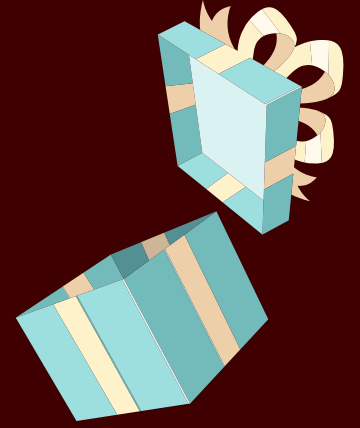
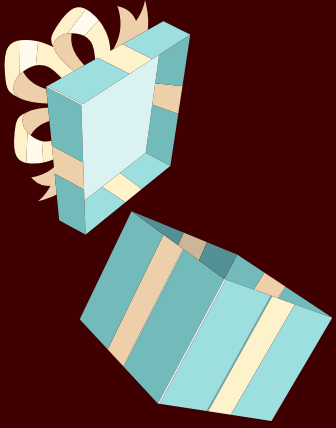


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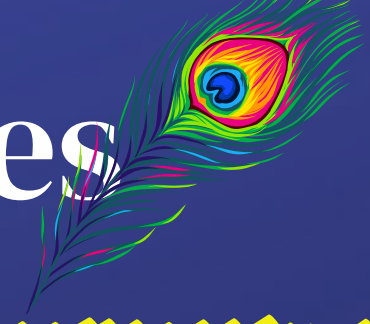


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# CHAPTER 1

## THE INDIAN CONTRACT ACT, 1872

### UNIT I - CONTRACT OF INDEMNITY & GUARANTEE

#### 1. PRACTICAL PROBLEMS

##### Concept Problem 1 [ICAI SM]

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

##### Solution

Rights of Indemnity- holder when sued (Section 125): The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—

- 1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
- 2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit;
- 3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

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

##### Concept Problem 2 [ICAI SM] [MTP May 2019]

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

##### Solution

Section 124 of the Indian Contract Act, 1872 says that “A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person”, is called a “contract of indemnity”.

Section 126 of the Indian Contract Act says that “A contract to perform the promise made or discharge liability incurred by a third person in case of his default.” is called as “contract of guarantee”.

The conditions under which the guarantee is invalid or void are stated in section 142, 143 and 144 of the Indian Contract Act are:

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

##### Concept Problem 3 [ICAI SM]

Mr. X is employed as a cashier on a monthly salary of INR 2,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of INR 1,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y?

### Solution

If the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change.

In the instant case, Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary. [Section 133, Indian Contract Act, 1872].

### Concept Problem 4 [ICAI SM]

M advances to N 5000 on the guarantee of P. The loan carries interest at the rate ten per cent annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six percent per annum and doesn't not sure N for one year after the loan becomes due N becomes insolvent. Can M sue P?

### Answer

M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (Section 133, Indian Contract Act, 1872).

### Concept Problem 5 [ICAI SM]

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

### Answer

According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the necessary construction material. Hence C is discharged from his liability.

### Concept Problem 6 [ICAI SM]

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

### Answer

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

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

### Concept Problem 7 [ICAI SM]

Mr. Chetan appointed as Site Manager of ABC Constructions Company on a two years contract at a monthly salary of INR 50,000. Mr. Pawan gave a surety in respect of Mr. Chetan's conduct. After six months the company was not in position to pay INR 50,000 to Mr. Chetan because of financial constraints. Chetan agreed for a lower salary of 30,000

from the company. This was not communicated to Mr. Pawan. This month afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole education of Chetan's appointment?

**Answer**

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

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

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

**Concept Problem 8 [ICAI SM]**

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

Case 1: If A is a Minor

Case 2: If B is a Minor

Case 3: If C is a minor

**Answer**

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

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

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

**Concept Problem 9 [ICAI SM]**

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

**Answer**

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

- a) Offer and acceptance
- b) Intention to create legal obligation
- c) Consideration
- d) Competency to contract
- e) Free consent
- f) Lawful object
- g) The agreement must not be expressly declared to be void- e.g.: an agreement in restraint of trade/ marriage etc.
- h) The terms of the agreement must not be vague or uncertain
- i) The agreement must be capable of performance- An agreement to do an impossible act is void.
- j) Legal formalities

**Concept Problem 10 [ICAI SM]**

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

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

### Answer

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

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

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

### Concept Problem 11 [ICAI SM] [MTP May 2018]

'C' advances to 'B', INR 2,00,000 on the guarantee of 'A'. 'C' has also taken a further security for the same borrowing by mortgage of B's furniture worth INR 2,00,000 without knowledge of 'A'. 'C' cancels the mortgage. After 6 months 'B' becomes insolvent and 'C' 'sues 'A' his guarantee. Decide the liability of 'A' if the market value of furniture is worth INR 80,000, under the Indian Contract Act, 1872.

### Answer

Surety's right to benefit of creditor's securities: According to section 141 of the Indian Contract Act, 1872, a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

In the instant case, C advances to B, INR 2,00,000 rupees on the guarantee of A. C has also taken a further security for INR 2,00,000 by mortgage of B's furniture without knowledge of A. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture i.e. INR 80,000 and will remain liable for balance INR 1,20,000.

### Concept Problem 12 [MTP May 2019] [ICAI Nov 2006] [RTP Nov 2018]

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

- A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability?
- C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability?

### Solution

- According to section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case, B does not supply the necessary material as per the agreement. Hence, C is discharged from his liability.
- According to Section 136 of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged. In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third



person. X is not the principal debtor. Hence, A is not discharged.

### Concept Problem 13 [MTP May 2019] [May 2018]

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

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

### Solution

#### Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872):

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

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

### Concept Problem 14 [MTP Nov 2018]

Mr. Ram was employed as financier in "Swaraj Ltd" on the surety of his good conduct, given by Mr. Janak, a good friend of the director of the company. Mr. Ram was kept on the salary of Rs. 45,000 per month. After 3 years, the company went into losses and so company decided for the cost cutting by retrenching of many employees and reducing the salaries of the employees. Mr. Ram was also proposed either to quit the job or continued with the lower salary of Rs. 35,000 per month. He accepted and continued with the job. After few months, it was reported by accounts department of the company that Mr. Ram manipulated with the funds of the company.

As per the provisions of the Indian Contract Act, 1872, analyse the legal positions of Mr. Janak, in the given situations:

- a) Mr. Ram has manipulated the funds of the company since the time of his appointment.
- b) Mr. Ram has manipulated the funds of the company since from few months before when he accepted to continue the job on lower salary.

### Solution

Section 133 of the Indian Contract Act, 1872 deals with the provision related to the discharge of the surety. Provisions states that where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Following is the answer in the light of the above provision:

- i) In case where, Mr. Ram has manipulated the funds of the company since the time of his appointment. In this case Mr. Janak is liable as a surety for the loss suffered by the Swaraj Company due to manipulation of the funds by Mr. Ram during the three years of his service.
- ii) In case where, Mr. Ram has manipulated the funds of the company since from few months before when he accepted to continue the job on lower salary. In this case, variance in the terms of the contract (i.e., to work on lower salary) was made without surety's consent. For all the transactions taking place subsequent to such variance, shall discharge the surety for the loss suffered by the Swaraj company.

### Concept Problem 15

[May 2006] [Nov 2002] [Nov 2017] [Sec 130]

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

Referring to the provision of the Indian Contract Act, 1872, decide

<p>a) Whether Ravi is discharged from his liabilities to Nalin for any subsequent loan?  b) Whether Ravi is liable if Ashok fails to pay the amount of INR 20,000 to Nalin?</p> <p style="text-align: center;"><b>Or</b></p> <p>'A' stands surety for 'B' for any amount which 'C' may lend to B from time to time during the next three months subject to a maximum of INR 50,000. One month later, A revokes the Guarantee, when C had lent to B INR 5,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether 'A' is discharged from all the liabilities to 'C' for any subsequent loan. What would be your answer in case 'B' makes a default in paying back to 'C' the money already borrowed i.e. INR 5,000?</p> <p style="text-align: center;"><b>Or</b></p> <p>'Ramesh' and 'Suresh' were engaged in business having same nature. 'Ramesh' stands surety for 'Suresh' for any amount which 'Kamlesh' may lend to 'Suresh' from time to time during the next 6 months subject to a maximum of INR 85,000. 3 months later, 'Ramesh' revokes the guarantee, when 'Kamlesh' had lent to 'Suresh' INR 35,000. Decide whether 'Ramesh' is discharged from all the liabilities to 'Kamlesh' for any subsequent loan under the provisions of the Indian Contract Act, 1872. Would your answer differ in case 'Suresh' makes a default in paying back to 'Kamlesh' the money already borrowed i.e. INR 35,000?</p>	
<b>Ravi is discharged</b>	<ul style="list-style-type: none"> <li>▪ From all the liabilities in respect of any loan given by Nalin to Ashok after the date of revocation of continuing guarantee.</li> </ul>
<b>Ravi is not discharged</b>	<ul style="list-style-type: none"> <li>▪ For the loan of INR 20,000 already given by Nalin to Ashok.</li> </ul>

<b>Concept Problem 16</b> <span style="float: right;"><b>[Nov 2008][Nov 2017][RTP May 2019][Sec 133]</b></span>	
<p>A gives to C, a continuing guarantee to the extent of INR 5,000 for the vegetables to be supplied by C to B from time to time on credit. Afterwards, B becomes embarrassed and without the knowledge of A, B and C contract that C shall continue to supply B with vegetables for ready money and that the payment shall be applied to the then existing debts between B and C.</p> <p>Examining the provision of the Indian Contract Act, 1872, decide whether A is liable on his guarantee given to C.</p> <p style="text-align: center;"><b>Or</b></p> <p>A' gives to 'M' a continuing guarantee to the extent of INR 8,000 for the fruits to be supplied by 'M' to 'S' from time to time on credit. Afterwards 'S' became embarrassed and without the knowledge of 'A', 'M' and 'S' contract that 'M' shall continue to supply 'S' with fruits for ready money and that payments shall be applied to the then existing debts between 'S' and 'M'. Examining the provision of the Indian Contract Act, 1872, decide whether 'A' is liable on his guarantee given to M.</p>	
<b>A is not liable to C</b>	<ul style="list-style-type: none"> <li>▪ For the transaction that take place after variation between B and C.</li> <li>▪ Since a surety is discharged if any variation is made in a contract of guarantee without the consent of the surety.</li> </ul>

<b>Concept Problem 17</b> <span style="float: right;"><b>[Nov 2008] [Sec 137]</b></span>	
<p>B owes C, a debt guaranteed by A. C does not sue B for a year after the debt has become payable. In the meantime, B becomes insolvent. Is A discharged? Decide with reference to the provisions of the Indian Contract Act, 1872.</p>	
<b>A is not discharged</b>	<ul style="list-style-type: none"> <li>▪ Since mere forbearance on the part of the creditor to sue the principal debtor does not discharge the surety.</li> </ul>

## UNIT II - CONTRACT OF BAILMENT

### Concept Problem 18 [ICAI SM] [ICAI May 2007]

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

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

#### Solution

- i) No. Mere custody of goods does not mean possession. For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it, Section 148, of the Indian Contract Act, 1872 is not applicable.



- ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists and section 148 is applicable.

**Concept Problem 19 [ICAI SM] [MTP Nov 2018]**

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

**Solution**

Referring to the Section 152 of the Indian Contract Act, 1872, B is liable to compensate A for his negligence to keep jewelry at his resident. Here, A and B agreed to keep the jewelry at the Bank's safe locker and not at the latter's residence.

**Concept Problem 20 [ICAI SM]**

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

**Solution**

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

**Concept Problem 21 [ICAI SM]**

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

**Answer**

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

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

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

**Concept Problem 22 [ICAI SM]**

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

**Answer**

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

**Concept Problem 23 [ICAI SM]**

State the essential elements of a contract of bailment.

**Answer**

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

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

**Concept Problem 24 [ICAI SM]**

Give four differences between Bailment and pledge.

**Answer**

Distinction between bailment and pledge. The following are the distinction between bailment and pledge:

- i) **As to purpose:** Pledge is a variety of bailment. Under pledge goods are bailed as a security for a loan or a performance of a promise. In regular bailment the goods are bailed for other purpose than the two referred above. The bailee takes them for repairs, safe custody etc.
- ii) **As to right of sale:** The pledgee enjoys the right to sell only on default by the pledgor to repay the debt or perform his promise, that too only after giving due notice. In bailment the bailee, generally, cannot sell the goods. He can either retain or sue for non-payment of dues.
- iii) **As to right of using goods:** Pledgee has no right to use goods. A bailee can, if the terms so provide, use the goods.
- iv) **Consideration:** In pledge there is always a consideration whereas in a bailment there may or may not be consideration.
- v) **Discharge of contract:** Pledge is discharged on the payment of debt or performance of promise whereas bailment is discharged as the purpose is accomplished or after specified time.

**Concept Problem 25 [ICAI SM]**

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

**Answer**

According to section 157 of the Contract Act, 1872, if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

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

**Concept Problem 26 [ICAI SM] [ICAI Nov 2019]**

- (i) Srushti acquired valuable diamond at a very low price by a voidable contract under the provisions of the Indian Contract Act, 1872. The voidable contract was not rescinded. Srushti pledged the diamond with Mr. VK. Is this a valid pledge under the Indian Contract Act, 1872?
- (ii) Whether a Pawnee has a right to retain the goods pledged.

**Answer**

- i) Pledge by person in possession under voidable contract [Section 178A of the Indian Contract Act, 1872]: When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

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

- ii) **Right of retainer [Section 173 of the Indian Contract Act, 1872]:** Yes, the pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

**Concept Problem 27 [MTP May 2018]**

Mr. Avinash wanted a loan for expanding his business, from ABC Bank. Mr. Avinash has pledged the stock of his business to obtain the loan from bank. However, the expansion of business did not reap the desired results and Mr. Avinash was not able to repay the loan. Now, ABC bank wants to retain the stock for adjustment of their loan. Advise, ABC Bank whether they can retain the stock for the adjustment of their loan and also for payment of interest. Give your answer as per the provisions of the Contract Act, 1872.

**Solution**

According to section 173 of the Indian Contract Act, 1872, the pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Hence, ABC Bank can retain the stock of business of Mr. Avinash, not only for adjustment of the loan but also for payment of interest.

**Concept Problem 28 [MTP Nov 2019]**

Mr. Dhannaseth delivers a rough blue sapphire to a jeweller, to be a cut and polished. The jeweller carries out the job accordingly. However, now Mr. Dhannaseth refuses to make the payment and wants his blue sapphire back. The jeweller denies the delivery of the goods without payment. Examine whether the jeweller can hold blue sapphire. Give your answer as per the provisions of the contract Act, 1872.

**Answer**

Accordingly to section 170 of the Indian Contract Act, 1872, where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of the contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect to them.

Thus, in accordance with the purpose of bailment if the bailee by his skill or labour improves the goods bailed, he is entitled for remuneration for such services. Towards such remuneration, the bailee can retain the goods bailed if the bailor refuses to pay the remuneration, Such a right to retain the goods bailed is the right of particular item. He however does not have the right to sue.

Where the bailee delivers the goods without receiving his remuneration, he has a right to sue the bailor. In such a case the particular lien may be waived. The particular lien is also lost if the bailee does not complete the work within the time agreed.

Hence, in the given situation the jeweller is entitled to retain the stone till he is paid for the services he has rendered.

### Concept Problem 29 [MTP May 2020]

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

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

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

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

Concept Problem 30		[June 2009] [May 2017] [Sec 149]
<p>A, the bailor, pledges cinema projector and other accessories with Cine Association Co-operative Bank Limited, the bailee, for loan. A requests the Bank to allow the pledged goods to remain in his possession and promises to hold the same in trust for the bailee and also further promises to handover the possession of the same to the Bank whenever demanded.</p> <p>Examining the provisions of Indian Contract Act, 1872 decide, whether a valid contract of pledge has been made between A, the bailor and Bank, the bailee?</p> <p style="text-align: center;"><b>OR</b></p> <p>Ram, the bailor, pledges a cinema projector and other accessories with Movie Association Co-operative Bank Limited, the bailee, for a loan. Ram request the bank to allow the pledged goods to remain in his possession and promises to hold the same in trust for the bailee and also further promises to handover the possession of the same to the bank whenever demanded. Examining the provision of the Indian contract Act, 1872 decide, whether a valid contract of pledge has been between Ram, the bailor and Bank, the bailee?</p>		
<b>There is a valid contract of pledge</b>	<ul style="list-style-type: none"> <li>▪ Since Mr. A has pledged the goods with the bank as a security for the loan;</li> <li>▪ Although the bank has given permission to Mr. A to continue to possess the goods in trust for the bank;</li> <li>▪ Since the bank is legally entitled to the possession of the goods although the physical possession of goods is with Mr. A.</li> <li>▪ Since 'constructive delivery' of cinema projector' from Mr. A to the bank has taken place in the given case.</li> </ul>	

Concept Problem 31		[Nov 2008] [Sec 163]
<p>M lends a sum of INR 5,000 to B, on the security of two shares of a limited company on 1<sup>st</sup> April 2007. On 15<sup>th</sup> June 2007, the company issued two bonus shares. B returns the loan amount of INR 5,000 with interest but M returns only two shares which were pledged and refuses to give the two bonus shares. Advice B in the light of the provisions of the Indian Contact Act, 1872.</p>		
<b>B is entitled to the two bonus shares</b>	<ul style="list-style-type: none"> <li>▪ Since the bailor (pawnor, in case of pledge of goods) is entitled to any accretion to the goods;</li> <li>▪ Since the issue of two bonus shares by the company amounts to accretion to the goods.</li> </ul>	

Concept Problem 32	[Nov 2003] [Sec 160 and 161]
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Sunil delivered his car to Mahesh for repairs. Mahesh completed the work but did not return the car to Sunil within reasonable time, though Sunil repeatedly reminded Mahesh for the return of car. In the meantime, a big fire occurred in the neighbourhood and the car was destroyed. Decide whether Mahesh can be held liable under the provisions of the Indian Contract Act, 1872.	
<b>Duty of Mahesh</b>	<ul style="list-style-type: none"> <li>To return the car to Sunil, without demand by Sunil, after completion of repairs (sec. 160)</li> </ul>
<b>Mahesh is liable for the loss of car by fire</b>	<ul style="list-style-type: none"> <li>Since Mahesh failed to return the car within reasonable time of completion of repairs.</li> <li>Even though the car was destroyed without Mahesh's fault or negligence or due to extraordinary circumstances or acts of God (sec. 161).</li> </ul>

<b>Concept Problem 33</b> <span style="float: right;"><b>[May 2008] [Nov 2010] [Nov 2014] [Sec 180 and 181]</b></span>	
<p><b>Case I.</b> Ravi sent a consignment of goods worth INR 60,000 by railways and got railway receipt. He obtained an advance of INR 30,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railways failed to deliver the goods at destination. The bank filed a suit against the railways for INR 60,000.</p> <p>Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?</p> <p style="text-align: center;"><b>OR</b></p> <p><b>Case II.</b> X sent a consignment of mobile phone worth INR 60,000 to Y and obtained a railway receipt therefore. Later, he borrowed a loan of INR 40,000 from Star Bank and endorsed the railway receipt in favour of the bank as security. In transit, the consignment of mobile phone was lost. The Bank files a suit against the railway for a claim of INR 60,000, the value of the consignment. The railway contended that the Bank is entitled to recover the amount of loan i.e. INR 40,000 only. Examining the provision of the Indian contract Act, 1872, decide whether the contention of the railway is valid.</p> <p style="text-align: center;"><b>OR</b></p> <p><b>Case III.</b> X sent a consignment of goods worth INR 2,90,000 by railway and got railway receipt for the same. He obtained an advance of INR 2,60,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security for the advance. The railway failed to deliver the goods at the destination. The bank filed a suit against the Railway for INR 2,90,000. Decide in the light of provision of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?</p>	
<b>The contract between Ravi /X and bank is a contact of pledge</b>	<ul style="list-style-type: none"> <li>Since deposit of title deeds with the bank as security against an advance constitutes a pledge.</li> </ul>
<b>Rights of Pawnee</b>	<ul style="list-style-type: none"> <li>If a third person wrongfully deprives the Pawnee of the goods, or causes any damage to the goods, the Pawnee is entitled to all the remedies as the owner (viz. the pawnor) might have exercised as if the goods were not pledged (sec.180).</li> </ul>
<b>The bank would succeed in suit filed against the Railways for entire value of the consignment</b>	<ul style="list-style-type: none"> <li>Since in case of pledge, the Pawnee can exercise all the rights which the pawnor could exercise in respect of such goods, if the goods are damaged or some third party deprives the pawnee of such goods [<i>Morvi Mercantile Bank Ltd. v Union of India</i>].</li> <li>The compensation received by the Pawnee shall be divided among the pawnor and Pawnee as per their respective interests (sec.181).</li> </ul>
<b>Case I</b>	<b>The bank shall pay over to Ravi</b> INR 30,000
<b>Case II</b>	<b>The bank shall pay over to X</b> INR 20,000
<b>Case III</b>	<b>The bank shall pay over to X</b> INR 30,000

## UNIT III - CONTRACT OF AGENCY

Concept Problem 34 [ICAI SM] [MTP May 2019]



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

### Solution

According to the provisions of Section 184 of the Indian Contract Act, 1872, as between the principal and a third person, any person, even a minor may become an agent. But no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal.

Thus, if a person who is not competent to contract is appointed as an agent, the principal is liable to the third party for the acts of the agent. Thus, in the given case, D gets a good title to the watch. M is not liable to A for his negligence in the performance of his duties.

### Concept Problem 35 [ICAI SM]

State with reason whether the following statement is correct or incorrect “Ratification of agency is valid even if knowledge of the principal is materially defective.”

### Solution

#### Incorrect:

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

### Concept Problem 36 [ICAI SM] [RTP May 2018]

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

### Solution

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

A typical case is where the ‘agent’ handling perishable goods like ‘apples’ can decide the time, date and place of sale, not necessarily as per instructions of the principal, with the intention of protecting the principal from losses. Here the agent acts in an emergency and acts as a man of ordinary prudence.

In the given case Suresh had acted in an emergency situation and Ramesh will not succeed against him.

### Concept Problem 37 [ICAI SM] [MTP May 2019] [ICAI Nov 2005] [ICAI May 2016] [RTP May 2018]

Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for INR 20 lakhs in the name of a nominee and then purchased it himself for INR 24 lakhs. He then sold the same house to Mr. Ahuja for INR 26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh.

Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain.

#### Or

Mr. A of Delhi engaged Mr. S as his agent to buy a house in Noida Extension area. Mr. S bought a house for INR 50 lakhs in the name of a nominee and then purchased it himself for INR 60 lakhs. He then sold the same house to Mr. A for INR 80 lakhs. Mr. A later comes to know the mischief of Mr. S and tries to recover the excess amount paid to Mr. S. Discuss whether he is entitled to recover any amount from Mr. S? If so, how much?

### Solution

The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read



with Section 216. The two sections provide that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

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

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

### Concept Problem 38 [ICAI SM] [MTP Nov 2018]

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

#### Solution

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

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

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

### Concept Problem 39 [ICAI SM]

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

#### Answer

Agent's authority in an emergency (Section 189 of the Indian Contract Act, 1872): An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

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

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

### Concept Problem 40 [ICAI SM]

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

#### Answer

To conduct the business of agency according to the principal's directions (Section 211 of the Indian Contract Act, 1872): An agent is bound to conduct the business of his principal according to the direction given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind

at the place where the agent conducts such business. When the agent act otherwise, if any loss sustained, he must take it good to his principal, and, if any profit accrues, he must account of it.

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

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

#### **Concept Problem 41 [ICAI SM]**

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

#### **Answer**

According to section 195 of the Contract Act, 1872, in selecting an agent (substituted) for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected. Thus, while selecting a “substituted agent” the agent is bound to exercise same amount of diligence as a man of ordinary prudence and if he does so he will not be responsible for acts or negligence of the substituted agent.

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

#### **Concept Problem 42 [ICAI SM]**

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

#### **Answer**

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

However, the implied authority can be challenged by the husband only in the following circumstances.

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

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

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

#### **Concept Problem 43 [ICAI SM] [ICAI May 2014] [ICAI Nov 2019]**

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

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

#### **Answer**

According to Section 202 of the Indian Contract Act, 1872 an agency becomes irrevocable where the agent has

himself an interest in the property which forms the subject-matter of the agency, and such an agency cannot, in the absence of an express provision in the contract, be terminated to the prejudice of such interest.

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

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

**Concept Problem 44 [RTP May 2018] [ICAI May 2005]**

Ramesh hires a carriage of Suresh and agrees to pay INR 1500 as hire charges. The carriage is unsafe, though Suresh is unaware of it. Ramesh is injured and claims compensation for injuries suffered by him. Suresh refuses to pay. Discuss the liability of Suresh.

**Solution**

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case Suresh is responsible to compensate Ramesh for the injuries sustained even if he was not aware of the defect in the carriage.

**Concept Problem 45 [MTP Nov 2018]**

Mr. Navin owns a big car and has leased his car to Mrs. Susie. The lease agreement is terminable on three months' notice. Mr. Bhalla, not being authorised by Mr. Navin, demands on behalf of Mr. Navin, the delivery of the car and gives a notice of termination of lease agreement to Mrs. Susie who was in possession of the car at that time. Examine whether Mr. Navin can ratify the notice sent by Mr. Bhalla. Give your answer as per the provisions of the Contract Act, 1872.

**Solution**

According to section 200 of the Indian Contract Act, 1872, an act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect. In other words, when the interest of third parties is affected, the principle of ratification does not apply. Ratification cannot relate back to the date of contract if third party has in the intervening time acquired rights.

Thus, in the instant case the notice cannot be ratified by Navin, so as to be binding on Susie.

**Concept Problem 46 [MTP May 2019]**

What is agent's authority in case of an emergency? What are the essential conditions to be satisfied to constitute a valid emergency? Give your answer as per the provisions of the Indian Contract Act, 1872.

**Solution**

An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

To constitute a valid agency in an emergency, following conditions must be satisfied:

- i) Agent should not be in a position or have any opportunity to communicate with his principal within the time available.
- ii) There should have been actual and definite commercial necessity for the agent to act promptly.
- iii) The agent should have acted bonafide and for the benefit of the principal.
- iv) The agent should have adopted the most reasonable and practicable course under the circumstances, and
- v) The agent must have been in possession of the goods belonging to his principal and which are the subject of contract.

**Concept Problem 47 [ICAI May 2018]**

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

**Solution**

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

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

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

**Concept Problem 48 [ICAI May 2018]**

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

**Solution**

**Agent's authority in an emergency** (Section 189 of the Indian Contract Act, 1872): An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

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

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

**Concept Problem 49 [ICAI May 2019]**

Aarthi is the wife of Naresh. She purchased some sarees on credit from M/s Rainbow Silks, Jaipur. M/s Rainbow Silks, Jaipur demanded the amount from Naresh. Naresh refused. M/s Rainbow Silks, Jaipur filed a suit against Naresh for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether M/s Rainbow Silks, Jaipur would succeed?

**Answer**

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

But the legal presumption can be rebutted in the following cases:

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

If the wife lives apart for no fault on her part, wife has authority to pledge her husband's credit for necessities. This legal presumption can be rebutted only in cases (iii) and (iv) above.

Applying the above conditions in the given case M/s Rainbow Silks will succeed. It can recover the said amount from Naresh if sarees purchased by Aarthi are necessities for her.

### Concept Problem 50 [ICAI May 2019]

An agent is neither personally liable nor can he personally enforce the contract on behalf of the principal." Comment.

#### Answer

According to section 230 of the Indian Contract Act, 1872, in the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them. Thus, an agent cannot personally enforce, nor be bound by, contracts on behalf of principal.

**Presumption of contract to the contrary:** But such a contract shall be presumed to exist in the following cases:

- i) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad/foreign principal;
- ii) Where the agent does not disclose the name of his principal or undisclosed principal; and
- iii) Where the principal, though disclosed, cannot be sued.

### Concept Problem 51 [ICAI May 2008] [RTP May 2020]

Pankaj appoints Shruti as his agent to sell his estate. Shruti, on looking over the estate before selling it, finds the existence of a good quality Granite-Mine on the estate, which is unknown to Pankaj. Shruti buys the estate herself after informing Pankaj that she (Shruti) wishes to buy the estate for herself but conceals the existence of Granite-Mine. Pankaj allows Shruti to buy the estate, in ignorance of the existence of Mine. State giving reasons in brief the rights of Pankaj, the principal, against Shruti, the agent. Give your answer as per the provisions of the Contract Act, 1872.

What would be your answer if Shruti had informed Pankaj about the existence of Mine before she purchased the estate, but after two months, she sold the estate at a profit of 10 lakh?

#### Answer

Agent's duty to disclose all material circumstances & his duty not to deal on his own account without principal's consent. The problem is based on Sections 215 & 216 of the Indian Contract Act, 1872. According to Section 215, if an agent deals on his own account in the business of the agency, without obtaining the consent of his principal and without acquainting him with all material circumstances, then the principal may repudiate the transaction.

On the other hand, section 216 provides that, if an agent, without the knowledge of his principal, acts on his own account in the business of the agency, then the principal may claim any benefit which may have accrued to the agent from such a transaction. Hence in the first instance, though Pankaj had given his consent to Shruti permitting the latter to act on his own account in the business of agency, Pankaj may still repudiate the sale as the existence of the mine, a material circumstance, had not been disclosed to him.

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

### Concept Problem 52

[June 2009] [Sec 237]

R of New Delhi sends his agent M to purchase certain goods from Global Enterprise, Mumbai on credit for him. Later on, R pays the amount for the goods purchased. On another occasion, he again sends M to purchase goods but this time pays sufficient cash to M for the purpose. M, however again purchases the goods from Global Enterprises but on credit and soon thereafter he dies. Global Enterprises files a suit against R for recovery of the said amount.

Decide whether Global Enterprise would be given any relief by the court under the provisions of the Indian Contract Act, 1872.	
<b>R is liable to Global Enterprise for goods purchased by M</b>	<ul style="list-style-type: none"> <li>▪ since the principal is bound to third parties for all such acts of the agent as are within the scope of authority of the agent.</li> <li>▪ since on a previous occasion, purchase of goods by M on behalf of R, and subsequent payment for such goods by R, established that it was within the scope of authority of M to purchase goods on credit on behalf of R.</li> </ul>

## 2. TRUE OR FALSE

State whether the following statement are True or False and give reasons (1 mark each):

1	May 2007	<p>Where there are co-sureties, a release by the creditor of one of them does not discharge the other.</p> <p><b>Ans.</b> The given statement is True.</p> <p><b>Reason:</b> As per sec. 138, where there are co-sureties, a release by the creditor of one of them does not discharge the others.</p>
2	May 2008	<p>In a contract of guarantee, forbearance by creditor to sue the principal debtor discharges the surety.</p> <p><b>Ans.</b> The given statement is False.</p> <p><b>Reason:</b> As per sec. 137, mere forbearance on the part of the creditor to sue the principal debtor does not discharge the surety.</p>
3	Nov 2008	<p>The contract of insurance is not fully covered under the contract of indemnity.</p> <p><b>Ans.</b> The given statement is True.</p> <p><b>Reason:</b> As per sec. 124, a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by conduct of any other person, is called a 'contract of indemnity'. In case of a contract of insurance, the loss may happen due to natural calamities, and not due to conduct of the promisor or any other person. Thus, contract of insurance is not contract of indemnity as per the definition given u/s 124 but have been held to be contracts of indemnity as per judicial decisions.</p>
4	Jun 2009	<p>Any variation in terms of contract made between principal debtor and a creditor without the consent of surety, automatically discharges the liability of the surety.</p> <p><b>Ans.</b> The given statement is True.</p> <p><b>Reason.</b> As per sec. 133, any variance made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to such variation.</p>
5	Nov 2013	<p>In a contract of guarantee, there are three contracts.</p> <p><b>Ans.</b> The given statement is True.</p> <p><b>Reason.</b> First contract is between the principal debtor and the creditor, second is between the surety and the creditor, and the third is between the surety and the principal debtor.</p>
6	May 2008	<p>A pledge of documents of title to goods by a mercantile agent is a valid pledge.</p> <p><b>Ans.</b> The given statement is True.</p> <p><b>Reason:</b> As per sec. 178, where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has no authority to pledge.</p>
7	Nov 2009	<p>If the pawnor makes a default in the payment of debt, or performance of duty as agreed, the pawnee has a right to sell the thing pledged for which no reasonable notice of sale is required.</p> <p><b>Ans.</b> The given statement is False.</p>



		<b>Reason.</b> As per sec. 176, if the pawnor makes a default in payment of the debt at stipulated time, pawnee may sell the goods pledged, on giving the pawnor reasonable notice of the sale.
8	Nov 2014	Bailee has no right to mix the goods bailed with his own goods without the consent of the bailor. <b>Ans.</b> The given statement is True. <b>Reason.</b> As per sec. 155, the bailee may mix the goods bailed with his own goods only with the consent of the bailor. If the goods are mixed without bailor's consent the bailee shall be liable to separate the goods as per sec. 156 or if the goods are not separable, then bailee shall be liable to the bailor for loss caused to him as per sec. 157.
9	May 2015	Depositing of ornaments in a bank locker is a bailment. <b>Ans.</b> The given statement is False. <b>Reason.</b> No delivery of goods takes place in such a case since the bank does not get the possession of the ornaments put in its locker.
10	May 2007	A minor cannot be appointed as an agent. <b>Ans.</b> The given statement is False. <b>Reason.</b> As per sec. 184, any person may become an agent.
11	Nov. 2009	An "Agency coupled with interest" may be terminated at the instance of principal at any time. <b>Ans.</b> The given statement is False. <b>Reason.</b> As per sec. 202, an agency coupled with interest cannot, in the absence of an express contract, be terminated to the prejudice of such interest.
12	May 2010	Ratification of agency is valid even if knowledge of the principal is materially defective. <b>Ans.</b> The given statement is False. <b>Reason.</b> As per sec. 198, no valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.
13	Nov. 2010	No consideration is necessary to create an agency. <b>Ans.</b> The given statement is True. <b>Reason.</b> As per sec. 185, no consideration is necessary to create an agency.
14	May 2011	An agreement with a minor may be ratified on his attaining majority. <b>Ans.</b> The given statement is False. <b>Reason.</b> Ratification can be made only if the person who wishes to ratify had the contractual capacity when the act was actually done.
15	Nov. 2013	Agency cannot be created without consideration. <b>Ans.</b> The given statement is False. <b>Reason.</b> As per sec. 185, consideration is not necessary to create an agency.
16	May 2015	Agency coupled with interest is irrevocable. <b>Ans.</b> The given statement is True. <b>Reason.</b> As per sec. 202, an agency coupled with interest cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

### 3. QUESTIONS FOR PRACTICE

- 1) State the essential elements of a contract of bailment [Nov. 2012]
- 2) What is the status of a finder of goods under the Indian contract act 1872? What are his rights? [May 2003]
- 3) What tests can be applied in determining whether a person is an agent of another? [May 2003]
- 4) What do you understand by agency by ratification? What is the effect of ratification? [Nov. 2003]
- 5) The relationship of principal and agent (i.e. agency) may be constituted by subsequent ratification by the principal examine the validity of the statement. [Nov. 2006]

- 6) “The relationship of principal and agent (i.e agency) may be constituted by subsequent ratification by the principal. States the requisites of a valid ratification in the light of prospectus of the Indian contract act 1872
- 7) Secret profit earned by the agent remedies available to the principal [**Nov. 2005, May 2016**]
- 8) State any five circumstances whereunder an agent is personally liable to a third party for the act during the course of agency [**May 2003**]
- 9) Give four differences between Bailment and Pledge. [**May 2018**]

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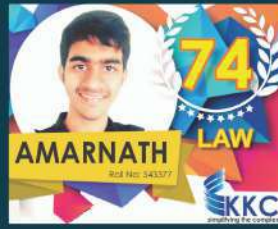
ARISE AWAKE AND STOP NOT  
TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

### About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
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# CHAPTER 2

# THE NEGOTIABLE INSTRUMENTS

# ACT, 1881

## 1. PRACTICAL QUESTIONS

### Concept Problem 1 [ICAI SM]

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

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

### Answer

**Person to be called as a holder:** As per section 8 of the Negotiable Instruments Act, 1881 'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases—

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

### Concept Problem 2 [ICAI SM]

P draws a bill on Q for INR 10,000. Q accepts the bill. On maturity, the bill was dishonoured by non-payment. P files a suit against Q for payment of INR 10,000. Q proved that the bill was accepted for value of INR 7,000 and as an accommodation to the plaintiff for the balance amount i.e. INR 3,000. Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether P would succeed in recovering the whole amount of the bill.

### Answer

As per Section 44 of the Negotiable Instruments Act, 1881, when the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.



Explanation- The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee, and the endorser with his endorsee. Other signers may by agreement stand in immediate relation with a holder.

On the basis of above provision, P would succeed to recover INR 7,000 only from Q and not the whole amount of the bill because it was accepted for value as to INR 7,000 only and an accommodation to P for INR 3,000.

### Concept Problem 3 [ICAI SM] [Nov 2004]

A draws a bill on B. B accepts the bill without any consideration. The bill is transferred to C without consideration. C transferred it to D for value. Decide-

- i) Whether D can sue the prior parties of the bill, and
- ii) Whether the prior parties other than D have any right of action inter se?

Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881.

### Answer

**Problem on Negotiable Instrument made without consideration:** Section 43 of the Negotiable Instruments Act, 1881 provides that a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

- i) In the problem, as asked in the question, A has drawn a bill on B and B accepted the bill without consideration and transferred it to C without consideration. Later on, in the next transfer by C to D is for value. According to provisions of the aforesaid section 43, the bill ultimately has been transferred to D with consideration. Therefore, D can sue any of the parties i.e. taken with consideration.
- ii) As regards to the second part of the problem the prior parties before D i.e. A, B and C have no right of action inter se because first part of section 43 has clearly lays down that a negotiable instrument, made, drawn, accepted indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction prior to the parties who receive it on consideration.

### Concept Problem 4 [ICAI SM]

Mr. V draws a cheque of INR 11,000 and gives to Mr. B by way of gift. State with reason whether -

- i) Mr. B is a holder in due course as per the Negotiable Instrument Act, 1881?
- ii) Mr. B is entitled to receive the amount of ` 11,000 from the bank?

### Answer

According to section 9 of the Negotiable Instrument Act, 1881, "Holder in due course" means-

- any person
- who for consideration
- becomes the possessor of a promissory note, bill of exchange or cheque (if payable to bearer), or the payee or endorsee thereof, (if payable to order), before the amount mentioned in it became payable, and
- without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In the instant case, Mr. V draws a cheque of INR 11,000 and gives to Mr. B by way of gift.

- i) Mr. B is holder but not a holder in due course since he did not get the cheque for value and consideration
- ii) Mr. B title is good and bonafide. As a holder he is entitle to receive INR 11,000 from the bank on whom the cheque is drawn.

### Concept Problem 5 [ICAI SM]

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

**Answer**

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

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

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

Also, Section 140 of the Negotiable Instruments Act, 1881, specifies absolute liability of the drawer of the cheque for commission of an offence under the section 138 of the Act. Section 140 states that it shall not be a defence in a prosecution for an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

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

**Concept Problem 6 [ICAI SM]**

Mr. S Venkatesh drew a cheque in favour of M who was sixteen years old. M settled his rental due by endorsing the cheque in favour of Mrs. A, the owner of the house in which he stayed. The cheque was dishonoured when Mrs. A presented it for payment on grounds of inadequacy of funds. Advise Mrs. A how she can proceed to collect her dues.

**Answer**

Capacity to make, etc., promissory notes, etc. (Section 26 of the Negotiable Instruments Act, 1881): Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

However, a minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself.

As per the facts given in the question, Mr. S Venkatesh draws a cheque in favour of M, a minor. M endorses the same in favour of Mrs. A to settle his rental dues. The cheque was dishonoured when it was presented by Mrs. A to the bank on the ground of inadequacy of funds Here in this case, M being a minor may draw endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable, Mrs A can, thus, proceed against Mrs. S Venkatesh to collect their dues.

**Concept Problem 7 [ICAI SM]**

What are the circumstances under which a bill of exchange can be dishonoured by non- acceptance? Also, explain the consequences if a cheque gets dishonoured for insufficiency of fund in their account.

**Answer**

As per section 91 of the Negotiable Instruments Act, 1881, a bill may be dishonoured either by non-acceptance or by non-payment.

Dishonour by non-acceptance may take place in any one of the following circumstances:

- i) When the drawee either does not accept the bill within forty-eight hours (exclusive of public holidays) of presentment or refuse to accept it;
- ii) When one of several drawees, not being partners, makes default in acceptance;
- iii) When the drawee makes a qualified acceptance;
- iv) When presentment for acceptance is excused and the bill remains unaccepted; and
- v) When the drawee is incompetent to contract

**Dishonour of Cheque for insufficiency, etc. of funds in the account:** As per section 138 of the Negotiable Instruments Act 1881, where any cheque drawn by a person on an account maintained by him with a banker for payment is dishonoured due to insufficiency of funds, he shall be punished with imprisonment for a term which may extend to two years or with fine which may extend to twice the amount of the cheque or with both.

### Concept Problem 8 [ICAI SM]

C issues a cheque for INR 55,00,00/- in favour of D. C has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank, in the meantime, C became bankrupt. Decide under the provisions of Negotiable Instruments Act, 1881, whether D can recover the money from C?

### Answer

Section 84(1) of the Act, provides that cheque should be presented to Bank within reasonable time. If cheque is not presented within reasonable time, meanwhile the drawer suffers actual damage, the drawer is discharged to the extent of such actual damage. This would be so if the cheque would have been passed if it was presented within reasonable time. As per section 84(2), in determining what is a reasonable time, regard shall be had to (a) the nature of the instrument (b) the usage of trade and of bankers, and (c) facts of the particular case. The drawer will get discharge, but the holder of the cheque will be treated as creditor of the bank, in place of drawer. He "Will be entitled to recover the amount from Bank [section 84(3)]. In the above case drawer i.e., C has suffered damage as cheque was not presented by D within reasonable time. Hence, C will get discharged but D will be the creditor of bank for amount of cheque and can recover the amount from bank.

### Concept Problem 9 [ICAI SM]

State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4<sup>th</sup> May, 2017.

### Solution

**Calculation of maturity of a Bill of Exchange:** The maturity of a bill, not payable on demand, at sight, or on presentment, is at maturity on the third day after the day on which it is expressed to be payable (Section 22, of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of bill payable on demand, at sight, or presentment.

When a bill is made payable at stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated.

When it is made payable after a stated number of months after sight, the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance.

When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates with the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date, a bill made payable a certain number of days after date or after sight or after a certain event

is at maturity, the day of the date, or the day of presentment for acceptance or sight or the day of protest for non-acceptance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable.

When the last day of grace falls on a day which is public holiday, the instrument is due and payable on the next preceding business day (Section 25).

**Answer to Problem:** In this case, the day of presentment for sight is to be excluded i.e. 4<sup>th</sup> May, 2017. The period of 100 days ends on 12<sup>th</sup> August, 2017 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15<sup>th</sup> August, 2017 which happens to be a public holiday. As such, it will fall due on 14<sup>th</sup> August, 2000 i.e. the next preceding business day.

### **Concept Problem 10 [ICAI SM] [RTP May 2019] [MTP May 2019]**

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

#### **Solution**

The question arising in this problem is whether the [making of promissory note is complete when one half of the note was delivered to N.

Under Section 46 of the Negotiable Instrument Act, 1881, the making of a promissory note is completed by delivery, actual or constructive. Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole.

So, the claim of N to have the other half of the promissory note sent to him is not maintainable. M is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the promissory note.

### **Concept Problem 11 [ICAI SM]**

M drew a cheque amounting to INR 2 lakh payable to N and subsequently delivered to him. After receipt of cheque, N endorsed the same to c but kept it in his safe locker. After sometime, N died, and P found the cheque in N's safe locker. Does this amount to indorsement under the negotiable instruments Act ,1881?

#### **Solution**

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

### **Concept Problem 12 [ICAI SM] [MTP Nov 2020]**

Mr. Muralidharan drew a cheque payable to Mr. Vyas or order. Mr. Vyas lost the cheque and was not aware of the loss of the cheque. The person who found the cheque forged the signature of Mr. Vyas and endorsed it to Mr. Parshwanath as the consideration for goods bought by him from Mr. Parshwanath. Mr. Parshwanath encashed the cheque, on the very same day from the drawee bank. Mr. Vyas intimated the drawee bank about the theft of the cheque after three days. Examine the liability of the drawee bank.

#### **Solution**

Cheque payable to order [section 85 of the negotiable instruments act ,1881]

- where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharged by payment in due course.
- where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether in full or in blank appearing thereon, and notwithstanding that any such indorsement purports to restrict or exclude further negotiation.

As per the given facts, cheque is drawn payable to “Mr. Vyas or order”. It was lost and Mr. Vyas was not aware of the same. The person found the cheque and forged and endorsed it to Mr. Parshwanath, who encashed the cheque from the drawee bank. After few days, Mr. Vyas intimated about the theft of the cheque, to the drawee bank, by which time, the drawee bank had already made the payment.

According to above stated section 85, the drawee banker is discharged when it has made a payment against the cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the signature of Mr. Vyas is forged, the banker is protected and is discharged. The true owner, Mr. Vyas, cannot recover the money from the drawee bank in this situation.

### Concept Problem 13 [ICAI SM]

Rama executes a promissory note in the following form, 'I promise to pay a sum of INR 10,000 after three months'. Decide whether the promissory note is a legal promissory note.

#### Answer

The promissory note is an unconditional promise in writing. In the above question, the amount is certain but the date and name of payee is missing make it a bearer instrument. As per RBI Act, a promissory note cannot be made payable to bearer whether on demand or after certain days. Hence, the instrument is illegal as per RBI Act and cannot be legally enforced.

### Concept Problem 14

'K' is an employee of 'Summit'. He fraudulently obtains from Summit a cheque crossed 'not negotiable'. He later transfers the cheque to 'D' who gets the cheque encashed from XYZ Bank, which is not the drawee bank. Summit comes to know about the fraudulent act of 'K', sues XYZ Bank for the recovery of money.

Examine with reference to the relevant provisions of the Negotiable Instruments Act, 1881, whether Summit will be successful in his claim? Would your answer be still the same in case 'K' does not transfer the cheque and gets the cheque encashed from XYZ Bank himself?

#### Solution

According to Section 130 of the Negotiable Instruments Act, 1881 a person taking cheque crossed generally or specially bearing in either case the words 'Not Negotiable' shall not have or shall not be able to give a better title to the cheque than the title the person from whom he took it had. In consequence, if the title of the transferor is defective, the title of the transferee would be vitiated by the defect.

Thus, based on the above provisions, it can be concluded that if the holder has a good title, he can still transfer it with a good title, but if the transferor has a defective title, the transferee is affected by such defects, and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value.

Since 'K' in the given case, had obtained the cheque fraudulently, he had no title to it and cannot give to the bank any title to the cheque or money; and the bank would be liable for the amount of the cheque for encashment. (Great Western Railway Co. v. London and Country Banking Co.)

The answer in the second case would not change and shall remain the same for the reasons given above. Thus, 'Summit' in both the cases shall be successful in his claim from XYZ Bank.

### Concept Problem 15 [ICAI Nov 2009] [ICAI Nov 2017] [RTP May 2018]

'E' is the holder of a bill of exchange made payable to the order of 'F'. The bill of exchange contains the following endorsements in blank:

- First endorsement 'F'
- Second endorsement 'G'.
- Third endorsement 'H' and
- Fourth endorsement 'I'

'E' strikes out, without I's consent, the endorsements by 'G' and 'H'. Decide with reasons whether 'E' is entitled to recover anything from 'I' under the provisions of Negotiable Instruments Act, 1881.

**Answer**

According to section 40 of the Negotiable Instruments Act, 1881, where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. Any party liable on the instrument may be discharged by the intentional cancellation of his signature by the holder.

In the given question, E is the holder of a bill of exchange of which F is the payee and it contains the following endorsement in blank:

First endorsement, 'F'

Second endorsement, 'G'

Third endorsement, 'H'

Fourth endorsement, 'I'

'E', the holder, may intentionally strike out the endorsement by 'G' and 'H'; in that case the liability of 'G' and 'H' upon the bill will come to an end. But if the endorsements of 'G' and 'H' are struck out without the consent of 'I', 'E' will not be entitled to recover anything from 'I'. The reason being that as between 'H' and 'I', 'H' is the principal debtor and 'I' is surety.

If 'H' is released by the holder under Section 39 of the Act, 'I', being surety, will be discharged. Hence, when the holder without the consent of the endorser impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder.

Thus, if 'E' strikes out, without I's consent, the endorsements by 'G' and 'H', 'I' will also be discharged.

**Concept Problem 16 [RTP Nov 2018]**

A bill of exchange has been dishonoured by non- payment. Now, Mr. Sandip, the holder wants a certificate of protest for such a dishonoured bill. Advise, Mr. Sandip whether he can get the certificate of protest. Also, advise him regarding the provisions of Protest for better security.

**Answer**

**Protest:** According to section 100 of the Negotiable Instruments Act, 1881, when a promissory note or bill of exchange has been dishonoured by non-acceptance or non- payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest.

**Protest for better security:** When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused may, with a reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security.

Thus, Mr. Sandip can get the certificate of protest by following the above provisions.

**Concept Problem 17**

Give the answer of the following as per the provisions of the Negotiable Instruments Act, 1881:

- a) A draws a cheque in favour of M, a minor. M endorses the same in favour of X. The cheque is dishonoured by the bank on grounds of inadequate funds. Discuss the rights of X.
- b) A promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. Does this amount to material alteration?
- c) A draws a cheque for Rs. 1000 and hands it over to B by way of gift. Is B a holder in due course? Explain whether he has right to receive the proceeds of the cheque. [ICAI May 2018]
- d) A cheque is drawn payable to "B or order". It is stolen and the thief forges B's endorsement and endorses it to C. The banker pays the cheque in due course. Whether B can recover the money from the banker.

**Answer**



- a) As per Section 26 of the Negotiable Instruments Act, 1881, a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable. X can, thus, proceed against
- b) As per the provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence adding the words “on demand” does not alter the business effect of the instrument.
- c) B is a holder but not a holder in due course as he does not get the cheque for value and consideration. His title is good and bonafide. As a holder he is entitled to receive Rs. 1000 from the bank on whom the cheque is drawn.
- d) According to Section 85 of the Negotiable Instruments Act, 1881, the drawee banker is discharged when he pays a cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the endorsement of Mr. B is forged, the banker is protected and he is discharged. The true owner, B, cannot recover the money from the drawee bank.

### Concept Problem 18 [MTP Nov 2018]

Explain the power of court for trial of cases summarily, as per the provisions of the Negotiable Instruments Act, 1881.

#### Answer

According to section 143 of the Negotiable Instruments Act, 1881,

- 1) **Trial of Offence:** Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials:

**In case of summary trial:** Provided that in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees:

**In case where no summary trial can be made:** Provided further that when at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

- 2) **Speedy Trial:** The trial of a case under this section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.
- 3) **Speedy and efficient Disposal:** Every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

### Concept Problem 19 [MTP May 2019]

Explain the meaning of ‘Negotiation by delivery’ with the help of an example. Give your answer as per the provisions of the Negotiable Instruments Act, 1881.

#### Solution

##### Negotiation by delivery

According to section 47 of the Negotiable Instruments Act, 1881, subject to the provisions of section 58, a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof.

**Exception:** A promissory note, bill of exchange or cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

**Example:** A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

**Concept Problem 20 [MTP May 2019] [MTP Nov 2020]**

On a Bill of Exchange for Rs. 1 lakh, X's acceptance to the Bill is forged. 'A' takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether 'A' can be considered as a 'Holder in due course' and whether he (A) can receive the amount of the Bill from 'X'.

**Solution**

According to section 9 of the Negotiable Instruments Act, 1881 'holder in due course' means any person who for consideration becomes the possessor of a promissory note, bill of exchange or cheque if payable to bearer or the payee or endorsee thereof, if payable to order, before the amount in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

As 'A' in this case *prima facie* became a possessor of the bill for value and in good faith before the bill became payable, he can be considered as a holder in due course.

But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue on tort the person who had received. This principle is universal in character, by reason where of even a holder in due course is not exempt from it.

A holder in due course is protected when there is defect in the title. But he derives no title when there is entire absence of title as in the case of forgery. Hence 'A' cannot receive the amount on the bill.

**Concept Problem 21 [MTP May 2019]**

Mr. S Venkatesh drew a cheque in favour of M who was sixteen years old. M settled his rental due by endorsing the cheque in favour of Mrs. A, the owner of the house in which he stayed. The cheque was dishonoured when Mrs. A presented it for payment on grounds of inadequacy of funds. Advise Mrs. A how she can proceed to collect her dues.

Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881.

**Solution**

**Capacity to make, etc., promissory notes, etc. (Section 26 of the Negotiable Instruments Act, 1881):**

Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

However, a minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself. As per the facts given in the question, Mr. S Venkatesh draws a cheque in favour of M, a minor. M endorses the same in favour of Mrs. A to settle his rental dues. The cheque was dishonoured when it was presented by Mrs. A to the bank on the ground of inadequacy of funds. Here, in this case, M being a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable. Mrs. A can, thus, proceed against Mr. S Venkatesh to collect her dues.

**Concept Problem 22 [ICAI Nov 2010] [MTP May 2019]**

P draws a bill on Q for Rs. 10,000. Q accepts the bill. On maturity, the bill was dishonoured by non-payment. P files a suit against Q for payment of Rs. 10,000. Q proved that the bill was accepted for value of Rs. 7,000 and as an accommodation to the plaintiff for the balance amount i.e. Rs. 3,000. Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether P would succeed in recovering the whole amount of the bill?

**Solution**

As per Section 44 of the Negotiable Instruments Act, 1881, when the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

**Explanation**—The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee, and the endorser with his endorsee. Other signers may by agreement stand in immediate relation with a holder.

On the basis of above provision, P would succeed to recover Rs. 7,000 only from Q and not the whole amount of the bill because it was accepted for value as to Rs. 7,000 only and an accommodation to P for Rs. 3,000.

### Concept Problem 23 [ICAI May 2019]

Explain the concept of 'Noting', 'Protest' and 'Protest for better security' as per the Negotiable Instruments Act, 1881.

#### Answer

**Noting:** When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each.

Such note must be made within a reasonable time after dishonour, and must specify the date of dishonour, the reason if any assigned for such dishonour, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured and the notary's charges.

**Protest:** When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest.

**Protest for better security:** When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused, may with a reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security.

### Concept Problem 24 [ICAI May 2019]

'M' draws bill on 'N'. 'N' accepts the bill without any consideration. The bill is transferred to 'O' without consideration. 'O' transferred it to 'P' for 10,000. On dishonour of the bill, 'P' sued 'O' for recovery of the value of 10,000. Examine whether 'O' has any right to action against 'M' and 'N'?

#### Answer

Negotiable instrument made, etc. without consideration: A negotiable instrument—

- made, drawn, accepted, endorsed, or transferred without consideration, or
- for a consideration which fails,

creates no obligation of payment between the parties to the transaction.

But if any such party has transferred the instrument with or without endorsement to a holder for a consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

In the light of the above provisions, in the given instance the bill was drawn, accepted and transferred without consideration by 'M' to 'N', and from 'N' to 'O' respectively. Therefore, no obligation of payment is created between the parties. So 'O' has no right to action against 'M' and 'N'.

### Concept Problem 25 [ICAI May 2017] [ICAI Nov 2019]

'A' draws a bill amounting INR 5,000 of 3 month's maturity period on 'B' but signs it in the fictitious name of 'C'. Bill is payable to the order of 'C' and it is duly accepted by 'B'. 'D' obtains the bill from 'A' and thus becomes its 'Holder-in-Due course. On maturity 'D' presents bill to 'B' for payment. Is 'B' bound to make the payment of the bill? Examine it referring to the provisions of the Negotiable Instruments Act, 1881.

**Answer**

Bill drawn in fictitious name: The problem is based on the provision of Section 42 of the Negotiable Instruments Act, 1881. In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for the acceptor to allege as against the holder in due course that such name is fictitious.

Accordingly, in the instant case, B cannot avoid payment by raising the plea that the drawer, C is fictitious. The only condition is that the signature of C as drawer and as endorser must be in the same handwriting. Therefore, in the given case, B is bound to make the payment of the bill to D.

**Concept Problem 26 [ICAI Nov 2015] [ICAI Nov 2019]**

Mr. X is the payee of an order cheque. Mr. Y steals the cheque and forges Mr. X signature and endorses the cheque in his own favour. Mr. Y then further endorses the cheque to Mr. Z, who takes the cheque in good faith and for valuable consideration Examine the validity of the cheque as per the provisions of the Negotiable Instruments Act, 1881 and also state whether Mr. Z can claim the privileges of holder-in-due course.

**Answer**

Forgery confers no title and a holder acquires no title to a forged instrument. Thus, where a signature on the negotiable instrument is forged, it becomes a nullity. Therefore, cheque further endorsed to Mr. Z, is not valid.

Since a forged instrument is a nullity, therefore the property in the such instrument remains vested in the person who is the holder at the time when the forged signatures were put on it. Forgery is also not capable of being ratified. In the case of forged endorsement, the person claiming under forged endorsement even if he is purchaser for value and in good faith, cannot acquire the rights of a holder in due course. Therefore, Mr. Z, acquires no title on the cheque.

<b>Concept Problem 27</b>	<b>[Nov 2002][May 2004] [Sec 4]</b>
Referring to the provisions of The Negotiable Instruments Act, 1881, examine the validity of the following promissory notes.	
i) I owe you a sum of Rs 1,000. A tells B.	
ii) X promises to pay Y, a sum of Rs 10,000 six months after Y's marriage with Z.	
<b>Solution</b>	
i. <b>It is not a valid promissory note</b> – since A has not made any promise to pay INR 1,000 to B (mere acknowledgement of indebtedness does not result in a valid promissory note).	
ii. <b>It is not a valid promissory note</b> – since the promise is conditional (as Y's marriage with Z is not certain to happen).	

<b>Concept Problem 28</b>	<b>[Nov. 2007] [Sec 4]</b>
Whether the following notes may be considered as valid promissory notes:	
i. I promise to pay INR 5,000 or 7,000 to Mr. Ram.	
ii. I promise to pay to Mohan INR 500 if he secures 60% marks in the examination.	
iii. I promise to pay INR 3,000 to Ravi after 15 days of the death of A.	
<b>Ans.</b>	
i. <b>It is not a valid promissory note</b> – since the amount payable is not certain.	
ii. <b>It is not a valid promissory note</b> – since the promise is conditional (since it is not certain that Mohan would secure 60% marks in examination).	
iii. <b>It is a valid promissory note</b> – since the promise is not conditional (since it is dependent upon death of A which is certain to happen, although the time of its happening is not certain).	

<b>Concept Problem 29</b>	<b>[Nov 2005, May 2015] [Sec 26]</b>
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<b>Solution</b>
<b>A is not entitled to sue X</b> – since there is no consideration between A and X. - since there is no obligation to pay if there is no consideration between the parties to the transaction.
<b>P is entitled to sue A and X</b> – since P is a holder for consideration since a holder for consideration can sue the transferor for consideration and every party prior to him.
<b>If A had transferred the bill after maturity</b> – the answer would have remained same since the right to sue the transferor for consideration and every party prior to him is available to holder for consideration even though he is not a holder in due course (i.e. even if the holder for consideration obtains the bill after maturity).

<b>Concept Problem 33</b>	<b>[May 2007] [Sec 44]</b>
A owes a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due payable by him. B fills up fraudulently the amount due payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. Referring to the provisions of The Negotiable Instruments Act, 1881, discuss the rights of B and C.	
<b>Solution</b>	
<b>B is entered to recover only such amount as was payable by A</b>	
<ul style="list-style-type: none"> <li>- Since B (i.e. payee) stands in immediate relation with A (i.e. drawer).</li> <li>- Since the consideration consists of money.</li> <li>- Since the consideration was originally absent in part.</li> </ul>	
<b>C is entitled to recover the whole amount of cheque</b>	
– Since a holder in due course is entitled to receive whole of the amount of the negotiable instrument.	

<b>Concept Problem 34</b>	<b>[Nov 2008] [Nov 2016] [Sec 8]</b>
Discuss with reasons whether the following persons can be called a Holder under the Negotiable Instrument Act, 1881.	
<ul style="list-style-type: none"> <li>a) X who obtains a cheque drawn by Y by way of gift.</li> <li>b) A, the payee of the cheque who is prohibited by a court order from receiving the amount of the cheque.</li> <li>c) M who finds a cheque payable to bearer on the road and retains it.</li> <li>d) B, the agent of C, is entrusted with an instrument without endorsement by C who is the payee.</li> <li>e) D, who steals a blank cheque of A and forges A's signature.</li> </ul>	
<b>Or</b>	
Discuss with reasons, in the following given conditions, whether 'M' can be called as a "holder" under the Negotiable Instrument Act, 1881:	
<ul style="list-style-type: none"> <li>1. 'M', the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.</li> <li>2. 'M', the agent of 'Q', is entrusted with an instrument without endorsement by 'Q' who is the payee.</li> </ul>	
<b>Solution</b>	
<b>X is a holder</b>	- Since X is entitled in his own name to the possession of the cheque and to receive the amount of the cheque.
<b>A is not a holder</b>	- Since he is not entitled to recover the amount of the cheque as per court's order.
<b>M is not a holder</b>	<ul style="list-style-type: none"> <li>- Since the cheque was not negotiated to him.</li> <li>- Since mere possession does not make a person a holder. It is the entitlement to possession which makes a person holder.</li> <li>- Since M is not entitled to the possession and is not entitled to receive or recover the amount of the cheque (sec 8).</li> <li>- Since a finder of a lost negotiable instrument has no rights to receive the amount of the negotiable instrument (sec. 58).</li> </ul>
<b>B is not holder</b>	<ul style="list-style-type: none"> <li>- Since he is entitled to the possession of the negotiable instrument but not in his own name.</li> <li>- Since he is entitled to receive the amount of the negotiable instrument but not in his own name.</li> </ul>
<b>D is not a holder</b>	<ul style="list-style-type: none"> <li>- Since he is in wrongful possession of the negotiable instrument.</li> <li>- Since he is not at all entitled to the possession of the negotiable instrument.</li> <li>- Since he is not entitled to receive or recover the amount of the negotiable instrument.</li> </ul>

	- Since a cheque containing forged signature of the drawer is a nullity and does not confer any title to any person.
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**Concept Problem 35** **[Nov. 2006] [Sec 9]**

B obtains A's acceptance to a bill of exchange by fraud. B endorses it to C who is a holder in due course. C endorsed the bill to D who knows of the fraud. Referring to the provisions of the Negotiable Instruments Act 1881, decide whether D can recover the money from A in the given case.

<b>Solution</b>	
<b>D is HDC</b>	<ul style="list-style-type: none"> <li>- Since all the conditions given u/s 9 are satisfied.</li> <li>- Since D has acquired the negotiable instrument from C and the title of C is not defective.</li> <li>- Since it is immaterial that D had knowledge of the fraud (provided D was not a party to the fraud).</li> </ul>
<b>D can recover payment from A</b>	- Since HDC has the right to receive or recover payment of the negotiable instrument from all the prior parties.

**Concept Problem 36** **[May 2010] [Sec 9, 36 and 120]**

J accepted a bill of exchange and gave it to K for the purpose of getting it discounted and handing over the proceeds to J. K, having failed to discount it returned the bill to J. J tore the bill in two pieces with the intention of cancelling it and threw the pieces in the street. K picked the pieces and pasted the two pieces together in such manner that the bill seemed to have been folded for safe custody rather than cancelled. K put it into circulation and it ultimately reached L who took it in good faith and for value. Is J liable to pay the bill under the provisions of the Negotiable Instrument Act, 1881?

<b>Solution</b>	
<b>L is a holder in due course</b>	<ul style="list-style-type: none"> <li>- Since he acquired the bill in good faith and for value.</li> <li>- Since he became the possessor of the bill payable to bearer (assuming that the bill was payable to bearer) (sec.9)</li> </ul>
<b>J cannot deny the validity of the bill</b>	- Since no drawer or acceptor of a bill shall, in a suit by a holder in due course, be permitted to deny the validity of the bill as originally drawn and thus, L who is the holder in due course, acquires a good title to the bill (sec 120)
<b>L is entitled to recover the payment of the bill from J and all prior parties</b>	- Since a holder in due course has the right to sue all the prior parties (sec 36)

**Concept Problem 37** **[Nov. 2014] [Nov 2016] [Sec 53]**

S, by inducing T, obtains a Bill of Exchange from him fraudulently in his (S) favour. Later, he enters into a commercial deal and endorses the bill to U towards consideration to him (U) for the deal. U takes the bill as a Holder-in-due-course. U subsequently endorses the bill to S for value, as consideration to S for some other deal. On maturity the bill is dishonoured. S sues T for recovery of the money.

With reference to the provision of the Negotiable Instruments Act, 1881, decide whether S will succeed in the case or not.

**Or**

'F' by inducing 'G' obtains a bill of exchange from him fraudulently in his (F) favour. Later he enters into a commercial deal with 'H' and endorses the bill to him (H) towards consideration for the deal. 'H' takes the bill as a holder in due course. 'H' Subsequently endorses the bill to 'F' for value as consideration to 'F' for some other deal. On maturity, the bill is dishonoured. 'F' sues 'G' for the recovery of the money. With reference to the provisions of the Negotiable Instrument Act 1881, explain whether 'F' will succeed in this case.

<b>Solution</b>	
<b>S cannot recover the money from T</b>	<ul style="list-style-type: none"> <li>- Since S was himself a party to the fraud.</li> <li>- Since S shall not have the same rights as that of 'U' from whom he (i.e. S) obtained the bill.</li> <li>- Since as per Sec. 53, a holder who derives his title from HDC has the same rights as that of HDC only if he himself was not party to the fraud or illegality which affected the bill in some stage of its journey.</li> </ul>

<b>Concept Problem 38</b>	<b>[May 2007] [Sec 130]</b>
Referring to the provision of the Negotiable Instrument Act, 1881, examine the validity of the following A cheque marked 'Not Negotiable' is not transferable.	
<b>Solution</b>	
<b>A cheque marked 'not negotiable' is transferrable</b> – but, no transferee shall have a title better than of the transferor, even though he acquired the cheque in good faith and without negligence (Sec.130)	

<b>Concept Problem 39</b>	<b>[Nov. 2002] [Nov. 2004] [Sec. 85 and 131]</b>
A induced B by fraud to draw a cheque payable to C or order. A obtained the cheque, forged C's endorsement and collected proceed to the cheque through his broken B, the drawer, wants to recover the amount from C's banker. Decide in the light of the provisions of Negotiable Instruments Act, 1881: (i) Whether B, the drawer, can recover the amount of the cheque from bankers? (ii) Whether C is the fictitious payee? (iii) Would your answer be still the same in case C is a fictitious person?	
<b>Solution</b>	
<b>B's banker is not liable</b>	<ul style="list-style-type: none"> <li>- Since a paying banker is not liable even if it is subsequently found that any endorsement on the cheque has been forged.</li> <li>- Provided the paying banker made the payment in due course (Sec. 85).</li> </ul>
<b>A's Banker is not liable</b>	<ul style="list-style-type: none"> <li>- Since a collecting banker is not liable for any loss caused to the true owner due to defective title of the holder;</li> <li>- Provides the collecting banker acted in good faith and without negligence while collecting the amount of the crossed cheque as an agent (Sec. 131).</li> </ul>
<b>(i) C's banker is not liable</b>	<ul style="list-style-type: none"> <li>- Since it has neither collected nor paid the cheque</li> </ul>
<b>(ii) C is not the fictitious payee</b>	<ul style="list-style-type: none"> <li>- Since C, in fact, exists.</li> </ul>
<b>(iii) If C were a fictitious payee, the answer would have been same</b>	<ul style="list-style-type: none"> <li>- Since protection is available to a collecting banker u/s 131 and paying banker u/s 85, irrespective of the fact that payee is a fictitious person or not;</li> <li>- Since C's banker would have neither collected nor paid the cheque.</li> </ul>

<b>Concept Problem 40</b>	<b>[May 2003, May 2005, May 2008, May 2014] [Sec 84]</b>
A issues a cheque for Rs. 25,000 in favour of B. A has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank, in the meantime, became bankrupt. Decide under the provisions of the Negotiable Instruments Act, whether B can recover the money from A?	
A draws a cheque for Rs. 50,000. When the cheque ought to be presented to the drawee bank, the drawer has sufficient funds to make payment of the cheque. The bank fails before the cheque is presented. The payee demands payment from the drawer. What is the liability of the drawer?	
B issued a cheque for INR 1,25,000 in favour of S. B had sufficient amount in his account with the bank. The cheque was not presented within reasonable time for payment and the bank in the meantime become insolvent. Decide under the provisions of the Negotiable Instruments Act, 1881, whether S can recover the money from B.	
A issued a cheque for INR 5,000 to B. B did not present the cheque for payment within reasonable period and the bank fails. However, when the cheque was ought to be presented to the bank, there was sufficient fund to make payment of the cheque. Now B demands payment from A under the Negotiable Instruments Act, 1881.	
<b>Solution</b>	
<b>The drawer is discharged</b>	<ul style="list-style-type: none"> <li>Since the drawer has sufficient balance when the cheque ought to be presented for payment.</li> <li>The holder has defaulted in presenting the cheque for payment within a reasonable time.</li> <li>The drawer has suffered actual damages due to the failure of the bank after issue of cheque but before presentation of the cheque.</li> </ul>

<b>Concept Problem 41</b>	<b>[Nov 2006] [Sec 138 and 141]</b>
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J, a shareholder of a company purchased for his personal use certain goods from a Mall (Department store) on credit. He sent a cheque drawn on the company's account to the mall (department store) towards the full payment of the bills. The cheque was dishonoured by the company's bank. J, the shareholder of the company was neither a director nor a person in charge of the company. Examining the provisions of the Negotiable Instruments Act, 1881, state whether J has committed an offence under sec. 138 of the Act and decide whether he (J) can be held liable for the payment for the goods purchased from the mall (departmental store).

**Solution**

**Company has committed on offence u/s 138** – since a company is held liable for dishonour of a cheque issued to discharged the debt or liability of any other person (Sec. 138)

**Person liable where offence u/s 138 is committed by a company** – in case of dishonour of a cheque issued by a company, the company as well as every officer in charge of the company is liable u/s 138 (Sec. 141)

**J has not committed any offence u/s 138** since J is not a director or an officer in charge of the company (*HNB Mulla firaze C Y somaya julu*)

**J is liable for the payment of goods purchased** – since J purchased the goods on credit and contracted to pay the price of the goods to the mall (departmental store).

**Concept Problem 42****[May 2016] [Sec 138 and 141]**

Mr. Bean is a promoter who has taken a loan on behalf of Company but he is neither a director nor a person-in-charge of the Company. He sent a cheque from the Company's account to discharge its legal liability. Subsequently, the cheque was dishonoured and a complaint was lodged against him. Can he be held liable for an offence under section 138 of the Negotiable Instruments Act, 1881?

**Solution**

**Company has committed on offence u/s 138** – Since a Company is held liable for dishonour of a cheque issued to discharge the debt or liability (Sec. 138)

**Person liable where offence u/s 138 is committed by a Company** – In case of dishonour of a cheque issued by a Company, the Company as well as every officer in charge of the Company is liable u/s 138 (Sec. 141).

**J has not committed any offence u/s 138 since J is not a director or an officer in charge of the company** (*HNB Mulla firaze C Y somaya julu*)

**Concept Problem 43****[May 2007] [May 2008] [May 2017] [May 2018] [Sec. 138]**

Examine whether there is an offence under the Negotiable Instruments Act, 1881 if a drawer of a cheque after having issued the cheque informs the drawee not be present the cheque as well as informs the bank to stop the payment.

X draws a cheque in favour of Y and after having issued the cheque, he informs Y not to present the cheque for payment. He also informs the bank to stop payment. Decide under provisions of the Negotiable Instruments Act, 1881 whether the said acts of X constitute an offence against him?

A drawer of a cheque after having issued the cheque, informs the drawee not to present the cheque as well as informs the Bank to stop the payment. Decide whether it constitutes an offence against the drawer under provisions of the Negotiable Instruments Act, 1881?

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

**Solution**

**Drawer has committed an offence u/s 138** – since the words 'the cheque is returned by the bank unpaid due to insufficiency of funds in the account of drawer' have to be given a wide interpretation to include dishonour of cheque due to issue of stop payment order given by the drawer to the bank and also where the drawer asks the holder not to present the cheque (*Modi Cements Ltd. V kuchil kumar nandi*).

**Concept Problem 44****[June 2009] [Sec 138 and 139]**

V makes a gift of INR 10,000 to W through a cheque issued in favour of W. Later, he (V) informs W not to present the cheque for payment and informs the bank also to stop payment. Examining the provisions of the Negotiable Instrument Act, 1881, decide whether V's above acts constitute an offence.

**Solution**

**V is not liable for an offence u/s 138** – since the drawer of a cheque is liable u/s 138 only if a cheque is issued to discharge a legally enforceable debt or other liability.

Since in the present case, the cheque has been issued by V as a gift to W and not for discharge of a legally enforceable debt or other liability (sec. 138).
<b>Presumption of consideration is not applicable</b> - Since it can be proved that the cheque was given as a gift (sec. 139).

<b>Concept Problem 45</b>		<b>[Nov 2007] [Sec 87]</b>
State whether the following alterations are material alteration under the Negotiable Instruments Act, 1881?		
i) The holder of the bill inserts the word "or order" in the bill.		
ii) The holder of the bearer cheque converts it into account payee cheque.		
iii) A bill payable to X is converted into a bill payable to X and Y.		
<b>Solution</b>		
<b>i) It is not a material alteration</b>	-	Since even after insertion of the words "or order", the negotiable instruments continues to be an order instrument.
<b>ii) It is a material alteration</b>	-	Since it restricts the right of the holder to obtain the payment of the cheque in cash and to negotiate it further. But such alteration authorised by the Act and so no party is discharged.
<b>iii) It is a material alteration</b>	-	Since the right to receive the payment has been altered (before alteration, right to receive was with X but after alteration, the right is with X and Y jointly).

<b>Concept Problem 46</b>		<b>[June 2009] [Sec 87 and 125]</b>
A issues an open bearer cheque for INR 10,000 in favour of B who strikes out the word "Bearer" and puts crossing across the cheque. The cheque is thereafter negotiated to C and D. when it is finally presented by D's banker, it is returned with remarks "Payment countermanded by drawer". In response to legal notice from D, A pleads that the cheque was altered after it had been issued and therefore, he is not bound to pay cheque. Referring to the provisions of the Negotiable Instruments Act, 1881, decide whether A's argument is valid or not?		
<b>Solution</b>		
<b>Effects of striking off the word bearer</b>	-	It amounts to a material alteration. - However, such material alteration is authorised by the Act. - Therefore, the cheque is not discharged it remains valid.
<b>Effects of crossing the cheque</b>	-	It amounts to a material alteration. - However, such material alteration is authorised by the Act. - Therefore, the cheque is not discharged it remains valid.
<b>A's argument is not valid</b>	-	Since the reason for dishonour of cheque is not material alteration but payment countermanded by drawer. - Therefore, A is liable for the payment of the cheque and he shall also be liable for dishonour of cheque is accordance with the provisions of sec 138.

<b>Concept Problem 47</b>		<b>[May 2003] [Sec 86]</b>
An acceptor accepts a bill of exchange but writes on it "Accepted but payments will be made when goods delivered to me is sold." Decide the validity.		
<b>Solution</b>		
<b>The acceptance is valid and the acceptor is liable</b>		
- But it amounts to qualified acceptance (since the acceptance is subject to some qualification or condition i.e. payment will be made when goods are sold)		
- But no other party shall be liable on the bill unless it has given its consent to the qualified acceptance.		
- However, the holder is entitled to object to qualified acceptance and treat the bill as dishonoured by non-acceptance and in such a case all the prior parties shall be liable towards the holder (Sec 86).		

<b>Concept Problem 48</b>		<b>[May 2003] [Sec 7]</b>
Examine the validity of the following in the light of the provisions of the negotiable Instruments Act, 1881.		
i. An oral acceptance.		
ii. An acceptance by mere signature without writing the word accepted.		
<b>Solution</b>		
<b>i. The acceptance is not valid</b> – Since it is not given in writing and is not signed.		
<b>ii. The acceptance is valid</b> – Since the drawee has signed the bill.		



- Since writing the word 'accepted' is not a statutory requirement.

**Concept Problem 49****[May 2007] [Sec 86]**

Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following "A bill of exchange originally drawn by M for a sum of INR 10,000 but acceptance by R only for INR 7,000."

**Solution**

**The acceptance is valid and the acceptor is liable for INR 7,000**

- But it amounts to qualified acceptance (since the acceptance is given for a part of the sum mentioned in the bill).
- But no other party shall be liable on the bill unless it has given its consent to the qualified acceptance.
- However, the holder is entitled to object to qualified acceptance and treat the bill as dishonoured by non-acceptance and in such a case all the prior parties shall be liable towards the holder (sec 86).

**Concept Problem 50****[June 2009] [Sec 86]**

Referring to the provisions of the Negotiable Instruments Act, 1881, examine whether acceptance of a bill of exchange in the following situations shall be treated as qualified acceptance where the acceptor

- i. Undertakes to pay INR 2,000 for a bill drawn for INR 5,000.
- ii. Declares the payment to be independent of any other event.
- iii. Writes: Accepted payable at ABC bank.

**Solution**

**The acceptance is qualified** - Since the acceptance is given for a part of the sum mentioned in the bill.

**The acceptance is not qualified** - Since the acceptance is given without any condition or qualification.

**The acceptance is not qualified** - Since an acceptance to pay at a particular place amounts to general acceptance (but if it is expressly stated that the bill shall be paid at the specified place only and not elsewhere, it amounts to qualified acceptance).

**2. TRUE OR FALSE**

State whether the following are True or False and give reasons (1 Mark each):

<b>1</b>	<b>Nov. 2010</b>	A promissory note duly executed in favour of minor is void. <b>Ans.</b> The given statement is false. <b>Reason:</b> As per sec. 26, where any party to a negotiable instrument is a minor, the negotiable instruments is not void. All the parties except the minor shall be bound on such negotiable instrument. Thus, the minor can recover the payment of the promissory note from all the prior parties.
<b>2</b>	<b>May 2011</b>	A cheque marked 'Not Negotiable' is not transferable. <b>Ans.</b> The given statement is false. <b>Reason:</b> In case of a cheque marked 'not negotiable', the transferee shall not have a better title than the title of the transferor. But the 'not negotiable' crossing does not restrict the transferability of the cheque (sec. 130).
<b>3</b>	<b>Nov. 2012</b>	The validity period of a cheque is three months. <b>Ans.</b> The given statement is true <b>Reason:</b> The validity period of cheque has been reduced from 6 months to 3 months vide RBI notification No. RBI/2011-12/251 dated 04-11-2011.
<b>4</b>	<b>May 2016</b>	In a promissory note, the promise to pay must be conditional. <b>Ans.</b> The given statement is false. <b>Reason:</b> As per sec. 4, in order to constitute a value promissory note, the promise must be unconditional.
<b>5</b>	<b>May 2016</b>	A bill of exchange may not be in writing. <b>Ans.</b> The given statement is false.

		<b>Reason:</b> As per sec. 5, 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 a certain person or the order of a certain person or the bearer of the instrument.
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### 3. QUESTIONS FOR PRACTICE

- 1) Define the term 'Cheque' as given in the Negotiable Instruments Act, 1881 as amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002. **[Nov 2004]**
- 2) Point out the difference between 'Cheque' and a 'bill of exchange' under the Negotiable Instruments Act, 1881. **[May 2011]**
- 3) Examining the provisions of the Negotiable Instruments Act, 1881, distinguish between a 'bill of exchange and a 'promissory note'. **[May 2012]**
- 4) In what way does the Negotiable Instruments Act regulate the determination of the 'date of maturity of bill of exchange? **[Nov 2005]**
- 5) What is meant by 'Sans Recourse Endorsement' of a bill of exchange? How does it differ from 'Sans frais Endorsement'? **[May 2015]**
- 6) Explain the concept and different forms of restrictive and qualified endorsement. **[Nov 2015]**
- 7) What are the differences between 'negotiability' and 'assignability'? **[Nov 2003] [May 2013]**
- 8) Point out the difference between 'transfer by negotiation' and 'transfer by assignment' under the provisions of the Negotiable Instruments Act, 1881. **[May 2006]**
- 9) Examine when a holder of a negotiable instrument shall be considered as a holder in due course under the provisions of the Negotiable Instruments Act, 1881. **[Nov 2005]**
- 10) Describe in brief the advantages and protections available to a holder in due course under the provisions of the Negotiable Instruments Act, 1881. **[Nov 2008]**
- 11) A draws and B accepts the bill payable to C or order. C endorses the bill to D and D to E who is holder in due course. From whom E can recover the amount? Examining the rights of E, state the privileges of the holder – in-due course provided under the Negotiable Instruments Act, 1881. **[Nov 2012]**
- 12) What do you understand by crossing of cheques? What is the use of crossing? State the implication of the following crossings:
  - a) Restrictive crossing
  - b) Not-negotiable crossing **[Nov 2003]**
- 13) Explain as to why shall the combination of 'not negotiable' with 'account payee crossing' be considered as the safest form of crossing a cheque. **[Nov 2007]**
- 14) State the grounds on the basis of which a cheque may be dishonoured by a banker inspite of the fact that there is sufficient amount in the account of the drawer. **[Nov 2003]**
- 15) State the cases in which a banker is justified or bound to dishonour cheques. **[May 2005]**
- 16) PQR Limited received a cheque for INR 50,000 from its customer Mr. LML. After a week, company come to know that the proceeds were not credited to the account of PQR Limited due to some 'defects' as informed by the banker. What according to you are the possible defects? **[May 2007]**
- 17) State in brief, the grounds on the basis of which a banker can dishonour a cheque under the provisions of the Negotiable Instruments Act, 1881. **[Nov 2011]**
- 18) State the circumstances on the basis of which a banker can dishonour a cheque under the provisions of Negotiable Instruments Act, 1881. **[Nov 2013]**

- 19) Describe in brief the main amendments incorporated by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act 2002 in sections 138, 141 and 142 of the principal Act, i.e. the Negotiable Instruments Act, 1881. **[May 2004]**
- 20) State the circumstances under which the drawer of a cheque will be liable for an offence relating to dishonour of the cheque under the Negotiable Instruments Act, 1881. **[May 2007]**
- 21) Ram has INR 2,000/- in his bank account and he has no authority to overdraw. He issued a cheque for INR 5,000/- to Gopal which was dishonoured by the bank. Point out whether Gopal must necessarily give notice of dishonour to Ram under the Negotiable Instruments Act, 1881? **[May 2014]**
- 22) When is an alteration in a negotiable instrument deemed to be a material alteration under the Negotiable Instruments Act, 1881? What are the consequences of material alteration in negotiable instrument? **[May 2006]**
- 23) Define material alteration under the Negotiable Instruments Act, 1881 and give examples. **[May 2013]**
- 24) Which are the essential elements of a valid acceptance of a bill of exchange? **[May 2003]**
- 25) When will a bill exchange be dishonoured by non- acceptance and non-payment under the provisions of Negotiable Instruments Act, 1881? **[Nov 2002]**
- 26) What is meant by presentment of bill of exchange under the Negotiable Instruments Act, 1881? When is such a bill of exchange presented? State when is the presentment not necessary. **[May 2008]**
- 27) Explain the term 'drawee' in case as used in the Negotiable Instruments Act, 1881. **[Nov 2014]**
- 28) Explain the term 'acceptance for honour' as used in the Negotiable Instruments Act, 1881. **[Nov 2014]**
- 29) What are the circumstances under which a bill of exchange can be dishonoured by non-acceptance? Give your answer as per the provisions of the Negotiable Instruments Act, 1881. **[MTP May 2019]**
- 30) State the rules laid down by the Negotiable Instruments Act, 1881 for ascertaining the date of maturity of a bill of exchange. **[May 2018]**



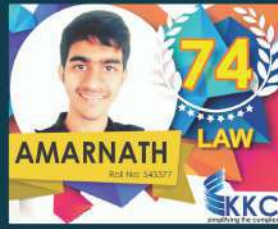
ARISE AWAKE AND STOP NOT  
TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

### About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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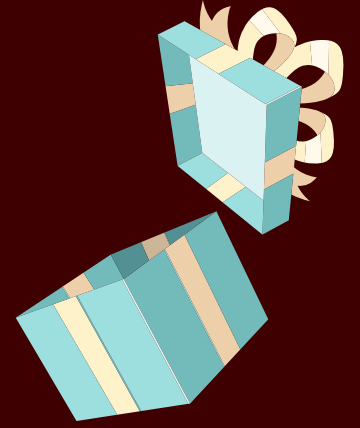
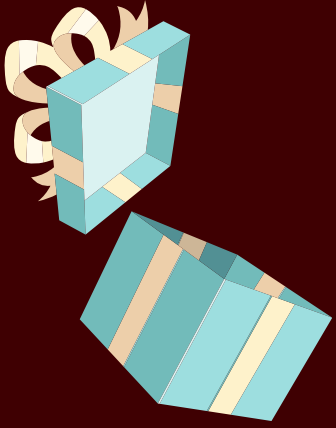
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# CHAPTER 3

## GENERAL CLAUSES ACT, 1897

### 1. PRACTICAL QUESTIONS

#### Concept Problem 1 [ICAI SM]

What is “Financial Year” under the General Clauses Act, 1897?

#### Solution

According to Section 3(21) of the General Clauses Act, 1897, ‘Financial Year’ shall mean the year commencing on the first day of April.

The term year has been defined under Section 3(66) as a year reckoned according to the British calendar. Thus, as per General Clauses Act, Year means calendar year which starts from January to December.

Hence, in view of the both above definitions, it can be concluded that Financial Year is a year which starts from first day of April to the end of March

#### Concept Problem 2 [ICAI SM]

What is “Immovable Property” under the General Clauses Act, 1897?

#### Solution

According to **Section 3(26) of the General Clauses Act, 1897**, ‘Immovable Property’ shall include:

- i) Land
- ii) Benefits to arise out of land, and
- iii) Things attached to the earth, or permanently fastened to anything attached to the earth.

For example, trees are immovable property because trees are benefits arise out of the land and attached to the earth. However, timber is not immovable property as the same are not permanently attached to the earth. In the same manner, buildings are immovable property.

#### Concept Problem 3 [ICAI SM]

As per the provisions of the Companies Act, 2013, a whole time Key Managerial Personnel (KMP) shall not hold office in more than one company except its subsidiary company at the same time. Referring to the Section 13 of the General Clauses Act, 1897, examine whether a whole time KMP can be appointed in more than one subsidiary companies?

#### Solution

**Section 203(3) of the Companies Act, 2013** provides that whole time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. With respect to the issue that whether a whole time KMP of holding company be appointed in more than one subsidiary company or can be appointed in only one subsidiary company.

**It can be noted that Section 13 of General Clauses Act, 1897** provides that the word ‘singular’ shall include the ‘plural’, unless there is anything repugnant to the subject or the context. Thus, a whole time key managerial personnel may hold office in more than one subsidiary company as per the present law.

#### Concept Problem 4 [ICAI SM] [RTP May 2019]

A notice when required under the Statutory rules to be sent by “registered post acknowledgment due” is instead sent by “registered post” only. Whether the protection of presumption regarding serving of notice by “registered post”

under the General Clauses Act is tenable? Referring to the provisions of the General Clauses Act, 1897, examine the validity of such notice in this case.

### Solution

As per the provisions of Section 27 of the General Clauses Act, 1897, where any legislation or Regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

- i) properly addressing,
- ii) pre-paying, and
- iii) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

Therefore, in view of the above provision, since, the statutory rules itself provides about the service of notice that a notice when required under said statutory rules to be sent by 'registered post acknowledgement due', then, if notice was sent by 'registered post' only it will not be the compliance of said rules. However, if such provision was not provided by such statutory rules, then service of notice if by registered post only shall be deemed to be effected.

Furthermore, in similar case of In United Commercial Bank v. Bhim Sain Makhija, AIR 1994 Del 181: A notice when required under the statutory rules to be sent by 'registered post acknowledgement due' is instead sent by 'registered post' only, the protection of presumption regarding serving of notice under 'registered post' under this section of the Act neither tenable not based upon sound exposition of law.

### Concept Problem 5 [ICAI SM] [MTP May 2019] [ICAI May 2018]

X owned a land with fifty tamarind trees. He sold his land and the timber (obtained after cutting the fifty trees) to Y. X wants to know whether the sale of timber tantamounts to sale of immovable property. Advise him with reference to provisions of "General Clauses Act, 1897"

### Solution

**“Immovable Property” [Section 3(26) of the General Clauses Act, 1897]:**

‘Immovable Property’ shall include:

- a) Land
- b) Benefits to arise out of land, and
- c) Things attached to the earth, or
- d) Permanently fastened to anything attached to the earth

It is an inclusive definition. It contains four elements: land, benefits to arise out of land, things attached to the earth and things permanently fastened to anything attached to the earth. Where, in any enactment, the definition of immovable property is in the negative and not exhaustive, the definition as given in the General Clauses Act will apply to the expression given in that enactment.

In the instant case, X sold Land along with timber (obtained after cutting trees) of fifty tamarind trees of his land. According to the above definition, Land is immovable property; however, timber cannot be immovable property since the same are not attached to the earth.

### Concept Problem 6 [ICAI SM]

What is the meaning of service by post as per provisions of the General Clauses Act, 1897?

### Answer

**Meaning of Service by post” [Section 27 of the General Clauses Act, 1897]:** Where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

- i) properly addressing
- ii) pre-paying, and
- iii) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

### Concept Problem 7 [ICAI SM]

Komal declares a dividend for its shareholders in its AGM held on 27<sup>th</sup> September 2018. Referring to the provisions of the General Clauses Act 1897 and Companies Act 2013, state

- i) The dates during which Komal Ltd. Is required to pay the dividend?
- ii) The dates during which Komal Ltd. Is required to transfer the unpaid or unclaimed dividend to unpaid dividend account?

### Answer

As per section 9 of the General Clauses Act, 1897, for computation of time the section states that in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word “from” and for the purpose of including the last in a series of days or any other period of time, to use the word “to”.

- i) **Payment of dividend:** In the given instance, Komal Ltd. declares dividend for its shareholder in its Annual General Meeting held on 27/09/2018. Under the provisions of Section 127 of the Companies Act, 2013, a company is required to pay declared dividend within 30 days from the date of declaration, i.e. from 28/09/2018 to 27/10/2018. In this series of 30 days, 27/09/2018 will be excluded and last 30th day, i.e. 27/10/2018 will be included. Accordingly, Komal Ltd. will be required to pay dividend within 28/09/2018 and 27/10/2018 (both days inclusive).
- ii) **Transfer of unpaid or unclaimed dividend:** As per the provisions of Section 124 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration, to any shareholder entitled to the payment of the dividend, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the “Unpaid Dividend Account” (UDA). Therefore, Komal Ltd. shall transfer the unpaid/unclaimed dividend to UDA within the period of 28th October, 2018 to 3rd November, 2018 (both days inclusive).

### Concept Problem 8 [ICAI SM]

Repeal’ of provision is different from ‘deletion’ of provision. Explain as per the General Clauses Act, 1897.

### Answer

In Navrangpura Gam Dharmada Milkat Trust Vs. Rmtuji Ramaji, AIR 1994 Guj 75 case, it was decided that ‘Repeal’ of provision is in distinction from ‘deletion’ of provisions. Repeal brings about complete obliteration (abolition) of the provisions as if it ever existed, thereby affecting all incoherent rights and all causes of action to the repealed provision while ‘deletion’ ordinarily takes effect from the date of legislature affecting the said deletion, never to effect total effecting goes wiping goes out of the provisions as if it is never existed.

### Concept Problem 9 [ICAI SM] [ICAI May 2019]

The Companies Act, 2013 provides that the amount of dividend remained unpaid/unclaimed on expiry of 30 days from the date of declaration of dividend shall be transferred to unpaid dividend account within 7 days from the date of expiry of such period of 30 days. If the expiry date of such 30 days is 30.10.2018, decide the last date on or before which the unpaid/unclaimed dividend amount shall be required to be transferred to a separate bank account in the light of the relevant provisions of the General Clauses Act, 1897?

### Answer

Section 9 of the General Clauses Act, 1897 provides that, for computation of time, in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word “from” and for the purpose of including the last in a series of days or any other period of time, to use the word “to”.

As per the facts of the question the company shall transfer the unpaid/unclaimed dividend to unpaid dividend account within the period of 7 days. 30<sup>th</sup> October 2018 will be excluded and 6th November 2018 shall be included, i.e. 31st October, 2018 to 6th November, 2018 (both days inclusive).

### Concept Problem 10 [ICAI SM] [ICAI May 2019]

Referring to the provisions of the General Clauses Act, 1897, find out the day/ date on which the following Act/Regulation comes into force. Give reasons also,

- i) An Act of Parliament which has not specifically mentioned a particular date.
- ii) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations, 2015 was issued by SEBI vide Notification dated 14th August, 2015 with effect from 1st January, 2016.

### Answer

- i) According to section 5 of the General Clauses Act, 1897, where any Central Act has not specifically mentioned a particular date to come into force, it shall be implemented on the day on which it receives the assent of the President in case of an Act of Parliament.
- ii) If any specific date of enforcement is prescribed in the Official Gazette, the Act shall come into enforcement from such date. Thus, in the given question, the SEBI (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations, 2015 shall come into enforcement on 1st January, 2016 rather than the date of its notification in the gazette.

### Concept Problem 11 [RTP Nov 2018]

Mr. Ram, an advocate has fraudulently deceived his client Mr. Shyam, who was taking his expert advice on taxation matters. Now, Mr. Ram is liable to a fine for acting fraudulently both under the Advocates Act, 1961 as well as the Income Tax Act, 1961. State the provision as to whether his offence is punishable under the both the Acts, as per the General Clauses Act, 1897.

### Answer

**“Provision as to offence punishable under two or more enactments” [Section 26]:** Where an act or omission constitutes an offence under two or more enactments, then the offender shall be liable to be prosecuted and punished under either or any of those enactments, but shall not be punished twice for the same offence.

Thus, Mr. Ram shall be liable to punished under the Advocates Act, 1961 or the Income Tax Act 1961, but shall not be punished twice for the same offence.

### Concept Problem 12 [MTP Nov 2018] [MTP May 2019]

What do you understand by the term ‘Good Faith’. Explain as per the provisions of the General Clauses Act, 1897.

### Answer

**“Good Faith” [Section 3(22) of the General Clauses Act, 1897]:** A thing shall be deemed to be done in “good faith” where it is in fact done honestly, whether it is done negligently or not.

The question of good faith under the General Clauses Act is one of fact. It is to determine with reference to the circumstances of each case. The term “Good faith” has been defined differently in different enactments. This definition of the good faith does not apply to that enactment which contains a special definition of the term “good faith” and there the definition given in that particular enactment has to be followed. This definition may be applied only if there is nothing repugnant in subject or context, and if that is so, the definition is not applicable.

### Concept Problem 13



Mr. Mike has lent his house property to Mr. Wise at a monthly rent of Rs. 15,0000 per month. The yearly rent agreement was due to expire in near future. However, Mr. Mike does not intend to continue this agreement and he has sent a notice to Mr. Wise for the termination of the agreement. Mr. Wise, on the other hand, does not want to vacate the property and hence has returned the notice with an endorsement of refusal. Now, Mr. Wise has contended that no notice was served to him and hence there is no need for him to vacate the property. As per the provisions of the General Clauses Act, 1897, discuss whether a notice was served to Mr. Wise.

### Answer

As per section 27 of the General Clause Act, 1897, where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

- a) properly addressing
- b) pre-paying, and
- c) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

Thus, where a notice is sent by the landlord by registered post and the same is returned by the tenant with an endorsement of refusal, it will be presumed that the notice has been served. Hence, in the given situation, a notice was rightfully served to Mr. Wise.

### Concept Problem 14

Excel Ltd. declared dividend for its shareholder in its Annual General Meeting held on 30<sup>th</sup> September, 2017. Under the provisions of the Companies Act, 2013, company is required to pay declared dividend within 30 days from the date of declaration. As per the provisions of the General Clauses Act, 1897, discuss what will be the commencement and termination time for posting of declared dividend.

### Answer

As per the provisions of Section 9 of the General Clauses Act, 1897, in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word "from" and for the purpose of including the last in a series of days or any other period of time, to use the word "to".

Section 127 of the Companies Act, 2013 uses the words, thirty days from. Thus, in the given situation Excel Ltd. is required to pay declared dividend within 30 days from the date of declaration i.e. from 01/10/2017 to 30/10/2017. In this series of 30 days, 30/09/2017 will be excluded and last 30<sup>th</sup> day i.e. 30/10/2017 will be included.

### Concept Problem 15

What is the effect on the implementation of the Rules that are issued between passing and commencement of enactment. Explain as per the provisions of the General Clauses Act, 1897.

### Answer

**“Making of rules or bye-laws and issuing of orders between passing and commencement of enactment” [Section 22]:**

Where, by any Central Act or Regulation which is not to come into force immediately, on the passing thereof, a power is conferred to make rules or bye-laws, or to issue orders with respect to the application of the Act or Regulation or with respect to the establishment of any Court or the appointment of any Judge or officer thereunder, or with respect to the person by whom, or the time when, or the place where, or the manner in which, or the fees for which, anything is to be done under the Act or Regulation, then that power may be exercised at any time after passing of the Act or Regulation; but rules, bye-laws or orders so made or issued shall not take effect till the commencement of the Act or Regulation.

### Concept Problem 16 [MTP May 2019] [RTP May 2020]

A notice was served on Mr. P for appearing in the court. However, the notice could not be served on account of the fact that the house of the Mr. P was found locked. Thus, Mr. P. did not appear in the court at the said date. Examine the situation as per the provisions of the General Clauses Act, 1897 and determine whether Mr. P. will be liable in the given situation.

### Solution

According to section 27 of the General Clauses Act, 1897, where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

- a) properly addressing
- b) pre-paying, and
- c) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would delivered in the ordinary course of post Hence, where the where the notice could not be served on account of the fact that the house of Mr P was found locked, it will be deemed that the notice was properly served as per the provisions of Section 27 of the General Clauses Act, and it would be for Mr. P to prove that it was not really served and that he was not responsible for such non- service.

### Concept Problem 17 [ICAI May 2018]

Explain briefly any four effects by repeal of an existing Act by central legislation enumerated in Section-6 of The General Clauses Act, 1897.

### Solution

According to Section 6 of the General Clauses Act, 1897, where any Central legislation or any regulation made after the commencement of this Act repeals any Act made or yet to be made, unless another purpose exists, the repeal shall not:

- Revive anything not enforced or prevailed during the period at which repeal is effected or;
- Affect the prior management of any legislation that is repealed or anything performed or undergone or;
- Affect any claim, privilege, responsibility or debt obtained, ensued or sustained under any legislation so repealed or;
- Affect any punishment, forfeiture or penalty sustained with regard to any offence committed as opposed to any legislation or
- Affect any inquiry, litigation or remedy with regard to such claim, privilege, debt or responsibility or any inquiry, litigation or remedy may be initiated, continued or insisted.

### Concept Problem 18 [ICAI Nov 2019]

Define the term "Affidavit" under the General Clauses Act, 1897.

### Answer

Affidavit" [Section 3(3) of the General Clauses Act, 1897]: 'Affidavit' shall include affirmation and declaration in the case of persons by law allowed to affirm or declare instead of swearing.

There are two important points derived from the above definition:

- i) Affirmation and declaration,
- ii) In case of persons allowed affirming or declaring instead of swearing.

The above definition is inclusive in nature. It states that Affidavit shall include affirmation and declarations. This definition does not define affidavit. However, we can understand this term in general parlance. Affidavit is a written statement confirmed by oath or affirmation for use as evidence in Court or before any authority.

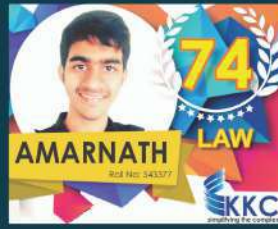
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### About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
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- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
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- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
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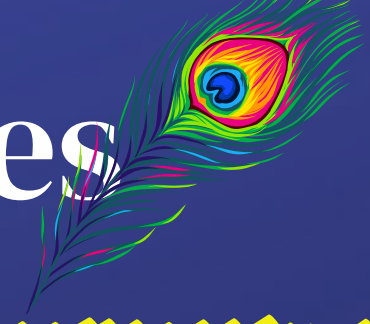


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# CHAPTER 4

## INTERPRETATION OF STATUTES,

## DEEDS AND DOCUMENTS

### 1. PRACTICAL QUESTIONS

#### Concept Problem 1 [ICAI SM] [MTP May 2019]

Explain the rule in 'Heydon's Case' while interpreting the statutes quoting an example.

Or

Explain the rule of 'beneficial construction' while interpreting the statutes quoting an example.

#### Answer

Where the language used in a statute is capable of more than one interpretation, the most firmly established rule for construction is the principle laid down in the Heydon's case. This rule enables, consideration of four matters in constructing an act:

- (1) what was the law before making of the Act,
- (2) what was the mischief or defect for which the law did not provide,
- (3) what is the remedy that the Act has provided, and
- (4) what is the reason for the remedy.

The Rule then directs that the Courts must adopt that construction which 'shall suppress the mischief and advance the remedy'. Therefore, even in a case where the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words.

If the object of any enactment is public safety, then its working must be interpreted widely to give effect to that object. Thus, in the case of Workmen's Compensation Act, 1923, the main object being provision of compensation to workmen, it was held that the Act should be so construed, as far as possible, so as to give effect to its primary provisions.

However, it has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning [*CIT v. Sodra Devi (1957) 32 ITR 615 (SC)*].

#### Concept Problem 2 [ICAI SM] [MTP May 2019] [May 2018]

Explain the principles of "Grammatical Interpretation" and "Logical Interpretation" of a Statute. What are the duties of a Court in this regard?

#### Answer

**Principles of Grammatical Interpretation and Logical Interpretation:** In order to ascertain the meaning of any law/ statute, the principles of Grammatical and Logical Interpretation is applied to conclude the real meaning of the law and the intention of the legislature behind enacting it.

**Meaning:** Grammatical interpretation concerns itself exclusively with the verbal expression of law. It does not go beyond the letter of the law, whereas Logical interpretation on the other hand, seeks more satisfactory evidence of the true intention of the legislature.

**Application of the principles in the Court:** In all ordinary cases, the grammatical interpretation is the sole form allowable. The Court cannot delete or add to modify the letter of the law.

However, where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness, it is the duty of the Court to look beyond the letter of law so as to determine the true intentions of the legislature. The duty of the Court is to administer the law as it stands rather it is just or unreasonable.

However, if there are two possible constructions of a clause, the Courts may prefer the logical construction which emerges from the setting in which the clause appears and the circumstances in which it came to be enacted and also the words used therein.

### Concept Problem 3 [ICAI SM]

- i) What is the effect of proviso? Does it qualify the main provisions of an Enactment? Give the distinction between proviso, exception and Saving Clause. [RTP May 2018]
- ii) Does an explanation added to a section widen the ambit of a section?

#### Answer

- i) The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the main provision to which it has been enacted as a proviso and to no other. (*Ram Narain Sons Ltd. vs. Assistant Commissioner of Sales Tax, AIR 1955 SC 765*).

#### Distinction between Proviso, exception and saving Clause

Proviso	Exception	Saving Clause
'Proviso' is used to remove special cases from general enactment and provide for them specially	Exception' is intended to restrain the enacting clause to particular cases	'Saving clause' is used to preserve from destruction certain rights, remedies or privileges already existing

- ii) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up the ambiguity in the main section. Something may be added to or something may be excluded from the main provision by insertion of an explanation. But the explanation should not be construed to widen the ambit of the section.

### Concept Problem 4 [ICAI SM]

Gaurav Textile Company Limited has entered into a contract with a Company. You are invited to read and interpret the document of contract. What rules of interpretation of deeds and documents would you apply while doing so?

#### Answer

Refer Book.

### Concept Problem 5 [ICAI SM]

How will you interpret the definitions in a statute, if the following words are used in a statute?

- (i) Means, (ii) Includes

Give one illustration for each of the above from statutes you are familiar with.

**Answer**

The definition of a word or expression in the definition section may either be narrow in scope or may be extensive of the same.

When a word is defined to 'mean' such and such, the definition is 'prima facie' narrow, restrictive and exhaustive. We must restrict the meaning of the word to that given in the definition section.

But where the word is defined to 'include' such and such, the definition is 'prima facie' extensive. Here the word defined is not restricted to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section.

**Examples:**

**Definition of Director [section 2(34) of the Companies Act, 2013]** – Director means a director appointed to the Board of a Company. The word “means” suggests exhaustive definition.

**Definition of Whole-time director [Section 2(94) of the Companies Act, 2013]**– Whole time director includes a director in the whole-time employment of the company. The word “includes” suggests extensive definition. Other directors may be included in the category of the whole-time director.

**Concept Problem 6 [ICAI SM] [ICAI May 2018]**

Differentiate Mandatory Provision from a Directory Provision. What factors decide whether a provision is directory or mandatory?

**Solution**

Practically speaking, the distinction between a provision which is 'mandatory' and one which is 'directory' is that when it is mandatory, it must be strictly observed; when it is 'directory' it would be sufficient that it is substantially complied with. However, we have to look to the substance and not merely the form, an enactment in mandatory form might substantially be directory and, conversely, a statute in directory form may in substance be mandatory.

Hence, it is the substance that counts and must take precedence over mere form. If a provision gives a power coupled with a duty, it is mandatory: whether it is or is not so would depend on such consideration as:

- the nature of the thing empowered to be done,
- the object for which it is done, and
- the person for whose benefit the power is to be exercised.

**Concept Problem 7 [ICAI SM] [ICAI Nov 2018]**

Write short note on:

- i) Proviso
- ii) Explanation,

with reference to interpretation of statutes deeds and documents. [4 Marks]

**Solution**

- i) **Proviso:** The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision

- ii) **Explanation:** An Explanation is at times appended to a section to explain the meaning of the text of the section. An Explanation may be added to include something within the section or to exclude something from it. An Explanation should normally be so read as to harmonise with and clear up any ambiguity in the main section. It should not be so construed as to widen the ambit of the section.

### Concept Problem 8 [ICAI SM]

Define Grammatical Interpretation. What are the exceptions to grammatical interpretation?

#### Solution

Grammatical Interpretation and its exceptions: 'Grammatical interpretation' concerns itself exclusively with the verbal expression of the law, it does not go beyond the letter of the law. In all ordinary cases, 'grammatical interpretation' is the sole form allowable. The Court cannot take from or add to modify the letter of the law This rule, however, is subject to some exceptions:

- i) Where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness. As regard the defect to ambiguity, the Court is under a duty to travel beyond the letter of the law so as to determine from the other sources the true intention of the legislature. In the case of the statutory expression being defective on account of inconsistency, the court must ascertain the spirit of the law.
- ii) If the text leads to a result which is so unreasonable that it is self-evident that the legislature could not mean what it says, the court may resolve such impasse by inferring logically the intention of the legislature.

### Concept Problem 9 [ICAI SM] [ICAI Nov 2018]

Explain Mischieve Rule for interpretation of statute. Also give four matters it considers in construing an Act.

#### Solution

**Mischief Rule:** Where the language used in a statute is capable of more than one interpretation, principle laid down in the Heydon's case is followed. This is known as 'purposive construction' or 'mischief rule'. The rule then directs that the courts must adopt that construction which 'shall suppress the mischief and advance the remedy'.

It has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning.

It enables consideration of four matters in construing an Act:

1. what was the law before the making of the Act;
2. what was the mischief or defect for which the law did not provide;
3. what is the remedy that the Act has provided; and
4. what is the reason for the remedy.

### Concept Problem 10 [ICAI SM] [MTP Nov 2018] [MTP May 2019]

Explain how 'Dictionary Definitions can be of great help in interpreting constructing an Act when the statute is ambiguous.

**Or**

When can the 'dictionary definitions' be used as an external aid for interpretation of any of the word or expression of an enactment?

#### Solution

**Dictionary Definitions:** First we have to refer to the Act in question to find out if any particular word or expression is defined in it. Where we find that a word is not defined in the Act itself, we may refer to dictionaries to find out the general sense in which that word is commonly understood.

However, in selecting one out of the several meanings of a word, we must always take into consideration the context in which it is used in the Act. It is the fundamental rule that the meanings of words and expressions used in an Act must take their colour from the context in which they appear. Further, judicial decisions laying down the meaning of words in construing statutes in '*pari materia*' will have greater weight than the meaning furnished by dictionaries. However, for technical terms reference may be made to technical dictionaries.

### Concept Problem 11 [ICAI SM]

When can the Preamble be used as an aid to interpretation of a statute?

#### Answer

While the Preamble can be used to know the aims and objects of the legislation it cannot be used to control or qualify the precise and unambiguous language of an enactment. The preamble is the key to the mind of the maker of the law, but it cannot override in order to enlarge or restrict the enacting provision of the Act.

A provision contained in the Act cannot be considered as invalid because they do not accord with the preamble, which is only a brief summary of legislative objectives behind the Act, and if there is any conflict between the preamble and any provision of an Act, the provision prevails.

The preamble merely affords help in the matter of construction if there is any ambiguity. Where the language of the Act is clear, the court is bound to give it effect.

### When will courts refer to the preamble as an aid to construction?

**Situation 1:** Where there is any ambiguity in the words of an enactment the assistance of the preamble may be taken to resolve the conflict.

**Situation 2:** Where the words of an enactment appear to be too general in scope or application then courts may resort to the preamble to determine the scope or limited application for which the words are meant.

### Concept Problem 12 [RTP Nov 2018]

The 'Statute should be read as a Whole'. Explain the statement.

#### Answer

**'Read the Statute as a Whole':** It is the elementary principle that construction of a statute is to be made of all its parts taken together and not of one part only. The deed/ statute must be read as a whole in order to ascertain the true meaning of its several clauses, and the words of each clause should be so interpreted as to bring them into harmony with other provisions – if that interpretation does no violence to the meaning of which they are naturally susceptible. And the same approach would apply with equal force with regard to Acts and Rules passed by the legislature.

One of the safest guides to the construction of sweeping general words is to examine other words of like import in the same enactment or instrument to see what limitations must be imposed on them. If we find that a number of such expressions have to be subjected to limitations and qualifications and that such limitations and qualifications are of the same nature, that circumstance forms a strong argument for subjecting the expression in dispute to a similar limitation and qualification.

### Concept Problem 13 [MTP Nov 2018] [MTP May 2019]

How far are (i) title and (ii) preamble in an enactment helpful in interpreting any of the parts of an enactment?

#### Answer

- a) **Title:** An enactment would have what is known as 'Short Title' and also a 'Long Title'. The short title merely identifies the enactment and is chosen merely for convenience. The 'Long title' describes the enactment and does not merely identify it. The Long title is a part of the Act and, therefore, can be referred to for ascertaining the object and scope of the Act.



**b) Preamble:** It expresses the scope and object of the Act more comprehensively than the long title. The preamble may recite the ground and the cause for making a statute and or the evil which is sought to be remedied by it.

The preamble like the Long title can legitimately be used for construing it. However, the preamble cannot override the provisions of the Act. Only if the wording of the Act gives rise to doubts as to its proper construction (e.g., where the words or a phrase has more than the one meaning and doubts arise as to which of the two meanings is intended in the Act) the preamble can and ought to be referred to arrive at the proper construction.

#### Concept Problem 14 [MTP Nov 2018]

How far are 'marginal notes' in an enactment helpful in interpreting any of the parts of an enactment?

#### Answer

**Marginal Notes:** Although there is difference of opinion regarding resort to Marginal Notes for construing an enactment, the generally held view is that the Marginal Notes appended to a Section cannot be used for construing the Section.

However, marginal notes appended to Articles of the Constitution have been held to be part of the Constitution as passed by the Constituent Assembly and therefore have been made use of in construing the Articles.

**Example:** Article 286 of the constitution furnishing "prima facie", some clue as to the meaning and purpose of the Article [Bengal Immunity Co. Ltd. v. State of Bihar, AIR 1955 SC]

#### Concept Problem 15 [RTP May 2019]

Many a time a proviso is added to a Section of the enactment. Explain the function of such a proviso in the interpretation of the section/ provision.

#### Solution

The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment ordinarily a proviso is not interpreted as it stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the provision to which it has been enacted as a proviso and not to the other. (*Ram Narain Sons Ltd. Vs. Assistant Commissioner of Sales Tax. A.I.R.,1995 SC 765*)

#### Concept Problem 16 [ICAI May 2018]

What is a Document as per the Indian Evidence Act, 1872?

#### Solution

**As per Indian the Evidence Act, 1872:** 'Document': Generally understood, a document is a paper or other material thing giving information, proof or evidence of anything. The Law defines 'document' in a more technical form. As per Section 3 of the Indian Evidence Act, 1872, 'document' means any matter expressed or described upon any substance by means of letters, figures or marks or by more than one of those means, intended to be used, or which may be used, for the purpose of recording that matter.

For Example: A writing is a document, any words printed, photographed are documents.

#### Concept Problem 17 [ICAI SM] [ICAI May 2019]

Preamble does not over-ride the plain provision of the Act.' Comment. Also give suitable example

#### Answer

**Preamble:** The Preamble expresses the scope, object and purpose of the Act more comprehensively. The Preamble of a Statute is a part of the enactment and can legitimately be used as an internal aid for construing it. However, the Preamble does not over-ride the plain provision of the Act. But if the wording of the statute gives rise to doubts as to its proper construction, for example, where the words or phrase has more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, the Preamble can and ought to be referred to in order to arrive at the proper construction.

In short, the Preamble to an Act discloses the primary intention of the legislature but can only be brought in as an aid to construction if the language of the statute is not clear. However, it cannot override the provisions of the enactment.

**Example:** Use of the word 'may' in section 5 of the Hindu Marriage Act, 1955 provides that "a marriage may be solemnized between two Hindus" has been construed to be mandatory in the sense that both parties to the marriage must be Hindus as defined in section 2 of the Act. It was held that a marriage between a Christian male and a Hindu female solemnized under the Hindu Marriage Act was void. This result was reached also having regard to the preamble of the Act which reads: 'An Act to amend and codify the law relating to marriage among Hindus' [Gullipoli Sowria Raj V. BandaruPavani, (2009)1 SCC714].

### Concept Problem 18 [ICAI May 2019]

If it is defined as:

- i) "Company means a company incorporated under the Companies Act, 2013 or under any previous company Law".
- ii) "Person" includes, \_\_\_\_\_ under the Consumer Protection Act, 1986.

How would you interpret/construct the nature and scope of the above definitions?

### Answer

**Restrictive and extensive definitions:** The definition of a word or expression in the definition section may either be restricting of its ordinary meaning or may be extensive of the same.

When a word is defined to 'mean' such and such, the definition is 'prima facie' restrictive and exhaustive, we must restrict the meaning of the word to that given in the definition section.

But where the word is defined to 'include' such and such, the definition is 'prima facie' extensive: here the word defined is not restricted to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section.

Thus,

- i) The definition is restrictive and exhaustive to the effect that only an entity incorporated under the Companies Act, 2013 or under any previous Companies Act, shall deemed to be company.
- ii) The definition is inclusive in nature, thereby the meaning assigned to the respective word (here 'person') is extensive. It has a wider scope to include other terms into the ambit of the definition having regard to the object of the definition.

### Concept Problem 19 [ICAI Nov 2019]

How will you interpret the term "Instrument" used in as statutes?

### Answer

**'Instrument':** In common parlance, 'instrument' means a formal legal document which creates or confirms a right or records a fact. It is a formal writing of any kind, such as an agreement, deed, charter or record, drawn up and executed in a technical form. It also means a formal legal document having legal effect, either as creating liability or as affording evidence of it. Section 2(14) of the Indian Stamp Act, 1899 states that 'instrument' includes every document by which any right or liability is or purports to be created, transferred, extended, extinguished or recorded.

**Concept Problem 20 [ICAI SM] [ICAI May 2019]**

At the time of interpreting a statute, what will be the effect of 'Usage' or 'Practice'?

**Answer**

**Effect of usage:** Usage or practice developed under the statute is indicative of the meaning recognized to its words by contemporary opinion. A uniform notorious practice continued under an old statute and inaction of the Legislature to amend the same are important factors to show that the practice so followed was based on correct understanding of the law. When the usage or practice receives judicial or legislative approval it gains additional weight.

In this connection, we have to bear in mind two Latin maxims:

- (i) 'Optima Legum interpret est consuetude' (the custom is the best interpreter of the law); and
- (ii) 'Contemporanea exposito est optima et fortissinia in lege' (the best way to interpret a document is to read it as it would have been read when made).

Therefore, the best interpretation/construction of a statute or any other document is that which has been made by the contemporary authority. Simply stated, old statutes and documents should be interpreted as they would have been at the time when they were enacted/written.

Contemporary official statements throwing light on the construction of a statute and statutory instruments made under it have been used as contemporanea exposition to interpret not only ancient but even recent statutes in India.

**Concept Problem 21 [MTP May 2020]**

'The meaning of a word is to be judged by the company it keeps'. Explain the concept of 'Noscitur A Sociis'.

**Answer**

**Associated words to be understood in common sense Manner:** When two words or expressions are coupled together one of which generally excludes the other, obviously the more general term is used in a meaning excluding the specific one. On the other hand, there is the concept of 'Noscitur A Sociis'. (it is known by its associates).

That is to say the meaning of a word is to be judged by the company it keeps'. When two or more words which are capable of analogous (similar or parallel) meaning are coupled together, they are to be understood in their cognate sense (i.e. akin in origin, nature or quality).

They take, as it were, their colour from each other i.e. the more general is restricted to a sense analogous to the less general. It is a rule wider than the rule of ejusdem generis, rather ejusdem generis is only an application of the noscitur a sociis. It must be borne in mind that 'Noscitur A Sociis' is merely a rule of construction and it cannot prevail in cases where it is clear that the wider words have been deliberately used in order to make the scope of the defined word correspondingly wider.

For example, in the expression 'commercial establishment means an establishment which carries on any business, trade or profession, the term 'profession was constructed with the associated words 'business' and 'trade' and it was held that a private dispensary was not within the definition, [Devendra M. Surti (Dr.) vs. State of Gujarat, AIR 1969 SC 63 at 67]

**Concept Problem 22 [RTP Nov 2020]**

Explain whether Foreign Decisions be used for construing Indian Acts.

**Answer**

Refer relevant portion of the Book.



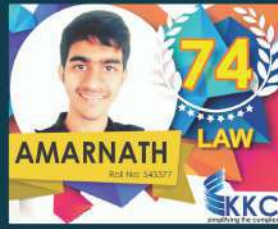
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### About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
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- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
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- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
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