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PREFACE

Dear Student,

Welcome to the World of Knowledge - **J.K. Shah Classes** !

I have the pleasure of presenting this study material to you. It contains exhaustive theory and good numbers of examples and graphs. It covers all the aspects which will bring in to focus all important concepts that you need to study in order to fortify yourself for your examination. The subject will be taught by eminent professors who are highly experienced and well - versed with the job.

The coaching is very exhaustive and wholly concept based. The conceptual explanations are entirely supported by good problems that cover the past and problems which peep into the future. Also, the coaching is very systematic, well - planned and absolutely time - bound. For a change, say good - bye to mechanical learning. I am sure you will feel that the study is a pleasurable job and not a painful exercise.

I wish you a very happy study time.

BEST OF LUCK !

Prof. J.K. Shah

Chartered Accountant

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CHAPTER 1 - THE INDIAN CONTRACT ACT, 1872

UNIT 1: NATURE OF CONTRACTS

This is one of the oldest in the Indian law regime, passed by the legislature of pre-independence India and received its assent on 25th April, 1872. But this Act was introduced on 1st September, 1872.

It is applicable to whole of India except Jammu and Kashmir.

- **DEFINITION OF CONTRACT :**

The term 'contract' is defined in Section 2 (h) of Indian Contract Act, as under : "An agreement enforceable by law is a contract".

Contract = An agreement + Enforceability.

- **DEFINITION OF AGREEMENT :**

The term 'agreement' is defined in Section 2 (e) of the Indian Contract Act, as under: "Every promise and every set of promises forming the consideration for each other, is an agreement."

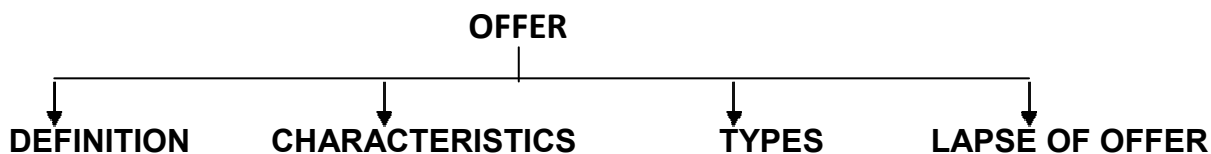
Agreement = Offer + Acceptance.

All Contracts are agreements but all agreements are not contracts.

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

Example:

- **DEFINITION OF PROPOSAL/OFFER:**



DEFINITION:

The term proposal/offer has been defined in **Section 2 (a)** as under:

“When one person signifies to another his willingness to do or to abstain (not to do) from doing anything, with a view to obtaining the assent of that another to such act or abstinence, he is said to make a proposal.”

CHARACTERISTICS:

(1) Offer must be capable of creating legal relationship :

Case law: In *Balfour v. Balfour*, a husband promised to pay maintenance allowance every month to his wife. When he failed to perform this promise, she brought an action to enforce it. As it is an agreement of domestic nature, it was held that it does not contemplate to create any legal obligation.

(2) The terms of the offer must be definite and certain:

The terms of the offer must be definite, unambiguous and certain and not vague.

(3) Offer must be different from invitation to offer.

An offer should be distinguished from an invitation to offer. An offer is definite and capable of converting an intention into a contract. Whereas an invitation to an offer is only a circulation of an offer, it is an attempt to induce offers and precedes a definite offer.

Difference between offer & Invitation to offer

Offer	Invitation to Offer
(i) Person expresses his willingness to be bound by the terms of the offer if other party accepts.	(i) Person is inviting other people to make an offer
(ii) Offers leads to acceptance Example – application form filled up by students for taking admission in college	(ii) Invitation to offers lays to offer Example – Issue of prospectus by college

Case law: Harvey vs. Facey [1893]

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

- (i) Will you sell us Bumper Hall Pen? and
- (ii) Telegraph lowest cash price.

The defendants replied through telegram that the "lowest price for Bumper Hall Pen is £ 900". The plaintiffs sent another telegram stating "we agree to buy Bumper Hall Pen at £ 900". However the defendants refused to sell the property at the price.

The plaintiffs sued the defendants contending that they had made an offer to sell the property at £ 900 and therefore they are bound by the offer.

However the Privy Council did not agree with the plaintiffs on the ground that while plaintiffs had asked two questions, the defendant replied only to the second question by quoting the price but did not answer the first question but reserved their answer with regard to their willingness to sell. Thus they made no offer at all.

Their Lordships held that the mere statement of the lowest price at which the vendor would sell contained no implied contract to sell to the person who had enquired about the price.

Case law: Mac Pherson vs Appanna [1951]: Where the owner of the property had said that he would not accept less than £ 6000/- for it. This statement did not indicate any offer but indicated only an invitation to offer.

(4) Offer should be communicated.

Unless an offer is properly communicated, there can be no acceptance of it.

As per *Lalman Shukla vs Gauri Dutt*, Gauri announced a reward for anyone who found his nephew. Lalman found the nephew in ignorance of reward. Held that, he is not entitled to reward as a person cannot accept an offer so long as he is unaware of its existence.

(5) Offer can be express or implied.

An offer which is expressed by words, written or spoken, is called an express offer. The offer which is expressed by conduct, is called an implied offer.

(6) Offer can be conditional.

Such conditional offer should be accepted along with the condition.

(7) Offer should not contain a term non-compliance of which would directly lead to acceptance.

Example:

TYPES OF OFFER:

(1) General offer: It is an **offer made to public in general**. Anybody knowing about the offer can accept such offer. No written acceptance is compulsory. Any person coming forward, acting accordingly can accept the offer.

Case Law: In *Carlill v/s Carbolic & Smoke Balls Co.*, a sole proprietary concern manufacturing a medicine which was a carbolic ball whose smoke could cure influenza issued an advertisement for sale of this medicine. The advertisement also included a reward of £100 to any person who contracted influenza, after using the medicine. Mrs. Carlill bought these smoke balls and used them as directed but contracted influenza. It was held that Mrs. Carlill was entitled to a reward of £100 as she had fulfilled the condition for acceptance as the advertisement did not require any communication of compliance of the condition, it was not necessary to communicate the same.

(2) Specific/Special offer: When offer is **made to a definite person/ definite group of persons**, it is known as special specific offer. Such offers can be accepted by that specified person only.

(3) Cross offer: When two parties **exchange identical offer** in ignorance at the time of each other's offer. The offers are called cross offers. There is no binding contract in such case as one's offer cannot be constituted as acceptance by other.

Example:

(4) **Counter offer:** When the offeree, offers to qualified acceptance to the offer, subject to modification and variation in terms of original offer he is said to have made a counter offer. A counter offer does not amount to acceptance of original offer.

Example:

(5) **Standing, open or continuing offer:** An offer is allowed to remain open for acceptance over a period of time is known as a standing, open or continuing offer.

LAPSE OF OFFER:

An offer should be accepted before it lapses (i.e. comes to an end). An offer may come to an end in any of the following ways stated in Section 6 of the Indian Contract Act:

1. By communication of notice of revocation by offeror:

An offer may come to an end by communication of notice of revocation by the offeror. an offeror can revoke his offer at any time before he becomes bound by it.

2. By lapse of time:

Where time is fixed for the acceptance of the offer, and it is not accepted within the fixed time, the offer comes to an end automatically on the expiry of fixed time. Where no time for acceptance is prescribed, the offer has to be accepted within reasonable time. The term 'reasonable time' will depend upon the facts and circumstances of each case.

3. By failure to accept condition in conditional offer:

Where, the offer requires that some condition must be fulfilled before the acceptance of the offer, the offer lapses, if it is accepted without fulfilling the condition.

4. By the death or insanity of the offeror/offeree:

Where, the offeror dies or becomes insane, the offer comes to an end if the fact of his death or insanity comes to the knowledge of the acceptor before he makes his acceptance. But if the offer is accepted in ignorance of the fact of death or insanity of the offeror, the acceptance is valid. This will result in a valid contract, and legal representatives, of the deceased offeror shall be bound by the contract. On the death of offeree before acceptance, the offer also comes to an end by operation of law.

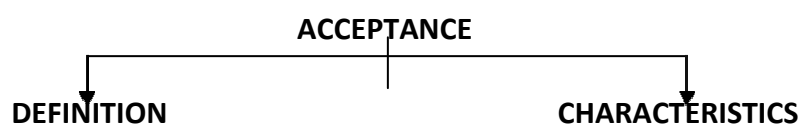
5. By counter-offer by the offeree:

Where, a counter-offer is made by the offeree, then the original offer automatically comes to an end, as the counter-offer amounts to rejections of the original offer.

6. By rejection of offer by the offeree:

Where, the offeree rejects the offer, the offer comes to an end. Once the offeree rejects the offer, he cannot revive the offer by subsequently attempting to accept it. The rejection of offer may be express or implied.

• DEFINITION OF ACCEPTANCE:



DEFINITION: The term acceptance has been defined in Section 2(b) as under: "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise".

CHARACTERISTICS OF ACCEPTANCE:

1. The acceptance must be communicated:

The acceptance is, completed only when it has been communicated to the offerer. Until the acceptance is communicated, it does not create any legal relations.

2. The acceptance must be communicated by a person who has the authority to accept.

3. The acceptance must be absolute and unqualified:

As a conditional acceptance is counter offer.

4. Acceptance must be within a specific/reasonable time :

The acceptance must be made while the offer is still in force, i.e. before the offer lapses. If any time-limit is prescribed in the offer, it should be accepted within the prescribed time-limit. However, if not time is prescribed, it must be accepted within "a reasonable time".

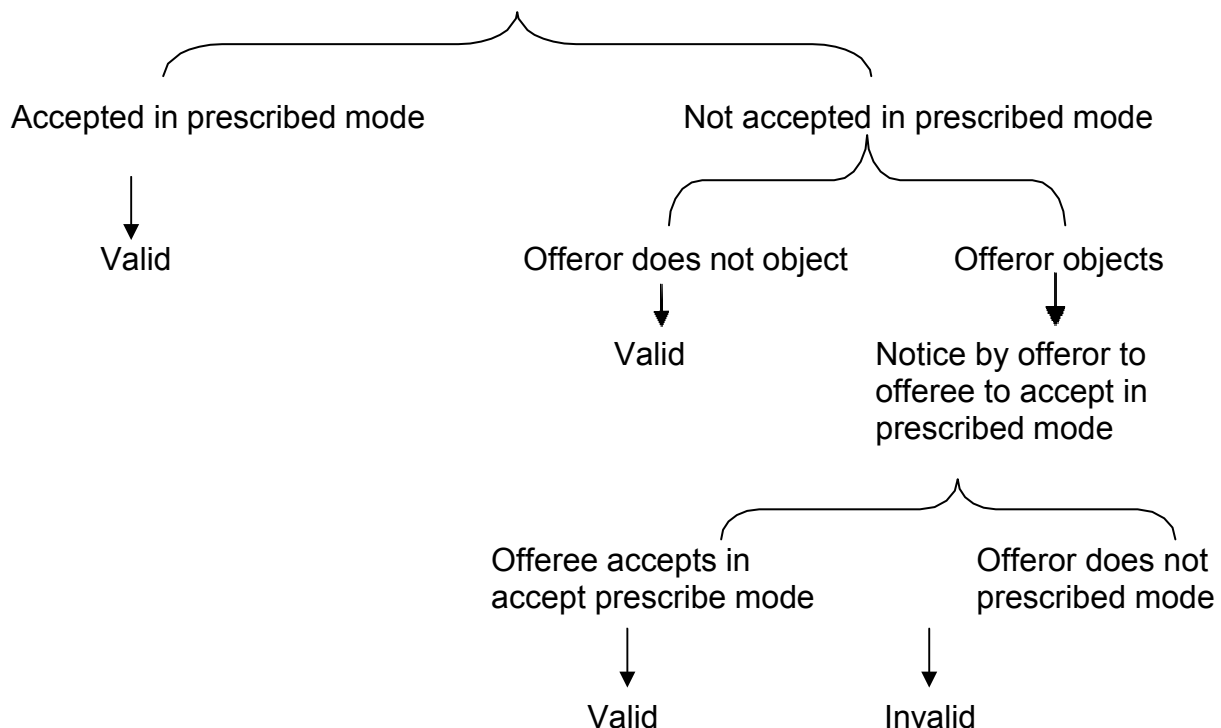
5. Acceptance can be express or implied.

Case law: Lilly White vs. Mannuswamy (1970)

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

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

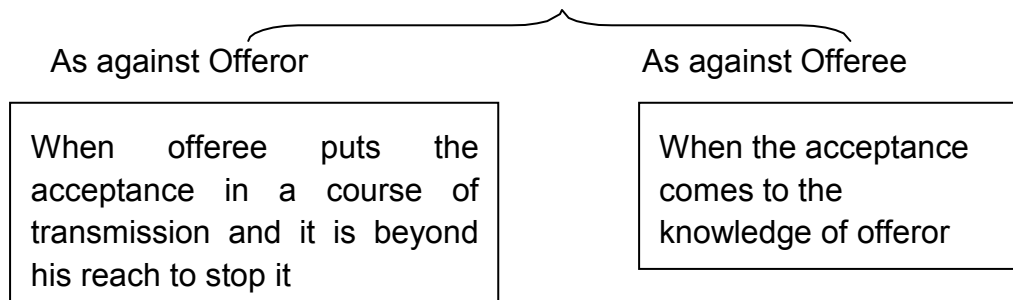
6. Acceptance should be via prescribed mode of communication.



COMMUNICATION OF OFFER AND ACCEPTANCE AND REVOCATION OF OFFER AND ACCEPTANCE :

1. Communication of offer is complete when it comes to the knowledge of offeree.

2. Communication of acceptance is complete



3. Revocation of offer is valid before offeree puts the acceptance in course of transmission and it is out of his reach to stop it.

4. Revocation of acceptance is valid before acceptance comes to the knowledge of offeror.

Example:

A offered, by a letter, to sell his car to B for Rs. 4,00,000. The letter was posted on 1st Jan which reached B on 4th Jan. B accepted the offer and posted his letter of acceptance on 6th Jan. Here, A became bound by the offer on 6th Jan. In this case, the offer could be revoked by A at any time before 6th Jan.

B accepted the offer and posted his letter of acceptance on 6th Jan which reached A on 9th Jan. Here, B becomes, bound by his acceptance on 9th Jan. In this case, the acceptance could be revoked at any time before 9th Jan.

• **TYPES OF CONTRACTS**

1. **Valid contract:** A valid contract is an agreement enforceable by law [Sec. 2(h)]. A valid contract is that contract which fulfills all the essential elements

2. **Void Contract:** It is a contract without any legal effect and cannot be enforced in a Court of Law. Section 2(i) defines a void contract as "a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable".

Void Agreement: Agreement which is not enforceable by law from the beginning

3. **Voidable Contract:** As per Section 2(i), "an agreement which is enforceable by law at the option of one or more the parties but not at the option of the other or others is a voidable contract" .

Example: A contract brought about as a result of Coercion, Undue influence, Fraud or misrepresentation would be voidable at the option of the person whose consent was caused by any one of these factors.

S. No.	Basis	Void Contract	Voidable Contract
1	Meaning	A Contract ceases to be enforceable by law becomes void when it ceases to be enforceable.	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.
2	Cause	A contract becomes void due to change in law or change in circumstances beyond the	A contract becomes a voidable contract if the consent of a party was not free.

3	Performance of contract	A void contract cannot be performed.	If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming
4	Rights	A void contract does not grant any right to any party.	The party whose consent was not free has the right to rescind the

4. **Illegal Agreement:** It is a contract which the law forbids to be made. The court will not only enforce such a contract but also connected contracts. All illegal agreements are void but all void agreements or contracts are not necessarily illegal.

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

5. **Unenforceable contract:** Where a contract is good in substance but because of some technical defect i.e., absence in writing, barred by, imitation etc., one or both the parties cannot sue upon it, it is described as an unenforceable contract..
6. **Express contract:** A contract which is made by words either spoken or written is said to be an express contract..
7. **Implied contract:** By implied contract means implied by law (i.e.,) the law implies a contract though parties never intended.
Example: A delivers by mistake goods at B's warehouse instead of at C's place. Here there is an obligation on the part of B to return the goods to A, though they never intended to enter into a contract.
8. **Tacit contract:** A contract is said to be tacit when it has to be inferred from the conduct of the parties.
Example: Obtaining cash through automatic teller machine, sale by fall of hammer at an auction sale.
9. **Executed contract:** If the consideration for the promise in a contract (i.e., any act or forbearance) is given or executed, such type of contract is called contract with executed consideration.
10. **Executory contract:** It is so called because the reciprocal promises or obligation which serves as consideration is to be performed in future.
11. **Unilateral contract:** A unilateral contract is a one - sided contract in which only one party has to perform his promise.
12. **Bilateral contract:** Where the obligation or promise in a contract is outstanding on the part of both the parties, it is known as bilateral contract.

- **TYPES OF CONTRACTS AS PER ENGLISH LAW**

The English Law classifies the contract into:

- (i) Formal contracts, and
- (ii) Simple contracts.
- (i) **Formal Contracts** include (a) Contract of record and (b) Contract under Seal.
 - (a) **Contract of Record:** A contract of record is either a judgment of a court. A judgment is an obligation imposed by a Court upon one or more persons in favour of another or others. As a matter of fact it is not a contract in the real sense, since it is not based upon any agreement between the two parties. Contracts of record derive their binding force from the authority of the Court.
 - (b) **Contract under Seal:** A contract under seal is one which derives its binding force from its form alone. It is in writing and is signed, sealed and delivered by the parties.
- (ii) **Simple Contracts:** All other contracts.

- **ESSENTIAL ELEMENTS OF A VALID CONTRACT**

In order to become a valid contract, an agreement must have the following essential elements :

1. **There must be an offer and its acceptance:** In an agreement there must be an offer by one party and its acceptance by the other. The offer when accepted becomes agreement.
2. **There must be mutual consent of the parties:** The parties to an agreement must have the mutual consent i.e., they must agree upon the same thing and in the same sense. This means that there must be consensus ad idem (i.e., meeting of minds).
3. **There must be legal obligation:** An agreement must create legal obligations i.e., an obligation enforceable by law. If the parties do not intend to create legal obligation, there is no contract between them. An obligation which gives rise to a moral or social obligation only is not a contract e.g., an invitation to a friend for dinner creates a mere social obligation.
4. **There must be free consent of the parties:** If the consent of the parties is not free, then no valid contract comes into existence. The consent is not free when it is obtained by coercion, undue influence, fraud, misrepresentation of facts and mutual mistake of fact.
5. **The parties must be competent to contract:** It means that the parties must be capable of entering into a contract. The minors, or persons of unsound mind are not competent to contract. If the parties are not competent to contract, then no valid contract comes into existence.
6. **The agreement must be supported by lawful consideration:** The lawful consideration is that which is neither fraudulent, forbidden by law, immoral nor opposed to public policy etc. If the consideration is not lawful, then no valid contract comes into existence.
7. **The object of the agreement must be lawful:** A lawful object is that which is neither fraudulent, forbidden by law, immoral, nor opposed to public policy etc.
8. **The agreement must not be declared to be void:** If certain agreement is expressly declared to be void by the law of the country, then such agreement if entered into, shall not be enforceable by Courts of Law.
9. **The agreement must be certain:** The meaning of the agreement must be certain. In other words, an agreement whose meaning is not certain, is not valid.
10. **The performance must not be impossible:** The performance of an agreement must be possible. An agreement to do an impossible act is not valid.

UNIT 2: CONSIDERATION

- **INTRODUCTION:**

The term 'consideration' may be defined as the price of the promise. This term is used in the sense of quid pro quo (i.e., something in return). It means that when a party to an agreement promises to do something, he must get something in return. This 'something' which a party gets in return is the consideration.

- **DEFINITION:**

The term 'consideration' is defined in section 2 (d) of the Indian Contract Act, as under:

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

- **CHARACTERISTICS OF CONSIDERATION:**

1. **The consideration must move (i.e., must be done or promised to be done) at the desire of the promisor :**

An act or abstinence, which forms consideration for the promise, must be done or promised to be done according to the desire of the promisor

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

2. **It may move from the promisee or any other person :**

Consideration may move from promisee or if the promisor has no objection from any other person.

Case law: In *Chinnayya v/s Ramayya*, A, a daughter in consideration of some property received from her father, entered into an agreement with C, her uncle to pay him annuity. Later on, she refused to pay on the ground that her uncle, a promisee, has not given consideration. It was held, that consideration had moved from her father and as such she was liable to pay.

3. **Consideration can be past, present or future:**

It can be executed or executory. But in England, past consideration is no consideration.

4. **Consideration need not be adequate:**

Consideration whether in the sense of benefit or in the sense of detriment, need not be adequate to the promise. Law requires the presence of consideration, but does not inquire about the adequacy.

5. **It must be real and not illusory :**

The consideration to be valid must be 'real' and 'valuable' and must not be 'imaginary'.

6. **It must not be illegal, immoral, or opposed to public policy :**
The consideration given for an agreement must be a lawful one. Where the consideration to a contract is illegal, immoral or against public policy, the courts do not allow an action on such contract.
7. **Consideration can be executed or executory.**
8. **It can be negative or positive.**
9. **Consideration for an act which a person a legally bound to perform is not a valid consideration.**
Example: A promised to pay Rs. 5000 to B (a Police Officer) for investigating a crime, which B was already bound to investigate by law. Here A's promise to pay the amount is without valid consideration as B is already under a legal obligation to investigate the crime.

- **DOCTRINE OF PRIVACY OF CONTRACTS**

Since a contract is a private relationship between parties who make it, the rights and obligations under such a contract are strictly confined to them. This is known as the doctrine of "privity of contract". It is a general rule of law that a person who is not a party to the contract cannot sue.

The rule is "**Stranger to contract cannot sue. But a stranger to a consideration can sue**".

Exception to Rule "A stranger to a contract cannot sue":

Under the Indian Law, the following are the exceptions to the rule that a stranger to a contract cannot sue.

- (1) **Beneficiaries in the case of trust:**

An agreement to create a trust can be enforced by the beneficiary, though he was not a party to the contract between the settlor and the trustees.

Example:

- (2) **Written family settlements:**

In the case of family settlement, if the terms of settlement are reduced in writing, members of the family who were not a party to the settlement can also enforce their claim.

Example:

- (3) **Partition of Hindu Undivided Family:**

In the case of certain marriage contracts a female member can enforce a provision for marriage expense based on a petition made by the Hindu undivided family.

Example:

(4) Assignment of contract:

Where there is an assignment of a contract, the assignee can enforce the contract for various benefits that would accrue to him on account of the assignment.

Example:

(5) Acknowledgement of Debts:

In case of part performance of a contractual obligations or where there is acknowledgment of liability on account of estoppel, a third party can sue for benefits. Where for example 'A' gives ` 25000/- to 'B' to be given to 'C' and 'B' informs 'C' that B is holding it on behalf of C, but subsequently refuses to pay 'C' then 'C' can sue and enforce his claim.

(6) Covenants with land:

Where a piece of land which is sold to buyer with certain covenants relating to land and the buyer is kept on notice of the covenants with certain duties, there the successors to the seller can enforce these covenants.

Example:

(7) Contracts made by the agent:

The principal can enforce the contracts entered by his agent where the agent has acted within the scope of his authority and in the name of the principal.

Example:

- **NO CONSIDERATION, NO CONTRACT**

Every agreement must be supported by a consideration and agreement without consideration is void.

To this general rule there are certain exceptions which are mentioned in Section 25 of the Indian Contract Act.

(1) Out of Natural Love and Affection :

Where an agreement is expressed in writing and registered under law for the time being in force for the registration of documents and is made on account of natural love and affection between the parties standing in a near relation to each other is enforceable even if there is no consideration. Nearness of relationship, however, does not necessarily imply love and affection.

Example:

(2) Compensation paid for past voluntary services:

A promise to compensate wholly or in part for past voluntary services rendered by someone to promisor does not require consideration for being enforced. However the past services must have been rendered voluntarily to the promisor. Further the promisor must have been in existence at that time and he must have intended to compensate.

Example:

(3) Promise to pay debts barred by limitation:

Where there is a promise in writing to pay a debt, which was barred by limitation, is valid without consideration.

Example:

(4) Creation of Agency:

No consideration is necessary to create an agency

Example:

(5) In case of completed gifts, no consideration is necessary.

(6) Bailment:

Bailment is a contract where goods are delivered for a particular purpose and once the purpose is served, goods are to be returned back. There are 2 parties; bailor and bailee.

Bailment can be gratuitous. i.e. without consideration.

Example:

(7) Charity

UNIT 3: OTHER ESSENTIAL ELEMENTS OF A VALID CONTRACT

• CAPACITY OF PARTIES

The 'capacity to contract' means the competence (i.e., capability) of the parties to enter into a valid contract.

The term 'capacity to contract' is defined in Section 11 of the Indian Contract Act, as under :

“Every person is competent to contract who is of the age of the majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject.”

An agreement will be valid and enforceable only if the parties to it are **legally competent** to enter into contract.

Following persons are not competent to contract:

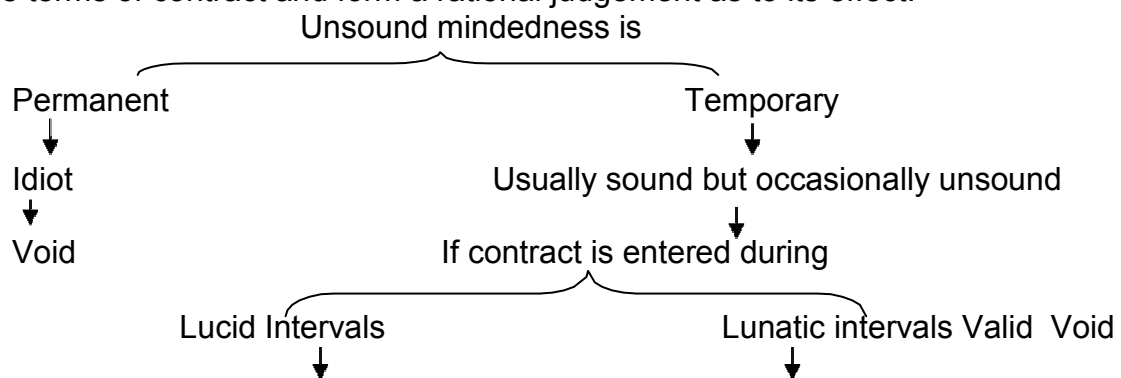
1. Minors :

- A minor is a person who is below the age of eighteen years.
- An agreement with a minor is void ab initio i.e., absolutely void, and cannot be enforced in a court of law.
- *Case law:* In *Mohiri Bibee vs. Dharmodos Ghose*, a minor, mortgaged his house in favour of a money-lender, to secure a loan of Rs. 20,000. A part of this amount (Rs. 10,500) was actually advanced to minor by money lender. Subsequently, minor sued for the cancellation of the mortgage on the plea that he was minor when he executed the mortgage. In this case, the mortgage was held void, and was thus cancelled. Further moneylender's request for the repayment of the amount advanced to minor as part consideration for the mortgage was also not accepted. Privy Council held that as the minor's contract was absolutely void, therefore, there was no question of refunding money in these circumstances.
- The minor's contracts do not impose any liability on his parents or guardians.
- Though an agreement with minor is void, valid contract can be entered into with the guardian on behalf of the minor. The guardian must be competent to make the contract and the contract should be for the benefit of the minor. But not all contracts by guardian are valid.
- A parent/guardian cannot bind a minor in a contract to purchase immovable properties
- A minor can be a beneficiary.
A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership.
- **Minor can always plead minority:**
Any money advanced to a minor cannot be recovered as he can plead minority and that the contract is void. Even if there had been false representation at the time of borrowing that he was a major, the amount lent to him cannot be recovered.

- **Ratification of agreement not permitted:**
A minor on his attaining majority cannot validate any agreement which was entered into when he was minor, as the agreement was void. Similarly a minor cannot sign fresh promissory notes on his attaining majority in lieu of promissory notes executed for a loan transaction when he was minor, or a fresh agreement without consideration.
- **Minor' property liable for necessaries :**
Sometimes, a person supplies necessaries to a minor. In such cases, the supplier of necessaries can claim reimbursement from the property of minor, but not personally from the minor.
- **The minor as an agent :**
A minor can be appointed as an agent. But he will not be liable for his acts as an agent

2. Person of unsound mind :

As per Section 12, a person is of unsound mind if he is not capable of understanding the terms of contract and form a rational judgement as to its effect.



3. Persons disqualified by law

The following persons, who are disqualified by the law to which they are subject are not competent to enter into a contract.

1. Alien enemies:

An 'alien' is a person who is a foreigner to the land. He may be either an 'alien friend' or an 'alien enemy.' If the country of the alien is at peace with the country of his stay, he is an alien friend. And if a war is declared between the two countries, he is termed as an alian enemy.

2. Insolvents:

When a person is declared as an insolvent, his property shall vest with the Receiver or 'Official Assignee'. However, this disqualification of an insolvent is removed 'when the court passes an order of discharge.

3. Convicts:

A convict cannot enter into a contract while he is undergoing imprisonment. But when he is pardoned or the sentence expires, he becomes capable of entering into a contract. Thus, the incapacity is only during the period of sentence.

4. Corporation and a company:

The contractual capacity of the corporation is expressly defined by the Special Act under which it is created. Whereas, the contractual capacity of a company, registered under the Companies Act 2013, is regulated by the terms of its 'Memorandum of Association' and the provisions of the Companies Act.

5. Foreign sovereigns, diplomatic staff, and accredited representatives of foreign states:

Such persons can enter into valid contracts and can enforce them in Indian courts. However, a suit cannot be filed against them, in the Indian courts, without the prior sanction of the central government.

● **FREE CONSENT**

The term 'consent' is defined in Section 13 of the Indian Contract Act, as under "Two or more persons are said to consent when they agree upon the same thing in the same sense." It is also known as consensus ad idem (i.e., meetings of the minds). For the creation of contract, there must be consensus ad idem.

The term 'free consent' may be defined as the consent which is obtained by the free will of the parties, and neither party was forced or induced to give his consent. It is defined in Section 14 of the Indian Contract Act, as under :

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

1. Coercion, as defined in Section 15, or
2. Undue influence, as defined in Section 16, or
3. Fraud, as defined in Section 17, or
4. Misrepresentation, as defined in Section 18, or
5. Mistake, subject to the provisions of Sections 20, 21 and 22.

● **COERCION**

- "Coercion is committing or threatening to commit, any act forbidden by the Indian Penal Code or unlawfully detaining or threatening to detain any property, to the prejudice of any person whatever with the intention of causing any person to enter into an agreements. (Section 15)
- It is not necessary that coercion must proceed from the party to the contract since relationship is not required. It may proceed from a third party who is not a party to the contract.
- It is immaterial whether Indian Penal Code is or is not in force in the place where coercion is employed.
- Physical force is involved.
- Suicide also amounts to coercion.

When consent to an agreement is caused by coercion, the agreement is a contract voidable at the option of the party whose consent was caused. In other words, either aggrieved party can rescind the contract or affirm the contract.

- **Example:**

• **UNDUE INFLUENCE**

- A contract is said to be induced by “undue influence” where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage of the other.
- A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other.

Following types of relations are judicially held to be of trust and confidence:’

- (a) Lawyer and client.
- (b) Doctor and patient.
- (c) Spiritual adviser and devotee.
- (d) Parents and child, etc
 - Mental force is involved
 - Can be exercised between same parties only as relationship is required.
 - The effect of undue influence is that it makes the contract voidable at the option of the party whose consent is obtained by undue influence, i.e., such party can put an end to the contract if he so chooses

DIFFERENCE BETWEEN COERCION AND UNDUE INFLUENCE:

Coercion	Undue Influence
1. The consent is given under the threat of an offence forbidden by Indian Penal Code or detaining or threatening to detain property unlawfully.	1. The consent is given by a person who is so situated in relation to another that the other position to dominate his will.
2. It is not necessary that some sort of relationship must exist between parties.	2. In case of undue influence, there is bound to be some sort of relationship.
3. Coercion need not proceed from parties to the contract.	3. Undue influence is always exercised between parties to the agreement.
4. Coercion is mainly of physical nature.	4. Undue influence is of moral/mental nature.

• **FRAUD**

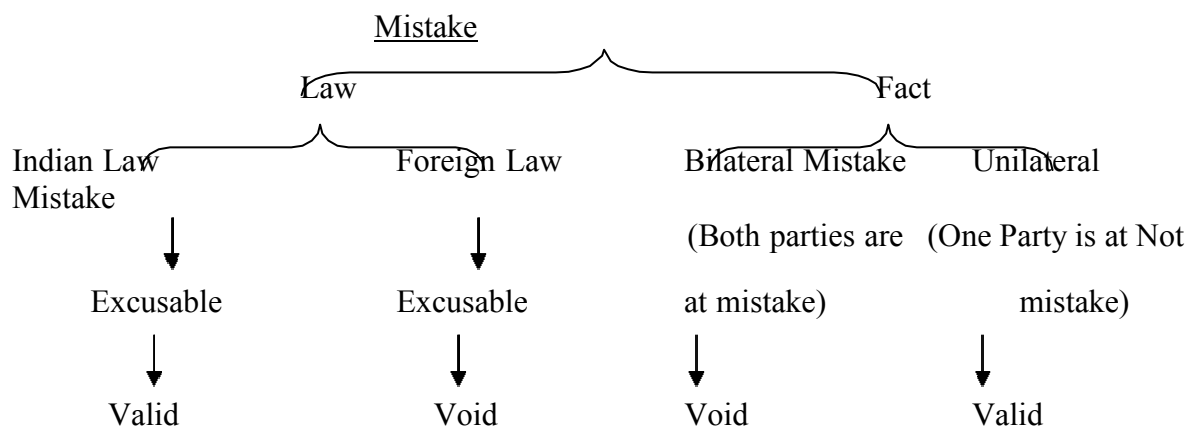
- The term ‘fraud’ may be defined as an intentional, deliberate or willful misstatement of facts, which are material for the formation of a contract.
- Fraud means and includes any of the following acts committed by a party to a contract with intent to deceive another party thereto or to induce him to enter into the contract :
 1. The active concealment of a fact by one having knowledge or belief of the fact;
 2. A promise made without any intention of performing it;
 3. Any other act fitted to deceive;
 4. Any such act or omission as the law specially declares to be fraudulent.
 5. Person making the statement does not believe it as true
- **Example:** A, intending to cheat B, falsely represented that five tonnes of ice was manufactured daily in his factory. And thereby, induced B to buy the factor. In fact, the production was 3.5 tonnes per day. The contract is voidable at the option of B, as his consent is obtained by fraud.

- Mere silence does not amount to fraud. But when silence is equivalent to speech or when there is a duty to speak and the person does not speak, it amounts to fraud.
- The effect of fraud is that it makes the contract voidable at the option of the party whose consent was obtained by fraud i.e., such party may put an end to the contract if he so chooses. **Aggrieved party can claim damages.**

● **MISREPRESENTATION**

- The term ‘misrepresentation’ may be defined as an innocent misstatement of facts which are material for the contract. In other words, misrepresentation is a false representation which is made innocently (i.e., without any intention to deceive the other party),
- A ‘representation: means a statement of facts made by one party to the other with a view to induce the other party to enter into the contract.
- There is no intention to cheat, hence it is not forbidden by Indian Penal Code
- Person making the statement does believes it as true
- The effect of misrepresentation is that it makes the contract voidable at the option of the party whose consent was obtained by misrepresentation i.e., such party may put an end to the contract if he so chooses. **Aggrieved party cannot claim damages** (Section 19)
- **Example:** A, by misrepresentation, lead B erroneously to believe that five hundred T.V. sets were manufactured per month in his factory. Upon this representation, B bought the factory. The actual production was found to be only four hundred sets per month. Here, B’s consent is caused by misrepresentation, and thus, the contract is voidable at his option

● **MISTAKE**



- (a) **Mistake of Law:** A mistake of law does not render a contract void as one can't take excuse of ignorance of the law of his own country. Since the mistake of Indian law cannot be given as an excuse, the contract must be performed after rectifying the mistake, hence the contract is valid. A mistake of foreign law is excusable and is treated like a mistake of fact. Contract may be avoided on such mistake.
- (b) **Mistake of Fact:** Where the contracting parties misunderstood each other and are at cross purposes, there is a bilateral or mutual mistake. Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void. For example, A offers to sell his Ambassador Car to B, who believes that A has only Fiat Car agrees to buy the car. Here the two parties are thinking about different subject matter so that there is no real consent and the agreement is void.

Where only one of the parties to a contract is under a mistake, i.e. unilateral mistake, the contract will not become void. A mistake on the part of one party only not caused or actively assisted by the act of the other party, cannot invalidate an agreement.

• **UNLAWFUL OBJECT AND UNLAWFUL CONSIDERATION**

1. Agreement forbidden by law: Acts forbidden by law means acts that are punishable under any Statute or Rules or Regulations made under any Statute.
2. Agreement defeating the provisions of law or defeating any rule for the time being in force.
3. Where object or consideration is unlawful because it involves or causing injury to a person or loss of property.
4. Where consideration is immoral.
5. Where object is fraudulent.
6. An agreement which is against the general public, is said to be an agreement opposed to public policy.

a) Trading with an enemy :

Trading with an enemy is regarded as opposed to public policy. Thus, an agreement made with an alien enemy is unlawful on the ground of public policy, and is void.

b) Trafficking in public offices :

The agreements which affect the normal working of government offices are void as they are opposed to public policy e.g., appointment decisions in consideration of money are void. Similarly, the agreement for the procurement of a public recognition such as Param Veer Chakra or any other title, for monetary or other consideration, is void.

c) Interference with course of law and justice:

Any agreement with the object of inducing a judicial officer or administrative officer of the state to act corruptly or not impartially is void.

d) Stifling prosecution:

Any agreement to stifle or prevent illegally any prosecution is void as it would amount to perversion or abuse of justice.

Example:

e) Maintenance and Champerty:

Maintenance is promotion of litigation in which the litigant has no interest. Champerty is bargain whereby one party agrees to assist the other in recovering property with a view to sharing the profit of litigation.

Example:

f) Marriage brokerage contracts :

An agreement to procure the marriage of a person in consideration of a sum of money is called a 'marriage brokerage contract'. Such agreements being opposed to public policy are void.

g) Interest against obligation:

The following is example of agreement that are void as they tend to create an interest against obligation. The object of such agreements is opposed to public policy. A, who is the manager of a firm, agrees to pass a contract to X if X pay to A 20000 privately; the agreement is void.

h) Agreement for the creation of monopolies:

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

• **AGREEMENTS EXPRESSLY DECLARED AS VOID**

1. Agreement in restraint of marriage (Section 26):

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

Exceptions:

- (1) Minors
- (2) Restraint for particular reasonable period is valid.

2. Agreement in restraint of trade (Section 27):

Any agreement through which a person is restrained from exercising a lawful profession, trade or business of any kind is to that extent void. The object of this law is to protect trade. The restraint, even if it is partial, will make the agreement void.

However there are certain exceptions:

- (i) Where a person sells his business along with the goodwill to another person, agrees not to carry on same line of business in certain reasonable local limits, such an agreement is valid.
- (ii) An agreement through which an outgoing partner will not carry on the business of the firm for a reasonable time will be valid, though it is in restraint of trade.
- (iii) An agreement of service through which an employee commits not to compete with his employer is not in restraint of trade. Example: 'B' is a Doctor and he employs 'A' a junior Doctor as his assistant. 'A' agrees not to practice as Doctor during the period of his employment with 'B' as a Doctor independently. Such an agreement will be valid.
- (iv) Trade Combinations are valid as long as they are not creating monopoly are valid: An agreement between manufacturer and a wholesale merchant that the entire production during a period will be sold by the manufacturer to the wholesale merchant is not in restraint of trade. An agreement among sellers not to sell a particular product below a particular price is not an agreement in restraint of trade.

3.

4. Agreement in restraint of legal proceedings (Section 28):

An agreement in restraint of legal proceedings resulting in restriction of one's right to enforce legal rights is void. Similarly any agreement which abridges the usual period for commencing the legal proceedings is also void.

However there are certain exceptions:

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

5. Agreement the meaning of which is uncertain (Section 29):

Where the meaning of the terms of an agreement is uncertain or if it is not capable of being understood with certainty, then the agreement is void.

Example: A agreed to sell his radio to B for Rs. 500 or Rs. 800. The agreement is void as there is no certainty about the price. It is not clear whether the price is Rs. 500 or Rs. 800.

6. Wagering Agreements (Section 30):

- The term 'wagering agreement' or 'wager' may be defined as an agreement in which one person agrees to pay certain amount of money (i.e., stake money) to the other person on the happening or non-happening of a specified uncertain event. The wagering agreements are void.
- But collateral to wagering are valid.
- Illegal agreements are void and collateral to illegal are also void.

Example :

A and B enter into an agreement that if it rains on Monday, A will pay Rs. 100 to B. And if it does not rain on Monday, B will pay Rs. 100 to A. This is a wagering agreement.

- The Act provides that an agreement to buy lottery tickets is one by way of wager and is void. However any subscription or contribution or agreement towards such subscription or contribution towards any plate or prize or sum of money, of the value of `500 or more to be awarded to a winner of a horse race is not unlawful.
- A promissory note given out of a wagering contract is not enforceable by way of a suit.
- Speculative transactions are valid as it involves skill.

UNIT 4: PERFORMANCE OF CONTRACT

- **INTRODUCTION**

After the formation of a valid contract, the next step is the fulfillment of the object that the parties had agreed to do. For the fulfillment of the object, the parties become liable to perform their respective obligations. When the parties perform their respective obligations, the object is fulfilled and the liability of the parties comes to an end. After the performance, the contract is said to be discharged. Thus, 'performance' is one of the various modes of discharge of the contract.

- **CONTRACT WILL BE PERFORMED BY:**

1. **Promisor himself:** If there is something in the contract to show that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor (Section 40). This means contracts which involve the exercise of personal skill or diligence, or which are founded on personal confidence between the parties must be performed by the promisor himself
2. **Agent:** Where personal consideration is not the foundation of a contract, the promisor or his representative may employ a competent person to perform it.(Section 40)
3. **Representatives:** A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor. As regards any other contract the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract (Section 37). But their liability under a contract is limited to the value of the property they inherit from the deceased.
4. **Third persons:** When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. That is performance by a stranger, accepted by the promisee, produces the result of discharging the promisor, although the latter has neither authorised nor ratified the act of the third party. (Section 41)

- **DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT Succession:**

When the benefits of a contract are succeeded by a process of law, both the burden and the benefit would sometimes devolve on the legal heir. For example 'B' is the son of 'A'. Upon A's death 'B' will inherit all the assets and liabilities of 'A' [These assets and liabilities are also referred to as debts and estates] Thus 'B' will be liable to all the debts of 'A', but if the liabilities inherited are more than the value of the estate [assets] inherited it will be possible to pay only to the extent of assets inherited.

Assignment: Assignment is voluntary transfer of right. Unlike succession, the assignor can assign only the assets to the assignee and not the liabilities.

- **REQUISITES OF A VALID TENDER:**

A tender to be valid must fulfill the following conditions:

(1) **It must be unconditional:**

The tender must be in accordance with the terms of the contract

(2) **Tender must be at a proper time and place:**

What is proper place and time normally can be gathered from the intention of the parties, the circumstances of the case as well as prevailing custom in the trade.

(3) **Tender must be within reasonable time.**

(4) **Tender must give reasonable opportunity for inspection :**

If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.

- **EFFECT OF REFUSAL OF A PARTY TO PERFORM:**

When a party to a contract has refused to perform or disabled himself from performing his promise in its entirety, the following two rights accrue to the aggrieved party namely:

(i) To terminate the contract; OR

(ii) Continue the contract.

The aggrieved party can also claim damages.

Example :

A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months, and B agrees to pay her Rs. 100 for each night's performance. On the sixth night, A wilfully absents herself from the theatre. B is at liberty to put an end to the contract.

- **LIABILITY OF JOINT PROMISORS**

Where two or more persons enter into a joint agreement with one or more person, the promise is known as a joint promise.

Example:

A, B, and C jointly borrowed a sum of Rs.15,000 from X, and jointly promised to repay the amount. It is a joint promise.

1. **The joint promisors or their representatives must jointly perform the promise :**

The joint promisors must jointly fulfill the promise during their joint life time. And if anyone of them dies, his legal representatives must jointly with the surviving promisors fulfill the promise. On the death of all the promisors, the representatives of all of them must jointly fulfill the promise

2. **The promisee may compel anyone of the joint promisors to perform the promise:**

Example:

A, B and C jointly promised to pay Rs. 30,000 to D. In this case D may compel either A, or B or C to pay him the entire sum of Rs. 30,000.

3. Rights and liabilities of the joint promisors among themselves:

(a) Joint promisors are liable to contribute equally :

If a joint promisor has been compelled to perform the whole of the promise, he may require the other joint promisors to make an equal contribution towards the performance of the promise [Section 43].

(b) Joint promisors liable to share losses equally:

If any one of the joint promisors does not make any contribution, the remaining joint promisors should bear the loss in equal shares [Section 43].

4. The promisee may release one of the joint promisors:

Where a promisee releases one of the joint promisors, the release of one promisor does not discharge the other joint promisor or promisors. Thus, the remaining joint promisors continue to be liable to pay the amount.

• **RIGHTS OF JOINT PROMISEES**

1. There may be joint promisees also i.e., one person may make a promise to more than one persons jointly.
2. The joint promisees have the joint right to ask for the performance of the promise.
3. Where one person has made a joint promise to, more than one person, then all the promisees must jointly claim performance so long as all are alive.
4. If anyone of them dies, his legal representatives must jointly with the surviving promisees claims the performance. On the death of all the joint promisees, the legal representatives of all of them must jointly claim the performance.

Example:

A and B jointly lent Rs. 10,000 to C. And C promised A and B jointly to repay them that amount on a specified day. Here, A and B must jointly claim the performance. If A dies before performance, the right to claim performance rests with A's representative jointly with B. And if both A and B die, the rights to claim performance rests with the representatives of both of them.

• **TIME AND PLACE FOR PERFORMANCE:**

The rules regarding the time and place for performance are contained in Sections 46 to 50 of the Indian Contract Act, which may be discussed as under:

1. Where the **day for performance is not specified** in the contract, and the promisor himself has to perform the promise without being asked (i.e., without any demand) by the promisee the promise must be performed **within a reasonable time** [Section 46].
2. Where the **time for performance is not specified** in the contract, and the promisor himself has to perform the promise without being asked (i.e., without any demand) by the promisee, promise may be performed at any time **during the usual hours of business** on the specified day. But the promise should be performed at the place where it was required to be performed [Section 47].

3. Where the day for the performance is specified in the contract and the promisor has to perform it only on being asked (i.e., on demand) by the promisee, then the promisee must first apply to the promisor (i.e., make a demand on the promisor) for the performance of the promise
Promisee's duty to specify day, time, place for performance [Section 48].
4. Where the **place for performance is not specified in the contract**, and the promisor himself has to perform the promise without being asked by the promisee, then **the promisor, must first apply to the promisee** to appoint a reasonable place for the performance of the promise. And thereafter, he should perform the promise at the place appointed by the promisee [Section 49].
5. Where the manner and time for performance is prescribed by the promisee himself, the promise should be performed in the manner and at the time prescribed by the promisee [Section 50].

- **PERFORMANCE OF RECIPROCAL PROMISES**

- **Definition of a Reciprocal Promise**

The term 'reciprocal promise' is defined in Section 2(f) of the Indian Contract Act, as under :

"Promises which form the consideration or part of consideration for each other are called reciprocal promises."

Thus, when a contract consists of exchange of promises, the promises are called reciprocal promises.

Example :

A and B promised to marry each other. These are reciprocal promises. In this case, A's promise is the consideration for B's promise. And B's promise is the consideration for A's promise.

- **Kinds of Reciprocal Promises and their Performance**

Following are the rules relating to the performance of different kinds of reciprocal promises:

1. **Mutual and concurrent:**

These are the **promises which are to be performed simultaneously** i.e., at the same time. In such promises, the promisor is not bound to perform his promise, unless the promisee is ready and willing to perform his own promise [Section 51].

2. **Conditional and dependent:**

These are the **promises where the performance of the promise by one party depends on the prior performance of the promise by the other party**. In such promises if the party who is bound to perform his promise first, fails to perform it, then he cannot claim performance from the other party. Moreover, the defaulting party becomes liable to pay the compensation to the other party for the loss suffered by the other on account of the non- performing of the contract [Section 54].

3. **Mutual and independent:**

These are the **promises where each party must perform his promise independently** without waiting for the other party to perform his promise, or without waiting whether or not the other party is willing to perform his promise. In such promises, if either party fails to perform his promise, the other party may proceed against him for the damages. Though a party can recover damages from the defaulting party, but he cannot excuse himself from the performance by reason of the non-performance by the defaulting party.

➤ **Effects of Preventing the Performance of Reciprocal Promises**

Where one party to a reciprocal promise prevents the other party from performing his promise, the contract becomes voidable at the option of the party who is so prevented. And the party so prevented may also recover compensation from the other party for any loss suffered due to non-performance of the contract [Section 53]. Thus, a party so prevented may put an end to the contract, and can also recover compensation from the party who so prevents.

➤ **Legal and Illegal Reciprocal Promises**

Following are the rules regarding enforcement of legal and illegal reciprocal promises:

Promises to do legal things and other illegal things :

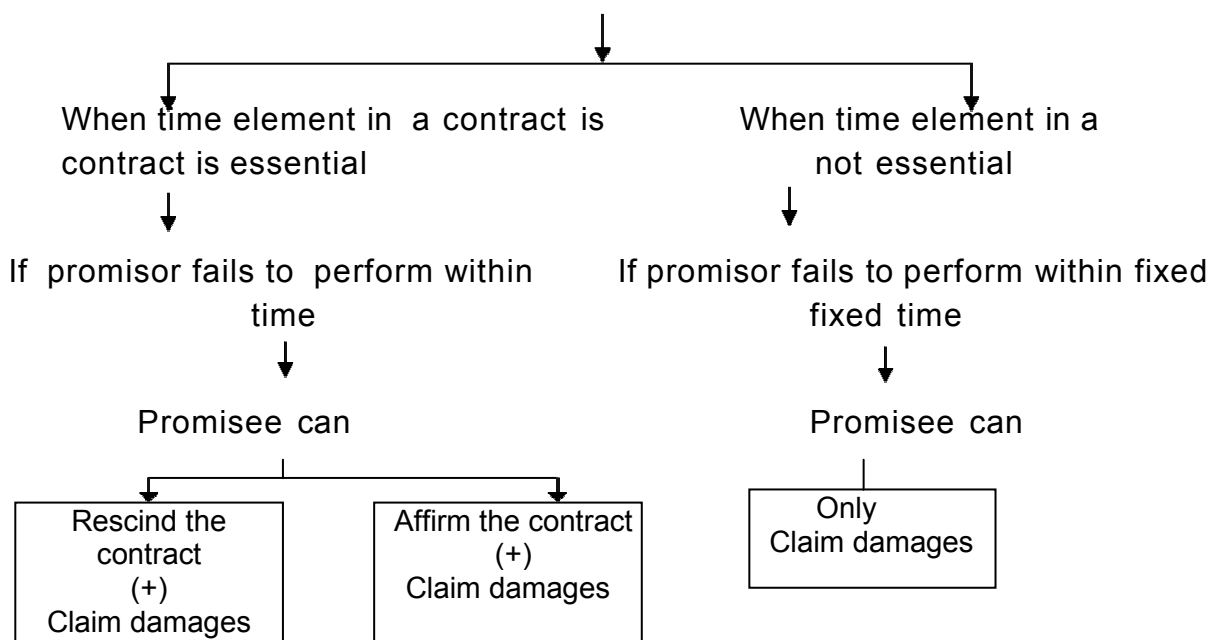
Sometimes, the persons enter into reciprocal promise, firstly to do certain things which are legal, and secondly to do certain other things which are illegal. In such cases, the first set of promises is a valid contract and can be enforced in a Court of Law. But the second set is a void agreement and thus, cannot be enforced in a Court of Law [Section 57 & 58].

Example :

A and B agreed that A shall sell his house for Rs. 40 lakhs. And that if B used it as gambling house, the price shall be Rs. 60 lakhs. In this case, the first set of reciprocal promises, namely to sell the house and to pay Rs. 40 lakh for it, is a valid contract and can be enforced. But the second set, namely, to sell the house and to pay Rs. 60 lakhs for it if the house is used as a gambling house, is a void agreement and cannot be enforced. In the second set of promises, the object is unlawful.

But if the things are inseparable then the entire agreement is void.

• **EFFECTS OF FAILURE TO PERFORM AT A TIME FIXED IN A CONTRACT IN WHICH TIME IS ESSENTIAL**



• **IMPOSSIBILITY OF PERFORMANCE**

(1) **Impossibility existing at the time of contract:** Even at the time of entering into the agreement, it may be impossible to perform certain contracts at the beginning or inception itself. The impossibility of performance may be known or may not be known to the parties

- (i) If the impossibility is known to the parties : A agreed with B to discover a treasure by magic. And B agreed to pay Rs. 500 to A for this act. This agreement is void
- (ii) If unknown to the parties: Even where both the promisor and the promisee are ignorant of the impossibility the contract is void.

Example:

(iii) If known only to the promisor: Where the promisor alone knows it is impossible to perform or even if he does not know but he should have known about the impossibility with reasonable diligence, the promisee is entitled to claim compensation for the loss suffered because of failure of the promisor to perform.

Example:

(2) **Supervening impossibility:** When performance of a promise becomes impossible on account of subsequent developments of events or change in circumstances, which are beyond the contemplation of parties, the contract becomes void. The idea of "supervening impossibility" is referred to as 'doctrine of frustration' in English law.. Supervening impossibility can arise due to a variety of circumstances as stated below.

(i) Accidental destruction of the subject matter of the contract :

Example:

(ii) Non-existence or non-occurrence of a particular state of things:

Example:

(iii) Incapacity to perform a contract of personal services: In case of contract of personal service, disability or incapacity to perform, caused by an Act of God e.g. illness, constitutes lawful excuse for non- performance of the contract. For example: A, a circus motor cyclist, contracted with B, the owner of a circus, to perform particular action on his motor cycle. -Before the performance, A died. In this case, the contract is discharged.

(iv) Change in law: Performance of a contract may also become impossible due to change in law subsequently. The law passed subsequently may prohibit the act which may form part as basis of contract. Here the parties are discharged from their obligations. For example 'A' and 'B' may agree to start a business for sale of lottery and contribute capital for the business. If the business of sale of lottery ticket is banned by a subsequent law, parties need not keep up their legal obligations.

(v) Outbreak of war: Outbreak of war will affect the enforceability of contracts in prohibiting or restraining transaction with alien enemy.

• **APPROPRIATION OF PAYMENTS**

Sometimes, a debtor owes several debts to the same creditor and makes payment which is not sufficient to discharge all the debts. In such cases, the payment is appropriated (i.e., adjusted against the debts) as per Sections 59 to 61 of the Indian Contract Act. These sections contain the rules as to against which debt the payment is to be appropriated, and' may be discussed as under :

1. Where the debtor has stated that the payment made by him should be adjusted against a particular debt, the creditor must do so if he accepts the payment [Section 59]. And if there is no express, intimation by the debtor, the law will gather his intention from the circumstances regarding the payment, e.g., if the amount paid by the debtor is the exact amount of one of the debts, it must be used to discharge that particular debt.
2. Where the debtor makes payment without any indication about the appropriation of the payment, the creditor may adjust the payment according to his discretion. The creditor would like to adjust the payment against a debt which is not likely to be recovered. But he can adjust the payment only against the legal debts and not against the illegal or disputed debts. However, the creditor may also adjust the payment against the debts which are time barred [Section 60].
3. Where the debtor does not expressly intimate anything about the appropriation of the payment and the creditor also fails to make any appropriation, the law prefers to wipe out the earlier debt in order of time irrespective of the fact that some of them are time barred [Section 61]., And if there are several debts of the same date, the payment shall be adjusted against each debt proportionately.

• **CONTRACTS WHICH NEED NOT BE PERFORMED**

1. **Novation :**

The term 'novation' means the substitution of existing contract for a new contract. In other words, when the parties to a contract agree to substitute the existing contract by a new contract, it is known as novation. The novation must be with the mutual consent of all the parties.

For example, A owes money to B under a contract. It is agreed between A, B and C that B shall thenceforth accept C as his debtor, instead of A. The old debt of A to B is at an end, and a new debt from C to B has been contracted.

2. **Rescission :**

The term 'rescission' means the cancellation of the contract. A contract may be rescinded by mutual agreement between the parties at any time before it is discharged by performance or in some other way.

3. **Alteration :**

The term 'alteration' means change in one or more terms of the contract. The alteration is valid when it is made with the consent of all the parties. And the valid alteration discharges the original contract, and the parties become bound by the new contract (i.e., contract with altered terms).It is important to note here that in case of a written contract, the material alteration by one party without the consent of the other, also discharges the contract.

4. Remission :

The term 'remission' means the acceptance of lesser fulfillment of the terms of the promise, e.g., acceptance of a less sum of money where more is due. In other words, the remission is the lesser fulfillment of the promise made. The remission is the valid discharge of the whole of the liability under the contract.

For example, A owed Rs. 5,000 to B. A paid Rs. 2,000 to B, and B accepted it in full satisfaction. In this case, A is discharged from his liability of Rs. 5,000.

- **RESTORATION OF BENEFIT UNDER A VOID CONTRACT**

Quantum Meruit (as much as is earned): If any work is done, get paid for it and if any benefit is received then pay for it.

1. Any benefit received under voidable contract which is subsequently avoided is to be returned back (Section 64)
2. Any benefit received under void contract is to be returned back (Section 65)

- **COMMUNICATION OF REMISSION**

Remission must be communicated to the other party in the same manner as a proposal is communicated. Similarly, a remission may be revoked in the same manner as a proposal is revoked.

- **EFFECTS OF NEGLECT OF PROMISEE**

If any promisee neglects or refuses to afford the promisor facilities for the performance of a promise, the promisor is excused from the performance of his promise.

UNIT 5: BREACH OF CONTRACT

• INTRODUCTION

In case of a valid contract, the parties are bound to perform their respective obligations. If any party fails to perform his obligations, there occurs a breach of the contract. The 'breach of contract' means the failure of a party to perform his obligations.

The party who fails to perform his obligations, is said to have committed a breach of contract. And a breach of a contract discharges the aggrieved party from performing his obligations. The breach of contract is of the following two types:

1. Anticipatory Breach
2. Actual Breach

1. Anticipatory Breach of Contract

It occurs when, prior to the due date of performance, the promisor absolutely refuses or disables himself from the performance of his obligations. In other words, it is a declaration by one party of his intention not to perform his obligations under the contract. Thus, the anticipatory breach is 'the premature destruction of the contract, i.e., the repudiation of the contract before due date of performance.'

Example :

A contracted to supply to B 100 pieces of denims on 15th December 2006. But before the due date of performance (i.e., 15th December, 2006), A informed B that he is not going to supply the denims at all. On A's refusal to supply the goods, the anticipatory breach of the contract occurs. And B may put an end to the contract.

The anticipatory breach may take place either by express refusal to perform the contract, or by some act of the promisor which makes the performance impossible.

Example : A agreed to marry B. But before the agreed date of marriage, A married C. This is anticipatory breach of contract by A's conduct which has made the performance impossible.

In case of an anticipatory breach of the contract, the aggrieved party may exercise either of the following two options :

- (i) He may treat the contract as discharged and bring an immediate action for damages.
- (ii) He may treat the contract as operative and wait till the time of performance arrives.

2. Actual Breach of Contract

It occurs when, on the due date of performance or during the performance, a party fails to perform his obligations. Thus, the actual breach of contract may be discussed under the following two heads.

i. Actual breach of contract on the due date of performance :

Sometimes, on the due date of performance, one party fails to perform his obligations. In such cases, the other party is discharged from the performance of his obligations, and can hold the guilty party liable for the breach of contract.

Example :

A agreed to sell his car to B on 1st June. But on 1st June, A refused to sell the car to B. On A's refusal to sell the car, there occurred a breach of the contract. And B can hold A liable for the breach of contract.

ii. **Actual breach of contract during its performance :**

Sometimes, one party performs his obligations under the contract but the other party fails or refuses to perform his obligations. It is an actual breach of contract during its performance. And sometimes, one party, no doubt, performs his obligations but not strictly according to the contract. It is also an actual breach of contract. This type of breach of contract occurs when the party, performing the contract, commits a breach of the essential conditions to contract.

Example :

A contracted to sell certain goods to B of particular description to be delivered on 15th March. On the due date of delivery, A delivered the goods to B. But the goods did not conform to the description. In this case, the breach of contract is committed during the performance of the contract as A has not performed the contract according to its terms. And thus, B is not bound to take delivery of the goods and pay for them.

DAMAGES FOR BREACH OF CONTRACT

The term 'damages' may be defined as the monetary compensation payable by the defaulting party to the aggrieved party for the loss suffered by him. On the breach of the contract, the aggrieved party may file a suit for damages against the party who is guilty of the breach of the contract. And the guilty party is liable to pay damages to the aggrieved party.

Kinds of Damages

Following are the different kinds of damages :

1. **Actual/Ordinary/ Usual damages :**

These are the damages which are payable for the loss arising naturally and directly, in the usual course, from the breach of contract. In other words, the ordinary damages are due to natural and probable consequence of the breach of the contract

Example :

A contracted to give his ship to B on hire for one year, from 1st of January, for Rs. 50,000. Subsequently, A broke his promise. And on 1st of January, B hired another similar ship for one year for Rs. 60,000, as no other ship was available for Rs. 50,000. In this case, A liable to pay B, by way of compensation, Rs. 10,000 (i.e., the difference between the contract price and the price for which B could hire another similar ship for one year from 1st of January).

2. **Liquidated damages :**

Sometimes, the amount of compensation fixed for the breach of the contract is fair and genuine pre-estimate of the probable damages. Such an amount is known as liquidated damages.

Example:

3. **Special damages :**

These are the damages which are payable for the loss arising due to some special or unusual circumstances. In other words, the special damages are not due to the natural and probable consequences of the breach of the contract.

The special damages are recoverable only if the parties knew about them and agree at the time of contract.

Example :

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

4. Exemplary/ vindictive/ punitive damages:

The exemplary damages are claim with the intention of punishing the party in default. As a general rule, the exemplary damages are not awarded for the breach of contract as they are punitive in nature. However, in following two cases, the court may award exemplary damages:

- (i) Where there is a breach of a promise to marry: In such cases, the damages will include compensation for loss to the feelings and reputation of the aggrieved party.
- (ii) Where a banker wrongfully dishonors customer's cheque, e.g., dishonor of customer's cheque when the banker has sufficient funds to the credit of the customer. In such cases, the damages are awarded taking into consideration the loss to the prestige and goodwill of the customer. The general rule, in this connection is, the smaller the amount of cheque the greater is the insult, and thus greater the amount of damages.

5. Nominal damages:

These are the damages which are very small in amount. Such damages are awarded simply to establish the right of the party to claim damages for the breach of contract even though the party has suffered no loss. Such damages are for nominal amounts like ten rupees or even ten paise.

Example:

6. Damages for deterioration caused by delay:

Compensation can be recovered even without notice for damages or 'deterioration' caused to goods on account of delay by carriers amounting to breach of contract. Here the word "deterioration" means not only physical damages but also loss of opportunity.

Case Law: In *Wilson vs. Lancashire and Yorkshire Railway Company*, the plaintiff bought velvet with a view to making it into caps for sale during spring. But due to delay in transit, he was unable to use the velvet for making caps for sale during season.

7. Remote or indirect damages :

These are the damages which are payable for the loss arising due to some remote or indirect causes. Generally, the remote damages are not recoverable.

• **LIQUIDATED DAMAGES AND PENALTY**

Sometimes, at the time of the formation of the contract, the parties fix the amount of compensation that will be payable in case of breach of the contract. The amount so specified may be (a) liquidated damages, or (b) penalty.

1. Liquidated damages :

Sometimes, the amount of compensation fixed for the breach of the contract is fair and genuine pre-estimate of the probable damages. Such an amount is known as liquidated damages.

2. Penalty :

Sometimes, the amount of compensation fixed for the breach of the contract is not fair and genuine pre-estimate of the probable damages, but is disproportionate to the damages which may result in case of the breach of the contract. Such an amount is known as penalty.

Liquidated damages	Penalty
1. Imposed by way of compensation	1. Imposed by way of punishment
2. It is an assessed amount of loss based on actual.	2. It is not based on actual. It is imposed to prevent parties from committing the breach.
3. English Law recognizes the difference between the two (liquidated damages & penalty)	3. Section 74 of the act does not recognize any difference between the two.

- The sum so named determines only the maximum liability. And the courts cannot allow damages beyond that limit, i.e., the courts cannot increase the amount of damages beyond the amount specified in the contract itself.
- In terms of Section 74, courts are empowered to reduce the sum payable on breach whether it is 'penalty' or "liquidated damages" provided the sum appears to be unreasonably high.

• **ADDITIONAL REMEDIES AVAILABLE IN CASE OF BREACH OF CONTRACT:**

Apart from claiming damages, following remedies are available in case of breach of contract:-

(1) Suit for Quantum Meruit: Where the aggrieved party in the contract has given any advance and if subsequently if there is breach, then the advance can be claimed back under the principle of Quantum Meruit.

(2) Rescission of contract : When a contract is broken by one party, the other party may treat the contract as rescinded. In such a case the other party is discharged from performing his part of promise and is entitled to claim compensation for any loss that he might have suffered.

(3) Suit for Specific Performance :

The term 'specific performance' may be defined as the actual carrying out the respective obligation by both the parties. Sometimes,

- (i) the damages are not an adequate remedy for breach of the contract or

- (ii) the damages cannot be estimated or
- (iii) the subject matter of contract is unique in nature.

In such cases, the party aggrieved by the breach may bring an action for specific performance of the contract. And the court may direct the defaulting party to carry out his obligations according to the terms of the contract.

It may be noted that the specific performance of the contract cannot be claimed as a matter of right. The **courts are always at discretion to grant the relief by specific performance**. The courts may, at their discretion, order specific performance of contracts.

However, in following cases the specific performance cannot be ordered by court:

- (i) If the performance involves personal skills
- (ii) If the performance is continuous in nature

Example:

(4) **Suit for Injunction :**

The term 'injunction' may be defined as an order of the courts restraining a person from doing something which he promised not to do. In this case also, the courts are at discretion to issue an injunction order. It is, usually, issued in cases where the compensation in terms of money is not an adequate relief.

Sometimes, a party to a contract does something which he had promised not to do. In such cases, the aggrieved party may file a suit for injunction. And the courts may at their discretion, issue an order restraining such person from doing what he promised not to do.

Case Law: In *Lumely v. Wagner*, A, a singer, agreed to sing at B's theatre for certain period. She further agreed that during the prescribed period she will not sing at any other theatre. Afterwards, A made a contract with C to sing at his theatre, and refused to sing at B's theatre. B filed a suit restraining A from singing at C's theatre. It was held that although A could not be compelled to sing at B's theatre, but she could be restrained by injunction from singing at C's theatre.

• **DISCHARGE OF CONTRACT**

A contract may be discharged either by an Act of the parties or by an operation of law in the different base set out below :

- (1) **Discharge by performance:** It takes place when the parties to the contract fulfill their obligations arising under the contract within the time and in the manner prescribed. Discharge by performance may be 1) actual performance or 2) attempted performance. Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement. When the promisor offers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance or tender.

- (2) **Discharge by mutual agreement:** Section 62 of the Indian Contract Act provides if the parties to a contract agree to substitute a new contract for it, or to refund or remit or alter it, the original contract need not be performed.
- (3) **By impossibility of performance:** The impossibility may exist from the very start. In that case, it would be impossibility ab initio.

Alternatively, it may supervene. Supervening impossibility may take place owing to: a) an unforeseen change in law, b) the destruction of the subject-matter essential to that performance c) the non-existence or non-occurrence of particular state of things, which was naturally contemplated for performing the contract, as a result of some personal incapacity like dangerous malady, or declaration of a war (Section 56).
- (4) **Discharge by lapse of time:** A contract should be performed within a specific period as prescribed by the Limitation Act, 1963. If it is not performed and if no action is taken by the promisee within the specified period of limitation, he is deprived of remedy at law. For example, if a creditor does not file a suit against the buyer for recovery of the price within three years the debt becomes time-barred and hence irrecoverable.
- (5) **Discharge by operation of law:** A contract may be discharged by operation of law which includes by death of the promisor, by insolvency etc.
- (6) **Discharge by breach of contract:** Breach of contract may be actual breach of contract or anticipatory breach of contract. If one party defaults in performing his part of the contract on the due date, he is said to have committed a breach thereof. When, on the other hand, a person repudiates a contract before the stipulated time for its performance has arrived, he is deemed to have committed anticipatory breach. If one of the parties to a contract breaks the promise the party injured thereby has not only a right of action for damages but he is also discharged from performing his part of the contract (Section 64).
- (7) A promisee may dispense with or remit the performance of the promise made to him or may accept any satisfaction he thinks fit. In the first case the contract will be discharged by remission and in the second by accord and satisfaction (Section 63)
- (8) When a promisee neglects or refuses to afford the promisor reasonable facilities for the performance of the promise, the promisor is excused by such neglect or refusal (Section 67).

UNIT 6: CONTINGENT AND QUASI CONTRACTS CONTINGENT CONTRACTS

• **DEFINITION**

Definition of a Contingent Contract

The term 'contingent contract', in simple words, may be defined as a conditional contract. This term, in legal words, is defined in Section 31 of the Indian Contract Act, as under: contract, does or does not happen."

Example: A contracts to pay Rs.10,000 to B if his (B's) house is burnt. This is a contingent contract as its performance is dependent upon an uncertain event (i.e., burning of B's house).

• **ESSENTIALS OF A CONTINGENT CONTRACT**

Following are the essential elements of a valid contingent contract :

1. **There must be a valid contract :**

A contract to do or not to do something must be legally valid, i.e., it must fulfil the basic requirements of a valid contract.

2. **The performance of the contract must be conditional:**

The performance of a contingent contract must depend upon the happening or non-happening of some future event.

3. **The event must be uncertain:**

The future event, upon which the performance of a contract depends, must be an uncertain event. If the event is certain, i.e., the event is bound to happen, then the contract is not a contingent contract.

4. **The uncertain event must be collateral to the contract:**

The uncertain event, upon which the performance of the contract is dependent, must not form a part of the consideration of the contract. In other words, the event must be independent or ancillary to the contract.

• **RULES REGARDING ENFORCEMENT OF CONTINGENT CONTRACTS**

The rules regarding the enforcement of contingent contracts are contained in Sections 32 to 36 of the Indian Contract Act, which may be discussed under the following heads:

1. **Contingent Contracts Dependent on the 'Happening' of Future Uncertain Event**

A contingent contract dependent on the 'happening' of a future uncertain event can be enforced only when that uncertain event has happened [Section 32].

Example:

A offered to sell his horse to B for Rs. 4,000. Subsequently, A entered into a contract with C to sell the same horse to him for Rs. 3,500 if B refused to buy it. The contract between A and C is contingent and can be enforced by law only when B refuses to buy the horse from A.

However, if the event becomes impossible then such contract becomes void, and thus cannot be enforced by law.

2. **Contingent Contracts Dependent on the 'Non-Happening' of Future Uncertain Event**

A contingent contract dependent on the 'non-happening' of future uncertain event can be enforced only when the happening of that event becomes impossible as then that event cannot happen [Section 33].

Example:

A agreed to pay B Rs. 500 if a certain ship did not return. The ship was sunk. It is a contingent contract and can be enforced by law when the ship sinks. Because when the ship sinks, the event becomes impossible as the ship can never return.

However, if the event happens or does not become impossible, then such contracts become void and cannot be enforced by law e.g., suppose in the above example, the ship returns, then the contract becomes void.

3. Contingent Contracts Dependent on future conduct of a living person.

A contingent contract dependent on the future conduct of living person is valid if person acts accordingly otherwise it becomes void.

4. Contingent Contracts Dependent on the Happening or Non-Happening of Specified Uncertain Event Within Fixed Time

A contingent contract dependent on the 'happening' of a specified uncertain event within fixed time, can be enforced if that event happens within the fixed time.

Example :

A agreed to pay Rs. 1,000 to B if a certain ship returned within a year. It is a contingent contract and can be enforced by law if the ship returns within a year. In this case also, if the event does not happen within the fixed time or if it becomes impossible before the expiry of the fixed time, then such contracts become void and cannot be enforced by law [Section 35]

5. Contingent Contracts Dependent on Impossible Events

A contingent contract dependent on the happening of impossible event is void and cannot be enforced by law [Section 36].

Example: A agreed to pay Rs. 500 to B if he proved that two straight lines can intersect. This is a void agreement as two straight lines can never' enclose a space

• DISTINCTION BETWEEN WAGERING AGREEMENT AND CONTINGENT CONTRACT

Wagering Agreement	Contingent Contract
1. Meaning: A wagering agreement is a promise to give money or money's worth upon the determination or ascertainment of an uncertain event.	1. Meaning: A contingent contract is a contract to do or not to do something if some event, collateral to such contract does or does not happen.
2. Reciprocal promises: A wagering agreement consists of reciprocal promises	2. Reciprocal promises: A contingent contract may not contain reciprocal promises.
3. Uncertain event: The uncertain event is the main event.	3. Uncertain event: The uncertain event is the collateral event.
4. All wagering agreements are contingent.	4. All contingent contracts are not wagering.
5. A wagering agreement is void	5. A contingent contract is valid.
6. A wagering agreement is a game of chance.	6. A contingent contract is not a game.

QUASI CONTRACTS

- **DEFINITION**

The term 'quasi contract' may be defined as 'a relation which resembles that created by a contract.

There is no real contract. The parties under such relations are put in the same position as if there was a contract between them.

It is based on the principle of "Prevention of unjust enrichment at the expense of other".

- **CIRCUMSTANCES (OR CASES) OF QUASI CONTRACTS**

Following are the circumstances in which the quasi contractual obligations arise. These are contained in Sections 68 to 72 of the Indian Contract Act :

1. Supply of necessaries to persons who are incompetent to contract (Section 68)
2. Payment by an interested person (Section 69)
3. Non-gratuitous acts (Section 70)
4. Finder of goods (Section 71)
5. Payment of money or deliver of goods by mistake or under coercion (Section 72)

1. **Supply of Necessaries to Persons Incompetent to Contract:**

Sometimes, a person supplies the necessaries to a person who is not competent to contract (i.e., minor, persons of unsound mind such as lunatics, etc.), or to another person to whom the incompetent person is bound to support. In such cases, the person supplying the necessaries is entitled to recover the cost of necessaries from the property of such incompetent person even if there is no valid contract between them.

Example:

A supplied necessaries of life to B, a minor, in this case, A is entitled to claim back from B's property.

2. **Payment by a Person Having Some Interest in Payment:**

Sometimes, a person makes the payment which is the legal duty of another person. In such cases, the person who has made the payment can recover such money from the person who is legally bound to pay.

Following conditions must be satisfied for the recovery of payment by an interested person:

- (a) The person making the payment must have some interest in paying the amount.
- (b) The person making the payment must not be bound by law to pay the amount.
- (c) The other person from whom the money is to be recovered must be legally bound to pay the money.

Example:

A held land in Bengal on a lease granted by B, a Zamindar. The revenue payable by B fell in arrears. As such, his land was advertised for sale by the government. Under the Revenue Law, the consequences of such sale was the cancellation of A's lease. In order to prevent the consequent annulment of his lease, A paid to the government the amount due from B. In this case, A is entitled to recover the amount from B. And B is bound to pay the same to A.

3. Non-Gratuitous Acts:

The 'non-gratuitous- acts' means the acts which are not done free. A person who does some non-gratuitous acts for another, is entitled to recover compensation for such acts if the other person enjoys the benefits of such acts.

Example:

A, a tradesman, gave certain goods to B to store at B's warehouse by paying rent. B sold A's goods to C for ₹ 100,000 without A's permission. A can claim ₹ 100,000 from B.

Following conditions must be satisfied for recovery of compensation for non-gratuitous act :

- (a) The person must lawfully do something for another person or deliver something to him.
- (b) The person doing some act or delivering something must not intend to act gratuitously.
- (c) The other person must voluntarily accept the acts or goods and he must have enjoyed their benefits.

4. Finder of Goods:

Sometimes, a person finds certain goods, belonging to some other person. In such cases, the goods do not become the property of the finder.

The law imposes certain obligations on the finder of goods. Under the law, the responsibility of finder of goods is the same as that of a bailee.

A 'bailee' is a person to whom the goods have been delivered for some specific purpose upon a condition that on the fulfillment of the purpose, the goods shall be returned to the actual owner.

Thus, it becomes the duty of the finder to keep the goods with care and take some steps to trace the true owner and return the goods to him. He is bound to take as much care of the goods as a man of ordinary prudence would take for his own goods under the similar circumstances.

He also gets some rights in respect of the goods in certain circumstances, when the true owner cannot be found, he can sell the goods which are of perishing nature.

5. Payment of Money or Delivery of Goods by Mistake or Under Coercion

Sometimes, a certain amount of money is paid or something is delivered to a person by mistake or under coercion. In such cases, the person receiving the money or goods must repay or return the same to the person who has paid or delivered by a mistake or under coercion.

Example:

A and B jointly owed Rs. 1000 to C. A alone paid the amount to C. And B not knowing this fact, also paid Rs.1000 to C. In this case, C is bound to repay the amount to B who has paid it by mistake.

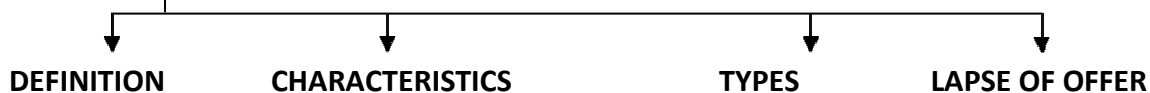
SUMMARY

UNIT 1: NATURE OF CONTRACTS

• INTRODUCTION

- ✓ It received its assent on 25th April, 1872 and was introduced on 1st September, 1872.
- ✓ It is applicable to whole of India except Jammu and Kashmir.
- ✓ Contract = Agreement + Enforceable by law
- ✓ Agreement = Offer + Acceptance
- ✓ Therefore, all contracts are agreements BUT all agreements are NOT contracts

• OFFER

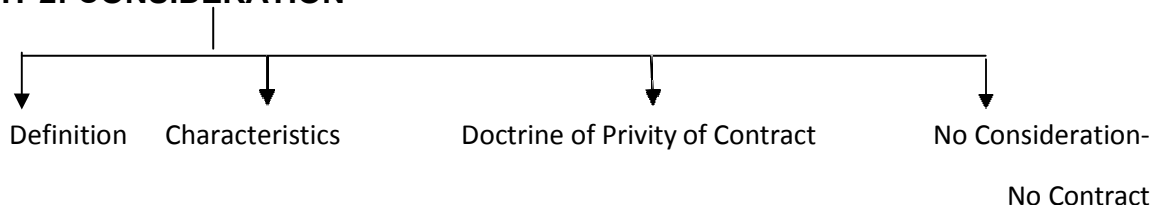


• ACCEPTANCE



- COMMUNICATION OF OFFER & ACCEPTANCE AND REVOCATION OF OFFER & ACCEPTANCE
- TYPES OF CONTRACTS
- TYPES OF CONTRACTS AS PER ENGLISH LAW
- ESSENTIAL ELEMENTS OF A VALID CONTRACT

UNIT 2: CONSIDERATION



UNIT 3: OTHER ESSENTIAL ELEMENTS OF A VALID CONTRACT

• CAPACITY OF PARTIES

1. Minor
2. Person of unsound mind
3. Persons disqualified by law

• CONSENSUS-AD- IDEM

• FREE CONSENT

Consent is said to be free if it is not induced by:

1. Coercion,
2. Undue influence,
3. Fraud,
4. Misrepresentation,
5. Mistake

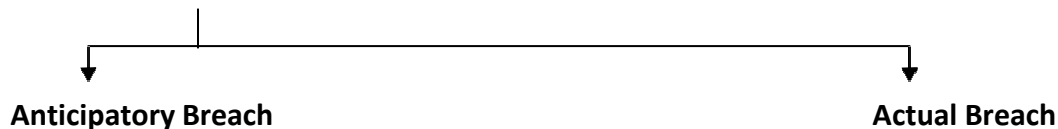
- **UNLAWFUL OBJECT & UNLAWFUL CONSIDERATION**
- **AGREEMENTS EXPRESSLY DECLARED AS VOID**
 - ✓ Agreement in restraint of marriage is void
 - ✓ Agreement in restraint of trade is void
 - ✓ Agreement in restraint of legal proceedings
 - ✓ Agreement the meaning of which is uncertain is void
 - ✓ wagering agreements

UNIT 4: PERFORMANCE OF CONTRACT

- **CONTRACT WILL BE PERFORMED BY:**
 1. Promisor himself
 2. Legal Representative
However, if the contract involves personal skills and if the promisor dies, the contract becomes void.
 3. Agent
 4. Third persons, if promise permits
- REQUISITES OF A VALID PERFORMANCE
- EFFECT OF REFUSAL OF A PARTY TO PERFORM
- DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT
- LIABILITY OF JOINT PROMISORS
- RIGHTS OF JOINT PROMISEES
- TIME AND PLACE FOR PERFORMANCE
- RECIPROCAL PROMISES
- EFFECTS OF FAILURE TO PERFORM AT A TIME FIXED IN A CONTRACT IN WHICH TIME IS ESSENTIAL
- IMPOSSIBILITY OF PERFORMANCE
- APPROPRIATION OF PAYMENTS
- CONTRACTS WHICH NEED NOT BE PERFORMED-Novation, Alteration, Rescission, Remission
- QUANTUM MERUIT
- EFFECTS OF NEGLIGENCE OF PROMISEE

UNIT 5: BREACH OF CONTRACT

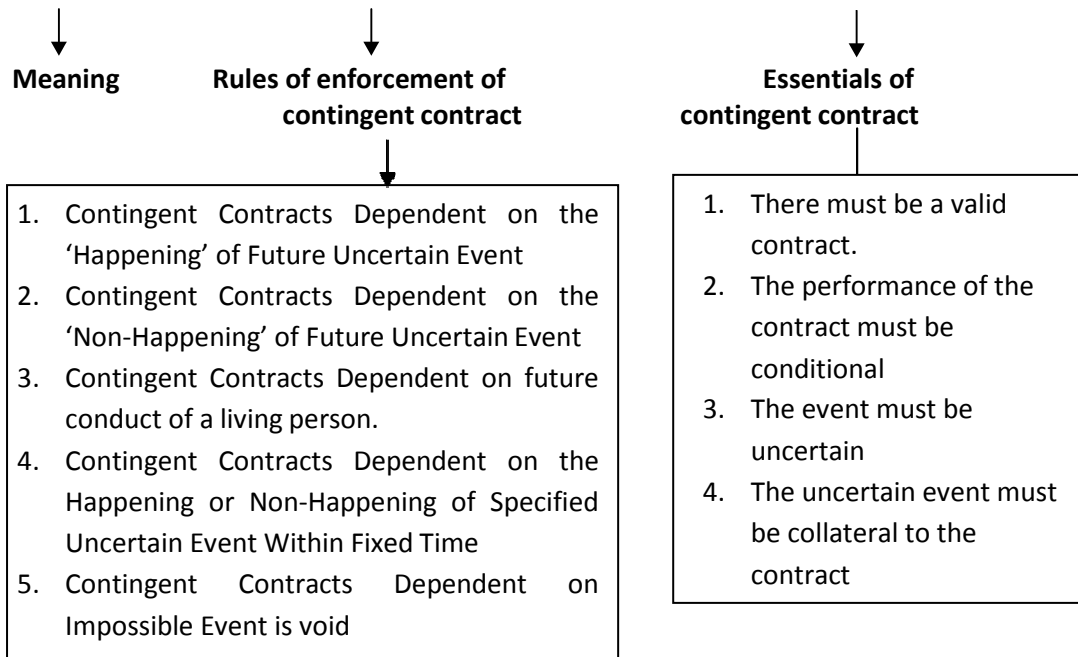
- **BREACH OF CONTRACT**



- **DAMAGES FOR BREACH OF CONTRACT**
 - 1) Ordinary/ Usual damages
 - 2) Liquidated damages
 - 3) Special damages
 - 4) Exemplary/ Vindictive/ Punitive damages
 - 5) Nominal damages
 - 6) Damages for deterioration caused by delay
 - 7) Remote or indirect damages.
- LIQUIDATED DAMAGES AND PENALTY
- DISCHARGE OF CONTRACT
- ADDITIONAL REMEDIES AVAILABLE IN CASE OF BREACH OF CONTRACT

UNIT 6: CONTINGENT AND QUASI CONTRACTS

• **CONTINGENT CONTRACTS**



• **QUASI CONTRACTS**

1. Supply of necessaries to persons who are incompetent to contract
2. Payment by a Person Having Some Interest in Payment Conditions:
3. Claim for any benefit received under a non-gratuitous act
4. Finder of goods
5. Payment of Money or Delivery of Goods by Mistake or Under Coercion

QUESTIONS

1. All contracts are agreements, but all agreements are not contracts". Comment
2. Define the term "Acceptance. Discuss the legal provisions relating to communication of acceptance.
3. Distinction between Void and Illegal Agreements.
4. Define consideration. State the characteristics of a valid consideration.
5. "No consideration, no contract" Comment
6. "To form a valid contract, consideration must be adequate". Comment.
7. "Mere silence does not amount to fraud". Discuss.
8. "Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor". Discuss.
9. "An agreement, the meaning of which is not certain, is void". Discuss.
10. Who are disqualified persons to do the contract?
11. "The basic rule is that the promisor must perform exactly what he has promised to perform." Explain stating the obligation of parties to contracts.
12. Discuss the effect of accepting performance from third person.
13. "When a party to a contract has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract". Explain.
14. "An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived". Discuss stating also the effect of anticipatory breach on contracts
15. "When a contract has been broken, the party who suffers by such a breach is entitled to receive compensation for any loss or damage caused to him". Discuss.
16. "Liquidated damage is a genuine pre-estimate of compensation of damages for certain anticipated breach of contract whereas Penalty on the other hand is an extravagant amount stipulated and is clearly unconscionable and has no comparison to the loss suffered by the parties". Explain.
17. Explain the meaning of 'Contingent Contracts' and state the rules relating to such contracts.
18. Explain the-term 'Quasi Contracts' and state their characteristics.

ADDITIONAL CASE LAW BASED QUESTIONS:

UNIT 1: NATURE OF CONTRACTS

- Q.1.** Father promised to pay his son a sum of one lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but father failed to pay the amount as promised. Son files a suit for recovery of the amount. State along with reasons whether son can recover the amount under the Indian Contract Act, 1872.
- Q.2.** Shambhu Dayal started "self-service" system in his shop. Smt. Prakash entered the shop, took a basket and after taking articles of her choice into the basket reached the cashier for payments. The cashier refuses to accept the price. Can Shambhu Dayal be compelled to sell the said articles to Smt. Prakash? Decide.
- Q.3.** Ramaswami proposed to sell his house to Ramanathan. Ramanathan sent his acceptance by post. Next day, Ramanathan sends a telegram withdrawing his acceptance. Examine the validity of the acceptance in the light of the following:
- (i) The telegram of revocation of acceptance was received by Ramaswami before the letter of acceptance.
 - (ii) The telegram of revocation and letter of acceptance both reached together.
- Q.4.** X's brother runs away from the house. Y who is an employee of X offers to search for the brother and goes out for the purpose. In the absence of Y, X offers a reward of ₹ 500 to anyone who can either find out the brother or give clues enabling X to find him out. Y gets the brother back to X in ignorance of the offer for reward. Can Y now claim the reward?

UNIT 2 : CONSIDERATION

- Q.1.** Mr. Singh, an old man, by a registered deed of gift granted certain landed property to A, his daughter. By the terms of the deed, it was stipulated that an annuity of ₹ 2,000 should be paid every year to B, who was the brother of Mr. Singh. On the same day A made a promise to B and executed in his favor an agreement to give effect to the stipulation. A failed to pay the stipulated sum. In an action against her by B, as he contended that since B had not furnished any consideration, he has no right of action. Examining the provisions to the Indian Contract Act, 1872, decide, whether the contention of A is valid?

UNIT 3: ESSENTIAL ELEMENTS OF A VALID CONTRACT

- Q.1.** Ramesh, aged 16 years, was studying in an engineering college. On 1 March, 2011 he took a loan of 1 lakh from Suresh for the payment of his college fee and agreed to pay by 30th May, 2012. Ramesh possesses assets worth ₹ 10 lakhs. On due date, Ramesh fails to pay back the loan to Suresh. Suresh now wants to recover the loan from Ramesh out of his assets. Whether Suresh would succeed? Decide, referring to the provisions of the Indian Contract Act, 1872.

- Q.2.** Sohan induced Suraj to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Suraj complained that there were many defects in the motorcycle. Sohan proposed to get it repaired and promised to pay 40% cost of repairs. After a few days, the motorcycle did not work at all. Now Suraj wants to rescind the contract. Decide giving reasons.
- Q.3.** X agreed to become an assistant for 5 years to 'Y' who was a Doctor practicing at Ludhiana. It was also agreed that during the term of agreement X will not practice on his own account in Ludhiana. At the end of one year, X left the assistantship of 'Y' and began to practice on his own account. Referring to the provisions of the Indian Contract Act, 1872, decide whether X could be restrained from doing so?
- Q.4.** M promised to pay N for his services at his (M) sole discretion found to be fair and reasonable. However, N dissatisfied with the payment made by M and wanted to sue him. Decide whether N can sue M under the provisions of the Indian Contract Act, 1872?
- Q.5.** A applies to banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. Is the contract induced by undue influence?

UNIT 4: PERFORMANCE OF CONTRACT

- Q.1.** 'A', 'B' and 'C' are partners in a firm. They jointly promise to pay ₹ 1,50,000 to 'P'. C became insolvent and his private assets are sufficient to pay only 1/5th of his share of debts. A is compelled to pay the whole amount to P. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which A can recover the amount from B.
- Q.2.** Akhilesh entered into an agreement with Shekhar to deliver him (Shekhar) 5,000 bags to be manufactured in his factory. The bags could not be manufactured because of strike by the workers and Akhilesh failed to supply the said bags to Shekhar. Decide whether Akhilesh can be exempted from liability under the provisions of the Indian Contract Act, 1872.
- Q.3.** Suppose, time is of the essence of the contract but yet promisor does not perform the promise within the stipulated time. But five days after the expiry of the stipulated time, the promisor offers to perform his promise. Can the promisee accept such performance and at the same time claim compensation from the promisor for the delay?
- Q.4.** A owes B ₹ 1,000 under a contract, B owes C ₹ 1,000. B orders A to credit C with ₹ 1,000 in his books, but C does not assent to the arrangement. Does B still owe C ₹ 1,000?
- Q.5.** A agrees to sell land to B for ₹ 40,000. B pays to A ₹ 4,000 as a deposit at the time of the contract, the amount to be forfeited to A if B does not complete the sale within a specified period. B fails to complete the sale within the specified period, nor is the ready and willing to complete the sale within a reasonable time after the expiry of that period. Can A rescind the contract and at the same time retain the deposit?

UNIT 5: BREACH OF CONTRACT

- Q.1.** A, an Indian, contracts to marry B. A is already married - a fact of which B was unaware. A breaks his promise in course of time. Thereupon B brings a suit against A for a breach of contract. A pleads that his promise is impossible of being performed as the law of the country does not permit polygamy. Can A get away with plea?
- Q.2.** Mr. Ramaswamy of Chennai placed an order with Mr. Shah of Ahmedabad for supply of Urid Dhall on 10.11.2006 at a contracted price of ₹ 40 per kg. The order was for the supply of 10 tonnes within a month's time viz. before 09.12.2006. On 04.12.2006 Mr. Shah wrote a letter to Mr. Ramaswamy stating that the price of Urid Dhall was sky rocketing to ₹ 50 Per. Kg. and he would not be able to supply as per original contract. The price of Urid Dhall rose to ₹ 53 on 09.12.06 Advise Mr. Ramaswamy citing the legal position.

UNIT 6 : CONTINGENT & QUASI CONTRACTS

- Q.1.** Y holds agricultural land in Gujarat on a lease granted by X, the owner. The land revenue payable by X to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of Y's lease. Y, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from X. Referring to the provisions of the Indian Contract Act, 1872 decide whether X is liable to make good to Y, the amount so paid?
- Q.2.** 'A' under a mistaken impression gives some money into B's hand believing him to 'C'. Can he obtain the return of money?

ANSWERS

UNIT 1: NATURE OF CONTRACTS

Ans.1. As per Section 2(h) of Indian Contract Act, 1872 Contract is an agreement which is enforceable by law. Social agreements are not enforceable by law. As per case law Balfour v. Balfour, a husband promised to pay maintenance allowance every month to his wife, so long as they remain separate. When he failed to perform this promise, she brought an action to enforce it. As it is an agreement of domestic nature, it was held that it does not contemplate to create any legal obligation.

Father promised to pay his son a sum of one lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but father failed to pay the amount as promised. This is a social agreement which is not enforceable by law. Accordingly, applying the above provisions and the case decision, in this case son cannot recover the amount of 1 lakh from father for the reasons explained above.

Ans.2. As per provisions of Indian Contract Act 1872, the offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party choose to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms. This is the basic distinction between offer and invitation to offer.

In the given question, the display of articles with a price in it in a self-service shop is merely an invitation to offer. It is in no sense an offer for sale, the acceptance of which constitutes a contract. In this case, Smt. Prakash by selecting some articles and approaching the cashier for payment simply made an offer to buy the articles selected by her. Therefore, if the cashier does not accept the price, the interested buyer cannot compel him to sell.

Ans.3. The problem is related with the communication and time of acceptance and its revocation. As per Section 4 of the Indian Contract Act, 1872, the communication of an acceptance is complete as against the acceptor when it comes to the knowledge of the proposer.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Referring to the above provisions

- (i) Yes, the revocation of acceptance by Ramanathan (the acceptor) is valid.
- (ii) If Ramaswami opens the telegram first (and this would be normally so in case of a rational person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded.

Ans.4. As per the provisions of the Indian Contract Act, 1872, a person cannot accept an offer so long as he is unaware of its existence. Unless an offer is properly communicated, there can be no acceptance of it. An acceptance of an offer in ignorance of the offer, is a nullity, and does not create any legal right or obligation. As per case law Lalman Shukla vs Gauri Dutt, Gauri announced a reward for anyone who found his nephew. Lalman found the nephew in ignorance of reward. Held that, he is not entitled to reward as a person cannot accept an offer so long as he is unaware of its existence. In the given question, Y gets the brother back in ignorance of the offer for reward. Hence, based on provisions and the above case law, Y cannot claim the reward.

UNIT 2 : CONSIDERATION

Ans.1. As per Section 2(d) of the Indian Contract Act, 1872, consideration is defined as "When at the desire of the promisor, the promisee or any other person did or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing something, such act or abstinence is called a consideration for the promise".

It is not necessary that consideration should be furnished by the promisee only. A promise is enforceable if there is some consideration for it and it is quite immaterial whether it moves from the promisee or any other person. The leading authority in the decision of the Chinnaya Vs. Ramayya, held that the consideration can legitimately move from a third party and it is an accepted principle of law in India. In the given problem, Mr. Singh has entered into a contract with A, but Mr. B has not given any consideration to A but the consideration did flow from Mr. Singh to A and such consideration from third party is sufficient to enforce the promise of A, the daughter, to pay an annuity to B. Further the deed of gift and the promise made by A to B to pay the annuity were executed simultaneously and therefore they should be regarded as one transaction and there was sufficient consideration for it. Thus, a stranger to the contract cannot enforce the contract but a stranger to the consideration may enforce it.

UNIT 3 : ESSENTIAL ELEMENTS OF A VALID CONTRACT

Ans.1. According to Section 11 of the Indian Contract Act, 1872, a person who is of the age of majority to the law to which he is subject is competent to enter into any contract. A person who has completed the age of 18 years is a major and otherwise he will be treated as minor. Thus Ramesh who is a minor is incompetent to contract and any agreement with him is void [Mohori Bibi Vs Dharmodas Ghose]. Section 68 of the Indian Contract Act, 1872 however, prescribes the liability of a minor for the supply of the things which are the necessaries of life to him. It says that though minor is not personally liable to pay the price of necessaries supplied to him or money lent for the purpose, the supplier or lender will be entitled to claim the money/ price of goods or services which are necessaries suited to his condition of life provided that the minor has a property. The liability of minor is only to the extent of the minor's property. This type of contract is called a Quasi-contract and the right of the supplier/lender is based on the principle of equity. Thus, according to the above provision, Suresh will be entitled to recover the amount of loan given to Ramesh for payment of the college fees from the property of the minor.

Ans.2. According to Section 18 of the Indian Contract Act, 1872, misrepresentation is present:

1. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
2. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.
3. When a party causes, however, innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it. Accordingly in the given case, Suraj could not rescind the contract, as his acceptance to the offer of Sohan to bear 40% of the cost of repairs impliedly amounts to final acceptance of the sale.

Ans.3. An agreement in restraint of trade/business/profession is void under Section 27 of the Indian Contract Act, 1872. But an agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else directly or indirectly to promote any business in direct competition with that of his employer is not in restraint of trade.

In the given question, X agreed to become an assistant for 5 years to 'Y' who was a Doctor practicing at Ludhiana. It was also agreed that during the term of agreement X will not practice on his own account in Ludhiana. Such agreement is not in restraint of trade and hence it is valid.

Therefore X can be restrained by an injunction from practicing on his own account in Ludhiana.

Ans.4. As per section 29 of the Indian Contract Act, 1872 - agreements, the meaning of which is not certain, or capable of being made certain, are void. In the given question, M promised to pay N for his services at his (M) sole discretion found to be fair and reasonable. Here the agreement is uncertain in terms of amount of salary.

Therefore, N's suit will not be valid because the performance of a promise is contingent upon the mere will and pleasure of the promisor; hence, there is no contract.

Ans.5. As per Section 16 of Indian Contract Act, 1872, A contract is said to be induced by "undue influence" where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage of the other A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other.

In the given problem, A applies to the banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the

contract is not induced by undue influence. As between parties on an equal footing, the court will not hold a bargain to be unconscionable merely on the ground of high interest. Only where the lender is in a position to dominate the will of the borrower, the relief is granted on the ground of undue influence.

But this is not the situation in this problem, and therefore, there is no undue influence.

UNIT 4 : PERFORMANCE OF CONTRACT

Ans.1. As per Section 43 of the Indian Contract Act, 1872, when two or more persons make a joint promise, the promisee may in the absence of express agreement to the contrary, compel anyone or more of such joint promisors to perform the whole of the promise. In such a situation the performing promisor can enforce contribution from other joint promisors. If anyone or more joint promisors make default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal share. Hence in the instant case, A is entitled to receive (a) from C's assets -

₹ 10,000 (1/5th of ₹ 50,000) and (₹ 50,000 is the amount to be contributed by C being 1/3rd of ₹ 1, 50,000), (b) from B - ₹ 70,000 (₹ 50,000 being his own share + 1/2 (50,000-10,000) i.e. ₹ 20,000 being one half share of total loss of ₹ 40,000 due to C's insolvency). A can recover ₹ 70,000 from B.

Ans.2. According to Section 56 of the Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently). But impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. Whether a promise becomes absolutely impossible depends upon the facts of each case.

The performance does not become absolutely impossible on account of strikes, lockout and civil disturbances and the contract in such a case is not discharged unless otherwise agreed by the parties to the contract.

In this case Mr. Akhilesh could not deliver the bags as promised because of strike by the workers. This difficulty in performance cannot be considered as impossible of performance attracting Section 56 and hence Mr. Akhilesh is liable to Mr. Shekhar for non-performance of contract.

Ans.3. As per Section 55 of Indian Contract Act, 1872, where the intention of the parties is that the time should be of the essence of the contract the contract must be performed within the fixed time. And if the party, who is bound to perform his promise within the fixed time, fails to do so then the contract becomes voidable at the option of the other party. Thus, the innocent party may put an end to the contract if he so chooses and he can also claim damages.

In the given question, time is of the essence of the contract but yet promisor does not perform the promise within the stipulated time. But five days after the expiry of the stipulated time, the promisor offers to perform his promise. With respect to above provisions, promisee can accept such performance and at the same time claim compensation from the promisor for the delay.

Ans. 4. As per Section 62 of Indian Contract Act, 1872, the term 'novation' means the substitution of existing contract for a new contract. In other words, when the parties to a contract agree to substitute the existing contract by a new contract, it is known as novation. The novation must be with the mutual consent of all the parties.

In the given question, A owes B ` 1,000 under a contract, B owes C ` ,000. B orders A to credit C with ` 1,000 in his books, but C does not assent to the arrangement. Hence, there is no valid novation. Therefore, B still owes C ` 1,000.

Ans.5. As per Section 54 of Indian Contract Act, 1872, if the promises are conditional and dependent, the performance of the promise by one party depends on the prior performance of the promise by the other party. In such promises if the party who is bound to perform his promise first, fails to perform it, then he cannot claim performance from the other party. Moreover, the defaulting party becomes liable to pay the compensation to the other party for the loss suffered by the other on account of the non- performing of the contract.

In the given question, A agrees to sell land to B for ` 40,000. B pays to A ` 4,000 as a deposit at the time of the contract, the amount to be forfeited to A if B does not complete the sale within a specified period. B fails to complete the sale within the specified period, nor is the ready and willing to complete the sale within a reasonable time after the expiry of that period.

Therefore, A can rescind the contract and at the same time retain the deposit

UNIT 5 : BREACH OF CONTRACT

Ans.1. As per Section 73 of Indian Contract Act, 1872, the vindictive damages are claim with the intention of punishing the party in default. As a general rule, the exemplary damages are not awarded for the breach of contract as they are punitive in nature. However, in following case, the court may award exemplary damages:

Where there is a breach of a promise to marry: In such cases, the damages will include compensation for loss to the feelings and reputation of the aggrieved party.

In the given question, A, an Indian, contracts to marry B. A is already married - a -fact of which B was unaware. A breaks his promise in course of time. Thereupon B brings a suit against A for a breach of contract. A pleads that his promise is impossible of being performed as the law of the country does not permit polygamy.

A can get away with the plea as the marriage cannot be forced upon. However, he is liable to vindictive damages as stated above.

Ans.2. The stated problem falls under the head 'anticipatory breach of contract' as per The Indian Contract Act, 1872. Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promisor is over. As per details in the problem, price as contracted ₹ 40 per

kg on 10.11. 2006 rose to ₹ 50 per kg as on 4.12.2006 and finally to ₹ 53 per kg, on 09.12.2006. The answer to the problem is that

1. Mr. Ramaswamy can repudiate the contract on 04.12.2006 and can claim damages of ₹ 10 per kg viz. ₹ 1, 00,000.
2. He could wait till 09.12.2006 and claim ₹ 130,000 i.e. ₹ 13 per kg.
3. If the Government, in the interim period i.e. between 04.12.2006 and 09.12. 2006 imposes a ban on the movement of the commodity to arrest rise of prices, the contract becomes void and Mr. Ramaswamy will not be able to recover any damages whatsoever.

UNIT 6: CONTINGENT & QUASI CONTRACTS

Ans.1. Section 69 of the Indian Contract Act, 1872, provides that "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other. In the given case Y, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from X. That means Y has made the payment of lawful dues of X in which Y had an interest. Therefore, Y is entitled to get the reimbursement from X. Hence, X is bound to make good to Y the amount so paid.

Ans.2. As per Section 72 of Indian Contract Act, 1872, a certain amount of money is paid or something is delivered to a person by mistake or under coercion. In such cases, the person receiving the money or goods must repay or return the same to the person who has paid or delivered by a mistake or under coercion.

In the given question, A under a mistaken impression gives some money into B's hand believing him to 'C. He can obtain the return of money

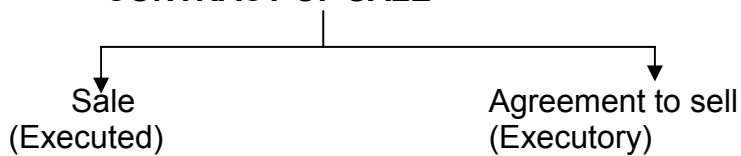
CHAPTER 2 - THE SALE OF GOODS ACT, 1930

UNIT 1: FORMATION OF CONTRACT OF SALE

- **INTRODUCTION :**

- ❖ It came into force on the 1st of July, 1930.
- ❖ It is applicable to whole of India except Jammu & Kashmir.
- ❖ The Law relating to this statute was contained in the Chapter VII of the Indian Contract Act, 1872.
- ❖ Where the Sale of Goods Act is silent on any point, the general principles of the law of contract apply.

- **CONTRACT OF SALE**



The term 'contract of sale' is defined in Section 4 (1) of the Sale of Goods Act, as under :
 "A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in the goods to the buyer for a price. "

- **DEFINITIONS**

1. **Buyer :**

"Buyer means a person who buys or agrees to buy goods." [Sec. 2(1)]

2. **Seller :**

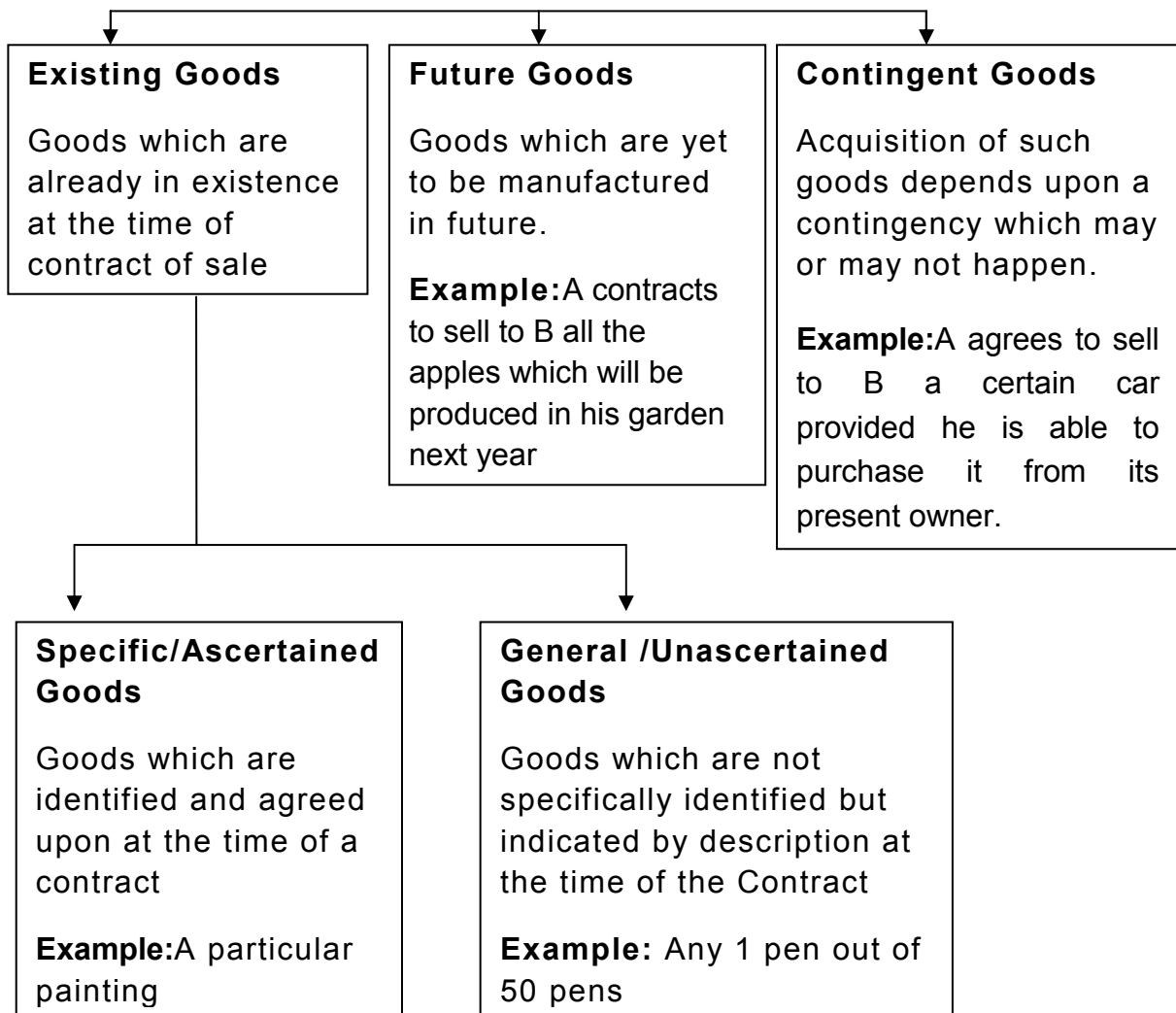
"Seller means person who sells or agrees to sell goods." [Sec. 2(13)]

3. **Goods :**

"Goods" means every kind of movable property other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. [Sec. 2 (7)].

- ❖ An actionable claim is a claim to any debt. For example: a money debt, book debts, etc.
- ❖ Money here means legal tender of money, i.e. the recognised circulation in the country; but not old rare coins.
- ❖ Things attached to the earth are not movables, but trees, growing crops which can be easily severed from the earth before sale. Fruits, vegetables and flowers which can be separated from the trees, are included in 'goods'.
- ❖ Livestock i.e. cows, buffaloes, cats etc are 'goods'.
- ❖ Patents, copyrights, goodwill, trade-marks, are all considered goods which can be the subject matter of a contract.
- ❖ A ship has also been considered to come within the definition of the word "goods". Similarly water, gas and electricity are included in the definition, though some writers doubt if they can be classed among "goods".

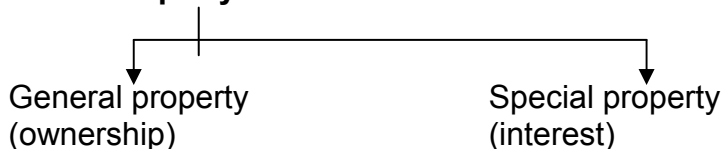
- ❖ As per English law, “shares and stock” are not treated as “goods”.
- ❖ To conclude, everything movable is goods, except the following:-
 1. Money
 2. Actionable Claims
 3. Immovable assets
 4. Services
- ❖ Classification of Goods:



4. Price

- ✓ “Price’ means the money consideration for a sale of goods.” [Sec. 2 (10)].
- ✓ No sale can take place without a price.
- ✓ Therefore,
 - a. Exchange of goods for goods will not be considered as sale
 - b. Gift of goods will not be considered as sale
 - c. Exchange of goods for goods along with price will be considered as sale

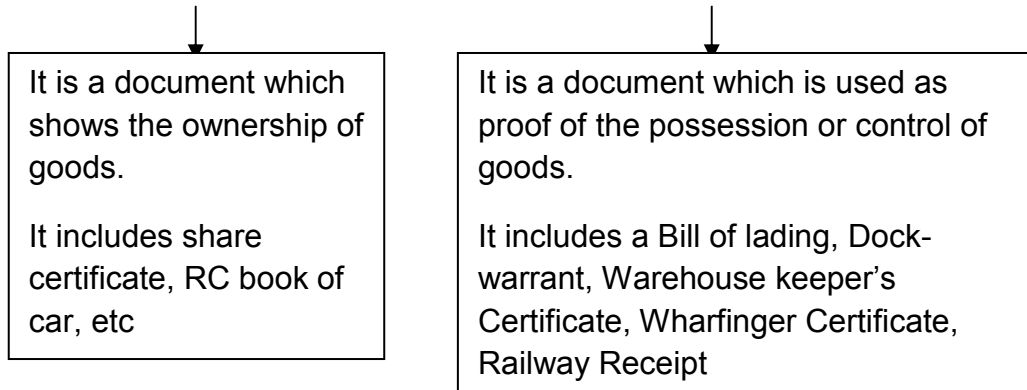
5. Property:



But in Sale Of Goods Act, 'property' means the general property in goods and not merely a special property

Example: A who owns the goods pledges them to B, then A has the general property in the goods, while B has a special property or interest in them.

6. Documents showing Title to Goods/ Documents of Title to Goods



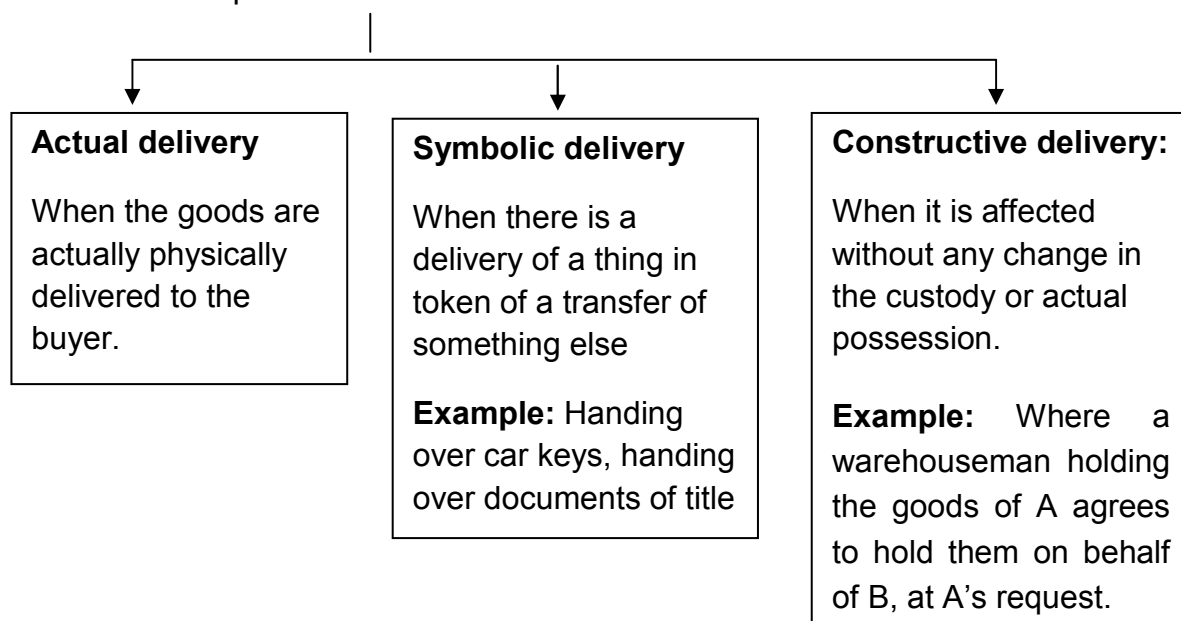
7. Mercantile Agent:

"Mercantile Agent' means an agent having in the customary course of business as such agent, authority either to sell goods, or to consign goods for the purpose of sale, or, to buy goods, or to raise money on the security of goods." [Section 2(9)].

If a person is not carrying on business as such agent, he would not fall under this definition. Thus, a contractor, a warehouseman, a carrier or a servant and a friend would be excluded.

8. Delivery:

"Delivery' means voluntary transfer of possession from one person to another" [Sec. 2 (2)]. Therefore, in case of theft, there is no delivery, though there is a transfer of possession.



- **ESSENTIAL ELEMENTS OF A VALID CONTRACT OF SALE**

Following are the essential elements of a valid contract of sale:

1. **All the requirements of a valid contract must be fulfilled:**

A contract of sale must fulfil all the requirements of a valid contract, e.g., free consent, consideration, competency of the parties, lawful object and consideration. If any of the essential elements of a valid contract is missing then the contract of sale will not be valid.

2. **There must be two parties to the contract of sale:**

There must be two parties, one seller and the other buyer. The reason for the same is that in a contract of sale, the ownership of the goods has to pass from one person to another.

3. **There must be some goods as a subject-matter:**

The 'goods' as defined in Section 2 (7) of the Sale of Goods Act.

4. **The property in the goods must be transferred to the buyer:**

The term 'property' in the goods means the ownership of the goods. In every contract of sale, the ownership of the goods must be transferred by the seller to the buyer, or there should be an agreement by the seller to transfer the ownership to the buyer. The term 'property' here means the general property, i.e., all ownership rights of the goods, and not merely a special property, i.e., limited rights such as right of a Pawnee.

5. **There must be some price for the goods:**

The goods must be sold for some price. The term 'price' is defined in Section 2 (10)

6. **A contract of sale can be absolute or conditional [Section 4(2)].**

- **DISTINGUISH BETWEEN**

1. SALE AND AGREEMENT TO SELL

SALE	AGREEMENT TO SELL
1.Transfer of property: the property in goods passes from the seller to the buyer immediately	1.Transfer of property: In agreement to sell, the ownership of the property will pass from the seller to the buyer at some future time or on fulfilment of some conditions.
2.Nature of contract: A sale is an executed contract	2.Nature of contract: An agreement to sell is an executory contract
3. Consequences of Breach by buyer : In a sale, if the buyer fails to pay for the goods, the seller can: i. Sue him for recovery of price ii. Claim damages	3. Consequences of Breach by buyer : In an agreement to sell, the seller can only sue for damages for breach of contract
4. Consequences of Breach by seller : In a sale, if the seller defaults, i.e. commits a breach, the buyer can: 1. Claim delivery of the goods from third party 2. Sue for damages	4. Consequences of Breach by seller: In the case of an agreement to sell, if the seller commits a breach, the buyer can only claim damages.

5. Transfer of risk: In a sale, if the goods are destroyed, the loss falls on the buyer even though they are in the possession of the seller.	5. Transfer of risk: In an agreement to sell, if the goods are destroyed, the loss falls on the seller, even though they are in the possession of the buyer.
6. Subsequent destruction: A subsequent loss or destruction of the goods is the liability of the buyer.	6. Subsequent destruction: Such loss or destruction is the liability of the seller.

2. SALE AND HIRE- PURCHASE

SALE	HIRE-PURCHASE
1. Property in the goods is transferred to the buyer immediately at the time of Contract.	1. The property in goods passes to the hirer upon payment of the last instalment.
2. The position of the buyer is that of an Owner of the goods.	2. The position of the hirer is that of a bailee till he pays the last instalment.
3. The buyer cannot terminate the contract and is bound to pay the price of the goods.	3. The hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining instalments.
4. The seller takes the risk of any loss resulting from the insolvency of the buyer.	4. The owner takes no such risk, for if the hirer fails to pay an instalment the owner has right to take back the goods.
5. The buyer can resell the goods.	5. The hirer cannot resell the goods till the last instalment.
6. Tax is levied at the time of the contract.	6. Tax is not leviable until it eventually ripens into a sale.

3. SALE AND BAILMENT

SALE	BAILMENT
1. The property in goods is transferred from the seller to the buyer.	1. There is only transfer of possession of goods from the bailor to the bailee for any of the reasons like safe custody, carriage, etc.
2. The return of goods in contract of sale is not possible.	2. The bailee must return the goods to the bailor on the accomplishment of the purpose for which the bailment was made.
3. The consideration is the price in terms of money.	3. The consideration may be gratuitous or non-gratuitous.

- **BARTER AND EXCHANGE**

Barter:

Where goods are transferred for goods, the transaction is one of a 'barter' and not sale, i.e. wheat is given in exchange of rice.

Exchange :

Where money is exchanged for money, the transaction is one of 'exchange' and not sale, i.e. 100 rupee note is exchanged for 2 notes of Rs. 50.

- **SALE AND CONTRACT FOR WORK AND LABOUR**

A contract of sale has to be distinguished from a contract for work and labour. The contract of sale contemplates the delivery of goods, whereas in contract for work and labour or materials, the contract is for the exercise of the skill and labour, and delivery of goods is only subsidiary.

Example: G commissioned R, an artist to paint a portrait and supplied the canvas and the paint. Held, it is a contract for work and labour and not one for the sale of goods.

- **FORMATION AND MODES OF A CONTRACT OF SALE**

A contract of sale is made by an offer to buy or sell by one person, and the acceptance of such offer by another person. And it may be made in anyone of the following modes [Section 5 (1)]:

1. There may be immediate delivery of goods, but the price to be paid at some future date.
2. There may be immediate payment of price, but the delivery to be made at some future date.
3. There may be immediate payment of price and the immediate delivery of goods.
4. The price and delivery of the goods may be postponed.
5. The price and delivery of the goods may be agreed to be made in instalments.

✓ It may be noted that no particular form is necessary for the making of a contract of sale.

✓ It may be in any form, e.g., a contract of sale may be made

(a) In writing, or

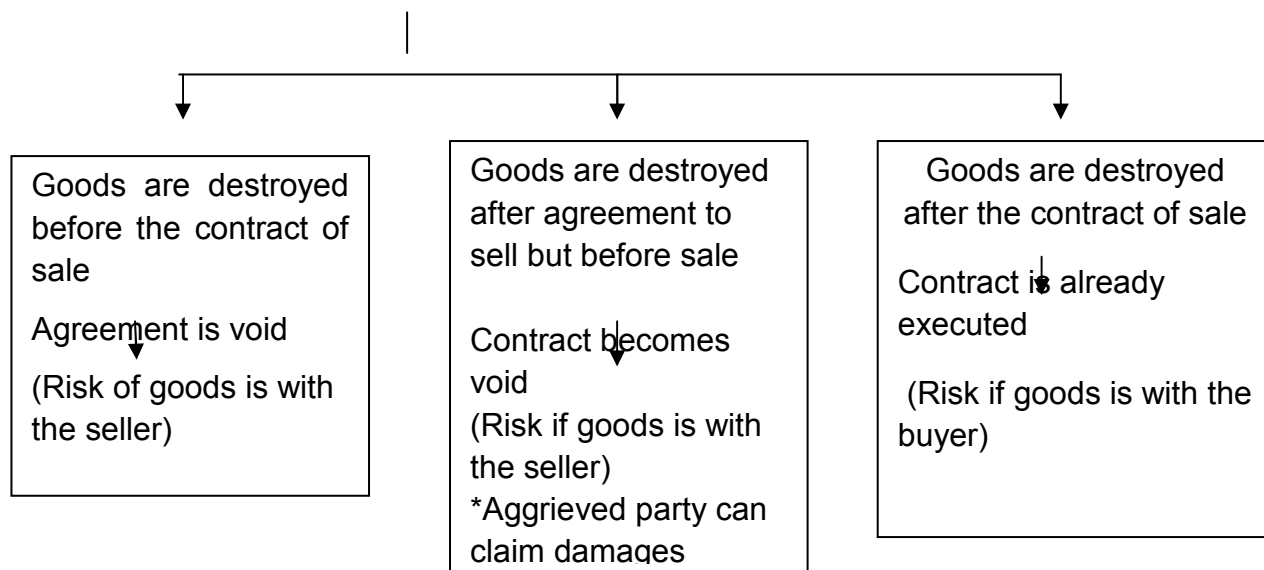
(b) By words of mouth, or

(c) Partly in writing and partly by words of mouth, or

(d) May be implied from the conduct of the parties.

However, if any particular mode is prescribed by any law, then the contract of sale must be made in that particular mode [Section 5 (2)].

- **EFFECT OF DESTRUCTION OF GOODS**



- **PRICE AND MODES OF FIXING THE PRICE**

The price means the money consideration for the sale of goods [Section 2 (10)]. Price may be fixed in any of the following modes provided in Section 9:

1. **The fixation of price by the contract of sale [Section 9 (1)]:**

The price may be expressly fixed the contract of sale. The parties may fix any price they like.

2. **The fixation of price in a manner provided in the contract of sale [Section 9 (1)]:**

The contract of sale may provide for some manner in which 'price is to, be fixed. In such cases, the price may be fixed in a manner provided in the contract.

3. **The fixation of price by course of dealings [Section 9 (1)]:**

Sometimes, the customs or usage of trade provides certain principles for the determination of the price. In such cases, the price may be determined from the course of dealings between the parties.

4. **The fixation of a reasonable price [Section 9 (2)]:**

Sometimes, none of the above principles is applicable. In such cases, the buyer shall pay to the seller a reasonable price. The term 'reasonable' price is a question of fact which depends on the circumstances of each particular case.

5. The fixation of price by third party [Section 10]:

- ✓ The parties may agree to sell and buy goods on the terms that the price shall be fixed by the valuation of a third party.
- ✓ However, if such third party fails to make the valuation, the contract becomes void. But if the buyer has received the goods and has appropriated them, he becomes bound to pay reasonable price to the seller.
- ✓ Sometime, the third party is influenced or prevented by the buyer or the seller from fixing the price. In such cases, the innocent party may recover damages from the defaulting party.

Example:

A agreed to sell his 100 bags of rice to B at a price to be fixed by C. But C failed to fix the price. In this case, the agreement becomes void on C's failure to fix the price.

Example:

A agreed to sell his 100 quintals of wheat to B at a price to be fixed by C. C is willing to value wheat and fix the price. But, A by his wrongful acts, prevents C from making the valuation of the goods. In this case, B can claim damages from A.

UNIT 2: CONDITIONS AND WARRANTIES• **INTRODUCTION :**

In every contract of sale of goods there are certain stipulations made with reference to goods which are the subject-matter thereof. Such stipulations differ in character and importance. The clause divides stipulations into conditions and warranties.

Condition:

“A condition is a stipulation essential to the main purpose of the contract, that breach of which gives a right to treat the contract as repudiated.”

Warranty:

“A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated”.

CONDITION	WARRANTY
1. A condition is essential to the main purpose of the contract.	1. It is only collateral to the main purpose of the contract.
2. In case of breach of condition, aggrieved party can: <ol style="list-style-type: none"> i. Rescind the contract, return the goods and claim refund. ii. Claim damages 	2. In case of breach of warranty, aggrieved party can only claim damages.
3. A breach of condition may be treated as a breach of warranty	3. A breach of warranty cannot be treated as a breach of condition.
4. Example:	4. Example:

• **WHEN A CONDITION CAN BE TREATED AS A WARRANTY :**1. **Voluntary waiver of condition:**

Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated.

2. **Where the buyer elects to treat the breach of the conditions, as one of a warranty. That is to say, he may claim only damages instead of repudiating the contract**3. **Compulsory waiver of a condition:**

Where a contract of a sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller

can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a terms of the contract, express or implied, to that effect

Example:

B agrees to buy from A 20 bales of cotton by sample. The cotton is delivered to B who makes payment of its price. B upon examination of cotton finds them not equal to sample but uses 2 bales and sells 3. At this point he cannot rescind the contract and recover the price. But A is bound to compensate for the loss caused to B by breach of warranty.

4. Impossibility:

Nothing in this section shall affect the case of any condition or warranty, fulfilment of which is excused by reason of impossibility or otherwise.

• **CONDITIONS :**

Express conditions: Express conditions are those, which are agreed upon between the parties at the time of contract and are expressly provided in the contract.

Implied Conditions:

- ✓ It is a condition, which the law implies into the contract of sale. The law presumes that the parties have incorporated it into their contract.
- ✓ The implied conditions are read into every contract of sale unless they are expressly excluded by the parties.
- ✓ In case of conflict between the express and implied conditions, the express term shall prevail and the implied terms shall not be considered.
- ✓ Following are the implied conditions which are contained in the Sale of Goods Act :

1. Conditions as to title:

- ❖ According to this condition, it is presumed that the seller has a valid title to the goods, i.e., he has the right to sell the goods. If later on, the buyer comes to know that the seller had no valid right to sell the goods, then he may reject the goods and claim the refund of the price, if already paid.
- ❖ This implied condition may be analysed as under:
 - (i) In case of sale, the implied condition is that the seller has the right to sell the goods, and
 - (ii) In case of an agreement to sell, the implied condition is that the seller will have the right to sell the goods at the time when the ownership is to pass from the seller to the buyer.
- ❖ **Example:**

2. Condition as to description:

- ❖ Sometimes, the goods are sold by description. In such cases, the implied condition is that the goods shall correspond with the description.
- ❖ The term 'correspondence with description' means that the goods purchased by the buyer must be the same which were described by the seller.
- ❖ If subsequently, it is discovered that the goods do not correspond with the description, the buyer may reject the goods and claim the refund of the price, if already paid.
- ❖ **Example:**

3. Condition as to sample:

- ❖ In case of sale of goods by showing the sample to the buyer, there are following three implied conditions,
 - (i) That the goods delivered shall correspond with the quality of the sample
 - (ii) That the buyer shall have a reasonable opportunity of comparing the bulk with the sample.
 - (iii) That the goods shall be free from latent defects (i.e., the defects which are not discoverable on reasonable examination of sample)

4. Condition as to sample as well as description:

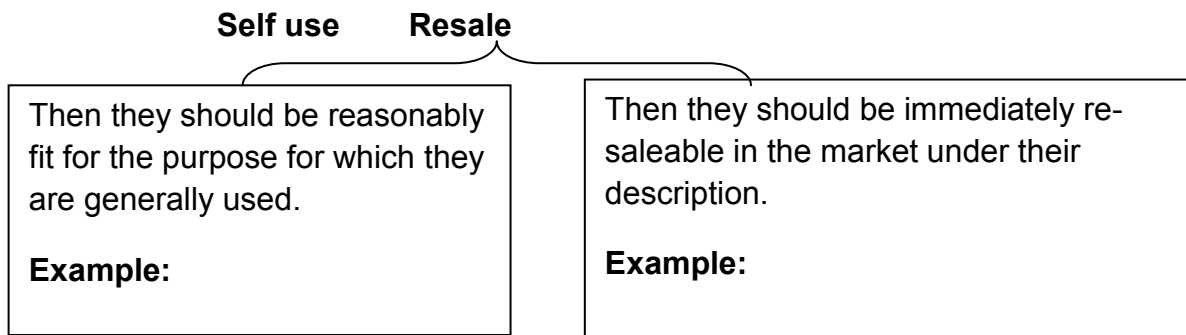
- ❖ Sometimes, the seller shows sample of the goods to the buyer and also gives him their description. In such cases, the implied condition is that the goods shall correspond with both, the sample as well as description.

5. Condition as to quality or fitness for buyer's purpose:

- ❖ Ordinarily, there is no implied condition that the goods shall be fit for the particular purpose of the buyer.
- ❖ Seller is not responsible:
 - (i) To know the particular purpose of buyer.
 - (ii) If buyer chooses the goods negligently.
- ❖ However in following exceptions, there is an implied condition that the goods shall be fit for the buyer's specific purpose. In following cases seller is responsible to the buyer:
 - (i) If the buyer makes his purpose clear to the seller.
 - (ii) If the buyer buys the goods 'relying upon his skill and judgment'.
- ❖ **Example:**

6. Condition as to merchantability:

The term 'merchantability' has not been defined in the Sale of Goods Act. However, it has been interpreted by the courts, and basically it means the two things, namely: If goods are purchased for

**7. Condition as to wholesomeness:**

This condition is a part of the condition as to merchantability. It is applicable in cases of eatables, i.e., foodstuffs and other goods which are used for human consumption. As per this condition, goods sold must be fit for human consumption.

Example:

- WARRANTIES :**

**Implied Warranties:**

- ✓ **It is a warranty, which the law implies into the contract of sale. The law presumes** that the parties have incorporated it into their contract.
- ✓ The implied warranties are read into every contract of sale unless they are expressly excluded by the parties.
- ✓ In case of conflict between the express and implied warranties, the express term shall prevail and the implied terms shall not be considered.
- ✓ Following are the implied warranties which are contained in the Sale of Goods Act :
 1. **Warranty as to quiet possession:**
 - ❖ Where the buyer has obtained the possession of the goods, he has a right to enjoy them in a way he likes, i.e., no one should interfere with the quiet enjoyment of the buyer.
 - ❖ If buyer's right of possession and enjoyment is disturbed by anyone, then the buyer can recover damages from the seller.
 - ❖ **Example:**

2. Warranty as to free from encumbrance:

- ❖ In every contract of sale there is an implied warranty that the goods sold shall be free from any charge.
- ❖ If the possession of the buyer is disturbed due to such charge in favour of third party, he can claim damages from the seller.
- ❖ **Example:**

3. Disclosure of dangerous nature of goods:

- ❖ There is another implied warranty on the part of the seller that in case the goods are inherently dangerous or they are likely to be dangerous to the buyer and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger.
- ❖ If there is breach of this warranty, the seller will be liable in damages.

4. Warranties implied by customs:

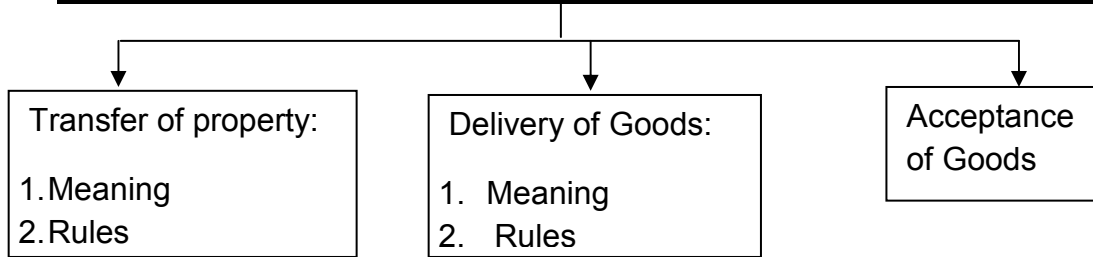
- ❖ Like implied conditions, implied warranties are also attached by custom or usage of trade. This is so because the parties enter into an agreement subject to the known customs or usages of trade.

• **THE DOCTRINE OF CAVEAT EMPTOR (BUYER BEWARE) :**

- ❖ 'Caveat Emptor' is a Latin expression which means "let the buyer beware".
- ❖ The Doctrine states generally seller is not responsible for bad goods.
- ❖ This Doctrine takes the side of the seller.
- ❖ As per the ruler, seller is not responsible in following cases:-
 - (i) To know the particular purpose of buyer.
 - (ii) If buyer chooses the goods negligently
 - (iii) If the goods are defective and the defect is patent (i.e. defect which can be discovered by mere inspection)

❖ **Exceptions :** The exceptions to the doctrine of Caveat Emptor; which are mentioned below (i.e in the following seller is responsible) :

1. Where the buyer specifies the particular purpose for which the goods are required to the seller.
2. Where buyer relies on the seller's skill or judgment.
3. Where there is contract of sale by sample, the rule of caveat emptor will not apply if the goods do not correspond with sample
4. Where goods are bought by description, the goods shall correspond with the description.
5. If the goods are bought both by sample as well as by description this rule will not apply if goods do not correspond with both sample and description.
6. There is an implied condition that the goods shall be of merchantable quality
7. When the seller actively conceals some defect in the goods so that the same could not be discovered by the buyer on a reasonable examination, then the rule of Caveat Emptor will not apply.
8. When the goods are purchased under some brand name.

UNIT 3: TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

- **TRANSFER OF PROPERTY (OWNERSHIP) :**

- A. **Meaning:**

- ❖ The term 'property in the goods' may be defined as the legal ownership of the goods.
 - ❖ Transfer of Ownership means transfer of Risk, Rights and Returns pertaining to the goods.
 - ❖ The term 'property in the goods' must be distinguished from the term 'possession of the goods'. The term 'property in the goods' means the ownership of the goods, whereas the term 'possession of goods' simply means the custody or physical control over the goods.

- B. **Rules:**

- 1. **The ownership is transferred at the time of making the contract** if the following conditions' are fulfilled:
 - (a) **The sale must be of specific goods:**
These are the goods which are identified and agreed upon at the time of contract.
 - (b) **The goods must be in a deliverable state:**
The goods are said to be in a deliverable state when they are in such a state that the buyer would, under the contract, be bound to take delivery of them.
 - (c) **The contract of sale must be unconditional:**
A contract is unconditional in which no condition is imposed regarding the transfer of ownership of the goods.
 - 2. **Transfer of ownership in case of sale of unascertained goods.**
The unascertained goods are the goods which are not specifically identified at the time of making the contract of sale.
In case of sale of unascertained goods, the ownership is transferred to the buyer on the fulfilment of both the following conditions:
 - (i) **Ascertainment of goods:**
It is the process by which the goods to be delivered under the contract are identified and set apart. It is a unilateral act of the seller alone to identify and set apart the goods.
 - (ii) **Appropriation of goods:**
It is the process by which the goods to be delivered under the contract are identified and set apart with the mutual consent of the seller as well as buyer. It is a bilateral act of the seller and the buyer to identify and set apart the goods.

Example:

3. **Where the specific goods are to be put in a deliverable state by the seller:** The ownership is transferred as soon as the seller has put the goods in a deliverable state and the buyer comes to know about the act of the seller.
4. **Where the specific goods in a deliverable state are to be weighed or measured by the seller** to ascertain the price, the ownership is transferred to the buyer as soon as the seller has done the act of ascertaining the price and the buyer comes to know about this act of the seller.

Example:

5. However, parties may decide to **pass the ownership as per the contract.**
6. **Transfer of ownership in case of sale on approval**
 - ❖ The ownership of goods is with seller and the possession of goods is with buyer
 - ❖ The buyer has an option to return the goods.
 - ❖ The ownership is transferred to the buyer in any of the following three ways:
 - (i) **When the buyer accepts the goods:**
The acceptance by the buyer may be express or implied.
 - (ii) **When the buyer adopts the transaction:**
The buyer may adopt the goods by doing some act which shows that he has accepted the goods e.g., where he further sells or pledges the goods.
 - (iii) **Where the buyer fails to return the goods within fixed or reasonable time**
7. **Reservation of right of disposal**
 - ❖ The seller may like to retain the ownership of the goods until some later date, e.g., until the price is paid or some conditions are fulfilled. The seller may do so by reserving his right of disposal.
 - ❖ Where the seller has reserved his right of disposal, the ownership of the goods is not transferred to the buyer even if the goods are delivered to the buyer or some carrier for the purpose of transmission to the buyer. The ownership is

transferred to the buyer only when the conditions imposed by the seller are fulfilled

- ❖ In the following two circumstances the seller is presumed to have reserved the right of disposal :
 1. By taking the documents showing title in his own name or his agent's name
 2. By sending the bill of exchange for the price, to the buyer, along with the documents of title
- ❖ **Example:**

8. Transfer of risk

- ❖ The risk and the ownership of the goods go together.
- ❖ In other words, the goods are at the risk of the party who has the ownership of the goods. This means that in case of loss of the goods, the loss shall be borne by the party who has the ownership of the goods at the time of loss.
- ❖ **Exceptions:**

In these exceptional circumstances, the goods may be at the risk of one party and their ownership may be with the other:

 1. **Agreement between the parties:**

The terms of agreement between the parties may provide as to when the ownership shall be transferred and who shall suffer the loss.
 2. **Goods are at the risk of the party in default:**

Sometimes, the delivery of the goods is delayed due to the fault of either seller or buyer. In such cases, the goods shall be at the risk of the party in default though their ownership is with the other party.
 3. **Trade customs :**

The risk and the ownership may also be separated by the trade customs e.g., the trade custom may provide that the goods shall be at the risk of the buyer whether or not the ownership has been transferred to him.

9. Transfer of title by non-owners

- ❖ "Nemodat quod non-habet": This means that 'no one can transfer a better title than he himself has'. Thus, the buyer cannot get a better title than that of the seller. If the seller's own title is defective, the buyer's title will also be defective.
- ❖ **Example:**

❖ **Exceptions:**

In the following exceptional circumstances a non-owner can transfer a valid title to a bonafide buyer:

1) **Sale by a mercantile agent**

A 'mercantile agent' is an agent who deals in the buying and selling of the goods on behalf of his principal, e.g., an auctioneer. Where a mercantile agent sells goods in the ordinary course of his business, the buyer who buys in good faith, gets a valid title to the goods even if he (the mercantile agent) is not the owner of the goods.

2) **Sale by a joint owner:** When the joint owner is in the sole possession of the goods, and he sells them to a person who buys in a good faith, the buyer gets a valid title to the goods.

Example:

3) **Sale by estoppel:** When the owner of goods, by his conduct or by statement, wilfully leads the buyer to believe that the seller has the authority to sell, then he is estopped (i.e., prevented) from denying the seller's authority to sell

Example:

4) **Sale by unpaid seller:** To be done in Unit 4

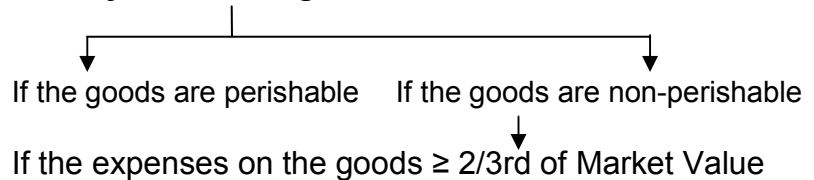
5) **Sale by a seller in possession of goods after their sale:** If the seller continues to have the possession of the goods even after their sale and if he resells the same goods to a new buyer then in such cases, the second buyer gets a valid title to the goods if he buys them in a good faith.

Example:

6) **Sale by a buyer in possession of goods after their sale:** If the buyer obtains the possession of the goods which he has bought or agreed to buy from the seller and the seller still has some lien or other rights over the goods. If the buyer resells the same goods to a new person. In such cases, the second buyer gets a valid title free.

Example:

7) **Sale by a finder of goods:**



8) **Sale by a person in possession under a voidable contract:** The buyer gets a valid title only if the following conditions are satisfied:-

- a. A person must obtain the possession of the goods by coercion, undue influence, fraud or misrepresentation.
- b. The seller must have obtained the possession of the goods under a voidable contract and not under a void contract.
- c. The contract must not have been rescinded (i.e., put to an end) at the time of sale
- d. The buyer must act in a good faith.

Example:

9) **Sale Under the Provision of Other Acts :**

- a. Sale by an Official Receiver or Liquidator of the Company will give a valid title to the purchaser.
- b. Sale by a pawnee/pledgee under default of pawnor in repayment of debt will give valid title to the purchaser.

❖ **In case of hire-purchase, hirer cannot pass a good title even to a bonafide buyer.**

• **DELIVERY OF GOODS**

A. Meaning:

- ❖ “Delivery” means a voluntary transfer of possession from one person to another”.
- ❖ Delivery of goods may be actual, symbolic or constructive

B. Rules:

1. Buyer in position to access the goods:

The delivery of the goods may be made in any of the modes, but it must have the effect of putting the goods in the possession of the buyer or his agent.

2. Demand for delivery of goods:

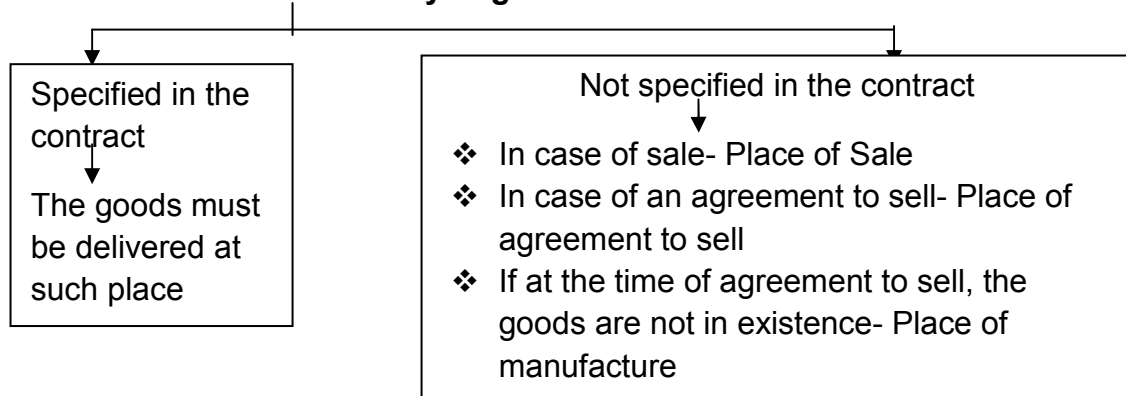
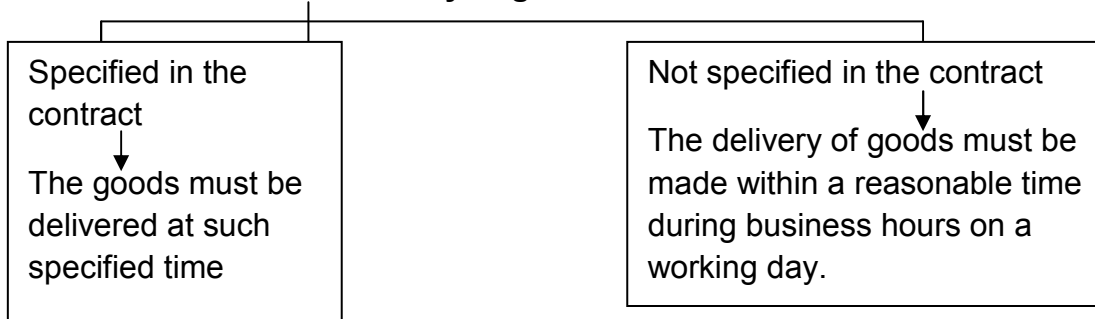
It is seller's duty to put the goods in deliverable state and inform the buyer regarding same. It is buyer's duty to make a demand for the delivery of the goods.

3. Goods in the possession of a third person:

Sometimes, at the time of sale, the goods are in the possession of a third person. In such cases, the effective delivery takes place when such person acknowledges to (i.e., inform) the buyer, that he holds the goods on his (buyer's) behalf.

4. Delivery to a carrier or wharfinger:

Where the sold goods are delivered to a carrier/wharfinger for the purpose of transmission to the buyer or safe custody, the delivery of goods to the carrier/wharfinger is treated as a delivery to the buyer

5. Place for the delivery of goods:**6. Time for the delivery of goods:****7. Time for demand or tender of delivery:**

The demand of delivery by the buyer must be made within reasonable time during business hours and on a working day.

8. Expenses for the delivery of goods:

The expenses of putting the goods into a deliverable state are borne by the seller. And the expenses of receiving the goods are borne by the buyer. However, the seller and the buyer may also agree otherwise

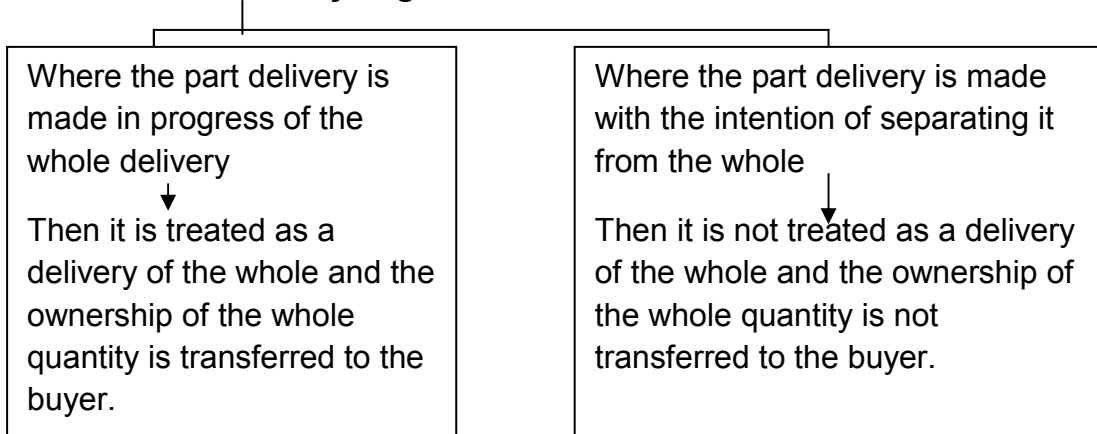
9. Deterioration of goods during transit:

The buyer shall bear the loss of deterioration of goods which is incidental i.e. natural in transit unless otherwise agreed.

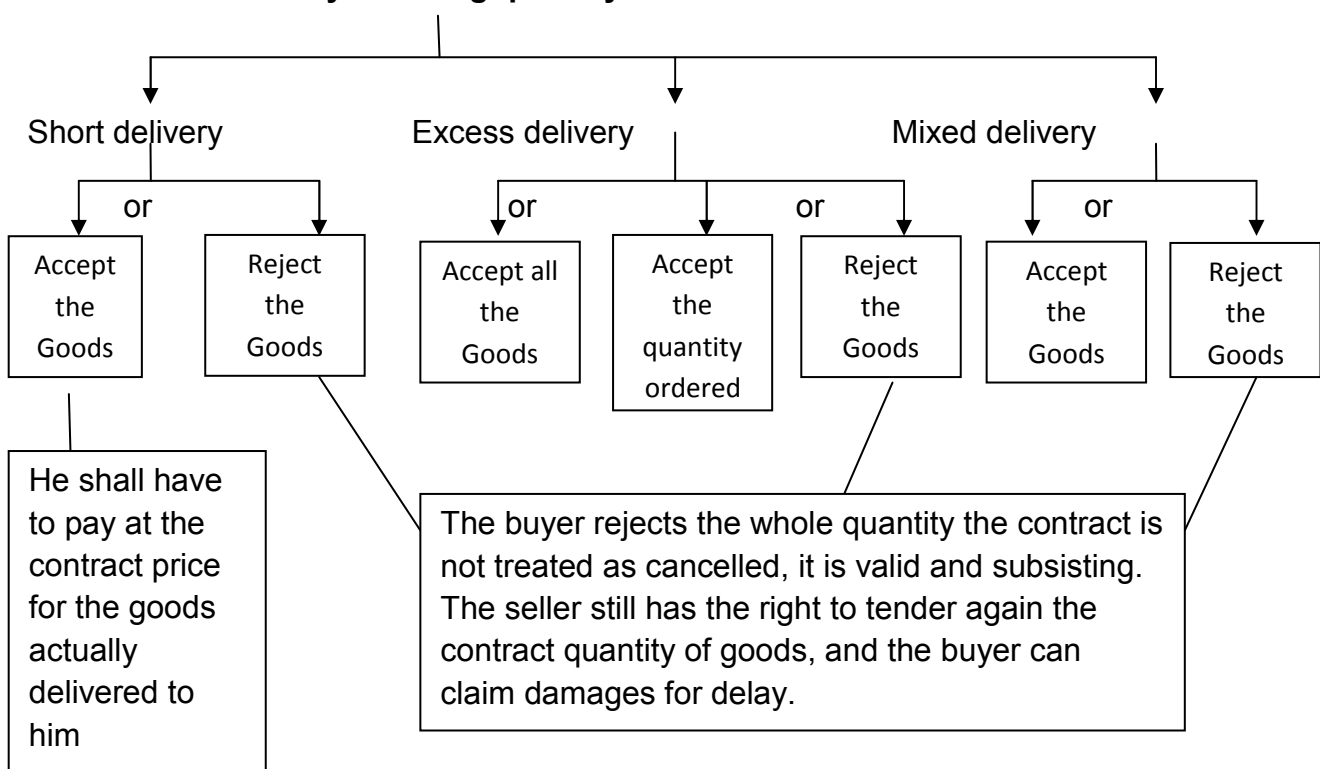
10. Delivery of goods by instalments:

As a rule, the delivery of goods by instalments is not considered as a good delivery and the buyer is not bound to accept the goods delivered to him by instalments, unless otherwise agreed.

11. Part delivery of goods:



12. Delivery of wrong quantity:



• **ACCEPTANCE OF DELIVERY OF GOODS**

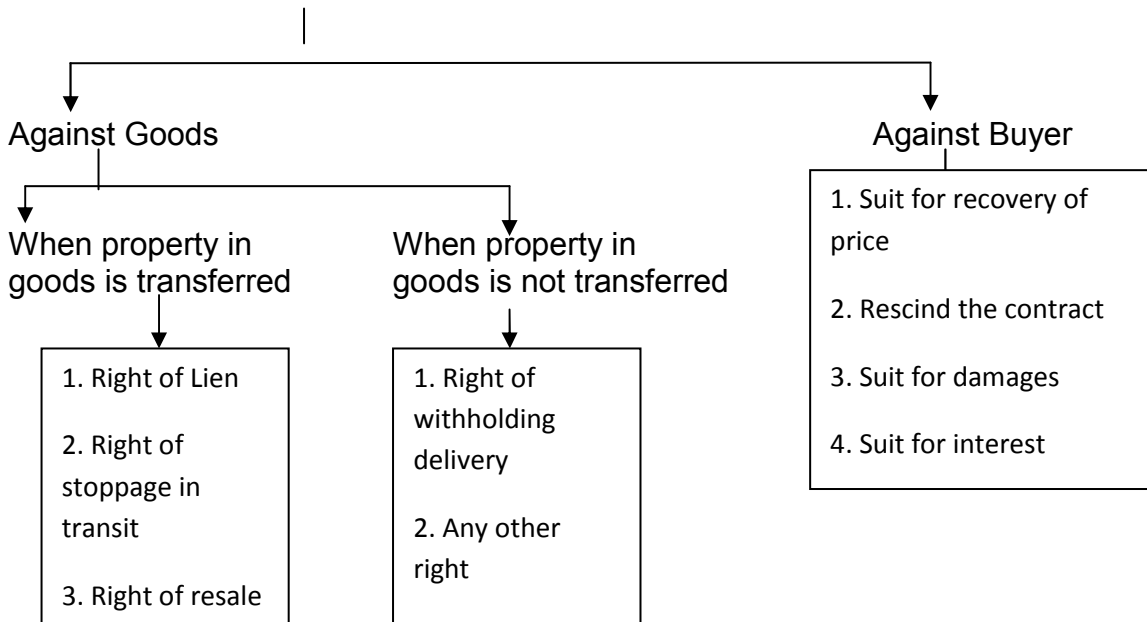
Acceptance is deemed to take place when the buyer-

- (a) Intimates to the seller that he had accepted the goods; or
- (b) Does any act to the goods, which is inconsistent with the ownership of the seller; or
- (c) Retains the goods after the lapse of a reasonable time, without intimating to the seller that he has rejected them.

UNIT 4 : UNPAID SELLER• **MEANING OF UNPAID SELLER:**

A seller will be called 'unpaid' if the following conditions are fulfilled:

- (1) The whole or part of the price has not been paid or tendered and that the seller has immediate right of action for the price.
- (2) A bill of exchange or other negotiable instrument has been received but the same has been dishonoured.

• **RIGHTS OF UNPAID SELLER****(A) Rights against the Goods:**

1. **Where the ownership of the goods has transferred to the buyer: In this case, the unpaid seller has the following rights:**

(a) Right of lien

- ❖ The right of lien is the right to **retain possession** of the goods.
- ❖ This right can be exercised only when the possession of goods is with the seller.
- ❖ The unpaid seller of goods can retain his possession of goods until payment of the price in following cases:
 - a) Where the goods are not sold on credit.
 - b) Where the goods have been sold on credit, but the term of credit has expired
 - c) Where the buyer becomes insolvent.
- ❖ The unpaid seller can retain the goods only for the payment of the price of the goods: He cannot retain the goods for any other charges, e.g., maintenance, charges for storage of goods during the exercise of lien etc.
- ❖ The right of lien is indivisible in nature.
- ❖ Termination of Lien:
 - a) By delivery of goods to the carrier
 - b) By delivery of goods to the buyer
 - c) By waiver of the lien
 - d) By payment of price by the buyer

❖ **Example:****(b) Right of stoppage in transit**

- ❖ The right of stoppage in transit is the right to **regain possession** of the goods.
- ❖ This right can be exercised only when,
 - (i) Seller should have parted with the possession
 - (ii) Possession should be with a carrier, &
 - (iii) Buyer has not acquired the possession.
- ❖ The right of stoppage in transit can be exercised only if the buyer has become insolvent.
- ❖ The unpaid seller can stop the goods in transit only for the payment of the price of the goods.
- ❖ Distinction between Right of Lien and Right of Stoppage in transit

Right of Lien	Right of stoppage in transit
1. The essence of a right of lien is to retain possession	1. The essence of stoppage in transit is to regain possession
2. Seller should be in possession of goods under lien	2. In stoppage in transit, (i) seller should have parted with the possession (ii) possession should be with a carrier, & (iii) buyer has not acquired the possession.
3. Right of lien can be exercised even when the buyer is not insolvent.	3. Right of stoppage in transit can be exercised only when buyer becomes insolvent
4. Right of lien precedes right of stoppage in transit.	4. Right of stoppage in transit begins when the right of lien ends

❖ **Example:**

(c) Right of Resale

The unpaid seller has the direct right to resell the goods in the following circumstances:

1. Where the goods are of perishable nature
2. Where the unpaid seller has expressly reserved his right of resale.

In any other case, the unpaid seller has the right to resell the goods by following the procedure:

1. Unpaid seller should give a notice to the buyer of his intention to resell the goods
(+)
Additional time for payment
2. If the buyer does not pay the price within a reasonable time, the seller may resell the goods
 - ❖ If the notice of resale is given then in case of loss on resale, it can be recovered and in case of profit on resale, it can be retained.
 - ❖ However the notice of resale is not given, the seller cannot recover the loss suffered on resale. Moreover, if there is any profit on resale he must return it to the original buyer

2. Where the ownership of the goods has not been transferred to the buyer:

(a) Right of Withholding Delivery

When the ownership of the goods sold is not transferred to the buyer, if the buyer fails to pay the price, the unpaid seller may refuse to deliver the goods to the buyer. Such right is known as right of withholding the delivery of the goods.

(b) Any other right

Since ownership and possession of goods is with the seller, seller can use, gift, resell the goods, etc.

(B) Rights against the Buyer

1. Suit for recovery of price

Where the buyer takes the ownership as well as possession of goods and the buyer fails to pay the price of the goods, the seller can file a suit against the buyer for recovery of the price.

2. Suit for damages for repudiation of the contract before the due date of delivery of goods :

Where the buyer repudiates (i.e., puts an end to) the contract before the due date of delivery of the goods, the seller has the following options:

- (i) He may not immediately take any action against the buyer, and treat the contract as subsisting and wait till the date of delivery of goods.
- (ii) He may immediately treat the contract as repudiated and bring a legal action against the buyer for the recovery of damages. Thus, the option of bringing the action lies with the seller. He may either wait till the date of delivery of goods arrives, or bring an immediate action for damages.

3. Suit for damages

Where the seller is ready and willing to deliver the goods to the buyer, but the buyer wrongfully neglects or refuses to accept the goods and pay for them, then the seller may bring a legal action against the buyer for the recovery of damages suffered due to non-acceptance of the goods.

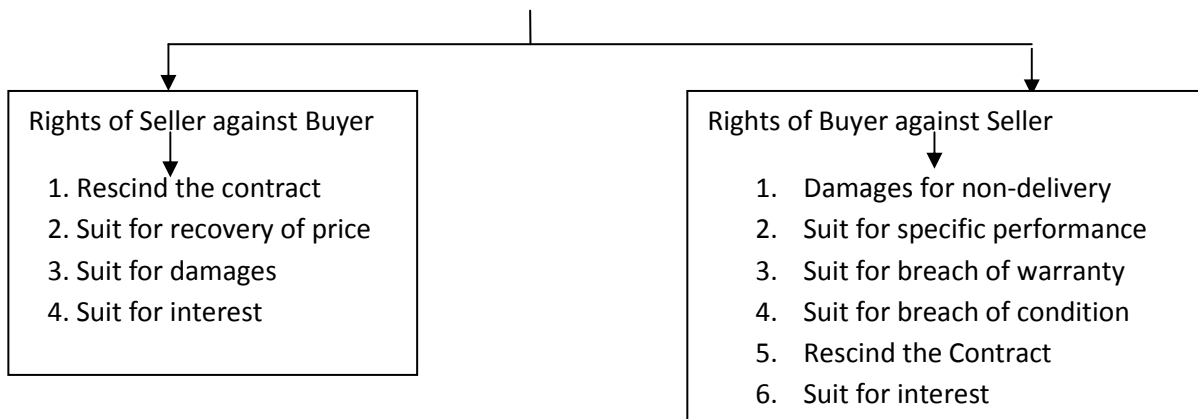
4. Suit for interest

The court may award the interest from the date of tender of the goods or from the date when the price is payable. The rate of interest to be awarded is at the discretion of the court.

- **EFFECTS OF SUB-SALE OR PLEDGE BY BUYER**

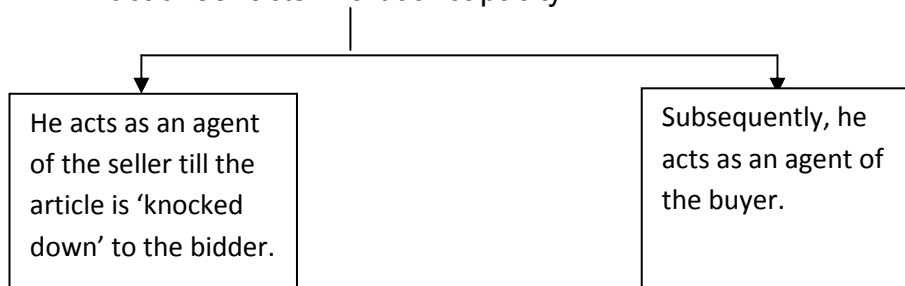
- ❖ The right of lien or stoppage in transit is not affected by the buyer selling or pledging the goods unless the seller has assented to it.
- ❖ Exceptions:
 - (a) When the seller has assented to the sale, mortgage or other disposition of the goods made by the buyer.
 - (b) When a document showing title to goods has been transferred to the buyer and the buyer transfers the documents to a person who has bought goods in good faith and for value.
- ❖ **Example:**

- **RIGHTS OF PARTIES IN BREACH OF CONTRACT**



- **AUCTION SALES**

- ❖ An auction sale is a sale at which the auctioneer, as agent for the seller, invites persons present to bid for goods sold.
- ❖ Auctioneer acts in a dual capacity



- ❖ Rules regarding Auction Sales:
 1. Where goods are put up for sale in lots, they are deemed to be sold in lots.
 2. The sale is complete and ownership is transferred when the auctioneer announces its completion by the fall of the hammer or in any other customary manner.
 3. Bidder may retract his bid anytime before auction sale is complete.
 4. The sale may be notified to be subject to a 'reserve price' or 'upset price.' When the sale is notified to be subject to a 'reserve price', the bidding and knocking down of the article to the highest bidder are all subject to the condition that the 'reserve price' should be reached.
 5. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.
 6. A right to bid may be 'reserved' expressly by or on behalf of the seller and, where such right is expressly so reserved, but not otherwise, the seller or any other person on his behalf, may bid at the auction.
 7. Implied warranties in auction sale: In an auction sale, the auctioneer warrants the following :
 1. that he has an authority to sell;
 2. that he is not aware of any defect in the title of the principal;
 3. that he undertakes to handover the quite possession of the goods as soon as the price is paid to him.

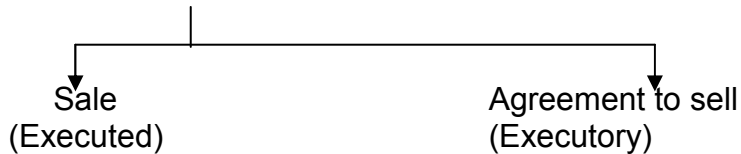
SUMMARY

UNIT 1: Formation of contract of sale

- **INTRODUCTION**

- ✓ It came into force on the 1st of July, 1930.
- ✓ It is applicable to whole of India except Jammu & Kashmir.
- ✓ The Law relating to this statute was contained in Indian Contract Act, 1872.
- ✓ Where the Sale of Goods Act is silent on any point, the general principles of the law of contract apply.

- **CONTRACT OF SALE**



- **DEFINITIONS**

1. Buyer
2. Seller
3. Goods
4. Price
5. Property
6. Documents showing Title to Goods/ Documents of Title to Goods
7. Mercantile Agent
8. Delivery

- **ESSENTIAL ELEMENTS OF A VALID CONTRACT OF SALE**

- **DISTINGUISH BETWEEN**

1. Sale and agreement to sell
2. Sale and hire- purchase
3. Sale and bailment
4. Sale and contract for work and labour

- **FORMATION AND MODES OF A CONTRACT OF SALE**

- **EFFECT OF DESTRUCTION OF GOODS**

- **PRICE AND MODES OF FIXING THE PRICE**

UNIT 2: CONDITIONS AND WARRANTIES

- **CONDITION**

“A condition is a stipulation essential to the main purpose of the contract

- **WARRANTY**

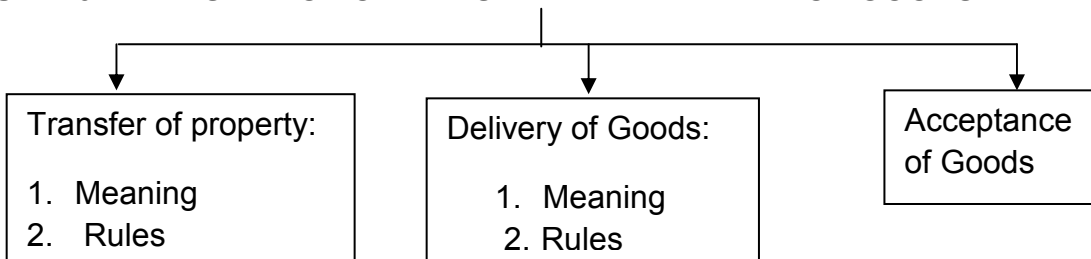
“A warranty is a stipulation collateral to the main purpose of the contract

- **WHEN A CONDITION CAN BE TREATED AS A WARRANTY**



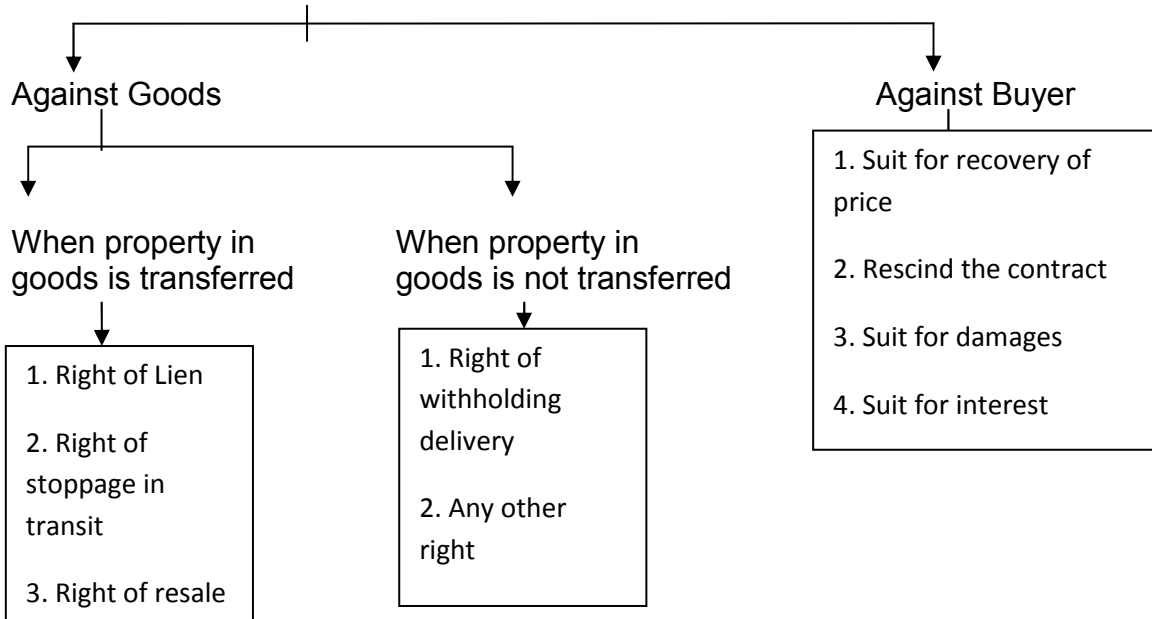
- **THE DOCTRINE OF CAVEAT EMPTOR (BUYER BEWARE)**

UNIT 3: TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS



UNIT 4 : UNPAID SELLER

- **MEANING OF UNPAID SELLER**
- **RIGHTS OF UNPAID SELLER**



- **EFFECTS OF SUB-SALE OR PLEDGE BY BUYER**
- **RIGHTS OF PARTIES IN BREACH OF CONTRACT**
- **AUCTION SALES**

QUESTIONS

1. What are the consequences of "destruction of goods" under the Sale of Goods Act, 1930, where the goods have been destroyed after the agreement to sell but before the sale is affected.
2. In what ways does a "Sale" differ from "Hire-Purchase"?
3. State briefly the essential element of a contract of sale under the Sale of Goods Act, 1930. Examine whether there should be an agreement between the parties in order to constitute a sale under the said Act.
4. What do you understand by "Caveat-Emptor" under the Sale of Goods Act, 1930? What are the exceptions to this rule?
5. What are the implied conditions in a contract of 'Sale by sample' under the Sale of Goods Act, 1930? State also the implied warranties operative under the said Act.
6. "There is no implied warranty or condition as to quality or fitness for any particular purpose of goods supplied under a contract of sale" Discuss the significance and State exceptions, if any.
7. Distinguish between a 'Condition' and a 'Warranty' in a contract of sale. When shall a 'breach of condition' be treated as 'breach of warranty' under the provisions of the Sale of Goods Act, 1930? Explain.
8. "Nemo Dat Quod Non Habet" - "None can give or transfer goods what he does not himself own." Explain the rule and state the cases in which the rule does not apply under the provisions of the Sale of Goods Act, 1930.
9. What are the rules related to Acceptance of Delivery of Goods?
10. Explain the provisions of law relating to unpaid seller's 'right of lien' and distinguish it from the "right of stoppage the goods in transit".
11. What do you understand by the term "unpaid seller" under the Sale of Goods Act, 1930? When can an unpaid seller exercise the right of stoppage of goods in transit?
12. When can an unpaid seller of goods exercise his right of lien over the goods under the Sale of Goods Act? Can he exercise his right of lien even if the property in goods has passed to the buyer? When such a right is terminated? Can he exercise his right even after he has obtained a decree for the price of goods from the court?

ADDITIONAL CASE LAW BASED QUESTIONS:**UNIT -1: FORMATION OF THE CONTRACT OF SALE**

- Q. 1.** Ms Prachi Dutt has hired 100 laptops for her office @Rs30000 per laptop (Rs3000000) for a monthly rent of Rs1 lakh. The stipulation is that if Ms Prachi pays the rent regularly for 20 months, she is entitled to either exercise the option of purchasing all the laptops or return the laptops immediately after 20 months. However, if purchase option is exercised, the installment facility would continue. She decides to exercise the purchase option. Is this a valid contract?
- Q. 2.** Mr Jigar Dhuvad agrees to sell his second hand Maruti Omni Van to Mr Katta for a price to be determined by Mr Dutta. Mr Katta took delivery of the Vehicle. Mr Dutta refuses to fix the price. Mr Jigar Dhuvad wants the vehicle back. What is the position?
- Q.3.** Mr Pruthvi Raj Chavan of Bangalore entered into contract for selling 10000 kgs of grapes in his garden in Kolar with Mr Menezes of Goa, a fruit merchant. The grapes were destroyed before the date of the agreement though Mr Pruthvi Raj Chavan was not aware of the same. The grapes could, however, be used for preparing wine. Mr Pruthvi Raj Chavan compels Mr Menezes to purchase the same. Is the contract valid?

UNIT - 2: CONDITIONS & WARRANTIES

- Q.1.** Mr A sold a tin of cleaning acid to Mrs B. Mr A knew that it was likely to be dangerous to Mrs B if she does not exercise caution and special care while opening the lid. Mrs B opened the tin in the normal course and her face was defaced by sprinkles of acid. Can she file a case against Mr A?
- Q.2.** Ms Pooja goes to a beauty salon. She asks for a facial and a hairdo. She does not disclose any allergies to the beautician. The beautician applied some hair dye without asking anything about the possible allergies. Ms Pooja developed dermatitis. Is the beautician liable?
- Q.3.** X agrees to supply to Y a certain quantity of timber of half-inch thickness. The timber actually supplied varies in thickness from one third inch to five-eighth inch. The timber is merchantable and commercially fit for the purpose for which it was ordered. Y rejects the timber. Is his action justified?

UNIT - 3: TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

- Q.1.** Mr A, a farmer, sold his 4 cows to Mr B. In a period of 2 years, cows had given birth to 2 calves. Now Mr.A demands the calves back as he claims that he has just sold the cows and not the calves. State whether Mr. B is required to return the calves?
- Q.2.** A contracts to sell to B all the oil to be produced from groundnut harvested from A's farm. The crops having been harvested and oil made there from, A fills the oil in cans supplied by B. However, A hasn't yet informed B. Does the property in oil pass to B?

- Q.3.** P brought a musical instrument from a musical shop on a condition that he will purchase it, if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument. When does the ownership get transferred?
- Q.4.** During ICL matches, P buys a TV set from R. R agrees to deliver the same to P after some days. In meanwhile R sells the same to S, at a higher price, who buys in good faith and without knowledge about the previous sale. Will S get a good title?

UNIT - 4: UNPAID SELLER

- Q.1.** A bids for an antique painting at a sale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the antique which gets damaged. Who shall bear the loss? What will be your answer if the antique gets damaged after the hammer was struck on table?
- Q.2.** A entered into a contract to sell cartons in possession of a wharfinger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now B sold goods to C and C duly paid to B. But anyhow B failed to make the payment to A. A wanted to exercise his right of lien and ordered the wharfinger not to make delivery to C. Can he do so?

ANSWERS

UNIT -1: FORMATION OF THE CONTRACT OF SALE

Ans.1. Contract of sale resembles with contracts of hire purchase very closely, and the real object of a contract of hire purchase is the sale of the goods ultimately.

Hire purchase agreements are governed by the Hire-purchase Act, 1972. Term "hire- purchase agreement" means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which—

- (a) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical installments, and
- (b) The property in the goods is to pass to such person on the payment of the last of such instalments, and
- (c) Such person has a right to terminate the agreement at any time before the property so passes; None the less a sale has to be distinguished from a hire purchase as their legal incidents are quite different.

In the given question, it is a hire purchase contract. It is a valid contract.

Ans.2. Section 10 of The Sale o provides for the determination of price by a third party. Where there is an agreement to sell goods on the terms that price has to be fixed by the third party and he either does not or cannot make such valuation, the agreement will be void. In case the third party is prevented by the default of either party from fixing the price, the party at fault will be liable to the damages to the other party who is not at fault. However, a buyer who has received and appropriated the goods must pay a reasonable price for them in any eventuality. In the given question, Mr Jigar Dhuvad agrees to sell his second hand Maruti Omni Van to Mr Katta for a price to be determined by Mr Dutta. Mr Katta took delivery of the Vehicle. Mr Dutta refuses to fix the price. Mr Jigar Dhuvad caannot get the vehicle back. Mr Jigar has to accept a reasonable amount and Mr Katta has to pay a reasonable amount. Mr Jigar cannot call back the goods.

Ans.3. As per section 7 of Sale of Goods Act,1930, where there is a contract for the sale of specific goods, the agreement is void if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description contract. In the given question, Mr Pruthvi Raj Chavan of Bangalore entered into contract for selling 10000 kgs of grapes in his garden in Kolar with Mr Menezes of Goa, a fruit merchant. The grapes were destroyed before the date of the agreement though Mr Pruthvi Raj Chavan was not aware of the same.

Since the goods no longer answered the description of fruits, the agreement is void.

UNIT - 2: CONDITIONS & WARRANTIES

Ans.1. As per section 16 of Sale of Goods Act, 1930, where the goods are dangerous in nature and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of warranty, the seller may be liable in damages.

In the given question, Mr A sold a tin of cleaning acid to Mrs B. Mr A knew that it was likely to be dangerous to Mrs B if she does not exercise caution and special care while opening the lid. Mrs B opened the tin in the normal course and her face was defaced by sprinkles of acid. For all dangerous goods, the seller is bound to inform the buyers all the dangers inherent and the precautions to be taken.

Therefore, Mr A is liable for the damages.

Ans.2. As per section 16 of Sale of Goods Act, 1930, where the goods are dangerous in nature and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of warranty, the seller may be liable in damages.

In the given question, Ms Pooja goes to a beauty salon. She asks for a facial and a hairdo. She does not disclose any allergies to the beautician. The beautician applied some hair dye without asking anything about the possible allergies. Ms Pooja developed dermatitis. Fitness of the dye to extends to that of a normal person. If a client has specific allergies, the client is bound to disclose the same. Therefore, the beautician is not liable.

Ans.3. As per section 15 of Sale of Goods Act, 1930, where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with the description. The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods.

In the given question, X agrees to supply to Y a certain quantity of timber of half-inch thickness. The timber actually supplied varies in thickness from one third inch to five- eight inch. Even though the timber is merchantable and commercially fit for the purpose for which it was ordered, Y can reject the same as it does not correspond with the description. Therefore, Y's action is justified.

UNIT - 3: TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

Ans.1. As per provisions of Sale of Goods Act 1930, the term 'property in the goods' is defined as the legal ownership of the goods. Transfer of Ownership means transfer of risk, rights and Returns pertaining to the goods.

In the given question, A, already sold his 4 cows to Mr B. So the calves of the cows also belong to Mr. B.

Therefore, Mr. B is not required to return calves to Mr.A.

Ans.2. As per provisions of Sale of Goods Act 1930, The ownership is transferred as soon as the seller has put the goods in a deliverable state and the buyer comes to know about the act of the seller.

In the given question, A contracts to sell to B all the oil to be produced from groundnut harvested from A's farm. The crops having been harvested and oil made there from, A fills the oil in cans supplied by B. However, A hasn't yet informed B. Since B doesn't know about deliverable state, the property in oil does not pass to B.

Ans.3. As per section 24 of Sale of Goods Act, 1930, when goods are delivered to the buyer on approval or "on sale or return" or other similar terms, the property therein passes to the buyer-

- (a) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction;
- (b) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time; or
- (c) he does something to the good which is equivalent to accepting the goods e.g.

The pledges or sells the goods.

In the given question, P brought a musical instrument from a musical shop on a condition that he will purchase it, if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument.

Therefore, the ownership is transferred when he has decided to purchase the instrument as his own.

Ans.4. As per section 27 of Sale of Goods Act, 1930, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had. However, if a person has sold goods but continues to be in possession of them, he may sell them to a third person, and if such person obtains the delivery thereof in good faith and without notice of the previous sale, he would have good title to them, although the property in the goods had passed to the first buyer earlier.

In the given question, P buys a TV set from R. R agrees to deliver the same to P after some days. In meanwhile R sells the same to S, at a higher price, who buys in good faith and without knowledge about the previous sale.

Hence, S will get a good title.

UNIT - 4: UNPAID SELLER

Ans.1. Under Section 26 of the Sale of Goods Act, unless otherwise agreed, the goods remain at the seller's risk until property therein has passed to the buyer. After that event they are at the buyer's risk, whether delivery has been made or not.

In the given question, A bids for an antique painting at a sale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the antique which gets damaged. Since, the ownership was not transferred, the loss will be borne by seller.

But, if the antique gets damaged after the hammer was struck on table, the loss will be borne by buyer.

Ans.2. As per section 53 of Sale of Goods Act 1930, the right of lien or stoppage in transit is not affected by the buyer selling or pledging the goods unless the seller has assented to it. This is based on the principle that a second buyer cannot stand in a better position than his seller. However, when the seller has assented to the sale, mortgage or other disposition of the goods made by the buyer, his right of lien or stoppage in transit is defeated. In the given question, A entered into a contract to sell cartons in possession of a what finger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now if B failed to make payment, the seller cannot exercise his right of lien as he had assented to the resale of the goods by the buyer to the sub-buyers. Therefore, he cannot exercise his right of lien.

CHAPTER 3 - THE PARTNERSHIP ACT, 1932

UNIT 1: GENERAL NATURE OF PARTNERSHIP

• INTRODUCTION :

- ❖ It came into force on 1st October, 1932.
- ❖ It is applicable to whole of India except Jammu & Kashmir.
- ❖ Prior to the passing of the Act, the law of partnership was included in Charter XI of the Indian Contract Act.
- ❖ Where the Partnership Act is silent on any point, the general principles of the law of contract apply. The partnership is a specialized branch of the Contract Act.

• DEFINITION OF PARTNERSHIP

Section 4 of the Partnership Act defines partnership as under:

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

• PARTNERSHIP

Partnership is the relation between two or more persons who have agreed to share profits of a business carried on by all or any of them acting for all.

• PARTNER & FIRM

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm", and the name under which their business is carried on is called the 'firm name'.

• ESSENTIAL ELEMENTS OF PARTNERSHIP

Therefore, the essential elements of the relationship of partnership may be stated as follows:

- (1) There must be an association of two or more persons.
- (2) There must be an agreement.
- (3) There must be a business
- (4) There must be an agreement to share the profits of a business, and
- (5) There must be an element of 'agency' i.e. the business must be carried on by all or any of them acting for all.

Thus, essential elements of relationship of partnership are:

(1) There must be two or more persons :

- ❖ There must be at least two persons to form a partnership. Maximum number of partners, partnership act is silent. But Section 464 Of The Companies Act 2013 specifies it as 50. If number of partners fall below it ceases to be partnership. If it goes beyond 50, it will become an illegal association.
- ❖ The persons can be natural or artificial. Hence 2 companies can be partners. But a firm cannot enter into a contract for partnership though their partners can become partners.

- ❖ All such persons must be competent to contract. According to Indian Contract Act every person except the following:
 - (i) Minor
 - (ii) Person of unsound mind
 - (iii) Person disqualified by any law to which they are subject (alien, insolvents etc)
- (2) There must be an agreement:**
- ❖ A partnership arises only as a result of an agreement. Such an agreement may be express or implied. Implied in the sense that it may be a voluntary act by the persons. Agreement can be oral or in writing but partnership deed must be in writing
 - ❖ Partnership is thus created by contract; it does not arise by operation of law or from status
 - ❖ Agreement must be valid
Partnership agreement like any other contract, so it must satisfy all the essentials of a valid contract. In other words, the parties must be 'competent', i.e. capable of entering into an agreement, their consent must be free and there should be a lawful consideration and object.
- (3) There must be a business:**
- ❖ The existence of a business is essential in a partnership. "Business" includes every trade, occupation and profession. If two or more persons join together to form a 'dramatic club' it is not a partnership because there is no business in this case. Similarly, if A and B are co-owners of a building and let it to a tenant for rent and divide the net rents between themselves. A and B are not partners because letting a house is not a business. But if A and B agree to convert the building into a hotel and to share the profits equally, there is a "business" here and hence A and B are partners in respect of such business.
 - ❖ The business must be lawful.
 - ❖ The business may consist of a single adventure or a single undertaking. Section 8 of the Indian Partnership Act provides:
"A person may become a partner with another person in particular adventures or undertakings." e.g. Two solicitors are engaged for a single case and they agree to share the profits. They would be partners.
- (4) Sharing of profits:**
- ❖ The element draws out the most essential feature and basis of partnership. The object of partnership undoubtedly is to earn "profit".
 - ❖ Sharing of losses :
The agreement to share profit is essential, but it should be noted that an agreement to share the losses is not essential. Where nothing is said as to the sharing of losses, it is implied in a partnership deed.
It may, however, be agreed that as between the partners anyone or more of them shall not be liable for losses. But the reverse is not just possible. So where persons agree to share the profits of a money-lending business, they become partners, but where one of them, so called partner is not to receive profits, he is not a partner. E.g. A and B agree to work together as carpenters, but that A shall receive all profits and shall pay wages to B, A and B are not partners. When

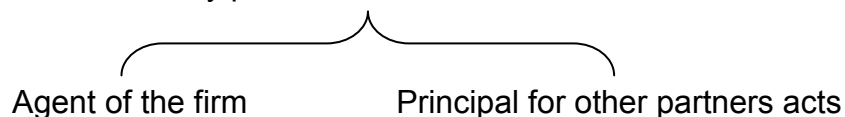
profit is made, it must be distributed (in absence of any agreement) equally, or in the agreed ratio.

- ❖ A person, who receives the profits of a business, is not necessarily a partner. The persons who receive the profits but are not the partners are referred as under:
 1. **Retired partner**
After retirement if the settlement of accounts is not done then the retired partner may get share in profits. But he is not treated as partner.
 2. **Money-lenders receiving profits:**
A money-lender is a person who lends money on interest. Sometimes, a money-lender receives, in addition to or in place of his interest, a portion of the profits of a business. In such cases, he cannot be said to be a partner only on the ground that he receives the profits of the business.
 3. **Employee or agent receiving profits:**
Sometimes, an employee or an agent of a business agrees to receive, in addition to or in place of his regular remuneration, a portion of the profits of the business. In such cases, he cannot be said to be a partner only on the ground that he receives the profits of the business.
 4. **Widow or child of a deceased partner:**
Sometimes, the widow or a child of deceased partner receives a portion of profits as annuity. In such cases, they cannot be said to be the partners of the firm only on the ground that they receive the profits of the business.
 5. **Seller of goodwill:**
Sometimes, a person who sells his business along with its goodwill, is given a share in the profits of the business he has sold. In such cases, that person does not become a partner in the business only on the ground that he receives the profits of the business.
 6. **Minor:**
Minor receives share in profits but is not considered as partner.
- ❖ Just because a person is sharing profits, he is not a partner. But if a person is a partner, he will definitely get share in profits.

(5) **Agency:**

- ❖ Again this last element is most crucial of partnership. The business of a firm is 'carried on by all or by anyone of them acting for all'. The underlying and fundamental principle herein which constitutes partnership is the idea of 'agency'. The other partners are bound by the acts of one of them only on the principle of agency. This is the cardinal principle of partnership law.

- ❖ It means every partner is a



That is to say, each partner is an agent binding the other partners who are his principals and each partner is again a principal, who in turn, is bound by the acts of the other partners. An act of one partner in the course of business of the firm is in fact an act of all partners.

❖ **Example :**

A, B and C are partners in a business. D an outsider, deals with the firm through A. As between A and D, A is the principal. But as between A, B and C, A is the agent of B and C. As such A, B and C can all sue D. D can also sue A, B and C. Furthermore, A is accountable to B and C because he is, in this transaction, an agent of B and C.

• **PARTNERSHIP DISTINGUISHED**

A) **PARTNERSHIP AND JOINT HINDU FAMILY FIRM (HINDU UNDIVIDED FAMILY):**

Partnership	HUF
1. It arises from agreement	1. It arises by status.
2. Governed by Indian Partnership Act, 1932.	2. It is governed by Hindu Law.
3. Maximum partners can be 50.	3. No such limit is applicable here.
4. A person can be admitted by the consent of the other existing partners.	4. A male person becomes a member merely by his birth.
5. A minor can be admitted only to the benefits of the firm.	5. A male minor becomes a member merely by his birth.
6. Each partner is implied authority to bind the firm for the actions done by him in the daily course of business.	6. Only Karta has such authority.
7. Unlimited liability.	7. Karta's liability is unlimited and the coparcener's liability is limited to their share in the family property
8. Each partner has the right to ask for the books of accounts and also for the profits and losses.	8. The coparceners have no such right
9. In case of death of a partner, partnership is dissolved unless otherwise agreed.	9. HUF continues to operate even after death of a coparcener.

B) PARTNERSHIP AND CO-OWNERSHIP:

Co-ownership means joint 'ownership X and Y jointly purchase a plot. They are co-owners but not necessarily partners. The distinction between the two is as under:

Partnership	Co-ownership
1. It arises from an agreement.	1. It may arise from agreement or operation of law.
2. It is formed to carry on business.	2. It may or may not involve carrying on a business.
3. It involves profit or loss.	3. It may or may not involve profit or loss
4. Partners have a mutual agency relationship.	4. Co-owners do not have a mutual agency agreement.
5. Maximum partners can be 50.	5. No such limit is applicable here.
6. A partner cannot transfer his share to a stranger without the consent of any other business.	6. A co-owner can transfer his share to a stranger without the consent of other owners.
7. A partner has no right to claim partition of property.	7. A co-owner has the right to claim partition of property.

C) PARTNERSHIP AND JOINT STOCK COMPANY:

Partnership	Company
1. A firm does not enjoy separate legal entity i.e. separate legal existence.	1. It has a separate legal existence.
2. The liability of the partner is unlimited.	2. Limited to the value of shares held by the members.
3. It does not enjoy a long lease of life because of dissolution due to different reasons.	3. It enjoys a perpetual existence.
4. Maximum partners can be 50.	4. In case of private limited company, Minimum members-2, maximum members -200 In case of public limited company, Minimum members -7, maximum members - no limit In case of One person Company (OPC)- only 1.
Partnership	Company
5. A partner cannot transfer his share without the consent of other partners.	5. A member can transfer his share as and when he wishes to.
6. There is mutual agency amongst the partners	6. There is no mutual agency amongst the members

7. Distribution of profits is compulsory as per the partnership deed	7. No such compulsion of distributing the profits.
8. The ownership & management lies with all the partners.	8. Ownership is with shareholders and the management is with board of directors
9. Property of the firm is the joint property of all the partners.	9. The property of company is not the joint property of the members.
10. The creditors of the firm can proceed against the partners jointly and severally.	10. The creditors of a company can proceed only against the company.
11. No compulsory Audit	11. Its compulsory

D) A PARTNERSHIP AND CLUB:

A club is an 'association of persons' formed for social purpose and not for the purpose of any 'gain' or 'profit'. It differs from the partnership in the following respects:

Partnership	Club
1. Business oriented objects	1. Not aimed at making profits entirely.
2. Maximum partners can be 50.	2. No such limit is applicable here.
3. Does not enjoy long lease of life	3. Enjoys a long lease of life
4. There is mutual agency amongst the partners	4. There is no mutual agency amongst the members

- **CLASSES OR TYPES OF PARTNERS :**

Partners can be classified as shown below:

1. **Active/Actual Partner :**

- ❖ A partner who is actively engaged in the conduct of the business of the partnership is known as 'active partner'.
- ❖ When an active partner retires from the firm, he has to give a public notice. Otherwise, he will be liable on the principle of 'holding out'.
- ❖ He is liable for acts of firm

2. **Sleeping or Dormant Partner :**

- ❖ A 'Sleeping partner' is one who does not take any active part in the business.
- ❖ Such partner joins the firm by agreement and invests capital and shares in the profit of the business like the other partners.
- ❖ A sleeping partner need not give public notice of his retirement from the firm.
- ❖ He is liable for acts of firm

3. Nominal Partner :

- ❖ A partner, who simply lends his name to the firm, without having any real interest in it, is called a nominal partner.
- ❖ He neither invests nor shares in the profits or takes part in the management of the business.
- ❖ He, along with other partners, is liable to outsiders for all the debts of the firm.
- ❖ Difference between sleeping and nominal partner: A nominal partner is known to the outside world as a partner of the firm but in reality does not share in the profit of the firm. A dormant partner on the other hand, even though not known as a partner to the world at large but in fact shares in the profits of the business.

4. Partner for profits only :

- ❖ Partners may agree that a particular partner shall get a share of the profits only but he will not be called upon to contribute towards the losses. Such a partner is known as 'partner for profits only'.
- ❖ This is simply an, inter-se agreement binding the partners only. Hence, he continues to be liable to third parties for all acts of the firm.

5. Sub-Partner :

- ❖ When a partner agrees to share his profits divided from the firm with a third person, that third person is known as 'sub-partner'. Such a sub-partner is in no way connected with the firm.
- ❖ He cannot represent the firm and bind the firm by his acts. He has no right against the firm nor is he liable for the acts of the firm.

6. Partner by Holding Out or by Estoppel :

- ❖ To hold a person liable as a partner by holding out, it is necessary to establish the following :
 1. He represented himself or knowingly permitted himself to be represented as a partner.
 2. Such representation occurred by words spoken or written or by conduct.
 3. The other party on the faith of that representation gave credit to the firm.
- ❖ Once he poses himself as a partner, though he is not a partner, he is estopped from saying that he is not a partner in a firm.
- ❖ **Example:**
X carried on business as RS. & Co. employed a person named RS. to act as manager of the business. It was held that RS. is a partner by the principal of estoppel.

7. Incoming Partner:

A person who is admitted as a partner into an already existing firm with the consent of all the existing partners is called as "incoming partner".

8. Outgoing Partner:

A partner who leaves a firm in which the rest of the partners continue to carry on business is called an outgoing partner.

- **CLASSES OF PARTNERSHIP :**

Partnership can be classified as under:

1. **Particular Partnership :**

- ❖ When a partnership is started for a particular purpose or period, it ends only when the purpose or period is completed.
- ❖ If the partnership is carried even after the completion of the target then it is deemed to be partnership at will.

2. **Partnership at will:**

- ❖ When no provision is made by contract between the partners for the duration of their partnership, or for the determination (termination) of their partnership, the partnership is "Partnership at will".
- ❖ Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.
- ❖ The firm is dissolved as from the date mentioned in the notice as the date of dissolution or if no date is mentioned, then from the date of the communication of the notice. The notice must be served on all other partners. The notice once given cannot be withdrawn unless all the other partners consent. The fact that one of the partners receiving the notice is of unsound mind does not affect the validity of the notice.

- **REGISTRATION OF FIRM**

- ❖ The registration of a firm is **not compulsory**. It is optional for the firm either to get itself registered or not. There is no penalty for non-registration of a firm. The registration can be done anytime, either in the beginning or during the continuance of business.

- ❖ **Procedure:**

1. **Step 1-** Obtain a statement in the form from the office of the Registrar.
2. **Step 2-** State the following information:
 - Name of the firm
 - Principal place of the firm
 - Name of the other places where the firm carries its business
 - Date when each partner joined
 - Name in full and permanent address of each partner
 - Duration of the firm.
3. **Step 3-** Get the statement of duly verified and signed by all the partners or their agents.
4. **Step 4-** File the statement along with prescribed fees
5. **Step 5-** Obtain a certificate or registration from the Registrar.

- ❖ The **registration becomes effective** from date of filing of duly signed and verified documents and not from the date of issue since the act of the Registrar in recording an entry of the statement in the firm is only a clerical act.

❖ **Consequences of non-registration:**

1. **The partners cannot file a suit against the firm or other partners:**

A partner of an unregistered firm cannot file a suit against the firm or his other present or past partners, for the enforcement of any right arising from a contract or conferred by the Indian Partnership Act. However, this disability may be removed by getting the firm registered before filing the suit.

2. **The firm cannot file a suit against third parties:**

An unregistered firm cannot file a suit against any third party for the enforcement of any right arising from some contract.

This disability of an unregistered firm can be removed by getting the firm registered before filing the suit.

3. **The partner of the firm cannot claim a set-off:**

The term 'set-off' means the adjustment of debts by one party due to him from the other party who files a suit against him. The partners of an unregistered firm or the firm itself cannot claim a set-off, in a suit filed against them or the firm. But the right of set-off is not affected if the claim for setoff does not exceed Rs 100 in value.

❖ **Following are not the disabilities of an unregistered firm:**

1. The third party can file a suit against the firm whether the firm is registered or not. And the firm cannot take the plea of its non-registration.

2. The partners of an unregistered firm can file a suit for the enforcement of the three things, namely,

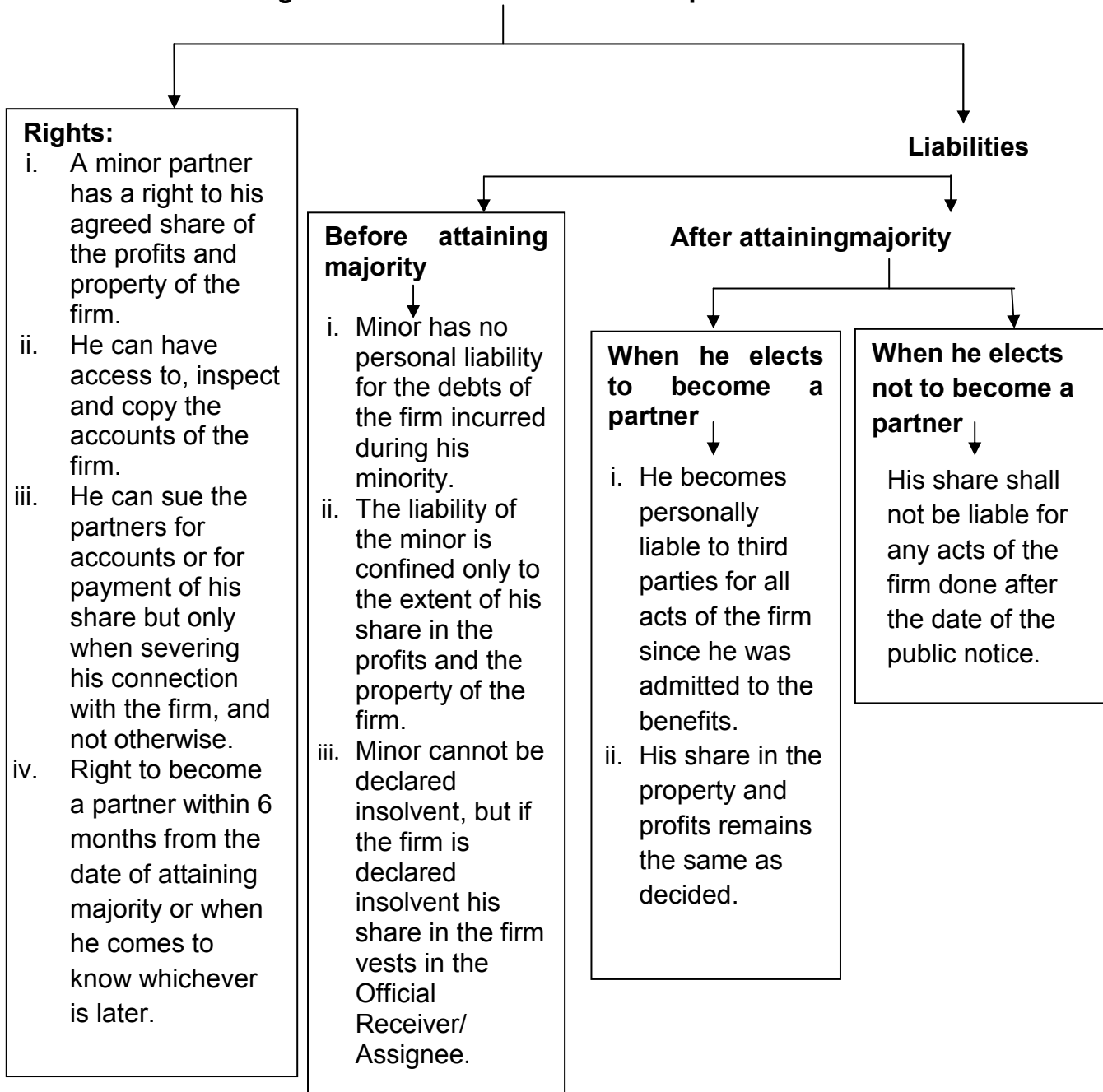
- (a) for the dissolution of the firm,
- (b) for the accounts of the dissolved firm, and
- (c) for realization of the property of the dissolved firm.

3. The right of an unregistered firm to enforce a right which arises otherwise than out of a contract. As a matter of fact, firm's disability is to enforce the contractual rights, and not the others.

• **MINOR'S POSITION IN PARTNERSHIP FIRM**

❖ A **minor cannot become a partner** in a firm because partnership is founded on a contract and contract with a minor is void-ab-initio. Though a minor cannot be a partner in a firm, he can be admitted to the benefits of partnership with the consent of all the partners.

❖ The rights and liabilities of such a partner are as follows:



UNIT 2: RELATION OF PARTNERS

- **RIGHTS OF PARTNERS:**

The mutual rights of partners depend upon the provisions of the partnership agreement. However, subject to an agreement between the partners; the law confers the following rights upon all the partners:

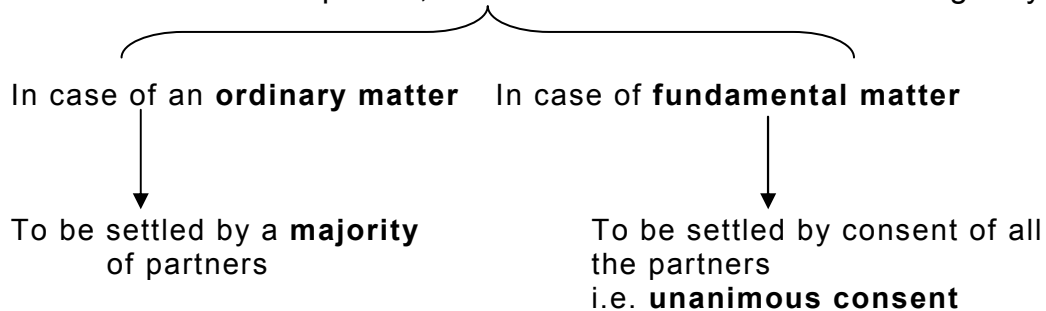
1. **Right to take part in business:**

It is the right of every partner to take part in the management of the business. This right is available to all the partners. This is, however, subject to contract between the partners i.e., the partners may provide, by a contract, that this right shall not be available to some partners.

2. **Right to be consulted:**

It is also the right of every partner to be consulted in all matters affecting the business of the firm. Moreover, every partner also has the right to express his opinion before any decision is taken by the other partners.

In case of difference of opinion, matter will be settled in following way:



3. **Right to have access to books:**

Every partner has the right to examine all the records, books and accounts of the firm. Moreover, he can also have the copy of such accounts etc. This right is, however, subject to a contract between the partners i.e., the partner may agree, by a contract that this right shall not be available to some of the partners.

4. **Right to share profits:**

Every partner has the right to have equal share in the profits of the firm. However, the partners may also agree to share the profits in different proportions. **No agreement between the partners can restrict this right.**

5. **Right to interest on capital and on advance:**

Right to interest on capital: Ordinarily, the partners have no right to receive any interest on their contribution towards the capital. However, the partnership agreement may provide that the partners shall be entitled to interest on capital at a certain rate. It may, however, be noted that where such interest is to be paid, it shall be paid only out of profit.

Right to interest on advances: Where in addition to the contribution towards the capital, a partner also advances a sum of money for the purpose of the business of the firm; he is entitled to interest on such advance at the rate of 6% per annum. Such interest on advance is payable even if the firm suffers loss.

6. Right to indemnity:

The partner of a firm has a right to be indemnified i.e., the right to recover expenses incurred and payments made by him in the following two circumstances.

(a) Expenses incurred in the ordinary course of business:

A partner has a right to recover from the firm any expenses incurred by him 'in the ordinary course of partnership business'.

(b) Expenses incurred in an emergency:

A partner has a right to recover from the firm any expenses incurred by him in order to protect the property of the firm from a loss threatened by an emergency.

No agreement between the partners can restrict this right.

7. Right to use the partnership property:

It is the right of every partner to use the partnership property. It may, however, be noted that the partnership property should be used exclusively for the purpose of the partnership business.

8. Right to be consulted at the time of admission of a new partner :

It is the right of every partner to be consulted at the time of admitting a new partner in the firm.

9. Right to retire from the firm :

It is the right of every partner to retire from firm, if he finds it difficult adjust with the other partners.

10. Rights of retiring partner:

To be covered later

11. Right not to be expelled:

Every partner has the right to continue in the firm and he cannot be expelled from it by the other partners. However, the partners may enter into a contract providing for the expulsion of a partner by majority of the partners. But the power of expulsion must be exercised in good faith:

12. Right to remuneration:

Generally, the partners are not entitled to receive any remuneration for taking part in the conduct of the business of the firm. However, the partnership agreement may expressly provide for the payment of remuneration to working partners.

Note:

The payment of remuneration to a working partner does not make partner an employee of the firm. The reason being that the firm and its partners are one and the same thing, and the firm is not a separate legal entity.

13. Right to dissolve the firm:

A partner has the right to dissolve the partnership with the consent of all partners. But where the partnership is at will the firm may be dissolved by any partner giving notice in writing to all other partners of his intention to dissolve the firm.

• **DUTIES OF PARTNERS**

Following are the duties of partners towards one another.

1. **Duty of good faith:**

It is the foremost and important general duty of the partners. Every partner should act in good faith, and he should be just and faithful in his dealings with the other partners. Good faith requires that a partner should not deceive the other partners by concealment of material facts e.g. a partner should not try to make secret profits, for himself, at the expense of the firm.

2. **Duty to carry on the firm business to the greatest common advantage:**

Every partner is bound to carry on the business of the firm to the greatest common advantage. He must use his knowledge and skill for the common benefit of the firm. And he should not make any personal or private profits.

3. **Duty to render true accounts:**

It is another duty of every partner that he should keep proper accounts, and render correct and true accounts of partnership.

4. **Duty to give full information:**

It is also the duty of every partner that he should give full information of all things affecting the firm, to his co-partners. Thus, if a partner is in possession of more information about the affairs and assets of the firm, he should not conceal that from the other partners.

5. **Duty to indemnify for loss caused by fraud :**

It is the duty of every partner to make good the loss suffered by the firm due to his fraud. Thus, if some loss is caused to the firm due to the fraud of a particular partner, the firm has the right to recover the loss from the same partner. It is an absolute duty and cannot be excluded by an agreement to the contrary.

However, the firm shall remain liable to the third parties for fraud of its partners.

6. **Duty to attend diligently:**

It is the duty of every partner that he should diligently (i.e., carefully) attend to the affairs of the business of the firm. If a partner does not attend diligently the business of the firm, and the firm suffers a loss due to his 'willful neglect', then he is bound to make compensation to the firm.

7. **Duty to share losses:**

It is the duty of every partner to share equally the losses suffered by the firm. However, this duty is subject to an agreement to the contrary i.e., the partners may agree to share the losses in different proportions. However this duty might be restricted by way of an agreement.

8. **Duty to account for personal profits:**

This duty is based on the principle of good faith, which requires that a partner shall not make personal profits at the expense of the firm. If a partner makes personal profits in any of the following ways, he must give account of those profits and pay back the same to the firm:

(a) Personal profits from any transaction of the firm.

- (b) Personal profits from the use of the property of the firm.
- (c) Personal profits from the business connection of the firm.
- (d) Personal profits from the use of the name of the firm.

However, the above duty is subject to a contract between the partners i.e., by a contract, the partners may allow/all or any of them to earn personal profits by using firm name, property etc.

However, the above duty is subject to a contract between the partners i.e., by a contract, the partners may allow all or any of them to carry on any business whether or not competing with the business of the firm.

10. Duty to use firm property exclusively for firm:

It is the duty of every partner to use the partnership property exclusively for the business of the firm. Thus, the partners should use the partnership property for the firm's business only. This duty is also subject to an agreement to the contrary.

11. Duty to act within authority:

It is the duty of every partner that he should act within the scope of actual or implied authority.

• **PROPERTY OF THE FIRM :**

Definition:

Section 14 of the Partnership Act provides:

Subject to contract between the partners, the property of the firm includes:

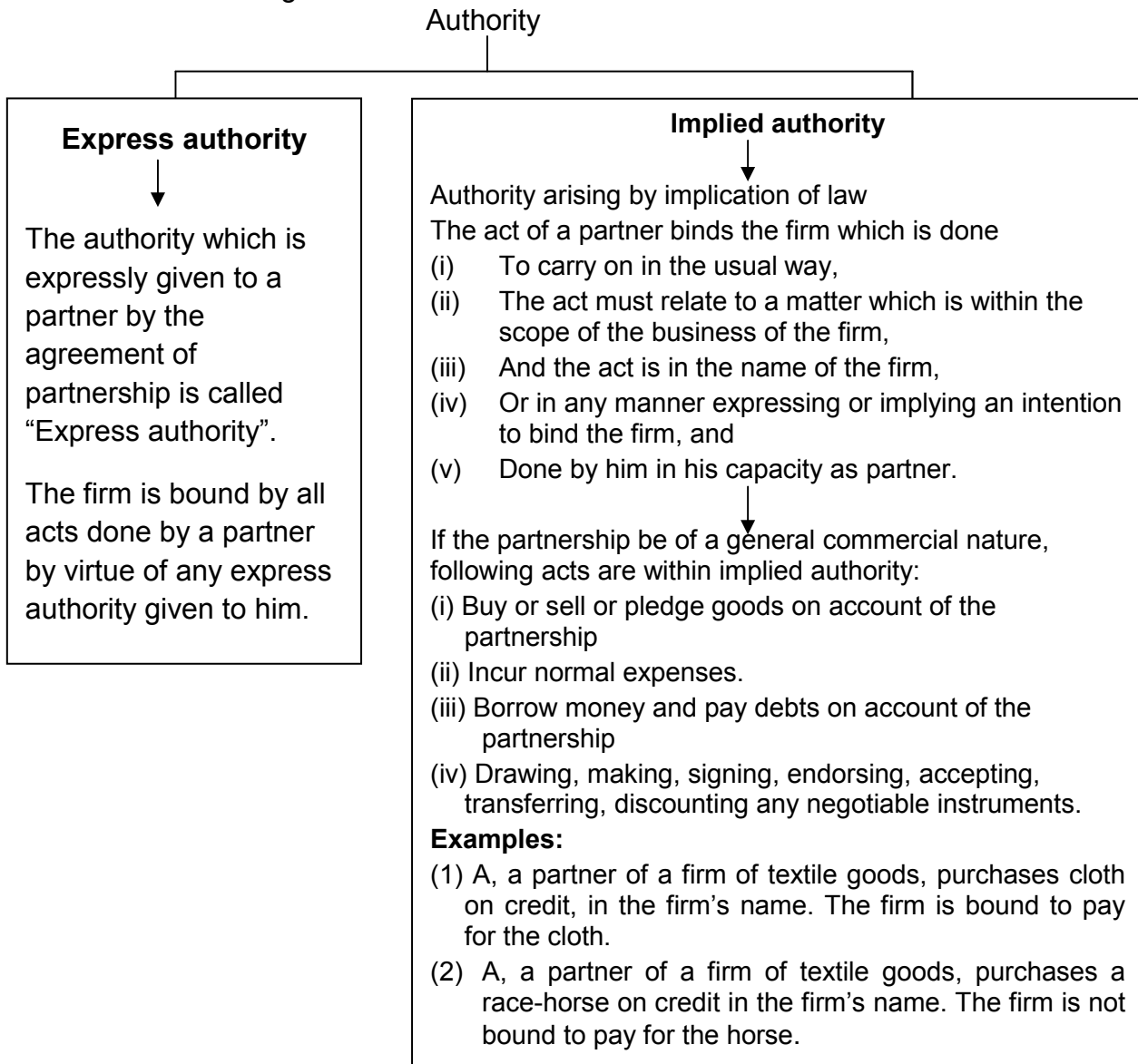
- (1) All property and rights and interest in property
 - ❖ Originally brought into the stock of the firm, or
 - ❖ Acquired, by purchase or otherwise, by or for the firm,
 - ❖ Or for the purposes and in the course of the business of the firm, and
- (2) Includes also the goodwill of the business.

• **THE AUTHORITY OF A PARTNER:**

- ❖ Partner to be agent of the firm:

“Subject to the provisions of this Act, a partner is the agent of the firm for the purposes of the business of the firm.”

- ❖ Authority : Authority means the right of a partner to bind the firm by his own acts. The authority of a partner to act on behalf of the firm can be divided into two categories:



- ❖ **Limitations of Partner's Implied Authority :**
In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to
 - Submit a dispute relating to the business of the firm to arbitration,
 - Open a banking account on behalf of the firm in his own name,
 - Compromise or relinquish any claim or portion of a claim by the firm,
 - Withdraw a suit or proceeding filed on behalf of the firm,
 - Admit any liability in a suit or proceeding against the firm,
 - Acquire immovable property on behalf of the firm.
 - Transfer immovable property belonging to the firm, or
 - Enter into partnership on behalf the firm.
- ❖ **Alteration of Authority :**
The partners in a firm may, by contract between the partners, extend or restrict the implied authority of any partner.

❖ **Authority in an emergency:**

A partner has authority, in an emergency, to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm.

❖ **Admission/Representation by a partner :**

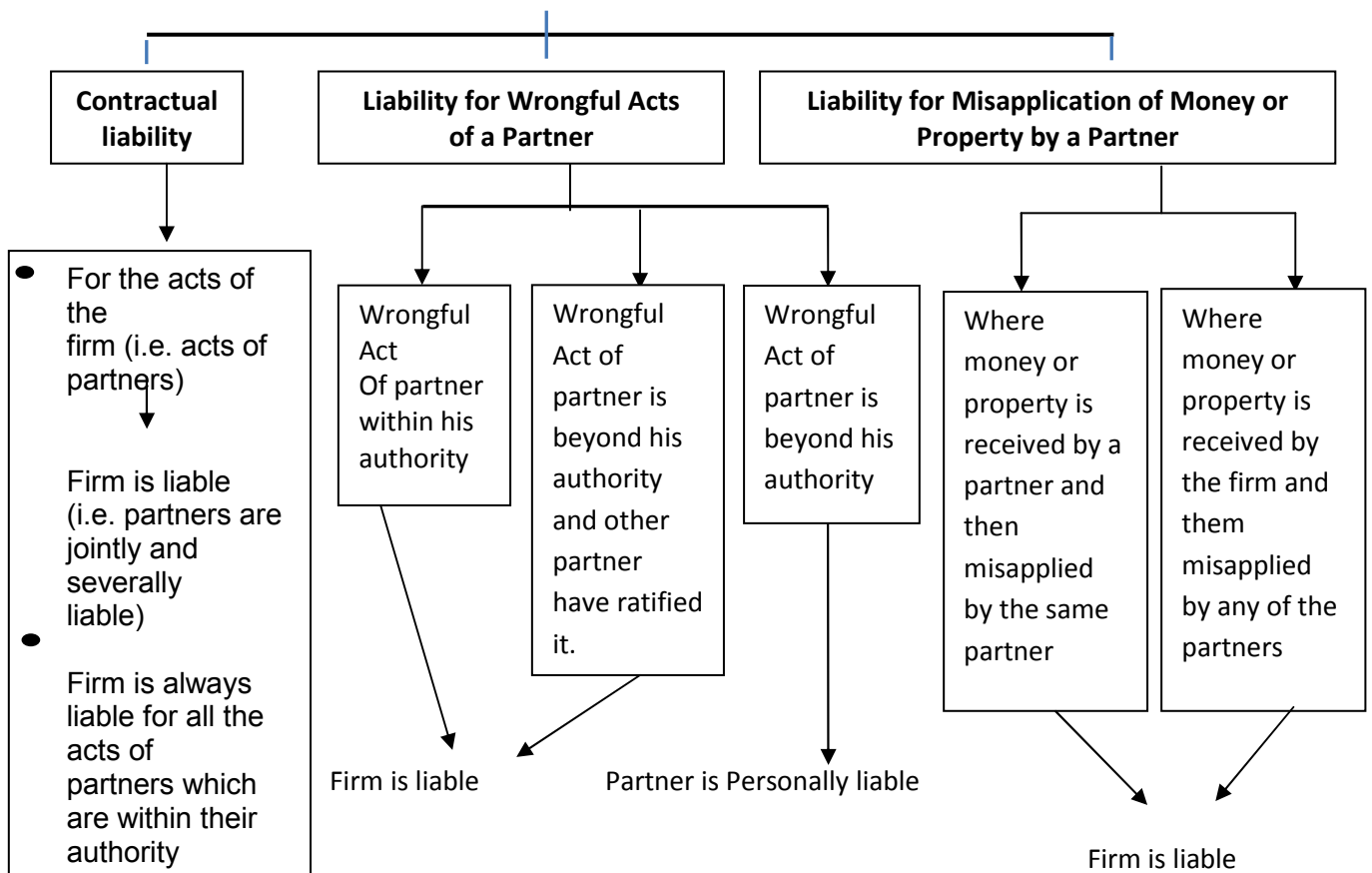
An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary of course of business.

❖ **Notice to the Acting Partner :**

Notice to a partner who habitually acts in the business of the firm of any matter relating to the affairs of the firm operates as notice to the firm, except in the case of a fraud on the firm committed by or with the consent, of that partner.

❖ **LIABILITY OF A FIRM AND ITS PARTNERS TO A THIRD PARTY**

This liability may be discussed under the following heads:

• **RECONSTITUTION OF A FIRM**

The reconstitution of a firm means a change in the constitution i.e., composition of the firm and it takes place in the following cases:

- (1) Admission of a new partner.
- (2) Retirement of a partner.
- (3) Expulsion of a partner.
- (4) Insolvency of a partner.

- (5) Death of a partner.
- (6) Transfer of a partner's interest
- (7) Revocation of continuing guarantee

(1) Admission of a Partner

- ❖ A newly admitted partner is known as 'incoming partner'.
- ❖ A new partner can be admitted into an existing firm in any of the following ways :
 - (a) With the consent of all the partners.
 - (b) In accordance with a contract already entered into between the partners for the admission of a new partner.
- ❖ The liability of an incoming partner may be discussed as under :
 - 1. Liability for the acts of the firm done before admission:
An incoming partner is not liable for the acts of the firm done before his admission into the firm. Thus, he is not liable for the past debts of the firm.
 - 2. Liability for the acts of the firm done after admission:
As a matter of fact, the liability of an incoming partner starts from the date of his admission into the firm. Thus, he is liable for all the acts of the firm done after he became a partner in the firm.
 - 3. If the incoming partner agrees to bear the past liabilities, then for past liabilities he shall not be liable to third parties as he is a stranger to contract but he shall be liable to other partners.

(2) Retirement of a Partner

- ❖ A partner may also retire from an existing firm. The partner who retires from an existing firm is known as a 'retiring partner' or an 'outgoing partner'.
- ❖ A partner may retire from the firm in anyone of the following three modes :
 - (a) By consent. A partner may retire, at any time with the consent of all other partners.
 - (b) By agreement. The partners may enter into an express agreement about the retirement of a partner. In such cases, a partner may retire according to the terms of the agreement.
 - (c) By notice. In case of partnership at will, a partner may retire by given a written notice of retirement to all other partners.
- ❖ The liability of a retiring partner may be discuss as under :
 - 1. Liability for the acts of the firm done before retirement:
A retiring partner continues to be liable to third parties for the acts of the firm done before his retirement.
 - 2. Liability for the acts of the firm done after retirement:
A retiring partner also continues to be liable to third parties for the acts of the firm done even after his retirement until a public notice of his retirement is given This liability of a retiring partner is based on the principle of 'holding out'.

(3) Expulsion of a Partner

- ❖ A partner cannot be ordinarily expelled from the firm.
- ❖ However, in certain exceptional cases, he can be expelled by following a prescribed procedure.

He can be expelled only if the following conditions are satisfied:

- (a) The power of expulsion should be given to the partners by an express contract between them.
- (b) The power of expulsion should be exercised by majority of partners.
- (c) The power of expulsion should be exercised in absolute good faith.

The test of good faith includes three things :

- (1) That the expulsion must be in the interest of the partnership
- (2) That the partner to be expelled is given a notice to that effect
- (3) That he was given an opportunity of being heard.

- ❖ If these conditions are not fulfilled the expulsion is null and void and the expelled partner can demand re-instatement in the firm
- ❖ An expelled partner continues to be liable to third parties for the acts of the firm done even after his retirement until a public notice of his retirement is given.
- ❖ The public notice can be given either by the expelled partner himself or by the firm.

RIGHTS OF AN OUTGOING PARTNER:

The rights of an outgoing partner are as follows:

1) To carry on competing business :

An outgoing partner may carry on a business, but it can be restricted by an agreement (below mentioned).

However he cannot:

- (a) Use the firm name.
- (b) Represent himself as carrying on the business of the firm, or
- (c) Solicit the customers of the old firm.

Restraint of trade agreement:

A partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within a specified period or within specified local limits, such agreement shall be valid if the restrictions imposed are reasonable (Section 27 of the Indian Contract Act, 1872).

2) To share subsequent profits:

If settlement of accounts is not yet done, then,

OR

Right of outgoing partner to share subsequent profits Right to claim interest @ 6%

(3) Insolvency of a Partner

- ❖ The partner declared an insolvent, ceases to be a partner on the date on which the order of adjudication is made.
- ❖ The firm is dissolved on the date of the order of insolvency unless there is a contract to the contrary.
- ❖ The estate of the insolvent is not liable for any act of the firm after the (date of the order of insolvency).
- ❖ The firm cannot be held liable for any acts of the insolvent partner after the date of the order of insolvency.

(4) Death of a Partner

- ❖ The firm is automatically dissolved on the death of a partner. However, the partners may specifically provide in their agreement that the firm shall not be dissolved, and the remaining partners shall continue the firm's business.
- ❖ Where the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any acts of the firm which are done after his death

(5) Transfer of Partner's Interest:

- ❖ A partner can transfer his share only with the consent of other partners.
- ❖ The transferee thereby does not become a partner of the firm,
- ❖ A transferee of a partner's interest cannot do the following, during the continuance of the partnership
 - (i) Interfere in the conduct of the business; or
 - (ii) Inspect or take a copy of accounts
- ❖ On the dissolution of the firm, the transferee will be entitled,
 - (i) To receive the share of the assets of the firm to which the transferring partner was entitled, and
 - (ii) For the purpose of ascertaining the share, he is entitled to an account as from the date of the dissolution.

(7) Revocation of continuing guarantee:

A continuing guarantee given to a firm, or to a third party in respect of the transaction of a firm, is in the absence of agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.

UNIT 3 : DISSOLUTION OF FIRM

- **DISSOLUTION OF PARTNERSHIP**

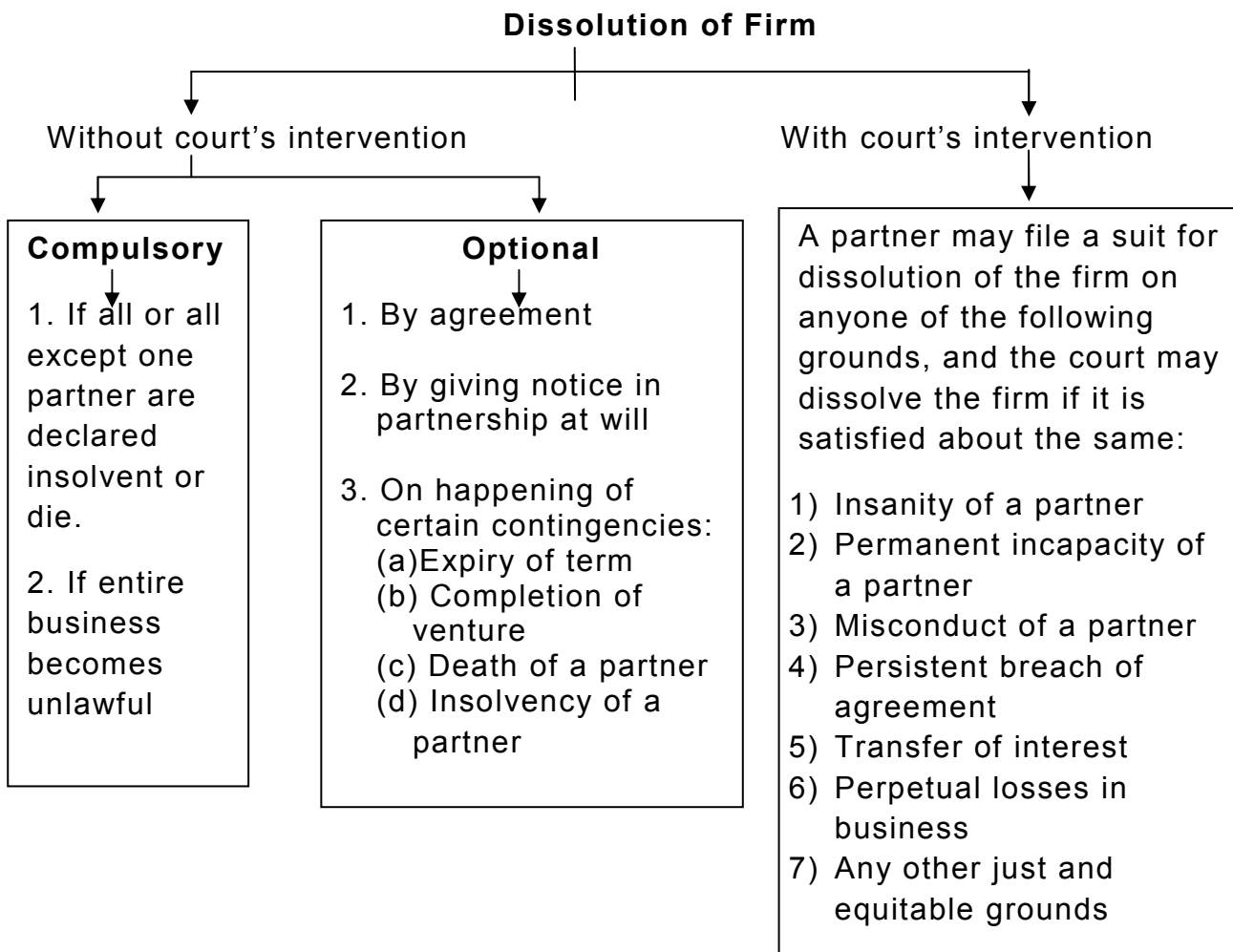
The term 'dissolution of partnership' may be defined as a change in the relations of partners, and not the extinction of relationship. In this case, the firm as a whole is not closed down. But only the relations between some of the partners come to an end, and the remaining partners continue to carry on the business of the firm. Thus, the 'dissolution of firm' is different from 'dissolution of partnership.'

Example :

A, B and C were partners in a firm. A retires. Only the partnership between A, B and C is dissolved and a new partnership between B and C comes into existence. The new firm is called the 'reconstituted firm'. Thus, only the relations between the partners are changed on A's retirement.

- **DISSOLUTION OF FIRM**

When the firm as a whole is closed down, it is called the dissolution of the firm. Thus, in case of dissolution of the firm, the business of the firm is stopped and the relations between all the partners come to an end.



(A) DISSOLUTION WITHOUT THE INTERVENTION OF COURT

A firm may be dissolved without the intervention of the court i.e., without going to the Court of Law. The dissolution without the intervention of the court may take place in any of the following ways:

1. Compulsory dissolution:

In the following cases, the firm is compulsorily dissolved even if there is a contrary contract between the partners i.e., even if the partners agree that the firm shall not be dissolved in such cases.

(a) Insolvency/death of all the partners:

Where all the partners of the firm become insolvent/death, the firm is dissolved. The firm is also dissolved when all the partners except one have become insolvent/died. The reason for the same is that when a partner is declared as insolvent by the court, he ceases to be a partner from the date of the order of insolvency.

(b) Business of the firm becoming unlawful :

Where an event happens which makes the business of the firm unlawful, the firm is also dissolved. This includes the cases where the business of the firm is rendered unlawful by the outbreak of war, or where the object for which the firm was formed becomes unlawful or illegal, or where the business remains lawful but it is forbidden to be carried on in partnership.

2. Optional dissolution:

(a) Dissolution by agreement between the partners:

A firm may also be dissolved in accordance with a contract between the partners in the same way as a firm is formed with the contract between the partners. There may be a separate contract for the dissolution of the firm, or it may also be contained in the partnership deed itself.

(b) Dissolution by notice:

A firm can also be dissolved by any partner by giving a notice of dissolution to the other partners where the partnership firm is 'at will'.

(c) Dissolution on the happening of certain contingencies:

On the happening of anyone of the following contingencies (i.e., events), the firm is automatically dissolved.

(i) Expiry of fixed term:

Where the firm is constituted for a fixed term, the firm is dissolved on the expiry of that term. This is, however, subject to a contract to the contrary i.e., if the contract provides that the firm shall not be dissolved, then it will not be dissolved.

(ii) Completion of the adventure or undertaking:

Where the firm is constituted to carry out one or more adventure or undertaking, the firm is dissolved on the completion of such adventure or undertaking. This is also subject to a contract to the contrary.

(iii) Death of a partner:

Sometimes, one of the partners of a firm dies during the continuance of the firm. In such cases, the firm is dissolved on the death of the partner. This is subject to a contract to the contrary.

(iv) Insolvency of a partner:

Sometimes, one of the partners of a firm is declared as insolvent by the court. In such cases the firm is dissolved from the date of the order of insolvency. This is also subject to a contract to the contrary.

(B) DISSOLUTION WITH THE INTERVENTION OF COURT

Sometimes, a partner wants that the firm should be dissolved. But the other partners may not agree to the dissolution. In such cases, he can go to Court of Law, and file a suit for dissolution of the firm. A partner may like to have the firm dissolved for various reasons. It may, however, be noted that the court has the discretion to pass an order of dissolution i.e., the court may not allow the dissolution of the firm. A partner may file a suit for dissolution of the firm on anyone of the following grounds, and the court may dissolve the firm if it is satisfied about the same:

1. Insanity of a partner:

Sometimes, a partner becomes insane i.e., of unsound mind. In such cases, the court may allow the dissolution of the firm. The suit for dissolution of the firm may be filed by anyone of the partners other than the partner who has become insane. The suit may also be filed by the next friend (i.e., legal representative) of the insane partner.

2. Permanent incapacity of a partner:

Sometimes, a partner becomes permanently incapable of performing his duties. In such cases also, the court may allow the dissolution of the firm. The suit for dissolution of the firm may be filed by anyone of the partners other than the partner who has become incapable.

3. Misconduct of a partner:

Where a partner is guilty of misconduct, the court may allow the dissolution of the firm. The suit for dissolution of the firm may be filed by anyone of the partners other than the partner who is guilty of misconduct.

4. Persistent breach of agreement:

Sometimes, a partner willfully or persistently (i.e., frequently) commits a breach of agreements relating to the management of the affairs of the firm, or conducts the partnership business in such a way that the other partners find it difficult to carry on the partnership business with him. In such cases, the court may allow the dissolution of the firm. The suit for dissolution of the firm may be filed by anyone of the partners other than the partner who commits the breach of agreements. Keeping erroneous accounts and not entering receipts, continuing quarrelling between the partners, refusal to meet on matters of business, taking away books of the firm, and misappropriations of income etc., are held to be sufficient ground for dissolution of a firm.

5. Transfer of interest:

Where a partner transfers the whole of his interest or share to a third party, the court may allow the dissolution of the firm. The court may also allow the dissolution when the entire share of a partner is attached or sold by an order of the court. The suit for dissolution of the firm may be filed by anyone of the partners other than the partner who has transferred his interest or share.

6. Perpetual losses in business:

Where the business of a firm cannot be carried on, except at a loss, the court may allow the dissolution of the firm. The suit for dissolution of the firm may be filed by anyone of the partner. When the court is satisfied that the business of a firm cannot be carried on, except at a loss, it may pass an order of dissolution of the firm.

7. Other just and equitable grounds:

A firm may also be dissolved by the court on any 'other just and equitable ground'. A 'just and equitable ground', is a ground which is fair and reasonable according to the opinion of the court.

• **CONSEQUENCES OF DISSOLUTION**

1. Liabilities for the acts done after dissolution:

On the dissolution of a firm, partners have to give a public notice of the dissolution. If it is not given, the partners shall remain liable to the third party for their acts done even after the dissolution of the firm

2. Continuing Authority for Winding Up:

On the dissolution of a firm, the authority of each partner to bind the firm continues for the following purpose:

- (a) If it is necessary to wind up the affairs of the firm, and
- (b) If it is necessary to complete the transactions started but not completed at the time of dissolution.

3. Partner's Right for Utilisation of Assets

On the dissolution of the firm, each partner is entitled to the following rights:

- (a) He is entitled to have the property of the firm utilised in payment of its debts and liabilities.
- (b) He is entitled to have the surplus distributed among all the partners according to their rights.

The surplus here means the surplus amount left after the payment of all the debts and liabilities of the firm.

4. Mode of Settlement of Accounts :

After the dissolution of a firm, the accounts of the firm are settled according to the terms of partnership. If there is no specific agreement, then the accounts are settled according to the following fundamental rules contained in the Indian Partnership Act.

A. Payment of losses:

The losses of the firm, including the deficiencies of capitals shall be paid in the following manner and order:

- (a) First of all, the losses shall be paid out of the profits.
- (b) If the profits, are not sufficient to pay the losses, then the balance of loss shall be paid out of capital, and
- (c) If still some balance of losses remains, it shall be paid by the partners individually in the proportion in which they were entitled to share profits.

B. Utilization of assets:

The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be utilised in the following manner and order:

- (a) First of all, the assets shall be utilized in paying the **debts of the firm to the third parties.**
- (b) If there is any surplus, the same shall be utilized in paying each partner the **amount of loan advanced** to the firm other than the capital. This is done in proportion to the advances made by the partners.
- (c) If there is still any surplus, the same shall be utilized in paying each partner towards the **amount of his capital.** This is done in proportion to the amount of capital contributed by the partners.
- (d) If there is still any surplus, the same shall be **divided among all the partners** in proportion to their share in the profits of firm.

5. Payment of firm's debts and Partner's Private Debts:

- 1) Firm's property shall be applied first in payment of firm's debts then the surplus, if any, shall be applied for payment of partner's private debts to the extent in which the concerned partner is entitled to the surplus.
- 2) Partner's private property shall be applied first in the payment of his debts and the surplus, if any, shall be used in payment of firm's debts.

6. Return on premium of partnership's premature dissolution:

- ❖ In the case of dissolution of partnership earlier than the period fixed for it, the partner paying the premium is entitled to the return of the premium of such part thereof as may be reasonable except when the partnership is dissolved:
 - (i) By the death of one of the partners;
 - (ii) When the dissolution is mainly due to the misconduct of the partner who paid the premium
 - (iii) The dissolution is according to an agreement which had no provision for the return of premium or any part thereof.

7. Treatment of Loss Arising due to Insolvency of a Partner:

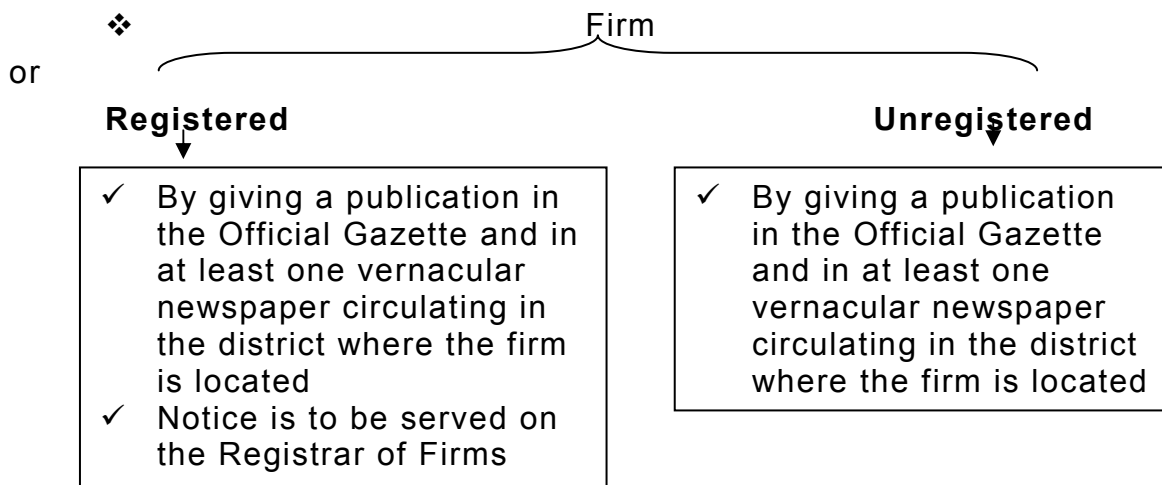
Unless otherwise agreed it requires that:

- 1) The solvent partners should bring in cash equal to their shares of the loss on realization
- 2) The solvent partners should bear the loss arising due to the insolvency of a partner in the ration of their Last Agreed Capitals.

8. Rights of a partner in case of Dissolution on Account of Fraud and Misrepresentation:

- 1) He has a right of lien on the surplus assets after the payment of firm's debts, for any sum paid by him for purchase of a share in the firm
- 2) He is entitled to rank as a creditor of the firm in respect of any payment made by him towards firm's debts
- 3) He is entitled to be indemnified by the partner guilty of fraud or misrepresentation against all the debts of the firm

- **MODE OF GIVING PUBLIC NOTICE**



- ❖ **When public notice is required to be given**

- a) On retirement or expulsion of a partner
- b) On the dissolution of the firm
- c) On the election to become or not to become a partner by a minor on attaining his majority.

When a public notice is not required

- a) On the death of a partner
- b) On the insolvency of partner

SUMMARY

UNIT 1: NATURE OF PARTNERSHIP

- INTRODUCTION
 - ❖ It came into force on 1st October, 1932.
 - ❖ It is applicable to whole of India except Jammu & Kashmir.
 - ❖ Prior to the passing of the Act, the law of partnership was included in Charter XI of the Indian Contract Act.
 - ❖ Where the Partnership Act is silent on any point, the general principles of the law of contract apply. The partnership is a specialized branch of the Contract Act.

- PARTNERSHIP

- PARTNER & FIRM
- ESSENTIAL ELEMENTS OF PARTNERSHIP
 1. It is an association of two or more persons
 2. There must be an agreement
 3. There must be business.
 4. Sharing of Profits:
 5. Mutual Agency

- DISTINCTION BETWEEN
 1. Partnership and HUF
 2. Partnership and Co-ownership
 3. Partnership and Company
 4. Partnership and Club

- TYPES OF PARTNERS
 1. Active/Actual Partner
 2. Sleeping or Dormant Partner
 3. Nominal Partner
 4. Partner for profits only
 5. Sub-Partner
 6. Partner by Holding Out or by Estoppel
 7. Incoming Partner
 8. Outgoing Partner

- TYPES OF PARTNERSHIP
 1. Particular Partnership
 2. Partnership at will

- REGISTRATION OF FIRM
- MINOR'S POSITION IN PARTNERSHIP FIRM

UNIT 2: Relation Of Partners

- RIGHTS OF PARTNERS

- DUTIES OF PARTNERS

- PROPERTY OF THE FIRM
- AUTHORITY OF A PARTNER
- LIABILITY OF A FIRM AND ITS PARTNERS TO A THIRD PARTY
- RECONSTITUTION OF A FIRM
 - (1) Admission of a new partner
 - (2) Retirement of a partner
 - (3) Expulsion of a partner
 - (4) Insolvency of a partner
 - (5) Death of a partner
 - (6) Transfer of a partner's interest
 - (7) Revocation of continuing guarantee

UNIT 3: DISSOLUTION OF FIRM

- DISSOLUTION OF PARTNERSHIP
- DISSOLUTION OF FIRM
- CONSEQUENCES OF DISSOLUTION
- MODE OF GIVING PUBLIC NOTICE

QUESTIONS

1. Explain the provisions of the Indian Partnership Act, 1932 relating to the creation of Partnership by holding out.
 2. What is the true test of partnership?
 3. Enumerate the differences between Partnership and Joint Stock Company.
 4. What do you mean by "implied authority" of the partners in a firm?
 5. State the rules of admission of partner.
 6. What are the rights of outgoing partner.
 7. Whether a minor may be admitted in the business of a partnership firm? Explain the rights of a minor in the partnership firm.
 8. What is the procedure of registration of a partnership firm under the Indian Partnership Act, 1932? What are the consequences of non-registration?
 9. When does dissolution of a partnership firm take place under the provisions of the Indian Partnership Act, 1932? Explain.
-

ADDITIONAL CASE LAW BASED QUESTIONS:

UNIT 1: GENERAL NATURE OF PARTNERSHIP

- Q.1.** X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. After expiry of credit period, Z did not get amount of T.V sets sold to the partnership firm. Z filed a suit against X and A for the recovery of price. Will he succeed?
- Q.2.** A partnership firm consisting of A, B and C as partners was formed and it commenced its business before getting itself registered. The firm filled a suit against X for a claim of Rs.5000 for goods supplied to him and immediately after filling the suit, the firm was registered. Will court consider the suit?

UNIT - 2: RELATIONS OF PARTNERS

- Q.1.** A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. Was A bound to account to the firm for the profit so made by him?
- Q.2.** A, B and C are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly. A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C. Considering the provisions of Indian Partnership Act, 1932 state whether they can expel a partner from the firm?
- Q.3.** A, B and C are partners in a manufacture of machinery. A is entitled to three-eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. Can A's official receiver demand any share?

UNIT - 3: DISSOLUTION OF FIRM

- Q. 1.** X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution. In such a case, who is liable to R?

ANSWERS

UNIT 1: GENERAL NATURE OF PARTNERSHIP

Ans.1. As per section 28 of Indian Partnership act, 1932, partnership by holding out/estoppel is where a man holds himself out as a partner, or allows others to do it, he is then stopped from denying the character he has assumed and upon the faith of which creditors may be presumed to have acted. A person may himself, by his words or conduct might have induced others to believe that he is a partner or he may have allowed others to represent him as a partner. The result in both the cases is identical.

In the given question, X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. The Manager is also liable for the price because he becomes a partner by holding out.

Therefore, Z will succeed.

Ans.2. Section 69 of The Indian Partnership Act, 1932 specifies that an unregistered firm cannot file a suit against any third party to enforce a right arising from a contract. This clause does not prohibit an unregistered firm to enter into contract with third parties; the bar is only against taking action against third parties. However, the third parties are free to take action against unregistered partnership.

In the given question, partnership firm consisting of A, Band C as partners was formed and it commenced its business before getting itself registered. The firm filled a suit against X for a claim of Rs.5000 for goods supplied to him and immediately after filling the suit, the firm was registered.

When the firm filed a suit, it was unregistered, so subsequent registration will not make any difference.

Therefore, court will not consider the suit.

UNIT - 2: RELATIONS OF PARTNERS

Ans.1. According to section 16 of Indian Partnership Act, 1932, subject to contract between the partners,-

- (a) If a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;
- (b) If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

In the given question, A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. A has made personal profit.

Therefore, A is bound to account to the firm for the profit so made by him

Ans.2. According to section 33 of Indian Partnership Act, 1932, a partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by contract between the partners. It is, thus, essential that:

- (i) The power of expulsion must have existed in a contract between the partners;
- (ii) The power has been exercised by a majority of the partners; and
- (iii) It has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bonafide interest of the business of the firm.

In the given question, spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly. A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C.

Thus, according to the test of good faith as required under Section 33, expulsion of Partner B is not valid.

Ans.3. According to section 37 of Indian Partnership Act, 1932, where any member of a firm has died or otherwise ceased to be partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm.

In the given question, A is entitled to three-eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate.

Therefore, A's official receiver is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

UNIT - 3: DISSOLUTION OF FIRM

Ans.1. As per provisions of Indian Partnership Act, 1932, on dissolution of a firm, the partners continue to be liable as such to third parties for any act done by any of them which would have been an act of the firm if done before the dissolution, until public notice is given of the dissolution.

In the given question, X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution.

Therefore, X & Y both shall be liable for the amount because no public notice was given.

CHAPTER 4 - THE LIMITED LIABILITY PARTNERSHIP ACT, 2008

• BACKGROUND AND AIM OF THE ACT

- The Parliament passed the Limited Liability Partnership Bill on 12th December, 2008 and the President of India has assented the Bill on 7th January, 2009 and called as the Limited Liability Partnership Act, 2008, and many of its sections got enforced from **31st March 2009**.
- This Act have been enacted to make provisions for the formation and regulation of Limited Liability Partnerships and for matters connected there with or incidental thereto.
- The LLP Act, 2008 has **81 sections and 4 schedules**.
- The **First Schedule** deals with **mutual rights and duties of partners**, as well limited liability partnership and its partners where there is absence of formal agreement with respect to them.
- The **Second Schedule** deals with **conversion of a firm into LLP**.
- The **Third Schedule** deals with **conversion of a private company into LLP**.
- The **Fourth Schedule** deals with **conversion of unlisted public company into LLP**.
- The Ministry of Corporate Affairs (MCA) and the Registrar of Companies (ROC) are entrusted with the task of administrating the LLP Act, 2008. The Central Government has the authority to frame the Rules with regard to the LLP Act, 2008, and can amend them by notifications in the Official Gazette, from time to time.
- It is also to be noted that **'The Indian Partnership Act, 1932 is not applicable to LLPs**.
- **Need of new form of Limited Liability Partnership:**

A need has been felt for a new corporate form that would provide an alternative to the traditional partnership with unlimited personal liability on the one hand and the statute-based governance structure of the limited liability company on the other hand, in order to enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.

It provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form enables entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements.

• MEANING OF LLP

- A LLP is a new form of legal business entity with limited liability.
- The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of the partners will be limited.
- Since LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure' LLP is called a hybrid between a company and a partnership.

➤ **CHARACTERISTICS OF LLP**

Following are the characteristics of a LLP:

1. **LLP is a body corporate:** Section 3 of LLP Act provides that a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
2. **Perpetual Succession:** The LLP can continue its existence irrespective of changes in partners. Death, insanity, retirement or insolvency of partners has no impact on the existence of LLP. It is capable of entering into contracts and holding property in its own name.
3. **Separate Legal Entity:** The LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. In other words, creditors of LLP shall be the creditors of LLP alone.
4. **Mutual Agency:** Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct. In other words, all partners will be the agents of the LLP alone. No one partner can bind the other partner by his acts.
5. **LLP Agreement:** Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners. The LLP Act, 2008 provides flexibility to partner to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act, 2008.
6. **Artificial Legal Person:** A LLP is an artificial legal person because it is created by a legal process and is clothed with all rights of an individual. It can do everything which any natural person can do, except of course that, it cannot be sent to jail, cannot take an oath, cannot marry or get divorce nor can it practice a learned profession like CA or Medicine. A LLP is invisible, intangible, immortal (it can be dissolved by law alone) but not fictitious because it really exists.
7. **Common Seal:** A LLP being an artificial person can act through its partners and designated partners. LLP may have a common seal, if it decides to have one [Section 14(c)]. Thus, it is not mandatory for a LLP to have a common seal. It shall remain under the custody of some responsible official and it shall be affixed in the presence of at least 2 designated partners of the LLP.
8. **Limited Liability:** Every partner of a LLP is, for the purpose of the business of LLP, the agent of the LLP, but not of other partners (Section. 26). The liability of the partners will be limited to their agreed contribution in the LLP.
9. **Management of Business:** The partners in the LLP are entitled to manage the business of LLP. But only the designated partners are responsible for legal compliances.
10. **Minimum and Maximum number of Partners:** Every LLP shall have least two partners and shall also have at least 2 individuals as designated partners, of whom at least one shall be resident in India. There is no maximum limit on the partners in LLP.

11. **Business for Profit Only:** The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit. Thus LLP cannot be formed for charitable or non-economic
12. **Investigation:** The Central Government shall have powers to investigate the affairs of an LLP by appointment of competence authority for the purpose.
13. **Compromise or Arrangement:** Any compromise or arrangement including merger and amalgamation of LLPs shall be in accordance with the provisions of the LLP Act, 2008.
14. **Conversion into LLP:** A firm, private company or an unlisted public company would be allowed to be converted into LLP in accordance with the provisions of LLP Act, 2008.
15. **E-Filing of Documents:** Every form or application of document required to be filed or delivered under the act and rules made thereunder, shall be filed in computer readable electronic form on its website www.mca.gov.in and authenticated by a partner or designated partner of LLP by the use of electronic or digital signature.
16. **Foreign LLPs:** Section 2(1)(m) defines foreign limited liability partnership "as a limited liability partnership formed, incorporated, or registered outside India which established a place of business within India". Foreign LLP can become a partner in an Indian LLP.

➤ **INCORPORATION OF LLP**

- Essential elements to incorporate LLP - Under the LLP Act, 2008, the following elements are very essential to form a LLP in India:
- (i) To complete and submit incorporation document in the form prescribed with the Registrar electronically;
 - (ii) To have at least two partners for incorporation of LLP [Individual or body corporate];
 - (iii) To have registered office in India to which all communications will be made and received;
 - (iv) To appoint minimum two individuals as designated partners who will be responsible for number of duties including doing of all acts, matters and things as are required to be done by the LLP. At least one of them should be resident in India.
 - (v) A person or nominee of body corporate intending to be appointed as designated partner of LLP should hold a Designated Partner Identification Number (DPIN) allotted by MCA.
 - (vi) To execute a partnership agreement between the partners inter se or between the LLP and its partners. In the absence of any agreement the provisions as set out in First Schedule of LLP Act, 2008 will be applied.
 - (vii) LLP Name.

- Limited Liability Partnerships are bodies corporate and must be registered with the Registrar of LLP after following the provisions specified in the LLP Act, in a similar way of setting up a company with distinct name. The LLP cannot have the same name with any other LLP, Partnership Firm or Company.

To create a LLP proper formation documents must be filed with the registrar along with the necessary filing fees.

- **Process:**

Deciding partners and designated partners

Obtaining DPIN and Digital Signature Certificate (DSC)

Checking the availability of names

The applicant has to file e-Form1, for ascertaining availability and reservation of the name of a LLP business (upto 6 choices can be indicated)

Drafting of LLP Agreement

Contents of LLP Agreements:

1. Name of LLP
2. Name & address of Partners & Designated Partners.
3. Form of contribution & interest on contribution
4. Profit sharing ratio
5. Remuneration of Partners
6. Rights & Duties of Partners
7. Proposed Business
8. Rules for governing LLP.

Electronic filing of some documents

After reserving a name, user has to file e-Form2 for incorporating a new LLP. e-Form2 contains the details of LLP proposed to be incorporated, partners and designated partners details and consent of the partners and designated partners to act as and designated partners

Issuing Certificate of Incorporation along with LLPIN (Limited Liability Partnership Identification Number) Execution of LLP Agreement is mandatory as per Section 23 of the Act. LLP Agreement is required to be filed with the registrar in e-Form3 within 30 days of incorporation of LLP

• **DIFFERENCES WITH OTHER FORMS OF ORGANISATION**

- Distinction between LLP and Partnership Firm: The points of distinction between a limited liability partnership and partnership firm are tabulated as follows:

	Basis	LLP	Partnership firm
1.	Regulating Act	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
2.	Body corporate	It is a body corporate.	It is not a body corporate.
3.	Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4.	Creation	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.
5.	Registration	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary. Only the registered partnership firm can sue the
6.	Perpetual succession	The death, insanity, Retirement or insolvency of the partner(s) does not affect its existence of LLP. Members may join or leave But its existence continues	The death, insanity retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7.	Name	Name of the LLP to contain the word limited liability partners (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8.	Liability	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.
9.	Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10.	Designated partners	At least two designated partners and atleast one of them shall be resident in	There is no provision for such partners under the Indian partnership Act, 1932.
11.	Common seal	It may have its common seal as its official signatures.	There is no such concept in partnership
12.	Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13.	Annual filing documents	LLP is required to file: (a) Annual statement of accounts (b) Statement of solvency (c) Annual return with the registration of LLP every year.	Partnership firm is not required to file any annual document with the registrar of firms.
14.	Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a
15.	Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the Benefits of the partnership with the prior consent of the existing partners.

Distinction between LLP and Limited Liability Company (LLC)

	Basis	LLP	LLC
1.	Regulating Act	The LLP Act, 2008.	The Companies Act, 2013.
2.	Members / Partners	The persons who contribute to LLP are known as partners of the LLP.	The persons who invest the money in the shares are known as members of the company.
3.	Internal governance structure	The internal governance structure of a LLP is governed by agreement between the partners.	The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).
4.	Name	Name of the LLP to contain the word "Limited liability partnership" or "LLP" as suffix.	Name of the public company to contain the word "limited" and Private company to contain the word "Private"
5.	Number of members/ partners	Minimum - 2 members Maximum - No such limit on the members in the Act. The members of the LLP can be individuals/or body corporate through the nominees.	Private company: Minimum - 2 members Maximum - 200 members Public company: Minimum - 7 members Maximum - No such limit on the members.
6.	Liability of members/ partners	Liability of a partners is limited to the extent of agreed contribution except in case of willful fraud.	Liability of a member is limited to the amount unpaid on the shares held by them.
7.	Management	The business of the company managed by the partners including the designated partners authorized in the agreement.	The affairs of the company are managed by board of directors elected shareholders.
8.	Minimum number of directors/ partners	Minimum 2 partners.	Private Co. - 2 directors Public Co. - 3 directors

• **QUESTIONS**

1. Examine the concept of LLP.
2. Enumerate the various characteristics of the LLP.
3. State the necessities required for incorporation of the LLP.
4. Distinguish between LLP and Partnership
5. Explain the process of incorporation of LLP.

CHAPTER 5 - THE COMPANIES ACT, 2013

- **BACKGROUND AND AIM OF THE ACT**

- It came into existence at once from the date of notification in the Official Gazette i.e., from **30th August, 2013**, however, the remaining provisions of the Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act.
- It extends to the **whole of India**.
- Structure of the Act: The Companies Act, 2013 has 470 Sections (covered in 29 Chapters) and 7 Schedules as against 658 Sections (covered in 13 Parts) and 15 Schedules of the Companies Act, 1956.
 - a. To promote the development of the economy by encouraging entrepreneurship and enterprise efficiency and creating flexibility and simplicity in the formation and maintenance of companies;
 - b. To encourage transparency, accountability and high standards of corporate governance;
 - c. To recognize various new concepts and procedures facilitating convenience of doing business while protecting interests of all the stakeholders;
 - d. To enforce stricter action against fraud and gross non-compliance with company law provisions;
- Purpose/ Objective of the Act :
 - e. To set up institutional structure in the form of various authorities, bodies and panels as well as by including recognition of various roles for professionals and other experts; and
 - f. To cater to the need for more effective and time bound approvals and compliance requirements relevant in the present context.

- **MEANING OF COMPANY**

The word '**company**' is derived from the Latin words (**com= with or together; and panis = bread or meal**); and originally referred to an association of persons who took their meals together.

- **DEFINITION OF COMPANY**

The term 'company' has been defined under Section 2(20) of the Companies Act, 2013. As per this, '**company**' means a company incorporated under Companies Act, 2013 or under any of the previous laws relating to companies.

It may be noted the term 'Company' shall be used in the sense as defined above for the entire Companies Act, 2013, unless the context otherwise requires.

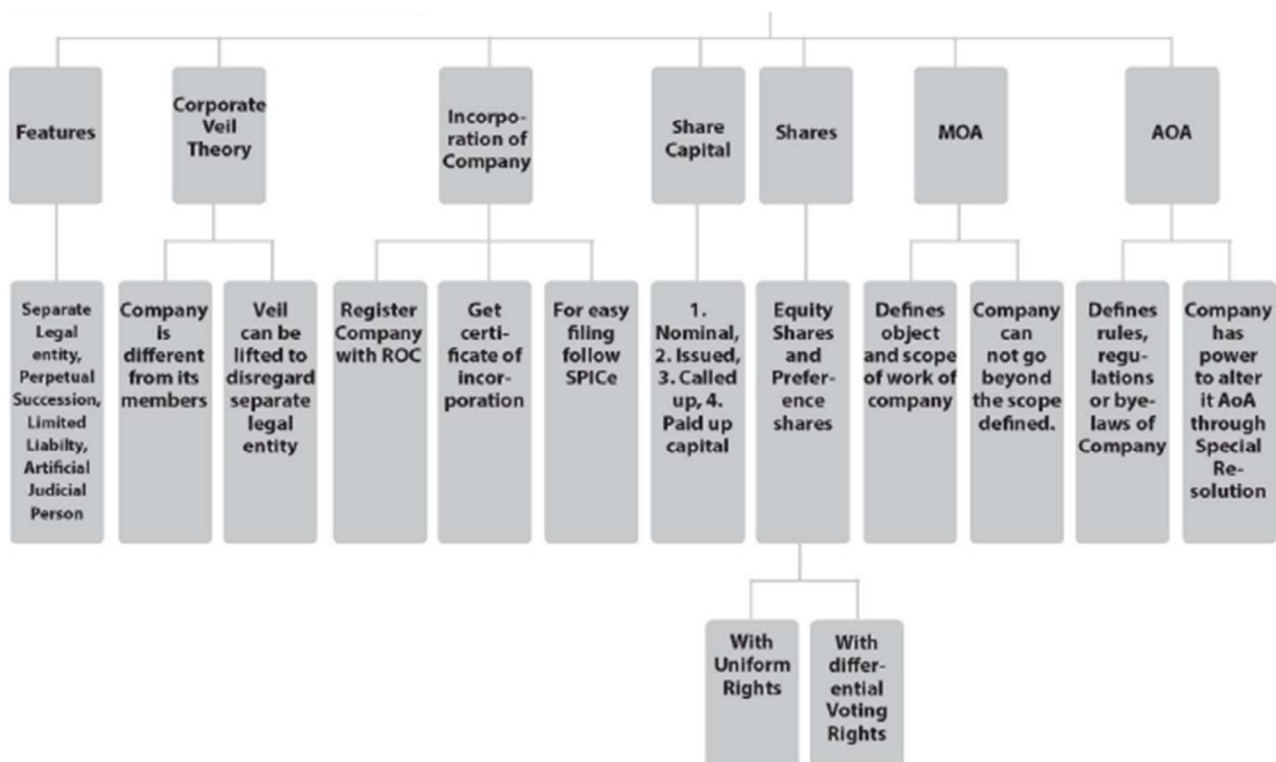
- **ACT APPLICABLE TO:**

The provisions of this Act shall apply to-

1. Companies incorporated under this Act or under any previous company law.
2. Insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;
3. Banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;
4. Companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;
5. Any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act, and
6. Such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification. Example: Food Corporation of India (FCI), National Highway Authority of India (NHAI) etc.

For example: ABC Ltd. was incorporated on 1.1.1912 under the Indian Companies Act, 1882. So, the Companies Act, 2013 shall also be applicable on ABC Ltd.

OVERVIEW OF CHAPTER



- **CHARACTERISTICS OF COMPANY**

Following are the characteristics of a company:

1. **Separate legal entity:** A company is an artificial person having a personality which is distinct from the members constituting it. Thus, a company has got an

entity which is separate from its members. And since this separate entity concept is conferred by law, it is said that a company has got a separate legal entity.

1. Salomon v. Salomon & Co. Ltd.

Salomon had, for some years, carried on a prosperous business as a leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife and a daughter, and his 4 sons as the shareholders, all of whom subscribed for one share of 1 pound each. Salomon was the managing director and two of his sons were other directors.

Salomon sold his business (which was perfectly solvent at that time) to the Company for the sum of **38,782 £**. He got the following consideration:-

10,000	Secured Debentures of 1£ each
20,000	Fully - paid Shares of 1 £ each
8,782	Cash

The company soon ran into difficulties and the debenture holders appointed a receiver and the company went into liquidation. The total assets of the company amounted to 6,050£, its liabilities were 10,000£ secured debentures and 8,000£ owing to unsecured trade creditors. The unsecured trade creditors claimed the whole of the company's assets, viz. 6,050 £ on the ground that as the company was a mere agent for Salomon and thus they were entitled to payment of their debts in priority to debentures.

The House of Lords rejected these contentions and held that a company, on registration, has its own existence or personality separate and distinct from its members and, as a result, a shareholder cannot be equated with a company, even if he holds virtually the entire share capital of the company.

2. **Limited liability:** A company limited by shares is a registered company having the liability of its members limited to the amount, if any, unpaid on the shares respectively held by them. If his shares are fully paid - up, he has nothing more to pay.
 - (i) Thus, in the case of a limited liability company, the debts of the company in totality do not become the debts of the shareholders. The liability of the members of the company is limited to the extent of the nominal value of shares held by them. In no case can the shareholders be asked to pay anything more than the unpaid value of their shares.
 - (ii) In the case of a company limited by guarantee, the members are liable only to the extent of the amount guaranteed by them and that too only when the company goes into liquidation.
 - (iii) However, if it is an unlimited company, the liability of its members is unlimited as well.
3. **Perpetual Succession:** An incorporated company never dies. Perpetual succession, therefore, means that the membership of a company may keep changing from time to time but does not affect its continuity. Members may come and go but the company will continue forever.
4. **Separate Property:** No member can claim himself to be the owner of the company's properties either during its existence or in its winding up. A member does not even have an insurable interest in the property of the company.

Macaura vs. Northern Assurance Co. Ltd.

M was the holder of nearly all the shares except one of a timber company. He was also a substantial creditor of the company. He insured the company's timber in his own name. The timber was destroyed by fire & M claimed the loss from Insurance Company.

Held that: The Insurance Company was not liable to him. A shareholder cannot insure the company's property in his own name even if he is the owner of all or most of the company's shares.

5. **Transferability of Shares:** The capital of a company is divided into parts called shares. The shares are said to be movable property and subject to certain conditions, freely transferable for that. No shareholder is permanently or necessarily wedded to a company. It may be noted that this right of shareholder is restricted in the case of a private company.
 6. **Common Seal:** Since a company has no physical existence, it must act through its agents. All the important documents of a company must be under the seal of the company. The common seal, thus, acts as the official signature of a company. The Companies (Amendment) Act, 2015 has made the common seal optional by omitting the words "and a common seal" from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. Rational for this amendment is that common seal is seen as a relic of medieval times. **This amendment provides that the documents which need to be authenticated by a common seal will be required to be so done, only if the company opts to have a common seal. In case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.**
 7. **Capacity to sue and be sued:** A company, being a body corporate, can sue and be sued in its own name.
 8. **Separate Management:** The members of a company may derive profits without being burdened with the management of the company. The company is administered and managed by its own managerial personnel.
 9. **Voluntary Association for Profit:** A company is a voluntary association for profit. It is formed for the accomplishment of some public goals and whatsoever profit is gained is divided among its shareholders.
- **IS COMPANY A CITIZEN?**
Although, a company is regarded as a legal person (though artificial), it is not a citizen either under the Constitution of India or the Citizenship Act, 1955.
 - **HAS COMPANY A NATIONALITY AND RESIDENCE?**
It is established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence.

- **LIFTING OR PIERCING THE CORPORATE VEIL**

- **Corporate veil:** It refers to a separate legal existence enjoyed by the company which is distinct from people who own & manage it. It is an artificial curtain created by law which separates the company from the people who own and manage it.
- **Effect of corporate veil:** Only company is liable for the acts/defaults done in name of company, even though directors/employees acted on behalf of company.
- **Lifting of corporate veil:** It means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade. Where the Courts ignore the company and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the **Courts shall lift the corporate veil.**

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

1. **Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations.**

Gilford Motor Co. v. Home

In, a former employee of a company covenanted not to solicit its customers. He formed a company to carry on his business and it undertook the solicitation. An injunction was granted against him and the company to restrain them.

2. **For determining residence and character :** The Courts also look behind the facade of the company and its place of registration in order to determine its residence for the purposes of taxation or the character of the company, for example whether it is enemy.

Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.

C company was floated in London for marketing tyres manufactured in Germany. The majority of the C's shares were held by German nationals residing in Germany. During World War I, C company filed a suit against D company for the recovery of trade debt. The D company contended that C company was an alien enemy company (Germany being at war with England at that time) and that the payment of the debt would be trading with the enemy. The court agreed with the contention of the defendants.

3. **Formation of Companies to divide income and avoid tax or avoid any welfare laws:**

1. *Sir Dinshaw Maneckjee Petit*

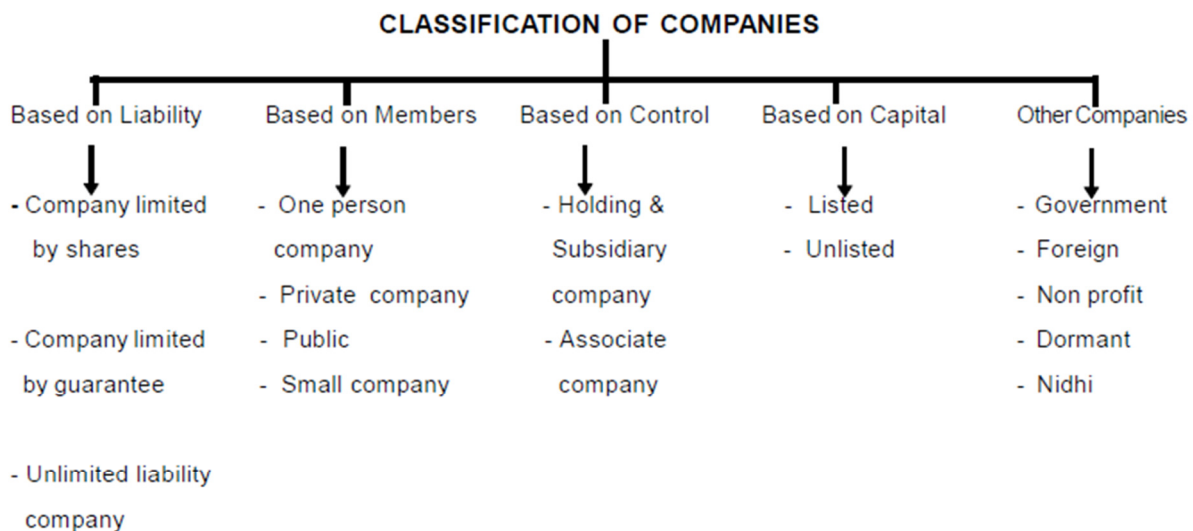
D was a rich man having dividend and interest income. He wanted to avoid income-tax. For this purpose, he formed four private companies, in all of which he was the majority share holder. The companies made investments and whenever interest and dividend income were received by the companies, D applied to the companies for loans, which were immediately granted and he never repaid. In a legal proceeding the corporate veil of all the companies were lifted and the income of the companies treated as if they were of 'D'.

2. Workmen employed in Associated Rubber Industries Ltd v. Associated Rubber Industries Ltd

A subsidiary company was formed wholly by the holding company with no assets of its own except those transferred to it by the holding company, with no business or income of its own except receiving dividend from shares transferred to it by the holding company. Court held that the new company was formed as a device to reduce the profits of the holding company and thereby reduce the bonus to workmen.

4. Where companies form other companies as their subsidiaries to act as their agent.**Merchandise Transport Limited vs. British Transport Commission (1982)**

Transport Company wanted to obtain licences for its vehicles, but could not do so if applied in its own name. It, therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the parent and the subsidiary were one commercial unit and the application for licences was rejected.

CLASSIFICATION OF COMPANY**A. BASED ON LIABILITY**

1. Company limited by shares: As per Section 2(22), A company limited by shares is a registered company having the liability of its members limited to the amount, if any, unpaid on the shares respectively held by them. If his shares are fully paid - up, he has nothing more to pay.

2. Company limited by guarantee:

➤ As per Section 2(21), a company limited by guarantee or a "guarantee company" is a company having the liability of its members limited to such an

amount as the members may respectively thereby undertake, by the memorandum of association of the company, to contribute to the assets of the company.

- A special feature of this type of company is that the liability of members to pay their guaranteed amounts arises only when the company has gone into liquidation and not when it is a going concern.
- Clubs, trade associations and societies for promoting different objects are examples of companies limited by guarantee.
- A **guarantee company without share capital** does not obtain its initial and working funds, from its members, but from some other source or sources e.g. grants, endowments, fees, subscriptions and the like.
- But a **guarantee company having a share capital** raises its initial capital from its members, while the normal working funds would be provided from other sources, such as fees, charges, subscriptions.

If a guarantee company has share capital, the shareholders have two-fold liability; to pay the amount which remains unpaid on their share whenever called upon to pay, and secondly, to pay the amount payable under the guarantee when the company goes into liquidation. The voting power of a guarantee company having a share capital is determined by the shareholding and not by the guarantee.

3. Unlimited Company:

- As per Section 2(92), unlimited company is a company not having any limit on the liability of its members. In such a company the liability of a member ceases when he ceases to be a member.
- Thus, the maximum liability of the members of such a company could extend to their entire personal property to meet the debts and obligations of the company.
- The members of an unlimited company are not liable directly to the creditors of the company, unlike in the case of partners of a firm. The liability of the members is only towards the company, so long it is a going concern; and in the event of its being wound up, only the Liquidator can ask the members to contribute to the assets of the company.

B. BASED ON MEMBERS

1. Private Company:

- As per Section 2(68), private company is a company which by its articles,—
 - (i) restricts the right to transfer its shares;
 - (ii) limits the number of its members to two hundred (except in case of One Person Company):

The clause provides that where two or more persons hold one or more shares in a company jointly, they shall be treated as a single member:

However following shall not be included in the number of members:

- ◆ persons who are in the employment of the company; and

- ◆ persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased.
- (iii) prohibits any invitation to the public to subscribe for any securities of the company.
- There should be at least two persons to form a private company i.e., the minimum no. of members in a private company is two. A private company should have at least two directors. The name of a private limited company must end with the words "Private Limited".

2. Public Company:

- As per Section 2(71), public company is a company which-
 - ◆ is not a private company
 - ◆ Seven or more members are required to form the company.
 - ◆ a private company which is a subsidiary of a public company shall also be deemed to be a public company for the purposes of this Act, even where such subsidiary company continues to be a private company in its articles (three restrictions).
- There should be at least seven persons to form a public company i.e., the minimum no. of members in a public company is seven. A public company should have at least three directors. The name of a public limited company must end with the word "Limited".

3. One Person Company:

- **Definition:** As per Section 2(62), one person company is a company which-
One Person Company' means a company which has only one person as a member.
It is basically a private company with some unique features.
As regards the name of a One Person Company, the Act provides that the words "One Person Company" or 'OPC' shall be mentioned in brackets below the name of such Company, wherever its name is printed, affixed or engraved.
- In the case of India, if you wish to set up a private company, minimum two shareholders are required. In many cases, because of this legal requirement a second shareholder is forcefully roped in. This second shareholder at times takes advantage of his position. Having recognized this problem the concept of OPC has been introduced.
- **Important points:**
 - ◆ Only one person as member.
 - ◆ Minimum paid up capital - no limit prescribed.
 - ◆ The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
 - ◆ The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation.
 - ◆ Such other person may be given the right to withdraw his consent.

- ◆ The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar.
- ◆ Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
- ◆ Only a natural person who is an Indian citizen and resident in India (person who has stayed in India for a period of not less than 182 days during the immediately preceding one calendar year)-
 - shall be eligible to incorporate a OPC;
 - shall be a nominee for the sole member of a OPC.
- ◆ No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
- ◆ No minor shall become member or nominee of the OPC or can hold share with beneficial interest.
- ◆ Such Company cannot be incorporated or converted into a company under section 8 of the Act. Though it may be converted to private or public companies in certain cases.
- ◆ Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporate.
- ◆ OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of incorporation, except where the paid up share capital is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.
- ◆ If One Person Company or any officer of such company contravenes the provisions, they shall be punishable with fine which may extend to ten thousand rupees and with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

Basis of difference	Private company	OPC
Incorporation	Requires 2 or more persons	1 person alone
Number of members	2 members	1 member only

4. Small Company:

- **Definition:** As per Section 2(85), small company means a company, **other than a public company**, -
 - (i) paid-up share capital of which **does not exceed fifty lakh rupees** or such higher amount as may be prescribed which shall not be more than five crore rupees;
 - and
 - (ii) turnover of which as per its last profit and loss account **does not exceed two crore rupees** or such higher amount as may be prescribed which shall not be more than twenty crore rupees:
- **Provided that nothing in this clause shall apply to--**
 - (i) a holding company or a subsidiary company;
 - (ii) a company registered under section 8; or
 - (iii) a company or body corporate governed by any special Act.

It is basically a private company meeting prescribed threshold.

C. BASED ON CONTROL**1. Holding & Subsidiary Company**

A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies.

[Section 2(46)]

Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

For the purposes of this section —

- (I) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (II) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- (III) the expression "company" includes anybody corporate;
- (IV) "layer" in relation to a holding company means its subsidiary or subsidiaries.

2. Associate company

- As per Section 2(6), In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
- The term "significant influence" means control of at least 20% of total share capital, or of business decisions under an agreement
- The term "Total Share Capital", means the aggregate of the - paid-up equity share capital; and convertible preference share capital.
- This is a new definition inserted in the 2013 Act.

D. BASED ON CAPITAL**1. Listed company:**

As per the definition given in the section 2(52), it is a company which has any of its securities listed on any recognised stock exchange.

2. Unlisted company: Means a company other than listed company.**E. OTHER COMPANIES****1. Government Company**

- As per Section 2(45), government company means any company in which not less than fifty- one per cent. of the paid-up share capital is held by-
 - (i) the Central Government, or
 - (ii) by any State Government or Governments, or
 - (iii) partly by the Central Government and partly by one or more State Governments,
- And the section includes a company which is a subsidiary company of such a Government company;

2. Foreign Company

As per Section 2(42), foreign company means any company or body corporate incorporated outside India which-

- (i) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (ii) conducts any business activity in India in any other manner

3. Company not for profit/Non-Profit companies

- Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members.

Examples of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

- **Power of Central government to issue the license-**

Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit. The registrar shall on application register such person or association of persons as a company under this section.

On registration the company shall enjoy same privileges and obligations as of a limited company.

- **Revocation of license:** The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

- **Order of the Central Government:** Where a licence is revoked there the Central Government may, in the Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members.

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- **Order of the Central Government:** Where a licence is revoked there the Central Government may, in the public interest order that the company registered under this section should be amalgamated with another company registered under this section having similar objects, to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order, or the company be wound up.
- **Penalty/punishment in contravention:** If a company makes any default in complying with any of the requirements laid down in this section, the company shall, be punishable with fine varying from ten lakh rupees to one crore rupees and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine varying from twenty- five thousand rupees to twenty-five lakh rupees, or with both and where it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447 which deals with Fraud.

4. **Dormant company:**

- Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.
- "Significant accounting transaction" means any transaction other than—
 - (i) payment of fees by a company to the Registrar;
 - (ii) payments made by it to fulfil the requirements of this Act or any other law;
 - (iii) allotment of shares to fulfil the requirements of this Act; and
 - (iv) payments for maintenance of its office and records.

5. **Nidhi company:**

As per Section 406, a company which has been incorporated as a nidhi with the object of cultivating the habit of thrift (cost cutting) and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefits and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

6. Public financial institutions

As per Section 2(72), following institutions are to be regarded as public financial institutions.

- (i) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956;
- (ii) the Infrastructure Development Finance Company Limited,
- (iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;
- (iv) institutions notified by the Central Government under section 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act;
- (v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless—

- (A) it has been established or constituted by or under any Central or State Act; or
- (B) not less than fifty-one per cent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

- **MODE OF REGISTRATION/ INCORPORATION OF COMPANY**

PROMOTERS: Persons who form the company are known as promoters. It is they who conceive the idea of forming the company. They take all necessary steps for its registration. It should, however, be noted that persons acting only in a professional capacity e.g., the solicitor, banker, accountant etc. are not regarded as promoters.

The Companies Act, 2013 defines the term "Promoter" under section 2(69) which means a person—

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

- **INCORPORATION OF COMPANIES**

[SECTION 7 READ WITH COMPANIES (INCORPORATION) RULES, 2014]

Following is the procedure, in brief, for the incorporation of a company:-

I. Selection of the type of company: The promoters of a company may however select the type of a company as they wish to form themselves into viz, One person company, private company, public company, non-profit company, etc.

II. Preliminary Requirements:

All the directors of the proposed company must ensure that they are having Director's Identification Number (DIN). Out of all the directors of the proposed company, at least one director should have digital signature to digitally sign the incorporation and other related documents.

III. Reservation of Name:

Any of the promoters should apply to the Registrar of Companies (ROC) regarding the reservation of name.

IV. Preparation of the Memorandum of Association and Articles of Association:

Drafting of the MOA and AOA is generally a step subsequent to the reservation of name made by the Registrar. MOA and AOA shall be in the respective forms as specified in Schedule -1. It should be noted that the main objects must be matched with the objects shown in e-Form INC.1. These two documents are basically the charter and internal rules and regulations of the company. Therefore, it must be drafted with utmost care and with the advice of the experts and the ancillary clause for attainment of the main object clause should be drafted in a very broader sense.

V. Filing of the documents with the Registrar of Companies:

An application shall be filed, with the Registrar of Companies within whose jurisdiction the registered office of the company is proposed to be situated, in **Form No. INC.2 (for One Person Company) and Form no. INC.7 (other than One Person Company) along with the following documents**, along with the fee as provided in the **Companies (Registration offices and fees) Rules, 2014** for registration of a company, within 20 days from the date of intimation regarding the reservation of name :-

The memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as prescribed under the Companies (Incorporation) Rules, 2014;

- (b) **a declaration in the prescribed Form INC.8** by an advocate or chartered accountant or cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;
- (c) **an declaration in Form INC-9** by each of the subscribers to the memorandum and by all the persons named as the first directors, if any, in the articles that they are not convicted of any offence in connection with the promotion, formation or management of any company, or that they has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of their knowledge and belief;
- (d) **The address for correspondence** till its registered office is established;
- (e) Certain **prescribed particulars of every subscriber** to the memorandum along with proof of identity;
- (g) The **particulars of the interests** of the persons mentioned in the articles as the first directors of the company in other firms
- (h) Verification of the location of the registered office.

VI. Certificate of Incorporation and allotment of Corporate Identity Number:

If the Registrar of Companies is satisfied that everything has been complied with in regard to incorporation of companies, he shall issue a certificate of incorporation in Form No. INC.11, normally within 7 days of the receipt of documents, to the company signed & dated under his hand.

The date of registration of a company is the date mentioned in the certificate and not that date on which the signature of the Registrar was written.

VII. Effect of Registration [Sec. 9]:

Section 9 provides that from the date of incorporation, the subscribers become the members of the company. The company shall be a body corporate with a name, capable of exercising all the functions of an incorporated company under this Act and shall have perpetual succession with power to acquire, hold and dispose of property, to contract, to sue and be sued, by the said name.

VIII. Commencement of Business [Sec. 11]:

A company (both public and private) having a share capital shall not commence any business or exercise any borrowing powers, unless the following documents are filed with the ROC:

- (i) a declaration by a director in the prescribed form that every subscriber to the memorandum has paid the value of shares taken by him (minimum five lakh rupees for public company and minimum one lakh rupees for private company); and
- (ii) The verification of its registered office.

Where no declaration has been filed with the Registrar within a period of 180 days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on business or operations, he may remove the name of the company from the register of companies.

Order of the Tribunal :

Where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants,—

- (a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or
- (b) direct that liability of the members shall be unlimited; or
- (c) direct removal of the name of the company from the register of companies; or
- (d) pass an order for the winding up of the company; or
- (e) pass such other orders as it may deem fit:

Provided that before making any order,—

- ◆ the company shall be given a reasonable opportunity of being heard in the matter; and
- ◆ the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

• **SIMPLIFIED PROFORMA FOR INCORPORATING COMPANY ELECTRONICALLY (SPICe)**

The Ministry of Corporate Affairs has taken various initiatives for ease of business. MCA has simplified the process of filing of forms of incorporation of company through Simplified Proforma For Incorporating Company ELECTRONICALLY (SPICe)

- MEMORANDUM OF ASSOCIATION

- “Fundamental Document”

- Memorandum of Association is the fundamental condition upon which alone is allowed to incorporate.

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| Definition and Meaning of Memorandum:
Section 2(56) of the Companies Act, 2013. | "memorandum" means memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act. |
|--|---|

Memorandum of association is a document, which contains the fundamental provisions of the company's constitution. It defines as well as confines the powers of the company. It not only shows the objects of formation but also determines the utmost possible scope of its operations beyond which its action cannot go.

Purpose of Memorandum:	The purpose of memorandum is two-fold. 1. The Prospective shareholder who contemplates the investment of his savings, should know the field in, or the purpose for which it is going to be used and what risk he is taking in making the investment. 2. Outsiders or Creditors dealing with the company will know without reasonable doubt whether the contractual relation into which he contemplates entering with the company is one relating to a matter within its corporate objects.
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Form of Memorandum [Section 4]:	<ul style="list-style-type: none"> • Table A is applicable to companies limited by shares; • Table B is applicable to companies limited by guarantee and not having a share capital; • Table C is applicable to the companies limited by guarantee and having a share capital; • Table D is applicable to unlimited companies and not having a share capital; • Table E is applicable to unlimited companies and having a share capital.
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- The memorandum must be printed, divided into paragraphs, numbered consecutively, and signed by at least seven persons (two in the case of a private company and one in the case of One Person Company) in the presence of at least one witness, who will attest the signatures.
- The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation etc., must also be entered.
- It is to be noted that a company being a legal person can through its agent, subscribe to the memorandum. However, a minor cannot be a signatory to the memorandum as he is not competent to contract. The guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.
- The Memorandum of Association of a company cannot contain anything contrary to the provisions of the Companies Act. If it does, the same shall be devoid of any legal effect. Similarly, all other documents of the company must comply with the provisions of the Memorandum.

- **Contents of Memorandum:** Section 4 of the Companies Act provides that the memorandum of association of every company must contain the following clauses:-

<p>1. Name clause</p>	<ul style="list-style-type: none"> • The first clause in the memorandum must state the name by which a company is known. • The name of the company with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act. • The name including phrase 'Electoral Trust' may be allowed for Registration of companies to be formed under section 8 of the Act, in accordance with the Electoral Trusts Scheme, 2013 notified by the Central Board of Direct Taxes (CBDT). For the Companies under section 8 of the Act, the name shall include the words foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust and will constitute an offence under any law.
<p>2. Situation or registered office clause</p>	<ul style="list-style-type: none"> • The name of the State in which the registered office of the company is to be situated must be given in the memorandum. But the exact address of the registered office is not required to be stated therein.
<p>3. Object clause</p>	<ul style="list-style-type: none"> • The objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof; • If any company has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities after complying with all the provisions as applicable to change of name.
<p>4. Liability Clause:</p>	<p>The liability of members of the company, whether limited or unlimited, and also state,—</p> <ul style="list-style-type: none"> • in the case of a company limited by shares, that the liability of its members is limited to the amount unpaid, if any, on the shares held by them; and • in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute— <ul style="list-style-type: none"> ✓ to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case maybe; and ✓ to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;
<p>5. Capital Clause (only in the case of a company having a share capital):</p>	<p>The amount of authorized capital divided into share of fixed amounts and the number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.</p>

6. Association Clause and Subscription:	<p>In this clause, the persons (includes a body corporate) subscribing to the memorandum declare their desire to be formed into a company and agree to take the shares indicated opposite their respective names.</p> <p>Following are the statutory requirements regarding subscription of memorandum:-</p> <p>(i) The memorandum must be signed by each subscriber in the presence of at least one witness who must attest the signatures;</p> <p>(ii) Each subscriber must take at least one share; if any and</p> <p>(iii) Each subscriber must write opposite his name the number of shares (if any) which he agrees to take.</p>
7. Succession Clause (only in the case of OPC):	<ul style="list-style-type: none"> • This clause shall state the name of the person who, in the event of the death of the subscriber, shall become the member of the company. • The above clauses are compulsory and are designated by the Companies Act as "conditions", on the basis of which alone a company is incorporated.

The above clauses of the Memorandum are called compulsory clauses, or "Conditions". In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

• ARTICLES OF ASSOCIATION

Definition and Meaning of Articles Section 2(5) of the Companies Act, 2013	'articles' means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act.
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The articles of a company are its bye — laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles of a company are sub—ordinate to and are controlled by the memorandum of association. The memorandum lays down the scope and powers of the company and the articles govern the ways in which the objects of the company are to be carried out. It may be noted that Companies Act, 2013 makes it compulsory for every company to have its own articles and file the same with ROC for registration.

Section 5 of the Companies Act, 2013 seeks to provide the contents and model of articles of association. The section lays the following law-

- (1) **Contains regulations:** The articles of a company shall contain the regulations for management of the company.
- (2) **Inclusion of matters:** The articles shall also contain such matters, as are prescribed under the rules. However, a company may also include such additional matters in its articles as may be considered necessary for its management.
- (3) **Contain provisions for entrenchment:** The articles may contain provisions for entrenchment (to protect something) to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with.
- (4) **Manner of inclusion of the entrenchment provision:** The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

- (5) **Notice to the registrar of the entrenchment provision:** Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.
- (6) **Forms of articles:** The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.
- (7) **Model articles:** A company may adopt all or any of the regulations contained in the model articles applicable to such company.
- (8) **Company registered after the commencement of this Act:** In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

The following are the key differences between the Memorandum of Association vs. Articles of Association:

1. **Objectives:** Memorandum of Association defines and delimits the objectives of the company whereas the Articles of association lays down the rules and regulations for the internal management of the company. Articles determine how the objectives of the company are to be achieved.
2. **Relationship:** Memorandum defines the relationship of the company with the outside world and Articles define the relationship between the company and its members.
3. **Alteration:** Memorandum of association can be altered only under certain circumstances and in the manner provided for in the Act. In most cases permission of the Regional Director, or the Tribunal is required. The articles can be altered simply by passing a special resolution.
4. **Ultra Vires:** Acts done by the company beyond the scope of the memorandum are ultra-vires and void. These cannot be ratified even by the unanimous consent of all the shareholders. The acts ultra-vires the articles can be ratified by a special resolution of the shareholders, provided they are not beyond the provisions of the memorandum.

- **EFFECT OF MEMORANDUM AND ARTICLES:**

As per section 10 of the Companies Act, 2013, where the memorandum and articles when registered, shall bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and an agreement to observe all the provisions of the memorandum and of the articles. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

- **DOCTRINE OF ULTRA VIRES**

- The meaning of the term 'ultra vires' is 'beyond the powers of'. Anything which is outside the specified objects and powers or not reasonably incidental to or necessary for the attainment of objects of the company is ultra vires the company and therefore is void.
- No rights and liabilities, on the part of the company, arise out of such transactions and it remains nullity even if every member assents to it.
- Consequently, an act, which is ultra vires the company, does not bind the company and neither the company nor the other contracting party can sue on it.

- An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company. Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

Ashbury Railway Carriage and Iron Company Limited v. Riche-(1875).

The facts of the case are:

The main objects of a company were:

- (a) To make, sell or lend on hire, railway carriages and wagons;
- (b) To carry on the business of mechanical engineers and general contractors.
- (c) To purchase, lease, sell and work mines.
- (d) To purchase and sell as merchants or agents, coal, timber, metals etc.

The directors of the company entered into a contract with Riche, for financing the construction of a railway line in Belgium, and the company further ratified this act of the directors by passing a special resolution. The company however, repudiated the contract as being ultra-vires. And Riche brought an action for damages for breach of contract. His contention was that the contract was well within the meaning of the word general contractors and hence within its powers. Moreover it had been ratified by a majority of shareholders.

However, it was held by the Court that the contract was null and void. It said that the terms general contractors was associated with mechanical engineers, i.e. it had to be read in connection with the company's main business. If, the term general contractor's was not so interpreted, it would authorize the making of contracts of any kind.

• **DOCTRINE OF CONSTRUCTIVE NOTICE**

- When the memorandum and articles of association of a company are registered, they become public documents and are open to inspection by anyone on payment of nominal fee. Hence, every person dealing with the company is under an obligation to know the contents of these documents.
- Whether a person reads the documents or not, he is presumed to have knowledge of the contents of the documents. He is not only presumed to have read the documents but also understood them in their true perspective, Thus, if a person enters into a contract which is beyond the powers of the company as defined in the memorandum, or outside the authority of directors as per memorandum or articles, he cannot acquire any rights under the contract against the company.

• **DOCTRINE OF INDOOR MANAGEMENT**

- While persons dealing with a company are presumed to have read the public documents and understood their contents and ascertain that the transaction is not inconsistent therewith, they are entitled to assume that the PROVISIONS of the articles have been observed by the officers of the company. It is no part of the duty of an outsider to see how the company carries out its own internal proceedings or indoor management. He can assume that all is being done regularly.
- The doctrine of indoor management, thus, imposes an important restriction on the scope of doctrine of constructive "notice. While the doctrine of "constructive notice" seeks to protect the company against the outsiders, the principle of indoor management operates to protect the outsiders against the company.

The Royal British Bank vs. Turquand

Mr. Turquand was the official manager (liquidator) of the insolvent Cameron's Coalbrook Steam, Coal and Swansea and Loughor Railway Company. It was incorporated under the Joint Stock Companies Act, 1844. The company had given a bond for £ 2,000 to the Royal British Bank, which secured the company's drawings on its current account. The bond was under the company's seal, signed by two directors and the secretary. When the company was sued, it alleged that under its registered deed of settlement (the articles of association), directors only had power to borrow up to an amount authorized by a company resolution. A resolution had been passed but not specifying how much the directors could borrow.

Held, it was decided that the bond was valid, so the Royal British Bank could enforce the terms. He said the bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed. Articles of association were registered with Companies House, so there was constructive notice. But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable. The bond was valid because there was no requirement to look into the company's internal workings. This is the indoor

➤ **Exceptions:** The doctrine of indoor management is subject to the following exceptions or limitations:-

1. **Actual or constructive knowledge of irregularity:** The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

In **Howard vs. Patent Ivory Manufacturing Co.** where the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

Likewise, in **Morris v Kanssen**, a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

2. **Suspicion of Irregularity:** Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or nothing the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

The protection of the "Turquand Rule" is also not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. Suspicion should arise, for example, from the fact that an officer is purporting to act in matter, which is apparently outside the scope of his authority.

In **AnandBihariLal vs. Dinshaw & Co.** the plaintiff accepted a transfer of a company's property from its accountant, the transfer was held void.

The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property.

Similarly, in **Haughton & Co. v. Nothard, Lowe & Wills Ltd.** where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said that it was something so unusual "that the plaintiff were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it" Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf"

3. **Forgery:** The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

Forgery may in circumstances exclude the '**Turquand Rule**'.

In **Ruben v Great Fingall Consolidated**, the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company.

The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.

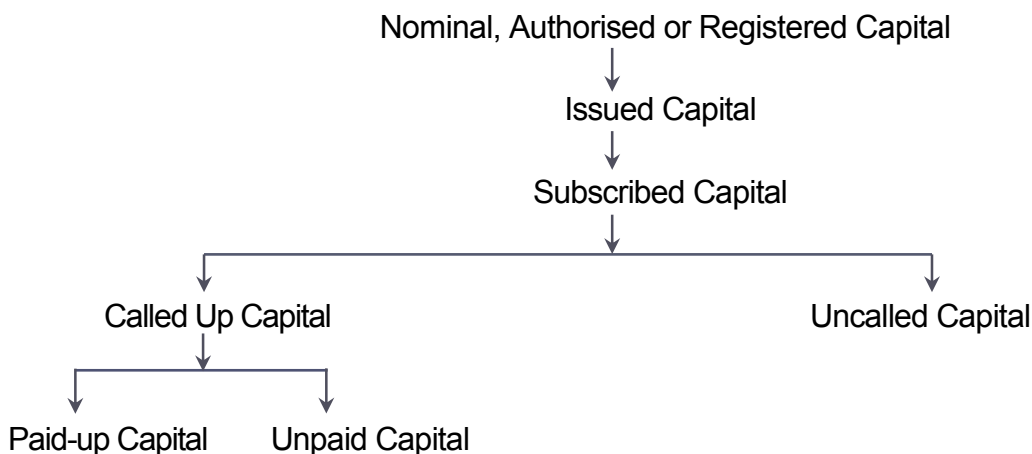
The plaintiff contended that whether the signature were genuine or forged was apart of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

• SHARE

- **Definition and Meaning of Share:** Section 2(84) of the Companies Act, 2013 defines the term "share". As per this, share means a share in the share capital of a company and includes stock.
- By its nature, a **share is not a sum of money but a bundle of rights and liabilities**. A share is a right to participate in the profits of a company, while it is a going concern and declares dividend; and a right to participate in the assets of the company, when it is wound up.
- The shares or debentures or other interests of any member in a company shall be movable property transferable in the manner provided by the articles of the company [Section 44 of the Companies Act, 2013]. Every share in a company having a share capital, shall be distinguished by its distinctive number [Section 45]. This shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

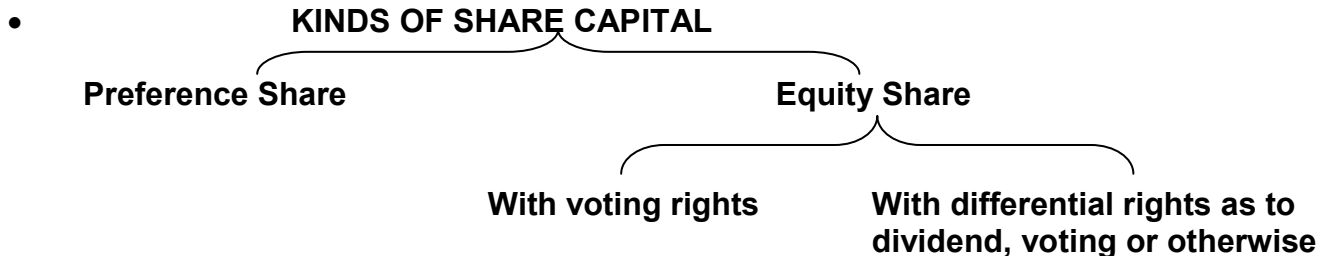
• CLASSIFICATION OF SHARE CAPITAL

The share capital of a company can be classified as :



- According to **Section 2(8)** "**authorised capital**" or "nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.
- Whereas **Section 2(86)** "**subscribed capital**" means such part of the capital which is for the time being subscribed by the members of a company.
- As per **Section 2(15)** "**Called-up capital**" means such part of the capital, which has been called for payment.

- **Section 2(64)** defines “paid-up share capital” or “share capital paid-up” means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.



(A) PREFERENCE SHARE

A preference share is a share which fulfils the following two conditions:

- ♦ It carries preferential right in respect of payment of dividend; and It also carries preferential right in regard to repayment of capital.
- ♦ In simple terms, preference share capital must have priority both regards to dividend as well as capital.

(B) EQUITY SHARE

- **"Equity share capital"** with reference to any company limited by shares, means all share capital which is not preference share capital;
- Equity share capital —
 - (1) with voting rights; or
 - (2) with differential rights as to dividend, voting or otherwise in accordance with prescribed rules;
- **Example:** It is to be noted that, **Tata Motors in 2008 introduced equity shares with differential voting rights** called 'A' equity shares in its rights issue. In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares. Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting. Other companies which have issued equity shares with differential voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others.

QUESTIONS

Theory questions

1. What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.
2. Can a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt?
3. Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company?
4. Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 2013. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'.
5. Short note on Articles of Association

PRACTICAL/CASE LAW BASED QUESTIONS:

1. F, an assessee, was a wealthy man earning huge income by way of dividend and interest. He formed three Private Companies and agreed with each to hold a bloc of investment as an agent for them. The dividend and interest income received by the companies was handed back to F as a pretended loan. This way, F divided his income into three parts in a bid to reduce his tax liability.
Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded?
2. The paid-up Share Capital of AVS Private Limited is ₹ 1 crore, consisting of 8 lacs Equity Shares of ₹ 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of ₹ 10 each, fully paid-up. XYZ Private Limited and BCL Private Limited are holding 3 lacs Equity Shares and 150,000 Equity Shares respectively in AVS Private Limited. XYZ Private Limited and BCL Private Limited are the subsidiaries of TSR Private Limited.
With reference to the provisions of the Companies Act, 2013, examine whether AVS Private Limited is a subsidiary of TSR Private Limited?
3. The object clause of the Memorandum of Association of LSR Private Ltd, Lucknow authorized it to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. J and traded in steel and incurred liabilities to Mr. J. The Company, subsequently, refused to admit the liability to J on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to J. Give reasons in support of your answer.

ANSWERS FOR PRACTICAL/CASE LAW BASED QUESTION

1. As per provisions of The Companies Act, 2013, courts can lift the corporate veil if companies are formed to divide income and avoid tax or avoid any welfare laws. As per the case of Sir Dinshaw Maneckjee Petit, he had formed four private companies, in all of which he was the majority shareholder. The companies made investments and whenever interest and dividend income were received by the companies, D applied to the companies for loans, which were immediately granted and he never repaid. In a legal proceeding the corporate veil of all the companies were lifted and the income of the companies treated as if they were of 'D'.
 - (a) The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the facade of the assessee himself. Therefore, the whole idea of Mr. F was simply to split his income into three parts with a view to evade tax. No other business was done by the company.
 - (b) The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried on no other business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to hand them over to the assessee as pretended loans.

2. As per Section 2(87) provides that a company shall be a subsidiary of another, if any of the following conditions are satisfied :-
 - (a) that other controls the composition of its Board of Directors;
 - (b) that other exercises or-controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies; or
 - (c) the first-mentioned company is a subsidiary of any company which is that other's subsidiary

In this case XYZ Pvt Ltd. and BCL Pvt Ltd. together hold a majority of equity shares in AVS Pvt Ltd. and both these companies are subsidiaries of TSR Pvt Ltd it will have a majority stake in the composition of the Board of Directors of AVS Pvt Ltd. Hence, TSR Pvt, Ltd will be treated as the holding company of AVS Pvt Ltd.

3. In terms of section 4(1)(c) of the Companies Act, 2013, the powers of the company are limited to:
 - (a) Powers expressly given in the "Objects Clause" of the Memorandum (which is popularly known as 'express' power), or conferred by the Companies Act, or by any other statute and
 - (b) powers reasonably incidental or necessary to the company's main objects (termed as "Implied" powers).

The Act further provides that the acts beyond the powers of a company are ultra vires and void and cannot be ratified even though every member of the company may give his consent [*Ashbury Railway Carriage Company Vs Richie*]

The objects clause enables the shareholders, creditors or others to know what its powers are and what the range of its activities is. The objects clause therefore is of fundamental importance to the shareholders, creditors and every other person who deals with the company in any manner what so ever. A company being an artificial legal person can act only within the ambit of the powers conferred upon it by the Memorandum through the "Objects Clause".

Every person who enters into a contractual relationship with a company on any matter is presumed to be aware of its objects and is supposed to have examined the Memorandum of Articles of the company to ensure proper contractual agreement. If a person fails to do so, it is entirely at his own peril.

It is also pertinent to note that the objects of a company may be changed by following the provisions for the change of Memorandum as laid out in section 13 of the said Act.

M/s LSR Pvt. Ltd is authorised to trade directly on fruits and vegetables. It has no power to enter into a partnership for Iron and steel with Mr. J. Such act cannot be treated as being within either the 'express' or 'implied' powers of the company. Mr J who entered into partnership is deemed to be aware of the lack of powers of M/s LSR(Pvt) Ltd. In the light of the above, Mr, J cannot enforce the agreement or liability against M/s LSR Pvt. Ltd under the Companies Act. Mr. J should be advised accordingly.

However, under the Indian Contract Act, 1872 where a person derives any benefit either in the absence of a contract or under a void agreement will be liable to make are reasonable payment for the value of such benefit.

MAY 2018 PAPER

Roll No:

Total No. of Printed Pages : 2

Total no. of Questions :

Time allowed : 3 Hours

Maximum Marks : 100 (Section A – 60 & Section B – 40 marks)

IMPORTANT INSTRUCTIONS TO CANDIDATES

Questions in Section A are to be answered in the medium opted by the candidate. If a candidate has not opted for Hindi medium, his/her answers in Hindi, will not be evaluated.

Questions in Section B, are to be answered in English only, by all the candidates, including those who have opted for Hindi medium.

Answers to both the sections are to be written in the same answer book.

Section A – (60 marks)

Question No. 1 is compulsory.

Answer any FOUR questions from the remaining FIVE questions.

Those any candidate answers extra question(s) sub – question (s) over and above the required number, then only the requisite number of questions first answered in the book shall be valued and subsequent extra question(s) answered shall be ignored.

1. (a) X, Y and Z are partners in a firm. They jointly promised to pay Rs. 3,00,000 to D. Y become insolvent and his private assets are sufficient to pay 1/5 of his share of debts. X is compelled to pay the whole amount to D. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which X can recover the amount from Z. **(4 marks)**
 - (b) Ravi Private Limited has borrowed Rs. 5 crores from Mudra Finance Ltd. This debt is ultra vires to the company. Examine, whether the company is liable to pay this debt state the remedy if any available to Mudra Finance Ltd.? **(4 marks)**
 - (c) What is meant by delivery of goods under the Sale of Goods Act, 1930; State various modes of delivery. **(4 marks)**
 2. (a) State the exception to the rule “An agreement without consideration is void”. **(5 marks)**
 - (b) What are the essential elements to form a LLP in India as per that LLP Act, 2008? **(5 marks)**
 - (c) (i) Distinguish between wagering agreement and contract of insurance. **(2 marks)**
- OR
- (ii) Examine with reason that the given statement is correct or incorrect “Minor is liable to pay for the necessaries supplied to him”. **(2 marks)**

3. (a) Distinguish between dissolution of firm and dissolution of partnership. **(2 marks)**
- (b) What are the consequences of Non – Registration of a partnership Firm? Discuss. **(4 marks)**
- (c) M Ltd., contract with Shanti Traders to make and deliver certain machinery to them by 30.6.2017 for Rs. 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and delivery the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for Rs. 12.75 lakhs. Due to this Shanti Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd and were compelled to pay compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act, 1872. **(6 marks)**
4. (a) What is appropriation of goods under the Sale of Goods Act, 1930? State the essentials regarding appropriation of unascertained goods. **(6 marks)**
- (b) X, Y and Z are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of X and Y fought in ladies club on their personal issue and X's wife was hurt badly. X got angry on the incident and he convinced Z to expel Y from their partnership firm. Y was expelled from partnership without any notice from X and Z. Considering the provisions of the Indian Partnership Act, 1932, state whether they can expel a partner from the firm. What are the criteria for test of good faith in such circumstance? **(6 marks)**
5. (a) Mr. D sold some goods to Mr. E for Rs. 5,00,000 on 15 days credit. Mr. D delivered the goods. On due date Mr. E refused to pay for it. State the position and rights of Mr. D as per The Sale of Goods Act, 1930. **(6 marks)**
- (b) Define OPC (One Person Company) and state the rules regarding its membership. Can it be converted into a non – profit company under Section 8 or a private company? **(6 marks)**
6. (a) Define Fraud whether “mere silence will amount to fraud” as per the Indian contract Act, 1872? **(5 marks)**
- (b) What is the conclusive evidence of partnership? State the circumstances when partnership is not considered between two or more parties. **(4 marks)**
- (c) State the limitations of the doctrine of indoor management under the Companies Act, 2013. **(3 marks)**

NOV 18 PAPER

Roll No:

Total No. of Printed Pages :3

Total no. of Questions : 11

Time allowed : 3 Hours

Maximum Marks : 100 (Section A – 60 & Section B – 40 marks)

Questions in Section A are to be answered in the medium opted by the candidate has not opted for Hindi medium, his/her answers in Hindi, will not be checked.

Questions in Section B. are to be answered in English only, by all the including those who have opted for Hindi medium.

Answers to both the Sections are to be written in the same answer book.

SECTION - A

Question No. 1 is compulsory.

Answer any four questions from the remaining five questions.

1. (a) Mr. X and Mr. Y entered into a contract on 1st August, 2018. by which Mr. X had to supply 50 tons of sugar to Mr. Y at a certain price strictly within a period of 10 days of the contract Mr. Y also paid an amount of ₹ 50,000 towards advance as per the terms of the above contract

The mode of transportation available between their places is roadways only. Severe flood came on 2nd August, 2018 and the only road connecting their places was damaged and could not be repaired within fifteen days. Mr. X offered to supply sugar on 20th August, 2018 for which Mr Y did not agree. On 1st September, 2018. Mr. X claimed compensation of ₹ 10,000 from Mr. Y for refusing to accept the supply of sugar, which was not there within the purview of the contract On the other hand, Mr.Y claimed for refund of ₹ 50,000. which he had paid as advance in terms of the contract. Analyse the above situation in terms of the provisions of the Indian Contract Act, 1872 and decide on Y's claim. **(4 Marks)**

- (b) A company registered under Section 8 of the Companies Act, 2013, financial year ended on 31st March, earned huge profits during the financial year ended on 31st March, 2018 due to some favourable policies declared by the Government of India and implemented by the company.

Considering the development, some members of the company wanted the company to distribute dividends to the members of the company. They approached you to advise them about the maximum amount of dividend that can be declared by the company as per the provisions of the Companies Act, 2013. Examine the relevant provisions of the Companies Act, 2013 and advise the members accordingly. **(4 Marks)**

- (c) Differentiate between Ascertained and Unascertained Goods with example.

(4 Marks)

2. (a) What is Contingent Contract ? Discuss the essentials of Contingent Contract as per the Indian Contract Act, 1872. **(7 Marks)**
- (b) Explain the essential elements to incorporate a Limited Liability Partnership and the steps involved therein under the LLP Act, 2008. **(5 Marks)**
3. (a) Though a minor cannot be a partner U, a firm, he can nonetheless be admitted to the benefits of partnership."
- (I) Referring to the provisions of the Indian Partnership Act, 1932, state the right which can be enjoyed by a minor partner. **(4 Marks)**
- (II) A. State the liabilities of a minor partner both : **(2 Marks)**
- (i) Before attaining majority .
- (ii) After attaining majority.
- OR
- B. State the legal position of a minor partner after attaining majority: **(2 Marks)**
- (i) When he opts to become a partner of the same firm.
- (ii) When he decide not to become a partner.
- (b) (i) Mr. Ramesh promised to pay ₹ 50,000 to his wife Mrs. Lali so that she can spend the sum on her 30th birthday. Mrs. Lali insisted he husband to make a written agreement if he really loved her. Mr. Ramesh mage a written agreement and the agreement was registered under the law. Mr. Ramesh failed to pat the specified amount to his wife Mr. Lali . Mrs. Lali wants to file a suit against Mr. Ramesh and recover the promised amount. Referring to the applicable provisions of the Contract Act, 1872, advise whether Mrs. Lali will succeed. **(3 Marks)**
- (ii) A shop keeper displayed a pair of dress in the show room and a price tag of ₹ 2,000 was attached to the dress. Mrs. Lovely, looked at the tag and rushed to the cash counter. Then she asked the shop-keeper to received the payment and pack up the dress. The shop-keeper refused to hand – over the dress to Mrs. Lovely in consideration of the price stated in the price tag attached to the dress. Mrs. Lovely seeks your advice whether she can sue the shop-keeper for the above cause under the Indian Contract Act, 1872. **(3 Marks)**
4. (a) What is the Doctrine of "Caveat Emptor"? What are the exceptions to the Doctrine of "Caveat Emptor"? **(6 Marks)**
- (b) (i) Mr. A, Mr. B and Mr. C were partners in a partnership firm ABC & Co., which is engaged in the business of trading of branded furniture. The name of the partners was clearly written along with the firm name in front of the head office of the firm as well as on letter-head of the firm. On 1st October, 2018, Mr. C passed away. His name was neither removed from the list of partners as stated in front of the head office nor from the letterheads of the firm. As per the terms of partnership, the firm continued its operations with Mr. A and Mr. B as partners. The accounts of the firm were settled and the amount due to the legal heirs of Mr. C was also determined on 10th October, 2018. But the same was not paid to the legal heirs of Mr. C. On 16th October, 2018, Mr. X, a supplier supplied furniture worth ? 20,00,000 to M/s ABC & Co. M/s ABC & Co. could not repay the amount due to heavy losses. Mr. X wants to recover the amount not only from M/s ABC & Co., but also from the legal heirs of Mr. C.

Analyse the above situation in terms of the provisions of the Indian Partnership Act, 1932 and decide whether the legal heirs of Mr, C can also be held liable for the dues towards Mr X. **(3 Marks)**

- (ii) Mr. M, Mr. N and Mr. P were partners in a firm, which was dealing in refrigerators. On 1M October, 2018, Mr. P retired from partnership, but failed to give public notice of his retirement.

After his retirement, Mr. M, Mr. N and Mr. P visited a trade fair and enquired about some refrigerators with latest techniques. Mr. X, who was exhibiting his refrigerators with the new techniques was impressed with the interactions of Mr. P and requested for the visiting card of the firm. The visiting card also included the name of Mi. P as a partner even though he had already retired. Mr. X supplied some refrigerators to the firm and could not recover his dues from the firm. Now, Mr. X wants to recover the dues not only from the firm, but also from Mr. P.

Analyse the above case in terms of the provisions of me Indian Partnership Act, 1932 and decide whether Mr. P is liable in this situation. **(3 Marks)**

5. (a) Mr. G sold some goods to Mr. H for certain price by issue of an invoice, but payment in respect of the same was not received on that day. The goods were packed and lying in the godown of Mr. G. The goods were inspected by H's agent and were found to be in order. Later on, the dues of the goods were settled in cash. Just after receiving cash, Mr. G asked Mr. H that goods should be taken away from his godown to enable him to store other goods purchased by him. After one day, since Mr. H did not take delivery of the goods, Mr. G kept the goods out of the godown in an open space. Due to rain, some goods were damaged.

Referring to the provisions of the Sale of Goods Act, 1930, analyse the above situation and decide who will be held responsible for the above damage. Will your answer be different, if the dues were not settled in cash and are still pending?

(6 Marks)

- (b) There are cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct from its shareholders or members. Elucidate. **(6 Marks)**

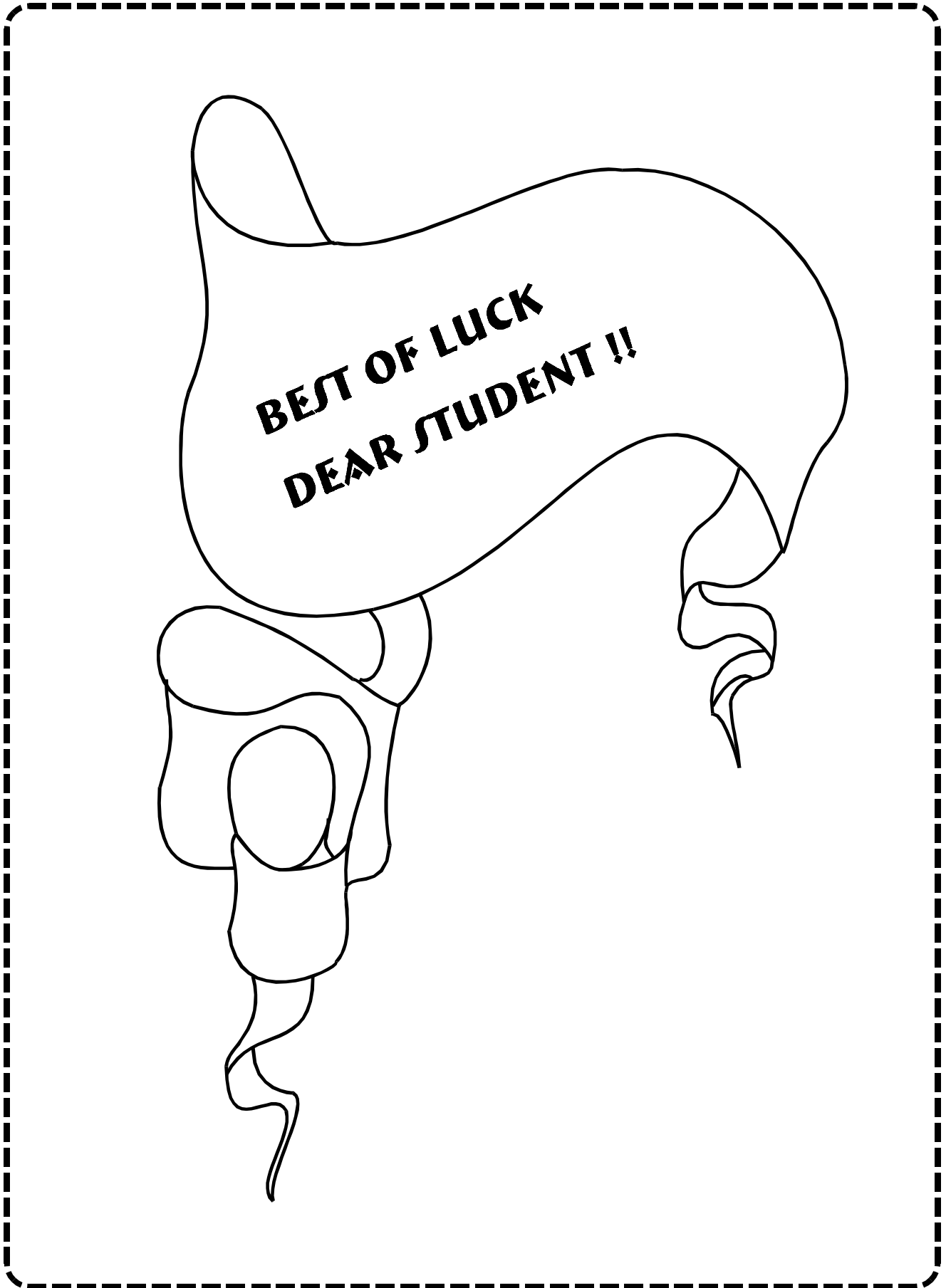
6. (a) Explain the modes of revocation of an offer as per the Indian Contract Act, 1872.

(5 Marks)

- (b) State any four grounds on which Court may dissolve a partnership firm in case any partner files a suit for the same. **(4 Marks)**

- (c) Mr. X had purchased some goods from M/s ABC Limited on credit. A credit period of one month was allowed to Mr. X Before the due date. Mr. X went to the company and wanted to repay the amount due from him. He found only Mr. Z there, who was the factory supervisor of the company. Mr. Z told Mr. X that the accountant and the cashier were on leave, he is in-charge of receiving money and he may pay the amount to him. Mr. Z issued a money receipt under his signature. After two months M/s ABC Limited issued a notice to Mr. X for non - payment of the dues within the stipulated period. Mr. X informed the company that he had already cleared the dues and he is no more responsible for the same. He also contended that Mr. Z is an employee of the company to whom he had made the payment and being and outsider, he trusted the words of Mr. Z as duty distribution is a job of the internal management of the company.

Analyse the situation and decide whether Mr. X is free from his liability. **(3 Marks)**



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