for non-performance of the lion cut due to the owner's neglect in providing reasonable facilities (i.e., a cooperative cat or assistance).*



## DISCHARGE OF A CONTRACT

### Discharge by performance:

*This occurs when parties fulfil their obligations within the prescribed time and manner. It includes both actual performance and attempted performance (tender).*

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

### Discharge by mutual agreement

*As discussed under Section 62, this includes novation, rescission, alteration, and remission.*

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

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

### Discharge by impossibility of performance:

*Initial impossibility:*

*Impossibility existing from the very start of the contract (ab initio).*

**Contact Number: 8007916622/33**

### Supervening impossibility

Performance becomes impossible or illegal after the contract due to: an unforeseen change in law; destruction of the subject-matter essential to performance; non-existence or non-occurrence of a particular state of things (e.g., personal incapacity); or declaration of a war.

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

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

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

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

### Discharge by lapse of time

If a contract is not performed within the specified period by the Limitation Act, 1963, and no action is taken, the promisee is deprived of legal remedy, making the debt time-barred and irrecoverable.

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

### Discharge by operation of law

This includes events such as the death of the promisor (for non-personal contracts) or insolvency.

### Discharge by breach of contract

If one party breaks the promise, the injured party has a right to sue for damages and is also discharged from performing their part of the contract. Breach can be:

#### Actual breach

Default on the due date of performance

#### Anticipatory breach

Repudiation of the contract before the stipulated time for performance has arrived.

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

### ◆ Promisee may waive or remit performance of promise (Section 63)

*As covered, the promisee can release the promisor from their obligation, wholly or partially, or extend time, or accept alternative satisfaction.*

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

### ◆ Effects of neglect of promisee to afford promisor reasonable facilities for performance (Section 67):

*As covered, the promisor is excused from non-performance if the promisee neglects or refuses to provide necessary facilities.*

### ◆ Merger of rights

*When inferior and superior rights coincide in the same person, the inferior rights merge into the superior rights and cease to be enforced.*

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

# Chapter 2

## Unit 5: Breach Of Contract and Its Remedies

### ANTICIPATORY BREACH OF CONTRACT

**Meaning-** An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. It occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived.

Rohan (Pet Owner): Oh, Priya, I'm so sorry! That was just a bad joke. Nutty is perfectly safe, not an ingredient! Yes, our deal for August 10th is absolutely still happening.



Priya (Collector): Rohan, your August 1st social media post, "My new favorite ingredient is Nutty!" with squirrel cookies, concerned me. Our August 10th agreement for your rare, hypoallergenic squirrel, Nutty – is it still on?

#### Modes of Anticipatory Breach

Expressly by words spoken or written.

Impliedly by the conduct of one of the parties

#### Example:

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

#### Example:

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

#### Legal Provision (Section 39):

Section 39 of the Indian Contract Act deals with anticipatory breach.

- ➔ It states that if a party to a contract refuses to perform or disables himself from performing his promise in its entirety, the promisee may terminate the contract.
- ➔ However, this right to terminate is waived if the promisee has, by words or conduct, signified their acquiescence in the contract's continuance.

## Effect of Anticipatory Breach

The promisee is excused from performance or from further performance of their obligations. The promisee is granted an option:

To treat the contract as rescinded and immediately sue the other party for damages arising from the breach, without waiting until the due date of performance.

To elect not to rescind, but to treat the contract as still operative and wait for the time of performance before holding the other party responsible for non-performance.

In this scenario, the contract is kept alive for the benefit of both parties; the defaulting party may still perform, and can also take advantage of any supervening impossibility that might discharge the contract.

CASE LAW: *Frost v. Knight* and *Hochster v. DelaTour*.

## ACTUAL BREACH OF CONTRACT

### Definition:

In contrast to anticipatory breach, actual breach involves a refusal to perform the promise on the scheduled date. When one party breaks the contract by refusing to perform their promise, the other party obtains a right of action against them.

### Occurrences of Actual Breach:

It can be committed:

At the time when the performance of the contract is due.

During the performance of the contract, when a party explicitly or implicitly fails or refuses to perform their obligation.

Ghost Whisperer: Well, you're one to talk. Didn't you sneeze mid-pose in the park and start yelling about pollen?

Human Statue: That's a straight-up breach, mate! You were supposed to show up *then*, not go candy-hunting.

Ghost Whisperer: Guess we both broke character—one before the act, one right in the middle!

Human Statue: Okay, fair. Breach during performance. I was supposed to stay still, not start a monologue on allergies.



## Remedies for Breach of Contract

### Remedies Available

Suit for Damages

Rescission of Contract

Suit for specific performance

Suit for Injunction

Suit upon quantum meruit

## SUIT FOR DAMAGES

*Section 73 The party affected by a breach of contract is entitled to compensation for any loss or damage caused by the breach, which can arise naturally.*

*Compensation can be claimed for any loss or damage that the party knew about at the time of contract entry due to the breach.*

*Special damage claims require notice, but parties must minimize loss, and no compensation is payable for remote or indirect losses.*

### (i) Ordinary damages (Section 73):

*A breach of a contract allows the party affected to receive compensation for any loss or damage resulting from the breach, which was likely or naturally arose.*

*Compensation is not provided for any indirect or remote loss or damage resulting from the breach.*

**CASE LAW: *Hadley Vs. Baxendale.***

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

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

### ❖ (ii) Special damages:

A party to a contract may be held liable for both natural and special damages if they receive notice of special circumstances affecting the contract.

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

### ❖ (iii) Vindictive or Exemplary damages

These damages may be awarded only in two cases:

for breach of promise to marry due to emotional harm.

A banker's wrongful dishonor of a customer's cheque can result in significant loss of credit and reputation, granting exemplary damages to business owners, but non-traders cannot receive heavy damages unless proven as special damages.

CASE LAW: *Gibbons v West Minister Bank*

### ❖ (iv) Nominal damages:

Nominal damages are awarded when a plaintiff proves a breach of contract without actual damage, establishing the right to decree, and can range from rupees to 10 paise.

Owner: I asked for a checkered lawn. You gave me stripes.

Owner: True. But it's still a breach of contract.

Owner: Doesn't matter. I can still sue for ₹1 as nominal damages — just to prove the breach.



Gardener: But you like stripes!

Gardener: You didn't lose anything.

### ❖ (v) Damages for deterioration caused by delay:

Delays in goods deterioration can result in damages from carriers, potentially resulting in loss of special sale opportunity.

### ⬢ (vi) Pre-fixed damages (Section 74):

Contract parties may stipulate damages payable in case of breach, either as liquidated damages or a penalty, based on a reasonable estimate of potential loss.

In a contract, if a specific sum is designated as the amount to be paid in case of breach, the aggrieved party is entitled to reasonable compensation.

#### Example:

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

#### Example:

X promised Y, a priest, to pay ₹ 10,000 as charity. The priest on X's promises incurred certain liabilities towards the repairing of the temple to the extent of Rs. 7,500. Y, the priest, can recover from X ₹ 7,500.



## PENALTY AND LIQUIDATED DAMAGES (SECTION 74)

Contract parties may agree on compensation amounts in case of non-performance, which raises the question of whether courts will accept this as a measure of damage.

#### English Law:

The sum fixed in a contract can be interpreted as either liquidated damages or a penalty. If it represents a genuine pre-estimate of future loss, it is liquidated damages. If it's unreasonable and used to force performance, it's a penalty, limiting recovery beyond actual loss.

#### Indian Law:

Indian law does not differentiate between 'penalty' and liquidated damages. Courts award reasonable compensation not exceeding the contract's specified amount. Section 74 of the Contract Act states that courts will never allow more damages, but may allow less.

#### Exception:

Where any person gives any bond to the Central or State government for the performance of any public duty or act in which the public are interested, on breach of the condition of any such instrument, he shall be liable to pay the whole sum mentioned therein.

*Example:* A contracts with B, that if A practices as a surgeon in Kolkata, he will pay B ₹ 50,000. A practice as a surgeon at Kolkata, B is entitled to such compensation not exceeding ₹ 50,000 as the court considers reasonable.

*Example:* A borrows ₹ 10,000 from B and gives him a bond for ₹ 20,000 payable by five yearly instalments of ₹ 4,000 with a stipulation that in default of payment, the whole shall become due. This is a stipulation by way of penalty.

*Example:* A undertakes to repay B, a loan of ₹ 10,000 by five equal monthly instalments with a stipulation that in default of payment of any instalment, the whole shall become due. This stipulation is not by way of penalty and the contract may be enforced according to its terms

### ◆ Distinction between liquidated damages and penalty

1. If the amount payable exceeds the probable damage on breach, it is considered a penalty.
2. A penalty is imposed when a sum is payable on a specific date and a further sum is added in case of default, as delay is unlikely to cause damage.
3. The court must determine if a contract sum is a penalty or liquidated damages, with extravagant or exorbitant amounts considered penalties even if referred to as liquidated damages.
4. Penalties are financial payments made to the offending party, while liquidated damages are a genuine pre-estimate of the damage.
5. English law distinguishes between liquidated damages and penalties, but in India, courts must determine actual loss and award reasonable compensation, not exceeding the contract sum.

Besides claiming damages as a remedy for the breach of contract, the following remedies are also available:

#### (i) Rescission of contract

A breached contract allows the other party to treat it as rescinded, absolving them of all obligations and entitled to compensation for any damages.

#### *Example:*

A promises B to deliver 50 bags of cement on a certain day. B agrees to pay the amount on receipt of the goods. A failed to deliver the cement on the appointed day. B is discharged from his liability to pay the price.



#### (ii) Quantum Meruit:

The law infers a promise to pay in cases where a party rendered service without a fixed remuneration, resulting in a Quantum Meruit claim, where the injured party had done part but not all of the contract's work.

Conditions for Application:

The doctrine is applicable only if the original contract has been discharged.

The claim must be brought by a party who is not in default of the contract.

Cases where the claim arises:

When an agreement is discovered to be void, or when a contract becomes void.

When something is done without any intention to do so gratuitously.

Where there is an express or implied contract for services, but no agreement exists regarding remuneration.

When one party abandons or refuses to perform the contract.

Where a contract is divisible, and the party not in default has enjoyed the benefit of part performance.

When an indivisible contract for a lump sum is completely performed, but badly; the performing person can claim the lump sum, but the other party can make a deduction for the deficient work.

**Example:**

X wrongfully revoked Y's (his agent) authority before Y could complete his duties. Held, Y could recover, as a quantum meruit, for the work he had done and the expenses he had incurred in the course of his duties as an agent.

**Example:**

A agrees to deliver 100 bales of cottons to B at a price of ₹ 1000 per bale. The cotton bales were to be delivered in two instalments of 50 each. A delivered the first instalment but failed to supply the second. B must pay for 50 bags.

**(iii) Suit for specific performance:**

In cases where damages are insufficient for contract breaches, the court may, in its discretion, instruct the party in breach to fulfill their promise.

**(iv) Suit for injunction:**

Courts can issue 'injunction orders' when a party in a contract is denying its terms, preventing them from fulfilling their promises.

**Example:** N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer. Held, she could be restrained by an injunction.

*Example:* A, a singer, agreed with B to perform at his theatre for two months, on a condition that during that period, he would not perform anywhere. In this case, B could move to the Court for grant of injunction restraining A from performing in other places.

Party rightfully rescinding contract, entitled to compensation (Section 75) -A person who rescinds a contract is entitled to compensation for any damages they have suffered due to non-fulfilment of the contract.

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*Example:* A, a singer, agreed with B to perform at his theatre for two months, on a condition that during that period, he would not perform anywhere. In this case, B could move to the Court for grant of injunction restraining A from performing in other places.

(v) Party rightfully rescinding contract, entitled to compensation (Section 75)

A person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through non-fulfilment of the contract.

*Example:*

A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹ 10000 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the nonfulfillment of the contract.

# Chapter 2

## Unit 6: Contingent And Quasi Contracts

### CONTINGENT CONTRACTS

A contract can be either absolute or contingent. An absolute contract is one where the promisor undertakes to perform the contract in any event without any condition.

#### Definition of 'Contingent Contract' (Section 31)

"A contract to do or not to do something, if some event, collateral to such contract, does or does not happen".

**Example:** A contracts to pay B ₹ 10,00,000 if B's house is burnt. This is a contingent contract.

**Example:** A makes a contract with B to buy his house for ₹ 50,00,000 if he is able to secure to bank loan for that amount. The contract is contingent contract.



#### Meaning of Collateral Event

A collateral event is defined as "an event which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise".

**Example:** A contracts to pay B ₹ 10,00,000 if B's house is burnt. This is a contingent contract. Here the burning of the B's house is neither a performance promised as part of the contract nor it is the consideration obtained from B. The liability of A arises only on the happening of the collateral event.

**Example:** A agrees to transfer his property to B if her wife C dies. This is a contingent contract because the property can be transferred only when C dies.

#### Essentials of a Contingent Contract

Performance depends upon the happening or non-happening of an event:

The condition can be precedent (happens before performance) or subsequent (happens after performance but affects its continuance).

**Example:** 'A' promises to pay ₹ 50,000 to 'B' if it rains on first of the next month.

### The event must be collateral to the contract:

The event is not part of the contract itself; it's neither the performance promised nor the consideration for a promise. If the event is directly connected to the contract, it's a conditional contract, not contingent.

Manish- "I told my neighbour, 'I'll bake you a cake if you build me a new fence.'"

Jiya- "That's a direct promise—cake for the fence."

Manish- "Then I said, 'I'll bake you a cake if flamingos land in your yard.'"

Jiya- "Now that's just a random event—totally collateral!"



### The contingent event should not be a mere 'will' of the promisor:

The event must be contingent in addition to being the will of the promisor. If it's solely based on the promisor's choice, it's not a contract at all.

**Example:** If A promises to pay B ₹ 100,000, if he so chooses, it is not a contingent contract. (In fact, it is not a contract at all). However, where the event is within the promisor's will but not merely his will, it may be contingent contract.

**Example:** If A promises to pay B ₹ 100,000 if it rains on 1st April and A leave Delhi for Mumbai on a particular day, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but raining is not merely his will.

### The event must be uncertain:

If the event is certain to happen, the contract is not contingent, as Performance is due regardless.

**Example:** 'A' agreed to sell his agricultural land to 'B' after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfilment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.

## RULES RELATING TO ENFORCEMENT

### Enforcement of contracts contingent on an event happening (Section 32)

#### Enforceable when

The uncertain future event happens.

**Becomes void if**

The event becomes impossible, or does not happen till the expiry of time fixed.

**Example:**

A contracts to pay B a sum of money when B marries C. C dies without being married to B. The Contract becomes void.

Niece: "Deal!"  
(She runs off, then trips on the patch...)

Niece: "Oh no! I stepped on them— they all turned into two-leaf clovers!"



Aunt: "Find a four-leaf clover, and I'll give you ₹5,000."

Aunt: "Then no ₹5,000. The deal's off!"

**Enforcement of contracts contingent on an event not happening (Section 33)**
**Enforceable when**

The happening of that event becomes impossible, or it does not happen at the expiry of the fixed time.

**Becomes void if**

The event has happened.

**Example:** Where 'P' agrees to pay 'Q' a sum of money if a particular ship does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.

**Contingent on the conduct of a living person (Section 34)**

A contract ceases to be enforceable if it's contingent on a living person's conduct, and that person does something to make the event impossible. The event is considered impossible if the person acts in a way that renders it impossible within a definite time or without further contingencies.

**CASE LAW: Frost V. Knight**

**Facts:** In Frost V. Knight, the defendant promised to marry the plaintiff on the death of his father. While the father was still alive, he married another woman. It was held that it had become impossible that he should marry the plaintiff and she was entitled to sue him for the breach of the contract.

**Example:** Where 'A' agrees to pay 'B' a sum of money if 'B' marries 'C'. 'C' marries 'D'. This act of 'C' has rendered the event of 'B' marrying 'C' as impossible; it is though possible if there is divorce between 'C' and 'D'.

*Contingent on happening of specified event within fixed time (Section 35):*

**Enforceable when:**

The specified uncertain event happens within the fixed time.

**Becomes void if:**

At the expiration of the fixed time, the event has not happened, or if, before the time fixed, the event becomes impossible.

*Example:* A promises to pay B a sum of money if certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

*Contingent on specified event not happening within fixed time (Section 35):*

**Enforceable when:**

The time fixed has expired and the event has not happened, or before the time fixed has expired, it becomes certain that such event will not happen.

**Becomes void if:**

The event has happened within the specified time.

*Contingent on an impossible event (Section 36):*

**Always Void**

Contingent agreements based on an impossible event happening are **void**, regardless of whether the parties knew about the impossibility at the time of the agreement.

*Example:* 'A' agrees to pay 'B' ₹ one lakh if sun rises in the west next morning. This is an impossible event and hence void.

*Example:* X agrees to pay Y ₹ 1,00,000 if two straight lines should enclose a space. The agreement is void.

## DIFFERENCE BETWEEN A CONTINGENT CONTRACT AND A WAGERING

Basis of difference	Contingent contract	Wagering contract
Meaning	A contingent contract is a contract to do or not to do something with reference to a collateral event happening or not happening.	A wagering agreement is a promise to give money or money's worth with reference to an uncertain event happening or not happening.

Reciprocal promises	Contingent contract may not contain reciprocal promises.	A wagering agreement consists of reciprocal promises.
Uncertain event	In a contingent contract, the event is collateral.	In a wagering contract, the uncertain event is the core factor.
Nature of contract	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.
Interest of contracting parties	Contracting parties have interest in the subject matter in contingent contract.	The contracting parties have no interest in the subject matter.
Doctrine of mutuality of lose and gain	Contingent contract is not based on doctrine of mutuality of lose and gain.	A wagering contract is a game, losing and gaining alone matters.
Effect of contract	Contingent contract is valid.	A wagering agreement is void.

## QUASI-CONTRACTS

Sometimes, the law imposes obligations and confers rights even without a formal offer, acceptance, consent, or consideration. These are not "contracts" in the strict sense but are recognized by courts as "relations resembling those of contracts," thus called Quasi-contracts (meaning "resembling a contract"). They are also known as constructive contracts.

Quasi-contracts are founded on principles of equity, justice, and good conscience. A key maxim is "No man must grow rich out of another person's loss".

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

**Example:** A pays some money to B by mistake. It is really due to C. B must refund the money to A.

**Example:** A fruit parcel is delivered under a mistake to R who consumes the fruits thinking them as birthday present. R must return the parcel or pay for the fruits. Although there is no agreement between R and the true owner, yet he is bound to pay as the law regards it a Quasi-contract.

### Salient features of quasi contracts:

- (a) In the first place, such a right is always a right to money and generally, though not always, to a liquidated sum of money.
- (b) Secondly, it does not arise from any agreement of the parties concerned, but is imposed by the law; and
- (c) Thirdly, it is a right which is available not against all the world, but against a particular person or persons only, so that in this respect it resembles a contractual right.

## Cases Deemed as Quasi-Contracts (Obligations Imposed by Law)

### Claim for necessaries supplied to persons incapable of contracting (Section 68):

If necessaries are supplied to a person incapable of entering a contract (e.g., a minor or a lunatic) or someone they are legally bound to support, the supplier is entitled to be reimbursed from the property of that incapable person.

The supplier must prove the goods were necessaries and suitable to the person's actual requirements.



### Payment by an interested person (Section 69):

A person who is interested in the payment of money which another is legally bound to pay, and who therefore pays it, is entitled to be reimbursed by the other.

**Example:** B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of the sale will be the annulment of B's lease. B, to prevent the sale and the consequent annulment of his own lease, pays to the government the sum due from A. A is bound to make good to B the amount so paid.

### Obligation of person enjoying benefits of non-gratuitous act (Section 70):

If a person lawfully does something for another, or delivers something to them, not intending to do so gratuitously (for free), and the other person enjoys the benefit, the latter is bound to pay compensation or restore the thing.

It thus follows that for a suit to succeed, the plaintiff must prove:

(i) that he had done the act or had delivered the thing lawfully;



(ii) that he did not do so gratuitously; and



(iii) that the other person enjoyed the benefit.

CASE LAW: *Shyam Lal vs. State of U.P.*

**Facts:** The above can be illustrated by a case law where 'K' a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in the meantime government went on appeal. The appeal was decided in favour of the government and 'K' was directed to return the salary paid to him during the period of reinstatement.

**Example:** A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them.

### Responsibility of finder of goods (Section 71):

A person who finds goods belonging to another and takes them into custody is subject to the same responsibility as a bailee.

The finder must:

(i) take proper care of the property,

(ii) not appropriate the goods, and

(iii) restore the goods if the owner is found.

### CASE LAW: *Hollins Vs. Howler L. R. & H. L.*

**Facts:** 'H' picked up a diamond on the floor of 'F's shop and handed over the same to 'F' to keep till the owner was found. In spite of the best efforts, the true owner could not be traced. After the lapse of some weeks, 'H' tendered to 'F' the lawful expenses incurred by him and requested to return the diamond to him. 'F' refused to do so. Held, 'F' must return the diamond to 'H' as he was entitled to retain the goods found against everybody except the true owner.

**Example:** 'P' a customer in 'D's shop puts down a brooch worn on her coat and forgets to pick it up and one of 'D's assistants find it and puts it in a drawer over the weekend. On Monday, it was discovered to be missing. 'D' was held to be liable in the absence of *ordinary care* which a prudent man would have taken.

### Money paid by mistake or under coercion (Section 72):

A person to whom money has been paid or anything delivered by mistake or under coercion must repay or return it. This applies to every kind of payment or delivery made under mistake. The term 'coercion' here is interpreted broadly to include oppression or extortion.

### CASE LAWS:

*Shivprasad Vs Sirish Chandra A.I.R. 1949 P.C. 297*

*Sales tax officer vs. Kanhaiyalal A. I. R. 1959 S. C. 835*

*Seth Khanjelek vs National Bank of India*

*Trikamdas vs. Bombay Municipal Corporation A. I. R. 1954*

Every kind of payment of money or delivery of goods for every type of 'mistake' is recoverable. *[Shivprasad Vs Sirish Chandra A.I.R. 1949 P.C. 297]*

Example: A payment of municipal tax made under mistaken belief or because of mis-understanding of the terms of lease can be recovered from municipal authorities. The above law was affirmed by Supreme Court in cases of *Sales tax officer vs. Kanhaiyalal A. I. R. 1959 S. C. 835*

Similarly, any money paid by coercion is also recoverable. The word coercion is not necessarily governed by section 15 of the Act. The word is interpreted to mean and include oppression, extortion, or such other means *[Seth Khanjelek vs National Bank of India]*.

In a case where 'T' was traveling without ticket in a tram car and on checking he was asked to pay ₹5/- as penalty to compound transaction. T filed a suit against the corporation for recovery on the ground that it was extorted from him. The suit was decreed in his favour. *[Trikamdas vs. Bombay Municipal Corporation A. I. R. 1954]*

In all the above cases the contractual liability arose without any agreement between the parties.

## DIFFERENCE BETWEEN QUASI CONTRACTS AND CONTRACTS

Basis of distinction	Quasi- Contract	Contract
Essential for the valid contract	The essentials for the formation of a valid contract are absent	The essentials for the formation of a valid contract are present
Obligation	Imposed by law	Created by the consent of the parties

# Chapter 2

## Unit 7: Contract Of Indemnity

### CONTRACT OF INDEMNITY

The term "Indemnity" literally means "security against loss," "to make good the loss," or "to compensate the party who has suffered some loss".

Definition (Section 124, Indian Contract Act, 1872): A contract where one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.



**Example:** Mr. X contracts with the Government to return to India after completing his studies (which were funded by the Government) at University of Cambridge and to serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

#### Parties

a. The party who promises to indemnify/ save the other party from loss- "indemnifier".

b. The party who is promised to be saved against the loss- "indemnified".....or "indemnity"

**Example:** A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ₹ 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

However, the above definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused by:

(i) the conduct of the promisor himself, or

(ii) the conduct of any other person

CASE LAW: *Gajanan Moreshwar v/s Moreshwar Madan (1942)*.

Facts: In case of *Gajanan Moreshwar v/s Moreshwar Madan (1942)*, decision is taken on the basis of English Law. As per English Law, Indemnity means promise to save another harmless from the loss. Here it covers every loss whether due to negligence of promisee or by natural calamity or by accident.

### Mode of contract of indemnity:

A contract of indemnity like any other contract may be express or implied.

- A contract of indemnity is said to be express when a person expressly promises to compensate the other from loss.
- A contract of indemnity is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case.

A contract of indemnity is like any other contract and must fulfil all the essentials of a valid contract.

**Example:** A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined ₹1000, B cannot claim this amount from A because the object of the agreement is unlawful.

### Rights of Indemnity-Holder When Sued (Section 125):

The promisee (indemnity-holder), acting within the scope of his authority, is entitled to recover from the indemnifier:

All damages he may be compelled to pay in any suit.

All costs he may have been compelled to pay in bringing or defending the suit.

All sums he may have paid under the terms of any compromise of suit.

### When does the liability of an indemnifier commence?

Under Indian law, an indemnifier's liability begins when the indemnity-holder's liability becomes absolute and certain, a principle established by judicial pronouncements given the Indian Contract Act, 1872's silence on the matter.

**Example:** A promise to compensate X for any loss that he may suffer by filing a suit against Y. The court orders X to pay Y damages of ₹ 10000. As the loss has become certain, X may claim the amount of loss from A and pass it to Y.

## CONTRACT OF GUARANTEE

Definition (Section 126, Indian Contract Act, 1872): A contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

**Parties to a Contract of Guarantee:**

There are three parties involved:

**Surety**

The person who gives the guarantee.

**Principal Debtor**

The person in respect of whose default the guarantee is given

**Creditor**

The person to whom the guarantee is given



**Example:** When A requests B to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he (A) will himself pay to B, there is a contract of guarantee. Here, B is the creditor, C the principal debtor and A the surety.

**Example:** X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y, and agrees that if Y fails to pay he will. In case of Y's failure to pay, the car showroom will recover its money from X.

**Tripartite Agreement**

A contract of guarantee is a tripartite agreement, meaning it involves three distinct, though interconnected, contracts:

<b>Principal Contract</b>	Between the <b>principal debtor and the creditor</b> . This is the core transaction (e.g., loan, sale of goods).
<b>Secondary Contract</b>	Between the <b>creditor and the surety</b> . This is the guarantee itself
<b>Implied Contract</b>	Between the <b>surety and the principal debtor</b> . The principal debtor is obligated to indemnify the surety if the surety is made to pay or perform.

## Essential Features of a Valid Guarantee

### Purpose: Existence of a Recoverable Debt

The purpose of a guarantee is to secure the payment of a debt. Therefore, the existence of a recoverable debt is necessary.

### Consideration

Like any other contract, a guarantee must be supported by consideration. A guarantee without consideration is void.

However, there is no need for direct consideration between the surety and the creditor.

### Section 127

Consideration received by the principal debtor is sufficient consideration for the surety to give the guarantee.

#### *Important:*

Past consideration is not valid consideration for a contract of guarantee.

**Example (Valid Consideration):** B asks A to sell goods on credit. A agrees if C guarantees payment. C promises in consideration of A's promise to deliver goods. This is sufficient consideration for C's promise.

**Example (Void Due to Past Consideration):** A sells goods to B. C afterwards, without consideration, agrees to pay for them in default of B. This agreement is void.

### Existence of a liability:

A valid guarantee requires an existing, legally enforceable, and not time-barred liability or promise whose performance is being guaranteed.

### No Misrepresentation or Concealment (Sections 142 & 143)

Any guarantee obtained by misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid (Section 142).

Any guarantee obtained by the creditor by keeping silence as to material circumstances is invalid (Section 143).

**Example (Misrepresentation):** C sells an AC to P, misrepresenting it as copper when it's aluminum. S guarantees without knowing the truth. S is not liable.

**Example (Concealment):** A engages B as a clerk. B fails to account for receipts. A asks for security from B, and C gives a guarantee for B's accounting. A does not tell C about B's past conduct. B defaults. The guarantee is invalid.

**Example (Concealment):** A guarantees C payment for iron supplied to B. B and C privately agreed B would pay ₹5/ton above market price to clear an old debt. This is concealed from A. A is not liable.

### Writing not necessary

Section 126 expressly declares that a guarantee may be either oral or written.

### Joining of Co-sureties (Section 144)

If a surety gives a guarantee on the condition that another person will also join as a co-surety, the guarantee becomes invalid if that other person does not join. The validity of the guarantee depends on the fulfillment of the surety's condition.

## TYPES OF GUARANTEES

### Specific Guarantee

A guarantee that extends to a single debt or specific transaction. The surety's liability ends when the guaranteed debt is duly discharged or the promise is performed.

Count Cashalot: Don't worry, Mr. Muffin, this gigantic muffin is on me.

Mr. Muffin: You're a lifesaver, Count!

Count Cashalot: Just remember, my generosity for muffins is now officially retired.



**Example:** A guarantees payment to B of the price of the five bags of rice to be delivered by B to C and to be paid for in a month. B delivers five bags to C. C pays for them. This is a contract for specific guarantee because A intended to guarantee only for the payment of price of the first five bags of rice to be delivered one time [Kay v Groves]

### Continuing Guarantee (Section 129)

A guarantee which extends to a series of transaction is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee. The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.



**Example:** On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5th of every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.

**Example:** A guarantees payment to B, a tea-dealer, to the amount of ₹ 10,000, for any tea he may from time-to-time supply to C. B supplies C with tea to above the value of ₹ 10,000, and C pays B for it. Afterwards B supplies C with tea to the value of ₹ 20,000. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of ₹ 10,000.

## DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND A CONTRACT OF GUARANTEE

Basis	Contract of Indemnity	Contract of Guarantee
Number of party / parties to the contract	There are only <b>two parties</b> namely the indemnifier [promisor] and the indemnified [promisee]	There are <b>three parties</b> – creditor, principal debtor and surety.
Nature of liability	The liability of the indemnifier is primary and unconditional.	The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor.
Time of liability	The liability of the indemnifier arises only on the happening of a contingency.	The liability arises only on the non-performance of an existing promise or non-payment of an existing debt.
Time to Act	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
Right to sue third party	Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	Surety can proceed against principal debtor in his own right because he gets all the rights of a creditor after discharging the debts.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	All parties must be competent to contract.	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

### NATURE AND EXTENT OF SURETY'S LIABILITY (SECTION 128)

- (i) The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. [Section 128]
- (ii) Liability of surety is of secondary nature as he is liable only on default of principal debtor.
- (iii) Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases.
- (iv) A creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

*Example:* A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

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## LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT (SECTION 132)

If two persons contract with a third person to undertake a certain liability, and they privately agree that one will be liable only on the other's default, this private agreement does not affect their liability to the third person, even if the third person knew about it.

**Example:** A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

## DISCHARGE OF A SURETY

A surety is said to be discharged when his liability as surety comes to an end. The various modes of discharge of surety are discussed below:

### Modes Of Discharge

(i) By revocation of the contract of guarantee.

(ii) By the conduct of the creditor, or

(iii) By the invalidation of the contract of guarantee.

### By revocation of the Contract of Guarantee

#### Revocation of Continuing Guarantee by Notice (Section 130):

A continuing guarantee can be revoked by the surety at any time as to future transactions by giving notice to the creditor.

However, the surety remains liable for all transactions that happened before the notice was given.

A specific guarantee can only be revoked if the liability to the principal debtor has not yet accrued.

**Example:** Arun promises to pay Rama for all groceries bought by Carol for a period of 12 months if Carol fails to pay. In the next three months, Carol buys ₹ 2000/- worth of groceries. After 3 months, Arun revokes the guarantee by giving a notice to Rama. Carol further purchases ₹ 1000 of groceries. Carol fails to pay. Arun is not liable for ₹ 1000/- of purchase that was made after the notice but he is liable for ₹ 2000/- of purchase made before the notice.

### Revocation of Continuing Guarantee by Surety's Death (Section 131):

Unless otherwise agreed, the death of the surety operates as a revocation of a continuing guarantee as to future transactions taking place after the death.

The surety's estate remains liable for past transactions that occurred before the death.

**Example:** 'S' guarantees 'C' for the transaction to be done between 'C' & 'P' for next month. After 5 days 'S' died. Now guarantee is revoked for future transactions but 'S's estate is still liable for transactions done during previous five days.

### By Novation (Section 62):

If a fresh contract is entered into (either between the same parties or different parties), and the original contract is mutually discharged, the surety under the original contract is discharged.

**Example:** 'S' guarantees 'C' for the payment of the supply of wheat to be done by 'C' & 'P' for next month. After 5 days, the contract is changed. Now 'S' guarantees 'C' for the payment of the supply of rice to be done by 'C' & 'P' for rest of next month. Here, guarantee is revoked for supply of wheat. But 'S' is still liable for supply of wheat done during previous five days.

### By Conduct of the Creditor:

#### By Variance in Terms of Contract (Section 133):

If there is any variance in the terms of the contract between the principal debtor and creditor without the surety's consent, it discharges the surety in respect of all transactions taking place subsequent to such variance.

**Example:** A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent and is not liable to make good this loss.

#### By Release or Discharge of Principal Debtor (Section 134):

The surety is discharged if the creditor:

i. enters into a fresh/ new contract with principal debtor; by which the principal debtor is released,

ii. does any act or omission, the legal consequence of which is the discharge of the principal debtor

*Example:* A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

*Example:* A gives a guarantee to C for goods to be delivered to B. Later on, B contracts with C to assign his property to C in lieu of the debt. B is discharged of his liability and A is discharged of his liability.

*Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135]:*

A contract between the creditor and the principal debtor to make a composition with, give time to, or not to sue the principal debtor, discharges the surety, unless the surety assents to such a contract.

**Composition:**

If the creditor agrees to accept less than the full debt from the principal debtor without consulting the surety, the surety is discharged.

**Promise to Give Time:**

If the creditor grants the principal debtor more time to pay than originally agreed, without the surety's consent, the surety is discharged.

**Promise Not to Sue:**

If the creditor agrees not to sue the principal debtor, the surety is discharged, as this violates the surety's right to compel the principal debtor to pay.

Cases Where Surety is NOT Discharged:

**Agreement Made with Third Person to Give Time (Section 136)**

If the creditor gives time to the principal debtor based on an agreement with a third person (not the principal debtor), the surety is not discharged.

**Creditor's Forbearance to Sue (Section 137)**

Mere forbearance (not suing or enforcing other remedies) on the part of the creditor does not discharge the surety, unless the guarantee contract specifically states otherwise.

**Discharge of Surety by Creditor's Act or Omission Impairing Surety's Eventual Remedy (Section 139):**

If the creditor does any act inconsistent with the surety's rights or omits to do any act that his duty to the surety requires, and this impairs the surety's eventual remedy against the principal debtor, the surety is discharged.

CASE LAW: *State Bank of Saurashtra V Chitranjan Rangnath Raja (1980)*

*Facts: In a case before the Supreme Court of India, “A bank granted a loan on the security of the stock in the godown. The loan was also guaranteed by the surety. The goods were lost from the godown on account of the negligence of the bank officials. The surety was discharged to the extent of the value of the stock so lost.”*

### By the Invalidation of the Contract of Guarantee:

#### (a) Guarantee obtained by misrepresentation [Section 142]:

*Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.*

*Example: ‘C’ sells AC to ‘P’ on misrepresenting that it is made of copper while it is made of aluminum. ‘S’ guarantees for the same as surety without the knowledge of fact that it is made of aluminum. Here, ‘S’ will not be liable.*

#### (b) Guarantee obtained by concealment [Section 143]:

*Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.*

*Example: A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B’s duly accounting. A does not acquaint C with B’s previous conduct. B afterwards makes default. The guarantee is invalid.*

#### (c) Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144):

*Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.*

*Example: ‘S1’ guarantees ‘C’ for payment to be done by ‘P’ to ‘C’ on the condition that ‘S1’ will be liable only if ‘S2’ joins him for such guarantee. ‘S2’ does not give his consent. Here, ‘S1’ will not be liable.*

## RIGHTS OF A SURETY

*The surety enjoys the following rights against the creditor:*

(a) Rights against the creditor,

(b) Rights against the principal debtor,

(c) Rights against co-sureties.

## Right against the principal debtor

### Right of Subrogation (Section 140):

When a guaranteed debt becomes due, or the principal debtor defaults, the surety, upon payment or performance of all that he is liable for, is invested with all the rights that the creditor had against the principal debtor.

This means the surety "steps into the shoes of the creditor". He acquires all the remedies the creditor had against the principal debtor.



**Example:** 'Raju' has taken a housing loan from Canara Bank. 'Pappu' has given guarantee for repayment of such loan. Besides, there was a condition that if 'Raju' does not repay the loan within time, the bank can auction his property by giving 15 days' notice to 'Raju'. On due date 'Raju' does not repay, hence Pappu being a surety has to repay the loan. Now 'Pappu' can take the house from bank and has a right to auction the house by giving 15 days' notice to 'Raju'.

### Implied Promise to Indemnify Surety (Section 145):

In every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety.

The surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but not sums paid wrongfully. This includes principal debt and reasonable costs of defence if incurred on reasonable grounds.

**Example:** B is indebted to C and A is surety for the debt. Upon default, C sues A. A defends the suit on reasonable grounds but is compelled to pay the amount. A is entitled to recover from B the cost as well as the principal debt.

## Rights Against the Creditor:

### Surety's Right to Benefit of Creditor's Securities (Section 141):

A surety is entitled to the benefit of every security the creditor has against the principal debtor at the time the suretyship contract is made, whether the surety knew about it or not.

If the creditor loses, or parts with such security without the surety's consent, the surety is discharged to the extent of the value of the security.

*Example:* C advances 200,000 to B on A's guarantee, and also has a mortgage on B's furniture (worth 80,000). C cancels the mortgage. B becomes insolvent, and C sues A. A is discharged to the extent of ₹ 80,000 (value of furniture) and remains liable for the balance.

#### Right to Set-off:

If the creditor sues the surety, the surety may benefit from any set-off (counter-claim) that the principal debtor had against the creditor.

*Example:* X took a 50,000 loan from Y, guaranteed by Z. X also had a 10,000 receivable from Y. If Y sues Z, Z is liable for 40,000 (50,000 - ₹ 10,000).

#### Right to Share Reduction:

The surety has a right to claim a proportionate reduction in his liability if the principal debtor becomes insolvent.

*Example:* X took 50,000 from Y, guaranteed by Z. X becomes insolvent, and only 25% (12,500) is realized from his property. Y gets 12,500 from X, and Z is then liable for 37,500 (50,000 - 12,500).

### ◆ Rights Against Co-sureties:

“Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties”

#### Co-sureties Liable to Contribute Equally (Section 146):

Unless otherwise agreed, each co-surety is liable to contribute equally for the discharge of the whole debt, or the part unpaid by the debtor.

This principle is based on "equality of burden".

*Example:* A, B, C are sureties for D for 300,000. D defaults. A, B, C are liable to pay 100,000 each.

*Example (Contract to the Contrary):* A, B, C are sureties for D for 100,000. They agree A pays 1/4, B pays 1/4, C pays 1/2. D defaults. A pays 25,000, B 25,000, C 50,000.

#### Liability of Co-sureties Bound in Different Sums (Section 147):

Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit. They don't have to contribute strictly proportionally to their maximum limits; it's equal contribution up to the limit of their bond.

*Example:* A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.

*Example:* A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.

*Example:* A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.

# Chapter 2

## Unit 8: Bailment and Pledge

### WHAT IS BAILMENT?

#### Meaning

The term "Bailment" comes from the French word "ballier," meaning "to deliver". Etymologically, it means 'handing over' or 'change of possession'.

#### Definition (Section 148 of The Indian Contract Act, 1872)

Bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

#### Parties to Bailment:

##### Bailor

The person delivering the goods.

##### Bailee

The person to whom the goods are delivered

**Example:** Where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

**Example:** X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is contract for bailment.

**Example:** Goods given to a friend for his own use, without any charge.

**Example:** X delivers goods to blue dart for carriage.

#### Essential Elements of a Contract of Bailment:

##### (a) Contract:

Bailment is always based on a contract, which can be express or implied. Importantly, no consideration is necessary to create a valid contract of bailment.

Jack- Hey Bob, I'm heading out on vacation. Can you keep my rubber duck collection safe while I'm gone?

Jack- Yep, just hold onto them till I'm back. No money or anything—just trust.



Bob: Of course! I'll take good care of them. You want them back when you return, right?

Bob: Got it. I won't let anything happen to them.

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**(b) Delivery of Goods:**

- ➔ This involves the transfer of goods from one person to another for a specific purpose.
- ➔ Bailment applies only to moveable goods, never to immovable goods or money.

Types of Delivery

**Actual Delivery**

Goods are physically handed over to the bailee by the bailor.

**Example:** Delivering a car to a workshop for repair.

**Constructive Delivery**

Delivery is made by doing something that puts the goods in the bailee's possession, or a person authorized to hold them on their behalf.

**Example:** Handing over the car keys to a workshop dealer for car repair.

**(c) Purpose:**

The goods are delivered for a specific purpose, which can be express or implied.

**(d) Possession:**

In bailment, possession of goods changes, but ownership does not. The bailor remains the owner. If a person merely has custody without possession, they are not a bailee.

**Example:** A servant having custody of their master's goods is not a bailee.

Depositing ornaments in a bank locker is not bailment because the owner retains the key and possession, even though the ornaments are physically at the bank.

Depositing money in a bank is not bailment because the exact currency notes are not returned; instead, different notes of the same value are returned.

Riya- Really? Thanks! I'll make sure nothing happens to it.

Priya- Hey, I'll lend you my fancy hat for the party tonight.

Riya- Got it! It's your hat, just on temporary loan.

Priya- Just remember, I still own it even if it's with you.



Priya- So if it gets wild and starts karaoke without warning, I'm still the one who has to apologize!

**(e) Return of Goods:**

The bailee is obliged to return the goods to the bailor once the purpose is accomplished. The goods should be returned in the same form or altered as per the bailor's direction; exchange of goods is not allowed.

## Types of bailments

1. On the basis of benefit, bailment can be classified into three types:

a. For the exclusive benefit of bailor:

**Example:** The delivery of some valuables to a neighbour for safe custody, without charge.

b. For the exclusive benefit of bailee:

**Example:** The lending of a bicycle to a friend for his use, without charge.

c. For mutual benefit of bailor and bailee:

**Example:** Giving of a watch for repair.

2. On the basis of reward, bailment can be classified into two types:

### a. Gratuitous Bailment

The word gratuitous means free of charge. So, a gratuitous bailment is one when the provider of service does it gratuitous i.e. free of charge. Such bailment would be either for the exclusive benefits of bailor or bailee.

### b. Non-Gratuitous Bailment

Non-gratuitous bailment means where both the parties get some benefit i.e. bailment for the benefit of both bailor & bailee.

## DUTIES OF A BAILOR

The duties of bailor are spelt out in a number of Sections [Section 150, 158, 159, 164]. These are categorized under the following headings:

<i>Duties of Bailor</i>	<i>Disclose known facts</i>
	<i>Bear necessary expenses</i>
	<i>Indemnify bailee</i>
	<i>Bound to accept the goods</i>

## Duty to Disclose Faults in Goods Bailed [Section 150]

*In case of Gratuitous Bailment:*

The bailor must disclose known faults that materially interfere with the goods' use or expose the bailee to extraordinary risks. Failure to do so makes the bailor responsible for damages arising from such faults.

**Example:** A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

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### In case of Non-Gratuitous Bailment (Bailed for Hire):

The bailor is responsible for damages from faults whether they were aware of them or not.

**Example:** A hire a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

#### CASE LAW: *Hyman & Wife v. Nye & Sons (1881)*:

**Fact:** In *Hyman & Wife v. Nye & Sons (1881)*, A hired from B a carriage along with a pair of horses and a driver for a specific journey. During the journey a bolt in the under-part of the carriage broke away. As a result of this, the carriage became upset and A was injured. It was held that B was liable to pay damages to A for the injury sustained by him. The court observed that it was the bailor's duty to supply a carriage fit for the purpose for which it was hired.

Sometimes, the goods bailed are of dangerous nature (e.g., explosives). In such cases it is the duty of the bailor to disclose the nature of goods.

#### CASE LAW: **Great Northern Ry' case (1932)**

### ◆ Duty to Pay Necessary Expenses [Section 158]:

#### In case of Gratuitous Bailment:

The bailor must repay the bailee for all necessary and extraordinary expenses incurred for the purpose of the bailment.

#### In case of Non-Gratuitous Bailment:

The bailor is liable for extraordinary expenses incurred by the bailee. Ordinary expenses (like petrol, toll tax for a hired car) are borne by the bailee.

**Example:** A hired a taxi from B for the purpose of going to Gurgaon from Noida. During the journey, a major defect occurred in the engine. A had to pay ₹ 5000 as repair charges. These are the extraordinary expenses and it is the bailor's duty to bear such expenses. However, the usual and ordinary expenses for petrol, toll tax etc. are to be borne by the bailee itself.

### ◆ Duty to Indemnify the Bailee for Premature Termination [Section 159]

If the bailor lent goods gratuitously and terminates the bailment early, they must compensate the bailee for any loss or damage suffered that exceeds the benefit the bailee received.

## ◆ Bailor's Responsibility to Bailee [Section 164]:

### a. Indemnify for Defective Title:

The bailor must indemnify the bailee for any loss sustained if the bailor was not entitled to make the bailment, receive goods back, or give directions regarding them.

### b. Bound to Accept the Goods:

The bailor must receive the goods back when the bailee returns them at the proper time. If the bailor refuses, the bailee can claim compensation for necessary expenses incurred for safe custody.

*Example:* X delivered his car to S for five days for safe keeping. However, X did not take back the car for one month. In this case, S can claim the necessary expenses incurred by him for the custody of the car.

## DUTIES OF A BAILEE

### ◆ Take Reasonable Care of the Goods [Section 151 & 152]:

The bailee must take as much care of the bailed goods as an ordinary prudent man would of his own goods of the same bulk, quality, and value under similar circumstances.

#### *Exception [Section 152]:*

The bailee is not responsible for loss, destruction, or deterioration if they have taken reasonable care, unless there's a special contract.

*Example:* If X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss caused on account of riot.

*Example:* A deposited his goods in B's warehouse. On account of unprecedented floods, a part of the goods was damaged. It was held that, B is not liable for the loss.

CASE LAW: *Shanti Lal V. Takechand*

### ◆ Not to Make Inconsistent Use of Goods (No Unauthorized Use) [Section 153 & 154]:

If the bailee uses the goods in a manner not consistent with the bailment terms, they are liable for any loss or destruction of the goods. The contract of bailment becomes voidable at the bailor's option.

**Example:** A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

**Example:** 'A' hires a horse in Kolkata from B expressly to march to Varanasi. 'A' rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'A' is liable to make compensation to B for the injury to the horse.

### ◆ Not to Mix the Goods [Section 155, 156 and 157]:

#### i. With Consent [Section 155]

If the bailee mixes goods with the bailor's consent, both parties will have an interest in the mixture proportionate to their respective shares.

#### ii. Without Consent, but Separable [Section 156]

If the bailee mixes goods without consent but they can be separated, the property remains with the original owners. However, the bailee must bear the expense of separation and any resulting damage.

**Example:** B mixes A's 100 bales of cotton with his own, without consent. A is entitled to his bales back, and B pays for separation and damages.

#### iii. Without Consent, and Impossible to Separate [Section 157]

If the bailee mixes goods without consent and separation is impossible, the bailor is entitled to compensation for the loss of their goods.

**Example:** B mixes A's Cape flour with his own cheaper country flour. B must compensate A for the loss of his flour.

### ◆ Return the Goods [Section 160 & 161]

The bailee must return or deliver the goods according to the bailor's directions, without demand, once the bailment period expires or purpose is accomplished.

If the bailee defaults in returning the goods at the proper time, they are responsible for any loss, destruction, or deterioration from that time, even if they took reasonable care.



**Example:** X delivered books to Y to be bound. Y promised to return the books within a reasonable time. X pressed for the return of the book. But Y, failed to deliver them back even after the expiry of reasonable time. Subsequently the books were burnt in an accidental fire at the premises of Y. In this case Y was held liable for the loss.

## Return any Extra Profit Accruing from Goods Bailed (Accretion) [Section 163]

The bailee is bound to deliver to the bailor any increase or profit accrued from the bailed goods, unless there's a contract to the contrary.

**Example:** If A leaves a cow with B, and the cow gives birth to a calf, B must deliver the calf along with the cow to A.

## Not to Set up Adverse Title:

The bailee must not claim ownership adverse to the bailor's title. They must hold the goods on behalf of the bailor.

## RIGHTS OF A BAILOR

### Right to Terminate the Bailment [Section 153]

The bailor can terminate the contract if the bailee acts inconsistently with the bailment conditions.



### Right to Demand Back the Goods [Section 159]:

In gratuitous bailment, the bailor can demand the goods back at any time, even before the agreed period expires or the purpose is achieved. However, if this causes the bailee loss exceeding the benefit received, the bailor must compensate the bailee.

**Example:** A, while going out of station delivered his ornaments to B for safe custody for one month. But A returned to station after one week. He may demand the return of his ornaments even though the time of one month has not expired.

### Right to File a Suit Against a Wrongdoer [Section 180 & 181]:

Both the bailor and bailee can sue a third party who wrongfully deprives the bailee of goods or causes injury to them. Any compensation obtained is apportioned according to their respective interests.

### Right to Sue the Bailee:

The bailor can sue the bailee to enforce all the bailee's liabilities and duties.

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### Right to Compensation:

The bailor has a right to claim compensation if goods are damaged due to unauthorized use or unauthorized mixing.

## RIGHTS OF A BAILEE

### Right to Deliver the Goods to Any One of the Joint Bailors [Section 165]:

If goods were bailed by joint owners, the bailee can return them to any one of the joint owners, unless there is a contract to the contrary.

**Example:** A, B, and C are joint owners of a harvesting combine, which they hire to D. D can return the combine to A, B, or C after the month expires.

### Right to Indemnity [Section 166]:

The bailee is entitled to be indemnified by the bailor for any loss arising because the bailor was not entitled to make the bailment, receive goods back, or give directions.

If the bailor has no title, and the bailee returns goods in good faith per the bailor's directions, the bailee is not responsible to the true owner. The bailee can also claim necessary expenses for gratuitous bailment.



### Right to Claim Compensation in Case of Faulty Goods [Section 150]:

The bailee can receive compensation from the bailor for any loss caused by the bailor's failure to disclose known faults. In bailments for hire, the bailor is liable even if unaware of the faults.

### Right to Claim Necessary Expenses [Section 158]:

In gratuitous bailment, the bailor must repay the bailee for necessary and extraordinary expenses incurred for the bailment.

Roy- "Hey, your prize-winning fish got sick. It needs a rare, expensive algae supplement."

Roy- "About \$300 a month."



Manish- "How much is it?"

Manish- "I'll cover the cost. It's my fish, don't worry about it."

### Right to Apply to Court to Decide the Title to the Goods [Section 167]:

If a person other than the bailor claims the bailed goods, the bailee can apply to the court to stop delivery and decide the title.

*Example:* A, a dealer in T.V. delivered a T.V. to B for using in summer vacation. Subsequently, C claimed that the T.V. belonged to him as it was delivered only for repairs, to A and thus, B should deliver it to him. In this case, B may apply to the Court to decide the question of ownership of the T.V. so that he may deliver it to the right owner.

### Right of Particular Lien [Section 170]:

(Discussed below)

### Right of General Lien [Section 171]:

(Discussed below)

## RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONGDOER (THIRD PARTY)

### Suit by Bailor & Bailee against Wrongdoers [Section 180]:

If a third person wrongfully deprives the bailee of possession or causes injury to the bailed goods, the bailee can use remedies available to an owner. Either the bailor or the bailee can sue the third person for such deprivation or injury.

### Apportionment of Relief or Compensation [Section 181]:

Any compensation received from such suits will be dealt with between the bailor and bailee according to their respective interests.

## RIGHT OF LIEN

Meaning: Lien is the right of a person to retain goods belonging to another until their claim is satisfied or a debt due to them is repaid.

### Types of Liens:

Particular Lien

General Lien

**Particular Lien [Section 170]:**

**Definition:**

A right to retain only the specific goods in respect of which the claim is due.

**Conditions:**

The bailee must have rendered a service involving labor or skill in respect of the goods bailed, in accordance with the bailment purpose, and is due remuneration.

It is automatic and comes into play when labor or skill has increased the value of goods.

**Example:** 'A' gives cloth to 'B', a tailor, to make into a coat. 'B' is entitled to retain the coat until he is paid.

**Example:** If in the above example, 'B' takes 15 days time to make the coat, right of lien will be applicable after 15 days.

**Example:** A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

**General Lien [Section 171]:**

**Definition:**

A right to retain goods not only for demands arising out of the goods retained but for a general balance of account in favor of certain persons.

**Applicability:**

This right is available specifically to Bankers, factors, wharfingers, policy brokers, and attorneys of law.

It is **not automatic**; it is recognized through an agreement.

Under a general lien, goods cannot be sold, only retained for dues.

**Example:** 'A' borrows ₹ 500/- from the bank without security and subsequently again borrows another ₹ 1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned ₹ 1000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

**Difference between Bailee's General and Particular Lien:**

General lien	Particular lien
Section 171 of the Indian Contract Act, 1872 confer on Bailee the right of General Lien.	Section 170 of the Indian Contract Act, 1872 confers on the Bailee, the right of particular lien.

General lien alludes to the right to keep possession of goods belonging to other against general balance of account.	Particular lien implies a right of the bailee to retain specific goods bailed for non-payment of amount.
A general lien is not automatic but is recognized through an agreement. It is exercised by the bailee only by name.	It is automatic.
It can be exercised against goods even without involvement of labor or skill.	It comes into play only when some labor or skill is involved has been expended on the goods, resulting in an increase in value of goods.
Only such persons as are specified under section 171, e.g., Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien.	Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc. are entitled to particular lien.

## FINDER OF LOST GOODS

### Right of finder of lost goods- may sue for specific reward offered [Section 168]:

*A finder of goods must return them to the true owner. The finder cannot sue the owner for expenses incurred in finding the owner or preserving the goods, but they can retain the goods until they receive compensation.*

*If a specific reward was offered, the finder can sue for the reward and retain the goods until it is paid.*



### When finder of thing commonly on sale may sell it [Section 169]:

*A finder can sell a lost item that is commonly sold if the owner cannot be found with reasonable effort, or if the owner refuses to pay the finder's lawful charges.*

*The Finder May Sell It—*

*(1) when the thing is in danger of perishing or of losing the greater part of its value, or*

*(2) when the lawful charges of the finder in respect of the thing found amount to two thirds of its value.*

## TERMINATION OF BAILMENT

### On Expiry of Stipulated Period:

*If goods were given for a fixed period, the bailment ends when that period expires.*

*Example: X gives his motorcycle to Y for a month. The bailment terminates after one month.*

### On Fulfillment of the Purpose:

*If goods were delivered for a specific purpose, the bailment ends when that purpose is fulfilled.*

*Example: X hires tents for his daughter's marriage. The bailment terminates after the marriage.*

### By Notice:

#### (a) Inconsistent Use:

*If the bailee acts inconsistently with the bailment terms, the bailor can terminate the contract by giving notice.*

#### (b) Gratuitous Bailment:

*A gratuitous bailment can be terminated by the bailor at any time by giving notice. However, the termination should not cause the bailee loss in excess of the benefit derived; if it does, the bailor must compensate the bailee.*

### By Death:

*A gratuitous bailment terminates upon the death of either the bailor or the bailee.*

### Destruction of the Subject Matter:

*Bailment terminates if the subject matter is destroyed or changes nature, making it unusable for the purpose.*

*Example: X gives his cycle to Y on hire. If the cycle is damaged beyond repair, the bailment ends.*

## PLEDGE

Definition [Section 172]: "Pledge" is the bailment of goods as security for payment of a debt or performance of a promise.

**Pawnor (Pledger):** The bailor in a pledge, who delivers the goods as security.

**Pawnee (Pledgee):** The bailee in a pledge, who receives the goods as security.

*Example: A lends money to B against jewelry deposited by B. This bailment of jewelry is a pledge. B is the pawnor, and A is the pawnee.*

Joey: Sure, but I'll need something valuable as security.

Joey: Deal. I'll keep the card until you return the \$50.



Kevin: Hey, can you lend me \$50? I'll pay you back soon.

Kevin: How about my signed baseball card? It means a lot to me, but I trust you.

### Essential Elements of a Contract of Pledge:

Since pledge is a special kind of bailment, all the essential elements of bailment apply. Additionally, for a pledge:

There shall be a bailment for security against payment or performance of the promise,

The subject matter of pledge is goods,

Goods pledged for shall be in existence,

There shall be the delivery of goods from pledger to pledgee.

## RIGHTS OF A PAWNEE/PLEDGEE

### Right to Retain the Pledged Goods [Section 173]:

The pawnee can retain the goods not only for the debt/promise payment but also for the interest on the debt and all necessary expenses incurred for possession or preservation of the goods.

**Example:** Where 'M' pledges stock of goods for certain loan from a bank, the bank has a right to retain the stock not only for adjustment of the loan but also for payment of interest.

### Right to Retention of Subsequent Debts [Section 174]:

The pawnee can retain the pledged goods for any other debt or promise from the pawnor, but only if there's a specific contract to that effect.

### Pawnee's Right to Extraordinary Expenses Incurred [Section 175]:

The pawnee is entitled to receive extraordinary expenses incurred for preserving the pledged goods. For such expenses, they do not have the right to retain the goods, but they can sue the pawnor.

### ◆ Pawnee's Right Where Pawnor Makes Default [Section 176]:

If the pawnor defaults on payment or performance at the stipulated time, the pawnee has two options:

#### i. Sue and Retain:

The pawnee can sue the pawnor for the debt/promise and retain the pledged goods as collateral security.

#### ii. Sell the Goods:

The pawnee can sell the pledged item after giving the pawnor **reasonable notice** of the sale.

*If sale proceeds are less than the amount due, the pawnor is still liable for the balance.*

*If sale proceeds are greater than the amount due, the pawnee must pay the surplus to the pawnor.*

## RIGHTS OF A PAWNOR

As the bailor of goods, a pawnor has all the rights of a bailor. Additionally, they have:

### ◆ Right to Redeem [Section 177]:

If the pawnor defaults on payment or promise, they may redeem (recover back) the goods pledged at any subsequent time before the actual sale. In this case, they must also pay any expenses arising from their default.

**Note:**

Redemption means recovering goods by paying the debt or performing the promise.

## DUTIES OF THE PAWNEE

*Pawnee has the following duties:*

- a. Duty to take reasonable care of the pledged goods.
- b. Duty not to make unauthorized use of pledged goods.
- c. Duty to return the goods when the debt has been repaid or the promise has been performed.
- d. Duty not to mix his own goods with goods pledged.
- e. Duty not to do any act which is inconsistent with the terms of the pledge.
- f. Duty to return accretion to the goods, if any.

## DUTIES OF THE PAWNOR

*Pawnee has the following duties:*

- a. The pawnor is liable to pay the debt or perform the promise as the case may be.
- b. It is the duty of the pawnor to compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned.
- c. It is the duty of the pawnor to disclose all the faults which may put the pawnee under extraordinary risks.
- d. If loss occurs to the pawnee due to defect in pawnor's title to the goods, the pawnor must indemnify the pawnee.
- e. If the pawnee sells the good due to default by the pawnor, the pawnor must pay the deficit.

## PLEDGE BY NON-OWNERS

### ◆ Pledge by Mercantile Agent [Section 178]:

*A mercantile agent in possession of goods or documents of title, with the owner's consent, can pledge them in the ordinary course of business. This pledge is valid if the pawnee acts in good faith and without notice that the pawnor lacks authority.*

### ◆ Pledge by Person in Possession under Voidable Contract [Section 178A]:

*If a pawnor obtained possession of goods under a voidable contract (e.g., due to fraud, coercion) that hasn't been rescinded, the pawnee acquires good title, provided they act in good faith and without notice of the pawnor's defective title.*

*Example: Srushti acquired a diamond by a voidable contract (not rescinded) and pledged it with Mr. VK. This is a valid pledge.*

### ◆ Pledge where Pawnor Has Only a Limited Interest [Section 179]:

*If a person pledges goods in which they have only a limited interest (not absolute ownership), the pledge is valid to the extent of that interest.*

*Example: Mr. X finds a defective mobile, repairs it for 5000, then pledges it for 2000. The true owner can recover it only by paying ₹5000 (X's interest).*

*Example: 'A' pledges jewelry worth 1,00,000 to 'B' for a 70,000 advance. 'B' then pledges the same jewelry to 'C' for 90,000. This second pledge is valid up to 70,000 plus interest due (B's limited interest).*

### 🔹 Pledge by a Co-owner in Possession:

If goods are owned by multiple persons, and one co-owner possesses them with the consent of others, that co-owner can make a valid pledge.

### 🔹 Pledge by Seller or Buyer in Possession:

A seller who retains possession of goods after sale, or a buyer who obtains possession with seller's consent before sale, can make a valid pledge. The pawnee must act in good faith and have no knowledge of the defect in the pawnor's title.

*Example:* A buys a cycle from B but leaves it with B. B then pledges the cycle with C, who doesn't know of the sale to A and acts in good faith. This is a valid pledge.

## DISTINCTION BETWEEN BAILMENT AND PLEDGE

Basis	Bailment	Pledge
<b>Meaning</b>	Transfer of goods by one person to another for some specific purpose is known as bailment.	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.
<b>Parties</b>	The person delivering the goods under a contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee".	The person who delivers the good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "Pawnee".
<b>Purpose</b>	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods).	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise.
<b>Consideration</b>	The bailment may be made for consideration or without consideration.	Pledge is always made for a consideration.
<b>Right to sell the goods</b>	The bailee has no right to sell the goods even if the charges of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed	The pawnee has right to sell the goods if the pawnor fails to redeem the goods.
<b>Right to use of goods</b>	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledge or Pawnee cannot use the goods pledged.

# Chapter 2

## Unit 9: Agency

### WHAT IS AGENCY?

The Indian Contract Act, 1872, does not explicitly define "Agency". However, Section 182 defines 'Agent' and 'Principal':

#### Agent:

A person employed to do any act for another or to represent another in dealing with third persons.

#### Principal:

The person for whom such act is done or who is so represented.

#### Test of Agency:

(a) Whether the person has the capacity to bind the principal and make him answerable to the third party.

(b) Whether he can establish privity of contract between the principal and third parties.

If the answer to these questions is in affirmative (Yes), then there is a relationship of agency.

Thus, 'Agency' is a comprehensive word used to describe the relationship between one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim "Qui facit per alium, facit per se" i.e., he who acts through an agent is himself acting.



### APPOINTMENT AND AUTHORITY OF AGENTS

Who May Employ an Agent (Principal): According to Section 183, any person who has attained majority (as per law) and is of sound mind may employ an agent.

#### Person qualified to appoint agent must be

- major
- sound mind

#### Who May Be an Agent:

According to Section 184, any person may become an agent, including a minor or a person of unsound mind.

The principal shall be bound by the agent's acts, even if the agent is a minor or of unsound mind. Caution: However, it's generally not advisable to appoint a minor or person of unsound mind as an agent because they are incompetent to contract. If such an agent commits misconduct or negligence, the principal cannot proceed against them.

**Example:** P appoints Q, a minor, to sell his car for not less than 2,50,000. Q sells it for 2,00,000. P will be held bound by the transaction and further shall have no right against Q for claiming the compensation for having not obeyed the instructions, since Q is a minor and a contract with a minor is 'void-ab-initio'.

**Consideration Not Necessary:**

According to Section 185, no consideration is necessary to create an agency. The acceptance of the office of an agent is considered sufficient consideration for the appointment.

## CREATION OF AGENCY

"The relationship between a principal and agent primarily arises from a contract. It is formed when the agent has authority to act on the principal's behalf and consents to do so."

### 1. Definitions of express and implied authority [Section 187]

**Express Authority:**

An authority is express when it is given by words, spoken or written.

**Example:** A is residing in Delhi and he has a house in Kolkata. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.

**Example:** If a customer of a bank wishes to transact his banking business through an agent, the bank will require written evidence of the appointment of the agent and will normally ask to see the registered power of attorney appointing the agent

### 2. Implied Authority

An authority is implied when it is inferred from the circumstances of the case, the conduct of the parties, things spoken or written, or in the ordinary course of dealing.



### Implied Agency also includes:

**a. Agency by Estoppel [Section 237]:**

This occurs when the principal, through their conduct or statement, wilfully causes another person to believe that a certain person is their agent. The principal is then prevented (estopped) from denying the agency later.

According to section 237 of the Contract Act, an agency by estoppel may be created when following essentials are fulfilled:

1. the principal must have made a representation;
2. the representation may be express or implied;
3. The representation must state that the agent has an authority to do certain act although really, he has no authority;
4. The principal must have induced the third person by such representation; and
5. The third person must have believed the representation and made the contract on the belief of such representation.

**Example:** A consigns goods to B for sale and gives him instructions not to sell below a fixed price. C being ignorant of B's instruction enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract. A cannot plead that he had given instructions to B to not sell the goods below certain price. An agency by estoppel is, consequently, deemed between A and B.

**Example:** If Piyal (the principal) has for several months permitted Sunil to buy goods on credit from Prasad and has paid for the goods bought by Sunil, Piyal cannot later refuse to pay Prasad who had supplied goods on credit to Sunil in the belief that he was Piyal's agent and was buying the goods on behalf of Piyal. Piyal is estopped from now asserting that Sunil is not his agent because on earlier occasions he permitted Prasad to believe that Sunil was his agent and Prasad had acted in that belief.

#### b. Agency by Necessity:

An agency of necessity occurs when an agent, facing an emergency, gains special authority to act beyond their normal scope to protect the principal from loss. This extraordinary power is only granted when circumstances prevent the agent from communicating with the principal.

**Example:** Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire and save the farm from destruction during Raja's absence from the country.

### 3. Agency by Operation of Law:

When law treats one person as an agent of other. For example, a partner is the agent of the firm for the purposes of the business of the firm.

### 4. Rights of person as to acts done for him without his authority, Effect of ratification [Section 196]:

When an individual acts on another's behalf without their authority, the principal can later approve (ratify) or reject the actions. If ratified, the actions are treated as if they had been authorized from the beginning. Ratification can be done either explicitly or implicitly through the principal's conduct.



Timmy: "Want to buy my dad's old, rusty bicycle for 5 rupees?"

Timmy: Dad "I sold it to the neighbour for 5 rupees!"

Dad: Smiles "Alright. In that case, I'll ratify your sale."

Neighbour: "Uh... sure, why not."

### Essentials of a Valid Ratification:

#### a. Express or Implied [Section 197]:

Can be given by words or inferred from conduct.

**Example:** A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A.

**Example:** A, without B's authority, lends B's money to C. Afterwards B accepts interests on the money from C. B's conduct implies a ratification of the loan.

#### b. Knowledge Requisite [Section 198]:

The person ratifying must have complete and non-defective knowledge of all material facts.

**Example:** A has an authority from P to buy certain goods at the market rate. He buys at a higher rate but P accepts the purchase. Afterwards P comes to know that the goods purchased by A for P belonged to A himself. The ratification is not binding on P.

#### c. Whole Transaction Must Be Ratified [Section 199]:

The principal must ratify the act entirely or reject it entirely. They cannot ratify only the beneficial parts and reject the rest.



#### d. Cannot Injure Third Person [Section 200]:

Ratification does not apply if it affects the interests of third parties. It cannot retroactively affect rights acquired by a third party in the intervening time.

*Example:* A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

#### e. Within Reasonable Time:

Ratification must occur within a reasonable period.

#### f. Communication:

Ratification must be communicated to the other party.

#### g. Act to be Ratified Must Be Valid:

The act must not be void or illegal (e.g., criminal offense, forgery).

### Extent of Agent's Authority

#### (a) Agent's authority in normal circumstances [Section 188]:

The authority to perform a specific act or to conduct a business implies the authority to perform all other lawful actions that are necessary to accomplish the main task or are customarily done in the course of that business.

Essentially, an agent's authority isn't just limited to the explicit instructions given; it extends to everything reasonably needed to fulfil those instructions.

*Example:* A is employed by B, residing in London, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt and may give a valid discharge for the same.

*Example:* A constitutes B as his agent to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on the business.

#### (b) Agent's Authority in an Emergency [Section 189]:

An agent can act for their principal in an emergency to prevent loss, as long as they act as a reasonable person would in their own case.

This "agency of necessity" is valid only if:

Communication with the principal is impossible.

There is a genuine, urgent need to act.

The agent acts in good faith for the principal's benefit.

The agent's actions are the most reasonable course available.

The agent possesses the goods that are the subject of the contract.

**Example:** An agent who has authority for sale of goods may repair it if necessary.

**Example:** A consigns perishable goods to B at Srinagar, with directions to send them immediately to C at Tamandu. B may sell the good if they begin to perish before reaching its destination.

## SUB-AGENTS

### When Agent Cannot Delegate [Section 190]:

An agent cannot lawfully employ another to perform acts they have expressly or impliedly undertaken to perform personally.

This is based on the maxim "delegatus non potest delegare" (a delegate cannot further delegate). Agency is a fiduciary relationship based on principal's confidence in the agent; thus delegation is generally restricted.

### "Sub-agent" Defined [Section 191]:

A "Sub-agent" is a person employed by, and acting under the control of, the original agent in the business of the agency.

#### Exceptions where an Agent Can Appoint a Sub-agent:

1. **Original Contemplation:** If the original terms of appointment allow for it.

2. **Custom of Trade:** If the customs of the trade permit it.

In these two cases, the sub-agent is treated as the agent of the principal.

3. **Unforeseen Emergency:** If an unforeseen emergency arises during the agent's employment, making delegation necessary.

#### Representation of Principal by Sub-agent Properly Appointed [Section 192]:

When a sub-agent is properly appointed (under the exceptions above):

**Principal's Liability:** The principal is liable to third parties for the sub-agent's acts.

**Agent's Responsibility:** The agent is responsible to the principal for the sub-agent's acts.

**Sub-agent's Liability:** The sub-agent is responsible for their acts to the agent, but not to the principal, except in cases of fraud or wilful wrong.

### Agent's Responsibility for Sub-agent Appointed Without Authority [Section 193]:

If an agent appoints a sub-agent without authority:

**Agent's Liability:** The agent is responsible for the sub-agent's acts to both the principal and third persons.

**Principal's Non-Liability:** The principal is not responsible for the sub-agent's acts.

**Sub-agent's Liability:** The sub-agent is not responsible to the principal at all; they are only answerable to the agent.

*Example:* A, a carrier, agreed to carry 60 bags of cotton waste from Morvi to Bhavnagar by a truck. A asked B, another carrier, to carry the goods. The goods were damaged in transit. Held, A was liable even though it was proved that B was the carrier.

## SUBSTITUTED AGENT

A Substituted Agent is a person appointed by the agent to act for the principal, in the business of agency, with the knowledge and consent of the principal.

Substituted agents are not sub-agents. They are considered agents of the principal themselves.



### Relation between Principal and Substituted Agent [Section 194]:

When an agent, with express or implied authority to name another person to act for the principal, names such a person, that person is not a sub-agent but an agent of the principal for the entrusted part of the business.

*Example:* A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a subagent, but is A's agent for the conduct of the sale.

### Agent's Duty in Naming Such Person [Section 195]:

When selecting a substituted agent for their principal, an agent must exercise the same amount of discretion as an ordinarily prudent person would in their own case.

If the agent does this, they are not responsible to the principal for the acts or negligence of the selected substituted agent.

*Example:* A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

*Example: A consigns goods to B, a merchant, for sale. B in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.*

## DIFFERENCE BETWEEN A SUB-AGENT AND A SUBSTITUTED AGENT

Sub Agent	Substituted Agent
A sub-agent does his work under the control and directions of agent.	A substituted agent works under the instructions of the principal.
The agent not only appoints a sub-agent but also delegates to him a part of his own duties.	The agent does not delegate any part of his task to a substituted agent.
There is no privity of contract between the principal and the sub-agent.	Privity of contract is established between a principal and a substituted agent.
The sub-agent is responsible to the agent alone and is not generally responsible to the principal.	A substituted agent is responsible to the principal and not to the original agent who appointed him
The agent is responsible to the principal for the acts of the sub-agent.	The agent is not responsible to the principal for the acts of the substituted agent.
The sub-agent has no right of action against the principal for remuneration due to him.	The substituted agent can sue the principal for remuneration due to him.
Sub-agents may be improperly appointed.	Substituted agents can never be improperly appointed.
The agent remains liable for the acts of the sub-agent as long as the sub-agency continues.	The agent's duty ends once he has named the substituted agent.

## DUTIES AND OBLIGATIONS OF AN AGENT

### ◆ Duty to Follow Instructions or Customs [Section 211]:

*An agent is bound to conduct the principal's business according to the directions given by the principal.*

*In the absence of directions, the agent must follow the customs prevailing in that type of business at that place.*

*If the agent acts otherwise:*

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*Any loss sustained by the principal must be indemnified by the agent.*

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*Any profit accrued must be accounted for by the agent to the principal.*



**Example:** A, an agent is engaged for managing the business of B, in which it is a custom to invest money at hand for interest. If A omits to make such investment, he must indemnify B for the losses i.e. for the interest B would have obtained for such investment.

### 🔹 Duty of Reasonable Care and Skill [Section 212]:

An agent must conduct the principal's business with as much skill as generally possessed by persons in similar business, unless the principal knows of their lack of skill.

The agent must act with reasonable diligence and use their existing skill.

They must compensate the principal for direct consequences of their neglect, lack of skill, or misconduct, but not for indirect or remote losses.

**Example:** A, a merchant in Kolkata, has an agent, B, in London, to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss- e.g. by variation of rate of exchange-but not further.

**Example:** A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. A must compensate his principal for the loss sustained by him.

**Example:** A, an insurance-broker, employed by B to affect an insurance on a ship, omits to see that the "usual clauses" are inserted in the policy. The ship is afterwards lost. In consequence of the omission nothing can be recovered from the underwriters. A is bound to make good the loss to B.

**Example:** A, a merchant in England, directs B, his agent at Mumbai, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

### 🔑 Duty to Render Proper Accounts [Section 213]:

An agent is bound to render proper accounts to their principal on demand.  
 "Proper accounts" means accounts supported by vouchers.

CASE LAW: *Anandprasad vs. Dwarkanath*.

### 🔑 Agent's Duty to Communicate with Principal [Section 214]:

It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.

### 🔑 Duty Not to Deal on His Own Account [Sections 215, 216]:

Agent should not deal on his own account without first obtaining the consent of the principal, otherwise the principal may—

(a) repudiate the transaction, (Section 215)

(b) claim from the agent any benefit which may have resulted to him from the transaction. (Section 216)

*Example:* A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

### 🔑 Duty Not to Make Secret Profits:

An agent must not make any secret profit in the agency business.

This duty arises from the fiduciary nature of the relationship, demanding absolute good faith.

Secret Profit: Any advantage obtained by the agent over and above their agreed remuneration, which they would not have made but for their position as agent.



### 🔑 Duty Not to Delegate [Section 190]:

As mentioned earlier, an agent generally cannot lawfully employ others to perform acts they undertook personally, unless custom or necessity dictates (see Sub-Agents section).

### 🔹 Agent's Duty to Pay Sums Received for Principal [Section 218]:

Subject to allowed deductions (advances, expenses, remuneration), the agent is bound to pay to the principal all sums received on their account.

### 🔹 Duty Not to Use Confidential Information:

An agent must not use any confidential information received during the agency against the principal.

## RIGHTS OF AN AGENT

### 🔹 (i) Right to Retain Out of Sums Received on Principal's Account [Section 217]:

An agent is legally permitted to keep money from any funds they receive on behalf of their principal to cover certain payments. This right, known as the right of retainer, allows the agent to essentially pay themselves back or take their fees before transferring the remaining balance to the principal.



The specific payments an agent can retain funds for are:

**Advances Made:** Money the agent has already paid out of their own pocket for the principal's business.

**Expenses Incurred:** Any costs the agent properly and legitimately spent while conducting the business of the agency.

**Remuneration:** The payment or commission that the agent is owed for their services.

### 🔹 (ii) Right to Remuneration (Sections 219):

An agent is typically entitled to payment as per their contract. If no amount is specified, they are entitled to the usual rate for that business. However, an agent who commits misconduct loses their right to any payment for the part of the business where the misconduct occurred.

**Example:** A employs B to recover 100,000 from C, and invest it in securities that give good returns. B recovers the amount and lays out 90,000 on good securities but lays out 10,000 on securities which he ought to provide poor returns, whereby A loses 2,000. B is entitled to remuneration for recovering the 1,00,000 and for investing the 90,000. He is not entitled to any remuneration for investing the 10,000, and he must indemnify A for 2000.

**Example:** A employs B to recover ₹ 1,00,000 from C. Because of B's misconduct the money is not recovered. B is entitled to no remuneration for his services and must make good the loss.

### ⬠ (iii) Agent's Lien on Principal's Property [Section 221]:

Unless there's a contract to the contrary, an agent can retain the principal's goods, papers, and other property (movable or immovable) received by them until amounts due for commission, disbursements, and services are paid or accounted for.

Conditions for Lien:

Agent is lawfully entitled to receive money from principal for commission, disbursement, or services.

Property must belong to the principal and be received by the agent in their capacity and during ordinary duties.

**Lien is Lost:**

When possession of property is lost.

When the agent waives their right (expressly or impliedly).

If there's a contract to the contrary.

### ⬠ (iv) Right to Indemnity:

**a. Right of indemnification for lawful acts [Section 222]:**

The principal is bound to indemnify the agent against all consequences of lawful acts done in exercise of his authority.

**Example:** 'A' residing in Delhi appoints 'B' from Mumbai as an agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But A fails to send the merchandise to B and B faces litigations for non- performance. Here, A is bound to protect B against the litigations and all costs, expenses arising of that.

**b. Right of indemnification against acts done in good faith [Section 223]:**

Where the agent acts in good faith on the instruction of principal, agent is entitled for indemnification of any loss or damage from the principal.

**Example:** Where P appoints A as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to P and if third parties sue A for this act, A is entitled for reimbursement and indemnification for such act done in good faith. However, the agent cannot claim any reimbursement or indemnification for any loss etc. arising out of acts done by him in violation of any penal laws of the country.

### c. Non-liability of employer of agent to do a criminal act:

According to section 224, where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that act.

**Example:** A employs B to beat C and agrees to indemnify him against all consequences of the act. B thereupon beats C and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

### ⬠(v) Right to Compensation for Injury Caused by Principal's Neglect [Section 225]:

The principal must compensate the agent for injury caused due to the principal's neglect or lack of skill. Principals owe their agents a duty of care not to expose them to unreasonable risks.

Ishwar: "The ladder you gave me was faulty; it broke, and I got hurt."

Ishwar: "Exactly. You need to compensate me for this."



Patrick: "My mistake. I was negligent. I'm responsible for your injuries."

Patrick: "I will."

## PRINCIPAL'S LIABILITY TO THIRD PARTIES

Generally, an agent acts on behalf of the principal and incurs no personal liability; the liability rests with the principal, unless stated otherwise. An agent also cannot personally enforce contracts made on the principal's behalf.

### ⬠(i) Principal's Liability for the Acts of the Agent [Section 226]:

The principal is liable for acts of agents that are within the scope of their authority.

**Example:** A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set off against that claim a debt due to himself from B.

### ⬠(ii) Principal's Liability When Agent Exceeds Authority [Sections 227, 228]:

When an agent exceeds their authority, only the part of the act that was within their authority is legally binding on the principal, provided that the authorized part can be separated from the unauthorized part.

*Example:* A, being owner of a ship and cargo, authorizes B to procure an insurance for ₹ 4,00,000 on the ship. B procures a policy for ₹ 4,00,000 on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo

### **Principal not bound when excess of agent's authority is not separable [Section 228]:**

Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction.

*Example:* A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of ₹ 6,00,000. A may repudiate the whole transaction.

### **Exception: Liability of Principal Inducing Belief (Agency by Estoppel revisited) [Section 237]:**

Even if an agent acts without authority, the principal is bound by such acts if they have, through words or conduct, induced third persons to believe that the acts were within the agent's authority. (This is Agency by Estoppel).

*Example:* A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

*Example:* A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A. The sale is good.

### **⬢ (iii) Consequences of Notice Given to Agent [Section 229]:**

Any notice given to or information obtained by the agent, provided it's acquired in the course of the business transacted for the principal, has the same legal consequence as if given to or obtained by the principal.

*Example:* A is employed by B to buy from C certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C against the price of the goods. Thus, the knowledge of the agent is treated as the knowledge of the principal.

### **⬢ (iv) Principal's Liability for the Agent's Fraud, Misrepresentation or Torts [Section 238]:**

Misrepresentations or frauds committed by agents acting in the course of their business for their principals have the same effect on agreements as if committed by the principals. However, misrepresentations or frauds by agents in matters outside their authority do not affect their principals.

## PERSONAL LIABILITY OF AGENT TO THIRD PARTIES

### General Rule [Section 230]:

*In the absence of a specific contract, an agent cannot personally enforce contracts entered into on behalf of their principal, nor are they personally bound by them. They can neither sue nor be sued on contracts made for their principal.*

### Exceptions:

#### Foreign Principal:

*If the agent contracts for a merchant resident abroad (foreign principal), it's presumed the agent undertakes personal liability.*

#### Undisclosed/Unnamed Principal:

*When the agent does not disclose the principal's name, it's presumed they undertake personal liability.*

#### Non-existent or Incompetent Principal:

*If the principal, though disclosed, cannot be sued (e.g., a minor), the agent is presumed to be personally liable.*

***Example:** An agent who contracts for a minor, the minor being not liable, the agent becomes personally liable. This result, may not, however, follow where the other party already knows that the principal is a minor.*

#### Pretended Agent [Section 235]:

*If a person pretends to be an agent but is not an actual agent, and the principal does not ratify the act, the pretended agent is personally liable.*

#### When Agent Exceeds Authority:

*If the agent exceeds their authority and misleads the third person into believing they had the requisite authority, the agent can be held personally liable for breach of warranty of authority.*

## RIGHTS OF THIRD PARTIES

## ● (i) Rights of Parties to a Contract Made by Undisclosed Agent [Section 231]:

If an agent makes a contract with someone who doesn't know or suspect they are an agent, the principal may demand performance.

However, the third party has the same rights against the principal as they would have had against the agent if the agent had been the principal.

If the principal discloses themselves before contract completion, the third party can refuse to fulfil the contract if they can show they wouldn't have entered it had they known who the principal was or that the agent wasn't the principal.

**Example:** SS bought for himself a ticket of IPL match at Wankahde Stadium through AB because on personal grounds Stadium management would not have issued the ticket to SS. Stadium management may repudiate the contract and refuse SS to enter the stadium

## ● (ii) Performance of Contract with Agent Supposed to Be Principal [Section 232]:

When an agent does not disclose, they are acting as an agent, and the principal demands contract performance, the principal gets performance subject to the rights and obligations existing between the agent and the other party.

**Example:** A, who owes 50,000 rupees to B, sells 1,00,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

## ● (iii) Option to Third Person - Sue the Agent or the Principal

## a. Right of person dealing with agent personally liable [Section 233]:

In cases where the agent is personally liable, the third party dealing with them may sue either the agent or the principal, or both.

**Example:** A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

## b. Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable [Section 234]:

If a person contracts with an agent and induces the agent to believe only the principal will be liable, or induces the principal to believe only the agent will be liable, they cannot later hold the other party liable.

## REVOCACTION OF AUTHORITY / TERMINATION OF AGENCY

### a. Revocation by Principal:

The principal can revoke the agent's authority at any time before the authority has been exercised to bind the principal [Section 203]. The principal cannot revoke authority after it has been partly exercised regarding acts and obligations already done [Section 204].

**Example:** A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

#### Compensation for Revocation by Principal [Section 205]:

If agency is revoked prematurely without sufficient cause, the principal must compensate the agent.

#### Notice of Revocation [Section 206]:

The principal must give reasonable notice of revocation to the agent. Failure to do so can make the principal liable for damages caused to the agent.

#### Revocation may be Expressed or Implied [Section 207]:

Revocation can be by words or implied by the principal's conduct.

### b. Renunciation by Agent [Section 206]:

An agent can renounce the business of agency similar to the principal's right of revocation.

If the agency is for a fixed period, the agent must compensate the principal for premature renunciation without sufficient cause [Section 205].

A reasonable notice of renunciation is necessary. If the agent renounces without proper notice, they must compensate the principal for resulting damage [Section 206].

### c. Completion of Business:

An agency is automatically and by operation of law terminated when its business is completed. Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed.

#### ◆ d. Death or Insanity:

An agency terminates automatically upon the death or insanity of either the principal or the agent. This also applies to the winding up of a company or dissolution of a partnership. Acts done by the agent *before knowing of the death* remain binding.

#### ◆ e. Principal's Insolvency:

An agency ends upon the principal being adjudicated insolvent.

#### ◆ f. On Expiry of Time:

If an agent is appointed for a fixed term, the agency ends automatically when the term expires, regardless of whether the purpose was achieved.

#### ◆ When the Agency is Irrevocable?

An agency becomes irrevocable when the agent has a personal interest in the property that forms the subject matter of the agency.

Such an agency cannot be terminated to the prejudice of the agent's interest, even by the principal's death or insanity, unless expressly stated otherwise in the contract.

**Example:** A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

**Example:** A consigns 1000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself, out of the price, the amount of his own advances. A cannot revoke this authority, nor it is terminated by his insanity or death.

#### ◆ Effects of Termination [Section 208]:

**When termination of agent's authority takes effect as to agent, and as to third persons [Section 208]:**

The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

**Example:** A directs B to sell goods for him and agrees to give B five per cent commission on the price fetched by the goods. A afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it sells the goods for ₹ 1,00,000. The sale is binding on A, and B is entitled to ₹ 5,000 as his commission.

*Example:* A, at Chennai, by letter directs B to sell for him some cotton lying in a warehouse in Mumbai, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C's payment is good as against A.

*Example:* A directs B, his agent, to pay certain money to C. A dies, and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

### Agent's Duty on Termination by Principal's Death or Insanity [Section 209]:

When an agency terminates due to the principal's death or insanity, the agent is bound to take all reasonable steps to protect and preserve the entrusted interests on behalf of the principal's representatives.

### Termination of Sub-agent's Authority [Section 210]:

The termination of the original agent's authority automatically causes the termination of all sub-agents' authority appointed by them.

# Chapter 3

## Unit 1: Formation of the Contract of Sale

### INTRODUCTION

The Sale of Goods Act, 1930, governs laws related to the sale of goods in India. This Act primarily derives from the English Sale of Goods Act, 1893. Before 1930, provisions concerning the sale of goods were integrated into Chapter VII of the Indian Contract Act, 1872, but a need for an independent Act led to its enactment on July 1, 1930, extending across all of India.



### SCOPE OF THE ACT

#### Applicability

The Act applies to contracts involving the sale of movable properties (goods).

#### Exclusions

It explicitly does not apply to the sale of immovable properties like land, fields, shops, or houses; for these, the Transfer of Property Act, 1882, is applicable.

#### Relationship with Indian Contract Act, 1872

General provisions of the Indian Contract Act, 1872, apply to a Contract of Sale of Goods unless they contradict the express provisions of the Sale of Goods Act, 1930. Expressions not defined in the Sale of Goods Act but defined in the Indian Contract Act carry the meanings assigned to them in the latter.

#### Customs and Usages

Reasonable customs and usages known to the parties at the time of contract formation will bind them.

Alex: Mr. Gable, I want to buy your prize-winning rose bush. We can use the Sale of Goods Act.



Mr. Gable: No, Alex. It's not for sale. That bush is part of my land, not a "good" you can just buy.

## DEFINITIONS

### ⬠ (A) Buyer and Seller

#### Buyer

A person who buys or agrees to buy goods [Section 2(1)].

#### Seller

A person who sells or agrees to sell goods [Section 2(13)].

### ⬠ (B) Goods and other related terms

#### Goods

Goods are every kind of movable property, excluding money and actionable claims. This includes things attached to the land, such as growing crops, if they are agreed to be separated before the sale.

#### Actionable claims

Actionable claims are claims that can only be enforced by a legal suit, such as a debt. They are not considered goods.

### ⬠ Classification of Goods:

#### (i) Existing Goods:

Goods that are in existence at the time of the contract of sale, owned, possessed, or acquired by the seller at that time [Section 6].

##### a. Specific Goods

Goods identified and agreed upon at the time a contract of sale is made [Section 2(14)].

##### Example

Any specified and finally decided goods like a Samsung Galaxy S7 Edge, Whirlpool washing machine of 7 kg etc.



##### Example

'A' had five cars of different models. He agreed to sell his 'Santro' car to 'B' and 'B' agreed to purchase the same 'Santro' car. In this case, the sale is for specific goods as the car has been identified and agreed at the time of the contract of sale.

##### b. Ascertained Goods

Goods identified in accordance with the agreement after the contract of sale is made. This term is often used interchangeably with 'specific goods' in practice. It refers to goods identified from a larger lot.

**Example:**

A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside. On selection, the goods become ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract. It may be noted that before the ascertainment of the goods, the contract was for the sale of unascertained goods.

**c. Unascertained Goods**

Goods not specifically identified or ascertained at the time of making the contract. They are indicated only by description or sample.

**Example:**

If A agrees to sell to B one packet of salt out of the lot of one hundred packets lying in his shop, it is a sale of unascertained goods because it is not known which packet is to be delivered. As soon as a particular packet is separated from the lot, it becomes ascertained or specific goods.

**Example:**

X has ten horses. He promises to sell one of them but does not specify which horse he will sell. It is a contract of sale of unascertained goods.

**(ii) Future Goods:**

Goods to be manufactured, produced, or acquired by the seller after making the contract of sale [Section 2(6)]. A contract for future goods is always an agreement to sell, never an actual sale, as something not in existence cannot be transferred immediately.

**Example:**

1,000 quintals of potatoes to be grown on A's field is an example of agreement to sell.

**Example:**

P agrees to sell to Q all the milk that his cow may yield during the coming year. This is a contract for the sale of future goods.

**Example:**

T agrees to sell to S all the oranges which will be produced in his garden this year. It is contract of sale of future goods, amounting to 'an agreement to sell.'

### (iii) Contingent Goods:

The acquisition of which depends upon an uncertain contingency (uncertain event) [Section 6(2)]. Like future goods, contingent goods also operate as an agreement to sell, not a sale, because property doesn't pass to the buyer at the time of contract formation.

**Example:**

A agrees to sell to B a Picasso painting provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

**Example:**

P contracts to sell 50 pieces of particular article provided the ship which is bringing them reaches the port safely. This is an agreement for the sale of contingent goods.

## ◆(C) Delivery - its forms and derivatives

Delivery: Voluntary transfer of possession from one person to another [Section 2(2)]. Generally, it involves putting goods in the buyer's possession or someone authorized by them.

### Forms of delivery

#### (i) Actual Delivery

When goods are physically delivered to the buyer or their authorized third party.

#### (ii) Constructive Delivery

Transfer of goods without actual change in custody or possession, often through attornment (acknowledgement). This happens when third-party holding goods acknowledges they now hold them for the buyer.

**Example:**

Where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request.

#### (iii) Symbolic Delivery

Delivery of something in token of a transfer of something else, like handing over documents of title (bill of lading, railway receipt) or the key to a warehouse containing the goods. It provides means of getting possession when actual delivery isn't feasible.

### Deliverable State

Goods are said to be in a deliverable state when they are in such a condition that the buyer would, under the contract, be bound to take delivery of them [Section 2(3)].

**Example:**

When A contracts to sell timber and make bundles thereof, the goods will be in a deliverable state after A has put the goods in such a condition.

### ⬠(D) Document of title to goods

A "document of title to goods" is a document, such as a bill of lading, that proves possession or control of goods and authorizes the holder to transfer or receive them by endorsement or delivery.

The provided list is illustrative, not exhaustive. A document of title must show an unconditional undertaking to deliver the goods to the holder.



This differs from a "document showing title," like a share certificate, which proves ownership but does not allow for transfer by simple endorsement and delivery. A mate's receipt is not considered a document of title, as it is only an acknowledgment of receipt.

Aryan: A golden ticket for chocolate from Willy Wonka's factory is a document of title; it gives you the goods.



Priya: And a certificate that just says you're a "chocolate fanatic" is just a document showing title?

Aryan: Exactly. It proves who you are, but it doesn't give you the chocolate.

**Example:**

Bill of lading, dock warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, warrant, an order of delivery of goods.

### ⬠(E) Mercantile Agent [Section 2(9)]

An agent who, in the customary course of business, has authority to sell goods, consign goods for sale, buy goods, or raise money on the security of goods. Auctioneers or brokers are examples. They can borrow money by pledging goods.

**Example:**

Such kind of agents are auctioneers or brokers, etc.

### ⬠(F) Property [Section 2(11)]

In a contract of sale, 'property' refers to the transfer of general property, or full ownership, of goods from the seller to the buyer. This is distinct from special property, which is a limited right, such as that held by a pledgee who can retain goods until payment is made.

General property, or full ownership, can be transferred even if a special property right exists with another person.

**Example**

If A who owns certain goods pledges them to B, A has general property in the goods, whereas B has special property or interest in the goods to the extent of the amount of advance he has made. In case A fails to repay the amount borrowed on pledging the goods, then B may sell his goods but not otherwise.

### ⬡ (G) Insolvent [Section 2(8)]

A person is insolvent when they cease to pay their debts in the ordinary course of business or cannot pay them when due, regardless of whether an act of insolvency has been committed.

### ⬡ (H) Price [Section 2(10)]

The money consideration for a sale of goods. It's the value of goods expressed in monetary terms and an essential requirement for a contract of sale.

### ⬡ (I) Quality of goods [Section 2(12)]

Includes their state or condition.

## SALE AND AGREEMENT TO SELL (SECTION 4)

- ➔ According to Section 4(1), a contract of sale is a contract where a seller transfers or agrees to transfer the ownership of goods to a buyer for a price.
- ➔ A contract of sale may be either absolute or conditional, as stated in Section 4(2).
- ➔ The contract is called a sale when the ownership is transferred immediately, but it is an agreement to sell when the transfer is set for a future time or depends on a condition to be fulfilled (Section 4(3)).
- ➔ An agreement to sell becomes a sale when that time has passed or the conditions have been met (Section 4(4)).

Contract of Sale	
Sale	Agreement to sell

### ⬡ Sale

A sale, as defined in Section 4(3) of the Sale of Goods Act, 1930, occurs when the ownership (property) in goods is transferred from the seller to the buyer immediately under a contract of sale.

### ⬡ Agreement to sell

An agreement to sell, as defined in Section 4(3) of the Sale of Goods Act, 1930, is a contract where the transfer of ownership of goods from seller to buyer is intended to happen at a future time or upon the fulfillment of specific conditions.

The key distinction between a sale and an agreement to sell is whether the ownership transfer is immediate (a sale) or delayed (an agreement to sell).

**Example:** X agrees with Y on 10th October, 2022 that he will sell his car to Y on 10th November, 2022 for a sum of 7 lakhs. It is an agreement to sell.

### When agreement to sell becomes sale:

An agreement to sell becomes a sale when the specified conditions or time for the transfer of goods are met, turning it from a promise to a completed transaction.

The following elements must co-exist so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930:

- (i) There must be at least two parties, the seller and the buyer and the two must be different persons. A person cannot be both the seller and the buyer and sell his goods to himself.
- (ii) The subject matter of the contract must necessarily be goods covering only movable property. It may be either existing goods, owned or possessed by the seller or future goods.
- (iii) A price in money (not in kind) should be paid or promised. But there is nothing to prevent the consideration from being partly in money and partly in kind.
- (iv) A transfer of property in goods from seller to the buyer must take place. The contract of sale is made by an offer to buy or sell goods for a price by one party and the acceptance of such offer by other.
- (v) A contract of sale may be absolute or conditional.
- (vi) All other essential elements of a valid contract must be present in the contract of sale, e.g. free consent of parties, competency of parties, legality of object and consideration etc.

## DISTINCTION BETWEEN SALE AND AN AGREEMENT TO SELL

Basis	Sale	Agreement to sell
Transfer of property	The property in the goods passes to the buyer immediately.	Property in the goods passes to the buyer on future date or on fulfillment of some condition.
Nature of contract	It is an executed contract i.e. contract for which consideration has been paid.	It is an executory contract i.e. contract for which consideration is to be paid at a future date.
Remedies for breach	The seller can sue the buyer for the price of the goods because of the passing of the property therein to the buyer.	The aggrieved party can sue for damages only and not for the price, unless the price was payable at a stated date.
Liability of parties	A subsequent loss or destruction of the goods is the liability of the buyer.	Such loss or destruction is the liability of the seller.
Burden of risk	Risk of loss is that of buyer since risk follows ownership.	Risk of loss is that of seller.

Nature of rights	Creates <u>Jus in rem</u> means right against the whole world.	Creates <u>Jus in personam</u> means rights against a particular party to the contract.
Right of resale	The seller cannot resell the goods.	The seller may sell the goods since ownership is with the seller.
In case of insolvency of seller	The official assignee will not be able to take over the goods but will recover the price from the buyer.	The official assignee will acquire control over the goods but the price will not be recoverable.
In case of insolvency of buyer	The official assignee will have control over the goods.	The official assignee will not have any control over the goods.

## SALE DISTINGUISHED FROM OTHER SIMILAR CONTRACTS

### ❖ (i) Sale and Hire Purchase:

A hire-purchase agreement is a contract where goods are let on hire, and the hirer has the option to purchase them later. It is governed by the Hire-purchase Act, 1972.

While it resembles a contract of sale, its ultimate goal is the sale of goods.

- (a) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and
- (b) The property in the goods is to pass to such person on the payment of the last of such instalments, and
- (c) Such person has a right to terminate the agreement at any time before the property so passes;

The main points of distinction between the 'sale' and 'hire-purchase' are as follows:

Basis	Sale	Hire- Purchase
Time of passing property	Property in the goods is transferred to the buyer immediately at the time of contract.	The property in goods passes to the hirer upon payment of the last instalment.
Position of the party	The position of the buyer is that of the owner of the goods.	The position of the hirer is that of a bailee till he pays the last instalment.
Termination of contract <sup>1</sup>	The buyer cannot terminate the contract and is bound to pay the price of the goods. <sup>2</sup>	The hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining instalments.

<b>Burden of Risk of insolvency of the buyer</b>	of	The seller takes the risk of any loss resulting from the insolvency of the buyer.	The owner takes no such risk, for if the hirer fails to pay an instalment, the owner has right to take back the goods.
<b>Transfer of title</b>	of	The buyer can pass a good title to a bona fide purchaser from him.	The hirer cannot pass any title even to a bona fide purchaser until he pays the last instalment.
<b>Resale</b>		The buyer in sale can resell the goods.	The hire purchaser cannot resell unless he has paid all the instalments.

### ❖(ii) Sale and Bailment

A bailment is the transfer of goods for a specific purpose under a contract. The person receiving the goods must return them to the owner (the bailor) or dispose of them as instructed once the purpose is fulfilled. This process is governed by the Indian Contract Act, 1872.

The difference between bailment and sale may be clearly understood by studying the following:

Basis		Sale	Bailment
<b>Transfer of property</b>	of	The property in goods is transferred from the seller to the buyer. So, it is transfer of general property.	There is only transfer of possession of goods from the bailor to the bailee for any of the reasons like safe custody, carriage etc. So, it is transfer of special property.
<b>Return goods</b>	of	The return of goods in the contract of sale is not possible.	The bailee must return the goods to the bailor on the accomplishment of the purpose for which the bailment was made.
<b>Consideration</b>		The consideration is the price in terms of money.	The consideration may be gratuitous or non-gratuitous.

### ❖(iii) Sale and contract for work and labour:

A contract for the sale of goods involves the exchange of goods for a price. In contrast, a contract for work and labor involves performing a service without the sale of goods.

#### Example:

Where gold is supplied to a goldsmith for preparing an ornament or when an artist is asked to paint a picture. Here, the basic substance of the contract is the exercise of skill and labour, therefore it is contract for work and labour.



## CONTRACT OF SALE HOW MADE (SECTION 5)

According to Section 5(1), A contract of sale may be made in any of the following modes:

- (i) Contract of sale is made by an offer to buy or sell goods for a price and acceptance of such offer.
- (ii) There may be immediate delivery of the goods; or
- (iii) There may be immediate payment of price, but it may be agreed that the delivery is to be made at some future date; or
- (iv) There may be immediate delivery of the goods and an immediate payment of price; or
- (v) It may be agreed that the delivery or payment or both are to be made in instalments; or
- (vi) It may be agreed that the delivery or payment or both are to be made at some future date.

**Example:**

R agrees to deliver his old motorcycle valued at ₹ 55,000 to S in exchange for a new motorcycle and agrees to pay the difference in cash, it is a Contract of Sale.

## SUBJECT MATTER OF CONTRACT OF SALE

Existing or future goods (section 6):

- (1) The goods which form the subject matter of a contract of sale may be either existing goods that are acquired, owned or possessed by the seller, or future goods.
- (2) There may be a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen.

**Example:**

A contract for sale of certain cloth to be manufactured by a certain mill is a valid contract. Such contracts are called contingent contracts.

- (3) There may be a contract of sale, where the seller purports to affect a present sale of future goods, such contract operates as an agreement to sell the goods.

Goods perishing before making of contract (Section 7):

A contract for the sale of specific goods is void if, unknown to the seller, the goods were already destroyed or damaged beyond their described state at the time the contract was made.

**Example:**

A agrees to sell B 50 bags of wheat stored in the A's godown. Due to water logging, all the goods stored in the godown were destroyed. At the time of agreement, neither party was aware of the fact. The agreement is void.

### ◆ Goods perishing before sale but after agreement to sell (Section 8)

*If specific goods are destroyed or significantly damaged without fault of either party after an agreement to sell, but before the risk of loss passes to the buyer, the agreement is void.*

### ◆ Perishing of future goods

*If the future goods are specific, the destruction of such goods will amount to supervening impossibility and the contract shall become void.*

#### *Example:*

*A agrees to sell B 100 tons of tomatoes grown on his land next year. But the crop failed due to some disease in plants and A could only deliver 80 tons of tomatoes to B. It was held A was not liable as the performance of contract became impossible due to supervening impossibility.*



## ASCERTAINMENT OF PRICE (SECTION 9 & 10)

### ◆ Ascertainment of price (Section 9)

'Price' means the monetary consideration for sale of goods [Section 2 (10)]. By virtue of Section 9, the price in the contract of sale may be-

- |  |
|--|
| (1) fixed by the contract, or  |
| (2) agreed to be fixed in a manner provided by the contract, e.g., by a valuer, or |
| (3) determined by the course of dealings between the parties.                      |

### ◆ Agreement to sell at valuation (Section 10)

Section 10 provides for the determination of price by a third party.

- |  |
|--|
| 1. Where there is an agreement to sell goods on the terms that price has to be fixed by the third party and he either does not or cannot make such valuation the agreement will be void. |
| 2. In case the third party is prevented by the default of either party from fixing the price the party at fault will be liable to the damages to the other party who is not at fault.    |
| 3. However, a buyer who has received and appropriated the goods must pay a reasonable price for them in any eventuality.   |

*Example: P is having two bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price.*

*As such P ask S to return the bike already delivered while S claims for the delivery of the second bike too. In the given instance, buyer S shall pay reasonable price to P for the bike already taken. As regards the Second bike, the contract can be avoided as the third-party Q refuses to fix the price.*

# Chapter 3

## Unit 2: Conditions & Warranties

### STIPULATION AS TO TIME (SECTION 11)

A stipulation concerning the time for payment of the price is generally not considered to be of the essence of a contract of sale, unless the contract terms indicate a different intention. However, the delivery of goods must be made without delay.

Whether or not a stipulation is "of the essence" depends on the specific terms agreed upon in the contract. Stipulations regarding time of delivery are typically considered essential to the contract.



### INTRODUCTION - CONDITIONS AND WARRANTIES

When a seller makes statements to entice a buyer, these are representations. If these representations become part of the contract and the buyer relies on them, they are called stipulations. Not all stipulations are equally important.

#### Conditions

A stipulation essential to the main purpose of the contract. A breach gives the buyer the right to repudiate the contract (treat it as ended and reject the goods) and/or claim damages.

#### Example:

P wants to purchase a car from Q, which can have a mileage of 20 km/litre. Q pointing at a particular vehicle says "This car will suit you." Later P buys the car but finds out later on that this car only has a top mileage of 15 km/ litre.



This amounts to a breach of condition because the seller made the stipulation which forms the essence of the contract. In this case, the mileage was a stipulation that was essential to the main purpose of the contract and hence its breach is a breach of condition.

## Warranty

A stipulation collateral to the main purpose of the contract. A breach gives the buyer only the right to claim damages, not to reject the goods or repudiate the contract.

### Example:

Ram consults Shyam, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Shyam suggests 'Maruti' and Ram accordingly buys it from Shyam. The car turns out to be unfit for touring purposes.

Here, the term that the 'car should be suitable for touring purposes' is a condition of the contract. It is so vital that its nonfulfillment defeats the very purpose for which Ram purchases the car. Ram is therefore entitled to reject the car and have refund of the price.

Let us assume, Ram buys a new Maruti car from the show room and the car is guaranteed against any manufacturing defect under normal usage for a period of one year from the date of original purchase and in the event of any manufacturing defect there is a warranty for replacement of defective part if it cannot be properly repaired. After six months, Ram finds that the horn of the car is not working, here in this case he cannot terminate the contract. The manufacturer can either get it repaired or replaced it with a new horn. Ram gets a right to claim for damages, if any, suffered by him but not the right of repudiation.



## Difference between conditions and warranties:

The following are important differences between conditions and warranties.

Basis	Condition	Warranty
<b>Meaning</b>	A condition is a stipulation essential to the main purpose of the contract.	A warranty is a stipulation collateral to the main purpose of the contract.
<b>Right in case of breach</b>	The aggrieved party can repudiate the contract or claim damages or both in the case of breach of condition.	The aggrieved party can claim only damages in case of breach of warranty.
<b>Conversion of stipulations</b>	A breach of condition may be treated as a breach of warranty.	A breach of warranty cannot be treated as a breach of condition.

## WHEN CONDITION IS TO BE TREATED AS WARRANTY (SECTION 13)

Section 13 specifies cases where a breach of condition be treated as a breach of warranty. As a result of which the buyer loses his right to rescind the contract and can claim damages only.

In the following cases, a contract is not avoided even on account of a breach of a condition:

**Waiver by Buyer**

The buyer voluntarily waives the performance of the condition for their own benefit.

**Treating Condition as Warranty**

The buyer accepts the breach but claims damages instead of cancelling the contract.

**Example:**

A agrees to supply B 10 bags of first quality sugar @ ₹ 625 per bag but supplies only second quality sugar, the price of which is ₹ 600 per bag. There is a breach of condition and the buyer can reject the goods. But if the buyer so elects, he may treat it as a breach of warranty, hence he may accept the second quality sugar and claim damages @ ₹ 25 per bag.

**Non-Severable Contract**

If goods are inseparable (e.g., basmati mixed with lower-quality rice) and partly accepted, the buyer can't reject the rest.

**Excused by Law**

Fulfilment is excused due to impossibility or other legal reasons.

◆ **Waiver of conditions**

**Voluntary Waiver**

*Waives performance of contract  
Elect to treat condition as warranty*

**Compulsory Waiver**

*Non-severability of contract  
Fulfilment of conditions excused by law*

● **EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES** ●

◆ **Express**

Conditions and warranties are express when they are explicitly stated as terms in the contract by the parties.

◆ **Implied**

Conditions and warranties are implied when they are presumed by law to be present in the contract, even if not explicitly stated. Implied conditions can be negated or waived by an express agreement.

**Implied Conditions**

Condition as to title

Sale by sample

Condition as to quality or fitness

Condition as to wholesomeness

Condition as to description

Sale by sample as well as by description

Condition as to merchantability

### (i) Condition as to Title (Section 14(a))

*In every contract of sale, unless agreed otherwise, it is implied that:*

#### In a sale

The seller already has the right to sell the goods.

#### In an agreement to sell

The seller will have the right to sell when ownership is to pass.

This means the seller should be the true owner at the relevant time. If the seller's title is defective, the buyer must return the goods to the real owner and can claim the price back from the seller.

#### Example:

A purchased a tractor from B who had no title to it. After 2 months, the true owner spotted the tractor and demanded it from A. Held that A was bound to hand over the tractor to its true owner and that A could sue B, the seller without title, for the recovery of the purchase price.

#### Example:

If A sells to B tins of condensed milk labelled 'C.D.F. brand', and this is proved to be an infringement of N Company's trade mark, it will be a breach of implied condition that A had the right to sell. B in such a case will be entitled to reject the goods or take off the labels, and claim damages for the reduced value. If the seller has no title and the buyer has to make over the goods to the true owner, he will be entitled to refund of the price.

### (ii) Sale by Description (Section 15)

*When goods are sold by description, there is an implied condition that the goods shall correspond with that description.*

*This condition is fundamental and goes to the root of the contract, allowing the buyer to reject non-conforming goods regardless of inspection opportunity.*



*The Act, however, does not define 'description'.*

(i) where the class or kind to which the goods belong has been specified, e.g., 'Egyptian cotton', 'java sugar', etc., defining the category of good

(ii) where the goods have been described by certain characteristics essential to their identification, e.g., jute bales of specified shipment, steel of specific dimension, etc.

*Here, the description may include details like place of origin or packing method. Whether such details are essential to the goods' identity depends on the facts and the contract's interpretation.*

**Example:**

A at Kolkata sells to B twelve bags of “waste silk” on its way from Murshidabad to Kolkata. There is an implied condition that the silk shall be such as is known in the market as “Waste Silk”. If it not, B is entitled to reject the goods.

**Example:**

A ship was contracted to be sold as “copper-fastened vessel” but actually it was only partly copper-fastened. Held that goods did not correspond to description and hence could be returned or if buyer took the goods, he could claim damages for breach.

**Baker:** I ordered organic, gluten-free, rainbow-colored sprinkles for my special cake.

**Baker:** Uh... this isn't sprinkles. It's just flour.

**Baker:** No, it's a breach of condition by description. I'm rejecting it — my sprinkles must match the description!



**Supplier:** Here's your order!

**Supplier:** Well... it's something for baking?

**Supplier:** Guess no colourful cakes today...

**(iii) Sale by sample [Section 17]**

In a contract of sale by sample, there is an implied condition that

- (a) the bulk shall correspond with the sample in quality;
- (b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample.

**Example:**

In a case of sale by sample of two parcels of wheat, the seller allowed the buyer an inspection of the smaller parcel but not of the larger parcel. In this case, it was held that the buyer was entitled to refuse to take the parcels of wheat.

(c) In a sale by sample, there's an implied condition that the goods are free from any hidden (latent) defects that a buyer couldn't have found through a normal inspection of the sample. If such a latent defect is discovered in the final goods, the buyer can cancel the contract.

**Example:**

A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of the price plus damages.

*(iv) Sale by sample as well as by description [Section 15]*

When goods are sold by both sample and description, the implied condition is that the bulk must correspond to both the sample and the description.

If the goods match one but not the other, or neither, the buyer can repudiate the contract.

*Example:*

A agreed with B to sell certain oil described as refined sunflower oil, warranted only equal to sample. The goods tendered were equal to sample but contained a mixture of hemp oil along with sunflower oil.

Hence, B can reject the goods because the goods were as per sample but do not correspond to the description.



*(v) Condition as to quality or fitness [Section 16(1)]*

Normally, there's no implied condition of quality or fitness.

A product is considered fit for a particular purpose if the buyer informs the seller of that purpose, trusts the seller's expertise to choose the right item, and the seller is someone who typically deals in those goods.

The condition for fitness for a specific purpose doesn't apply to goods sold under a patent or trade name.

- (a) The buyer should have made known to the seller the particular purpose for which goods are required.
- (b) The buyer should rely on the skill and judgement of the seller.
- (c) The goods must be of a description dealt in by the seller, whether he be a manufacturer or not.



If goods can only serve one purpose, or the purpose is clear from the parties' conduct or the nature of the goods, the buyer need not state it to the seller.

"Caveat emptor" is a legal principle meaning "let the buyer beware." It places the responsibility on the buyer to inspect goods and ensure they are suitable for their purpose before making a purchase.

**Example:**

'A' bought a set of false teeth from 'B', a dentist. But the set was not fit for 'A's mouth. 'A' rejected the set of teeth and claimed the refund of price. It was held that 'A' was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled.

**Example:**

'A' went to 'B's shop and asked for a 'Merrit' sewing machine. 'B' gave 'A' the same and 'A' paid the price. 'A' relied on the trade name of the machine rather than on the skill and judgement of the seller 'B'. In this case, there is no implied condition as to fitness of the machine for buyer's particular purpose.

**(vi) Condition as to Merchantability [Section 16(2)]**

When goods are bought by description from a seller who deals in such goods, there is an implied condition that they will be of merchantable quality, regardless of whether the seller is the manufacturer or producer.

There are two requirements for this condition to apply:

- (a) Goods should be bought by description.
- (b) The seller should be a dealer in goods of that description

If the buyer examines the goods, there is no implied condition for defects that such examination should reveal. "Merchantable quality" means goods that an ordinary prudent person would accept for that description; it does not relate to legal right or title to sell.

**Example:**

If a person orders motor horns from a manufacturer of horns, and the horns supplied are scratched and damaged owing to bad packing, he is entitled to reject them as unmerchantable.

**Example:**

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

**(vii) Condition as to Wholesomeness**

Specifically for eatables and provisions, there's an implied condition that the goods shall be wholesome (i.e., fit for human consumption), in addition to merchantability.

Example:

**Shopkeeper:** "Here you go — fresh and delicious."

**Buyer:** I'll take one gourmet jelly donut, please.

**Buyer:** Uh... this isn't jelly... it's industrial-grade lubricant!

**Buyer:** That's disgusting! This is a breach of condition as to wholesomeness. I want my money back, compensation for the shock, and maybe even a stomach pump!

Example:

A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

### Implied Warranties

- Warranty as to Undisturbed Possession (Section 14(b))
- Warranty as to Non-existence of Encumbrances (Section 14(c))
- Warranty as to Quality or Fitness by Usage of Trade (Section 16(3))
- Disclosure of Dangerous Nature of Goods

#### Warranty as to Undisturbed Possession (Section 14(b))

An implied warranty that the buyer shall have and enjoy quiet possession of the goods. If the buyer's possession is later disturbed, they can sue the seller for breach of this warranty and claim damages.

**Seller:** Yours to keep, no trouble.

**Hobbyist:** Love this gnome! I'll buy it.

**Hobbyist:** Great... now I'm suing the seller for my money back—and for the tiny hat!

**Gardener:** That's my gnome—return it.

Example:

X buys a laptop from Y. After the purchase, X spends some money on its repair and uses it for some time. Unknown to the parties, it turns out that the laptop was stolen and was taken from X and delivered to its rightful owner. Y shall be held responsible for a breach and X is entitled to damages of not only the price but also the cost of repairs.

### Warranty as to Non-existence of Encumbrances (Section 14(c))


An implied warranty that the goods shall be free from any charge or encumbrance (e.g., a pledge, lien) in favor of a third party, unless declared or known to the buyer before or at the time of contract.

#### Example:

A pledges his car with C for a loan of ₹15,0000 and promises him to give its possession the next day. A, then sells the car immediately to B, who purchased it on good faith, without knowing the fact. B, may either ask A to clear the loan or himself may pay the money and then, file a suit against A for recovery of the money with interest.

### Warranty as to Quality or Fitness by Usage of Trade (Section 16(3))

An implied warranty concerning quality or fitness for a particular purpose may be attached or annexed by the usage of trade.



**Buyer:** One magical invisibility potion, please.

**Shopkeeper:** Here you go.

**Buyer:** Wait... where's my chameleon charm?

**Shopkeeper:** Uh... wasn't part of the deal.

**Buyer:** In this village, it's always included. That's a breach of warranty by usage of trade!

### Disclosure of Dangerous Nature of Goods

If goods are dangerous in nature and the buyer is unaware of the danger, the seller must warn the buyer of the probable danger. A breach of this warranty can lead to damages.

## CAVEAT EMPTOR

Caveat Emptor (“let the buyer beware”) means it is the buyer's responsibility to examine goods and ensure they meet their needs before purchase. The seller is not bound to point out defects and cannot be held liable if the goods later prove defective or unfit, provided the buyer relied on their own skill or judgment.

As per Section 16, unless expressly provided by the Sale of Goods Act or any other law, there is no implied warranty or condition as to the quality or fitness of goods for any particular purpose.



Following are the conditions to be satisfied:

if the buyer had made known to the seller the purpose of his purchase, and

the buyer relied on the seller's skill and judgement, and

seller's business to supply goods of that description (Section 16).

**Example:**

A sold pigs to B. These pigs being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy. The rule of the law being "Caveat Emptor".

**Example:**

A purchases a horse from B. A needed the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the carriage. Caveat emptor rule applies here and so A can neither reject the horse nor can claim compensation from B.

### Exceptions to Caveat Emptor:

#### Fitness as to Quality or Use (Section 16(1)):

Where the buyer makes their particular purpose known to the seller, relies on the seller's skill/judgment, and the seller deals in such goods. Here, the seller has a duty to supply reasonably fit goods.

**CASE LAWS:**

#### 1. *Bombay Burma Trading Corporation Ltd. vs. Aga Muhammad*

Timber was purchased for the express purpose of using it as railways sleepers and when it was found to be unfit for the purpose, the Court held that the contract could be avoided.

#### 2. *Priest vs. Last*

P, a draper, purchased a hot water bottle from a retail chemist, P asked the chemist if it would stand boiling water. The Chemist told him that the bottle was meant to hold hot water. The bottle burst when hot water was poured into it and injured his wife. It was held that the chemist shall be liable to pay damages to P, as he knew that the bottle was purchased for the purpose of being used as a hot water bottle.

**Example :**

An order was placed for some trucks to be used for heavy traffic in a hilly country. The trucks supplied by the seller were unfit for this purpose and broke down. There is a breach of condition as to fitness.

**Goods Purchased Under Patent or Brand Name (Section 16(1)):**

If goods are purchased under their patent or brand name, there is no implied condition that they shall be fit for any particular purpose. While listed as an exception to caveat emptor, it effectively means the buyer relies on the brand, and the seller is not liable for fitness in this specific scenario.

**Goods Sold by Description (Section 15):**

There is an implied condition that goods sold by description must correspond with that description. If not, the seller is responsible.

**Goods of Merchantable Quality (Section 16(2)):**

Where goods are bought by description from a seller who deals in such goods, there's an implied condition that they are of merchantable quality. Caveat Emptor does not apply for latent defects, but it does apply if defects were obvious on ordinary examination.

**Sale by Sample (Section 17):**

If the bulk does not correspond with the sample, Caveat Emptor does not apply.

**Goods by Sample as well as Description (Section 15):**

If goods don't correspond to both the sample and description, or either, Caveat Emptor is not applicable.

**Trade Usage (Section 16(3)):**

An implied warranty or condition as to quality or fitness can be annexed by trade usage. If the seller deviates, Caveat Emptor is not applicable.

**Example:**

In readymade garment business, there is an implied condition by usage of trade that the garments shall be reasonably fit on the buyer.

**Seller Actively Conceals a Defect or is Guilty of Fraud:**

If the seller misrepresents or commits fraud, or actively conceals a defect not discoverable by reasonable examination, Caveat Emptor does not apply. The buyer can avoid the contract and claim damages.

# Chapter 3

## Unit 3: Transfer Of Ownership and Delivery of Goods

### INTRODUCTION

A contract of sale of goods involves three stages of transfer: Passing of Property, Delivery of Goods, and Passing of Risk.

### IMPORTANCE OF THE TIME OF TRANSFER

As a general rule, risk passes along with the ownership of goods. Therefore, if goods are lost or damaged, the loss falls on the person who is the owner at that time. In case of damage by a third party, the owner has the right to take legal action. Further, a seller can sue the buyer for the price only after the ownership of the goods has passed to the buyer.

### PASSING OF PROPERTY (SECTIONS 18 – 26)

Passing or transfer of property signifies the transfer of ownership. This is the most critical factor in determining the legal rights and liabilities of sellers and buyers. If the property has passed to the buyer, the risk of loss is generally with the buyer, even if the goods are still in the seller's possession.

The rules for transferring property depend on two main factors:

#### (a) Identification of Goods (Section 18):

For unascertained goods, ownership cannot pass until the goods are ascertained (specifically identified and agreed upon). The buyer gains ownership rights only when the goods are specific and ascertained.

#### (b) Intentions of Parties (Section 19):

Property is transferred to the buyer at the time the parties intend it to be transferred. To determine this intention, factors like the terms of the contract, the conduct of the parties, and the circumstances of the case are considered.

Section 19(2) further provides that for the purpose of ascertaining the intention of the parties regard shall be:

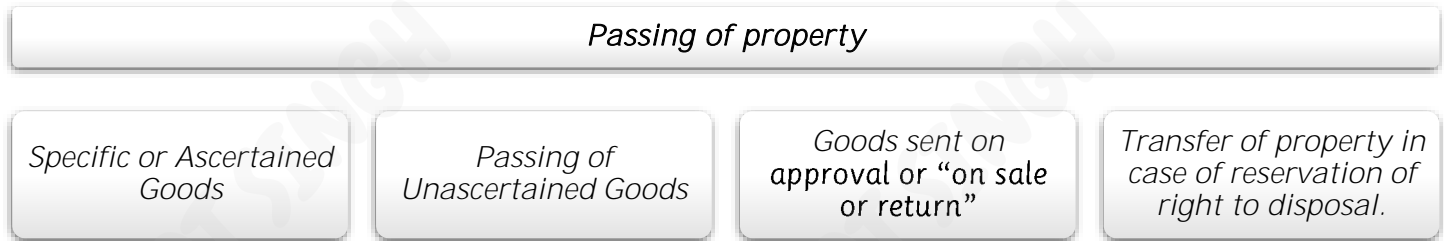
(i) To the terms of the contract

(ii) To the conduct of the parties and

(iii) To the circumstances of the case



The primary rules determining the passing of property from seller to buyer are as follows:



◆ **A. Property (Specific or ascertained goods) passes when intended to pass (Section 19):**

For the sale of specific or ascertained goods, ownership transfers when the parties intend it to. To determine this intention, one must consider the contract's terms, the parties' actions, and the surrounding circumstances. If their intention is not clear, the rules outlined in Sections 20 to 24 of the Sale of Goods Act apply to determine when ownership passes.

Stages of goods while passing of property



**1. Specific goods in a deliverable state (Section 20):**

In an unconditional sale of specific goods in a deliverable state, ownership passes to the buyer when the contract is made, regardless of whether payment or delivery is postponed, provided the goods are ready for delivery.

**Example:** X goes into a shop and buys a television and asks the shopkeeper for its home delivery. The shopkeeper agrees to do it. The television immediately becomes the property of X.

**2. Specific goods to be put into a deliverable state (Section 21):**

When specific goods need the seller to do something to put them in a deliverable state, the ownership does not pass to the buyer until the required work is completed and the buyer has been informed of it.

**Example:** Peter buys a laptop from an electronics store and asks for a home delivery. The shopkeeper agrees to it. However, the laptop does not have a Windows operating system installed. The shopkeeper promises to install it and call Peter before making the delivery. In this case, the property transfers to Peter only after the shopkeeper has installed the OS making the laptop ready for delivery and intimated the buyer about it.



3. *Specific goods in a deliverable state, when the seller has to do anything thereto in order to ascertain price (Section 22):*

In a sale of specific goods in a deliverable state, if the seller must weigh, measure, test, or perform any act to ascertain the price, ownership passes only after that act is completed and the buyer is notified.

**Example:** A sold carpets to the Company which were required to be laid. The carpet was delivered to the company's premises but was stolen before it could be laid. It was held that the carpet was not in deliverable state as it was not laid, which was part of the contract and hence, the property had not passed to the buyer company.

## ◆ B. Unascertained Goods

Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained. [Section 18]

Goods of the description in deliverable state

Delivery to the carrier for transmission

The rules in respect of passing of property of unascertained goods are as follows:

1. *Sale of unascertained goods by description and Appropriation [Section 23(1)]:*

Appropriation of goods means selecting goods for fulfilling the contract with the mutual consent of both seller and buyer.

The essentials are:

- |   |
|---|
| (a) There is a contract for the sale of unascertained or future goods.  |
| (b) The goods should conform to the description and quality stated in the contract.   |
| (c) The goods must be in a deliverable state.   |
| (d) The goods must be unconditionally (as distinguished from an intention to appropriate) appropriated to the contract either by delivery to the buyer or his agent or the carrier. |
| (e) The appropriation must be made by:  |
| (i) the seller with the assent of the buyer; or   |
| (ii) the buyer with the assent of the seller.   |
| (f) The assent may be express or implied.   |
| (g) The assent may be given either before or after appropriation.   |

## 2. Delivery of the goods to the carrier [Section 23(2)]:

When a seller, as part of a contract, delivers goods to a buyer or to a third-party carrier for delivery, and does not retain any control over them, this action is considered an unconditional transfer of ownership to the buyer.

### Example:

A bill of lading of railway parcel is made out in the name of the buyer and is sent to him, the ownership in the goods passes from the seller to the buyer. In case the goods are subjected to accidental loss or by theft, the seller will not be liable.



### Example:

M places an order for book with a book seller in Mumbai. He asks him to send the book by courier. Payment of the book was to be made by cheque. The seller sends the book by courier. The book is lost in the way. The seller wants the buyer to bear the loss. According to Section 23(2), it is an unconditional appropriation of goods because of which buyer M has become the owner of the goods. Therefore, he will bear the risk of loss of the book in the way.

## ◆ C. Goods sent on approval or “on sale or return” (Section 24)

When goods are delivered to the buyer on approval or “on sale or return” or other similar terms, the property therein passes to the buyer-

- (a) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction;
- (b) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time; or
- (c) he does something to the good which is equivalent to accepting the goods e.g. he pledges or sells the goods.

### Example:

P brought a musical instrument from a musical shop on a condition that he will purchase it, if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument. The ownership is transferred when he has decided to purchase the instrument as his own.

Under a “sale or return” contract, a buyer’s ownership is confirmed by an act demonstrating a clear intention to buy, like pledging the goods. However, merely being unable to return them doesn’t mean the buyer has purchased them.

**Example:**

'A' delivered some jewellery to 'B' on sale or return basis. 'B' pledged the jewellery with 'C'. It was held that the ownership of the jewellery had been transferred to 'B' as he had adopted the transaction by pledging the jewellery with 'C'. In this case, 'A' has no right against 'C'. He can only recover the price of the jewellery from 'B'.

**Example:**

A sends to B a water motor on approval or returns in March, 2020. B to return it after trial in August, 2020. The water motor has not been returned within a reasonable time, and therefore, A is not bound to accept it and B must pay the price.

**Sale for cash only or Return**

In a "sale or return" arrangement where the terms explicitly state that ownership remains with the seller until the goods are paid for, ownership does not pass to the buyer until payment is made.

**Example:**

'A' delivered his jewellery to 'B' on sale for cash only or return basis. It was expressly provided in the contract that the jewellery shall remain 'A's property until the price is paid. Before the payment of the price, 'B' pledged the jewellery with 'C'. It was held that at the time of pledge, the ownership was not transferred to 'B'. Thus, the pledge was not valid and 'A' could recover the jewellery from 'C'.

### ◆ D. Reservation of right of disposal (Section 25)

This section allows the seller to reserve the right to dispose of the goods until certain conditions (typically payment) are fulfilled, even if goods have been delivered to the buyer or carrier.

Property will not pass to the buyer until the condition imposed by the seller is fulfilled.

**Example:**

X sends furniture to a company by a truck and instructs the driver not to deliver the furniture to the company until the payment is made by company to him. The property passes only when the payment is made.



Circumstances where right of disposal is presumed reserved:

(1) Goods shipped/delivered to carrier with bill of lading/railway receipt made to seller's order:

If the document of title makes the goods deliverable to the order of the seller or their agent, the seller is presumed to have reserved the right of disposal.

(2) Seller draws bill of exchange on buyer for price and sends it with bill of lading/railway receipt:

If the buyer doesn't accept or pay the bill, they must return the document. If wrongfully retained, property does not pass.

This section deals with "conditional appropriation" as opposed to the "unconditional appropriation" under Section 23(2).

Mad Scientist: I'll sell you this doomsday device, but I'm keeping the glowing red activation button.

Mad Scientist: Remember, you own it only after you pay me and I press the button remotely.

Mad Scientist: Exactly. Until I press it, I still have the right of disposal.



Bob: Fine, send it over

Bob: So even though it's here, it's not really mine yet?

## RISK PRIMA FACIE PASSES WITH PROPERTY (SECTION 26)

As per Section 26, unless there is an agreement to the contrary, goods remain at the seller's risk until the property (ownership) passes to the buyer. Once ownership passes, the goods are at the buyer's risk, even if delivery has not yet been made.

However, an exception applies where delivery is delayed due to the fault of either the buyer or the seller in such cases, the loss is borne by the party at fault.

Thus, under normal circumstances, risk follows ownership, but the parties may, by special agreement, decide that risk will pass before or after the transfer of ownership.



### ◆ Risk prima facie passes with ownership:

#### General Rule

Risk passes with ownership.

#### Seller's Risk

Until property passes to the buyer.

#### Buyer's Risk

After property passes from the seller.

#### Example:

A bids for an antique painting at a sale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the antique which gets damaged. The loss will have to be borne by the seller, because the ownership of goods has not yet passed from the seller to the buyer.

### ◆ Exceptions / Qualifications:

#### 1. Delay in Delivery:

If caused by either party's fault, that party bears the risk for loss arising from the delay.

#### 2. Bailment Duties:

Seller/Buyer's duties as bailee remain unaffected even if risk has passed.

*Example:* A contracted to sell 100 bales of cotton to B to be delivered in February. B took the delivery of the part of the cotton but made a default in accepting the remaining bales.

Consequently, the cotton becomes unfit for use. The loss will have to be borne by the buyer. It should, however, be remembered that the general rule shall not affect the duties or liabilities of either seller or buyer as a bailee of goods for the other, even when the risk has passed. It is their duty to take care of the goods as a man of ordinary prudence would have done.

Risk usually passes with ownership, but parties can agree otherwise—risk may pass before or after ownership transfers.

## TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27 – 30)

### Core Principle:

A seller cannot transfer a better title to goods than they themselves possess.

### Result:

If a non-owner sells goods, the buyer does not acquire legal ownership, regardless of having paid for them.

### Legal Maxim:

This principle is encapsulated by the Latin phrase *Nemo dat quod non habet*, meaning "no one can give what he has not got."

If enforced strictly, the rule could cause losses to innocent buyers. Hence, to safeguard their interests, the law provides several exceptions.



### Example:

If A sells some stolen goods to B, who buys them in good faith, B will get no title to that and the true owner has a right to get back his goods from B.

### Example:

P, the hirer of vehicle under a hire purchase agreement, sells them to Q. Q, though a bona fide purchaser, does not acquire the ownership in the vehicle. At the most he acquires the same right as that of the hirer.

### Exceptions:

#### (1) Sale by a Mercantile Agent:

A mercantile agent's sale passes a good title if certain legal conditions are met.

- (a) If he was in possession of the goods or documents with the consent of the owner;
- (b) If the sale was made by him when acting in the ordinary course of business as a mercantile agent; and
- (c) If the buyer had acted in good faith and has at the time of the contract of sale, no notice of the fact that the seller had no authority to sell (Proviso to Section 27)

#### Mercantile Agent

Authority to sell, consign, buy, or raise money on goods.

### ❖ (2) Sale by one of the joint owners (Section 28):

If one of several joint owners has sole possession of the goods by permission of the co-owners, and sells them, the buyer gets good title if they buy in good faith and without notice that the seller lacks authority.

**Example:**

A, B, and C are three brothers and joint owners of a T.V and VCR and with the consent of B and C, the VCR and T.V was kept in possession of A. A sells the T.V and VCR to P who buys it in good faith and without notice that A had no authority to sell. P gets a good title to VCR and T.V.



### ❖ (3) Sale by a person in possession under voidable contract (Section 29):

A buyer acquires good title if they buy goods from a seller who obtained possession under a voidable contract (e.g., due to coercion, fraud, misrepresentation, undue influence), provided the contract had not been rescinded before the sale.

**Example:**

X fraudulently obtains a diamond ring from Y. This contract is voidable at the option of Y. But before the contract could be terminated, X sells the ring to Z, an innocent purchaser. Z gets the good title and Y cannot recover the ring from Z even if the contract is subsequently set aside.

### ❖ (4) Sale by one who has already sold the goods but continues in possession thereof:

If a seller has already sold goods but retains possession of them or their documents of title, he can validly sell, pledge, or otherwise dispose of them to a third party. If that third party takes delivery in good faith and without knowledge of the prior sale, they acquire a good title, even though ownership had already passed to the first buyer [Sec. 30(1)].

**Example:**

During IPL matches, P buys a TV set from R. R agrees to deliver the same to P after some days. In meanwhile R sells the same to S, at a higher price, who buys in good faith and without knowledge about the previous sale. S gets a good title.

### ❖ (5) Sale by buyer obtaining possession before the property in the goods has vested in him (Section 30(2)):

Where a buyer, with the seller's consent, obtains possession of goods before property has passed to them, they can sell, pledge, or dispose of the goods to a third person.

If this third person obtains delivery in good faith and without notice of the original seller's rights (like a lien), they get good title.

**Note:**

This exception does not apply to a person in possession under a hire-purchase agreement (which is an option to buy, not a sale) unless it effectively amounts to a sale.

**Example:**

Furniture was delivered to B under an agreement that price was to be paid in two instalments, the furniture to become property of B on payment of second instalment. B sold the furniture before second instalment was paid. It was held that the buyer acquired a good title. (Lee Vs Butler).

**Example:**

A took a car from B on this condition that A would pay a monthly instalment of ₹ 5,000 as hire charges with an option to purchase it by payment of ₹ 1,00,000 in 24 instalments. After the payment of few instalments, A sold the car to C. B can recover the car from C since A had neither bought the car, nor had agreed to buy the car. He had only an option to buy the car.

### ◆ (6) Effect of Estoppel:

If the true owner, by their conduct, prevents themselves from denying the seller's authority to sell, the transferee gets good title. It must be shown that the true owner actively allowed or presented the seller as the true owner or as authorized to sell.


**Example:**

'A' said to 'B', a buyer, in the presence of 'C' that he (A) is the owner of the horse. But 'C' remained silent though the horse belonged to him. 'B' bought the horse from 'A'. Here the buyer (B) will get a valid title to the horse even though the seller (A) had no title to the horse. In this case, 'C', by his own conduct, is prevented from denying 'A's authority to sell the horse. Here, 'C's silence has induced 'B' to believe that 'A' is the owner of the horse.

### ◆ (7) Sale by an unpaid seller (Section 54(3)):

Where an unpaid seller who has exercised their right of lien (right to retain possession) or stoppage in transit (right to stop goods during transit) resells the goods, the new buyer acquires a good title against the original buyer.

### ◆ (8) Sale under the provisions of other Acts:

- (i) A purchaser from an official receiver or company liquidator gets a valid title.
- (ii) Buying goods from a finder gives valid title only in certain cases [Sec. 169, Indian Contract Act, 1872].
- (iii) A Pawnee's sale can give the buyer a good title [Sec. 176, Indian Contract Act, 1872].

## PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31 – 44)

### Definition

The performance of a contract of sale implies delivery of goods by the seller and acceptance of the delivery of goods and payment of price for them by the buyer in accordance of the terms of the contract.

### Definition Delivery [Sec. 2(2)]:

Voluntary transfer of possession; physical possession not essential—buyer must be able to exercise rights over goods. No delivery if possession is unfairly taken. Delivery can be by agreement or by placing goods with buyer/authorized person.

### Types of Delivery:



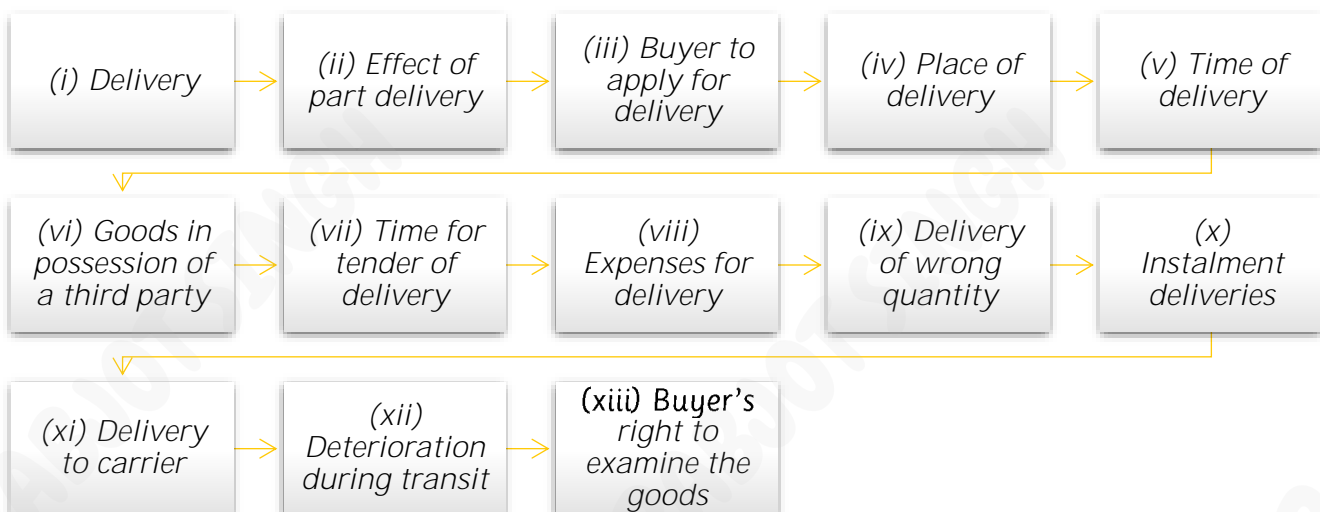
### Duties of seller and buyer (Section 31):

The seller must deliver the goods, and the buyer must accept and pay for them according to the contract.

### Payment and delivery are concurrent conditions (Section 32):

Unless otherwise agreed, delivery of goods and payment of the price are concurrent obligations. The seller must be ready to deliver in exchange for payment, and the buyer must be ready to pay in exchange for possession.

### Rules Regarding Delivery of goods (Section 33-41)



**(i) Delivery (Section 33):**

As defined above, voluntary transfer of possession, by agreement or by placing goods in buyer's possession.

**(ii) Effect of part delivery (Section 34):**

A part delivery in progress of delivering the whole has the same effect as delivery of the whole for passing property. A part delivery with the intention of severing it from the whole does not operate as delivery of the remainder.

**Example:**

Certain goods lying at wharf were sold in a lot. The seller instructed the wharfinger to deliver them to the buyer who had paid for them and the buyer, thereafter, accepted them and took away part. Held, there was delivery of the whole.

**(iii) Buyer to apply for delivery (Section 35):**

Unless expressly agreed, the seller is not bound to deliver until the buyer applies for delivery.

**(iv) Place of delivery (Section 36(1)):**

Whether the buyer must collect the goods or the seller must send them depends on the express or implied terms of the contract.

Goods must be delivered at their location at the time of sale.

Goods to be sold must be delivered from their location at the time of the agreement.

If goods don't yet exist, they must be delivered from where they're manufactured or produced [Sec. 36(1)]

**(v) Time of delivery (Section 36(2)):**

If the seller must send goods but no time is fixed, they must be sent within a reasonable time [Sec. 36(2)].

**(vi) Goods in possession of a third party (Section 36(3)):**

No delivery occurs until the third party acknowledges holding goods on the seller's behalf. Does not affect transfer of document of title.

**(vii) Time for tender of delivery (Section 36(4)):**

Delivery must be at a reasonable hour; what is reasonable depends on facts.

*(viii) Expenses for delivery (Section 36(5)):*

*Seller bears expenses to put goods in deliverable state unless agreed otherwise.*

*(ix) Delivery of wrong quantity (Section 37):*

**Less quantity:**

Buyer may reject or accept and pay at contract rate. [Sub-sec (1)]

**More quantity:**

Buyer may accept contract quantity and reject rest, reject whole, or accept all and pay at contract rate. [Sub-sec (2)]

**Mixed goods:**

Buyer may accept conforming goods and reject others, or reject whole. [Sub-sec (3)]

**Trade usage/agreement:**

Rules subject to trade usage, special agreement, or prior dealings. [Sub-sec (4)]

*Example:*

*A agrees to sell 100 quintals of wheat to B at ₹ 1,000 per quintal. A delivers 1,100 quintals. B may reject the whole lot or accept only 1,000 quintals and reject the rest or accept the whole lot and pay for them at the contract of sale.*

*(x) Instalment deliveries (Section 38):*

*Unless agreed otherwise, buyer need not accept delivery in instalments; rights/liabilities depend on contract terms.*

*Example:*

*There was sale of 100 tons of paper to be shipped in November. The seller shipped 80 tons in November and 20 tons in December. The buyer was entitled to reject the whole 100 tons.*

*(xi) Delivery to carrier (Section 39(1)):*

*Delivery to carrier for transmission to buyer is deemed delivery to the buyer, subject to contract terms.*

*(xii) Deterioration during transit (Section 40):*

*Buyer bears risk of deterioration necessarily incidental to transit, even if seller agrees to deliver at own risk.*

*Example:*

*P sold to Q a certain quantity of iron rods which were to be sent by proper vessel. It was rusted before it reached the buyer. The rust of the rod was so minimal and was not effecting the merchantable quality and the deterioration was not necessarily incidental to its transmission. It was held that Q was bound to accept the goods.*

**(xiii) Buyer's right to examine the goods (Section 41):**

*Buyer has a reasonable opportunity to inspect goods on delivery to check conformity; seller must allow inspection if requested.*

◆ **Rule related to Acceptance of Delivery of Goods (Section 42):**

Acceptance is deemed to take place when the buyer-

*(a) intimates to the seller that he had accepted the goods; or*

*(b) does any act to the goods, which is inconsistent with the ownership of the seller; or*

*(c) retains the goods after the lapse of a reasonable time, without intimating to the seller that he has rejected them.*

◆ **Buyer not bound to return rejected goods (Section 43):**

*If a buyer rightfully refuses to accept goods, he is not obliged to return them to the seller; it is enough if he informs the seller of his refusal.*

◆ **Liability of buyer for neglecting or refusing delivery of goods (Section 44):**

*If the seller is ready to deliver and the buyer fails to take delivery within a reasonable time, the buyer must compensate the seller for any loss and pay reasonable charges for care of the goods. This does not affect the seller's rights if such refusal amounts to contract repudiation.*

# Chapter 3

## Unit 4: Unpaid Seller

### UNPAID SELLER

#### Meaning:

A seller is deemed an Unpaid Seller when –

**Price not paid/tendered:**

Whole of the price remains unpaid, and seller has immediate right of action for price.

**Conditional payment dishonoured:**

Bill of exchange or negotiable instrument received as conditional payment is dishonoured or condition not fulfilled.

#### Who is Seller?

Includes not only the actual seller but also:

Seller's agent to whom bill of lading is endorsed,

Consignor/agent who has paid or is directly responsible for price.



#### Example:

X sold certain goods to Y for ₹ 50,000. Y paid ₹ 40,000 but fails to pay the balance. X is an unpaid seller.

#### Example:

P sold some goods to R for ₹ 60,000 and received a cheque for a full price. On presentment, the cheque was dishonoured by the bank. P is an unpaid seller.

## RIGHTS OF AN UNPAID SELLER

### Unpaid seller's right (Sec. 46):

Even if ownership has passed to the buyer, the law gives the unpaid seller certain rights against the goods.

- |  |
|--|
| (a) a lien on the goods for the price while he is in possession of them;   |
| (b) in case of the insolvency of the buyer a right of stopping the goods in transit after he has parted with the possession of them; |
| (c) a right of re-sale as limited by this Act. [Sub-section (1)]   |

Where property has not passed the unpaid seller can withhold delivery, a right equal to lien and stoppage in transit.

An unpaid seller has been expressly given the rights against the goods as well as the buyer personally which are discussed as under:

#### (a) Rights of an unpaid seller against the goods:

The right of unpaid seller against goods can be categorized under two headings.

#### Against the goods

- Where the property in goods has passed to the buyers
- Where the property in goods has not passed to the buyers

## RIGHT OF UNPAID SELLER AGAINST THE GOODS

### (1) Seller's lien (Section 47)

#### Right of Lien

An unpaid seller has a lien on the goods for the price, allowing him to retain possession and refuse delivery until the price is paid or tendered. This lien is possessory in nature and exists only while the seller continues to hold the goods.

#### Exercise of right of lien:

This right can be exercised by him in the following cases only:

- |  |
|--|
| (a) where goods have been sold without any stipulation of credit; (i.e., on cash sale) |
| (b) where goods have been sold on credit but the term of credit has expired; or        |
| (c) where the buyer becomes insolvent.   |

**Example:**

A sold certain goods to B for a price ₹ 50,000 and allowed him to pay the price within one month. B becomes insolvent during this period of credit. A, the unpaid seller, can exercise his right of lien.

**Seller in possession as agent/bailee:**

The seller may exercise lien even when holding the goods as agent or bailee for the buyer. A person is considered insolvent if he has stopped paying debts in the normal course of business or is unable to pay them as they fall due, whether or not a formal act of insolvency is committed.

**Part Delivery (Section 48):**

If part delivery has been made, the seller can exercise lien on the remainder, unless the part delivery implied a waiver of the lien.

**Termination of lien (Section 49):**

The unpaid seller loses his right of lien under the following circumstances:

- |  |
|--|
| (i) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods. |
| (ii) Where the buyer or his agent lawfully obtains possession of the goods.  |
| (iii) Where seller has waived the right of lien.   |
| (iv) By Estoppel i.e., where the seller so conducts himself that he leads third parties to believe that the lien does not exist.                               |

**Exception:**

An unpaid seller does not lose his lien merely because he has obtained a court decree for the price of the goods.

**Example:**

A, sold a car to B for ₹ 1,00,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now A cannot exercise the right of lien.

**2. Right of Stoppage in Transit (Section 50-52):**

The right of stoppage in transit (Sec. 50) allows an unpaid seller to stop goods while they are with a carrier if the buyer becomes insolvent, regain possession, and keep them until full payment is made. It is an extension of the right of lien since it lets the seller recover possession even after parting with the goods.

However, the right of stoppage in transit is exercised only when the following conditions are fulfilled:

- |   |
|---|
| (a) The seller must be unpaid.                                  |
| (b) He must have parted with the possession of goods.           |
| (c) The goods are in transit.                                   |
| (d) The buyer has become insolvent.                             |
| (e) The right is subject to provisions of the Act. [Section 50] |

**Example:**

A of Mumbai sold certain goods to B of Delhi. He delivered the goods to C, a common carrier for the purpose of transmission of these goods to B. Before the goods could reach him, B became insolvent and A came to know about it. A can stop the goods in transit by giving a notice of it to C.

**Duration of transit (Section 51):**

The goods are in transit from the time they are handed over to a carrier/bailee for delivery to the buyer, until the buyer or his agent takes delivery from them.



**When does the transit come to an end?**

The right of stoppage in transit is lost when transit comes to an end.

Transit comes to an end in the following cases:

When the buyer or other bailee obtains delivery.

If the buyer takes delivery before the goods reach the destination, it is called interception, with or without the carrier's consent.

Transit ends when the carrier acknowledges to the buyer/agent that he holds the goods for them, unless the seller has reserved the right of disposal.

If the carrier wrongfully refuses to deliver the goods to the buyer.

Where goods are delivered to the carrier hired by the buyer, the transit comes to an end.

If part delivery is made, transit ends for the rest of the goods still in transmission.

Transit ends when goods are delivered to a ship chartered by the buyer.

**How stoppage in transit is affected (Section 52):**

1. An unpaid seller may stop goods in transit by taking possession or by notifying the carrier/bailee (or their principal) in time to prevent delivery to the buyer.
2. On notice of stoppage, the carrier must re-deliver goods as directed by the seller, and the seller bears the re-delivery expenses.

<i>Stoppage in transit</i>	<i>By taking actual possession of goods</i>
	<i>By giving notice to the carrier not to deliver the goods.</i>

### Distinction between Right of Lien and Right of Stoppage in Transit

Basis	Right of Lien	Right of Stoppage in Transit
Meaning	Right to <u>retain possession</u> of goods until payment.	Right to <u>regain possession</u> of goods while they are in transit.
Possession	Seller is still in possession of goods.	Seller has parted with goods; they are with a carrier/bailee, and buyer has not yet received them.
Insolvency	Can be exercised even if the buyer is not insolvent.	Can be exercised only when the buyer is insolvent.
Commencement	Exists as long as seller retains possession.	Begins when lien ends, i.e., after seller parts with possession but before buyer receives goods.
Termination	Ends once the seller parts with possession of goods.	Ends once goods are delivered to the buyer.
Relation	Independent right.	Considered an <u>extension of lien</u> .

#### Effects of Sub-sale or Pledge by Buyer (Sec. 53)

Seller's lien or stoppage in transit is **not affected** by buyer's resale or pledge, unless seller has assented.

A second buyer cannot have better rights than the first buyer.

#### Example:

A sold certain goods to B of Mumbai and the goods are handed over to railways for transmission to B. In the mean time, B sold these goods to C for consideration. B becomes insolvent. A can still exercise his right of stoppage in transit. Here we assume that seller did not give his assent for sub sale, therefore he can still exercise his right of stoppage in transit.

#### Exceptions where unpaid seller's right of lien and stoppage in transit are defeated:

**1. Seller's Assent:** If seller consents to resale, mortgage, or other transfer by buyer, lien/stoppage is lost.

**Example:**

A entered into a contract to sell cartons in possession of a wharfinger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now B sold goods to C and C duly paid to B.

But anyhow B failed to make the payment to A. A wanted to exercise his right of lien and ordered the wharfinger not to make delivery to C. Held that the seller had assented to the resale of the goods by the buyer to the sub-buyers. As a result, A's right to lien is defeated

**Case Law: (Mount D. F. Ltd. vs Jay & Jay (Provisions) Co. Ltd).**

**2. Document of Title transferred:**

- ✓ If transferred by way of **sale** → lien/stoppage defeated.
- ✓ If transferred by way of **pledge** → lien/stoppage subject to pledgee's rights.
- ✓ Seller may require pledgee to use other securities first before using goods.

**Effect of Stoppage**

Exercising stoppage in transit does not cancel the sale; the contract continues, and the buyer can get the goods by paying the price.

**RIGHT OF RE-SALE [SECTION 54]:**

The right of re-sale is an important protection for an unpaid seller, as lien and stoppage alone would not be effective without it.

**Conditions where seller can re-sell:**

**(i) Where the goods are of a perishable nature:**

If goods are perishable, seller may resell immediately.

No need to give notice to the buyer.

**(ii) Where he gives notice to the buyer of his intention to re-sell the goods:**

If seller gives notice of intention to resell and buyer fails to pay within reasonable time, seller may resell.

On such resale, seller may:

**Recover damages** (contract price – resale price). **Retain profits** if resale price is higher.

If resale is made **without notice**, seller cannot recover damages and any profit must be handed over to the buyer.

(iii) Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods:

If seller has exercised lien or stoppage in transit and resells the goods, the subsequent buyer acquires good title against the original buyer, even if notice of resale was not given.

(iv) A re-sale by the seller where a right of re-sale is expressly reserved in a contract of sale:

Sometimes the contract expressly reserves the seller's right of resale on buyer's default.

In such cases, seller may resell without giving notice.

He can still recover damages from the original buyer even without notice.

(v) Where the property in goods has not passed to the buyer:

If property in goods hasn't passed, the unpaid seller can withhold delivery. This right, like lien, is called quasi-lien and applies in an agreement to sell.

## RIGHTS OF UNPAID SELLER AGAINST THE BUYER (SECTIONS 55-61)

### ◆ Rights of unpaid seller against the buyer personally:

An unpaid seller not only has rights against the goods but also certain personal rights against the buyer, known as rights in personam. These are essentially the seller's remedies for breach of the contract of sale and exist in addition to his rights against the goods, enabling him to proceed directly against the buyer.

#### 1. Suit for price (Section 55)

##### Contract of Sale [Sec. 55(1)]

- ✓ If property in goods has passed to buyer.
- ✓ Buyer neglects/refuses to pay.
- ✓ Seller may sue for price.

##### Agreement to Sell [Sec. 55(2)]

- ✓ Price payable on a fixed date, irrespective of delivery.
- ✓ Buyer neglects/refuses to pay.
- ✓ Seller may sue for price even if property has not passed and goods not appropriated.

*Example:*

**Fred:** Eddie, it's Tuesday—the payment for the Invisible Clothes is due.

**Fred:** The contract clearly says you must pay on Tuesday, whether delivery is visible or not.

**Fred:** Exactly. I can sue you for the price as per the agreement.



**Eddie:** But I don't see any clothes. Why should I pay for something invisible?

**Eddie:** So, you're saying I still owe you, even without seeing them?

### Suit for Damages for Non-Acceptance (Sec. 56):

If the buyer wrongfully refuses to accept and pay for goods, the seller may sue for damages, with Section 73 of the Indian Contract Act applying to measure of damages.

### Repudiation of Contract Before Due Date (Sec. 60):

If the buyer repudiates before delivery date, the seller may treat the contract as rescinded and claim damages. This is called anticipatory breach of contract.

*Example:*

**Chris (Buyer):** Sally, I'm cancelling the order! I've turned into a Grinch and hate everything festive.

**Chris:** I don't care. I don't want those 1,000 miniature reindeer anymore.



**Sally (Seller):** But Chris, the delivery is due on December 24th—why cancel now?

**Sally:** In that case, I don't need to wait until Christmas Eve. I can sue you for damages right away.

### Suit for Interest (Sec. 61):

If agreed, the seller can recover interest from the buyer from the due date. If no agreement, the seller may charge interest from the date notified to the buyer.

In the absence of agreement, the court may award interest at a suitable rate from the date of tender of goods or the date on which the price was payable.

## REMEDIES OF BUYER AGAINST THE SELLER

### Breach of contract by seller

Breach of contract by seller, where he-

- Fails to deliver the goods at the time or in manner prescribed
- Repudiates the contract
- Deliver non-conforming goods and buyer rejects and revokes acceptance

If the seller commits a breach of contract, the buyer gets the following rights against the seller:

Rights of buyer

- Damages for non-delivery
- Suit for specific performance
- Suit for breach of warranty
- Suit for anticipatory breach
- Suit for interest

### 1. Damages for Non-Delivery (Sec. 57):

If the seller wrongfully refuses to deliver, the buyer can sue for damages. Damages are the difference between contract price and market/resale price.

#### Example:

A' a shoe manufacturer, agreed to sell 100 pairs of shoes to 'B' at the rate of ₹ 10,500 per pair. 'A' knew that 'B' wanted the shoes for the purpose of further reselling them to 'C' at the rate of ₹ 11,000/- per pair. On the due date of delivery, 'A' failed to deliver the shoes to 'B'. In consequence, 'B' could not perform his contract with 'C' for the supply of 100 pairs of shoes. In this case, 'B' can recover damages from 'A' at the rate of ₹ 500/- per pair (the difference between the contract price and resale price).



### 2. Suit for Specific Performance (Sec. 58):

Buyer may seek court order to compel seller to perform the contract, but only if goods are specific/ascertained, damages are inadequate, and remedy falls under the Specific Relief Act. Granted for unique/special goods.

This remedy is allowed by the court subject to these conditions:

- The contract must be for the sale of specific and ascertained goods.
- The power of the court to order specific performance is subject to provisions of Specific Relief Act of 1963.
- It empowers the court to order specific performance where damages would not be an adequate remedy.

(d) It will be granted as remedy if goods are of special nature or are unique.

**Example:**

**Jacky:** Monty, we had a contract! Sparkle hoof the Unicorn is mine.

**Jacky:** You can't do that! Sparkle hoof is one of a kind.

**Jacky:** No, he's unique. I'll sue for specific performance to make you deliver Sparkle hoof as promised.



**Monty:** Sorry, Jacky. Someone else offered me more money—I'm selling to them.

**Monty:** Well, can't you just buy another unicorn?

**Example:**

'A' agreed to sell a rare painting of Mughal period to 'B'. But on the due date of delivery, 'A' refused to sell the same. In this case, 'B' may file a suit against 'A' for obtaining an order from the Court to compel 'A' to perform the contract (i.e. to deliver the painting to 'B' at the agreed price).

3. Suit for Breach of Warranty (Sec. 59):

When a seller breaches a warranty, or a buyer treats a condition as a warranty, the buyer cannot reject the goods but may claim reduction in price or damages.

Buyer cannot reject goods but may

- (i) claim reduction/extinction of price, or
- (ii) sue seller for damages.

4. Repudiation of Contract before Due Date (Sec. 60):

If either party repudiates before delivery, the other may either treat the contract as continuing till delivery or treat it as rescinded and sue for damages (anticipatory breach).

5. Suit for Interest (Sec. 61):

Seller or buyer may recover interest or special damages where law allows, or recover money paid if consideration fails.

In absence of agreement, the court may award interest at a suitable rate from the date of payment/tender or when price was due.

**Example:**

In case of a sale of cigarettes which turned out to be mildewed and unfit for consumption, damages were awarded on the basis of the difference between the contract price and the price of the goods.

**Example:**

*In case of absence of transfer of title or registration, the purchaser cannot claim damages for breach of conditions and warranties relating to sale.*

## AUCTION SALE (SECTION 64)

*An auction sale is a public method of selling property to the highest bidder. The auctioneer, governed by the Law of Agency, generally acts as the seller's agent. However, if he sells his own property, he acts as the principal and is not bound to disclose this fact.*

### Legal Rules of Auction Sale (Section 64):

Section 64 of the Sale of Goods Act, 1930 provides following rules to regulate the sale by auction:

#### a. Where goods are sold in lots:

*Where goods are put up for sale in lots, each lot is prima facie deemed to be subject of a separate contract of sale.*

#### b. Completion of the contract of sale:

*The sale is complete when the auctioneer announces its completion by the fall of hammer or in any other customary manner. Until such announcement is made, any bidder may retract from his bid.*

#### c. Right to bid may be reserved:

*In an auction, the seller's right to bid must be expressly reserved; only then may the seller or his agent place a bid, otherwise such bidding is not permitted.*

#### d. Where the sale is not notified by the seller:

*If the right to bid is not reserved, the seller or his agent cannot bid, and the auctioneer cannot accept such bids; any sale in violation may be treated as fraudulent by the buyer.*

#### e. Reserved price:

*The sale may be notified to be subject to a reserve or upset price; and*

#### f. Pretended bidding:

*If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.*

**Example:**

P sold a car by auction. It was knocked down to Q who was only allowed to take it away on giving a cheque for the price and signing an agreement that ownership should not pass until the cheque was cleared. In the meanwhile, till the cheque was cleared, Q sold the car to R. It was held that the property was passed on the fall of the hammer and therefore R had a good title to the car. Both sale and sub sale are valid in favour of Q and R respectively.



## INCLUSION OF INCREASED OR DECREASED TAXES IN CONTRACT OF SALE (SECTION 64A)

After a contract is made but before performance, if a tax revision occurs (imposition, increase, decrease, or remission) on the goods, and there is no prior stipulation about tax, the price must be readjusted accordingly.

Taxes on sale or purchase of goods are covered under this rule.

Any duty of customs or excise on goods,

Any tax on the sale or purchase of goods

If taxes increase, the buyer must pay the higher price; if reduced, the buyer benefits. The seller can add increased taxes, but parties may agree otherwise through a contrary stipulation.

**Example:**



**Rick:** The rocket's fixed price, right?

**Rick:** And if taxes are removed?

**Sally:** Yes—but a new “Lunar Launch Tax” means you pay extra.

**Sally:** Then you get a discount—unless our contract says the price is final.

# Chapter 4

## Unit 1: General Nature of Partnership

### WHAT IS PARTNERSHIP?

#### Definition [Section 4]

According to Section 4 of The Indian Partnership Act, 1932, a 'Partnership' is defined as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".



Persons who have entered into a partnership are individually called '**partners**'.

Collectively, they are called '**a firm**'.

The name under which their business is carried on is called the '**firm name**'.

#### Example:

Priya, Shashank, and Lekhraj decide to open a "Geek-Chic Boutique." If they agree to put in money and split the profits from selling comic-book-themed clothing, they've formed a partnership. Priya is convinced it will make millions, Shashank insists on a strict profit-sharing algorithm, and Lekhraj just wants to buy more Star Wars collectibles.



### ESSENTIAL ELEMENTS OF PARTNERSHIP

For a partnership to exist, five fundamental elements must co-exist:

#### Association of Two or More Persons

A partnership must involve two or more persons.

Only persons recognized by law can enter a partnership agreement.

A firm cannot be a partner as it's not a person in the eyes of the law.

A minor cannot be a partner, but with the consent of all partners, they can be admitted to the benefits of partnership.

The Partnership Act does not specify a maximum number of partners, but Section 464 of the Companies Act, 2013, limits it to 50 partners in any association/partnership firm.

#### Example:



**Gaurav:** Fardeen, two people aren't enough. To conquer Middle-Earth with our delivery service, we need more. I say we bring in Shankar—he's powerful and can fly.

**Fardeen:** Gaurav, that's ridiculous! Shankar's a dragon—not a legal person. He can't sign contracts or be held liable. We need hobbits, not fire-breathing liabilities.



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*Fardeen: Agreed. Sameer and Meet are solid—loyal, reliable, and just what we need. With them, Middle-Earth Deliveries is destined for success!*

*Gaurav: Excellent. With Sameer and Meet on board, our partnership is official. Now we deliver from the Shire to Mordor—and everywhere in between!*



## Agreement

Partnership is always a result of an agreement between two or more persons, making its nature voluntary and contractual.

This agreement can be express (oral or in writing) or implied from the partners' actions and consistent conduct.

Partnership is created by agreement and not by status. This distinguishes it from arrangements like a Hindu Undivided Family (HUF) or Burmese Buddhist husband and wife businesses, which arise from status.

### Example:



*Devendra: "Eshwar, who is the real leader here? The 'World's Best Boss' mug is rightfully mine. The Force itself wills it."*

*Devendra: That "agreement" was a whisper at best. I never agreed—I'm your boss!*

*Eshwar: That's absurd, Devendra. I built this Galactic Evil Empire—I'm the mastermind. The mug is mine. Remember, our agreement clearly states I'm in charge.*

*Eshwar: We need a clear written partnership deed. A simple document could've avoided all this confusion.*



## Business

There must exist a business, which includes every trade, occupation, and profession.

The primary motive of the business must be the "acquisition of gains" (profit motive).

Without an intention to carry on business and share profits, there can be no partnership.

*Note: Co-owners sharing rent from a piece of land are not partners, as there is no active 'business' being carried on.*

*Charitable institutions or clubs cannot be floated in partnership, as their motive is not profit acquisition.*

### Example:

Two squirrels, Sonu and Nandu, decided to "partner" in collecting acorns. They gathered thousands, but their motive wasn't "gains" (beyond winter survival), nor were they selling them. When a wise old owl informed them, they weren't a business partnership under the Act, Sonu declared, "Darn! All this hard work for just... food!"



## Agreement to Share Profits

Sharing of profits is an essential feature of partnership.

Partners must agree to share profits in any chosen manner.

A partnership cannot exist if only one partner is entitled to all profits.

Agreement to share losses is NOT an essential element. Partners may agree for one or more to bear all losses. However, unless agreed otherwise, losses are borne in the profit-sharing ratio.

### Example:

Sanjay and Mohan decided to form a "Whale Watching & Bait Shop." Sanjay insisted on taking all the profits, while Mohan just wanted free krill. Their venture failed because, legally, you can't have a partnership if only one side gets the "gains." Mohan later sued for emotional distress and lack of proper krill.



### Example:

No charitable institution or club may be floated in partnership [A joint stock company may, however, be floated for non-economic purposes].

### Example:

X and Y buy certain bales of cotton which they agree to sell on their joint account and to share the profits equally. In these circumstances, X and Y are partners in respect of such cotton business.

## Business Carried on by All or Any of Them Acting for All (Mutual Agency)

This is the cardinal principle of partnership law and the true test of partnership.

It implies a binding contract of mutual agency among partners.

Every partner is both a principal and an agent for all other partners.

**Agent:** Can bind other partners by their acts in the firm's business.

**Principal:** Is bound by the acts of other partners.

An act of one partner in the course of the firm's business is an act of all partners.

If mutual agency is absent, there will be no partnership.

### CASE LAW: *KD Kamath & Co.*

The Supreme Court has held that the two essential conditions to be satisfied are that:

- (1) there should be an agreement to share the profits as well as the losses of business; and
- (2) the business must be carried on by all or any of them acting for all, within the meaning of the definition of 'partnership' under section 4.

The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied. Note:- The 'Partnership Agreement' is also known as 'Partnership Deed'.

**Example:**

Badal and Raghav opened a detective agency, "Dynamic Duo Investigations." Raghav, acting as an agent, once ordered 50,000 extra-fluffy capes without consulting Badal. When the bill arrived, Badal, as the principal, was legally bound to pay. He muttered, "Holy financial crisis, Raghav! You bind me too much!" This shows how one partner's act binds all.



**Example:**

A, B and C are partners in ABC Associates, a partnership firm. If A made certain purchases for the purpose of business from Mr. K, then Mr. K can recover the money from A, B or C as all partners are liable for any act done on behalf of firm.

## TRUE TEST OF PARTNERSHIP (SECTION 6)

Determining whether a group of persons constitutes a firm or if a person is a partner involves examining the real relation between the parties, based on all relevant facts taken together.



It must be proven that:

There was an agreement between all concerned persons.

The agreement was to share the profits of a business.

The business was carried on by all or any of them acting for all (mutual agency).

Partnership is created by agreement and not by status.

While sharing of profit is an essential element and a strong test, it is only a prima facie evidence and not conclusive evidence. The entire contract between parties must be considered.

The existence of Mutual Agency is the cardinal principle and the most helpful element in reaching a conclusion regarding partnership existence. If mutual agency exists within a group formed to earn profits through business, a partnership may be deemed to exist.

**CASE LAW: Santiranjan Das Gupta Vs. Dasyran Murzamull (Supreme Court).**

In Santiranjan Das Gupta Vs. Dayan Murzamull, following factors weighed upon the Supreme Court to reach the conclusion that there is no partnership between the parties:

- (a) Parties have not retained any record of terms and conditions of partnership.
- (b) Partnership business has maintained no accounts of its own, which would be open to inspection by both parties.
- (c) No account of the partnership was opened with any bank.
- (d) No written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership.

**Example:** Siddharth: "Interesting, Vijay. One clown stated they share profits, and another mentioned a secret handshake. Yet, they are not a partnership."

Vijay: Exactly, Siddharth. They lack mutual agency can't bind each other in deals. They're just performers splitting show earnings.

Siddharth: Precisely, Vijay. A true partnership isn't just shared pies—it's shared liabilities. Without authority to act for the group, they're just co-workers.

## PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANISATION

### Partnership Vs. Joint Stock Company

Basis	Partnership	Joint Stock Company
Legal Status	<u>Not a legal entity</u> ; no legal personality distinct from its members.	<u>Separate legal entity</u> distinct from its members (e.g., Salomon v. Salomon).
Agency	Every partner is <u>an agent</u> of other partners and of the firm.	A member is <u>not an agent</u> of other members or of the company; their actions do not bind either.
Distribution of Profits	Profits <u>must be distributed</u> among partners according to the partnership deed.	<u>No compulsion to distribute</u> all profits; only a portion may be distributed as dividends if declared.
Extent of Liability	<u>Unlimited liability</u> for each partner; private property can be used to meet firm's debts if joint estate is insufficient.	Generally, <u>liability is limited</u> to unpaid share amount (for shares) or agreed amount (for guarantee); though unlimited companies exist.

Property	Firm's property is the " <u>joint estate</u> " of <u>all partners</u> , not belonging to a distinct legal body.	Company's property is <u>separate</u> from its members, who receive it back only as dividends or capital refund.
Transfer of Shares	A share <u>cannot be transferred without the consent of all partners</u> .	Shares can generally be transferred, subject to Articles of Association; public company shares are often unrestricted on stock exchanges.
Management	All partners are generally <u>entitled to participate</u> in management, unless agreed otherwise.	Members are <u>not entitled to take part in management</u> unless appointed as directors. They can vote on certain questions in general meetings.
Registration	<u>Not compulsory</u> .	<u>Cannot come into existence unless registered</u> under the Companies Act, 2013.
Winding Up	Can be <u>dissolved at any time if all partners agree</u> .	Wound up by the National Company Law Tribunal (NCLT) or its name struck off by the Registrar of Companies (ROC).
Number of Membership	<u>Maximum 50 partners</u> (as per Companies Act, 2013, Section 464, and Companies (Miscellaneous) Rules, 2014).	Private company: 2-200 members. Public company: Minimum 7, no maximum. One Person Company also exists.
Duration of Existence	<u>Death, retirement, or insolvency of a partner generally results in dissolution</u> of the firm, unless contract states otherwise.	Enjoys <u>perpetual succession</u> .

### ◆ Partnership Vs. Club

Basis	Partnership	Club
Definition	Association formed for <u>earning profits from a business</u> .	Association formed for <u>promoting beneficial purposes</u> (e.g., health, recreation), <u>not for earning profit</u> .
Relationship	Persons are <u>partners</u> , and a partner is an <u>agent for others</u> .	Persons are <u>members</u> ; a member is <u>not an agent of other members</u> .
Interest in Property	Partner has <u>interest in the property of the firm</u> .	A member of a club has <u>no interest in the property of the club</u> .
Dissolution	A change in partners <u>affects its existence</u> .	A change in membership <u>does not affect its existence</u> .

## Partnership Vs. Hindu Undivided Family (HUF)

Basis	Partnership	Joint Hindu Family
Mode of Creation	Created <u>necessarily by an agreement.</u>	Right in the joint family is created by <u>status (birth in the family).</u>
Death of a Member	Death of a partner <u>ordinarily leads to dissolution.</u>	Death of a member <u>does not give rise to dissolution</u> of the family business.
Management	All partners are <u>equally entitled to take part in business.</u>	Right of management usually vests in the Karta (governing male or female member).
Authority to Bind	Every partner can, by his act, bind the firm.	The Karta or manager has the authority to contract for the family business and other members.
Liability	Liability of a partner is unlimited.	Only the Karta's liability is unlimited; other coparceners are liable only to the extent of their share in profits.
Calling for Accounts on Closure	A partner can sue for accounts, provided he also seeks dissolution of the firm.	On separation, a member is not entitled to ask for account of the family business.
Governing Law	Governed by the Indian Partnership Act, 1932.	Governed by Hindu Law.
Minor's Capacity	A minor cannot become a partner, though can be admitted to benefits with consent.	A minor becomes a member of ancestral business by birth; no need to wait for majority.
Continuity	Dissolves by death or insolvency of a partner (subject to contract).	Has continuity till it is divided; status not affected by member's death.
Number of Members	Should not exceed 50.	Can be unlimited in number.
Share in the Business	Each partner has a defined share by agreement.	No coparcener has a definite share; interest is fluctuating, enlarged by deaths and diminished by births.

## Partnership Vs. Co-Ownership or Joint Ownership

Basis	Partnership	Co-ownership
Formation	Always arises out of a contract (express or implied).	May arise from agreement or by operation of law (e.g., inheritance).
Implied Agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.

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<b>Nature of Interest</b>	There is a community of interest, implying sharing of profits and losses.	Co-ownership does not necessarily involve sharing of profits and losses.
<b>Transfer of Interest</b>	A share can only be transferred with the consent of all other partners.	A co-owner may transfer their interest or rights without the consent of other co-owners.

### Partnership Vs. Association

Basis	Partnership	Association
<b>Meaning</b>	Involves setting up a relation of agency between persons for gains with the intention to share profits from a business.	Evolves out of a social cause; no necessary motive to earn and share profits. Intention is not to enter a business for gains.
<b>Examples</b>	Partnership to run a business and earn profit.	Members of a charitable society, religious association, improvement scheme, building corporation, mutual insurance society, trade protection association.

## KINDS OF PARTNERSHIPS

### With Regard to Duration



#### Partnership at Will (Section 7)

This type of partnership exists when:

No fixed period has been agreed upon for its duration.

No provision is made as to its determination (how it will end).

A partnership at will can be dissolved by any partner giving written notice of their intention to dissolve it to all other partners.

If a partnership entered into for a fixed term continues after that term expires, it is treated as having become a partnership at will.

#### Example:

**Chetan:** "Hey Gaurav, I have an idea for our next show. It's a joke about... actually, never mind. It's too funny for you to understand."



**Gaurav:** "What's that note on my forehead? 'I'm dissolving this partnership! My jokes are funnier solo.' You can't just do that!"

**Chetan:** "Yes, I can. We never agreed on how long this partnership would last or how to end it. So, legally, it's a partnership at will. I can dissolve it with a simple notice, even a sticky one."

**Gaurav:** "So that's it? Our 'Spontaneous Stand-up' partnership is over just like that? You're going to regret this, Chetan. My jokes are much funnier than yours!"

### Partnership for a Fixed Period

This is a partnership where a specific duration has been agreed upon by contract. Such a partnership automatically comes to an end upon the expiry of the fixed period.



#### Example:

The "Seasonal Snow Shoveling Service" was a partnership formed by Prakash and Sheetal. They explicitly agreed it would only last from November to March. As soon as April 1st hit, their partnership automatically dissolved. Prakash was already planning his summer "Lemonade Stand" partnership, knowing it too would have a fixed duration.

## With Regard to the Extent of the Business

### Particular Partnership

A partnership formed for the prosecution of a single adventure or undertaking. It is generally dissolved by the completion of that adventure or undertaking.

#### Example:

Two treasure hunters, Dev and Pradeep, formed a particular partnership to find the legendary "Lost Gummy Bear Empire." Once they found the (sadly, stale) gummy bears, their partnership was automatically dissolved. They didn't sign up for future adventures like finding the "Fabled Pizza Scrolls."

### General Partnership

This type of partnership is constituted with respect to the business in general, covering all aspects of the firm's operations.

Unlike a particular partnership, the liability of partners extends to the business in general, not just a specific venture.

#### Example:

Flora and Fauna opened "The Evergreen Emporium," a general partnership. They sold everything from exotic plants to pet rocks. Their partnership covered the entire sprawling, chaotic business, not just one specific venture like "that time we tried selling magic beans."

## TYPES OF PARTNERS

Partners can be classified based on their involvement, liability, and relationship with the firm:

### Active or Actual or Ostensible Partner

Actively participates in the conduct of the partnership business.

Acts as an agent of other partners for all ordinary business acts.

Must give public notice of their retirement to absolve themselves of future liabilities.

**Example:**



**Ajay:** "I'm retiring. As the active partner here—cooking, managing, even yelling at the dishwasher—it's been too much. I'm done."

**Friend:** "Ajay, what are you doing? Why are you putting up these billboards? We have a restaurant to run!"

**Friend:** "But... but what about the restaurant? The customers? What will we do without you?"



**Ajay:** "Don't worry, the restaurant will be fine, but I'm no longer liable for any future culinary disasters. This notice ensures I'm not responsible after I leave."

### Sleeping or Dormant Partner

Is a partner by agreement but does not actively take part in the conduct of the business. Shares profits and losses and is liable to third parties for all acts of the firm.

Not required to give public notice of their retirement.

**Example:**

Count Vikram was a dormant partner in "Bloody Good Brews" coffee shop. He invested heavily and received profits but only "worked" at night (and never actually showed up). He was still fully liable for the coffee shop's debts, but when he retired to his coffin, he didn't need to post an announcement. No one even knew he was there!



### Nominal Partner

A person who lends their name to the firm without having any real interest in it. Not entitled to share profits. Does not invest in the firm and does not take part in the conduct of the business.

Is, however, liable to third parties for all acts of the firm. Must give public notice of retirement.

### Partner in Profits Only

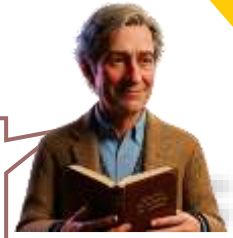
A partner who is entitled to share the profits only without being liable for the losses is known as the partner for profits only and also liable to the third parties for all acts of the profits only.

**Example:**



**Professor Kumar:** "My friend, our partnership is brilliant! I've invested in 'Potions & Potables' and with my magic, success is certain. I share in the profits, but not the losses or liabilities."

**Friend:** "But what about the unpaid cauldron bills? You're still a partner, and liable for the firm's debts—special arrangement or not. That's how partnerships work."



**Professor Kumar:** "What?! My magic can't pay for our ingredients? This is an outrage! I was assured I would only get the profits. I guess I'll have to pay the supplier after all."

### ◆ Incoming Partner

A person who is admitted as a partner into an already existing firm with the consent of all existing partners. Not liable for any act of the firm done before their admission as a partner.

**Example:**

When Arun joined "Archaeological Relics R Us," he was an incoming partner. He famously declared, "I'm not liable for that missing Ark of the Covenant incident from last year, before I joined!" And legally, he was right. He was only responsible for new adventures, not old booby traps.



**Example:**

Mr. A joined as a partner on 10th September, 2021 in a firm MNO Associates which was existing from 10th July, 2017. Mr. A will not be liable for any acts of the firm done before his date of joining i.e. 10th September, 2021

### ◆ Outgoing Partner (or Retiring Partner)

A partner who leaves a firm while the remaining partners continue the business.

Remains liable to third parties for all acts of the firm until public notice is given of their retirement.

**Example:**

**Devraj:** "I'm being sued for a warp core breach that happened years after I retired! I wasn't even on the ship!"

**Spock:** "Captain, without public notice of your retirement, creditors assumed you were still a partner—your liability continued."



**Devraj:** "So, because I skipped a sign, I'm paying for their mistakes? Ridiculous!"

**Spock:** "Logical, Captain. No notice means they reasonably believed you remained a partner. Thus, you are liable."

## Partner by Holding Out (Section 28) / Partner by Estoppel

This occurs when a person holds themselves out as a partner, or knowingly allows others to do so, even if they are not actually a partner.

They are then estopped (stopped) from denying the character they have assumed.



They become liable, like a real partner, to anyone who has given credit to the firm based on such representation.

The rule also applies to a former partner who retired without giving proper public notice; they remain liable to creditors who gave credit believing them to be a partner. Fraudulent intention is not necessary to fix liability.

### Example:

A partnership firm consisting of P, Q, R and S. S retires from the firm without giving public notice and his name continues to be used on letterheads. Here, S is liable as a partner by holding out to creditors who have lent on the faith of his being a partner.

### Example:

X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. After expiry of credit period, Z did not get amount of T.V sets sold to the partnership firm. Z filed a suit against X and A for the recovery of price. Here, in the given case, A, the Manager is also liable for the price because he becomes a partner by holding out (Section 28, Indian Partnership Act, 1932).

## Sub-Partner

This occurs when a partner agrees to share their own share of profits in the partnership firm with an outsider. Such an outsider is called a sub-partner.

A sub-partner neither has rights against the firm nor is they liable for the debts of the firm. Their agreement is solely with the individual partner, not the firm.

### Example:

Pihu, a partner in "The Pie Palace," was always broke. So, she secretly promised 10% of her pie profits to her friend, Sahil, in exchange for a loan. Sahil became Pihu's sub-partner. When the Pie Palace got sued for a rogue cherry incident, Sahil couldn't be held liable, nor could he demand free pie from the firm directly. His entire relationship was just with Pihu and her slice of the pie.

## PARTNERSHIP DEED

The 'Partnership Agreement' is also known as the 'Partnership Deed'.

- Partnership is formed by an agreement, which does not require particular formalities and can be oral or in writing.
- However, it is highly desirable to have the partnership agreement in writing to prevent future disputes.
- The written document containing the terms and conditions of the partners' relationship is the Partnership Deed.
- It should be drafted carefully and stamped according to the provisions of the Stamp Act, 1899.
- If the partnership involves immovable property, the instrument of partnership must be in writing, stamped, and registered under the Registration Act.

### Information a Partnership Deed May Contain

A partnership firm can add or delete provisions based on its needs. Key information often includes:

- Name of the partnership firm.
- Names of all the partners.
- Nature and place of the business of the firm.
- Date of commencement of partnership.
- Duration of the partnership firm.
- Capital contribution of each partner.
- Profit Sharing ratio of the partners.
- Provisions for admission and retirement of a partner.
- Rates of interest on Capital, Drawings, and loans.
- Provisions for settlement of accounts in case of firm dissolution.
- Provisions for Salaries or commissions payable to partners, if any.
- Provisions for expulsion of a partner in case of gross breach of duty or fraud.



### Example:

When three wizards, Devendra, Pooja, and Vivek, decided to open "Hogwarts School of Charm and Commerce," they initially had a verbal agreement. But disputes quickly arose: "Whose turn is it to clean the dragon pens?" "Who gets the most gold galleons from the Potions class?" "Is the Headmaster allowed to wear novelty socks on casual Fridays?" They finally drafted a meticulously detailed partnership deed. It even included a clause for "expulsion for gross magical misconduct or turning another partner into a ferret." They found that a written deed, even with magic, was far better than relying on memory for who promised to sweep the dungeons.



# Chapter 4

## Unit 2: Relations Of Partners

### RELATION OF PARTNERS TO ONE ANOTHER

The Indian Partnership Act, 1932, contains various provisions that regulate the relationship between partners. These rules are generally subject to any contract between the partners.

#### General Duties of Partners [Section 9]

Partners are bound to carry on the business of the firm for the greatest common advantage. They must render to any partner, or their legal representatives, full information of all things affecting the firm.



Crucially, partners must observe the utmost good faith in their dealings with one another and are bound to render accounts to each other. If one partner primarily keeps the accounts, they are responsible for explaining and providing full information about them.

#### Example:

Three partners, Ananya, Bhavin, and Chetan, running a detective agency called "Sleuths R Us." Ananya discovers a hidden treasure map related to a case they're working on but decides to secretly follow it alone.

Her failure to inform Bhavin and Chetan about the map and share the potential "treasure" violates her duty of utmost good faith and providing full information for the common advantage of "Sleuths R Us."



#### Example:

In a transaction between partners for the sale and purchase of a share in the business, if one of them is better acquainted with the accounts than the other, it is his duty to disclose all material facts.

#### Duty to Indemnify for Loss Caused by Fraud [Section 10]

A partner who commits fraud in the conduct of the firm's business must make good the loss sustained by the firm due to their misconduct.

The amount recovered should then be divided among the partners. If a partner's act, imputable to the firm, is a fraud on their co-partners, those co-partners are entitled to place the entire consequences of the fraud upon the defaulting partner.

**Example:** Partner Z: "I don't know how that happened!"

Co-partner 1: "Partner Z, our latest shipment of premium coffee beans turned out to be low-grade substitutes. Customers are furious."

Co-partner 2: "We do. You swapped the beans, sold the real ones yourself, and pocketed the profit. That's theft."



Co-partner 1: "And when a partner steals from the firm, they must repay the full loss personally. You'll cover every refund."

## ◆ Determination of Rights and Duties of Partners by Contract [Section 11]

The mutual rights and duties of partners can be determined by a contract, which can be express or implied by a course of dealing. This contract can also be varied by consent of all partners, either expressly or through a course of dealing.

Partnership is based on the consent of the parties, not only for its existence but also for the terms of their agreement. Agreements can even stipulate that a partner shall not carry on any business other than that of the firm while they are a partner, notwithstanding Section 27 of the Indian Contract Act, 1872 (which generally deals with restraint of trade).

**Example:**

Prakash and Chetan run "The Daily Grind," with Prakash on coffee and Chetan on pastries. Over time, their conduct shifts duties to Prakash handling mornings and Chetan evenings. Under Section 11(2) of their agreement, Prakash cannot secretly start a competing shop like his "Late Night Brew" while still a partner.



## ◆ The Conduct of the Business [Section 12]

Subject to the partnership contract:

**Right to take part in the conduct of the Business (Section 12(a))**

Every partner has a right to participate in the firm's business, as management powers are generally co-extensive.

**Example:** Bhavin: "Ananya! What a surprise! What brings you to the bookstore?"

Ananya: "I saw things weren't organized as I like, so I rearranged some shelves and ordered new books."

Bhavin: "But Ananya, Chetan and I handle daily operations and decide together."

Ananya: "I'm a partner too! I have the right to join in and I demand to read all the new releases first!"

Bhavin: "You can participate, but this oversteps your role. We agreed you'd be a silent partner, investing while we run daily operations."

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**Unit 2: Relations Of Partners**

**4.15**

**Example:**

Now suppose this management power of the particular partner is interfered with and he has been wrongfully precluded from participating therein. Can the Court interfere in these circumstances? The answer is in the affirmative. The Court can, and will, by injunction, restrain other partners from doing so. It may be noted in this connection that a partner who has been wrongfully deprived of the right of participation in the management has also other remedies, e.g., a suit for dissolution, a suit for accounts without seeking dissolution, etc.

**Duty to Attend Diligently (Section 12(b))**

Every partner is bound to attend diligently to their duties in the business.

**Right to be consulted / Majority Decision (Section 12(c))**

Differences on ordinary matters of business can be decided by a majority of partners, but every partner has the right to express their opinion before the decision. However, no change in the nature of the business can be made without the consent of all partners. The majority must act in good faith and consult every partner.

**Example:**

The partners of "Pet Palace," a pet grooming salon, are deciding whether to switch from pineapple-scented shampoo to lavender. This is an ordinary matter, so a majority vote suffices after everyone shares their opinion.

However, if they decide to suddenly start selling vintage comic books instead of grooming pets, that's a change in the nature of the business, requiring every single partner's enthusiastic "woof" (unanimous consent).


**Right of access to books (Section 12(d))**

Every partner (active or sleeping) has the right to access, inspect, and copy any of the firm's books, provided the right is exercised bona fide.

**Right of legal heirs/representatives (Section 12(e))**

In case of a partner's death, their heirs, legal representatives, or authorized agents also have this right.

## ◆ Mutual Rights and Liabilities [Section 13]

Subject to the partnership contract:

### Right to remuneration (Section 13(a))

A partner is not entitled to receive remuneration for participating in the business in addition to their share in profits, unless there is an express agreement, a course of dealings, or customary usage of the firm allowing it.

#### Example:

Daisy and Gopal are partners in "The Cookie Crumble" bakery. Daisy works 18-hour days while Gopal occasionally shows up to taste-test. By default, Gopal

can't demand extra pay for "supervising," nor can Daisy demand a salary for her hard work, unless their partnership deed specifically says so, or they've always implicitly paid a "Head Baker" bonus to whoever bakes the most.



### Right to share Profits (Section 13(b))

Partners are entitled to share equally in profits and contribute equally to losses. This presumption of equality applies if there's no agreement on profit sharing, and the burden of proving unequal shares lies on the party claiming it. The proportion of capital contribution does not necessarily dictate the proportion of profit sharing.

#### Example:

**Siddharth:** "Jai, our stand's a hit! But is our profit split fair? I invested the fancy cart, and you brought a bag of buns and a jingle."

**Siddharth:** "Fair enough—your jingle is catchy. But next time, we'll have a formal agreement."



Jai: "True, but without an agreement, the law says partners split profits equally, no matter their contributions."

Jai: "Deal! Now, let's go celebrate our success with some hot dogs."

### Interest on Capital (Section 13(c))

Interest on capital subscribed by a partner is payable only out of profits and requires an express agreement, practice of the partnership, trade custom, or statutory provision.

#### Example:

Partner Sheldon invested a huge sum in "Big Bang Enterprises" expecting 10% interest on his capital. However, if "Big Bang Enterprises" suffers a loss



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one year, Sheldon can't demand his interest, as it's only payable if they make a profit, and only if there was an explicit agreement to pay it in the first place.

### Interest on advances (Section 13(d))

A partner making an advance (beyond agreed capital) for the business is entitled to interest at 6% per annum on that advance. Unlike interest on capital, interest on advances continues to run even after dissolution until payment.

#### Example:

**Priya:** "Don't worry. I'll lend the firm the money it's beyond my capital contribution, so it's a loan, not a gift."

**Priya:** "It's a loan, so I'm entitled to 6% annual interest, even if the firm struggles it's a debt, not my investment."



Co-partner: "Priya, the roof leak's getting worse. We need repairs, but the firm's low on cash."

Co-partner: "That's generous, Priya. But what about interest? We're struggling financially."

### Right to be indemnified (Section 13(e))

The firm must indemnify a partner for payments made and liabilities incurred:

(i) in the ordinary and proper conduct of business,

OR

(ii) in an emergency act to protect the firm from loss, acting with ordinary prudence.

#### Example:

While delivering cakes for "Sweet Success Bakery," Partner Gaurav swerves to avoid a rogue squirrel, causing his van's tire to blow out. Since repairing the tire was necessary for business and done prudently to avoid a bigger accident, the firm must reimburse Gaurav for the tire replacement.



### Right to indemnify the firm (Section 13(f))

A partner must indemnify the firm for any loss caused by their wilful neglect in the conduct of business.

#### Example:

Partner Ursula, in "The Little Mermaid Emporium," was supposed to clean the rare seashell collection, but she intentionally left them outside in a storm because she thought they looked "prettier with a bit of erosion." If the shells are ruined, Ursula is personally liable to the firm for the loss caused by her wilful neglect.



## PARTNERSHIP PROPERTY (SECTION 14)

The "property of the firm" (also called partnership property, assets, joint stock) includes all property, rights, and interests to which the firm (all partners collectively) may be entitled.

What constitutes partnership property?

In the absence of contrary agreement, it comprises:

All property, rights, and interests partners brought into common stock as their contribution.

All property, rights, and interests acquired or purchased by or for the firm, or for the purposes and in the course of the business.

Goodwill of the business.

The real intention or agreement of partners determines whether a property is firm property. Mere use of a partner's property for firm purposes doesn't make it partnership property unless intended as such. Partners can, by agreement, convert individual property into partnership property (if done in good faith).

Goodwill

Goodwill is considered 'property' of the firm. It represents the value of the reputation of a business in terms of expected future profits beyond normal levels for similar businesses. When a firm dissolves, every partner has a right (unless agreed otherwise) to have the goodwill sold for the benefit of all partners.

Goodwill can be sold separately or with other firm properties. An outgoing partner can agree with the buyer not to carry on a similar business within a specified period or local limits, and such an agreement is valid if the restrictions are reasonable (even overriding Section 27 of the Indian Contract Act).



## APPLICATION OF THE PROPERTY OF THE FIRM (SECTION 15)

The firm's property must be held and used exclusively for the purpose of the firm. While partners have a community of interest in the firm's property, no single partner has a proprietary interest in the firm's assets while the partnership subsists.

Each partner has a right to their share of profits and a right to ensure assets are used for partnership business.

**Example:**


Bob: "That life-sized ceramic unicorn would look great in my garden. I'm taking it home."

Bob: "But I'm a partner! I helped pay for it!"

\_\_\_\_\_ "So I

Partner: "You can't—it's a firm asset, not personal property."

Bob: "It belongs to the firm, not us individually, and must be used for firm purposes." "No. If you want one, buy your own—this one stays."



## PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16)

Subject to contract between the partners:

If a partner derives any profit for themselves from a firm transaction or from the use of the firm's property, business connection, or firm name, they must account for that profit and pay it to the firm.

If a partner carries on any business of the same nature as and competing with that of the firm, they must account for and pay to the firm all profits made in that competing business.

**Example:**

When two or more individuals enter into a business relationship with the intention of making a profit, it is a partnership. In this case, two partners, Ramsay and Gordon, have a partnership in a grocery store. But then, one of the partners, Ramsay, starts a food truck that is in direct competition with their grocery store.


**Example:**

A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. It was held that A was bound to account to the firm for the profit so made by him. This rule, however, is subject to a contract between partners.

**Example:**

A, B, C and D started a business in partnership for importing salt from foreign ports and selling it at Chittagong. A struck certain transactions in salt on his own account, which were found to be of the same nature as the business carried on by the partnership. It was held that A was liable to account to the firm for profits of the business so made by him. This rule is also subject to a contract between the partners.

## RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM (SECTION 17)

A change in the firm's constitution can occur in four ways:

introduction of a new partner,

departure of a partner (death/retirement),

carrying on a different business than originally formed for, or

continuing business after a fixed term.

Subject to contract, if a change occurs in the firm's constitution, the mutual rights and duties of partners in the reconstituted firm remain the same as they were immediately before the change, as far as possible.

This also applies if a firm constituted for a fixed term continues business after that term expires (making it a partnership at will), or if a firm constituted for specific undertakings carries out other undertakings.

Chetan: "So we still share profits and decide the same way? Nothing suddenly changes?"

**Example:**

Ananya: "Five years in and still strong! But our agreement didn't say what happens after five years."

Bhavin: "Don't worry. Section 17 says if we continue after the term ends, our rights and duties stay the same—it just becomes a partnership at will."

Ananya: "That's a relief. So, what's our next project? I'm thinking bespoke rocking chairs."

Bhavin: "Right. If we continue, the law assumes the same terms—just with the flexibility to dissolve anytime."

## RELATION OF PARTNERS TO THIRD PARTIES

### Partner to be an Agent of the Firm [Section 18]

A partner is an agent of the firm for the purpose of the business of the firm. This means a partner virtually acts as both a principal (for themselves) and an agent (for co-partners). The key distinction from a mere agent is the partner's community of interest in the firm's property, business, and liabilities.

This agency rule applies to acts done by partners for the firm's business, not necessarily to internal dealings between partners themselves.

**Example:**

Co-partner: "Good. Don't forget to get enough for the new batch."

Elara: "I'm off to buy rare newt eyes for our potion—this will bind the firm."

Co-partner: "That's fine, but the firm isn't bound by that—it's not for business."

Elara: "I won't. I'm also grabbing a personal jar of pickled eyeballs—I've always wanted to try them."

Elara: "I know. As a firm's agent, I bind it only with business-related actions. The pickled eyeballs are my own affair."

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## ◆ Implied Authority of Partner as Agent of the Firm [Section 19]

The act of a partner done in the usual way of carrying on business of the kind carried on by the firm, binds the firm. This is called their "implied authority". To bind the firm, the act must be done in the firm name or in a manner expressing or implying an intention to bind the firm.

### Restrictions on Implied Authority (Section 19(2))

Unless there's a custom to the contrary, a partner's implied authority does not empower them to:

Submit a dispute relating to the firm's business to arbitration.

Open a bank account on behalf of the firm in their own name.

Compromise or relinquish any claim or portion of a claim by the firm.

Withdraw a suit or proceedings filed on behalf of the firm.

Admit any liability in a suit or proceedings against the firm.

Acquire immovable property on behalf of the firm.

Transfer immovable property belonging to the firm.

Enter into partnership on behalf of the firm.

### For a general commercial nature firm, a partner may:

Pledge or sell partnership property.

Buy goods on account of the partnership.

Borrow money, contract debts, and pay debts on account of the partnership.

Draw, make, sign, endorse, transfer, negotiate, and procure to be discounted promissory notes, bills of exchange, cheques, and other negotiable papers in the firm's name.

### Example:

Two partners, Captain and Tenille, run "The Love Boat Tours." Captain, using his implied authority, can buy fuel, hire deckhands, and collect fares because these are usual acts for a boat tour business. However, he cannot decide to open a separate "Love Boat Casino" and bind the firm to a gambling venture, because entering a new partnership is beyond his implied authority.



## Mode Of Doing Act To Bind Firm [Section 22]

A partner's implied authority is the power they have to legally bind the partnership firm through their actions, as they are considered an agent of the firm. This authority is not explicitly stated but is a normal part of their role.

### Conditions for Implied Authority

For a partner's act to legally bind the firm, it must meet these criteria:

- The act must be related to the usual business of the firm.
- The act must be done in a way that shows an intent to bind the firm, either by using the firm's name or other means.

### Examples of Acts Under Implied Authority

In a general commercial partnership, a partner typically has the implied authority to:

- Buy or sell partnership property.
- Acquire goods on the firm's behalf.
- Borrow or lend money, as well as contract and pay debts for the firm.
- Draw, sign, or negotiate financial instruments like checks and promissory notes in the firm's name.

**Section 19(2)** of the law specifies certain acts that are considered beyond a partner's implied authority.

Partners have implied authority to perform actions that are a normal part of the firm's business. In a general commercial partnership, a partner's implied authority typically includes the power to:

Pledge or sell partnership property.

Buy goods on behalf of the partnership.

Borrow money, incur debts, and pay debts for the partnership.

Draw, sign, and negotiate financial instruments like promissory notes and checks in the name of the firm.

Acts that are beyond a partner's implied authority are listed in Section 19(2).

**Example:**

X, a partner in a firm of solicitors, borrows money and executes a promissory note in the name of firm without authority. The other partners are not liable on the note, as it is not part of the ordinary business of a solicitor to draw, accept, or endorse negotiable instruments; however, it may be usual for one partner of firm of bankers to draw, accept or endorse a bill of exchange on behalf of the firm.

## Extension and Restriction of Partners' Implied Authority [Section 20]

The implied authority of a partner can be extended or restricted by contract between the partners. For these restrictions to be effective against a third party, two conditions must be met:

1. The third party knows about the restrictions.

2. The third party does not know that he is dealing with a partner in a firm. (This phrasing can be a bit confusing; it essentially means if the third party is unaware that they are interacting with a partner acting on behalf of a firm, the restriction might not bind the firm.) However, the first point, knowledge of the restriction, is usually the primary factor.

Such an extension or restriction requires the consent of all partners: a single partner or even a majority cannot do it alone.

### Example:

Partner: "Barry, our agreement clearly says you can only buy office supplies up to \$100. You know that!"



Barry: "I've got a great idea a vibrating nose hair trimmer! I'm ordering \$1000 in parts to make it."

Barry: "I know, but it's a great idea! The firm will love it. I'll order the parts from Mr. Knowitall." "But... I'm a partner! My actions should bind the firm!"

Partner: "Mr. Knowitall knows about your \$100 limit. If you order more, the firm isn't bound to pay over that. Normally your actions bind the firm, but if a third party knows your authority is limited, they can't hold the firm liable. You'll have to cover the extra \$900 yourself."

### Example:

A, a partner, borrows from B ₹ 1,000 in the name of the firm but in excess of his authority, and utilizes the same in paying off the debts of the firm. Here, the fact that the firm has contracted debts suggests that it is a trading firm, and as such it is within the implied authority of A to borrow money for the business of the firm. This implied authority, as you have noticed, may be restricted by an agreement between him and other partners. Now if B, the lender, is unaware of this restriction imposed on A, the firm will be liable to repay the money to B. On the contrary, B's awareness as to this restriction will absolve the firm of its liability to repay the amount to B.

## Partner's Authority in an Emergency [Section 21]

In an emergency, a partner has the authority to do all such acts that a person of ordinary prudence would do in their own case to protect the firm from loss. Such acts bind the firm.

### Example:

The partners of "The Wobbly Widget Factory" are away at a convention. A freak storm causes the factory roof to collapse, threatening to ruin all their widgets.



Partner Phil, who was left behind, immediately hires a temporary crew and buys emergency tarps to cover the damaged area. This act, though unauthorized in normal circumstances, is binding on the firm because it was done prudently in an emergency to prevent further loss.

## EFFECT OF ADMISSIONS BY A PARTNER (SECTION 23)

Admissions or representations made by a partner can bind the firm, but only if they relate to a partnership transaction and are made in the ordinary course of business.

However, an admission will not bind the firm if the partner's authority on that point is limited AND the other party knows of the restriction. These admissions affect the firm when tendered by third parties, but may not have the same effect in disputes between partners.



### Example:

Priya: "It's just high-quality, long-simmered tomato paste—our little trick. Don't tell the other partners!"



Rohan: "Priya, your dish has such a deep flavor. Is there a secret ingredient?"

Rohan: "My lips are sealed! Simple yet brilliant—makes me appreciate the salsa even more."

This shows that Priya's casual "secret" to a customer, made in her role as a partner, can legally count as the firm's official admission about its product, making it binding on the firm.

### Example:

X and Y are partners in a firm dealing in spare parts of different brands of motorcycle bikes. Z purchases a spare part for his Yamaha motorcycle after being told by X that the spare part is suitable for his motorcycle. Y is ignorant about this transaction. The spare part proves to be unsuitable for the motorcycle and it is damaged. X and Y both are responsible to Z for his loss.

## EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24)

A notice given to a partner who habitually acts in the firm's business, on matters relating to the firm's affairs, operates as a notice to the firm. The only exception is in cases of fraud on the firm committed by or with the consent of that partner.



The notice must be actual (not constructive), received by a working partner (not a sleeping one), and relate to the firm's business to constitute notice to the firm.

**Example:**

Karan: "Yes, yes, I saw it. Just file it with the other supplier correspondence—I'm late for golf."

Karan: "Relax, Anjali. It's probably minor. I'll handle it when I'm back—it's not the end of the world."



Anjali: "Good morning, sir. There's an urgent email from Apex Chemical Supply about a defect in the last ink batch. I've marked it 'High Importance' in your inbox."

Anjali: "Sir, they mention a 'significant quality issue' that could affect client projects. Shouldn't we tell Rajiv and Sameer right away?"

This shows that Karan's receipt of the notice counts as formal notification to the whole partnership. His knowledge is imputed to the firm, so it cannot claim ignorance even if Rajiv and Sameer were never told.

**Example:**

A, a partner who actively participates in the management of the business of the firm, bought for his firm, certain goods, while he knew of a particular defect in the goods. His knowledge as regards the defect, ordinarily, would be construed as the knowledge of the firm, though the other partners in fact were not aware of the defect. But because A had, in league with his seller, conspired to conceal the defect from the other partners, the rule would be inoperative and the other partners would be entitled to reject the goods, upon detection by them of the defect.

**Example:**

P, Q, and R are partners in a business for purchase and sale of second hand goods. R purchases a second hand car on behalf of the firm from S. In the course of dealings with S, he comes to know that the car is a stolen one and it actually belongs to X. P and Q are ignorant about it. All the partners are liable to X, the real owner. The only exception would lie in the case of fraud, whether active or tacit.

## LIABILITY TO THIRD PARTIES (SECTION 25 TO 27)

### ◆ Liability of a Partner for Acts of the Firm [Section 25]

Partners are jointly and severally responsible to third parties for all acts that fall within the scope of their express or implied authority.

An "act of firm" includes any act or omission by all partners, or by any partner or agent of the firm, that creates a right enforceable by or against the firm. To enforce liability under this section, the act must have been done while the person was a partner.

**Example:**

The "Whisker Wonderland Cat Cafe" partners, Mr. Mehra and Ms. Patel, sign a lease for a new cafe space.

Due to their joint and several liability, if the rent isn't paid, the landlord can recover the entire debt from either Mr. Mehra or Ms. Patel individually, or both together, because signing the lease was an act within their authority as partners.



### Liability of the Firm for Wrongful Acts of a Partner [Section 26]

The firm is liable to the same extent as the partner for any loss or injury caused to a third party by the wrongful acts of a partner, if those acts are done while the partner is acting:

(a) in the ordinary course of the business of the firm, or

(b) with the authority of the partners.

Even if the method used by the partner was unauthorized or wrongful, it doesn't affect the firm's liability if the act itself was authorized or fell within the ordinary course of business. All partners are liable for a partner's negligent acts done in the ordinary course of business.

**Example:**

In "Acme Anvil Co.", Partner Rakesh, while testing a new "Super Springy" anvil in the firm's workshop (ordinary course of business), accidentally launches it through the neighbor's roof due to his habitual carelessness (negligent act). The firm is liable for the damage, even though Rakesh's specific testing method was unusually reckless.

**Example:**

One of the two partners in coal mine acted as a manager was guilty of personal negligence in omitting to have the shaft of the mine properly fenced. As a result thereof, an injury was caused to a workman. The other partner was also held responsible for the same.

### Liability of Firm for Misapplication by Partners [Section 27]

This section covers two categories of misapplication of money by partners:

Clause (a)

Applies when a partner acts within their authority and, due to that authority, receives money or property belonging to a third party and misapplies it. It's not necessary for the money to have actually come into the firm's custody.

**Clause (b)**

Applies when such money or property has come into the custody of the firm and is misapplied by any of the partners.

The firm is liable in both cases. However, if a partner's receipt of money is not within their apparent authority, their receipt isn't considered a receipt by the firm, and other partners won't be liable unless the money came into their possession or control.

**Example:**

Partner Devraj, from "Himalayan Holiday Travels," takes a client's payment for a cruise to Goa (within his authority). Instead of booking the cruise, he uses the money to buy a lifetime supply of mangoes. Even though the money never reached the firm's account, since he received it in his capacity as a partner, the firm is liable for his misapplication.



However, if a client gave Devraj money for his personal "shawl collection fund" and it never involved the firm, the partnership wouldn't be liable.

**Example:**

A, B, and C are partners of a place for car parking. P stands his car in the parking place but A sold out the car to a stranger. For this liability, the firm is liable for the acts of A.

## RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29)

A share in a partnership is transferable, but because partnership is based on mutual confidence, the assignee (transferee) of a partner's interest cannot enjoy the same rights and privileges as the original partner.

### ◆ Rights of a transferee

- ✓ During the continuance of partnership, such transferee is NOT entitled to:

Interfere with the conduct of the business.

Require accounts.

Inspect books of the firm.

They are only entitled to receive the share of the profits of the transferring partner and must accept the profits as agreed to by the partners (i.e., they cannot challenge the accounts).

- ✓ On the dissolution of the firm or on the retirement of the transferring partner, the transferee IS entitled, against the remaining partners, to:

Receive the share of the assets of the firm to which the transferring partner was entitled.

An account from the date of the dissolution for the purpose of ascertaining the share.

- ✓ A partner cannot, by transferring their interest, unilaterally make someone else a partner without the consent of all other partners. However, a partner is not prevented from transferring their interest, as it is considered an existing and tangible property.

#### Example:

In "Mystic Ganga Travels," Partner Ananya sells her share of the partnership to her cousin, Rohit. Rohit can collect Ananya's share of the profits on payday, but he cannot demand access to the firm's books, inspect the tour buses, or give instructions to the staff, because he is only a transferee, not a full partner.



## MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30)

A minor cannot be bound by a contract (as a minor's contract is void), and therefore, a minor cannot become a partner in a firm because partnership is founded on a contract. However, a minor can be admitted to the benefits of partnership (i.e., given a share in profits) with the consent of all partners.

### ◆ Rights of a minor admitted to benefits (before attaining majority)

Right to their agreed share of the profits and of the firm's property.

Access to, inspect, and copy the accounts of the firm.



Can sue the partners for accounts or payment of their share but only when severing their connection with the firm not otherwise.

On attaining majority they may within 6 months elect to become a partner or not to become a partner.

### ◆ Liabilities of a minor (before attaining majority)

Their liability is confined only to the extent of their share in the profits and property of the firm.

They have no personal liability for the firm's debts incurred during their minority.

A minor cannot be declared insolvent. If the firm is declared insolvent, their share vests in the Official Receiver/Assignee, meaning they can recover their share proportionately.

### After attaining majority (Sections 30(5) and 30(7))

- ✓ Within 6 months of attaining majority or gaining knowledge of being admitted to benefits (whichever is later) the minor must decide whether to remain a partner or leave and give public notice of their decision.
- ✓ If they fail to give such notice, they automatically become a partner upon the expiry of the six months.

*When they become a partner (by election or failure to give notice)*

*They become personally liable to third parties for ALL acts of the firm done since they were admitted to the benefits of partnership (i.e., retrospective liability).*

*Their share in the property and profits of the firm remains the same as what they were entitled to as a minor.*

*When they elect not to become a partner*

*Their rights and liabilities continue to be those of a minor up to the date of giving public notice.*

*Their share is not liable for any acts of the firm done after the date of the notice.*

*They can sue the partners for their share of the property and profits.*

- ✓ The minor must give notice to the Registrar of Firms regarding their decision.

**Example:**



**Adi:** "Right, the public notice—I forgot. I'll handle it soon, don't worry."

**Adi:** "But that loan was taken when I was a minor! I can't be held liable for it, right?"

**Prakash:** "You're right—you weren't liable when the loan was taken. But by staying over six months after turning 18 without sending a public notice, you've become personally liable for all firm debts, even old ones. Now you share the liabilities like the rest of us."

**Prakash:** "Adi, now that you're 18, you must send a public notice—it's a legal formality to protect yourself."

**Prakash:** "Adi, we have a problem. The bank is demanding repayment on our old loan, and the firm has defaulted."



## LEGAL CONSEQUENCES OF PARTNER COMING IN AND GOING OUT (SECTION 31 – 35)

*Any change in the relation of partners results in the reconstitution of the partnership firm.*

### (i) Introduction of a Partner (Section 31)

No new partner can be introduced without the consent of all existing partners unless the partnership contract provides otherwise or it relates to minors.

Rights and liabilities of new partner: Their liabilities ordinarily commence from the date they are admitted unless they agree to be liable for prior obligations.

For the new firm (including the new partner) to assume liability for the old firm's existing debts the creditors must agree to accept the new firm as their debtor and discharge the old partners (this is called novation). A mere agreement among partners is not enough for novation.

This section does not apply to a partnership of two partners which is automatically dissolved by the death of one.

**Example:**

*“The Three Warriors” (Arjun, Bhaskar, and Karan) are partners in an adventure firm. If they want to add a fourth warrior, Dev, all three must agree. If they do, Dev’s liability begins from the day he joins. If “The Three Warriors” already owe money to the Raja, Dev won’t be liable for that debt unless the Raja specifically agrees to accept him as a debtor.*

## ❖ (ii) Retirement of a Partner (Section 32)

A partner may retire in one of three ways:

(a) With the consent of all other partners.

(b) In accordance with an express agreement by the partners.

c) Where the partnership is at will, by giving notice in writing to all other partners of their intention to retire.

### CASE LAW: *Vishnu Chandra Vs. Chandrika Prasad*

The Supreme Court in *Vishnu Chandra Vs. Chandrika Prasad*, held that the expression ‘if any partner wants to dissociate from the partnership business’, in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from the partnership. The expression clearly indicated that in the event of retirement, the partnership business will not come to an end.

#### Discharge from liability

A retiring partner may be discharged from liability to any third party for acts done *before* retirement by an agreement with that third party and the reconstituted firm. Such an agreement can be implied by a course of dealing after the third party knows of the retirement.

#### Continuing liability to third parties

Despite retirement, the retiring partner and the remaining partners continue to be liable as partners to third parties for any act done which would have been an act of the firm *before* retirement, until public notice is given of the retirement.

A retired partner is not liable to a third party who deals with the firm without knowing they were a partner.

Notice can be given by the retired partner or any partner of the reconstituted firm.

**Example:**

Mere retirement of a partner, who was the tenant of the premises in which the partnership business was carried out, would not result in assignment of the tenancy rights in favour of the remaining partners even though the retiring partner ceases to have any right, title or interest in the business as such.

🟡 (iii) Expulsion of a Partner (Section 33)

A partner can be expelled only if three conditions are met:

1. The power of expulsion must have existed in a contract between the partners.
2. The power has been exercised by a majority of the partners.
3. It has been exercised in good faith. If any of these conditions are absent, the expulsion is not considered bona fide and is null and void.

Test of good faith includes three things (Section 33(1))

The expulsion must be in the interest of the partnership.

The partner to be expelled is served with a notice.

They are given an opportunity of being heard.

Under the Act, expelling a partner does not dissolve the firm. If the expulsion is invalid, the partnership continues as before, even if it is at will.

A partner can only be expelled if the partnership contract allows it, a majority exercises the power, and it is done in good faith. If these conditions aren't met, the expulsion is invalid under **Section 33(1)**.

An expelled partner has the same rights as a retired partner under **Sections 32(2), (3), and (4)**.



**Example:**

A, B and C are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly.

A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C. Considering the provisions of Indian Partnership Act, 1932 state whether they can expel a partner from the firm?

**Example:**

Sameer: "Raj, the secret sauce keeps going missing after your shifts—we even found a jar in your bag. This is serious."

Raj: "It's just a little sauce for myself! No big deal—you're overreacting."

Raj: ""You can't just kick me out for this! It's not fair!"

Sameer: "The agreement allows expulsion for misconduct. This is your chance to correct yourself—stealing sauce is a clear violation, unlike something trivial."



Tara: "Raj, our agreement says misuse of firm property is grounds for expulsion. This is your final warning—if it happens again, we can vote you out."

#### (iv) Insolvency of a Partner (Section 34)

When a partner is adjudicated as an insolvent, they cease to be a partner on the date the adjudication order is made.

The firm is typically dissolved by a partner's insolvency, but partners can agree otherwise.

The insolvent partner's estate is not liable for any firm act done after the adjudication order date.

The firm is also not liable for any act of the insolvent partner done after the adjudication order date.

No public notice is required regarding a partner's insolvency to absolve the estate or the firm from future liabilities.

**Example:**

Arnav: "Diya, I just heard—Lakshya has been declared insolvent by court order."

Diya: "That's a relief. From now on, Lakshya is no longer a partner in Golden Goose Investments"

Arnav: "Exactly. Any new debts won't be his responsibility, and his bankruptcy won't affect our business."



Diya: "And importantly, the firm isn't bound by any new ventures he tries. His authority to act for the firm ended the moment he was declared bankrupt."

#### (v) Liability of Estate of Deceased Partner (Section 35)

Ordinarily a partner's death dissolves the partnership but partners can agree that the death of one will not dissolve the partnership for the surviving partners (unless it's a two-partner firm).

To absolve the deceased partner's estate from liability for future firm obligations no public notice is necessary.

**Example:**

X was a partner in a firm. The firm ordered goods in X's lifetime; but the delivery of the goods was made after X's death. In such a case, X's estate would not be liable for the debt; a creditor can have only a personal decree against the surviving partners and a decree against the partnership assets in the hands of those partners.

A suit for goods sold and delivered would not lie against the representatives of the deceased partner. This is because there was no debt due in respect of the goods in X's lifetime.

Example:



**Sameer:** "No need, Anjali. By law, a partner's estate isn't liable for future debts after their death. The death itself serves as notice—no formal intimation required."

**Sameer:** "Exactly. His estate covers only debts from before his death. New obligations, like today's order, are solely on us, the surviving partners."

**Anjali:** "Sameer, I'm placing a ₹50,00,000 order for flux capacitors. Should we notify the supplier that Professor Vijay's estate isn't liable for this new debt?"

**Anjali:** "So his antique artifact collection is safe from this new debt?"



## RIGHTS OF OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS (SECTION 36)

An outgoing partner may carry on a business competing with that of the firm and may advertise it, but subject to a contrary contract, they may not:

- (a) Use the firm name.
- (b) Represent themselves as carrying on the business of the firm.
- (c) Solicit the custom of persons who were dealing with the firm before they ceased to be a partner.

An agreement in restraint of trade (where an outgoing partner agrees not to carry on a similar business within specified limits/time) is valid if the restrictions are reasonable, despite Section 27 of the Indian Contract Act.

Example:

**Gautam:** "So, Bharath's retired. He says he's starting a rival company, Bharath's Better Blimps. Is that allowed?"

**Gautam:** "But can he use our company's name—like calling it Bharath's Best Blimps, Version 2.0?"



**Divya:** "Yes, he can. Unless our agreement had a non-compete clause, a retired partner is free to start and advertise a rival business."

**Divya:** "No, he can't. Using a name too similar to ours or trying to confuse customers would violate trademark and partnership law. He also can't hand out flyers like 'Still Bharath's, just over here!' or poach our customer list—that breaches his duty to the firm and harms its goodwill."

## RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS (SECTION 37)

If a member of a firm dies or ceases to be a partner, and the surviving or continuing partners carry on the business using the firm's property without a final settlement of accounts with the outgoing partner or their estate, then (in the absence of a contrary contract), the outgoing partner or their estate is entitled to one of two options:

Such share of the profits made since they ceased to be a partner as is attributable to the use of their share of the firm's property;

OR

Interest at the rate of 6% per annum on the amount of their share in the firm's property.

**Exception:** If the partners had a contract giving an option to the surviving/continuing partners to purchase the interest of the deceased/outgoing partner, and that option is duly exercised, the outgoing partner/estate is not entitled to further profits or interest.

### Example:

When Professor Iyer leaves the "Ancient Knowledge Academy" partnership, his share of the rare manuscripts (firm property) remains in use by Partners Sharma and Ramanathan. If they don't settle accounts, Iyer's estate can demand either a percentage of the profits earned from using his share of the manuscripts or 6% annual interest on the value of his share until it is paid out.



### Example:

A, B and C are partners in a manufacture of machinery. A is entitled to three-eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. A's estate is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

### Example:

A, B and C are partners. C retires after selling his share in the partnership firm. A and B fail to pay the value of the share to C as agreed to. The value of the share of C on the date of his retirement from the firm would be pure debt from the date on which he ceased to be a partner as per the agreement entered between the parties. C is entitled to recover the same with interest.

## REVOCAION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38)

A continuing guarantee given to a firm or to a third party in respect of firm transactions is, unless agreed otherwise, revoked as to future transactions from the date of any change in the constitution of the firm.

**Example:**

*“The Super Duper Delivery Service” (Partners Amit and Raj) has a continuing bank guarantee for any new delivery vans they purchase. When a new, slower partner, Suresh, joins the firm, the guarantee is automatically revoked for future van purchases—unless the bank explicitly agrees to extend it to the reconstituted “Super Duper Delivery Service with Suresh” firm.*



# Chapter 4

## Unit 3: Registration and Dissolution of a Firm

### REGISTRATION OF FIRMS

The registration of a partnership firm is a formal process that can be initiated at any time.

#### Application For Registration (Section 58)

To register a firm, a statement in the prescribed form, accompanied by the prescribed fee, must be sent by post or delivered to the Registrar of the area where the firm's business is located or proposed to be located.

#### Contents of the Application Statement

The statement must include:

The firm's name.

The place or principal place of business of the firm.

Names of any other places where the firm conducts business.

The date when each partner joined the firm.

Full names and permanent addresses of all partners.

The duration of the firm.

#### Signing and Verification

The statement must be signed by all partners or by their specially authorized agents. Each person signing the statement must also verify it as prescribed.

#### Firm Name Restrictions

A firm's name cannot contain words such as 'Crown', 'Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or words implying government sanction, approval, or patronage, unless the State Government provides written consent.

#### Example:

"The Imperial Crown Royal Knights of the Round Table Partnership" would likely need special government permission, especially if their business was selling unusually shaped stationery.



### Registration (Section 59)

The Registrar, upon being satisfied that Section 58's provisions have been met, records an entry of the statement in a Register of Firms and files the statement. A certificate of Registration is then issued.

However, registration is deemed complete as soon as the application (in the prescribed form with fee and necessary details) is delivered to the Registrar. Recording the entry is considered a routine duty.

#### Example:

Imagine a partner frantically checking the post office tracking number for their registration application, thinking, "The moment that 'Delivered' status updates, we're officially 'Widgets & Wonders LLP!'"



### Late Registration On Payment Of Penalty (Section 59A-1)

If the statement is not submitted within the specified time, the firm can still be registered upon payment of a penalty of one hundred rupees per year of delay or a part thereof.

### Registration after a Suit is Filed

Registration can even be effected after a firm has initiated a suit.

However, in such a scenario, the existing suit must first be withdrawn, the firm must get registered, and then a fresh suit can be filed.

## CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

While the Indian Partnership Act, 1932, does not mandate registration or impose a penalty for non-registration (unlike English Law where it's compulsory with a penalty), Section 69 outlines several significant disabilities arising from non-registration. These consequences often create a "persuasive pressure" for firms to register.

### Disabilities Due to Non-Registration

Non-registration restricts a firm's legal capabilities in several key areas:

#### No Suit by Firm or Partners Against Third Parties

An unregistered firm, or any person on its behalf, cannot bring a suit in a civil court against a third party for breach of contract. For a suit to be maintainable, the firm must be registered, and the persons suing must be listed as partners in the register of firms.

*Example:*

**Raghav:** "So, the firm 'Sharma & Co.' can still sue Mr. Verma even after Mr. Sharma passed away, as long as the other partners, Bela and Chaman, are registered."



**Pooja:** "Exactly. But I heard they brought in a new partner, Dhruv. Didn't they?"

**Raghav:** "They did. And that's why they can't sue *as a new firm*. Since Dhruv's name isn't registered, they can't legally go after Mr. Verma. Only Bela and Chaman can proceed, based on the original firm's registration status."

### No Relief for Set-Off of Claim

If a third party sues an unregistered firm, neither the firm nor its partners can claim a set-off if the suit's value exceeds ₹ 100, nor can they pursue other proceedings to enforce contractual rights.

### Aggrieved Partner Cannot Sue Other Partners or the Firm

A partner in an unregistered firm is generally prevented from bringing legal action against the firm or other partners.

**Exception:** uch a partner can sue for the dissolution of the firm, or for accounts and realization of their share in the firm's property if the firm is already dissolved.

*Example:*

**Aarav:** "Our unregistered 'Gupt Jasoo Agency' can't sue that villain who stole our secret plan. The law says we need to be on the official register first!"



**Ishaan:** "Great. Now we're just 'The Guys Who Lost Their Secret Plan.' We really lived up to our name, didn't we?"

## ◆ Rights Not Affected by Non-Registration (Exceptions)

Despite the disabilities, non-registration does not impact certain rights:

### Third Parties Can Sue the Firm

An action can be brought against an unregistered firm by a third party.

### Partners' Rights for Dissolution/Accounts

The right of partners to sue for **dissolution of the firm**, for the **settlement of accounts of a dissolved firm**, or for **realization of property** of a dissolved firm remains intact.

### Powers of Official Assignees/Receivers

The power of an Official Assignee or a Court Receiver to realize an insolvent partner's property and bring an action is unaffected.

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### Small Claims

The right to sue or claim a set-off if the **value of the suit does not exceed ₹100.**

### Rights of Legal Representatives/Heirs

Legal representatives or heirs of a deceased partner can sue for accounts or to realize the firm's property.

### Firms with No Indian Business

Rights of firms or partners having no place of business in India.

### Criminal Proceedings

Rights of partners to sue for criminal proceedings against other partners or third parties.

#### Example:

*"Our rival, 'The Unregistered Pranksters,' thought they were safe from our legal wrath. But then our lawyer pointed out, 'Ah, but third parties can sue! And your pranks caused over ₹100 in damages! Time for a small claims battle!'"*

#### Example:

*A & Co. is registered as a partnership firm in 2017 with A, B and C partners. In 2018, A dies. In 2019, B and C sue X in the name and on behalf of A & Co. without fresh registration. Now the first question for our consideration is whether the suit is maintainable.*

*As regards the question whether in the case of a registered firm (whose business was carried on after its dissolution by death of one of the partners), a suit can be filed by the remaining partners in respect of any subsequent dealings or transactions without notifying to the Registrar of Firms, the changes in the constitution of the firm, it was decided that the remaining partners should sue in respect of such subsequent dealings or transactions even though the firm was not registered again after such dissolution and no notice of the partner was given to the Registrar.*

*The test applied in these cases was whether the plaintiff satisfied the only two requirements of Section 69 (2) of the Act namely,*

- (i) the suit must be instituted by or on behalf of the firm which had been registered;*
- (ii) the person suing had been shown as partner in the register of firms. In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.*

*Now, in the above example, what difference would it make, if in 2019 B and C had taken a new partner, D, and then filed a suit against X without fresh registration?*

*Where a new partner is introduced, the fact is to be notified to Registrar who shall make a record of the notice in the entry relating to the firm in the Register of firms.*

*Therefore, the firm cannot sue as D's (new partner's) name has not been entered in the register of firms. It was pointed out that in the second requirement, the phrase "person suing" means persons in the sense of individuals whose names appear in the register as partners and who must be all partners in the firm at the date of the suit.*

## DISSOLUTION OF FIRM

The dissolution of a firm signifies the discontinuation of the legal relationship between all partners of the firm. This is distinct from the dissolution of a partnership, which may only involve one or more partners leaving while the rest continue the business.

### ◆ Dissolution of Firm Vs. Dissolution of Partnership [Section 39]

Basis	Dissolution of Firm	Dissolution of Partnership
Continuation of business	Involves <u>discontinuation of business</u> in partnership.	Does <u>not affect continuation of business</u> ; only involves reconstitution of the firm.
Winding up	Involves <u>winding up of the firm</u> , realization of assets, and settlement of liabilities.	Involves only <u>reconstitution</u> , requiring revaluation of assets and liabilities.
Order of court	May be dissolved by an <u>order of the court</u> .	Is <u>not ordered by the court</u> .
Scope	Necessarily involves dissolution of partnership.	May or may not involve dissolution of firm.
Final closure of books	Involves final closure of the firm's books.	Does not involve final closure of the books.

### ◆ Modes of Dissolution of a Firm (Sections 40-44)

A partnership firm can be dissolved in several ways:

#### I. Dissolution Without the Order of the Court (Voluntary Dissolution)

##### 1. Dissolution by Agreement (Section 40)

A firm can be dissolved with the consent of all partners or in accordance with a pre-existing contract between the partners.

**Example:**

**Rahul:** "I can't believe it. After all these years, 'The Baker Brothers' are dissolving the business because of a simple fight."



**Rohan:** "I know. Rahul wanted to add sprinkles to the brownies, and Sameer didn't. They just couldn't agree on something so small, so they're ending the whole firm by mutual agreement."

##### 2. Compulsory Dissolution (Section 41)

A firm is compulsorily dissolved in these situations:

By an event that makes it unlawful for the firm's business to be carried on or for the partners to carry it on in partnership.

**Example:**

A firm trading a particular chemical would be compulsorily dissolved if a new law bans the trading of that chemical making the business unlawful.

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When all partners or all but one are adjudicated as insolvent.

**Example:**

A firm is carrying on the business of trading a particular chemical and a law is passed which bans on the trading of such a particular chemical. The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.

### 3. Dissolution on the Happening of Certain Contingencies (Section 42)

Subject to any contract between partners, a firm can be dissolved upon:

The expiry of a fixed term for which the firm was constituted.

The completion of the adventure or undertaking for which the firm was constituted.

The death of a partner.

The adjudication of a partner as an insolvent.

**Example:**

**Aarav:** "I can't believe it. 'The Diwali Decorators' automatically dissolved yesterday, on the day after Diwali."



**Anjali:** "That's how their partnership works. It's a contractual clause that says the firm dissolves after they complete their annual task. It saves them the hassle of officially 'un-decorating' themselves."

### 4. Dissolution by Notice (Section 43)

If the partnership is "at will", any partner can dissolve the firm by giving written notice to all other partners of their intention to dissolve it.

The firm dissolves from the date mentioned in the notice, or if no date is mentioned, from the date the notice is communicated.

A notice once given cannot be withdrawn without the consent of all partners.

**Example:**

**Rahul:** "I can't believe it. 'The Competitive Kachori Eating' partnership is done. Rohit got tired of it and sent a notice saying, 'I'm out! Effective immediately, or whenever you finish counting the leftover kachoris!'"



**Sameer:** "What? Just like that? But we were still planning the next competition! I guess since it was an 'at-will' partnership, he could just dissolve it and leave us hanging."

## II. Dissolution by the Court (Section 44)

A court may, at the suit of a partner, dissolve a firm on any of the following grounds:

### Insanity/Unsound Mind

If a partner (excluding a sleeping partner) becomes of **unsound mind**, the court can dissolve the firm at the request of other partners or the insane partner's next friend. Temporary sickness is not a sufficient ground.

**Example:**

*Sanjay: "The court had to intervene and dissolve 'The Logic Puzzle Enthusiasts.' The partner, Rahul, started trying to solve Rubik's Cubes with his feet and was insisting all their assets were sentient teacups."*



*Priya: "I knew it! That's not just brain fog from a lack of coffee; that's clearly an unsound mind. The court had to step in and handle the firm's dissolution."*

**Example:**

A, B and C are partners in a firm. A has severe infection and got typhoid. Due to this, he was not able to conduct business for few weeks. This kind of illness cannot be treated as the ground for dissolution.

**Permanent Incapacity**

If a partner (other than the one suing) becomes permanently incapable of performing their duties, perhaps due to physical disability or illness, the court may dissolve the firm.

**Example:**

*Aarav: "I heard the 'The Dazzling Duo' jugglers had to be dissolved by the court. The lead performer, Rohan, developed a permanent fear of small, round objects."*

*Ishan: "Oh, that's terrible. Since juggling was their core business and he couldn't perform his duties anymore, the court had to intervene."*

**Misconduct**

If a partner (other than the one suing) is guilty of conduct likely to prejudicially affect the business, the court may order dissolution. The misconduct doesn't have to be directly related to the business, but its adverse effect is key. The nature of the business determines what constitutes misconduct.

**Example:**

"The partner in 'The Professional Secret Keepers Agency' kept spilling clients' secrets on a popular gossip blog. While not strictly a business transaction, it definitely 'prejudicially affected' their 'secret' keeping business, leading to court-ordered dissolution."

**Persistent Breach of Agreement**

If a partner (other than the one suing) **willfully or persistently breaches agreements** regarding the firm's management or business conduct, or behaves in a way that makes it impractical for other partners to continue the business, the court may dissolve the firm. Examples include embezzlement, keeping erroneous accounts, holding excessive cash, or refusing to show accounts despite requests.

**Example:**

If one of the partners keeps erroneous accounts and omits to enter receipts or if there is continued quarrels between the partners or there is such a state of things that destroys the mutual confidence of partners, the court may order for dissolution of the firm.

**Transfer of Interest**

If a partner (other than the one suing) **transfers their entire interest** in the firm to a third party, or allows their share to be charged or sold by the court (e.g., for recovery of arrears), another partner can seek dissolution.



**Example:**

"The partner of 'The Exotic Pet Rental' firm quietly sold his entire share to a rival 'Gerbil Emporium.' The other partners, finding themselves in business with a gerbil enthusiast instead of their trusted colleague, had the court dissolve the firm."

**Continuous/Perpetual Losses**

If the firm's business **cannot be carried on except at a loss in the future**, the court may order its dissolution.

**Example:** "After years of selling 'Invisible Widgets' at a perpetual loss, the partners realized their business model was, well, invisible. The court, seeing no profit in sight, dissolved 'The Invisible Widget Co.'"

**Just and Equitable Grounds**

The court can dissolve a firm if it considers **any other ground to be just and equitable**.

**Examples include:**

*Deadlock in management.*

*Partners not on talking terms.*

*Loss of substratum (the core basis or foundation of the firm's business).*

*Gambling by a partner on a stock exchange.*

**Example:**

"The 'Debating Society' firm experienced such an extreme deadlock in management that they couldn't even agree on whether to debate. The court, finding it unjust and inequitable for a debating firm not to debate, ordered dissolution."



CONSEQUENCES OF DISSOLUTION (SECTIONS 45-55)

◆ Liability for Acts of Partners Done After Dissolution (Section 45)

- ➔ Partners remain liable to third parties for acts done by any partner that would have been firm acts before dissolution, until public notice of dissolution is given.
- ➔ Exceptions to Public Notice Requirement: Even without public notice, liability for subsequent acts does not apply to:

The estate of a deceased partner.

An insolvent partner.

A dormant partner (one not known to be a partner by the person dealing with the firm)

→ Any partner can give the public notice.

→ **Section 45** aims to protect third parties without notice of dissolution and to protect dissolved firm partners from ongoing liability.

**Example:**

**Sanjay:** A customer is suing the dissolved 'Secret Samosa Co.' because Rahul, one of the original partners, continued to sell samosas under the old name, and the customer purchased a stale one.



**Kunal:** "What?! But you and Rahul were partners, too! Now you're liable for his crumbly samosa misdeed just because you didn't put a 'CLOSED' sign up? You've moved on to 'The Chai Crew!'"

**Example:**

X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution. In such a case, Y also would be liable for the amount because no public notice was given.

### Right of Partners to Have Business Wound Up (Section 46)

Upon dissolution, every partner or their representative has the right to have the firm's property applied to pay debts and liabilities, and to have any surplus distributed according to their rights.

**Example:**

**Aarav:** "I heard the partners of 'The Extravagant Wedding Planners' are finally dividing everything up."

**Kavita:** "Yeah, but they have to settle all the debts for the marigolds, the *dhol*, and that horse for the *baraat* first. Only then can they start dividing the leftover confetti and balloons."



### Continuing Authority of Partners for Winding Up (Section 47)

After dissolution, the authority of each partner to bind the firm, and their mutual rights and obligations, continue only as far as necessary to wind up the firm's affairs and complete unfinished transactions. This authority does not extend beyond winding-up activities.

**Proviso:** The firm is not bound by the acts of a partner who has been adjudicated insolvent.

**Example:**

"After 'The Epic Adventure Guides' dissolved, one partner tried to book a new 'Quest for the Golden Spatula.' The others quickly reminded him, 'Dude, we're only allowed to finalize payment for the last 'Quest for the Rubber Chicken.' No new adventures!'"

### Mode of Settlement of Partnership Accounts (Section 48)

Unless partners agree otherwise, accounts are settled after dissolution according to these rules:

Losses (including capital deficiencies) are paid first out of profits, then out of capital, and finally, by partners individually in their profit-sharing ratio.

**Example:** If partners X and Y share profits equally, and X contributed ₹6,60,000 capital while Y contributed ₹40,000, and assets are ₹2,00,000, the ₹5,00,000 deficiency would be shared equally by Y and X's estate. However, if the agreement stipulated surplus assets divide by capital interests, X's estate would bear a larger loss in case of a capital deficiency.

**Assets of the firm** (including sums contributed by partners for capital deficiencies) are applied in the following order:

First, in paying debts of the firm to third parties.

Second, in paying each partner rateably what is due to them as advances (loans) from the firm.

Third, in paying each partner rateably what is due to them on account of capital.

Fourth, the residue (if any) is divided among partners in their profit-sharing ratio.

**Example:**

"The 'Unprofitable Pet Rock Emporium' dissolved. First, they paid off the rock supplier (a very patient pebble company). Then, they reimbursed the partner who lent money for fancy rock polish. Next, they tried to return the partners' initial capital contributions (which, tragically, were mostly just more rocks). Finally, any leftover lint from their pockets was shared equally as 'residual profits.'"


**Example:**

X and Y were partners sharing profits and losses equally and X died. On taking partnership accounts, it transpired that he contributed ₹ 6,60,000 to the capital of the firm and Y only ₹40,000. The assets amounted to ₹ 2,00,000. In such situation, the deficiency (₹ 6,60,000 + ₹ 40,000 – ₹ 2,00,000 i.e. ₹ 5,00,000) would have to be shared equally by Y and X's estate.

If in the above example, the agreement provided that on dissolution the surplus assets would be divided between the partners according to their respective interests in the capital and on the dissolution of the firm a deficiency of capital was found, then the assets would be divided between the partners in proportion to their capital with the result that X's estate would be the main loser.

## Payment of Firm Debts and Separate Debts (Section 49)

When there are both joint debts from the firm and separate debts from any partner:

### Firm Property

The firm's property is primarily used to **pay the firm's debts**. Any surplus from a partner's share is then used to pay their separate debts or given to them.

### Separate Property

A partner's separate property is first used to **pay their separate debts**. Any surplus is then used to pay the firm's debts.

*Example:*

*Rahul: "So, the firm 'The Street Food Vendors' dissolved, and all the leftover samosas and jalebis had to be sold to pay off the rent."*



*Pooja: "And you know how one of the partners, Bhuvan, had his own separate debt for that collection of old movie posters? He had to use his personal profits from selling those posters to pay off his own creditors first, before he could add any leftover cash to the firm's funds."*

# Chapter 5

## The Limited Liability Partnership Act, 2008

### INTRODUCTION

*The Limited Liability Partnership Act, 2008 was notified on 9th January 2007, passed on 12th December 2008, and assented on 7th January 2009. It applies to the whole of India and provides for the formation and regulation of LLPs.*

The Act contains 81 sections and 4 Schedules:

**First** (mutual rights and duties of partners in absence of agreement),

**Second** (conversion of firm),

**Third** (conversion of private company), and

**Fourth** (conversion of unlisted public company).

*The Ministry of Corporate Affairs and Registrar of Companies administer the Act, while the Central Government makes rules through notifications. The Indian Partnership Act, 1932 does not apply to LLPs. It was amended by the LLP (Amendment) Act, 2021 dated 13th August 2021.*

#### Need for LLP:

*Lawmakers recognized the need for a new corporate form to facilitate the contemporary growth of the Indian economy. This new form acts as an alternative to traditional partnerships (which have unlimited personal liability) and the heavily statute-governed limited liability companies.*

*It was designed to enable professionals and entrepreneurs to combine, organize, and operate in a flexible, innovative, and efficient manner.*



#### Concept of LLP:

*An LLP is an alternative corporate business vehicle that combines the benefits of limited liability (like a company) with the flexibility of organizing its internal structure as a partnership (like a traditional partnership). It is considered a hybrid between a company and a partnership due to having elements of both corporate and partnership firm structures.*

#### Key Aspects:

It is a new form of legal business entity with limited liability.

It is a separate legal entity.

The LLP itself is liable for the full extent of its assets, but the liability of its partners is limited to their agreed contribution.

It allows partners flexibility in organizing their internal structure based on a mutual agreement.

LLPs are suitable for entrepreneurs, professionals (like engineers, legal advisors, accounting professionals), and enterprises providing services or engaged in scientific/technical disciplines. Its flexibility makes it ideal for small enterprises and venture capital investments.

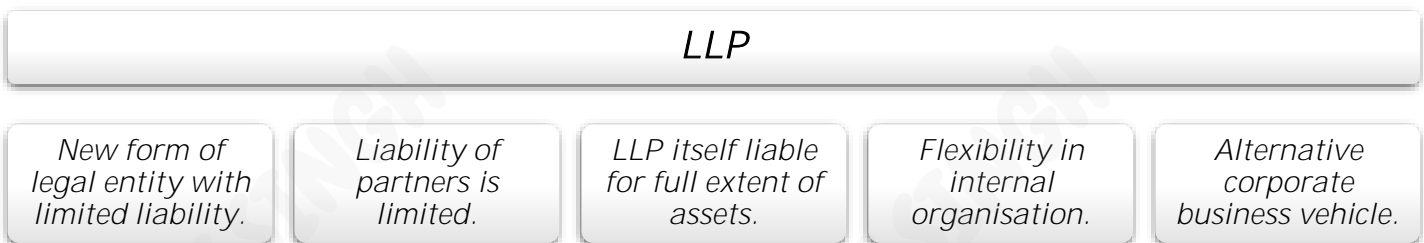


## LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT

### Meaning of LLP

An LLP is a legal business entity with limited liability, combining the advantages of a company and a partnership. It provides limited liability at low compliance cost while giving partners the flexibility to organise their internal structure like a traditional partnership.

Being a separate legal entity, the LLP itself is liable for the full extent of its assets, while the partners' liability remains limited. Since it contains features of both a corporate structure and a partnership firm structure, an LLP is regarded as a hybrid between a company and a partnership.



## ◆ Important Definitions

### 1. Body Corporate [Sec 2(1)(d)]

#### Includes:

- ✓ LLP registered under this Act.
- ✓ LLP incorporated outside India.
- ✓ Company incorporated outside India.

#### Excludes:

- ✓ Corporation sole.
- ✓ Co-operative society under any law.
- ✓ Any other body corporate notified by Central Government.

### 2. Business [Sec 2(1)(e)]

*Business includes every trade, profession, service, and occupation, but it does not cover those activities which the Central Government may exclude by notification.*

### 3. Designated Partner [Section 2(1)(j)]

*A designated partner means any partner who has been designated as such pursuant to Section 7 of the LLP Act.*

### 4. Entity [Section 2(1)(k)]

*Entity means anybody corporate and also includes a firm set up under the Indian Partnership Act, 1932 for the purposes of specified sections of the LLP Act.*

### 5. Financial Year [Section 2(1)(l)]

*Financial year, in relation to an LLP, means the period beginning from the 1st day of April of a year and ending on the 31st day of March of the following year.*

*However, if an LLP is incorporated after 30th September of a year, its financial year may end on the 31st March of the year after the next.*

#### **Example:**

*If a LLP has been incorporated on 15th October, 2019, then its financial year may be from 15th October, 2019 to 31st March, 2021.*

### 6. Foreign LLP [section 2(1)(m)]:

*A Foreign LLP is one formed or registered outside India but having a place of business in India.*

### 7. Limited liability partnership [Section 2(1)(n)]:

Limited Liability Partnership means a partnership formed and registered under this Act.

### 8. Limited Liability partnership agreement [Section 2(1)(o)]:

An LLP Agreement is a written agreement defining the mutual rights and duties of the partners and the LLP.

### 9. Partner [Section 2(1)(q)]:

Partner, in relation to an LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement.

### 10. Small Limited Liability Partnership [Section 2(1) (ta)]:

It means a limited liability partnership-

- (i) the contribution of which, does not exceed twenty-five lakh rupees or such higher amount, not exceeding five crore rupees, as may be prescribed; and
- (ii) the turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed; or
- (iii) which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed.

### ◆ Non-applicability of the Indian Partnership Act, 1932 (Section 4):

Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 shall not apply to an LLP.

### ◆ Partners (Section 5):

Any individual or body corporate may be a partner in an LLP. However, an individual shall not be capable of becoming a partner of a LLP, if-

- he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- he is an undischarged insolvent; or
- he has applied to be adjudicated as an insolvent and his application is pending.

### ◆ Minimum number of partners (Section 6):

- (i) Every LLP shall have at least two partners.
- (ii) If an LLP has only one partner for over six months, that partner becomes personally liable for the LLP's obligations during that period.

### Designated partners (Section 7):

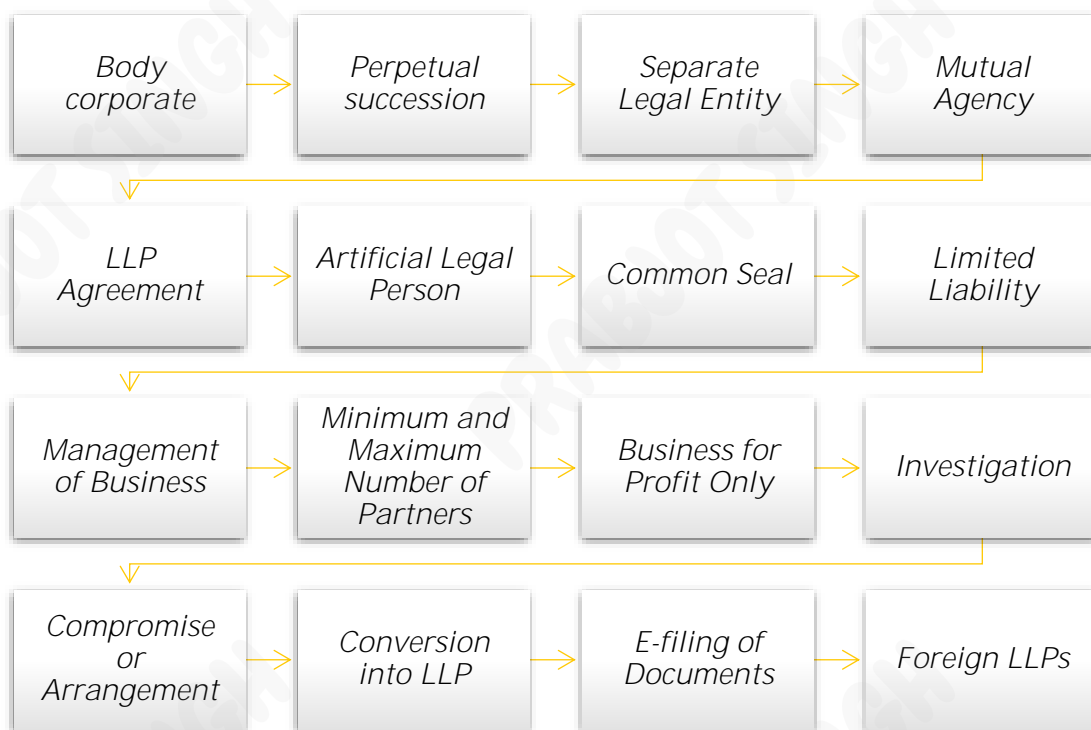
(i) Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

(ii) In an LLP with only body corporates or with both individuals and body corporates as partners, at least two individuals (partners or nominees) must be designated partners.

(iii) **Resident in India:** For the purposes of this section, the term resident in India means a person who has stayed in India for a period of not less than 120 days during the financial year.

*Example:* There is an LLP by the name Indian Helicopters LLP having 5 partners namely Mr. A (Non-resident), Mr. B (Non-Resident) Ms. C (resident), Ms. D (resident) and Ms. E (resident). In this case, at least 2 should be named as Designated Partner out of which 1 should be resident. Hence, if Mr. A and Mr. B are designated then it will not serve the purpose. One of the designated partners should be there out of Ms. C, Ms. D and Ms. E.

## CHARACTERISTICS OF LLP



### Body Corporate:

An LLP is a body corporate formed and incorporated under the LLP Act, 2008. This means it's a legal entity separate from its partners.

### Perpetual Succession:

An LLP enjoys perpetual succession, meaning its existence continues irrespective of changes in its partners. The death, insanity, retirement, or insolvency of a partner does not affect the LLP's existence, rights, or liabilities.

#### **Separate Legal Entity:**

An LLP is a separate legal entity distinct from its partners. It is liable to the full extent of its assets, while partners' liability is limited to their agreed contribution. Creditors of the LLP are creditors of the LLP alone.

#### **Mutual Agency:**

In an LLP, no partner is liable for the independent or unauthorized actions of other partners. Individual partners are shielded from joint liability arising from another partner's wrongful business decisions or misconduct. All partners act as agents of the LLP alone, not of other partners.

#### **LLP Agreement:**

The mutual rights and duties of partners, and between the LLP and its partners, are governed by a written agreement. The Act provides flexibility to partners to devise this agreement, but in its absence, the provisions of the LLP Act, 2008, apply.

#### **Artificial Legal Person:**

An LLP is an artificial legal person created by a legal process. It possesses all the rights of an individual, such as entering contracts and holding property, but cannot perform acts exclusive to natural persons (e.g., getting married, going to jail, practicing certain professions like CA or Medicine as a natural person). It is intangible and immortal (dissolved by law) but not fictitious.

#### **Common Seal:**

An LLP may have a common seal if it decides to, but it is not mandatory. If adopted, it must be kept in the custody of a responsible official and affixed in the presence of at least two designated partners.

#### **Limited Liability:**

The liability of each partner is limited to their agreed contribution to the LLP, which can be tangible or intangible.

#### **Example:**

The professionals like Engineering consultants, Legal Advisors and Accounting Professional are afraid of entering into business due to unlimited liability. Hence the LLP partnership Act provides an avenue for these professionals to Limited Liability Partnership firms which restricts their liability to the agreed amount. This has encouraged Professionals to form LLP.

#### **Management of Business:**

Partners are entitled to manage the LLP's business, but only designated partners are responsible for legal compliances.

#### **Minimum and Maximum Number of Partners:**

Every LLP must have at least two partners. There is no maximum limit on the number of partners.

**Business for Profit Only:**

An LLP must be formed for carrying on a lawful business with a view to earning profit. It cannot be formed for charitable or non-economic purposes.

**Investigation:**

The Central Government has powers to investigate the affairs of an LLP by appointing a competent authority.

**Compromise or Arrangement:**

Provisions for compromise, arrangement, merger, and amalgamation of LLPs exist under the LLP Act, 2008.

**Conversion into LLP:**

A firm, private company, or an unlisted public company can be converted into an LLP as per the Act.

**E-filing of Documents:**

All required forms, applications, or documents must be filed electronically in a computer-readable format on [www.mca.gov.in](http://www.mca.gov.in) and authenticated by a partner or designated partner using an electronic or digital signature.

**Foreign LLPs:**

A foreign LLP is one formed outside India that establishes a place of business within India. Foreign LLPs can become partners in an Indian LLP.

### Advantages of LLP form

- ✓ Is organized and operates on the basis of an agreement
- ✓ Provides flexibility without imposing detailed legal and procedural requirements
- ✓ Easy to form
- ✓ All partners enjoy limited liability
- ✓ Flexible capital structure
- ✓ Easy to dissolve

## INCORPORATION OF LLP

### Incorporation document (Section 11):

The most important document needed for registration is the incorporation document.

(1) For an LLP to be incorporated:

(a) Two or more persons must subscribe their names to an incorporation document to carry on a lawful business with the objective of earning profit.

(b) The incorporation document must be filed with the Registrar of the State where the LLP's registered office will be located, in the prescribed manner and with the prescribed fees.

**(c) Statement to be filed:**

- ✓ there shall be filed along with the incorporation document, a statement in the prescribed form,
- ✓ made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the LLP and
- ✓ by anyone who subscribed his name to the incorporation document,
- ✓ that all the requirements of this Act and the rules made thereunder have been complied with,
- ✓ in respect of incorporation and matters precedent and incidental thereto.

*(2) The incorporation document shall—*

- (a) be in a form as may be prescribed;
- (b) state the name of the LLP;
- (c) state the proposed business of the LLP;
- (d) state the address of the registered office of the LLP;
- (e) state the name and address of each of the persons who are to be partners of the LLP on incorporation;
- (f) state the name and address of the persons who are to be designated partners of the LLP on incorporation;
- (g) contain such other information concerning the proposed LLP as may be prescribed.

*(3) If a person makes a statement as discussed above which he—*

- (a) knows to be false; or
- (b) does not believe to be true, shall be punishable
  - ✓ with imprisonment for a term which may extend to 2 years and
  - ✓ with fine which shall not be less than 10,000 but which may extend to 5 Lakhs.

**◆ Incorporation by registration (Section 12):**

(1) Once the requirements of clauses (b) and (c) of Section 11(1) are met, and clause (a) is not violated, the Registrar shall retain the incorporation document and, within 14 days, proceed accordingly.

- (a) register the incorporation document; and
- (b) give a certificate that the LLP is incorporated by the name specified therein.

(2) The Registrar may treat the statement filed under Section 11(1)(c) as sufficient proof of compliance with Section 11(1)(a).

(3) The certificate under Section 11(1)(b) shall be signed by the Registrar and sealed with his official seal.

(4) The certificate shall be conclusive evidence that the LLP is incorporated by the name specified therein.

### Registered office of LLP and change therein (Section 13):

(1) Every LLP must maintain a registered office for receiving all communications and notices.

(2) A document may be served on an LLP, partner, or designated partner by post or any prescribed manner at the registered office or declared address.

(3) An LLP may change its registered office by filing notice with the Registrar in the prescribed form and manner, and the change is effective only after such filing.

(4) For contravention, the LLP and each partner are liable to a penalty of ₹500 per day, up to ₹50,000 each.

### Effect of registration (Section 14):

*On registration a LLP shall, by its name, be capable of*

*Suing and being sued;*

*acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;*

*having a common seal, if it decides to have one; and*

*doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.*

### Name of LLP (Section 15)

1. Every LLP must end with “limited liability partnership” or “LLP”.

2. **Name cannot be registered if, in opinion of Central Government, it is:**

a) Undesirable, or

b) Identical / too nearly resembles another LLP, company, or registered trademark (under Trade Marks Act, 1999).

### Reservation of Name (Section 16)

1. **Application (with prescribed fee) can be made to Registrar for reserving:**

- ✓ Name of a proposed LLP, or
- ✓ Name to which an LLP proposes to change.

2. Registrar may reserve name for 3 months from date of intimation if it does not fall under rejection grounds of Section 15(2).

## Change of Name of LLP (Section 17)

### When required to change name

If LLP is registered with a name identical/too similar to:

- (a) another LLP or company, or
- (b) registered trade mark (likely to cause confusion).
- ✓ On application by affected LLP/company/trade mark proprietor, Central Govt. may direct LLP to change name within 3 months.
- ✓ Trade mark proprietor's application valid within 3 years of incorporation / registration / change of name.

### Procedure for change

- ✓ LLP must, within 15 days of change, give notice to Registrar along with Central Government's order.
- ✓ Registrar to make changes in Certificate of Incorporation.
- ✓ LLP must also change its name in the LLP Agreement within 30 days.

### Default in Complying [Sec. 17(3)]

- ✓ If LLP fails to comply, **Central Government will allot a new name.**
- ✓ Registrar will substitute the new name in the Register and issue a fresh Certificate of Incorporation.
- ✓ LLP shall use this new name thereafter.
- ✓ This does not prevent the LLP from later changing its name under Section 16.

## DIFFERENCES WITH OTHER FORMS OF ORGANISATION

*Distinction between LLP and Partnership Firm: The points of distinction between a limited liability partnership and partnership firm are tabulated as follows:*

Basis	LLP	Partnership firm
1. Regulating Act	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
2. Body corporate	It is a body corporate.	It is not a body corporate.
3. Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4. Creation	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.
5. Registration	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary. Only the registered partnership firm can sue the third parties.

6. Perpetual succession	The death, insanity, retirement or insolvency of the partner(s) does not affect its existence of LLP. Partners may join or leave but its existence continues forever.	The death, insanity, retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7. Name	Name of the LLP to contain the word Limited Liability Partnership (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8. Liability	Liability of each partner is limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended up to the personal assets of the partners.
9. Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10. Designated partners	At least two designated partners and at least one of them shall be resident in India.	There is no provision for such partners under the Partnership Act, 1932.
11. Common seal	It may have its common seal as its official signatures.	There is no such concept in partnership.
12. Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13. Annual filing of documents	LLP is required to file: (i) Annual statement of accounts (ii) Statement of solvency (iii) Annual return with the registration of LLP every year.	Partnership firm is not required to file any annual document with the registrar of firms.
14. Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
15. Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

### ◆ Distinction between LLP and Limited Liability Company

Basis	LLP	Limited Liability Company
1. Regulating Act	The LLP Act, 2008.	The Companies Act, 2013.
2. Members/Partners	The persons who contribute to LLP are known as partners of the LLP.	The persons who invest the money in the shares are known as members of the company.

3. Internal governance structure	The internal governance structure of a LLP is governed by contract agreement between the partners.	The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).
4. Name	Name of the LLP to contain the word “Limited Liability partnership” or “LLP” as suffix.	Name of the public company to contain the word “limited” and Pvt. Co. to contain the word “Private limited” as suffix.
5. No. of members/partners	Minimum – 2 partners Maximum – No such limit on the partners in the Act. The partners of the LLP can be individuals/or body corporate through the nominees.	<b>Private company:</b> Minimum – 2 members Maximum 200 members <b>public company:</b> Minimum – 7 members Maximum – No such limit on the members. Members can be organizations, trusts, another business form or individual.
6. Liability of members/partners	Liability of a partners is limited to the extent of agreed contribution except in case of willful fraud.	Liability of a member is limited to the amount unpaid on the shares held by them.
7. Management	The business of the company is managed by the partners including the designated partners authorized in the agreement.	The affairs of the company are managed by board of directors elected by the shareholders.
8. Minimum number of directors/designated partners	Minimum 2 designated partners.	Pvt. Co. – 2 directors Public co. – 3 directors

# Chapter 6

## The Companies Act 2013

### INTRODUCTION

*The Companies Act, 2013, was enacted to consolidate and amend the law relating to companies, replacing the Companies Act, 1956. This new legislation aims to improve corporate governance, simplify regulations, strengthen minority investor interests, and introduce provisions for whistle-blowers and class action suits. It contains 470 sections and seven schedules, divided into 29 chapters, with a substantial part in the form of Companies Rules.*

#### ◆ Applicability of the Companies Act, 2013:

The provisions of the Act shall apply to-

Companies incorporated under this Act or under any previous company law.

Insurance companies (except where the provisions of the said Act are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999)

Banking companies (except where the provisions of the said Act are inconsistent with the provisions of the Banking Regulation Act, 1949)

Companies engaged in the generation or supply of electricity (except where the provisions of the above Act are inconsistent with the provisions of the Electricity Act, 2003)

Any other company governed by any special Act for the time being in force.

Such body corporate which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.

### COMPANY: MEANING AND ITS FEATURES

A company is an artificial legal person created by law, having a separate entity, perpetual succession, and a common seal.

**Chief Justice Marshall:**

A corporation is an artificial being, invisible and intangible, existing only in law, with powers conferred by its charter.

**Professor Haney:**

A company is an incorporated association, an artificial person with separate entity, perpetual succession, and common seal.

*Companies Act, 2013 (Sec. 2(20)):*

*A company means a company incorporated under this Act or any previous company law.*

### Key Features of a Company:

#### 1. Separate Legal Entity

- Legally separate from the members

#### 2. Perpetual succession

- Change in members does not affect existence of Company

#### 3. Limited Liability

- Liability of Company is different from liability of members

#### 4. Artificial Juridical Person

- Company can act through human agency only
- Company can contract, sue and be sued in its own name

### I. Separate Legal Entity:

The distinctive feature of a company is its status as a separate legal entity. Once registered, it acquires a legal personality independent of its members, enabling it to own property, open bank accounts, raise loans, incur liabilities, and enter into contracts.

a. A company has a legal personality separate from its members.

b. Members can contract with the company, but only creditors can sue it for its debts, not the members.

A company owns and controls its property in its own name. Shareholders contribute capital but are not owners of the company's property.

**CASE LAW: *Macaura Vs. Northern Assurance Co. Limited (1925)***

*Fact: Macaura (M) was the holder of nearly all (except one) shares of a timber company. He was also a major creditor of the company. M insured the company's timber in his own name. The timber was lost in a fire. M claimed insurance compensation. Held, the insurance company was not liable to him as no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest in them. Hence in this case, since the timber was not insured in the company's name, M could not claim the compensation from insurance company.*



**Mr. Bonkers:** Since I own all the shares of *Silly Hats Inc.*, these hats are basically mine. I'll use them for my party!

(A pigeon ruins one hat.)



**Mr. Bonkers:** No worries, I'll claim it under my home insurance.

**Insurer:** Sorry, Mr. Bonkers. That hat belongs to *Silly Hats Inc.*, not you. The company is a separate legal entity. Your personal insurance can't cover it.

## II. Perpetual Succession:

A company has perpetual succession — its existence is unaffected by the death, insolvency, or change of members. It continues until wound up by law.

**Example:** Many companies in India are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence. There was a company which has 7 members and all of them died in an aircraft. Despite this the company still exists unlike partnership form of business.

## III. Limited Liability:

A member's liability depends on the type of company, since a company is a separate legal entity distinct from its members.

(i) In a limited liability company, members' liability is restricted to the unpaid value of their shares; company debts are not shareholders' personal debts.

(ii) In a company limited by guarantee, members are liable only up to the guaranteed amount, and only if the company is liquidated.

(iii) In an unlimited company, members' liability is unlimited.



(Ferris wheel crashes, debts arise.)

**Creditor:** You only owe the unpaid ₹50 per share.

**Creditor:** Exactly—that's limited liability.

**Friend:** So, our personal property is safe?

**Friend:** We invested ₹100 per share, with ₹50 unpaid.

#### IV. Artificial Legal Person:

A company is an artificial person created by law, not by natural birth, and is clothed with the rights of an individual.

As a separate legal entity, it can own property, open bank accounts, raise loans, incur liabilities, enter into contracts, and sue or be sued in its own name. However, it cannot perform acts like marrying, taking an oath, or being jailed.

Since it is artificial, a company acts only through directors, who manage its affairs as its agents, but not as agents of the members.

Thus, a company is regarded as an artificial legal person.

#### V. Common Seal:

A company, being an artificial person, acts through humans. Its common seal serves as the official signature and symbol of incorporation, affixed on company documents.

The Companies (Amendment) Act, 2015 made the use of a common seal optional by removing the words “and a common seal” from Section 9. This change was introduced because the seal was considered outdated, and even the U.K. had made it optional since 2006.

Now, documents requiring authentication need the seal only if a company chooses to have one. If not, they can be signed by two directors or by one director and the Company Secretary (where appointed).

**Ms. Mehra:** Then let's stop using it and just sign documents ourselves.



**Mr. Singh:** Our big common seal is majestic, but the law made it optional.

**Mr. Singh:** Deal! Let's see who signs faster.

## CORPORATE VEIL THEORY

### (i) Corporate Veil

The corporate veil refers to the legal concept that a company is treated as a separate entity from its members. It shields shareholders from the liabilities of the company, ensuring that they are not personally responsible for the company's debts or legal wrongs. In this way, shareholders enjoy protection, known as corporate insulation, from the acts of the company.

**CASE LAW: *Salomon Vs. Salomon and Co Ltd.***

*Facts: In Salomon vs. Salomon & Co. Ltd. the House of Lords laid down that a company is a person distinct and separate from its members. In this case one Salomon incorporated a company named “Salomon & Co. Ltd.”, with seven subscribers consisting of himself, his wife, four sons and one daughter. This company took over the personal business assets of Salomon for £ 38,782 and in turn, Salomon took 20,000 shares of £ 1 each, debentures worth £ 10,000 of the company with charge on the company’s assets and the balance in cash. His wife, daughter and four sons took up one £ 1 share each. Subsequently, the company went into liquidation due to general trade depression. The unsecured creditors to the tune of £ 7,000 contended that Salomon could not be treated as a secured creditor of the company, in respect of the debentures held by him, as he was the managing director of one-man company, which was not different from Salomon and the cloak of the company was a mere sham and fraud.*

*It was held by Lord Mac Naughten: “The Company is at law a different person altogether from the subscribers to the memorandum, and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustees for them. Nor are the subscribers, as members, liable, in any shape or form, except to the extent and in the manner provided by the Act.” Thus, this case clearly established that company has its own existence and as a result, a shareholder cannot be held liable for the acts of the company even though he holds virtually the entire share capital. The whole law of corporation is in fact based on this theory of separate corporate entity.*

*Now, the question may arise whether this Veil of Corporate Personality can even be lifted or pierced.*

*“Lifting the veil” means disregarding the company’s separate legal personality to look at the real individuals behind it. It occurs when courts ignore the corporate entity and deal directly with its members or managers. Courts lift the corporate veil only in appropriate cases—mainly where issues of control, not just ownership, are involved.*

### ◆(ii) Lifting of Corporate Veil

*Lifting of Corporate Veil means situations where company law disregards the principle of separate legal personality and looks beyond the company to its real controllers or members.*

**1. To determine the character of the company i.e. to find out whether co-enemy or friend:**

*Courts may lift the corporate veil to determine the true character of a company in cases of trading with the enemy.*

*As held in CASE LAW: *Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.*, although a company has no mind or conscience to be a friend or foe, it may still be treated as an enemy if its control and management rest in the hands of persons belonging to an enemy country.*

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## 2. To protect revenue/tax:

In tax, duty, and stamp matters, courts may lift the veil to examine controlling interest, as in CASE LAW: *S. Berendsen Ltd. vs. Commissioner of Inland Revenue*.

1. Where a company is used to evade or avoid tax, courts may disregard its separate entity.

CASE LAW: [*Juggilal vs. Commissioner of Income Tax*]

2. In *Dinshaw Maneckjee Petit*, companies formed only to divert dividend and interest income back to the assessee were held sham; the veil was lifted and the assessee was treated as the real owner.

## 3. To avoid a legal obligation:

Courts may lift the veil where a company is created only to evade statutory duties.

CASE LAW: *The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar vs. The Associated Rubber Industries Ltd., Bhavnagar and another*:

- ✓ The parent company invested in another company and showed dividend income in its accounts, which was considered for bonus calculation.
- ✓ Later, it transferred these shares to a wholly owned subsidiary so that the dividend income no longer appeared in its accounts, reducing surplus for bonus payment.
- ✓ The subsidiary had no independent assets or business; it existed only to reduce bonus liability.
- ✓ The Supreme Court disregarded its separate existence and treated it as a mere device to avoid paying full bonus to workers.

## 4. Formation of subsidiaries to act as agents

- ✓ A company may lose its individuality if it acts as an agent or trustee of another.

CASE LAW: *In Merchandise Transport Ltd. vs. British Transport Commission (1982)*,

Fact: In the case of *Merchandise Transport Limited vs. British Transport Commission (1982)*, a transport company wanted to obtain licences for its vehicles but could not do so if applied in its own name. It, therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the parent and the subsidiary were one commercial unit and the application for licences was rejected.

- ✓ Court held parent and subsidiary were one commercial unit, so the licence application was rejected.

### 5. Company formed for fraud / improper conduct / to defeat law

- ✓ If incorporation is used to defeat law, defraud creditors, or for improper purpose, the veil will be lifted.
- ✓ CASE LAW: *Gilford Motor Co. vs. Horne* is a leading case.

#### Corporate veil will be lifted

Trading with enemy

Evasion of tax

Subsidiary acting as agent

Avoidance of legal obligation

Fraud or improper purpose

## CLASSES OF COMPANIES UNDER THE ACT

The growth of business complexities has led to different forms of corporate organizations. Under the Companies Act, 2013, companies may be incorporated as a one-person, private, or public company. They may be unlimited or limited by shares, guarantee, or both. Based on control, they can be associate, holding, or subsidiary companies. Other types include foreign, government, small, dormant, nidhi, and charitable companies.

### 1. On the basis of liability

#### (a) Company limited by shares

Defined under Section 2(22) of the Companies Act, 2013. Liability of members is restricted to the unpaid amount on their shares. Shareholders are not co-owners of the company's assets, and their personal property cannot be used to pay company debts.

#### (b) Company limited by guarantee

Defined under Section 2(21). Liability of members is limited to the amount they agree to contribute in the memorandum, enforceable only at the time of winding up. Such companies do not raise working funds from members and are often used for non-profit purposes (e.g., endowments, fees, donations).

CASE LAW: *Narendra Kumar Agarwal vs. Saroj Maloo*,

Fact: The Supreme Court has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

**(c) Unlimited company**

Defined under Section 2(92). Members have unlimited liability for company debts but can claim contribution from other members. Liability ends when membership ceases. If the company has share capital, liability on shares is enforceable while it is a going concern, but during winding up, members can be called to contribute without limit.

**Unlimited Co.**

No limit on the liability of members

The liability ceases on when he ceases to be member

Liability is not unlimited till the time Company is not wound up.

Liability of each member extends to amount of Company's debt and liabilities.

Member can be called to contribute only in the event of winding up of Company

However, he can claim contribution from other members.

**2. On the basis of Members:**

**(a) One Person Company (OPC):**

As per Section 2(62) of the Companies Act, 2013, an OPC is a company having only one person as a member. It was introduced to promote entrepreneurship and corporatization. Unlike a sole proprietorship, OPC is a separate legal entity with limited liability of the member, while in proprietorship the owner's liability extends to personal assets.

The Act provides simplified procedural requirements and, under Section 3(1)(c), an OPC is treated as a private limited company with prescribed minimum paid-up capital and one member.

OPC (One Person Company) - significant points

Only one person as member.

Minimum paid up capital – no limit prescribed.

The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.

The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation of the company along with its memorandum and e-articles.

Such other person may be given the right to withdraw his consent.

The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar.

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Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

**Only a natural person who is an Indian citizen whether resident in India or otherwise-**

- ✓ shall be eligible to incorporate a One Person Company;
- ✓ shall be a nominee for the sole member of a One Person Company.

**Explanation 1** - For the purposes of this rule, the term “resident in India” means a person who has stayed in India for a period of not less than one hundred and twenty days during the immediately preceding financial year.

No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.

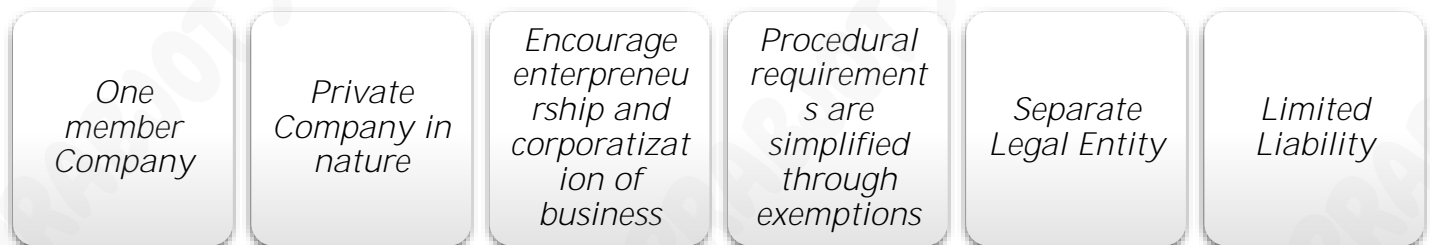
No minor shall become member or nominee of the OPC or can hold share with beneficial interest.

Such Company cannot be incorporated or converted into a company under section 8 of the Act. Though it may be converted to private or public companies in certain cases.

Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporate.

Here the member can be the sole member and director.

### OPC



#### (b) Private Company [Section 2(68)]:

“Private company” means a company having a minimum paid-up share capital as may be prescribed, and which by its articles, —

**Restricts share transfer** – A private company limits the right of members to transfer shares.

**Limits membership** – Maximum 200 members (except OPC). Joint holders are counted as one member.

- a. Persons in the employment of the company are not included in the member limit.
- b. Ex-employees who became members during employment and continued after are also excluded from the member limit.

**No Public Invitation:** The company is prohibited from inviting the public to subscribe for its securities.

Private company - significant points

No minimum paid-up capital requirement.
Minimum number of members – 2 (except if private company is an OPC, where it will be 1). Maximum number of members – 200, excluding present employee-cum-members and erstwhile employee-cum-members.
Right to transfer shares restricted.
Prohibition on invitation to subscribe to securities of the company.
Small company is a private company.
OPC can be formed only as a private company.

**Small Company [Sec. 2(85)]:**

A company (other than a public company) with—

- |  |
|--|
| (i) <b>paid-up share capital</b> up to ₹50 lakh (extendable to ₹10 crore), and |
| (ii) <b>turnover</b> up to ₹2 crore (extendable to ₹100 crore).                |

✚ Exceptions:

This clause shall not apply to:

- |   |
|---|
| 1. a holding company or a subsidiary company;               |
| 2. a company registered under section 8; or                 |
| 3. a company or body corporate governed by any special Act. |

For the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed rupees four crores and rupees forty crores respectively. [Companies (Specification of definition details) Amendment Rules, 2022, w.e.f. 15th September, 2022]

Small Company -significant points

A private company
Paid up capital - not more than ₹ 4 crores and
Turnover - not more than ₹ 40 crores.
Should not be - Section 8 company - Holding or a Subsidiary company

**Public company [Section 2(71)]:**

“Public company” means a company which—

- |                                   |
|-----------------------------------|
| (i) is not a private company; and |
|-----------------------------------|

(ii) has a minimum paid-up share capital, as may be prescribed:

If a company is a subsidiary of a non-private company, it will be treated as a public company for the purposes of the Act, even if its articles continue to describe it as a private company.

### Public company - significant points

Is not a private company (Articles do not have the restricting clauses).

Shares freely transferable.

No minimum paid up capital requirement.

Minimum number of members – 7.

Maximum numbers of members – No limit.

Subsidiary of a public company is deemed to be a public company.

Sec. 3(1)(a): A public company may be formed by seven or more persons for any lawful purpose

### 3. On the basis of Control:

(a) Holding and Subsidiary Companies [Sec. 2(46) & 2(87):

Holding Company: A company of which one or more companies are its subsidiaries; includes anybody corporate.

Subsidiary Company: A company in which the holding company—

(i) controls the composition of the Board of Directors, or

(ii) exercises/controls >50% of total voting power (alone or with subsidiaries).

### Key Points:

Even indirect control through another subsidiary makes a company a subsidiary.

Board is deemed controlled if another company can appoint/remove all or majority of directors.

“Company” includes anybody corporate.

“Layer” means subsidiary/subsidiaries; certain classes of holding companies cannot have layers beyond prescribed limit.

*Example:* A will be subsidiary of B, if B controls the composition of the Board of Directors of A, i.e., if B can, without the consent or approval of any other person, appoint or remove a majority of directors of A.

*Example:* A will be subsidiary of B, if B holds more than 50% of the share capital of A.

*Example:* B is a subsidiary of A and C is a subsidiary of B. In such a case, C will be the subsidiary of A. In the like manner, if D is a subsidiary of C, D will be subsidiary of B as well as of A and so on.

**Status of Private Company (Subsidiary of Public) [Sec. 2(71)]:**

A private company that is a subsidiary of a public company shall be deemed to be a public company under the Act, even if its articles continue to state it as a private company.

**(b) Associate Company [Sec. 2(6)]:**

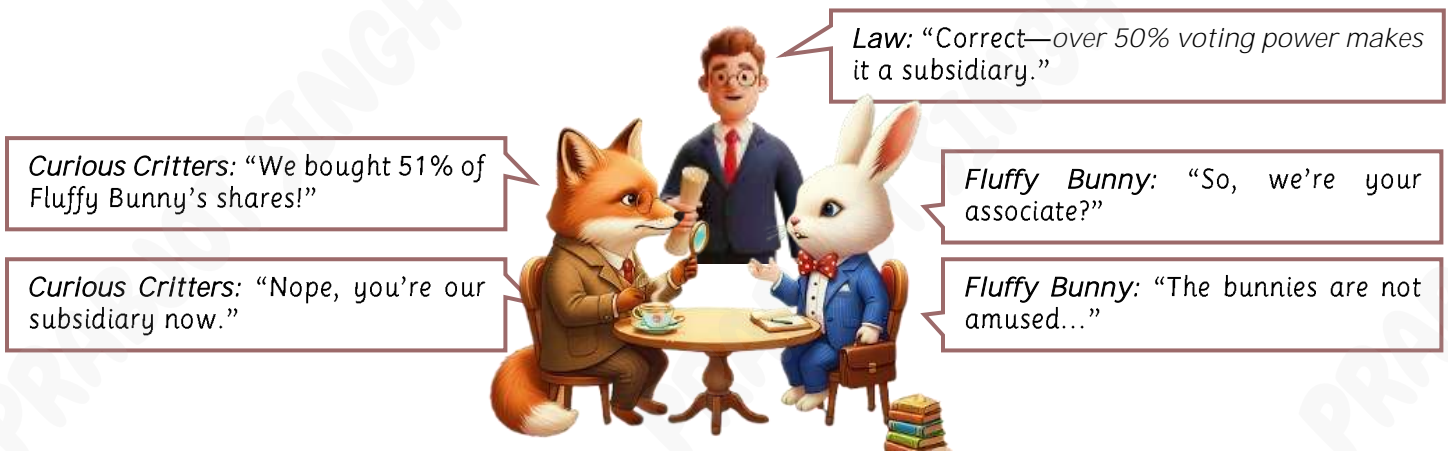
In relation to another company, it means a company in which that other company has significant influence, but which is not a subsidiary. It includes a joint venture company.

**Significant influence:**

Control of at least 20% of total voting power, or control/participation in business decisions under an agreement.

**Joint venture:**

A joint arrangement where parties having joint control share rights to the net assets of the arrangement.



**4. On the Basis of Access to Capital:**

**(a) Listed Company [Sec. 2(52)]:**

A company is called a listed company if any of its securities are listed on a recognized stock exchange.

However, certain classes of companies, which have listed or intend to list specific securities (as may be prescribed in consultation with SEBI), are not regarded as listed companies. The term "securities" here carries the same meaning as defined under Sec. 2(h) of the Securities Contracts (Regulation) Act, 1956.

*Example:* Scan Steel Rods Limited is a Public Limited Company whose shares are listed in the Stock Exchange, Kolkata. Hence Scan Steel Rods Limited is a Listed Company. The reason for calling it “Listed” is because the company and the Stock Exchange have signed a Listing Agreement for trading of shares in the capital market.

**(b) Unlisted Company:**

Any company which is not a listed company.

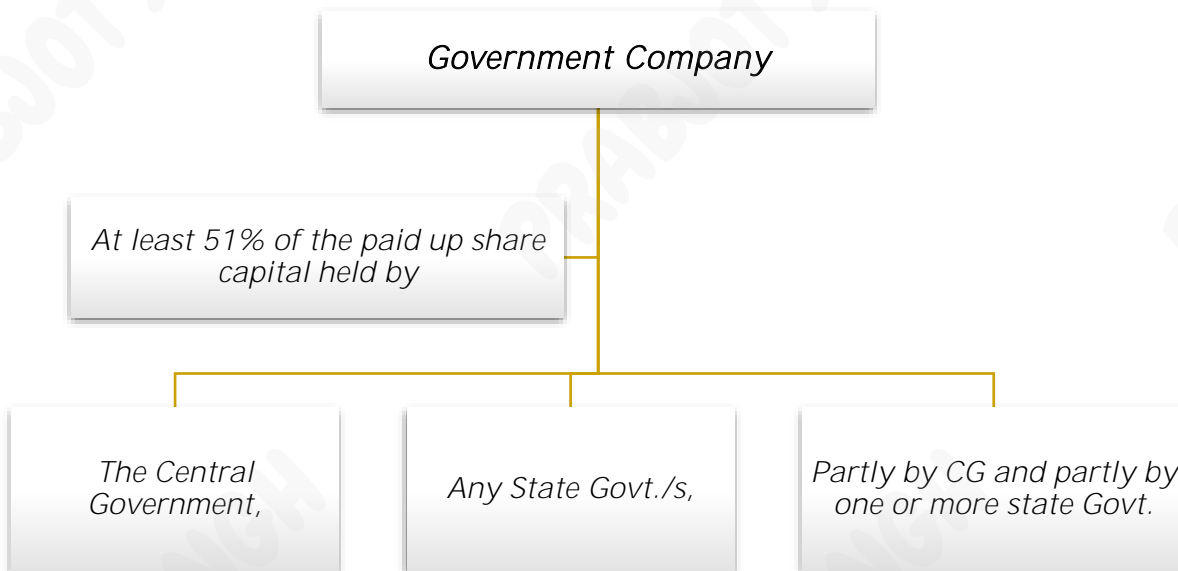
5. Other companies:

**(a) Government company [Section 2(45)]:**

Government Company means any company in which not less than 51% of the paid-up share capital is held by-

- (i) the Central Government, or
- (ii) by any State Government or Governments, or
- (iii) A Government company includes one owned partly by the Central Government and partly by one or more State Governments, and also its subsidiary companies.

Explanation: For this clause, “paid-up share capital” means “total voting power” in case of shares with differential voting rights.



**(b) Foreign Company [Sec. 2(42)]:**

A company/body corporate incorporated outside India that—

- (i) has a place of business in India (by itself/agent, physical/electronic), and
- (ii) conducts any business activity in India.

*(c) Formation of companies with charitable objects etc. (Section 8 company):*

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.

Such company intends to apply its profit in

promoting its objects and

prohibiting the payment of any dividend to its members.

**Examples** of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

*Power of Central Government to Issue License [Sec. 8]:*

(i) Central Government may grant a license to register a person/association as a company with limited liability, without adding "Ltd." or "Pvt. Ltd." to its name, subject to conditions.

(ii) Registrar shall register such person/association as a company on application.

(iii) Such company enjoys same privileges and obligations as a limited company.

*Revocation of License [Sec. 8]:*

The Central Government may revoke a company's licence if it violates conditions, acts fraudulently, beyond its objects, or against public interest. On revocation, the Registrar adds

"Limited/Private Limited" to its name, but the company must first get notice and a chance to be heard.

*Order of Central Government [Sec. 8]:*

On revocation of licence, the Central Government may, in public interest, order the company to be amalgamated with another Sec. 8 company having similar objects with specified rights and obligations, or direct the company to be wound up

*Penalty for Contravention [Sec. 8]:*

If a company defaults in complying with this section, it is punishable with a fine ₹10 lakh–₹1 crore, and every director/officer in default is punishable with a fine ₹25,000–₹25 lakh.

If the company's affairs are proved fraudulent, every officer in default is liable under Sec. 447.

### Section 8 Company- Significant points

Formed for the promotion of commerce, art, science, religion, charity, protection of environment, sports, etc.

Requirement of minimum share capital does not apply.

Uses its profits for the promotion of the objective for which it is formed.

Does not declare dividend to members.

Operates under a special licence from Central Government.

Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.

Licence revoked if conditions contravened.

On revocation, Central Government may direct it to – Converts its status and change its name – Wind – up – Amalgamate with another company having similar object.

Can call its general meeting by giving a clear 14 days' notice instead of 21 days.

Requirement of minimum number of directors, independent directors etc. does not apply.

Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.

A partnership firm can be a member of Section 8 company

#### Formation

- To promote Charitable objects

#### Application of profits

- To promote its objects
- No payment of dividends out of profits

#### Type of Co.

- Limited Liability
- Without the addition of words "Ltd" or "Pvt Ltd."

#### How status is granted

- The CG can grant such status
- However, CG has delegated the power to grant licence to ROC

#### Revocation of licence

- CG may revoke licence
- If conditions of section 8 are contravened, or
- affairs of the company are conducted fraudulently, or prejudicial to public interest

#### Effect of revocation of licence

- Co has to use words "Ltd." or "Pvt Ltd."

**(d) Dormant Company [Sec. 455]:**

A company formed for a future project or to hold assets/IP, having no significant accounting transaction, may apply to the Registrar for status of a dormant company.

*Inactive company:* A company that has neither carried on business/operations nor made significant transactions, or failed to file financial statements and annual returns for the last two financial years.

**“Significant accounting transaction”**

- (i) payment of fees by a company to the Registrar;
- (ii) payments made by it to fulfil the requirements of this Act or any other law;
- (iii) allotment of shares to fulfil the requirements of this Act; and
- (iv) payments for maintenance of its office and records.

**Jay:** Ever heard of Sleeping Dragon Tech Solutions Pvt. Ltd.?

**Manish:** No, what’s that?

**Jay:** It was set up to make an anti-gravity coffee maker, but for two years it only paid fees and kept an empty office.

**Manish:** More “sleeping” than “dragon.”

**Jay:** True—so they applied for dormant status until the floating coffee market is ready



**(e) Meaning of Nidhi Companies [Section 406(1) of the Companies Act, 2013]:**

A Nidhi or Mutual Benefit Society is a company which the Central Government, through notification in the Official Gazette, declares as such. These companies are primarily formed to encourage thrift, savings, and mutual financial support among their members.

**(f) Public Financial Institutions (PFI):**

By virtue of Section 2(72) of the Companies Act, 2013, certain specified institutions are deemed to be public financial institutions.

- (i) Life Insurance Corporation of India, formed under the LIC Act, 1956.
- (ii) the Infrastructure Development Finance Company Limited,
- (iii) Specified company under the UTI (Transfer of Undertaking and Repeal) Act, 2002.
- (iv) Institutions notified by the Central Government under Sec. 4A (2) of the repealed Companies Act, 1956.
- (v) Any other institution notified by the Central Government in consultation with RBI.

*Conditions for an institution to be notified as PFI:*

No institution shall be so notified unless—

- (A) Established or constituted under any Central or State Act, other than this Act or the previous Companies Law.
- (B) At least 51% of paid-up share capital is held or controlled by the Central and/or State Government(s).

## MODE OF REGISTRATION/INCORPORATION OF COMPANY

### ◆ Promoters:

The Companies Act, 2013 defines the term “Promoter” under section 2(69) which means a person—

- (a) Named as such in a prospectus or identified in the company’s annual return under Sec. 92.
- (b) One who controls the company’s affairs, directly or indirectly, as a shareholder, director, or otherwise.
- (c) A person whose advice or instructions the Board of Directors is accustomed to follow.

In simple terms we can say,

Persons who form the company are known as promoters.

It is they who conceive the idea of forming the company.

They take all necessary steps for its registration.

It should, however, be noted that persons acting only in a professional capacity e.g., the solicitor, banker, accountant etc. are not regarded as promoters.

### ◆ Formation of Company:

Section 3 of the Companies Act, 2013 provides that a public company may be formed by seven or more persons for any lawful purpose, by subscribing their names to the memorandum and complying with all requirements of the Act relating to registration.

In the same way, 2 or more persons can form a private company and one person can form one person company

**Public Co.**

- 7 or more persons

**Private Co.**

- 2 or more persons

**One Person Co.**

- One person

## ◆ Incorporation Of Company:

Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

### (1) Filing of the documents and information with the registrar:

For company registration, required documents and information must be filed with the Registrar of the jurisdiction where the registered office is proposed.

Duly signed memorandum and articles by all subscribers.

A declaration by a professional (advocate, CA, cost accountant, or CS) and a proposed director/manager/secretary confirming compliance with all registration requirements.

A declaration from each subscriber and first directors (if any) named in the articles stating that—

- ✓ He has not been convicted of any offence related to promotion, formation, or management of a company, or
- ✓ He has not been found guilty of fraud, misfeasance, or breach of duty to any company under this Act or previous company law in the last five years.
- ✓ And that all documents filed with the Registrar for company registration are true, complete, and correct to the best of his knowledge and belief.

Address for correspondence till registered office is set up.

Particulars of each subscriber (name, surname, address, nationality, proof of identity) and, if a body corporate, prescribed details.

Particulars of persons in the articles as subscribers, including name, surname, DIN, address, nationality, proof of identity, and other prescribed details.

Particulars of first directors' interests in other firms/companies along with their consent to act as directors, in the prescribed form and manner.

Particulars required are of the individual subscriber, not of the professional involved in incorporation [Companies (Incorporation) Rules, 2014].

### (2) Issue of certificate of incorporation on registration:

The Registrar, after examining and registering all filed documents and information, issues a certificate of incorporation in the prescribed form, confirming that the proposed company stands incorporated under the Act.

### (3) Allotment of Corporate Identity Number (CIN):

From the date of incorporation, the Registrar allots a unique Corporate Identity Number (CIN) to the company, which is also mentioned in the certificate.

#### (4) Maintenance of copies of all documents and information:

The company must keep copies of all originally filed documents and information at its registered office until dissolution under the Act.

#### (5) Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. at the time of Incorporation):

Anyone giving false details or hiding material information in documents filed for company registration is liable for fraud under Section 447.

#### (6) Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation):

If it is proved after incorporation that the company was formed by false information, misrepresentation, suppression of facts, or any fraudulent act, then the promoters, first directors, and persons making the declaration shall each be held liable for fraud under Section 447.

#### (7) Order of the Tribunal:

If a company is incorporated through false information, misrepresentation, suppression of facts, or fraud, the Tribunal may, on application and being satisfied, take appropriate action.

(a) The Tribunal may regulate the company's management, including altering its memorandum or articles, in public or stakeholder interest.

(b) direct that liability of the members shall be unlimited; or

(c) direct removal of the name of the company from the register of companies; or

(d) pass an order for the winding up of the company; or

(e) pass such other orders as it may deem fit:

Provided that before making any order, —

- ✓ The company must be given a reasonable opportunity to be heard in the matter.
- ✓ The Tribunal shall consider the company's transactions, obligations, and liabilities while making its decision.

#### Simplified Proforma for Incorporating Company Electronically (SPICE)

To promote ease of doing business, the MCA introduced SPICE, a simplified electronic proforma that streamlines the process of filing forms for company incorporation.

#### Effect of Registration (Section 9):

From the date of incorporation, subscribers and future members become a body corporate with the name in the memorandum.

The registered company can exercise all functions of an incorporated company, has perpetual succession, and can acquire, hold, and dispose of property (movable/immovable, tangible/intangible), contract, and sue/be sued in its name.

Registration creates a separate legal person binding the company and its members by the MOA and AOA.

The Certificate of Incorporation is conclusive evidence of compliance with legal formalities.

**CASE LAW: *Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala.***

*Fact: From the date of incorporation, a company becomes a separate legal entity distinct from its members. It has perpetual existence until it is dissolved. A shareholder does not hold any direct interest in the company's property, though in certain cases, a writ petition may be maintainable by the company or its shareholders.*

**CASE LAW: *State Trading Corporation of India vs. Commercial Tax Officer.***

*Fact: A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the legal person begins to function as an entity. A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members.*

**CASE LAW: *Spencer & Co. Ltd. Madras vs. CWT Madras.***

*Fact: It may be noted that under the provisions of the Act, a company may purchase shares of another company and thus become a controlling company. However, merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company and each company is a separate juristic entity.*

**CASE LAW: *Heavy Electrical Union vs. State of Bihar.***

*Fact: As has been stated above, the law recognizes such a company as a juristic person separate and distinct from its members. The mere fact that the entire share capital has been contributed by the Central Government and all its shares are held by the President of India and other officers of the Central Government does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government.*

#### Effect Of Memorandum and Articles:

As per Section 10, once registered, the Memorandum and Articles bind the company and its members as if signed by each, creating an agreement to follow their provisions. Any money payable by a member under them is a debt due to the company.

*Founders: relaxing on their couches*  
 "So... what if our next game is about a llama running for president?"



*Pixel Perfect Games Inc.: signs contracts for office space and hires game developers*

*Founders: "We're a real company now!"*

## CLASSIFICATION OF CAPITAL

Capital has different meanings for economists, accountants, businessmen, and lawyers. In a company limited by shares, it means share capital the money contributed by members to the common stock, divided into fixed-value shares. A share is not just money but an interest in the company, representing rights and obligations defined by contract.

### Types Of Capital:

#### (a) Nominal or Authorised or Registered Capital (Section 2(8))

The maximum amount of share capital authorised by the memorandum for the company to raise by issuing shares. Stated in the memorandum, and stamp duty is paid on this amount.

#### (b) Issued Capital (Section 2(50))

That part of authorised capital which the company offers for subscription from time to time, including shares allotted for non-cash consideration. Must be disclosed in the balance sheet (Schedule III).

#### (c) Subscribed Capital (Section 2(86)):

That part of the capital which is for the time being subscribed by the members. The nominal number of shares taken up by the public. If authorised capital is stated in any official communication, subscribed and paid-up capital must also be stated conspicuously.

#### (d) Called-up Capital (Section 2(15)):

Such part of the capital which has been called for payment. The total amount called up on issued shares.

#### (e) Paid-up Capital:

The total amount paid or credited as paid up on shares issued. Calculated as called-up capital less calls in arrears.

*Example:* The "Giant Bubble Gum Company Ltd." has an authorized capital of 1,000,000 bubble gum shares (worth ₹1 each). They've issued 500,000 shares to the public. Of those, only 400,000 shares have been "subscribed" (taken up). They've "called up" payment for 75% of those subscribed shares. And finally, the "paid-up capital" is what people actually paid after some shareholders forgot to send in their "bubble gum money."



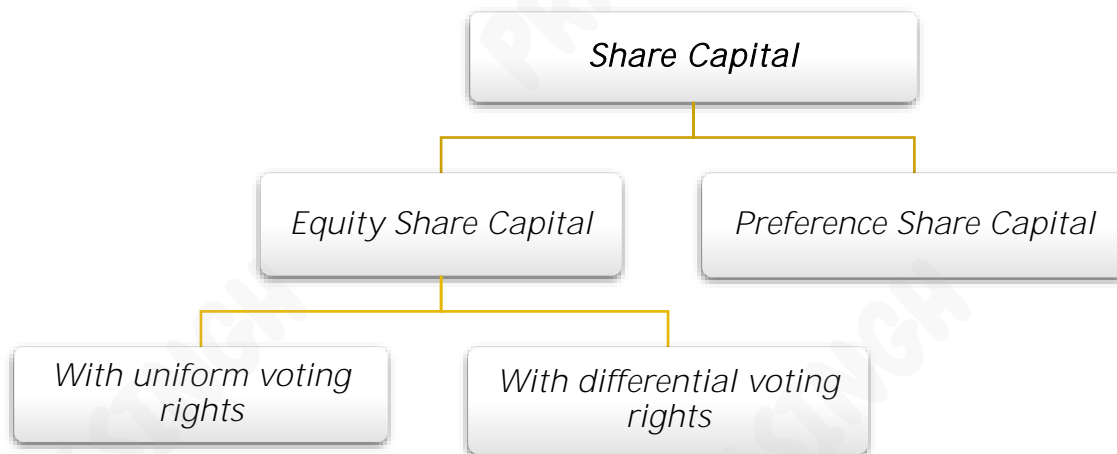
## SHARES

### (I) Nature of Shares:

As per Section 2(84) of the Companies Act, 2013, a share means a share in a company's share capital and includes stock. It represents the proportion of a shareholder's interest in the company's assets, based on the amount paid compared to the total capital.

**CASE LAW:** *Borland Trustees vs. Steel Bors. & Co. Ltd.*

*Fact:* Observed that "a share is not a sum of money but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount". You should note that the shareholders are not, in the eyes of law, part owners of the undertaking. The undertaking is somewhat different from the totality of the shareholders. The rights and obligations attaching to a share are those prescribed by the memorandum and the articles of a company. It must, however, be remembered that a shareholder has not only contractual rights against the company, but also certain other rights which accrue to him according to the provisions of the Companies Act.



### Shares as Movable Property (Sec. 44):

Shares, debentures, or other interests of members are treated as movable property. They are transferable in the manner provided by the company's articles of association.

### Numbering of Shares (Sec. 45):

Every share in a company having share capital must be given a distinctive number for identification.

Exception: This rule does not apply to shares held in a depository system, where the beneficial owner is recorded electronically instead of by share number.

### ◆ (II) Kinds of Share Capital:

Section 43 of the Companies Act, 2013 states that in a company limited by shares, the share capital shall be of two kinds:

#### (i) Equity share capital —

- (1) with voting rights; or
- (2) with differential rights as to dividend, voting or otherwise in accordance with prescribed rules;

**Example:** It is to be noted that, Tata Motors in 2008 introduced equity shares with differential voting rights called 'A' equity shares in its rights issue. In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares. Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting. Other companies which have issued equity shares with differential voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others.

#### (ii) Preference share capital:

This Act does not affect the rights of preference shareholders to participate in winding-up proceeds if such rights existed before its commencement.

According to explanation to section 43:

1. **"Equity share capital"**, In a company limited by shares, it means all share capital other than preference share capital.
2. **"Preference share capital"**, In a company limited by shares, it is the part of issued capital that carries preferential rights.
  - (a) Payment of dividend as a fixed amount or at a fixed rate, either tax-free or subject to income tax.
  - (b) In case of winding up or capital repayment, shareholders are entitled to the paid-up share capital (with any specified premium, if applicable, as per the company's memorandum or articles).

**Exception:** In case of private company - Section 43 shall not apply where memorandum or articles of association of the private company so provides

Investor 1: "What's the Golden Goose Egg Company offering?"

Investor 1: "And the other?"



Investor 2: "Two shares: Golden Eggs—preference shares with first rights on dividends and repayment."

Investor 2: "Feathered Friends—equity shares with voting power. But if the company fails, only the Golden Eggs get their money back."

## MEMORANDUM OF ASSOCIATION (MOA)

The Memorandum of Association is the company's charter, defining its constitution and the scope of its powers. It is the foundation upon which the company is built.

### Objects of Registering a Memorandum:

Defines the company's objects, identifying its possible scope of operations, beyond which it cannot act.

Enables shareholders, creditors, and others dealing with the company to know its powers and activities.

It is a public document (Section 399); thus, anyone contracting with the company is presumed to know its contents.

Shareholders know how their money can be used and the risks involved.

A company cannot deviate from its memorandum's provisions. Acts beyond its powers (*ultra vires*) are void.

Memorandum forms are given in Tables A, B, C, D, and E of Schedule I of the Companies Act, 2013.

### Content of the Memorandum:

**(a) Name Clause:** The company's name, ending with "Limited" (public) or "Private Limited" (private), unless it's a Section 8 company. OPCs must include "One Person Company" below their name.

**(b) Registered Office Clause:** The state where the company's registered office is situated.

**(c) Object Clause:** The objects for which the company is incorporated, and necessary matters in furtherance thereof. If activities change not reflected in the name, the name must be changed within six months.

**(d) Liability Clause:** States whether members' liability is limited or unlimited. For limited by shares, liability is limited to unpaid amounts. For limited by guarantee, it states the amount members undertake to contribute during winding up (or within one year of ceasing to be a member), including costs/expenses.

**(e) Capital Clause:** The amount of authorised capital, divided into fixed-amount shares, and the number of shares taken by subscribers (at least one). Not applicable to companies without share capital.

**(f) Subscribers' Details/Association Clause:** Details of subscribers to be formed into a company. In OPC, the nominee's name.

The memorandum must be printed, paragraphed, numbered, and signed by at least 7 persons (public), 2 (private), or 1 (OPC), in the presence of at least one witness.

A company, through its agent, can subscribe to the memorandum. A minor cannot be a signatory.

The MOA cannot contain anything contrary to the Companies Act.

## DOCTRINE OF ULTRA VIRES

Doctrine of Ultra Vires means “beyond powers.” It states that a company cannot act beyond the objects mentioned in its memorandum, except as permitted by law. Any act or contract outside these powers is void and not binding on the company. The company can be restrained from using its funds or carrying on activities not authorized by the memorandum. Since the memorandum is a public document, outsiders are presumed to know its limits. Hence, ultra vires transactions cannot be enforced against the company, nor can the company sue on them.

**Example:** If you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company.



As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company, then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act ultra vires the company is void and cannot be ratified. However, if it is ultra vires the directors, shareholders may ratify; if ultra vires the articles, the company may amend them; and if within company powers but irregularly done, shareholders can validate it.

**CASE LAW:** *Ashbury Railway Carriage and Iron Company Limited v. Riche (1875)*.

**Fact:** The facts of the case are: The main objects of a company were:

- (a) To make, sell or lend on hire, railway carriages and wagons;
- (b) To carry on the business of mechanical engineers and general contractors.
- (c) To purchase, lease, sell and work mines.

(d) To purchase and sell as merchants or agents, coal, timber, metals etc.

The company's directors contracted with Riche to finance a railway project in Belgium, which was later ratified by shareholders. However, the court held the contract *ultra vires* and void, stating that the term "*general contractors*" must be interpreted in connection with the company's main business (mechanical engineering) and not as granting unlimited powers.

An *ultra vires* contract can never be made binding on the company. It cannot become "**Intravires**" by reasons of estoppel, acquiescence, lapse of time, delay or ratification.

The whole position regarding the doctrine of *ultra vires* can be summed up as:

(i) When an act is performed, which though legal in itself, is not authorized by the object clause of the memorandum, or by the statute, it is said to be *ultravires* the company, and hence null and void.

(ii) An act which is *ultravires*, the company cannot be ratified even by the unanimous consent of all the shareholders.

(iii) An act which is *ultravires* the directors, but *intravires* the company can be ratified by the members of the company through a resolution passed at a general meeting.

(iv) If an act is *ultravires* the Articles, it can be ratified by altering the Articles by a Special Resolution at a general meeting.

The doctrine's disadvantages outweigh its main benefit of protecting shareholders and creditors. Though it restrains directors, it also restricts companies from changing activities even with full agreement. Moreover, its purpose is largely defeated since the object clause can now be easily altered by a special resolution.

## ARTICLES OF ASSOCIATION

Articles of Association are the internal rules and regulations of a company for managing its affairs. They act as subsidiary to the Memorandum of Association, defining the duties, rights, and powers of the company's governing body, and the manner in which its business and internal regulations are conducted or altered.

They are a business document that must be strictly construed, regulating domestic management and creating rights and obligations between members and the company.

**CASE LAW:** *Guinness vs. Land Corporation of Ireland; Ashbury Carriage Co. vs. Riche;*

**Fact:** "The articles play a part subsidiary to memorandum of association. They accept the memorandum as the charter of incorporation, and so accepting it the articles proceed to define the duties, the rights and powers of the governing body as between themselves and the company and the mode and form in which the business of the company is to be carried on, and the mode and form in which changes in the internal regulation of the company may from time to time be made."

**CASE LAW: *S.S. Rajkumar vs. Perfect Castings Pvt. Ltd.***

*Fact: The document containing the articles of association of a company (the Magna Carta) is a business document; hence it has to be construed strictly. It regulates domestic management of a company and creates certain rights and obligations between the members and the company.*

*In essence, they serve as the company's bye-laws, guiding directors and officers in carrying out management functions. The auditor must study the company's accounts and audit provisions and note the relevant matters.*

◆ **Contents of Articles of Association (Sec. 5):**

**Contains regulations:** The articles of a company set out its management regulations.

**Inclusion of matters:** The articles must include prescribed matters and may also add any other matters necessary for the company's management.

**Contain provisions for entrenchment:** The articles may include "entrenchment provisions", allowing certain clauses to be altered only under stricter conditions than a special resolution.

**Manner of inclusion of the entrenchment provision:** Entrenchment provisions can be included at formation, or later—by unanimous consent in a private company, or by special resolution in a public company.

**Notice to the registrar of the entrenchment provision:** If the articles include entrenchment provisions, whether at formation or by amendment, the company must notify the Registrar in the prescribed form and manner.

**Forms of articles:** A company's articles must be in the applicable form specified in Tables F, G, H, I, and J of Schedule I.

**Model articles:** A company may adopt wholly or partly the regulations in the model articles applicable to it.

**Company registered after the commencement of this Act:** For companies registered after this Act, any unaltered provisions of the model articles automatically apply as if included in the company's registered articles.

◆ **Difference Between MOA And AOA**

Basis	Memorandum of Association (MOA)	Articles of Association (AOA)
<b>Objectives</b>	Defines and limits the objectives of the company.	Lays down rules and regulations for internal management and achieving objectives.
<b>Relationship</b>	Establishes the company's relationship with the outside world.	Defines the relationship between the company and its members.
<b>Alteration</b>	Can be altered only under strict conditions as per the Act, often requiring approval of Regional Director/Tribunal.	Can be altered easily by passing a special resolution.

<b>Ultra Vires</b>	Acts beyond MOA are ultra vires, void, and cannot be ratified even by unanimous shareholder consent.	Acts beyond AOA (but within MOA) can be ratified by shareholders through a special resolution.
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## DOCTRINE OF INDOOR MANAGEMENT

### ◆ Doctrine of Constructive Notice:

Under Section 399 of the Companies Act, 2013, the memorandum and articles of association are public documents, open for inspection on payment of fees. Anyone dealing with a company is presumed to know their contents, whether actually read or not. This presumption is called constructive notice.

It means:

1. A person is deemed to have knowledge and true understanding of the documents.
2. The notice extends to all registered documents (e.g., special resolutions).

Thus, if someone enters into a contract beyond the company's powers (ultra vires MOA or AOA), they cannot claim rights against the company.

### ◆ Doctrine of Indoor Management:

The Doctrine of Indoor Management is an exception to constructive notice. Outsiders are not deemed to know a company's internal procedures. If an act is authorized by the MOA or AOA, outsiders can assume that all internal formalities have been duly complied with. This principle, known as the Turquand Rule,

was established in -

**CASE LAW: *Royal British Bank vs. Turquand*.**

**Fact:** Mr. Turquand was the official manager (liquidator) of the insolvent Cameron's Coalbrook Steam, Coal and Swansea and Loughor Railway Company. It was incorporated under the Joint Stock Companies Act, 1844. The company had given a bond for £ 2,000 to the Royal British Bank, which secured the company's drawings on its current account. The bond was under the company's seal, signed by two directors and the secretary. When the company was sued, it alleged that under its registered deed of settlement (the articles of association), directors only had power to borrow up to an amount authorized by a company resolution. A resolution had been passed but not specifying how much the directors could borrow.

**Held,** it was decided that the bond was valid, so the Royal British Bank could enforce the terms. He said the bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed. Articles of association were registered with Companies House, so there was constructive notice. But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable. The bond was valid because there was no requirement to look into the company's internal workings.

This is the indoor management rule, that the company's indoor affairs are the company's problem.

### ◆ Exceptions to the Doctrine of Indoor Management:

Outsiders dealing with a company may assume that directors' or officers' acts are valid if within their apparent authority and consistent with the Articles. They can presume that internal formalities required for such acts have been duly complied with.

*Exceptions to the Doctrine of Indoor Management (when Turquand Rule does not apply):*

**(a) Actual or constructive knowledge of irregularity:** The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

**CASE LAW: Howard vs. Patent Ivory Manufacturing Co.**

**Fact:** where the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

**CASE LAW: Morris v Kanssen.**

**Fact:** a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

**(b) Suspicion of irregularity:** If circumstances surrounding a transaction are suspicious or unusual, requiring inquiry, the doctrine does not apply. The outsider has a duty to make necessary inquiries.

**CASE LAW: Anand Bihari Lal vs. Dinshaw & Co.**

**Fact:** the plaintiff accepted a transfer of a company's property from its accountant; the transfer was held void. The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property.

**CASE LAW: Haughton & Co. v. Nothard, Lowe & Wills Ltd.**

**Fact:** where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said that it was something so unusual "that the plaintiff were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it." Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf."

(c) **Forgery:** The doctrine applies to irregularities, but not to forgery, which is a nullity.

**CASE LAW: Ruben v Great Fingall Consolidated.**

**Fact:** In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate. The plaintiff contended that whether the signature were genuine or forged was apart of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

*Lawyer:* "Even if the board meeting lacked quorum, you're protected under Indoor Management."

*Lawyer:* "But if you knew of the irregularity, or if the document was a forgery, you're not protected."



*Investor:* "I lent money; MOA says directors can borrow."

# Chapter 7

## The Negotiable Instruments Act, 1881

### INTRODUCTION

The law of negotiable instruments, derived from English Common Law, facilitates trade and commerce by allowing credit instruments to be easily transferable like goods. In India, it is governed by the Negotiable Instruments Act, 1881, which defines and amends the law relating to promissory notes, bills of exchange, and cheques. The Act extends to all of India, except provisions affecting the RBI Act, 1934, or local usages. It came into force on 1st March 1882.

The Act also applies to Hundis and other instruments like Treasury Bills, Bearer Debentures, Railway Receipts, Delivery Orders, and Bills of Lading, recognized either by mercantile custom or law.

Recent amendments:

Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002

Negotiable Instruments (Amendment) Act, 2015

Negotiable Instruments (Amendment) Act, 2018

### MEANING OF NEGOTIABLE INSTRUMENTS

A Negotiable Instrument is a transferable document passing property to a bona fide transferee for value. Though not defined in the Act, Section 13 recognizes three types—bills of exchange, promissory notes, and cheques (payable to order or bearer). Other instruments like Hundies, Treasury Bills, Debentures, Railway Receipts, Delivery Orders, and Bills of Lading are also treated as negotiable by custom or usage.

#### Type of Negotiable Instrument

Promissory Note

Bill of Exchange

Cheque

**(1) A negotiable instrument is payable to order when:**

- a. It is expressed to be so payable
- b. Payable to a specified person without restriction, hence transferable by endorsement and delivery.

**(2) A negotiable instrument is payable to bearer when:**

- a. When it is expressed to be so payable e.g. pay bearer
- b. If the last endorsement is in blank, the holder can demand payment (e.g., a cheque endorsed by the payee's signature).

**Contact Number: 8007916622/33**

## Essential Characteristics of Negotiable Instruments

1. It is necessarily in writing.
2. It should be signed.
3. It is freely transferable from one person to another.
4. Holder's title is free from defects.
5. It can be transferred any number of times till its satisfaction.
6. Every negotiable instrument must contain an unconditional promise or order to pay money. The promise or order to pay must consist of money only.
7. The sum payable, the time of payment, the payee, must be certain.
8. The instrument should be delivered. Mere drawing of instrument does not create liability.

Characteristics

written

signed

transferable

title free from defects

can be transferred number of times

unconditional promise/order to pay

certainty of sum payable, time of payment and the payee

delivered

**Maddy:** Imagine a treasure map that says, "You get the gold, IF you can find the pirate's left sock!"

**Maddy:** Exactly! Because the "payment" — the gold — is conditional on finding a sock, not just about paying money. And the condition itself is uncertain.

**Maddy:** A true negotiable instrument is much simpler. It's like a direct order: "Pay Gold to Bob."



**Jiya:** (laughs) That doesn't sound negotiable at all

**Jiya:** Oh, I get it.

**Jiya:** So, no socks involved!

## PROMISSORY NOTE

### Meaning

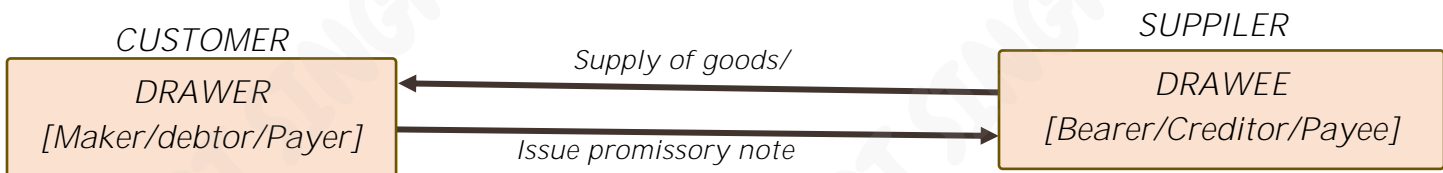
A promissory note (Sec. 4, NI Act, 1881) is a written, signed instrument containing an unconditional promise by the maker to pay a certain sum of money to a specific person, their order, or the bearer.

## Specimen of Promissory note

₹ 10,000	Lucknow April 10, 2022
Three months after date, I promise to pay Shri Ramesh (Payee) or to his order the sum of Rupees Ten Thousand, for value received.	
To, Shri Ramesh, B-20, Green Park, Mumbai. (Maker)	Stamp Sd/- Ram

### Parties to promissory note

- 1. Maker:** The person who makes the promise to pay is called the Maker. He is the debtor and must sign the instrument.
- 2. Payee:** Payee is the person to whom the amount on the note is payable



### Essential Characteristics of a Promissory Note

- In writing- An oral promise to pay is not sufficient.
- There must be an express promise to pay. Mere acknowledgment of debt is insufficient.
 

**Example:** I acknowledge myself to be indebted to B in 1,000, to be paid on demand, for value received. (Valid promissory note as the promise to pay is definite)

**Example:** "Mr. B, I.O.U 1,000." – Invalid promissory note as there is no promise to pay. It is just an acknowledgement of debt.
- A promise to pay must be definite and unconditional. If it depends on an uncertain act or event, it is not a promissory note. But if the condition is certain to happen in ordinary experience, it remains valid.
 

**Example:** I promise to pay B ₹ 500 seven days after my marriage with C. (the promissory note is invalid as marriage with C may or may not happen.)

**Example:** I promise to pay B ₹ 500 on D's death- as the death of D is certain, promise is unconditional. Thus, the promissory note is valid.

**Example:** I promise to pay B ₹ 500 on D's death, provided D leaves me enough to pay that sum. Invalid promissory note as promise is dependent on D's leaving behind money which is not certain.

d. A promissory note must be signed by the maker otherwise it is incomplete and ineffective.

e. Promise to pay money only.

**Example:** I promise to pay B ₹ 500 and to deliver to him my black horse on 1st January next. It is not a valid promissory note, as the promisor needs to deliver its black horse which is not money.

f. Promise to pay a certain sum.

**Example:** "I promise to pay B ₹ 500 and all other sums which shall be due to him."- Promissory note invalid as the amount payable is not certain.

But sometimes, the language of a promissory note is such that the amount payable can be easily ascertained. In such cases, the promissory note will be valid.

**Example:** "I promise to pay B ₹ 500 along with simple interest at the rate of 12% per annum.

g. The maker and payee must be certain, definite and different persons. A promissory note cannot be made payable to the bearer [Section 31 of the Bank of India Act, 1934 (RBI Act)]. Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.

h. Stamping: A promissory note must be properly stamped in accordance with the provisions of the Indian Stamp Act and such stamps must be duly cancelled by maker's signatures or initials on such stamp or otherwise.

## BILL OF EXCHANGE

### Meaning

A bill of exchange is a written, unconditional order by the maker, directing a certain person to pay a definite sum of money to a specified person, their order, or the bearer.

Specimen of Bill of Exchange

		Mr. A (Drawer)
		48, MP Nagar, Bhopal (M.P.)
		April 10, 2022
₹ 10,000/-		
Four months after date, pay to Mr. B (Payee) a sum of Rupees Ten Thousand, for value received.		
To,		
Mr. C (Drawee)		
576, Arera Colony, Bhopal (M.P.)	Signature	
	Mr. A	

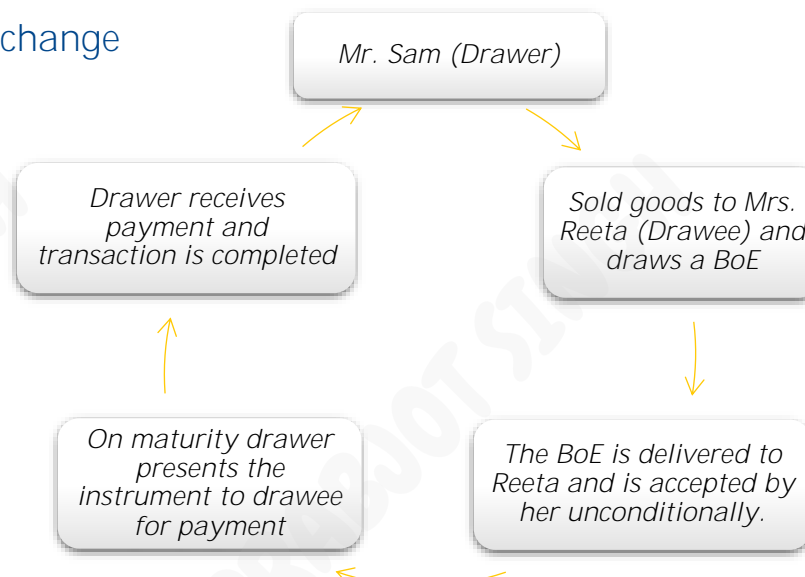
## Parties to the bill of exchange

- a. Drawer:** The maker of a bill of exchange.
- b. Drawee:** The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill, he is called an acceptor and is liable for the payment of the bill. His liability is primary and unconditional.
- c. Payee:** The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid.

## Essential characteristics of bill of exchange

- (a) It must be in writing.
- (b) Must contain an express order to pay.
- (c) The order to pay must be definite and unconditional.
- (d) The drawer must sign the instrument.
- (e) Drawer, drawee, and payee must be certain. They need not be three different persons, but at least two distinct persons are required. As per Section 31 of the RBI Act, 1934, a bill of exchange cannot be payable to bearer on demand.
- Example:** "On demand pay to the bearer the sum of rupees five hundred, for value received." It is invalid BOE. However, a bill of exchange payable on demand, in which name of the payee is mentioned, is valid.
- Example:** "On demand pay to A or order the sum of rupees five hundred for value received." It is valid BOE.
- (f) The sum must be certain.
- (g) The order must be to pay money only.
- (h) It must be stamped.

## Process of bill of exchange



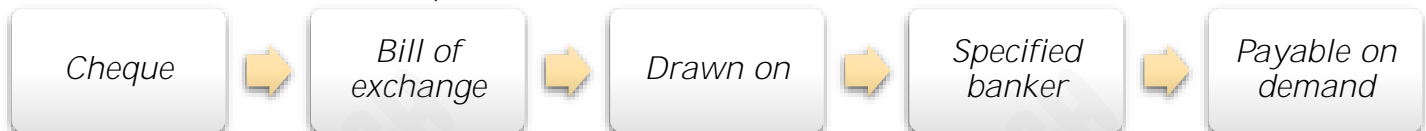
### ◆ Difference between promissory note and bill of exchange

Basis	Promissory Note	Bill of Exchange
<b>Definition</b>	"A Promissory Note" is an instrument in writing (not being a banknote or a currency-note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.	"A bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.
<b>Nature of Instrument</b>	In a promissory note, there is a promise to pay money.	In a bill of exchange, there is an order for making payment.
<b>Parties</b>	In a promissory note, there are only 2 parties namely: i. the maker and ii. the payee	In a bill of exchange, there are 3 parties which are as under: i. the drawer ii. the drawee iii. the payee
<b>Acceptance</b>	A promissory note does not require any acceptance, as it is signed by the person who is liable to pay.	A bill of exchange needs acceptance from the drawee.
<b>Payable to bearer</b>	A promissory note cannot be made payable to bearer.	On the other hand, a bill of exchange can be drawn payable to bearer. However, it cannot be payable to bearer on demand.

## CHEQUE [SECTION 6]

### ◆ Meaning

A cheque is a bill of exchange drawn on a specified banker, payable only on demand, and includes truncated and electronic cheques.



### ◆ Payable on demand means-

It is payable whenever the holder presents it to the banker, which includes any banker or post office savings bank [Sec. 3].

### ◆ Explanation I:

For the purposes of this section, the expressions-

**a. Cheque in electronic form** – A cheque in electronic form is a cheque created electronically using a computer resource and signed with a digital or electronic signature (with/without biometrics).

**Note:** Terms like asymmetric crypto system, computer resource, digital signature, electronic form, and electronic signature carry the same meanings as in the IT Act, 2000.

**b. Truncated cheque** – A physical cheque whose movement is stopped during clearing and replaced by its electronic image for transmission.

### Explanation II:

For this section, a clearing house refers to one that is either managed directly by the Reserve Bank of India or recognized as a clearing house by the RBI.

### Explanation III:

For this section, the terms asymmetric crypto system, computer resource, digital signature, electronic form, and electronic signature have the same meanings as given in the Information Technology Act, 2000.

A bill of exchange is a written negotiable instrument directing a third party to pay a certain sum on demand or at a future date, while a cheque is a bill of exchange drawn on a banker, payable only on demand.

### Specimen of Cheque

Pay .....	Date:.....
a sum of Rupees..... ₹	
A/C No. 12345678910	
ABC Bank	
622, Vijay Nagar, Indore (M. P.)	
	Signature
01212 1125864 000053 38	

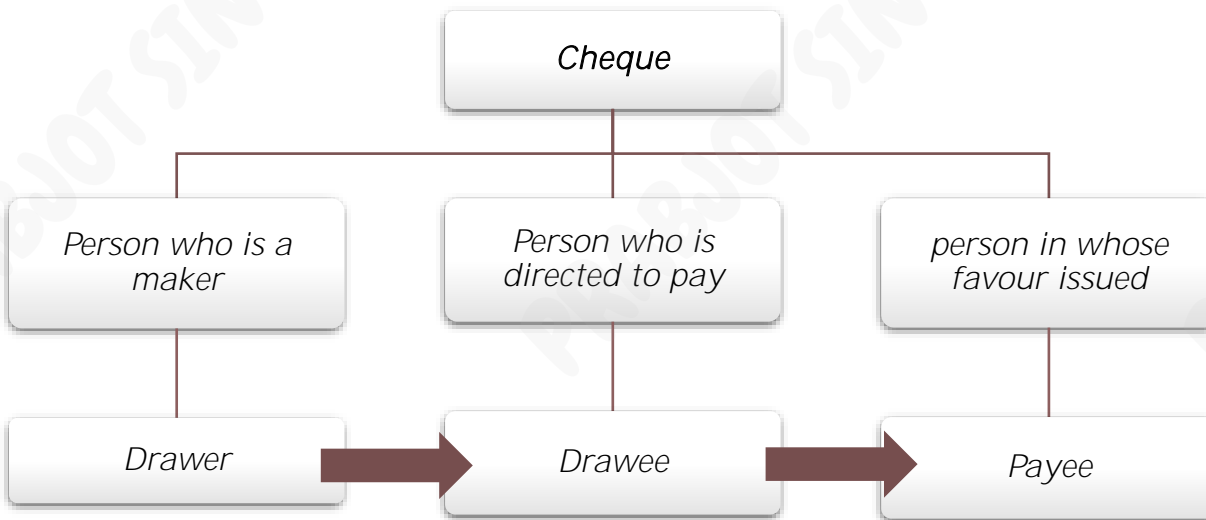
### Parties to Cheque

**1. Drawer:** The person who draws a cheque i.e., makes the cheque (Debtor). His liability is primary and conditional.

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

**“Drawee in case of need”**— If a bill or its endorsement names someone besides the drawee to be approached if needed, that person is the “drawee in case of need.”

**3. Payee:** The person named in the instrument (i.e., the person in whose favour cheque is issued), to whom or to whose order the money is, by the instrument, directed to be paid, is called the payee. The payee may be the drawer himself or a third party.



### Essential Characteristics of a cheque

According to the definition of cheque under section 6, a cheque is a species of bill of exchange. Thus, it should fulfil:

- a. all the essential characteristics of a bill of exchange
- b. Must be drawn on a specified banker.
- c. It must be payable on demand.

Note: These two features distinguish a cheque from a bill: all cheques are bills, but not all bills are cheques.

## CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

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

#### Bearer Instrument:

It is an instrument payable to bearer, i.e., where the payee's name is blank, specified as "or bearer," or the last endorsement is blank, and it is transferable by mere delivery.

#### Order Instrument:

It is an instrument payable to order, i.e., payable to a person, to his order, or where the last endorsement is in full, and it is transferable by endorsement and delivery.

#### Bearer Instrument

name of the payee is blank or  
 name of payee is specified with the words "or bearer" or  
 the last indorsement is blank  
 negotiated by mere delivery

**Order Instrument** payable to a person, or  
 Payable to a person / his order, or  
 Payable to order of a person, or  
 the last indorsement is in full,  
 negotiated by indorsement and delivery

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

"Inland instrument":

A promissory note, bill of exchange, or cheque made or drawn in India and payable in India or on a resident of India is an inland instrument.

**Supplier:** "Of course, I'll deliver them. I live in Mumbai."



**Chef:** "Hey supplier, please send me spices for my dish in Delhi."

**Chef:** "Even if I sign this here in France, it's still an Indian spice order!"

Place where Instrument is drawn and made payable	Residence of Person on whom Instrument is drawn	Nature of Instrument
P/N, BOE, C drawn/made in India	+ Payable in India OR + drawn upon a person resident in India.	are Inland Instruments

**Example:**

- (i) A promissory note made in Kolkata and payable in Mumbai.
- (ii) A bill drawn in Varanasi on a person resident in Jodhpur (although it is stated to be payable in Singapore)
- (iii) A, a resident of Agra, drew (i.e., made) a bill of exchange in Agra on B, a merchant in New York. And B accepted the bill of exchange as payable in Delhi. It is an inland bill of exchange. In this case, the bill of exchange was drawn in India and also payable in India.
- (iv) A, resident of Mumbai, drew a bill of exchange in Mumbai on B, a merchant in Mathura. And B accepted the bill of exchange as payable in London. It is also an inland bill of exchange. In this case, the bill of exchange was drawn in India on a person resident in India. It is immaterial that the amount is payable in London. An inland instrument remains inland even if it has been endorsed in a foreign country.

(v) If the bills of exchange mentioned in above two examples, are endorsed in France, they will remain inland bills.

**"Foreign instrument":**

A foreign instrument is one which is not an inland instrument.

Place where bill is drawn	Residence of Person on whom drawn and place where made payable	Nature of Instrument
P/N, BOE, C drawn/made outside India	on a person resident in or outside India + made payable in India	are foreign bills.
	on a person residing outside India + payable outside India.	are foreign bills.
	on a person residing in India + payable outside India	are foreign bills.

**Liability of maker/ drawer of foreign bill**

In absence of a contrary contract, the maker/drawer of a foreign bill is liable as per the law of the place where it is made, while the acceptor and indorser are liable as per the law of the place where it is payable (Sec. 134).

**Example:** A bill of exchange is drawn by A in Berkley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%. The bill is indorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 15%.

Inland instrument-when B.o.E/ P/N, Cheque	drawn /made in India
	made payable in/drawn upon person resident in India
Foreign instrument-when B.o.E/ P/N, Cheque, IS NOT	Drawn in India
	Made in India
	Made payable in India

**Inchoate and Ambiguous Instruments**

**Inchoate Instrument:**

An instrument that is incomplete in certain respects. A person may sign and deliver a wholly blank or incomplete instrument, giving authority to the holder to complete it for any amount within the limits specified or by the stamp affixed.

**Liability:** The signer is liable to both a holder and a holder in due course.

**A holder:** can only recover the amount intended by the signer.

**A holder in due course:** can recover any amount filled, provided it's covered by the stamp.

**Crucial Point:** Delivery is essential. If a blank instrument is stolen and filled, the signer is generally not liable to a holder in due course if it was never delivered with the intention of being used as a negotiable instrument.

**Example:** A person signed a blank acceptance on a bill of exchange and kept it in his drawer. The bill was stolen by X and he filled it up for ` 20,000 and negotiated it to an innocent person for value. It was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument. Further, as a condition of liability, the signer as a maker, drawer, indorser or acceptor must deliver the instrument to another. In the absence of delivery, the signer is not liable. Furthermore, the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.

**Ambiguous Instrument (Section 17):**

An instrument that can be construed either as a promissory note or a bill of exchange. The holder can choose to treat it as either, and once the choice is made, it cannot be changed.

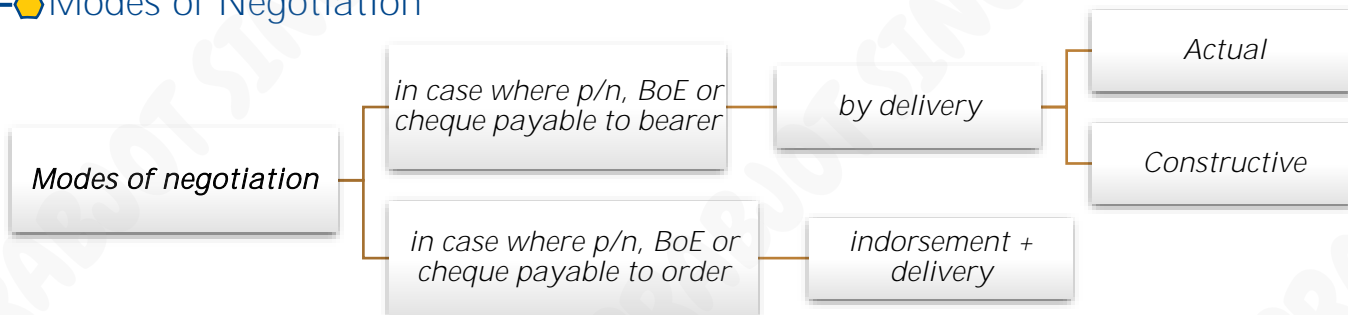


**NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS**

**Meaning**

A negotiable instrument is freely transferable by negotiation, which transfers ownership to a new holder. This can be done by delivery for instruments payable to the bearer, or by indorsement and delivery for instruments payable to order.

**Modes of Negotiation**



- (i) A promissory note, bill of exchange or cheque payable to bearer is negotiable by the delivery thereof.
- (ii) A promissory note, bill of exchange or cheque payable to order is negotiable by the holder by indorsement and delivery thereof.

**Example:** X drew a cheque for Rs. 50,000 payable to Y and delivered it to him. Y indorsed the cheque in favour of Z but kept it in his table drawer. Subsequently, Y died, and cheque was found by Z in Y's table drawer. In this case, Z does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him.

### ◆ Negotiation by delivery (Section 47)

A promissory note, bill of exchange, or cheque that is payable to bearer can be transferred from one person to another simply by delivery. However, this is subject to Section 58, which restricts instruments obtained unlawfully or for unlawful consideration.

#### Exception:

If delivered conditionally (effective only on a certain event), it is not negotiable unless that event occurs, except when held by a holder for value without notice.

**Example:** A, the holder of a negotiable instrument payable to bearer, which is in the hands of A's banker, who is at the time the banker of B, directs the banker to transfer the instrument to B's credit in the banker's account with B. The banker does so, and accordingly now possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

### ◆ Negotiation by indorsement [Section 48]

A promissory note, bill of exchange, or cheque payable to order is negotiable by the holder through endorsement and delivery, subject to Sec. 58.

### ◆ Importance of Delivery in Negotiation [Section 46]

Delivery is essential for negotiation, whether the instrument is payable to bearer or order. It must be voluntary with the intent to transfer property in the instrument.

Delivery may be actual (physical handover) or constructive (to an agent/servant or when the indorser holds as agent). If delivery is conditional or for a special purpose, ownership does not pass unless negotiated to a holder in due course.

A negotiable instrument contract remains incomplete and revocable until delivery. Rights are not transferred by endorsement alone—delivery is also required. If an indorser dies before delivery, his legal representatives cannot complete negotiation by mere delivery.

## Delivery when effective between the parties

Negotiation of instruments between the parties	How delivery is to be made
As between parties standing in immediate relation	Delivery to be effectual must be made by the party making, accepting, or endorsing the instrument, or by a person authorized by him in that behalf.
As between such parties and any holder of the instrument other than a holder in due course	It may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

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

### Dishonor of Cheque for Insufficiency, Etc. of Funds in the Accounts [Section 138]

Where any cheque drawn by a person on an account maintained by him with a banker—

- for payment of any amount of money
- to another person from that account
- A cheque must be issued to discharge a debt or liability; if given as a gift, donation, security, moral obligation, or for illegal consideration, it is outside this section's scope.
- is returned by the bank unpaid,
- either because of the—
  - ✓ amount of money standing to the credit of that account is insufficient to honor the cheque,
  - ✓ that it exceeds the amount arranged to be paid from that account by an agreement made with that bank,

*The person is guilty of an offence and punishable with imprisonment up to 2 years, or fine up to twice the cheque amount, or both.*

### When section 138 shall be not applied:

unless the below given conditions are complied with—

- (a) Cheque must be presented within 3 months or its validity period, whichever is earlier.
- (b) Payee/holder must give written notice to the drawer within 30 days of cheque return.
- (c) Drawer must pay within 15 days of receiving notice; failure makes him liable.

**Explanation:**

“Debt or liability” means a legally enforceable obligation. Hence, a complaint can be filed after 45 days of cheque dishonor (30 days for notice + 15 days for payment).

**Penalty (Sec. 138):**

Dishonour of cheque is a criminal offence punishable with imprisonment up to 2 years, or fine up to twice the cheque amount, or both.

**Example:** X issued a post-dated cheque to Y on the account of discharge of its liability. Further, X instructed to the bank to stop the payment due to unavailability of the adequate amount in the account. Here, in this instance section 138 of the Act is attracted as when a cheque is dishonoured on account of stop payment instructions sent by the drawer to his banker in respect of a post-dated cheque irrespective of insufficiency of funds in the account.

A post-dated cheque is deemed to have been drawn on the date it bears and the three months period for the purposes of section 138 is to be counted from that date. So, X will be liable for dishonour of cheque. Once a cheque is issued by the drawer, a presumption under section 139 must follow.

**Presumption in favor of holder (Sec. 139):**

On cheque dishonour, it is presumed that the holder received it for discharging a debt or liability. This is a rebuttable presumption, and the burden lies on the accused to prove otherwise.

**Defence Which May Not Be Allowed in Any Prosecution Under Section 138 [Section 140]**

In a prosecution under Sec. 138, the drawer cannot defend himself by claiming he had no reason to believe, at the time of issuing the cheque, that it might be dishonoured on presentment.

## SUMMARY OF SECTION 61 TO 77

Section	Subject	Provision / Requirement	Key Condition / Effect
61	Presentment for Acceptance	If no time/place for presentment is specified; A bill of exchange <b>payable after sight</b> must be presented for <b>acceptance</b> to the drawee (if he can be found after reasonable search), by a person entitled to it. Must be presented <b>within reasonable time, during business hours</b> , and on a <b>business day</b> .	If the <b>drawee cannot be found</b> after reasonable search → the <b>bill is dishonoured</b> . If not duly presented → <b>no party is liable</b> to the person who fails to present it. Failure to present properly releases other parties from liability.

		If the bill is directed to a <b>specific place</b> , it must be presented <b>at that place</b> . <b>Presentment by post</b> (registered letter) is valid if authorized by agreement or usage.	If drawee not found there → <b>bill is dishonoured</b> .
62	<b>Presentment of Promissory Note for Sight</b>	A promissory note payable after sight must be presented to the maker for sight (if he can be found after reasonable search) by the entitled person. Must be presented <b>within reasonable time, during business hours, on a business day</b> .	If not presented properly → <b>no party is liable</b> to the person who failed to make such presentment. Protects other parties from liability due to negligence of holder.
63	<b>Drawee's Time for Deliberation</b>	If the <b>drawee</b> of a <b>bill of exchange</b> requests, the <b>holder must allow 48 hours</b> (excluding public holidays) to decide whether to accept the bill.	
64	<b>Presentment for Payment</b>	Promissory notes, bills of exchange, and cheques must be presented for payment to the <b>maker, acceptor, or drawee</b> respectively, by or on behalf of the holder. Presentment through <b>registered post</b> is valid if <b>authorized by agreement or usage</b> .	If not presented → <b>other parties not liable</b> to such holder.
	<b>Exception</b>	If a <b>promissory note is payable on demand and not at a specified place</b> , no presentment is needed to charge the <b>maker</b> .	
	<b>Truncated Cheque</b>	If a <b>truncated cheque</b> (scanned electronic image) is presented, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is	If payment is made after such demand, the <b>cheque must be retained</b> by the drawee bank.

		entitled to further demand the presentment of the truncated cheque itself for verification:	
65	Hours for Presentment	Presentment must be during <b>business hours</b> ; if at a <b>banker</b> , then during <b>banking hours</b>	
66	Payment after Date or Sight	Note/Bill payable after date/sight must be presented <b>at maturity</b>	
67	Promissory Note by Instalments	Must be presented on the <b>3rd day after due date</b> of each instalment	Non-payment on such presentation has same effect as non-payment at maturity
68	Instrument Payable at Specified Place and Nowhere Else	Must be presented for payment <b>at the specified place</b> to charge any party	Presentment elsewhere is invalid
69	Instrument Payable at Specified Place	Must be presented for payment <b>at the specified place</b> to charge <b>maker or drawer</b>	
70	No Exclusive Place Specified	Presentment for payment must be made <b>at place of business or usual residence</b> of maker/drawee/acceptor	Applies when no specific place is mentioned
71	No Known Place of Business or Residence	Presentment for payment or acceptance may be made <b>in person</b> wherever the party can be found	For cases where address is unknown and not mentioned on instrument
72	Presentment of Cheque to Charge Drawer	Cheque must be presented at <b>drawee bank</b> before the relationship between <b>drawer and bank is altered</b>	Necessary to charge drawer
73	Presentment of Cheque to Charge Others	Cheque must be presented within a <b>reasonable time</b> after delivery by such person	To charge anyone other than the drawer
74	Instrument Payable on Demand	For payment Must be presented within a <b>reasonable time</b> after it is received by holder	

75	Presentment by or to Agents/Representatives for acceptance or payment	Can be made to <b>agent, legal representative</b> (if deceased), or <b>assignee</b> (if insolvent)	Shall be Valid
75A	Excuse for Delay	Delay excused if caused by <b>circumstances beyond holder's control</b> , not due to his fault/negligence	Must present within <b>reasonable time</b> once cause of delay ends
<p><b>When presentment unnecessary (Section 76)</b>  <b>No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:</b></p> <p>(a) (i) If the maker, drawee or acceptor intentionally prevents the presentment of the instrument,  (ii) if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or  (iii) if the instrument being payable at some other specified place, neither he nor any person authorized to pay it attends at such place during the usual business hours, or  (iv) if the instrument not being payable at any specified place, he cannot after due search be found;</p> <p>(b) If the person <b>agreed to pay even without presentment</b>, then presentment is not needed to make them liable.</p> <p>(c) If the person, <b>after the instrument matures, and knowing it hasn't been presented, does any of the following:</b></p> <ul style="list-style-type: none"> <li>• Makes a <b>part payment</b>,</li> <li>• <b>Promises to pay</b> (fully or partially),</li> <li>• Or <b>waives</b> the objection to lack of presentment in any other way</li> </ul> <p>(d) as against the drawer, if the drawer could not suffer damage from the want of such presentment.</p>			
77	<b>Liability of Banker for Negligence</b>	If a bill of exchange payable at a specified bank is <b>duly presented and dishonoured</b> , and the <b>banker negligently or improperly</b> keeps, handles, or returns the bill	The <b>banker must compensate</b> the holder for <b>any loss</b> caused due to such negligence

## RULES AS TO COMPENSATION (SECTION 117)

The compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:

### (a) Holder's right to amount + expenses

- The holder of the instrument is entitled to:
  - ✓ The amount due (i.e., the face value of the instrument),
  - ✓ Plus, all properly incurred expenses such as:
    - i. Presenting the instrument for payment,
    - ii. Noting the dishonour (official record of refusal),
    - iii. Protesting (formal certificate of dishonour).

### (b) Rate of exchange when parties are in different places

- If the person liable (charged) resides in a different place than where the instrument was payable, The holder is entitled to payment at the current rate of exchange between those two places.

### (c) Endorser's right to compensation

- An endorser, who was liable and has paid the amount due to the holder, is entitled to:
  - a. The full amount paid,
  - b. Interest on that amount at 18% per annum from the date of payment until recovery, and
  - c. Any expenses caused by the dishonour and subsequent payment.

### (d) Rate of exchange for endorser

- If the liable person and the endorser live in different places, then the endorser is also entitled to the amount at the current exchange rate between those places.

### (e) Right to draw a bill for compensation

- The party entitled to compensation (whether holder or endorser) can draw a bill ) on the party liable to compensate.
  - a. The bill must be payable at sight or on demand.
  - b. It must be accompanied by:
    - i. The dishonoured instrument,
    - ii. And the protest (if any).
- If this compensation bill is dishonoured, the same rules of compensation apply as if it were the original instrument.



