Arjun Chhabra Tutorial's

Bulls Eye Notes

(Question Bank)

On

Business Laws

For CA Foundation Exams

CS Arjun Chhabra
(CS LLB LLM)

Arjun Chhabra Tutorial
Pune, Maharashtra

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Blue Print Of Contents

Chapter 1 - Indian Regulatory Framework

Chapter 2 – The Indian Contract Act, 1872

Unit – I Nature of Contracts

Unit– 2: Consideration

Unit – 3: Other Essential Elements of a Contract

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Chapter 7 - The Negotiable Instruments Act, 1881

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Chapter 1 - Indian Regulatory Framework

Question 1

What are the main sources of law in India, and how do they contribute to the legal framework of the country?

Answer:

The main sources of law in India are the Constitution, statutes passed by Parliament and State Assemblies, judicial precedents, and established customs and usages. India's legal system is founded on the principles of parliamentary democracy, with the Constitution serving as the fundamental basis for all laws. Parliament and State Assemblies, where elected representatives make laws, are the ultimate law-making bodies. While laws passed by Parliament apply across India, state legislatures enact laws applicable only within their respective states.

Question 2

Explain the distribution of law-making powers between the Central Government and State Governments as outlined in the Indian Constitution.

Answer:

The Government of India Act, 1935, was a precursor to the Indian Constitution and played a crucial role in defining the transition from a "unitary" to a "federal" system. It allocated powers between the Centre and the States to prevent conflicts. The Federal Court, established in 1937, had jurisdiction over appellate, original, and advisory matters, including civil and criminal cases. The Advisory Jurisdiction allowed the Federal Court to advise the Governor-General on public matters. The Federal Court was eventually succeeded by the Supreme Court of India.

The Constitution of India, adopted in 1950, forms the cornerstone of the Indian legal system. It outlines the framework for the democratic system and the rights and responsibilities of citizens. Fundamental rights and duties are enshrined in the Constitution, providing a strong foundation for laws made for and by the people. India's legal system is a hybrid one, with interconnected laws.

The Constitution divides the law-making power between the Central Government and State Governments through three lists: the Central List, State List, and Joint List. Matters listed in each list determine whether a subject becomes the domain of Central law, State law, or both. For instance, Income Tax falls under the Central List, resulting in a single Income Tax law for the entire country, administered by the Central Government's Ministry of Finance. In contrast, issues like the levy of stamp duty are governed by both Central and State laws, exemplifying the cooperative nature of Indian law-making.

Question 3

Describe the legislative process that a proposed law, also known as a Bill, undergoes in India before becoming an Act of Parliament. Explain the key stages and authorities involved in this process.

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Answer:

In India, the legislative process for a proposed law, known as a Bill, involves several key stages and authorities. First, the Bill is introduced in either the Lok Sabha or the Rajya Sabha, where it is subject to discussion and debate.

After passing in the Lok Sabha, it proceeds to the Rajya Sabha for further consideration. Following approval in both houses, the Bill is presented to the President of India for assent. Once the President provides assent, the law is officially notified by the Government in the Official Gazette of India. The effective date of the law is mentioned in the notification, and at this point, it becomes an Act of Parliament.

Question 4

Explain the fundamental differences between Criminal Law and Civil Law in India. Provide insights into the key legal frameworks governing each type of law and their primary objectives.

Answer:

In India, Criminal Law and Civil Law are distinct legal domains with different purposes and frameworks. Criminal Law is concerned with violations of the rule of law or public wrongs and the subsequent punishment. It is primarily governed by the Indian Penal Code, 1860, which defines crimes, their nature, and the associated penalties. The Code of Criminal Procedure, 1973 (Crpc), outlines the procedural aspects for enforcing these penalties.

Examples of criminal offenses under Indian law include murder, rape, theft, fraud, cheating, and assault. The focus in criminal cases is on punishment and societal order.

In contrast, Civil Law pertains to disputes between individuals or organizations and focuses on resolving conflicts rather than punishment. The Code of Civil Procedure, 1908 (CPC), governs the process and administration of civil law.

Civil law encompasses various areas such as Law of Contract, Family Law, Property Law, and Law of Tort. Examples of civil offenses include breach of contract, non-delivery of goods, non-payment of dues, defamation, and disputes between landlords and tenants

Question 5

Explain the concept of Common Law and the principle of Stare Decisis in the Indian legal system. How does State Decisis influence judicial decisions, and what is its significance in legal proceedings?

Answer:

Common Law in India is a legal system where decisions made by courts in previous cases serve as binding precedents for future cases. The doctrine of Stare Decisis, a Latin phrase meaning "to stand by that which is decided," is fundamental to this legal framework. It mandates that courts must follow the principles or judgments established in previous cases when ruling on similar or analogous cases. This principle helps maintain consistency and predictability in the legal system.

In practical terms, when a new case presents facts and circumstances similar to a prior case with a legal precedent, the doctrine of Stare Decisis obliges the court to follow the earlier decision. This ensures that the law is applied consistently and that individuals and organizations can rely on established legal principles when navigating the legal system.

Stare Decisis is of great significance in the Indian legal system as it promotes fairness, equity, and the rule of law by ensuring that legal decisions are not arbitrary but based on established legal principles. It provides guidance to both the judiciary and legal practitioners when interpreting and applying the law to specific cases.

Question 6

Can you elaborate on the key responsibilities and functions of the Ministry of Finance within the Government of India? How does it impact the daily work of a Chartered Accountant, and why is it significant for the financial landscape of the country?

Answer

The Ministry of Finance, also known as Vitta Mantralaya, is a vital government department in India responsible for the nation's economy. It serves as the Treasury of India and has a wide range of responsibilities. These include taxation, the formulation and enactment of financial legislation, oversight of financial institutions, regulation of capital markets, management of both central and state finances, and the presentation of the Union Budget.

For Chartered Accountants, this ministry holds immense importance as many aspects of their daily professional activities are influenced by its policies and proclamations. It impacts their work through tax regulations, financial reporting standards, and compliance requirements. Chartered Accountants play a crucial role in helping individuals and businesses navigate these financial aspects efficiently while ensuring compliance with the Ministry's directives. The presentation of the Union Budget is a highly anticipated annual event that reveals the tax rates and budget allocations for the upcoming year. It has far-reaching effects on the financial planning and strategies of businesses, investments, and the common man.

Finance professionals, including Chartered Accountants, closely monitor the Union Budget as it significantly influences financial decision-making, investment choices, and tax planning for their clients. Given the Ministry of Finance's broad influence on the economic and financial landscape of India, it's no surprise that several ministers have opted to hold the portfolio of Finance Minister. This underscores the ministry's critical role in shaping the country's economic policies and regulations

Question 7

Can you describe the structure of the Indian judicial system, including its key components and their respective roles within the system?

Answer: The Indian judicial system is a complex and hierarchically organized system that serves as the guardian of the rule of law and justice in the country. It can be divided into multiple layers, each with its specific functions and jurisdictions.

Supreme Court of India: At the apex of the Indian judicial system is the Supreme Court. It acts as the highest court of appeal and is responsible for interpreting the Constitution and ensuring uniformity in the application of laws throughout the country. The Supreme Court can hear appeals from High Courts and other specialized courts, making it the ultimate authority in legal matters.

High Courts: India has 25 High Courts, each serving one or more states or union territories. High Courts have jurisdiction over their respective states or territories and serve as appellate courts for cases decided by lower courts. They also have the authority to issue writs and handle matters related to the violation of fundamental rights.

District Courts: Below the High Courts are District Courts, which are established in every district of the country. District Courts handle civil and criminal cases and are typically the first level of the judiciary that individuals encounter. These courts have the authority to try cases involving a wide range of issues.

Subordinate Courts: Subordinate Courts, also known as lower courts, come under the District Courts. These include various levels of courts, such as sessions courts, magistrate courts, and specialized courts (e.g., family courts, consumer courts). Subordinate Courts primarily handle cases within their specified jurisdictions, and appeals from their decisions can be made to the District Court or High Court, depending on the nature of the case

Tribunals and Specialized Courts: India has various tribunals and specialized courts to handle specific types of cases. These include the National Green Tribunal, Income Tax Appellate Tribunal, and others, which are designed to expedite justice and provide expertise in their respective areas of law.

Gram Nyayalayas: These are rural or village courts established to ensure access to justice for residents of rural areas. Gram Nyayalayas handle petty civil and criminal cases and aim to reduce the burden on higher courts.

In summary, the Indian judicial system is structured with the Supreme Court at the apex, followed by High Courts, District Courts, and Subordinate Courts. Specialized tribunals and village-level Gram Nyayalayas contribute to a comprehensive system that aims to provide access to justice for all citizens.

Question 8

Describe in brief about the following Regulatory bodies of the. Government of India: -
(i) Securities Exchange Board of India
(ii) Reserve Bank of India
(iii) Insolvency & Bankruptcy Board of India **(June 24 - 6 Marks)**

Answer:

Refer module

Question 9

What is Law and what is the process of making a law? **(RTP Sep 24)**

Answer:

Law is a set of obligations and duties imposed by the government for securing welfare and providing justice to society. India's legal framework reflects the social, political, economic, and cultural aspects of our vast and diversified country.

The Process of Making a Law

(i) When a law is proposed in parliament, it is called a Bill.
(ii) After discussion and debate, the law is passed in Lok Sabha.
(iii) Thereafter, it has to be passed in Rajya Sabha.
(iv) It then has to obtain the assent of the President of India.
(v) Finally, the law will be notified by the Government in the publication called the Official Gazette of India.
(vi) The law will become applicable from the date mentioned in the notification as the effective date.
(vii) Once it is notified and effective, it is called an Act of Parliament.

Question 10

Explain in brief the various types of laws in the Indian Legal System.

Answer:

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

Criminal Law: Criminal law is concerned with laws pertaining to violations of the rule of law or public wrongs and punishment of the same. Criminal Law is governed under the Indian Penal Code, 1860, and the Code of Criminal Procedure, 1973 (Crpc). The Indian Penal Code, 1860, defines the crime, its nature, and punishments whereas the Criminal Procedure Code, 1973, defines exhaustive procedure for executing the punishments of the crimes. Murder, rape, theft, fraud, cheating and assault are some examples of criminal offences under the law.

Civil Law: Matters of disputes between individuals or organisations are dealt with under Civil Law. Civil courts enforce the violation of certain rights and obligations through the institution of a civil suit. Civil law primarily focuses on dispute resolution rather than punishment. The act of process and the

administration of civil law are governed by the Code of Civil Procedure, 1908 (CPC). Civil law can be further classified into Law of Contract, Family Law, Property Law, and Law of Tort. Some examples of civil offences are breach of contract, non-delivery of goods, non-payment of dues to lender or seller defamation, breach of contract, and disputes between landlord and tenant.

Common Law: A judicial precedent or a case law is common law. A judgment delivered by the Supreme Court will be binding upon the courts within the territory of India under Article 141 of the Indian Constitution. The doctrine of Stare Decisis is the principle supporting common law. It is a Latin phrase that means "to stand by that which is decided." The doctrine of Stare Decisis reinforces the obligation of courts to follow the same principle or judgement established by previous decisions while ruling a case where the facts are similar or "on all four legs" with the earlier decision.

Principles of Natural Justice: Natural justice, often known as Jus Natural deals with certain fundamental principles of justice going beyond written law. Nemo judex in causa sua (Literally meaning "No one should be made a judge in his own cause, and it's a Rule against Prejudice), audi alteram partem (Literally meaning "hear the other party or give the other party a fair hearing), and reasoned decision are the rules of Natural Justice. A judgement can override or alter a common law, but it cannot override or change the statute.

Question 11

Write a short note on the following:
(i) Ministry of Corporate Affairs (MCA)
(ii) Ministry of Home Affairs **(MTP 3 June 24 – 6 Marks)**

Answer:

(i) Ministry of Corporate Affairs (MCA): MCA is an Indian Government Ministry which primarily concerned with administration of the Companies Act, 2013, the Companies Act, 1956, the Limited Liability Partnership Act, 2008, and the Insolvency and Bankruptcy Code, 2016. It is responsible mainly for the regulation of Indian enterprises in the industrial and services sector.
The Ministry is mostly run by civil servants of the ICLS cadre. These officers are elected through the Civil Services Examination conducted by Union Public Service Commission.
The highest post, Director General of Corporate Affairs (DGCoA), is fixed at Apex Scale for the ICLS.
(ii) Ministry of Home Affairs: It is a ministry of the Government of India. As an interior ministry of India, it is mainly responsible for the maintenance of internal security and domestic policy. The Home Ministry is headed by Union Minister of Home Affairs.

Question 12

What is the significance of the Supreme Court and High Court in the Indian judiciary? **(MTP 1 June 24 - 6 Marks)**

Answer

(i) Supreme Court

The Supreme Court is the apex body of the judiciary. It was established on 26th January 1950. The Chief Justice of India is the highest authority appointed under Article 126. The principal bench of the Supreme Court consists of seven members including the Chief Justice of India. Presently, the number has increased to 34 including the Chief Justice of India due to the rise in the number of cases and workload. An individual can seek relief in the Supreme Court by filing a writ petition under Article 32.

(ii) High Court

The highest court of appeal in each state and union territory is the High Court. Article 214 of the Indian Constitution states that there must be a High Court in each state. The High Court has appellant, original jurisdiction, and Supervisory jurisdiction. However, Article 227 of the Indian Constitution limits a High Court's supervisory power. In India, there are twenty-five High Courts, one for each state and union territory, and one for each state and union territory. Six states share a single High Court. An individual can seek remedies against violation of fundamental rights in High Court by filing a writ under Article 226.

Chapter 2 - The Indian Contract Act, 1872

Unit – I Nature of Contracts

Definitions under The Indian Contract Act, 1872 [Sec. 2]

1. Proposal/ Offer [Sec.2(a)]: A person is said to make a Proposal when he signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence.
2. Promise [Sec.2(b)]: When the person to whom a proposal is made, signifies his assent thereto, the proposal is said to be accepted. When a proposal is accepted, it becomes a Promise.
3. Reciprocal Promises [Sec.2(f)]: Promises which form the consideration or part of the consideration for each other are called Reciprocal Promises.
4. Promisor and Promisee [Sec.2(c)]: The person making the promise is called the Promisor, and the person accepting the proposal is called the Promisee.
5. Consideration [Sec.2(d)]: When at the desire of the Promisor, the Promisee or any other person, has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing, something, such act or abstinence or promise is called a Consideration for the promise.
6. Agreement [Sec.2(e)]: Every promise and every set of promises, forming the Consideration for each other, is an Agreement.
7. Contract [Sec.2(h)]: An Agreement enforceable by law is a Contract.
8. Voidable Contract [Sec.2(i)]: 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.
9. Void Agreement [Sec.2(g)]: An Agreement not enforceable by law is void.
10. Void Contract [Sec.2(j)]: A Contract which ceases to be enforceable by law becomes void, when it ceases to be enforceable.

Essentials of a Valid Contract:

(a) Agreement between two parties,

(b) Consensus-ad-idem - meeting of minds - agreeing to the same thing in the same sense. [Section 13]

(c) Intention to create legal relationship. No domestic and social nature,

(d) Consent of parties must be free, [Section 13 & 14]

(e) Parties should be competent to contract, [Section 11]

i. age of majority
ii. sound mind [Section 12]
   - able to understand the terms of Contract
   - capable of forming a rational judgment
iii. not disqualified from contracting

- Alien Enemy
- Foreign Sovereign and Ambassadors
- Convicts (He can enter into contracts only when the term is completed.)
- Insolvents

(f) Lawful consideration,

(g) Lawful and legal object,

(h) Not expressly declared void,

(i) Meaning of agreement must be certain or capable of being made certain,

(j) Capable of performance, and

(k) Legal formalities i.e Writing, registered & stamped. wherever required. [Sec. 1]

Related Question: "All contracts are agreements, but all agreements are not contracts." Comment. [MTP Nov 21 – 4 Marks]

Answer:

"All Contracts are Agreements but all Agreements are not Contracts"

1. Contract = Agreement + Enforceability by law. Thus, for a Contract, there should first be an Agreement.
2. Agreements that do not give rise to legal obligations are not Contracts. Example: A invites B for his son's wedding. B accepts the invitation. This is a mere agreement, not a Contract, there being no intention to create legal obligation.
3. Agreements to do an unlawful, immoral or illegal act, like smuggling or murdering a person, cannot be enforceable by law. Such agreements cannot be considered as a Contract.
4. Also, certain Agreements are specifically declared Void or Unenforceable. Example: Agreements to bet i.e wagering Agreements, Agreements in restraint of trade, agreements to do an impossible act, etc.
5. Hence, all Agreements are not Contracts, but all contracts are in fact Agreements.

Intention to create legal relationship

Case Laws based on Intention to create legal relationship

Balfour Vs. Balfour (1919)	Merritt v Merritt [1970]	Rose & Frank Co. v. Crompton Bros [1924]
1. It was held that the characteristics of the agreement was purely and completely domestic in nature, Lord Justice Atkin held that when a husband and a wife enter into an	1. Mr Merritt's appeal was unsuccessful. 2. When parties are in the process of separating, or are separated, the presumption of there being no intention to create legal relations does not apply.	1. The agreement was not enforceable by law as parties never intended to create legal relationship despite being business agreement because it was having honour clause.

agreement they never intend to create a legal relationship. 2. The agreement was outside the scope of contracts.	3. The arrangement was sufficiently certain to be enforceable, and the paying of the mortgage was ample consideration for Mr Merritt's promise. Mrs Merritt was entitled to the matrimonial home entirely.	2. Honour clause: Express statement that an agreement is intended to be binding in honour only and is therefore not legally enforceable.

Question 1

Mr. Ramesh promised to pay Rs. 50,000 to his wife Mrs. Lali so that she can spend the sum on her 30th birthday. Mrs. Lali insisted her husband to make a written agreement if he really loved her. Mr. Ramesh made a written agreement and the agreement was registered under the law. Mr. Ramesh failed to pay the specified amount to his wife Mrs. 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) [Nov 18]

Answer

1. Parties must intend to create legal obligations: There must be an intention on the part of the parties to create legal relationship between them.
2. Social or domestic type of agreements are not enforceable in court of law and hence they do not result into contracts.

In the given question

Mr. Ramesh promised to pay Rs. 50,000 to his wife so that she can spend the same on her birthday. However, subsequently, Mr. Ramesh failed to fulfil the promise, for which Mrs. Lali wants to file a suit against Mr. Ramesh.

Here, in the given circumstance wife will not be able to recover the amount as it was a social agreement and the parties did not intend to create any legal relations.

Related Question: Radha invited her ten close friends to celebrate her 25th birthday party on 1st January, 2023 at 7.30 P.M. at a well-known "Hi-Fi Restaurant" at Tonk Road, Jaipur. All invited friends accepted the invitation and promised to attend the said party. On request of the hotel manager, Radha deposited § 5,000/- as non-refundable security for the said party. On the scheduled date and time, three among ten invited friends did not turn up for the birthday party and did not convey any prior communication to her. Radha, enraged with the behaviour of the three friends, wanted to sue them for loss incurred in the said party. Advise as per the provisions of the Indian Contract Act, 1872. Would your answer differ if the said party had been a "Contributory 2023 New Year celebration Party" organized by Radha? (4 Marks) [June 23]

Answer: As per one of the requirements of Section 10 of the Indian Contract Act, 1872, there must be an intention on the part of the parties to create legal relationship between them. Social or domestic agreements are not enforceable in court of law and hence they do not result into contracts.

In the instant case, Radha cannot sue her three friends for the loss incurred in the said party as the agreement between her and her ten friends was a social agreement, and the parties did not intend to create any legal relationship.

If the said party organised by Radha had been a "Contributory 2023 New year celebration party", then Radha could have sued her three friends for the loss incurred in the said party as the agreement between her and her friends would have legal backing; on the basis of which Radha deposited the advance amount and the parties here intended to create legal relationship.

Related/Expected Question	Hint Answer
A invites B to stay with him during the winter vacation at his residence. B accept the invitation and informs A accordingly. When B reaches A's house, he finds it locked and he has to stay in a hotel. Can B claim damages from A? (3 Marks)	Mr. A invites to Mr. B to stay with him during winter vacation at his residence as it is a social contract and offer and acceptance to hospitality does not create contract.
Arjun invites Sunny to Satish's [Brother of Arjun] Birthday party. Sunny accepts the invitation and promises to attend. Arjun made special arrangement for Sunny at the party but she did not came. Arjun is upset with Sunny's behaviour, wanted to sue for loss incurred in making special arrangements. Arjun is seeking your advice.	Arjun cannot sue sunny for loss. Agreement was a kind of social nature and therefore, lacked the intention to create legal relationship.
A Father promised to pay his son a sum of ₹ 1 Lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but the father failed to pay the amount as promised. The son files a suit for recovery of the amount. State whether the son can recover the amount under the Indian Contract Act, 1872. [Mock Test Paper Oct 18 ICAI]	The son cannot recover the amount of ₹ 1 Lakh from his father. An agreement of domestic nature cannot be considered as a valid Contract.

Invitation to offer Vs Offer

Question 2

A shop-keeper displayed a pair of dress in the show-room and a price tag of Rs. 2,000 was attached to the dress. Ms. Lovely looked to the tag and rushed to the cash counter. Then she asked the shop-keeper to receive the payment and pack up the dress. The shop-keeper refused to hand-over the dress to Ms. Lovely in consideration of the price stated in the price tag attached to it. Ms. Lovely seeks your advice whether she can sue the shop-keeper for the above cause under the Indian Contract Act, 1872. (3 Marks) [Nov 18]

Answer

1. Offer should be distinguished from an invitation to offer:

Basis of Distinction	Offer	Invitation to Offer
1. Meaning	Where a person shows his willingness to enter into a contract, it is called as an offer.	Where a person invites others to make an offer to him, it is called as an invitation to offer.
2. Purpose	An offer is made by a person with the purpose of entering into a contract.	The purpose of making an invitation to offer is to receive the offers or to negotiate the terms on which the person making the invitation is willing to contract.
3. Legal effect	An offer, if acted upon (i.e., accepted), results in a contract.	An invitation to offer, if acted upon, only results in making of an offer.

2. 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, Ms. Lovely by selecting the dress and approaching the shopkeeper for payment simply made an offer to buy the dress selected by her. If the shopkeeper does not accept the price, the interested buyer cannot compel him to sell.

Related Question: 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 as per the provisions of the Indian Contract Act, 1872. [MTP March 19, 4 Marks] [MTP Nov 21 – 4 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Same as above.

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. If the cashier does not accept the price, the interested buyer cannot compel him to sell.

Related/Expected Question	Hint Answer
Ajit sees a book displayed in a shelf of a book shop with a price tag of ₹ 95. Ajit tenders ₹ 95 at the counter and asks for the book. The Bookseller refuses to sell saying that the book has already been sold to someone else and he does not have another copy of that book in the stock. Is the Bookseller bound to sell the book to Ajit?	No, Book Seller is not bound to sell the book to Ajit. Display of goods with prices marked there-on is only an invitation to offer.

Related Question: Rahul goes to super market to buy a washing machine. He selects a branded washing machine having a price tag of Rs.15000 after a discount of Rs. 3000. Rahul reaches at cash counter for making the payment, but cashier says, "Sorry sir, the discount was upto yesterday. There is no discount from today. Hence you have to pay Rs.18000." Rahul got angry and insists for Rs. 15000. State with reasons whether under Indian Contract Act, 1872, Rahul can enforce the cashier to sale at discounted price i.e., Rs.15000. [MTP Oct 21- 4 Marks]

Answer:

An invitation to offer is different from offer. Quotations, menu cards, price tags, advertisements in newspaper for sale are not offer. These are merely invitations to public to make an offer. An invitation to offer is an act precedent to making an offer. Acceptance of an invitation to an offer does not result in the contract and only an offer emerges in the process of negotiation.

In the instant case, Rahul reaches to super market and selects a washing machine with a discounted price tag of Rs.15000 but cashier denied to sale at discounted price by saying that discount is closed from today and request to make full payment. But Rahul insists to sale at discounted price.

On the basis of above provisions and facts, the price tag with washing machine was not offer. It is merely an invitation to offer. Hence, it is the Rahul who is making the offer not the super market. Cashier has right to reject the Rahul's offer. Therefore, Rahul cannot enforce cashier to sale at discounted price.

Related Question: Mr. Aseem is a learned advocate. His car was stolen from his house. He gave an advertisement in newspaper that he will give the reward of Rs. 10,000 who will give the information about his car. Mr. Vikram reads the advertisement and on making some efforts got the stolen car and informed Mr. Aseem. Mr. Aseem found his car but denied giving reward of Rs. 10,000 to Mr. Vikram with the words, "An advertisement in newspaper is just an invitation to make offer and not an offer. Hence, he is not liable to make the reward." State with reasons whether under Indian Contract Act, 1872, Mr. Vikram can claim the reward of Rs. 10,000.

Answer:

An invitation to offer is different from offer. Quotations, menu cards, price tags, advertisements in newspaper for sale are not offer. These are merely invitations to public to make an offer. An invitation to offer is an act precedent to making an offer. Acceptance of an invitation to an offer does not result in the contract and only an offer emerges in the process of negotiation. But there is an exception to above provisions. When advertisement in newspaper is made for reward, it is the general offer to public.

On the basis of above provisions and facts, it can be said that as advertisement made by Mr. Aseem to find lost car is an offer, he is liable to pay Rs. 10,000 to Mr. Vikram.

Expected question based on Invitation to offer

Related Question: X, gave an advertisement in a newspaper that a sale of office furniture by auction will be held at 2 p.m. On 9th August 1997 at 'bharat Maidan, Stall No. 420, New Delhi.' Y from Mumbai reached New Delhi on the appointed date and time but X had cancelled the auction sale. Advise Y.

Answer:
Y cannot file a suit against X for his loss of time and expenses because the advertisement was merely an invitation to offer and not an offer to self.

Offer [Section 2 (a)]

Question 3

Define an offer. Explain the essentials of a valid offer. How an offer is different from an invitation to offer? [RTP Nov 19]

Answer

Definition: The word Proposal and offer are used interchangeably and it is defined under Section 2(a) of the Indian Contract Act, 1872 as

1. When one person signifies to another his willingness to do or to abstain from doing anything
2. With a view to obtain the assent of that other to such act or abstinence
3. he is said to make a proposal.

Essentials: The following are important essentials of an offer:-

I) Must be capable of creating legal relation.

II) Must be certain, definite and not vague.

III) Must be communicated.

IV) Must be made with a view to obtaining the assent of the other party

V) May be conditional

VI) Offer should not contain a term the non-compliance of which would amount to acceptance

VII) May be general or specific

VIII) May be expressed or implied

IX) A statement of price is not an offer

Question 4

Explain the modes of revocation of an offer as per the Indian Contract Act, 1872. (5 Marks) [Nov 18] [MTP Aug 18, 7 Marks]

Answer

Modes of revocation of Offer

(i) By notice of revocation

(ii) By lapse of time: The time for acceptance can lapse if the acceptance is not given within the specified time and where no time is specified, then within a reasonable time.

(iii) By non-fulfillment of condition precedent: Where the acceptor fails to fulfill a condition precedent to acceptance the proposal gets revoked.

(iv) By death or insanity: Death or insanity of the proposer would result in automatic revocation of the proposal but only if the fact of death or insanity comes to the knowledge of the acceptor.

Acceptance

Question 5

Define the term Acceptance. Discuss the legal provisions relating to communication of Acceptance. [Back question of Module] [RTP Nov 20] [Jan 21- 7 Marks]

Answer

As per the provisions of the Indian Contract Act, 1872, when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. The proposal, when accepted, becomes a promise. This is known as acceptance.

Legal rules regarding valid acceptance:

1. Acceptance can only be given by the person to whom the offer is made or who has the knowledge of the offer: In the case of a specific offer, it can be accepted only by the person to whom it is made. In the case of a general offer, it can be accepted by any person who has the knowledge of the offer.

2. Acceptance must be absolute and unqualified: The acceptance is valid only when it is absolute and unqualified and is also expressed in some usual and reasonable manner unless the proposal prescribes the manner in which it must be accepted. If the proposal prescribes the manner in which it must be accepted, then it must be accepted accordingly.

3. The acceptance must be communicated: To conclude the contract between the parties, the acceptance must be communicated in a reasonable form. Any conditional acceptance is no acceptance. If the proposal is accepted by the offeree, he must have the complete knowledge of the offer made to him.

4. Acceptance must be in a prescribed mode: Where the mode of acceptance is prescribed in a proposal, it must be accepted in that manner. But, if the proposer does not insist on the proposal being accepted in the manner prescribed after it has been accepted otherwise (not in the prescribed manner), the proposer is presumed to have consented to the acceptance.

5. Time: Acceptance must be given within a specified time limit, and if no time is fixed, then the acceptance shall be given within a reasonable time and before the offer lapses.

6. Mere silence is not acceptance: The acceptance of an offer cannot be implied from the silence of the offeree or his failure to answer unless the offeree has in any previous conduct indicated that his silence is the evidence of the acceptance.

7. Acceptance by conduct/Implied Acceptance: The performance of the conditions of a proposal or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, constitutes an acceptance of the proposal.

Related Question: Mr. Pratham applied for a job as principal of a school. The school management decided to appoint him. One member of the school management committee privately informed Mr. Pratham that he was appointed but official communication was not given from the school. Later, the management of the school decided to appoint someone else as a principal. Mr. Pratham filed a suit against the school for cancellation of his appointment and claimed damages for loss of salary. State with reasons, will Mr. Pratham be successful in suit filed against school under the Indian Contract Act, 1872? [RTP Nov 21]

Answer:

1. As per the rules of acceptance, the acceptance should be communicated to offeror by offeree himself or his authorized agent. Communication of acceptance by third person cannot be concluded in valid acceptance.
2. In the instant case, Mr. Pratham applied for a job as principal of a school and one member of the school management committee privately informed Mr. Pratham that he was appointed. Later, the management of the school appointed someone else as a principal.
3. On the basis of above provisions and facts, communication of appointment of Mr. Pratham should be made by school management committee or any authorised agent. The communication by third person cannot be termed as communication of acceptance. Therefore, no valid contract was formed between Mr. Pratham and school and Mr. Pratham cannot file a suit against the school for cancellation of his appointment.

Related Question: Miss Shakuntala puts an application to be a teacher in the school. She was appointed by the trust of the school. Her friend who works in the same school informs her about her appointment informally. But later due to some internal reasons her appointment was cancelled. Can Miss Shakuntala claim for damages? [Module Back Vague Question]

Answer:

No, Miss Shakuntala cannot claim damages. As per Section 4, communication of acceptance is complete as against proposer when it is put in the course of transmission to him.

In the present case, school authorities have not put any offer letter in transmission. Her information from a third person will not form part of contract.

Related Question: A sends an offer to B to sell his second-hand-car for ₹ 40,000 with a condition that if B does not reply within a week, he (A) shall treat the offer as accepted. Is A correct in his proposition? What is the position if B communicates his acceptance after one week? [RTP Nov 19]	Answer: When B remains silent, it does not amount to Acceptance, as acceptance cannot be implied merely from silence of offeree. Acceptance must be made within the time limit prescribed in the offer. Hence, B's Acceptance after one week (i.e., after the time prescribed by the Offeror has elapsed), will not operate to turn the offer into a Contract.

Communication, Acceptance and Revocation of Proposals [Sec 4, 5 & 6]

Question 6

Ramaswamy 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 -

A. The telegram of revocation of acceptance is received by Ramaswamy before the letter of acceptance (by Post).

B. The telegram of revocation and letter of acceptance both reached together. [RTP Nov 18]

Answer

1. The problem is related with the communication and time of acceptance and its revocation.
2. 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.
3. 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:

a. Yes, the revocation of acceptance by Ramanathan (the acceptor) is valid.

b. 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.

Related Question: Mr. B makes a proposal to Mr. S by post to sell his house for Rs. 10 lakhs and posted the letter on 10th April 2020 and the letter reaches to Mr. S on 12'h April 2020. He reads the letter on 13th April 2020.

Mr. S sends his letter of acceptance on 16th April 2020 and the letter reaches Mr. B on 20th April 2020. On 17th April Mr. S changed his mind and sends a telegram withdrawing his acceptance. Telegram reaches to Mr. B on 19'h April 2020'

Examine with reference to the Indian Contract Act, 1872:

(i) On which date, the offer made by Mr. B will complete?

(ii) Discuss the validity of acceptance.

(iii) What would be validity of acceptance if letter of revocation and letter of acceptance reached together? [Jan 21 – 6 Marks]

Answer

1. The problem is related with the communication of offer and time of acceptance and its revocation.
2. According to Section 4 of The Indian Contract Act, 1872
   - Communication of a proposal when complete - The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made.
   - Communication of an acceptance when complete - The communication of an acceptance is complete as against the acceptor when it comes to the knowledge of the proposer.
3. 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:

1. In the Instant case, the communication of offer will complete on 13th April 2020 because S read the offer on 13th April i.e the date on which offer comes to his knowledge.
2. In the Instant case, acceptance is not valid, instead revocation of acceptance is valid because S (Acceptor) revoked his acceptance by sending a telegram withdrawing his acceptance which reaches B on 17th April before 20th April i.e., before the communication of acceptance comes to the knowledge of B (Offeror).
3. When both the letter of acceptance and revocation is reached at the same time, the validity of acceptance is determined by which is opened first, i.e., telegram or post. The revocation is sent by telegram but the acceptance is sent by post.

   A rational person would normally open the telegram first, and hence the acceptance stands revoked. So, if the proposer (B) opens the telegram first and reads it, the revocation of acceptance is valid, and there is no contract.

   However, if B opens the letter first and reads it, then the acceptance is complete and cannot be revoked. There is a valid contract in such a case.

   Note: An alternative view is given as under -

   Two communications (letter and telegram) reaching simultaneously will neutralize each other, and there is no agreement due to lack of consensus-ad-idem. [Countess of Dunmore vs Alexander]

Expected questions based on Communication, acceptance and revocation of proposals

Question 7

A, the secretary of a building society, handed over to B, in the office of the society, an offer to sell a property at £750. Fourteen days' time was given to B for acceptance. B was residing in a different town, and took away with him the offer to that town. The next day, at about 3.30 p.m. B sent, by post, his letter of acceptance. This letter was received at society's office at 8.30 Pm. But before that at about 1.00 p.m. the society had posted a letter revoking its offer. B received the letter of revocation at 5.30 p.m. Advice B.

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Answer

Revocation of Proposals (Section 5 of The Indian Contract Act, 1872)

A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards.

Completion of communication of acceptance against proposer (Section 4 of The Indian Contract Act, 1872)
The communication of an acceptance is complete — as against the proposer, when it is put in a course of transmission to him so as to be out of the power of the acceptor.

Thus, the offeror becomes bound by the acceptance as soon as the letter of acceptance is posted by the acceptor.

The revocation was held to be ineffetive [Henthorn v. Fraser]. In order that revocation to be effective, it shold have been reached B before he sent his acceptance i.e. before 3.30 p.m.

Question 8

A applied for shares in a company. A withdrew his offer on 26th October. His letter of withdrawal was received by the company at 11.30 a.m. on 27th October. But on 27th October at 10.00 a.m., the company had already resolved to allot the shares to A, and the letter of allotment (acceptance) was given to a peon to post, but the letter was not actually posted till 11.30 a.m. Advice A and also to company.

Answer

Revocation of acceptance (Section 5 of The Indian Contract Act, 1872)

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

Thus, the acceptor becomes bound by his acceptance only when it comes to the knowledge of the offeror.

Completion of communication of acceptance against acceptor (Section 4 of The Indian Contract Act, 1872)
When it comes to the knowledge of the proposer.

It was held that the revocation was valid. The aceptance was too late as the letter was not actually posted till the offer had been revoked. But, if the letter of acceptance had been actually posted before the letter of revocation reached the company (i.e. before 11.30 a.m.), the acceptance would have been binding [London and Northern Bank v. Jones]. It may be noted that a revocation is effective only when it is brought to the notice of the person to whom it is made.

Communication of special conditions of Offer/ Acceptance

- Tacit communication and acceptance: Sometimes there are situations where there are contracts with special conditions. These special conditions are conveyed tacitly and the acceptance of these conditions are also conveyed by the offeree again tacitly or without himeven realizing it.
- Deemed Acceptance: In any event, the passenger is treated as having accepted thespecial condition the moment he bought his ticket if they are communicated to him in some reasonable manner, e.g. conditions on the reverse of a train ticket, air ticket, bill issued byservice providers, etc.
- Notice of Conditions mandatory: The party delivering the document should have given reasonable notice of the special terms / conditions. Words like See Back for Conditions, Please Turn Over, Subject to Terms and Conditions contained in Annexure, are indicative of a reasonable notice to the Acceptor. It shall be binding even though the Acceptor did not read the same or could not understand it.
- No Notice — Acceptor not incur/bound:
    - Any contractual obligation, if the document is printed and delivered to him in such conditionthat, it does not give reasonable notice on its face that it contains certain special conditions.
    - When the conditions are contained in a document that is delivered after the Contract iscomplete.
    - If conditions limiting or defining his rights are not brought to his notice.

CASE LAW		
	A passenger was travelling with luggage from Dublin to Whitehaven on a ticket, on the back of which there was a term that exempted the Shipping Company from liability for loss of luggage. He never looked at the back of the ticket and there was nothing on the face of it to draw his attention to the terms on its back. He lost his luggage and sued for damages. Held,he was entitled to damages as he was not bound by something which was not communicated to him.	**Henderson vs Stevenson**
	A passenger deposited a bag in the cloakroom at a Railway Station. Acknowledgement Receipt given to him carried, on the face of it, the words "See back". One condition limited the liability of Railways for any package to £10. The bag was lost, and passenger claimed £24 being its value, pleading that he had not read conditions. Held, passenger was bound by conditions printed on the back, as the Company gave reasonable notice.	**Parker vs South Eastern Rly. Co.**
	A Transport Carrier accepted goods for transport without any conditions. Subsequently, he issued a circular to owners of goods limiting his liability for goods. Since the special conditions were not communicated prior to the date of contract for transport, these were not binding on the owners of goods.	**Raipur Transport Co. vs Ghanshyam**

	T purchased a Railway Ticket, on the face of which was written - For Conditions See Back. One condition excluded liability for injury, however caused. T was illiterate and could not read. She was injured andsued for damages. Held, the Railway Company had properly communicated conditions to her who had constructive notice ofconditions whether she read them or not. The Company was not boundto pay any damages.	**Thompson vs LM&L Rly. Co.**
	A launderer had given to his customer a receipt for clothes received for washing. Special conditions for this were printed on the reverse of receipt. Held that special conditions were duly communicated to thecustomer who had impliedly accepted the same.	**Lily White vs R.Muthuswami**
	Persons entering into Contracts on special terms are deemed to have impliedly accepted those terms.	**Mukal Datta vsIndian Airlines**

Void Agreements/Contract | Illegal Agreement | Types of Contract

Difference between Void and Illegal Agreements

Basis	Void Agreements	Illegal Agreements
1. Enforceability by law	It is an agreement not enforceable by law, but they are not forbidden under law.	Illegal Agreements are forbidden under law.
2. Interchangeability	All Void Agreements need not be illegal.	All Illegal Agreements are void ab-initio.
3. Punishment	Void Agreements are not punishable.	Illegal agreements may be punishable with fine or imprisonment or both.
4. Other related transactions	Collateral Transactions are not affected.	Collateral Transactions are also void.
5. Example	Agreement entered into with a Minor is VOID AB INITIO (from the very beginning)	Agreement to murder a person.

Example of Collateral Transactions in case of illegal Agreements: X agrees to pay Y ₹ 1, 00,000 if Y kills Z. Y kills Z and claims ₹1, 00,000. Y cannot recover from X because the agreement between X and Y is illegal as its object is unlawful.

If in the above example, X borrows ₹1, 00, 000 from W who is aware of the purpose of the loan, the main agreement between X and Y is illegal and the agreement between X and W which is collateral to the main agreement is also void. Hence, W cannot recover the money from X.

Question: Distinguish between Void Contract and Voidable Contract according to the Indian Contract Act, 1872. (June 23 - 5 Marks)

Answer

S. No	Basis	Void Contract	Voidable Contract
1	Meaning	A Contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.
2	Enforceability	A void contract cannot be enforced at all.	It is enforceable only at the option of aggrieved party and not at the option of the other party.

3	Cause	A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties.	A contract becomes a voidable contract if the consent of a party was not free.
4	Performance of contract	A void contract cannot be performed.	If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming the performance of the contract.
5	Rights	A void contract does not grant any legal remedy to any party.	The party whose consent was not free has the right to rescind the contract within a reasonable time. If so rescinded it becomes a void contract. If it is not rescinded it becomes a valid contract.

Question 9

X agrees to pay Y Rs. 1,00,000/-, if Y kills Z. To pay Y, X borrows Rs. 1,00,000/- from W, who is also aware of the purpose of the loan. Y kills Z but X refuses to pay. X also to repay the loan to W. Explain the validity of the contract.

(i) Between X and Y.

(ii) Between X and W [Nov 22 - 4 Marks]

Answer

(a) Illegal Agreement: It is an agreement which the law forbids to be made. As an essential condition, the lawful consideration and object is must to make the agreement valid. (Section 10). As per Section 23 of the Indian Contract Act, 1872, an agreement is illegal and void, if the consideration and object is unlawful / contrary to law i.e. if forbidden by law. Such an agreement is void and is not enforceable by law. Even the connected agreements or collateral transactions to illegal agreements are also void.

(b) In the present case,

(i) X agrees to give Rs. 1,00,000 to Y if Y kills Z. Thus, the agreement between X and Y is void agreement being illegal in nature.

(ii) X borrows Rs. 1,00,000 from W and W is also aware of the purpose of the loan. Thus, the agreement between X and W is void as the connected agreements of an illegal agreements are also void.

Expected question based on illegal & void agreement

Related Question: X threatens to kill Y if he (Y) does not sell his house to X for Rs. 1, 00,000. Y agrees. X borrows Rs. 1, 00,000 from Z who is also aware of the purpose of the loan. What is the nature of the agreement between X and Y, and X and Z?

Answer:

The contract between X and Y is a contract which is voidable at the option of Y because Y's consent is not free as it has been obtained by coercion. The contract between X and Z is a valid contract because the object of contract (i.e. borrowing for the purchase of a house) is lawful.

Arjun sir be like: Kyu hila dala na.?

Question 10

Mr. Y is a devotee and wants to donate an elephant to the temple as a core part of ritual worship. He contacted Mr. X who wanted to sell his elephant. Mr. X contracted with Mr. Y to sell his elephant for Rs. 20 Lakhs. Both were unaware that the elephant was dead a day before the agreement. Referring to the provisions of the Indian Contract Act, 1872, explain whether it is a void, voidable or a valid contract. [RTP Nov 22]

Answer

Institute's answer:

As per Section 2(j) of the Indian Contract Act, 1872 a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. The fact of impossibility may be known or unknown to the promisor or promisee.

It may be added by clarification here that the term "contract" shall be understood as an "agreement".

Thus, when the parties agree on doing something which is obviously impossible in itself the agreement would be void.

In this case, Mr. X and Mr. Y were ignorant of the fact that the elephant was dead and therefore the performance of the contract was impossible from the very start (impossibility ab initio).

Hence, this contract is void being not enforceable by law.

Author's answer: students should right this answer in exam

Section 20 in The Indian Contract Act, 1872

Agreement void where both parties are under mistake as to matter of fact. —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.

Agreement Void [Sec. 56]: An Agreement to do an act impossible in itself is void ab-initio (void from the very beginning). Whether the fact of impossibility was known to the parties or not is immaterial.

Void Agreement [Sec.2(g)]: An Agreement not enforceable by law is void.

In this case, Mr. X and Mr. Y were ignorant of the fact that the elephant was dead and therefore the performance of the contract was impossible from the very start (impossibility ab initio).

Hence, this agreement is void being not enforceable by law.

Miscellaneous Questions

Question 11

Explain the type of contracts in the following agreements under the Indian Contract Act, 1872:

(i) A coolie in uniform picks up the luggage of A to be carried out of the railway station without being asked by A and A allows him to do so.

(ii) Obligation of finder of lost goods to return them to the true owner

(iii) A contracts with B (owner of the factory) for the supply of 10 tons of sugar, but before the supply is effected, the fire caught in the factory and everything was destroyed. [RTP May 20] [MTP Nov 22 – 4 Marks]

Answer: (i)

1. It is an implied contract and A must pay for the services of the coolie.
2. Implied Contracts: This implies a contract though parties never intended. Where a Proposal or Acceptance is made otherwise than in words, promise is said to be implied.

Answer: (ii)

Obligation of finder of lost goods to return them to the true owner cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent. These are said to be quasi-contracts.

Quasi-Contract: A quasi-contract is not an actual contract but it resembles a contract. It is a contract in which there is no intention on part of either party to make a contract but law imposes a contract (rights and obligations) upon the parties.

Answer: (iii)

The above contract is a void contract.

Void Contract: Section 2 (j) of the Act states as follows: *"A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable"*. Thus, a void contract is one which cannot be enforced by a court of law.

Question 12

State whether there is any contract in following cases:
(a) A engages B to do certain work and remuneration to be paid as fixed by C.
(b) A and B promise to pay for the studies of their maid's son
(c) A takes a seat in public bus.
(d) A, a chartered accountant promises to help his friend to file his return. [Module back question]

Answer

(a) It is a valid express contract
(b) It is not a contract as it is a social agreement
(c) It is an implied contract. A is bound to pay for the bus fare.
(d) It is a social agreement without any intention to create a legal relationship.

Question 13

State which of the following agreements are valid contract under the Indian Contract Act, 1872?
(a) A, who owns two cars is selling red car to B. B thinks he is purchasing the black car.
(b) A threatened to shoot B if he (B) does not lend him Rs. 2,00,000 and B agreed to it.
(c) A agrees to sell his house to B against 100 kgs of cocaine (drugs).
(d) A ask B if he wants to buy his bike for & 50,000. B agrees to buy bike.
(e) Mr. X agrees to write a book with a publisher. But after few days, X dies in an accident. [RTP June 23]

Answer

(a) A, who owns two cars is selling red car to B. B thinks he is purchasing the black car. There is no consensus ad idem and hence not a valid contract.
(b) A threatened to shoot B if he (B) does not lend him Rs. 2,00,000 and B agreed to it. Here the agreement is entered into under coercion and hence not a valid contract.

(c) A agrees to sell his house to B against 100 kgs of cocaine (drugs). Such agreement is illegal as the consideration is unlawful.
(d) A ask B if he wants to buy his bike for Rs. 50,000. B agrees to buy bike. It is agreement which is enforceable by law. Hence, it is a valid contract.
(e) Mr. X agrees to write a book with a publisher. But after few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract.

Unit– 2: Consideration

Very Important Unit

Question 1

Define consideration. What are the legal rules regarding consideration under the Indian Contract Act, 1872? [Nov 19 - 7 Marks] [RTP Nov, 2018] [MTP March 19, 5 Marks]

Answer:

Consideration [Section 2(d) of the Indian Contract Act, 1872]: When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or abstain from doing something, such an act or abstinence or promise is called consideration for the promise.

Legal Rules Regarding Consideration

(i) Consideration must move at the desire of the promisor: Consideration must be offered by the promisee or the third party at the desire or request of the promisor.

Durga Prasad vs Baldeo: D constructed a market at the instance of District Collector. Occupants of shops promised to pay D a commission on articles sold through their shops. Held, there was no consideration because money was not spent by Plaintiff at the request of the Defendants, but at instance of a third person viz. the Collector and, thus the Contract was void.

(ii) Consideration may move from promisee or any other person: In India, consideration may proceed from the promisee or any other person who is not a party to the contract. In other words, there can be a stranger to a consideration but not stranger to a contract.

(iii) Executed and executory consideration: A consideration which consists in the performance of an act is said to be executed. When it consists in a promise, it is said to be executory.

(iv) Consideration may be past, present or future:

Past Consideration: The consideration which has already moved before the formation of agreement.

For Consideration to be treated as past it must move by a previous request.

Example X renders some service to Y at Y's request in the month of May. In June, Y promises to pay X Rs. 1,000 for his past services. Past services amount to past consideration. X can recover Rs. 1,000 from Y.

Present Consideration Executed Consideration (consists in the performance): The consideration which moves simultaneously with the promise, is called present consideration.

Future Consideration or Executory consideration(consists in a promise): The consideration which is to be moved after the formation of agreement is called future consideration.

(v) Consideration need not be adequate: Provision is given below

(vi) Performance of what one is legally bound to perform: The performance of an act by a person who is legally bound to perform the same cannot be consideration for a contract Because a promise to do what a promisor is already bound to do adds nothing to the existing obligation.

Hence, a promise to pay money to a witness is void, for it is without consideration. Hence such a contract is void for want of consideration. But where a person promises to do more that he is legally bound to do, such a promise provided it is not opposed to public policy, is a good consideration.

Example: X promises Y, his advocate, to pay an additional sum if the suit was successful. The suit was declared in favour of X but X refused to pay additional sum. It was held that Y could not recover additional sum because the promise to pay additional sum was void for want of consideration as Y was already bound to render his best services under the original agreement.

(vii) Consideration must be real and not illusory: Consideration is not valid if it is - (i) physically impossible (e.g. to discover treasure by magic), (ii) legally not permissible (e.g. to murder a person), (iii) uncertain (e.g. to pay a "reasonable" salary for services rendered), or (iv) illusory (e.g. fulfilment of a pre-existing obligation).

(viii) Consideration must not be unlawful, immoral, or opposed to public policy. Only presence of consideration is not sufficient it must be lawful. Anything which is immoral or opposed to public policy also cannot be valued as valid consideration.

Related Question: Mr. Balwant, an old man, by a registered deed of gift, granted certain landed property to Ms. Reema, his daughter. By the terms of the deed, it was stipulated that an annuity of Rs. 20, 000 should be paid every year to Mr. Sawant, who was the brother of Mr. Balwant.

On the same day Ms. Reema made a promise to Mr. Sawant and executed in his favour an agreement to give effect to the stipulation. Ms. Reema failed to pay the stipulated sum. In an action against her by Mr. Sawant, she contended that since Mr. Sawant had not furnished any consideration, he has no right of action.

Examining the provisions of the Indian Contract Act, 1872, decide, whether the contention of Ms. Reema is valid? [RTP Nov 2018] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

1. In India, consideration may proceed from the promise or any other person who is not a party to the contract.
2. The definition of consideration as given in section 2(d) makes the above statement clear. According to the definition, when at the desire of the promisor, the promisee or any other person does something such an act is consideration. In other words, there can be a stranger to a consideration but not stranger to a contract.

In the given problem

1. Mr. Balwant has entered into a contract with Ms. Reema, but Mr. Sawant has not given any consideration to Ms. Reema but the consideration came from Mr. Balwant to Ms. Reema and such consideration from third party is sufficient to the enforce the promise of Ms. Reema, the daughter, to pay an annuity to Mr. Sawant.

2. Further the deed of gift and the promise made by Ms. Reema to Mr. Sawant 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. Hence, the contention of Ms. Reema is not valid.

Related Question: "To form a valid contract, consideration must be adequate." Comment. [Back Question of Module] [MTP Oct 19, 5 Marks] [MTP Aug 18, 5 Marks] [RTP NOV 20] [RTP May 21] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8 [RTP Nov 22 – 3 Marks]

Answer:

Consideration Need not be adequate:

(a) Adequacy of consideration should be decided from the view-point of the Promisor.

(b) Explanation to Sec.25 provides that an agreement to which consent of the party is freely given is not void merely because consideration is inadequate.

(c) However, inadequacy of consideration may be taken into account by Court to determine whether the Promisor's consent was freely given.

(d) Example: K promises to sell a house worth ₹ 8 Lakhs for ₹ 2 Lakhs only. The transaction is valid even if the consideration is inadequate. But, where a party pleads coercion, undue influence or fraud to avoid a transaction, inadequacy of consideration will also be taken as a piece of evidence.

Expected question based on adequacy of consideration

Related Question: X, who was badly in need of money offered to sell his car worth Rs. 1,00,000 to Y for Rs. 10,000. Before the car was delivered, X received an offer of Rs. 20,000 and refused to carry out the contract on the ground of inadequacy of consideration. Is X liable to Y for damages? [2 Marks]

Answer:
Provision same as above
In the light of the above provision and facts of the case we conclude X is liable to Y for damages.

Reason: An agreement to which the consent of the party is freely given is not void merely because the consideration is inadequate.

Suit by third party to Contract (Doctrine of Privity of Contract)

Question 2

"Only a person who is party to a contract can sue on it." Explain this statement and describe its exceptions, if any. [RTP May 20] [7 Marks June 23] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Or

Stranger to a contract cannot sue, However in some cases even a stranger to a contract may enforce a claim. Explain [RTP May 18] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Though under the Indian Contract Act, 1872, the consideration for an agreement may proceed from a third party, the third party cannot sue on contract. Only a person who is party to a contract can sue on it.

Thus, the concept of stranger to consideration is valid and is different from stranger to a contract.

The aforesaid rule, that stranger to a contract cannot sue is known as a "doctrine of privity of contract", is however, subject to certain exceptions. In other words, even a stranger to a contract may enforce a claim in the following cases:

1. In the case of trust, a beneficiary can enforce his right under the trust, though he was not a party to the contract between the settler and the trustee.
2. In the case of a family settlement, if the terms of the settlement are reduced into writing, the members of family who originally had not been parties to the settlement may enforce the agreement.
3. In the case of certain marriage contracts, a female member can enforce a provision for marriage expenses made on the partition of the Hindu Undivided Family.
4. In the case of assignment of a contract, when the benefit under a contract has been assigned, the assignee can enforce the contract.
5. Acknowledgement or estoppel – where the promisor by his conduct acknowledges himself as an agent of the third party, it would result into a binding obligation towards third party.
6. In the case of covenant running with the land, the person who purchases land with notice that the owner of land is bound by certain duties affecting land, the covenant affecting the land may be enforced by the successor of the seller.
7. Contracts entered into through an agent: The principal can enforce the contracts entered by his agent where the agent has acted within the scope of his authority and in the name of the principal.

Related Question: Mr. Sohanlal sold 10 acres of his agricultural land to Mr. Mohanlal on 25th September 2018 for Rs. 25 Lakhs. The Property papers mentioned a condition, amongst other details, that whosoever purchases the land is free to use 9 acres as per his choice but the remaining 1 acre has to be allowed to be used by Mr. Chotelal, son of the seller for carrying out farming or other activity of his choice.

On 12th October, 2018, Mr. Sohanlal died leaving behind his son and life. On 15th October, 2018 purchaser started construction of an auditorium on the whole 10 acres of land and denied any land to the son.

Now Mr. Chotelal wants to file a case against the purchaser and get a suitable redressed. Discuss the above in light of provisions of Indian Contract Act, 1872 and decide upon Mr. Chotelal's plan of action? [4 Marks May 2019]

Answer:

1. Problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in section 2(d) and on the principle 'privity of consideration'.
2. Consideration is one of the essential elements to make a contract valid and it can flow from the promisee or any other person.
3. As the clear language used in definition of 'consideration' in Section 2(d), it is not necessary that consideration should be furnished by the promisee only.
4. 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.
5. In case of the *Chinnaya Vs. Ramayya*, held that the consideration may move from a third party and it is an accepted principle of law in India.

In the given problem

1. Mr. Sohanlal has entered into a contract with Mr. Mohanlal, but Mr. Chotelal has not given any consideration to Mr. Mohanlal but the consideration came from Mr. Sohanlal to Mr. Mohanlal on the behalf of Mr. Chotelal and such consideration from third party is sufficient to enforce the promise of Mr. Mohanlal to allow Mr. Chotelal to use 1 acre of land.
2. Further the deed of sale and the promise made by Mr. Mohanlal to Mr. Chotelal to allow the use of 1 acre of land were executed simultaneously and therefore they should be regarded as one transaction and there was sufficient consideration for it.
3. Moreover, it is provided in the law that "in case covenant running with the land, where a person purchases land with notice that the owner of the land is bound by certain duties affecting land, the covenant affecting the land may be enforced by the successor of the seller."

Conclusion

1. In such a case, third party to a contract can file the suit although it has not moved the consideration.
2. Hence, Mr. Chotelal is entitled to file a petition against Mr. Mohanlal for execution of contract.

Expected question based on suit by third party to contract

Related Question: A was appointed by his father as his successor. A was put in possession of the entire estate of his father. It was agreed between A and his father that he (A) would give certain sum of money and a village to B (an illegitimate son of A's father), on his attaining majority. A is refusing on attainment of majority of B. Advice B.

Answer:

Only those persons, who are parties to a Contract, can sue and be sued upon the contract. This Rule is called "Doctrine of Privity of Contract". A Third Party to a Contract cannot sue upon it, even though the Contract may be for his benefit.

One of the exception of such doctrine is "Trust"

The beneficiary (i.e. the person for whose benefit the trust has been created) may enforce the right under the trust, though he was not a party to the contract between the settler and the trustee.

Trust was created in favour of B for the specific amount and a village, therefore he was entitled to receover it from A.

No Consideration No Contract

Question 3

State the exceptions to the rule "An agreement without consideration is void".

OR

No Consideration No Contract, Comment.

[May 2018, 5 Marks] [Jan 21- 5 Marks] [May 22 - 4 Marks] [Nov 22 - 7 Marks] [MTP April 19, 5 Marks] [MTP Oct 18, 5 Marks] [MTP March 18, 5 Marks] [RTP May 19] [RTP Nov 19] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

No consideration, no contract

1. Every agreement, to be enforceable by law must be supported by valid consideration. An agreement made without any consideration is void.
2. No consideration, no contract is a general rule.
3. However, Section 25 of the Indian Contract Act, 1872 provides some exceptions to this rule, where an agreement without consideration will be valid and enforceable.
4. These exceptions are as follows:
   (i) Agreement made on account of natural love and affection Section 25 (1): If an agreement is
      a) in writing
      b) registered under the law and
      c) made on account of natural love and affection
      d) between the parties standing in a near relation to each other

It will be enforceable at law even if there is no consideration.

Thus, where A, for natural love and affection, promises to give his son, B, ` 1, 00,000 in writing and registers it. This is a valid contract.

(ii) Compensation for past voluntary services Section 25(2):

a) A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable.

b) Thus, when A finds B's purse and gives it to him and B promises to give A Rs. 5,000, this is a valid contract.

(iii) Promise to pay time-barred debts Section 25 (3):

a) Where there is an agreement, made in writing and signed by the debtor or by his agent, to pay wholly or in part a time barred debt, the agreement is valid and enforceable even though there is no consideration.

b) If A owes B Rs. 1,00,000 but the debt is lapsed due to time-bar and A further makes a written promise to pay Rs. 50,000 on account of this debt, it constitutes a valid contract.

(iv) Contract of agency (Section 185): No consideration is necessary to create an agency.

(v) Completed gift (Explanation 1 to Section 25): A completed gift needs no consideration. Thus, if a person transfers some property by a duly written and registered deed as a gift, he cannot claim back the property subsequently on the ground of lack of consideration.

(vi) Bailment (Section 148): No consideration is required to effect the contract of bailment.

(vii)Charity: If a promisee undertakes the liability on the promise of the person to contribute to charity, there the contract shall be valid.

Expected question based on natural love & affection

Related Question: X, a Hindu husband executed a registered document in favour of Y, his wife, whereby he promised to pay her Rs. 1,000 per month. Later, X did not pay. Can Y recover from X (a) if this promise was made without any disagreement and quarrels between them? (b) if this promise was made after disagreement and quarrels between them? [2 Marks]

Answer:

The agreement though made without consideration, will be valid and enforceable in thefollowing situation

Natural Love and Affection: Conditions to be fulfilled under section 25(1)

(i) It must be made out of natural love and affection between the parties.

(ii) Parties must stand in near relationship to each other.

(iii) It must be in writing.

(iv) It must also be registered under the law.

A written and registered agreement based on natural love and affection between theparties standing in near relation (e.g., husband and wife) to each other is enforceable even without consideration.

Case (a)

Therefore, Y could recover from X because the agreement was valid because it was made on account of natural love and affection between X and Y.

Case (b)

Therefore, Y could not recover from X because the agreement was void because it was not made an account of natural loveand affection between X and Y.

[Leading case: Rajlakhi Devi v. Bhoot Nath Mookherjee]

Related Question: Mr. Ram Lal Birla was a big businessman of city Pune having two sons and one married daughter. He decided to gift his one house to his daughter. For this purpose, he called his lawyer at his house and made a written document for such gift. The lawyer advised him to get the transfer document properly registered. When they both were going for registration of document, they met with an accident and both of them died. Later, his daughter found the document and claimed the house on the basis of that document. Explain, whether she can get the house as gift under the Indian Contract Act, 1872? [RTP Nov 21] [RTP Nov 22] [RTP June 23]

Answer: Section 25 of Indian Contract Act, 1872 provides that an agreement made without consideration is valid if

- it is expressed in writing and registered under the law for the time being in force for the registration of documents and
- is made on account of natural love and affection between parties standing in a near relation to each other.

In the instant case, the transfer of house made by Mr. Ram Lal Birla on account of natural love and affection between the parties standing in near relation to each other is written but not registered. Hence, this transfer is not enforceable and his daughter cannot get the house as gift under the Indian Contract Act, 1872.

Expected question based on time barred debt

Related Question: X owes Y Rs. 10,000 but this debt is time barred. In a birthday party of Z, who is a friend of X and Y, X promises Y to pay this debt. Later, X refuses to Y. Can Y recover the promised amount from X? [2 Marks]

Answer:

Promise to pay time-barred debts Section 25 (3):

Where there is an agreement, made in writing and signed by the debtor or by his agent, to pay wholly or in part a time barred debt, the agreement is valid and enforceable even though there is no consideration. In the instant case Y cannot recover anything from X because X's promise was neither in writing nor signed by him or his agent.

Related Question: Mr. Y given loan to Mr. G of INR 30,00,000. Mr. G defaulted the loan on due date and debt became time barred. After the time barred debt, Mr. G agreed to settle the full amount to Mr. Y. Whether acceptance of time barred debt Contract is enforceable in law? [Dec 20, 2 Marks]

Answer:

Promise to pay time-barred debts Section 25 (3):

a) Where there is an agreement, made in writing and signed by the debtor or by his agent, to pay wholly or in part a time barred debt, the agreement is valid and enforceable even though there is no consideration.
b) If A owes B Rs. 1,00,000 but the debt is lapsed due to time-bar and A further makes a written promise to pay Rs. 50,000 on account of this debt, it constitutes a valid contract.

In the instant case

G agreed to settle the full amount to Mr. Y of time barred debt. If such promise is in writing & signed by G or by his authorised agent then acceptance of such time barred debt is enforceable otherwise not enforceable.

Expected question based on past voluntary service

Related Question: X supports Y's infant son without being asked to do so. Y promises to pay X Rs. 10,000 for doing so. Later, Y refuses to pay. Can X recover the promised amount from Y? [2 Marks]

Answer:

Compensation for past voluntary services Section 25(2):

A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable.

In order that a promise to pay for the past voluntary services be binding, the following essential factors must exist:

(i) The services should have been rendered voluntarily.
(ii) The services must have been rendered for the promisor.
(iii) The promisor must be in existence at the time when services were rendered.
(iv) The promisor must have intended to compensate the promisee.

Related Question: Anita and Sonali are friends, Sonali treats Anita during Anita's illness.
Sonali does not accept payment from Anita for treatment and Anita promises Sonali's daughter Tania to pay her Rs. 75,000. Anita, being in poor circumstances is unable to pay.
Tania sues Anita for the money. Can Tania recover?
Offer your views based on provisions of the Indian Contracts Act, 1872. [5 Marks]

Answer:

No, Tania cannot recover the money from Anita. The agreement between Tania and Anita is not a contract in the absence of consideration. In this case, Tania's mother Sonali, voluntarily treats Anita

during her illness. Apparently it is not a valid consideration because it is voluntary whereas consideration to be valid must be given at the desire of the promisor-Section 2(d).

The question now is whether this case is covered by the exception given in Section 25(2) which provides.

"If it is a promise to compensate a person who has already voluntarily done something for the promisor"

Thus as per the exception the promise must be to compensate a person who has himself done something for the promisor and not to a person who has done nothing for the promisor.
As Sonali's daughter, Tania to whom the promise was made, did nothing for Anita, so Anita's promise is not enforceable even under the exception.

Expected question based on charity

Related Question: X promises to donate Rs. 10,000 towards the repairs of a temple. X does not pay. Can the trustees recover the promised amount from X (a) if they have not incurred any liability on the faith of the X's promise, (b) if they have incurred any liability on the faith of this promise. [2 Marks]

Answer:
Charity: If a promisee undertakes the liability on the promise of the person to contribute to charity, there the contract shall be valid (Kedarnath v. Gorie Mohammad)

Case (a)
The trustees cannot recover the promised amount from X because the agreement is void in the absence of any consideration. [Leading case: Abdul Aziz v. Masum Ali]

Case (b)
The trustees can recover the promised amount from X as the agreement is valid because it was supported by consideration in the form of a detriment to the trustees who had incurred liability on the faith of the promise made by X. [Leading case: Kedar Nath v. Gorie Mohammad]

Expected question based on gift

Related Question: X gifted Rs. 50,000 to Y his neighbour's wife by executing a registered gift deed without any consideration. There is no near relation between X and Y. Is this gift valid? [2 Marks]

Answer:
Section to which the given problem relates: Explanation I to Section 25. Decision: The gift is valid because a completed gift needs no consideration and need not be a result of natural love and affection or near relation.

Related Question: X promises to make a gift of Rs. 50,000 to Y, his neighbour's wife. Is this promise valid? [2 Marks]

Answer:
Section to which the given problem relates: Explanation I to Section 25 because a promise to gift is not valid.
This agreement is void for want of consideration and at the same time, there is only a promise to gift and not a completed gift.

Miscellaneous Question

Question 4

Explain the type of contracts in the following agreements under the Indian Contract Act, 1872:
(i) X promise to sell his scooter to Y for Rs. 1 Lac. However, the consent of X has been procured by Y at a gun point.
(ii) A bought goods from B in 2015. But no payment was made till 2019.
(iii) G agrees to give tuitions to H, a pre-engineering student, from the next month and H in consideration promises to pay G RS. 5,000 per month. [RTP May 21]

Answer:

(i) In the instant case, X is an aggrieved party and the contract is voidable at his option but not at the option of Y. It means if X accepts the contract, the contract becomes a valid contract then Y has no option of rescinding the contract.

(ii) B cannot sue A for the payment in 2019 as it has crossed three years and barred by Limitation Act. A good debt becomes unenforceable after the period of three years as barred by Limitation Act.
(iii) Where, G agrees to give tuitions to H, a pre-engineering student, from the next month and H in consideration promises to pay G Rs. 5,000 per month, the contract is executory because it is yet to be carried out.

Unit – 3: Other Essential Elements of a Contract

Agreement/Contract with minor

Question 1

Examine with reason that the given statement is correct or incorrect "Minor is liable to pay for the necessaries supplied to him". [May 2018, 2 Marks]

Answer:

1. Minor is liable to pay for the necessaries supplied to him: This statement is incorrect.
2. The case of necessaries supplied to a minor or to any other person whom such minor is legally bound to support is governed by section 68 of the Indian Contract Act, 1872.
3. A claim for necessaries supplied to a minor is enforceable by law, only against minor's estate, if he possesses.
4. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries. There is no personal liability of the minor, but only his property is liable.

Related Question: Ishaan, aged 16 years, was studying in an engineering college. On 1st March, 2016 he took a loan of Rs. 2 lakhs from Vishal for the payment of his college fee and agreed to pay by 30th May, 2017. Ishaan possesses assets worth Rs.15 lakhs. On due date Ishaan fails to pay back the loan to Vishal. Vishal now wants to recover the loan from Ishaan out of his assets. Decide whether Vishal would succeed referring to the provisions of the Indian Contract Act, 1872. [MTP March 18, 4 Marks] [RTP May 2020] [MTP Oct 20- 6 Marks]

Answer:

1. According to Section 11 of the Indian Contract Act, 1872, every person is competent to contract who is of the age of 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.
2. A person who has completed the age of 18 years is a major and otherwise he will be treated as minor. Thus, Ishaan who is a minor is incompetent to contract and any agreement with him is void [Mohori Bibi Vs Dharmo Das Ghose 1903].
3. Same as point 2, 3 & 4 Above.
4. Thus, according to the above provision, Vishal will be entitled to recover the amount of loan given to Ishaan for payment of the college fees from the property of the minor.

Related Question: Examine the validity of the following contracts as per the Indian Contract Act, 1872, giving reasons.

X, aged 16 years, borrowed a loan of 50,000 for his personal purposes. A few months later, he had become major and could not pay back the amount borrowed on the due date. The lender wants to file a suit against X. [Dec 21 3 Marks]

Answer:

1. According to Section 11 of the Indian Contract Act, 1872, every person is competent to contract who is of the age of 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.
2. A person who has completed the age of 18 years is a major and otherwise he will be treated as minor. Thus, X who is a minor is incompetent to contract and any agreement with him is void [Mohori Bibi Vs Dharmo Das Ghose 1903].
3. A claim for necessaries supplied to a minor is enforceable by law, only against minor's estate, if he possesses.
4. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries. There is no personal liability of the minor, but only his property is liable.
5. Thus, according to the above provision, lender will not be entitled to recover the amount of loan given to X.

Question 2

"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. [RTP May 18] [RTP Nov 22] [Back Question of Module]

Answer:

1. Minor can be a beneficiary or can take benefit out of a contract: Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor.
2. For example: A promissory note duly executed in favour of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.
3. A mortagage was executed in favour of minor. Held, he can get a decree for the enforcement of the mortgage.
4. A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership (Section 30 of the Indian Partnership Act, 1932).

Question 3

Rahul, a minor, falsely representing his age, enters into an agreement with a shopkeeper for a loan amount for purchasing a laptop. He gave his expensive watch as a security and took a loan of Rs. 40,000. He was very happy to get Rs. 40,000 and quickly went to the market and purchased a laptop worth Rs. 30,000. He happily spent the rest of the amount with his friends on a pleasure trip.

Later on, Rahul realized that his watch was an expensive watch and he should not have given like this to the shopkeeper. So, he went back to the shopkeeper and asked for his watch back. Also, he refused to repay the loan amount. The shopkeeper disagrees to this and files a case against minor for recovery of the loan amount. Can the shopkeeper succeed in recovering the loan amount under the Indian Contract Act, 1872? [RTP Nov 21]

Answer:

1. As per Section 11 of Indian Contract Act, 1872, a minor is not competent to enter into any contract. Any agreement with minor is void-ab-initio means void from the very beginning.

2. When a person forms an agreement with minor, such an agreement is devoid of any legal consequences for the person because minor cannot be enforced by law to perform his part of performance in an agreement.

3. However, if minor obtains any property by fraudulently misrepresenting his age, he can be ordered to restore the property or goods thus obtained. Although no action can be taken against the minor, but if has any property (of other party) in his possession, court can order him to return the same.

4. Hence, in the present case, Rahul is not liable to repay Rs.40,000 that he has borrowed from the shopkeeper, but he can be ordered by the court to return the laptop (which was in his possession) to the shopkeeper.

Related Question: Srishti, a minor, falsely representing her age, enters into an agreement with an authorised Laptop dealer Mr. Gupta, owner of SP Laptops, for purchase of Laptop on credit amounting Rs. 60,000/- for purchasing a laptop, on 1st August 2021. She promised to pay back the outstanding amount with interest @ 16% p.a. by 31st July 2022. She told him that in case she won't be able to pay the outstanding amount, her father Mr. Ram will pay back on her behalf. After One year, when Srishti was asked to pay the outstanding amount with interest she refused to pay the amount and told the owner that she is minor and now he can't recover a single penny from her.

She will be adult on 1st January 2024, only after that agreement can be ratified. Explain by which of the following way Mr. Gupta will succeed in recovering the outstanding amount with reference to the Indian Contract Act, 1872.

(i) By filing a case against Srishti, a minor for recovery of outstanding amount with interest?
(ii) By filing a case against Mr. Ram, father of Srishti for recovery of outstanding amount?
(iii) By filing a case against Srishti, a minor for recovery of outstanding amount after she attains maturity? [May 22 - 6 Marks] [RTP Dec 23]

Answer:
A contract made with or by a minor is void ab-initio: Pursuant to Section 11, a minor is not competent to contract and any agreement with or by a minor is void from the very beginning.
(i) By following the above provision, Mr. Gupta will not succeed in recovering the outstanding amount by filing a case against Srishti, a minor.

(ii) Minor cannot bind parent or guardian: In the absence of authority, express or implied, a minor is not capable of binding his parent or guardian, even for necessaries. The parents will be held liable only when the child is acting as an agent for parents.

In the instant case, Mr. Gupta will not succeed in recovering the outstanding amount by filing a case against Mr. Ram, father of Srishti.

(iii) No ratification after attaining majority: A minor cannot ratify the agreement on attaining majority as the original agreement is void ab initio and a void agreement can never be ratified.
Hence, in this case also, Mr. Gupta will not succeed in recovering the outstanding amount by filing a case against Srishti, after she attains majority.

Free Consent

Coercion – Section 15

Question 4

Explain the term 'Coercion" and what are the effects of coercion under Indian Contract Act, 1872. [Nov 19, 5 Marks] [MTP Oct 18, 5 Marks] [RTP May 18] [MTP Oct 21, 5 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Coercion is –

Act	Intention
(a) the committing, or threatening to commit any act forbidden by the Indian Penal Code, or (b) the unlawful detaining or threatening to detain, any property, to the prejudice [harm or injury] of any person,	With the intention of causing any person to enter into an agreement.

Effects of coercion under section 19 of Indian Contract Act, 1872

(i) Contract induced by coercion is voidable at the option of the party whose consent was so obtained.
(ii) As to the consequences of the rescission of voidable contract, the party rescinding a void contract should, if he has received any benefit, thereunder from the other party to the contract, restore such benefit so far as may be applicable, to the person from whom it was received.
(iii) A person to whom money has been paid or anything delivered under coercion must repay or return it.

Expected question based on coercion

Related Question: An agent refused to hand over the account books of the business, at the end of his term of office, to the new agent unless the principal freed him from the liability in respect of his agency. The principal executed a release deed under which the agent was freed from liability. Advice principal.

Answer:

Coercion and its effects under section 15 and 19 of The Indian Contract Act, 1872

Provision same as above

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

Release deed was voidable at the option of the principal as he was made to execute the release deed under coercion. In this case, the consent was obtained by unlawfully detaining the property (i.e., account books) of the principal.

Undue Influence

Question 5

Discuss the essentials of Undue Influence as per the Indian Contract Act, 1872. [May 2019, 5 Marks]

Related Question: Explain the circumstances in which the person is deemed to be in a position to dominate the will of the other person under the Indian Contract Act, 1872. [RTP May 20]

Answer:

A Contract is said to be induced by undue influence where the relations subsisting between the parties are such that -

(a) one of the parties is in a position to dominate the will of the other **AND**

(b) uses that position to obtain an unfair advantage over the other. [Section 16 (1)]

The essentials of Undue Influence as per the Indian Contract Act, 1872 are the following:

(1) Relation between the parties: A person can be influenced by the other when a near relation between the two exists.

(2) Position to dominate the will: Relation between the parties exist in such a manner that one of them is in a position to dominate the will of the other.

(3) A person is deemed to be in such position in the following circumstances: [Section 16(2)]

Presumed	Examples of character	Case Law
1. Where a person holds a real authority over the other.	Master and servant, parent and child, Income Tax Officer and assesse, teacher and student.	X advanced Rs. 10,000 to his son Y during his minority and obtained upon Y's coming of age, a bond from Y for Rs. 1,00,000. Here, there is misuse of parental influence.

2. Where relation of trust and confidence (fiduciary relation) exists between the parties to a contract.	Trustee and beneficiary, spiritual adviser (Guru) and his disciples, solicitors and client, guardian and ward	A devotee gifted her property to her spiritual guru to secure benefits to her soul in next world. It was held that spiritual guru was in position to dominate the will of devotee. **[Mannu Singh v. Umadat Pandey]**
3. Where he makes a contract with with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress.	Medical attendant and patient	X, an illiterate old man of about 90 years, physically infirm and mentally in distress, executed a gift deed of his properties in favour of Y his nearest relative who was looking after his daily needs and managing his cultivation. It was held that Y was in a position to dominate the will of X. **[Sher Singh v. Prithi Singh]**

(4) **Unconscionable bargains:** Where one of the parties to a contract is in a position to dominate the will of the other and the contract is apparently unconscionable i.e., unfair, it is presumed by law that consent must have been obtained by undue influence. Unconscionable bargains are witnessed mostly in money lending transactions and in gifts. [Section 16(3)]

Example: X was in great need of money. The market rate of interest prevailing at that time was 15% to 24%. A lender agreed to grant the loan at 30% because of stringency in the money market. This cannot be called as unconscionable transaction merely because of an unusual high rate of interest. However, if the lender agreed to grant the loan at a rate which is so high (say 75% or 100%) then the Court considers it unconscionable, and the transaction will be called unconscionable.

Burden of proof: The burden of proving the absence of the use of the dominant position in such a contract (Unconscionable bargains) to obtain the unfair advantage will lie on the party who is in a position to dominate the will of the other.

(5) The object must be to take undue advantage: Where the person is in a position to influence the will of the other in getting consent, must have the object to take advantage of the other.

Related Question: A student was induced by his teacher to sell his brand-new car to the latter at less than the purchase price to secure more marks in the examination. Accordingly, the car was sold. However, the father of the student persuaded him to sue his teacher. State on what ground the student can sue the teacher? [RTP May 18] [RTP Nov 19] [RTP Nov 22]

Answer: Yes, the student can sue his teacher on the ground of undue influence under the provisions of Indian Contract Act, 1872. A contract brought as a result of coercion, undue influence, fraud or misrepresentation would be voidable at the option of the person whose consent was caused.

Related Question: Chandan was suffering from some disease and was in great pain. He went to Dr. Jhunjhunwala whose consultation fee was Rs. 300. The doctor agreed to treat him but on the condition that Chandan had to sign a promissory note of Rs. 5000 payable to doctor. Chandan signed the promissory note and gave it to doctor. On recovering from the disease, Chandan refused to honour the promissory note. State with reasons, can doctor recover the amount of promissory note under the provisions of the Indian Contract Act, 1872? [RTP May 22]

Answer:

Section 16 of Indian Contract Act, 1872 provides that a contract is said to be induced by "undue influence" where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

Further, a person is deemed to be in a position to dominate the will of another—
(a) Where he holds a real or apparent authority over the other, or
(b) Where he stands in a fiduciary relation to the other; or
(c) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

Section 19A provides that when consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. Any such contract may be set aside either absolutely or, if the party who was entitled to avoid it has received any benefit thereunder, upon such terms and conditions as to the Court may seem just.

From the facts of the case, Chandan signed the promissory note under undue influence applied by doctor. Hence, Dr. Jhunjhunwala cannot recover the amount of promissory note but can claim his normal consultation fee from Chandan.

Related Question: Mr. A, the employer induced his employee Mr. B to sell his one room flat to him at less than the market value to secure promotion. Mr. B sold the flat to Mr. A. Later on, Mr. B changed his mind and decided to sue Mr. A. Examine the validity of the contract as per the provisions of the Indian Contract Act, 1872. (2 Marks – June 23)

Answer:

According to section 16 of the 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 he uses that position to obtain an unfair advantage over the other.

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

Hence, the contract between Mr. A and Mr. B is voidable at the option of Mr. B as it was induced by undue influence by Mr. A and therefore Mr. B can sue Mr. A.

Fraud

Question 6

Define Fraud. Whether "mere silence will amount to fraud" as per the Indian Contract Act, 1872? [May, 2018, 5 Marks) [MTP April 19, 5 Marks] [MTP March 18, 5 Marks] [RTP Nov 18]

Answer

Fraud means and includes -

Commission of the following acts -	Committed by -	Intention
(b) Suggestion as a Fact, of something which is not true, by a person who does not believe it to be true, (c) Active concealment of a Fact by one having knowledge or belief of the fact, (d) Promise made without any intention of performing it, (e) Any other act fitted to deceive, (f) Any such act or omission as specifically declared by law to be fraudulent.	(a) A party to the Contract, or (b) By any person with the connivance of the party to the Contract, or (c) An agent of the party to the Contract.	To deceive another party to the contract, or his Agent, OR To induce another party to enter into the contract.

DOES SILENCE AMOUNT TO FRAUD?

Silence Not Fraud [Explaination to Section 17]	Exceptions i.e., Silence = Fraud
Mere silence as to facts, likely to affect the willingness of a person to enter into a Contract is not Fraud. Caveat Emptor' i.e., let the purchaser beware is the rule applicable to contracts. Example: A sells, by auction, to B a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not fraud by A.	a) Having regard to the circumstances, if it is the duty of the person (keeping silence) to speak, b) Silence by itself is equivalent to Speech.

Related Question: P sells by auction to Q a horse which P knows to be unsound. The horse appears to be sound but P knows about the unsoundness of the horse. Is this contract valid in the following circumstances:

(a) If P says nothing about the unsoundness of the horse to Q.

(b) If P says nothing about it to Q who is P's daughter who has just come of age.

(c) If Q says to P "If you do not deny it, I shall assume that the horse is sound." P says nothing. [RTP May 19]

Answer: Provision Same as above table DOES SILENCE AMOUNT TO FRAUD?

(a) This contract is valid since as per section 17 mere silence as to the facts likely to affect the willingness of a person to enter into a contract is not fraud. Here, it is not the duty of the seller to disclose defects.

(b) This contract is not valid since as per section 17 it becomes P's duty to tell Q about the unsoundness of the horse because a fiduciary relationship exists between P and his daughter Q. Here, P's silence is equivalent to speech and hence amounts to fraud.

(c) This contract is not valid since as per section 17, P's silence is equivalent to speech and hence amounts to fraud.

Related Question: Karan agreed to purchase wooden table for his study room from Mr. X. Table was in good condition and was examined by Karan before purchasing. He found no defects in it and paid Rs. 20,000 for that table. Later on, it was found that one leg of table is broken, and Mr. X has pasted the wood and tried to hide the defects in the table. Can Karan return the table and claim the amount back? Discuss the same with reference to Indian Contract Act, 1872. [RTP Nov 22]

Answer:

As per Section 17 of Indian Contract Act, 1872, "A false representation of material facts when made intentionally to deceive the other party to induce him to enter into a contract is termed as a fraud." Section 17(2) further states about active concealment. When a party intentionally conceals or hides some material facts from the other party and makes sure that the other party is not able to know the truth, in fact makes the other party believe something which is false, then a fraud is committed.

In case a fraud is committed, the aggrieved party gets the right to rescind the contract. (Section 19).
In the present case, Karan has examined the study table before purchasing it from Mr. X and could not find any defect in the table as it was concealed by Mr. X.
On the basis of above provisions and facts of the case, Karan can rescind the contract and claim compensation for the loss suffered due to fraud done by Mr. X.

Related Question: Kapil went to a departmental store to purchase a steel pan. He asked the salesman about the area in departmental store where steel pans are kept. The salesman indicated him the area with instructions that with steel pans, other metal's pans were also kept. Kapil wrongfully picked an aluminium pan in place of steel pan. The salesman watched but said nothing to Kapil. Kapil reached his house and found that pan was not a steel pan but actually an aluminium pan. Kapil filed a suit against departmental store for fraud. Discuss, whether Kapil was eligible to file suit for fraud against departmental store under Indian Contract Act, 1872? [RTP May 22 - 6 Marks]

Answer:

Provisions same as answer 6 above
It was also explained that mere silence is not fraud. Silence amounts to fraud where (a) there is a duty to speak or (b) where silence is equivalent to speech.
On the basis of provisions of Section 17 and the facts given above, it was not the duty of salesman to inform Mr. Kapil about his mistake. Hence, there was no fraud and Kapil was not eligible to file suit for fraud against departmental store under Indian Contract Act, 1872.

Misrepresentation

Question 7

(a) Explain the concept of 'misrepresentation' in matters of contract.

(b) 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. [RTP May 19] [RTP May 20]

Answer: Misrepresentation means and INCLUDES –

Positive Assertion	• of such fact, which is not true, though he believes it to be true, • made in a manner not warranted by the information of the person making it.
Any Breach of Duty	• made without an intent to deceive, • but bringing gains and advantage to the person committing it, or to any one claiming under him, • by misleading another to his prejudice, or to the prejudice of anyone claiming under him.
Causing the other party to make mistake	• as to the substance of the subject matter of the agreement.

In simple words misrepresentation means:

1. Positive false statement made without any basis for info
2. a beach of duty which brings advantage to person committing it
3. inducement of mistake about subject matter

In the instant case

1. The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872].
2. 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 amount to final acceptance of the sale.

Related Question: Mr. SAMANT owned a motor car. He approached Mr. CHHOTU and offered to sale his motor car for Rs. 3, 00,000. Mr. SAMANT told Mr. CHHOTU that the motor car is running at the rate of 30 KMs per litre of petrol. Both the fuel meter and the speed meter of the car were working perfectly. Mr. CHHOTU agreed with the proposal of Mr. SAMANT and took delivery of the car by paying Rs. 3, 00,000/- to Mr. SAMANT. After 10 days, Mr. CHHOTU came back with the car and stated that the claim made by Mr. SAMANT regarding fuel efficiency was not correct and therefore there was a case of misrepresentation. Referring to the provisions of the Indian Contract Act, 1872, decide and write whether Mr. CHHOTU can rescind the contract in the above ground. [MTP Aug 18, 6 Marks] [RTP NOV 20] [RTP May 21]

Answer:

1. As per the provisions of Section 19 of the Indian Contract Act, 1872, when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.
2. A party to contract, whose consent was caused by fraud or misrepresentation, may, if he think fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representations made had been true.
3. Exception- If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 17, the contract, nevertheless, is not voidable if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

In the situation given in the question, BOTH THE FUEL METER AND THE SPEED METER OF THE CAR WERE WORKING PERFECTLY, Mr. CHHOTU had the means of discovering the truth with ordinary diligence. Therefore, the contract is not voidable. Hence, Mr. CHHOTU cannot rescind the contract on the above ground.

Expected question based on misrepresentation

Related Question: X bought Shares in a Company on the faith of a Prospectus which contained an untrue statement that one Z was a Director of the Company. X had never heard of Z and the untrue statement of Z being a Director was immaterial from his point of view. Can X claim damages on grounds of fraud?

Answer:

Though the Prospectus contains an untrue statement, that untrue statement was not the one that induced X to purchase the Shares. Hence X cannot claim damages. (Smith vs Chadwick)

Related Question: The Vendor of a piece of land told a prospective purchaser that, in his opinion, the land can support 2000 heads of sheep whereas, in truth, the land could support only 1500 sheep. Does it amount to Fraud?

Answer:

The Vendor says that in his opinion the land could support 2000 heads of sheep. This statement is only an opinion and not a representation and hence cannot amount to fraud. (Bisset Vs Winkinson)

Related Question: Define Misrepresentation and Fraud. Explain the difference between Fraud and Misrepresentation as per the Indian Contract Act, 1872. [Dec 20 - 7 Marks]

Answer:

Definition: Same as given in answer of Q6 & Q7

Basis of difference	Fraud	Misrepresentation
Intention	To deceive the other party by hiding the truth.	There is no such intention to deceive the other party.
Knowledge of truth	The person making the suggestion believes that thestatement as untrue.	The person making the statement believes it to be true, although it is not true.
Recession of the contract and claim for damages	The injured party can repudiate the contract and claim damages.	The injured party is entitledto repudiate the contract or sue for restitution but cannot claim the damages.
Means to discover the truth	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.

Mistake

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

Mistake of Law		Mistake of Fact	
Law of OwnCountry	Foreign Law	Unilateral	Bilateral
(a) One cannot take excuse of ignorance of thelaw of his own country. (Ignorantia juris non excusat) (b) Such Mistake will not affect the validity of the Contract. (c) Sec.21: Contract is not voidable.	(a) Treated asmistake of fact. (b) Agreement is void if both the parties are under a mistake as to a foreign law because one cannot be expected to know the law of other country.	(a) Sec 22: If one of the parties is under a mistake the contract remains valid. (b) Exceptions: (i) Mistake as to Identity of the party (ii) Mistake as toNature of thecontract	(a) Sec 20: "Where both the parties to an agreement are under a mistake as to a matter of fact (but not of law) essential to the agreement, the agreement isvoid" (b) There is no agreement as there is absence of consensus. Hence, the agreement is void.

A and B make a Contract on erroneous belief that a particular debt is time- barred by Indian Law of Limitation. Contract is valid & not voidable. [Sec.21]

But if the mistake of law is caused through the inducement of another, the contract may be avoided. [Sec.21]

Agreements expressly declared void by the Indian Contract Act

1. Agreement to enter into an agreement in future.
2. Agreement that gives rise to social obligations.
3. Sec.11: Agreements entered into by incompetent parties.
4. Sec.20: Agreements entered into through a mutual mistake of fact between the parties.
5. Sec.23: Agreements, the object or consideration of which is unlawful.
6. Sec.24: Agreements, part of the consideration or object of which is unlawful and the unlawful object, cannot be separated from the lawful objects.
7. Sec.25: Agreements, made without consideration.
8. Sec.26: Agreements in restraint of marriage.
9. Sec.27: Agreements in restraint of trade.
10. Sec.28: Agreements in restraint of legal proceedings.
11. Sec.29: Uncertain Agreements.
12. Sec.30: Wagering Agreements.
13. Sec.36: Agreements contingent upon impossible events.
14. Sec.56: Agreements to do impossible acts.
15. Sec.57: Agreements to do reciprocal promises, one set of which is legal, and the other set is illegal.

Agreements, the object or consideration of which is unlawful & oppose to public policy [Section 23]

Question 8

X a businessman has been fighting a long-drawn litigation with Mr. Y an industrialist. To support his legal campaign, he enlists the services of Mr. C a Judical officer stating that the amount of Rs. 10 lakhs would be paid to him if he does not take up brief of Mr. Y.

Mr. C agrees but, at the end of the litigation Mr. X refuses to pay to Mr. C. Decide whether Mr. C can recover the amount promised by Mr. X under the provisions of the Indian Contract Act, 1872? [Dec 20 4 Marks] [RTP Dec 23]

Answer:

The problem as asked in the question is based on Section 10 of the Indian Contract Act, 1872.

This Section says that all agreements are contracts if they are made by the

- ✓ free consent of the parties competent to contract,
- ✓ for a lawful consideration and
- ✓ with a lawful object and are not expressly declared to be void.

Further, Section 23 also states that every agreement of which the object is unlawful is void.

Accordingly,

- one of the essential elements of a valid contract in the light of the said provision is that the agreement entered into must not be which the law declares to be either illegal or void.
- An illegal agreement is an agreement expressly or impliedly prohibited by law.
- A void agreement is one without any legal effects.

The given instance is a case of interference with the course of justice and results as opposed to public policy. This can also be called as an agreement in restraint of legal proceedings. This agreement restricts one's right to enforce his legal rights. Such an agreement has been expressly declared to be void under section 28 of the Indian Contract Act, 1872.

Hence, Mr. C in the given case cannot recover the amount of RS. 10 lakhs promised by Mr. X because it is a void agreement and cannot be enforced by law.

Related Question: Explain the terms "Trafficking relating to public offices and titles" and "Stifling prosecution" as per the Indian Contract Act, 1872. **(Dec 23 - 7 Marks)**

Answer:

Trafficking relating to Public Offices and titles: An agreement to trafficking in public office is opposed to public policy, as it interferes with the appointment of a person best qualified for the service of the public. Public policy requires that there should be no money consideration for the appointment to an office in which the public is interested. The following are the examples of agreements that are void since they are tantamount to sale of public offices.

(1) An agreement to pay money to a public servant in order to induce him to retire from his office so that another person may secure the appointment is void.

(2) An agreement to procure a public recognition like Padma Vibhushan for reward is void.

Stifling Prosecution: An agreement to stifle prosecution i.e. "an agreement to present proceedings already instituted from running their normal course using force" tends to be a perversion or an abuse of justice, therefore, such an agreement is void. The principle is that one should not make a trade of felony. The compromise of any public offence is generally illegal.

For example, when a party agrees to pay some consideration to the other party in exchange for the later promising to forgo criminal charges against the former is an agreement to stifle prosecution and therefore is void.

Under the Code of Criminal Procedure, there is however, a statutory list of compoundable offences and an agreement to drop proceeding relating to such offences with or without the permission of the Court, as the case may be, in consideration the accused promising to do something for the complainant, is not opposed to public policy.

Question 9

Mr. S, aged 58 years was employed in a Govt. Department. He was going to retire after two years. Mr. D made a proposal to Mr. S to apply for voluntary retirement from his post so that Mr. D can be appointed in his place. Mr. D offered a sum Rs. 10 Lakhs as consideration to Mr. S in order to induce him to retire.

Mr. S refused at first instance but when he evaluated the amount offered as consideration is just double of his cumulative remuneration to be received during the tenure of two years of employment, he agreed to receive the consideration and accepted the above agreement to receive money to retire from his office.

Whether the above agreement is valid? Explain with reference to provision of Indian Contract Act, 1872. [Jan 21 – 4 Marks] [RTP May 21] [Dec 23]

Answer:

Trafficking relating to Public Offices and titles (Section 23 of The Indian Contract Act,1872)

An agreement to trafficking in public office is opposed to public policy, as it interferes with the appointment of a person best qualified for the service of the public. Public policy requires that there should be no money consideration for the appointment to an office in which the public is interested.

In the instant case

Mr. S (Public Servant) agreed to receive the consideration to apply for voluntary retirement from his post so that Mr. D can be appointed in his place is opposed to public policy and hence void.

An agreement to pay money to a public servant in order to induce him to retire from his office so that another person may secure the appointment is void.

Agreements, part of the consideration or object of which is unlawful and the unlawful object, cannot be separated from the lawful objects [Sec 24]

Question 10

A enters into a contract with B that he (A) sells his house for Rs. 10,00,000 to B. Further they both signed an agreement that if B uses the house for gambling purposes, then B shall pay A Rs. 50,000 for it. B agreed to this, however after a year of sale, B started gambling business in that house. Can A claim Rs. 50,000 from B? Discuss with reference to the provisions of Indian Contract Act, 1872. [RTP May 22]

Answer:

According to Section 24 of the Indian Contract Act, 1872, in an agreement, where some part of the object is legal and the other part is illegal, the question arises about the validity and enforceability of such agreements. Where the legal and illegal part can be severed and divided, and separated, lawful part of object is enforceable, and the unlawful part of the object is void.

In the given case, A sells the house to B, is a valid transaction as the sale of house and consideration paid for the same i.e. Rs.10,00,000 is valid and enforceable. However, the agreement to pay Rs. 50,000 for gambling done in the house is illegal and thus void.

Hence, in the instant case, sale of house agreement is valid agreement and gambling agreement is illegal and not enforceable by law.

Agreements in restraint of marriage [Sec 26]

Expected case study: A husband and his wife entered into an agreement that upon the husband marrying a second wife, the first wife would get the right to divorce him. It was held that the agreement was not void as the husband was not restrained from marrying. Simply a penalty was imposed if he married the second time. [Badu v. Badarnessa (1919)

Expected case study: Two co-widows entered into an agreement that if anyone of them remarried she would forfeit her right to her share in the deceased husband's property. It was held that the agreement was not void as no restraint was imposed upon either of the two widows from remarrying. Similarly, an agreement that upon remarrying, the widow would lose the right to maintenance was not held void.

Agreements in restraint of trade [Sec 27]

Question 11 Rohan is running a grocery store in Delhi. He sells his grocery business, including goodwill worth Rs. 1,00,000 to Rohit for a sum of Rs. 5,00,000. After the sale of goodwill, Rohit made an agreement with Rohan. As per this agreement, Rohan is not to open another grocery store (similar kind of business) in the whole of India for next ten years. However, Rohan opens another store in the same city two months later. What are the rights available with Rohit regarding the restriction imposed on Rohan with reference to Indian Contract Act, 1872? [MTP Oct 21 - 6 Marks] [RTP June 23]

Answer:

Section 27 of the Indian Contract Act, 1872 provides that any agreement that restrains a person from carrying on a lawful trade, profession or business is void agreement. However, there are certain exceptions to this rule. One of the statutory exceptions includes sale of Goodwill. The restraint as to sale of goodwill would be a valid restraint provided-

(i) Where the restraint is to refrain from carrying on a similar business.

(ii) The restrain should be within the specified local limits.

(iii) The restraint should be not to carry on the similar business after sale of goodwill to the buyer for a price.

(iv) The restriction should be reasonable. Reasonableness of restriction will depend upon number of factors as considered by court.

In the given case, Rohan has sold the goodwill and there is restraint for not carrying on the same business of grocery store. However, the restriction imposed on Rohan is unreasonable as he cannot carry similar business in whole of India for next 10 years. The restriction on restraint to similar kind of trade should be reasonable to make it a valid agreement. Therefore, Rohit cannot take any legal action against Rohan as the restriction is unreasonable as per Section 27 of Indian Contract Act, 1872. Hence, the agreement made between Rohan and Rohit in restraint of trade is void agreement.

Related Question: Kashish was running a business of artificial jewellery since long. He sold his business to Naman and promises, not to carry on the business of artificial jewellery and real diamond jewellery in that area for a period of next one year. After two months, Kashish opened a show room for real diamond jewellery. Naman filed a suit against Kashish for closing the business of real diamond

jewellery business as it was against the agreement. Whether Kashish is liable to close his business of real diamond jewellery following the provisions of Indian Contract Act, 1872? **(MTP June 24 - 7 Marks)**

Answer: In the instant case, Kashish sold his running business of artificial jewellery to Naman and promises, not to carry on the business of artificial jewellery and real diamond jewellery in that area and for a period of next one year but just after two months, Kashish opened a show room of real diamond jewellery. Naman sued Kashish for closing the business of real diamond business as it was against the agreement.

As exceptions to section 27 is applicable to similar business only, agreement between Naman and Kashish will not be applicable on business of real diamond jewellery. Hence, Kashish can continue his business of real diamond jewellery.

Expected question based on restrained in trade & opposed to public policy [Sec 27]

Related Question: X and Y were two organizations trading in wheat of 'Popular Brand' in Uttar Pradesh. X realizes that the wheat business is high yielding. To expand his business X offered Y a sum of ₹ 10 Lakhs on the condition that Y shall not sell Popular Brand' wheat in Uttar Pradesh. X failed in making the promised payment to Y. Y filed a suit against

X for non-fulfillment of the promise. Is the suit maintainable? [4 Marks]

Answer:

An agreement by which any person is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void. [Section 27]

Exceptions, i.e., where Restraint of Trade is valid:

The following are valid agreements, even if they are in restraint of trade - (These are explained in detail below)

(a) Agreement with Buyer of Goodwill - as per explanation to Sec.27.

(b) Trade Combinations, to the extent they do not create monopoly or opposed to public policy.

(c) Service Agreements with employees.

(d) Agreements under the Partnership Act, 1932. Conclusion

In the light of the above provision & facts of the case we conclude that a Combination which create monopoly, or when two Firms enter into an Agreement to avoid competition, they are against public policy and hence void.

Therefore, the suit is not maintainable.

Expected case study: A, a businessman sold the goodwill of his trade to B. Both of them agreed that A will not practice the same trade for 3 years, and also that A will not carry on any business competing in any way with the business of B. Here, the agreement being divisible, the first part was held to be valid as necessary to protect the interest of the purchaser of goodwill The second part was held to be void as it prevented A from carrying on any business.

Related Question: 'X' agreed to become an assistant for 2 years to 'Y' who was practicing Chartered Accountant at Jodhpur. It was also agreed that during the term of agreement 'X' will not practice as a Chartered Accountant on his own account within 20 kms of the office of 'Y' at Jodhpur. At the end of one year, 'X' left the assistantship of 'Y' and started practice on his own account within the said area of 20 kms. [RTP May 18]

Answer:

Agreement in Restraint of Trade

1. Section 27 of the Indian Contract Act, 1872 deals with agreements in restraint of trade.
2. According to the said section, every agreement by which any person is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.
3. Exception: In the case of the service agreements restraint of trade is valid. In an agreement of service by which a person binds himself during the term of 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, so it is a valid contract.

In the instant case

Agreement entered by 'X' with 'Y' is reasonable, and do not amount to restraint of trade and hence enforceable.

Therefore, 'X' can be restrained by an injunction from practicing on his own account in within the said area of 20 Kms for another one year.

Expected question based on restraint of legal proceedings [Sec 28

Question 12

A clause in a life insurance policy was that "no suit to recover under the policy shall be brought after one year from the date of death of assured." X died and his legal representatives filed a suit to recover the assured sum after two and half years. Is this suit maintainable? [2 Marks]

Answer:

Agreement in restraint of legal proceedings (Section 28):

An agreement in restraint of legal proceeding is the one by which any party thereto is restricted absolutely from enforcing his rights under a contract through a Court or which abridges the usual period for starting legal proceedings. A contract of this nature is void.

In the instant case the suit is not maintainable because the clause in policy is void because it curtailed the prescribed period of limitation (which is 3 years) according to Law of Limitation Act.

Uncertain Agreements Sec.29

Question 13

"An agreement, the meaning of which is not certain, is void." Discuss. [RTP Nov 21]

Answer:

Agreement - the meaning of which is uncertain (Section 29 of the Indian Contract Act, 1872): An agreement, the meaning of which is not certain, is void, but where the meaning thereof is capable of being made certain, the agreement is valid.

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

Wagering Agreements Sec.30

Question 14

What is a wagering agreement? Describe the transactions which resembles with wagering transactions but are not void. [RTP May 20] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8 [June 24 - 6 Marks]

Answer:

Wagering agreement (Section 30 of the Indian Contract Act, 1872)

1. An agreement by way of a wager is void. It is an agreement involving payment of a sum of money upon the determination of an uncertain event.
2. The essence of a wager is that each side should stand to win or lose, depending on the way an uncertain event takes place in reference to which the chance is taken and in the occurrence of which neither of the parties has legitimate interest.
3. For example, A agrees to pay Rs. 50,000 to B if it rains, and B promises to pay a like amount to A if it does not rain, the agreement will be by way of wager. But if one of the parties has control over the event, agreement is not a wager.

Transactions resembling with wagering transaction but are not void

(i) Chit fund: Chit fund does not come within the scope of wager (Section 30). In case of a chit fund, a certain number of persons decide to contribute a fixed sum for a specified period and at the end of a month, the amount so contributed is paid to the lucky winner of the lucky draw.

(ii) Commercial transactions or share market transactions: In these transactions in which delivery of goods or shares is intended to be given or taken, do not amount to wagers.

(iii) Games of skill and Athletic Competition: Crossword puzzles, picture competitions and athletic competitions where prizes are awarded on the basis of skill and intelligence are the games of skill and hence such competition are valid. According to the Prize Competition Act, 1955 prize competition in games of skill are not wagers provided the prize money does not exceed Rs. 1,000.

(iv) A contract of insurance: A contract of insurance is a type of contingent contract and is valid under law and these contracts are different from wagering agreements.

Question 15

Distinguish between wagering agreement and contract of insurance. [May 2018, 2 Marks] [Dec 20 – 5 Marks]

Answer:

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

Miscellaneous Questions

Question 16

State with the reason(s) whether the following agreements are valid or void: [July 21- 1 Mark each] [RTP Dec 23]

I. A clause in a contract provided that no action should be brought upon in case of a breach.

II. Where two courts have jurisdiction to try a suit, an agreement between the parties that the suit should be filed in one of those courts alone and not in the other.

III. X offers to sell his Maruti car to Y. Y believes that X has only Wagon R Car but agrees to buy it.

IV. X, a physician and surgeon, employs Y as an assistant on a salary of ₹ 75,000 per month for a term of two years, and Y agrees not to practice as a surgeon and physician

during these two years.

Answer:

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

An agreement in restraint of legal proceeding is the one:

1. by which any party thereto is restricted absolutely from enforcing his rights under a contract through a Court

or

2. which abridges the usual period for starting legal proceedings.

A contract of this nature is void.

In the instant case

A clause in a contract provided that no action should be brought upon in case of a breach is void because such clause is restricting the parties to enforce their right in case of breach.

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

An agreement in restraint of legal proceeding is the one by which any party thereto is RESTRICTED ABSOLUTELY from enforcing his rights under a contract through a Court.

In the instant case

An agreement between the parties that the suit should be filed in one of those courts alone and not in the other is partial restriction and not an absolute one. Hence, the agreement between the parties is valid.

III. Contract caused by mistake of one party as to matter of fact (Section 22):

- Unilateral mistake is when only one party to the contract is under a mistake.
- If one of the parties is under a mistake the contract remains valid.

IV. Exception to section 27 i.e., Agreement in Restraint of Trade

1. In the case of the service agreements restraint of trade is valid: In an agreement of service by which a person binds himself during the term of 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, so it is a valid contract.
2. Therefore, in the instant case the agreement between x and y is valid.

Question 17 Decide with reasons whether the following agreements are valid or void under the provisions of the Indian Contract Act, 1872:

(i) Vijay agrees with Saini to sell his black horse for Rs. 3,00,000. Unknown to both the Parties, the horse was dead at the time of the agreement.

(ii) Sarvesh sells the goodwill of his shop to Vikas for Rs. 10,00,000 and promises not to carry on such business forever and anywhere in India.

(iii) Mr. X agrees to write a book with a publisher. After few days, X dies in an accident. [RTP May 18]

Answer (i)

1. As per Section 20 of the Indian Contract Act, 1872 an agreement under by mistake of fact are void.
2. In this case, there is mistake of fact as to the existence of the subject- matter, i.e., with respect to the selling of horse which was dead at the time of the agreement. It is unknown to both the parties.
3. Therefore, it is a void agreement.

Answer (ii)

1. As per Section 27 of the Indian Contract Act, 1872 an agreement in restraint of trade is void.
2. However, a buyer can put such a condition on the seller of goodwill, not to carry on same business, provided that the conditions must be reasonable regarding the duration and place of the business.
3. Since in the given case, restraint to carry on business was forever and anywhere in India, so the agreement in question is void.

Answer (iii)

1. As per section 2(j) of the Contract Act, 1872 "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable".
2. In the present case, Mr. X agrees to write a book with a publisher.
3. After few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract.

Question 18

Point out with reason whether the following agreements are valid or void:

(a) Kamala promises Ramesh to lend Rs 500,000 in lieu of consideration that Ramesh gets Kamala's marriage dissolved and he himself marries her.

(b) Sohan agrees with Mohan to sell his black horse. Unknown to both the parties, the horse was dead at the time of agreement.

(c) Ram sells the goodwill of his shop to Shyam for Rs 4,00,000 and promises not to carry on such business forever and anywhere in India.

(d) In an agreement between Prakash and Girish, there is a condition that they will not institute legal proceedings against each other without consent.

(e) Ramamurthy, who is a citizen of India, enters into an agreement with an alien friend. [RTP Nov 18] [MTP Oct 19]

Answer:

(a) Void Agreement: As per Section 23 of the Indian Contract Act, 1872, an agreement is void if the object or consideration is against the public policy.

(b) Void Agreement: As per Section 20 of the Indian Contract Act, 1872 the contracts caused by mistake of fact are void. There is mistake of fact as to the existence of subject-matter.

(c) Void Agreement: As per Section 27 of the Indian Contract Act, 1872 an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of good will, not to carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.

(d) Void Agreement: An agreement in restraint of legal proceedings is void as per Section 28 of the Indian Contract Act, 1872.

(e) Valid Agreement: An agreement with alien friend is valid, but an agreement with alien enemy is void.

Unit – 4: Performance of Contract

Obligation of parties to contracts [Sec 37]

Question 1

"The basic rule is that the promisor must perform exactly what he has promised to perform." Explain stating the obligation of parties to contracts. [Module] [RTP May 20]

Answers:

Obligations of parties to contracts (Section 37 of the Indian Contract Act, 1872)

1. The parties to a contract must either perform, or offer to perform, their respective promises unless such performance is dispensed with or excused under the provisions of the Contract Act or of any other law.
2. Promises bind the representatives of the promisor in case of death of such promisor before performance, unless a contrary intention appears from the contract.

   Example 1: A promises to deliver goods to B on a certain day on payment of Rs. 1, 00,000. A dies before that day. A's representatives are bound to deliver the goods to B, and B is bound to pay Rs. 1, 00,000 to A's representatives.

   Example 2: A promises to paint a picture for B by a certain day, at a certain price. A dies before the day. The contract cannot be enforced either by A's representatives or by B because it involves use of personal skill.

Analysis of Section 37

1. A contract being an agreement enforceable by law, creates a legal obligation, which subsists until discharged. Performance of the promise or promises remaining to be performed is the principal and most usual mode of discharge.
2. Thus, it may be noted that it is necessary for a party who wants to enforce the promise made to him, to perform his promise for himself or offer to perform his promise.
3. He is absolved from such a responsibility only when under a provision of law or an act of the other party to the contract, the performance can be dispensed with or excused.
4. Thus, from above it can be drawn that performance may be actual or offer to perform.

Related Question: Nitesh Gupta is constructing his house. For this purpose, he entered in a contract with M/s Baba Brick House to supply of 10,000 bricks on 12th August 2023. M/s Baba Brick House has two Lorries of 5,000 brick capacity. On 12th August 2023, one of the Lorries was not in working condition so M/s Baba Brick House supplied only 5,000 bricks and promised Nitesh Gupta to supply rest 5,000 bricks on next day. Nitesh Gupta wants to cancel the contract, as M/s

Baba Brick House did not supply the bricks as per the contract. M/s Baba Brick House gave the plea that no fault has been made from its part, hence contract should not be cancelled. In this situation, whether Nitesh Gupta can avoid the contract under Indian Contract Act, 1872? (MTP 1 June 24 - 4 Marks)

Answers:

"Performance of Contract" means fulfilment of obligations to the contract. According to Section 37 of Indian Contract Act, 1872, the parties to a contract must either perform, or offer to perform, their respective promises unless such performance is dispensed with or excused under the provisions of the Contract Act or of any other law. Further, the performance should be for whole obligations. Part delivery cannot be considered as valid performance.

In the instant case, Nitesh Gupta contracted with M/s Baba Brick House to supply of 10,000 bricks on 12th August 2023. M/s Baba Brick House had only two Lorries of 5,000 brick capacity. But on the agreed date one lorry was not in working condition so only 5,000 bricks were supplied on 12th August 2023 and promised to supply rest 5,000 bricks on next day.

After taking into account the above provisions and facts, Plea of M/s Baba Brick House cannot be considered. Performance should be for whole obligation. Hence, part performance by M/s Baba Brick House cannot be taken as valid performance. Nitesh Gupta is right in avoiding the contract.

Person by whom promise is to be performed [Sec 40]

Question 2

Enumerate the persons by whom a contract may be performed under the provisions of the Indian Contract Act, 1872. [MTP Oct 18, 7 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 626261438

Answer:

As per section 40 of the Indian Contract Act, 1872, the promise under a contract may be performed, as the circumstances may permit, by the promisor himself, or by his agent or his legal representative.

(i) Promisor himself: If there is something in the contract to show that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor. This means contracts which involve the exercise of personal skill or diligence, or which are founded on personal confidence between the parties must be performed by the promisor himself.

(ii) Agent: Where personal consideration is not the foundation of a contract, the promisor or his representative may employ a competent person to perform it.

(iii) Legal Representatives:

- A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor.

- As regards any other contract the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract. But their liability under a contract is limited to the value of the property they inherit from the deceased.

(iv) Third persons: As per Section 41 of the Indian Contract Act, 1872, 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 promise, produces the result of discharging the promisor, although the latter has neither authorised nor ratified the act of the third party.

(v) Joint promisors: When two or more persons have made a joint promise, then unless a contrary intention appears by the contract, all such persons must jointly fulfill the promise. If any of them dies, his legal representatives must, jointly with the surviving promisors, fulfill the promise. If all of them die, the legal representatives of all of them must fulfill the promise jointly.

Effect of accepting performance from third person [Sec 41]

Question 3

X received certain goods from Y and promised to pay Rs. 60,000. Later on, X expressed his inability to make payment. Z, who is known to X, pays Rs. 40,000 to Y on behalf of X. However, X was not aware of the payment. Now Y is intending to sue X for the amount of Rs. 60,000. Can Y do so? Advise. [RTP May 19] [RTP May 18]

Related Question: Discuss the effect of accepting performance from third person. [Module]

Answers: Answer for Both Practical and Direct Question is same

As per section 41 of the Indian Contract Act, 1872

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.

Therefore, in the instant case, Y can sue X only for the balance amount i.e., Rs. 20,000 and not for the whole amount.

Effect of refusal of party to perform promise wholly [Sec 39]

Question 4

"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. [Module]

Answer:

Effect of a Refusal of Party to Perform Promise

According to Section 39, 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, unless he has signified, by words or conduct, his acquiescence (acceptance of something without protest) in its continuance.

Example: A, singer, enters into a contract with B, the Manager of a theatre, to sing at his theatre two nights in every week during next two months, and B engages to pay her Rs.10000 for each night's performance. On the sixth night, A willfully absents herself from the threatre. B is at liberty to put an end to the contract.

Analysis of Section 39

From language of Section 39 it is clear that in the case under consideration, the following two rights accrue to the aggrieved party, namely, (a) to terminate the contract; (b) to indicate by words or by conduct that he is interested in its continuance.

In case the promisee decides to continue the contract, he would not be entitled to put an end to the contract on this ground subsequently. In either case, the promisee would be able to claim damages that he suffers as a result on the breach.

Related Question: Mr. X was a Disk Jockey at a five-star hotel bar. As per the contract, he is supposed to perform every weekend (i.e., twice a week). Mr. X will be paid Rs.1500 per day. However, after a month, Mr. X willfully absents himself from the performance.

(i) Does the hotel have the right to end the contract?

(ii) If the hotel sends out a mail to X that they are interested to continue the contract and X accepts, can the hotel rescind the contract after a month on this ground subsequently?

(iii) In which of the cases – (termination of contract or continuance of contract) can the hotel claim damages that it has suffered as a result of this breach? [RTP Nov 21]

Answer:

By analyzing Section 39 of the Indian Contract Act 1872, it is understood that when a party to a contract has refused to perform or disabled himself from performing his promise entirely, the following two rights accrue to the aggrieved party (promisee)

(a) To terminate the contract

(b) To indicate by words or by conduct that he is interested in its continuance.

In either of the two cases, the promisee would be able to claim damages that he suffers. In the given case,

(i) Yes, the hotel has the right to end the contract with Mr. X, the DJ.

(ii) The hotel has the right to continue the contract with X. But once this right is exercised, they cannot subsequently rescind the contract on this ground subsequently.

(iii) In both the cases, the hotel (promisee) is entitled to claim damages that has been suffered as a result of breach.

Related Question: Sheena was a classical dancer. She entered into an agreement with Shital Vidya Mandir for 60 dance performances. As per the contract, she was supposed to perform every weekend and she will be paid Rs. 10,000/- per performance. However, after a month, she was absent without informing, due to her personal reasons. Answer the following questions as per the Indian Contract Act, 1872.

(i) Whether the management of Shital Vidya Mandir has right to terminate the contract?

(ii) If the management of Shital Vidya Mandir informed Sheena about its continuance, can the management still rescind the contract after a month on this ground subsequently?

(iii) Can the Shital Vidya Mandir claim damages that it has suffered because of this breach in any of the above cases? [May 22 - 4 Marks] RTP Dec 23

Answer:

Section 39 provides that 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 unless he had signified, by words or conduct his acquiesce in its continuance.

Further, in term of Section 40, the promisee shall be required to perform personally, if there is such an apparent intention of the parties.

Also, as per Section 75 of the Act, a person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through non-fulfilment of the contract.

Therefore, in the instant case,

(i) Since, Sheena could not perform as per the terms of contract, Shital Vidya Mandir can terminate the contract.

(ii) In the second situation, the management of Shital Vidya Mandir informed Sheena about the continuance of the contract. Hence, the management cannot now rescind the contract after a month on this ground subsequently.

(iii) As per Section 75, Shital Vidya Mandir can claim damages that it has suffered because of this breach in part (i).

Related Question: On 1st March 2023, T Readymade Dress Garments, Shimla enters into a contract with J Readymade Garments, Jaipur for the supply of different sizes of shirts 'S'

(Small), 'M' (Medium), and 'L' (Large). As per the terms of the contract, 300 pieces of each category i.e. 'S'@ 7900; 'M'@ 1,000 and 'L'@ 1,100 per piece have to be supplied on or before 31st May, 2023.

However, on 1st May, 2023, T Readymade Dress Garments, Shimla informed J Readymade Garments, Jaipur that the firm is not willing to supply the shirts at the above rate due to the rise of prices in the raw material cost. In the meantime, prices for similar shirts have gone up in the market to the tune of Rs. 1,000; Rs. 1,100; and Rs. 1,200 for 'S', 'M' and 'L' sizes respectively.

Examine the rights of J Readymade Garments, Jaipur in this regard as per the provisions of the Indian Contract Act, of 1872. **(Dec 23 - 3 Marks)**

Answer:

Provision: Section 39 same as above

J Readymade Garments in the given situation has two options, out of which he has to select any one:

(i) Either to treat the contract as rescinded and sue T Readymade Dress Garments for damages from breach of contract immediately without waiting until the due date of performance or

(ii) He may elect not to rescind but to treat the contract as still operative and wait for the time of performance and then hold the other party responsible for the consequences of non-performance.

Important Note: The answer can also be given as per Section 73 of the Indian Contract Act, 1872 which lays down that when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it.

In the instant case, J Readymade Garments, Jaipur would be entitled to get the damages i.e. difference between the contract price and the market price on the day of default from T Readymade Dress Garments, Shimla. In other words, the amount of damages would be Rs. 90,000 [300 piece @ Rs. 100 (Small), 300 piece @ Rs. 100 (Medium) and 300 piece @ Rs. 100 (Large)].

Related Question: Mr. Singhania entered into a contract with Mr. Sonu to sing in his hotel for six weeks on every Saturday and Sunday. Mr. Singhania promised to pay Rs. 20,000 for every performance. Mr. Sonu performed for two weeks but on third week his health condition was very bad, so he did not come to sing. Mr. Singhania terminated the contract. State in the light of provisions of the Indian Contract Act, 1872: -

(a) Can Mr. Singhania terminate the contract with Mr. Sonu?

(b) What would be your answer in case Mr. Sonu turns up in fourth week and Mr. Singhania allows him to perform without saying anything?

(c) What would be your answer in case Mr. Sonu sends Mr. Mika on his place in third week and Mr. Singhania allows him to perform without saying anything? [RTP May 22]

Answer:

According to Section 40 of the Indian Contract Act, 1872, if it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it should be performed by the promisor himself, such promise must be performed by the promisor.

Section 41 provides that when a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor.

Therefore, in the instant case,

(a) As Mr. Sonu could not perform as per the contract, Mr. Singhania can repudiate the contract.

(b) In the second situation, as Mr. Singhania allowed Mr. Sonu to perform in the fourth week without saying anything, by conduct, Mr. Singhania had given his assent to continue the contract. Mr. Singhania cannot terminate the contract however he can claim damages from Mr. Sonu.

(c) In case Mr. Singhania allows Mr. Mika to perform in the third week without saying anything, by conduct, Mr. Singhania had given his assent for performance by third party. Now Mr. Singhania cannot terminate the contract nor can claim any damages from Mr. Sonu.

Section 42: Devolution of joint liabilities | Section 43: Any one of joint promisors may be compelled to perform | Each promisor may compel contribution | Sharing of loss by default in contribution | Section 44: Effect of release of one joint promisor.

Question 5

X, Y and Z jointly borrowed Rs. 50,000 from A. The whole amount was repaid to A by Y. Decide in the light of the Indian Contract Act, 1872 whether:

(i) Y can recover the contribution from X and Z,

(ii) Legal representatives of X are liable in case of death of X,

(iii) Y can recover the contribution from the assets, in case Z becomes insolvent. [RTP Nov 19] [MTP Oct 19- 4 Marks]

Answer:

As per Section 42 of the Indian Contract Act, 1872

1. When two or more persons have made a joint promise, then, unless otherwise agreed, all such persons jointly must fulfill the promise.
2. In the event of the death of any of them, his representative jointly with the survivors and in case of the death of all promisors, the representatives of all jointly must fulfill the promise.

As per Section 43 of the Indian Contract Act, 1872

1. When two or more persons make a joint promise, the promisee may, unless otherwise agreed, compel any one or more of such joint promisors to perform the whole of the promise.
2. The liability of the joint promisors has thus been made not only joint but "joint and several".

Section 43 deals with the contribution among joint promisors

1. The promisors, may compel every joint promisor to contribute equally to the performance of the promise unless otherwise agreed.
2. If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

Conclusion

As per the provisions of above sections,

(i) Y can recover the contribution from X and Z because X, Y and Z are joint promisors.

(ii) Legal representative of X is liable to pay the contribution to Y. However, a legal representative is liable only to the extent of property of the deceased received by him.

(iii) Y also can recover the contribution from Z's assets.

Related Question: 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. [May 18, 4 Marks] [MTP April 19, 4 Marks] [RTP Nov 18] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Provisions same as above

In the instant case

X, Y and Z jointly promised to pay Rs. 3, 00,000. 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. X is entitled to receive Rs. 20,000 from Y's estate, and Rs. 1,40,000 from Z.

Related Question: A, B, C and D are the four partners in a firm. They jointly promised to pay 6,00.000 to F. B and C have become insolvent B was unable to pay any amount, and C could pay only 50.000. A is compelled to pay the whole amount to F. Decide the extent to which A can recover the amount from D with reference to the provisions of the Indian Contract Act 1872. [Dec 21, 4 Marks]

Answer:

Provisions same as above

In the instant case

A, B, C and D jointly promised to pay Rs. 6, 00,000. B and C have become insolvent, B was unable to pay any amount, and C could pay only 50,000. A is compelled to pay the whole amount. A is entitled to receive Rs. 50,000 from C, and Rs. 2,75,000 [150000 of his own (d) + (150000 of B + 100000 of C /2)] from D.

Related Question: X, Y and Z jointly borrowed ₹ 90,000 from L. Decide each of the following in the light of The Indian Contract Act, 1872:

i. Whether L can compel only Y to pay the entire loan of ₹ 90,000.

ii. Whether L can compel only the legal representatives of Y to pay the loan of ₹ 90,000, if X, Y and Z died?

iii. Whether Y and Z are released from their liability to L and X is released from his liability to 'Y and Z for contribution, if L releases X from his liability and sues Y and Z for payment? [July 21 – 4 Marks]

Answer:

Same provision as given above under section 42 & 43.

Release of Joint Promisor [Sec. 44]:

(a) In case of a Joint Promise, release of one of Joint Promisors by the Promisee does not discharge the other Joint Promisor(s).

(b) Such discharge does not free such Promisor from responsibility to the other Joint Promisor(s).

In the light of the above provision and facts of the case the following are the answers to the questions

i. L can compel only Y to pay the entire loan of ₹ 90,000. (Section 43)

ii. L may compel legal representatives of all the joint promisors i.e., X, Y & Z but L cannot compel the legal representative of Y alone. However, a legal representative is liable only to the extent of property of the deceased received by him. (Section 42)

iii. If L releases X from his liability and sues Y and Z for payment, it does not discharge Y and Z from their liability and such release by L does not free X from his responsibility to Y and Z. (Section 44)

Expected question based on section 42 43 & 44

Related Question: X, Y and Z jointly borrowed Rs. 60,000 from L. Decide in the light of The Indian Contract Act, 1872:

(i) Whether L can compel only Y to pay the entire loan of Rs. 60,000.

(ii) If X, Y and Z died, whether L can compel only the Legal representatives of X to pay the loan of Rs. 60,000.

(iii) If the whole amount was repaid to L by Y. How much Y can recover from Xand Z?

(iv) If the whole amount was repaid to L by Y and Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. How much Y can recover from X and Z?

(v) If the whole amount was repaid to L by Y, Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts and X died and his sonW inherited the assets of Rs. 17000. How much Y can recover from X and Z?

(vi) If L releases X from his liability and sues Y and Z for payment, whether Y and Z are also released from their liability to L and X is released from his liability to Y and Z for contribution. [6 Marks]

Answer:

Section to which the given problem relates: Section 42 to 45 Decision:

(i) Yes. L can compel only Y to pay Rs. 60,000 since as per Sec. 43 in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.

(ii) No. L can compel the Legal representatives of X, Y and Z jointly to pay the loan of Rs. 60,000, since as per Sec. 45 unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly, with the survivor or survivors and after the death of the last survivor, with the representatives of all jointly.

(iii) Y can recover the contribution of Rs. 20,000 each from X and Z since as per Sec. 43 in the absence of express agreement to the contrary, the promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract).

(iv) Y can recover the contribution of Rs. 28,000 (i.e. Rs.60,000 × 1/3) + (16,000 × 1/2) from X and Rs. 4,000 (i.e. Rs. 60,000 x 1/3 × 1/5) from Z since as per Sec. 43 in the absence of express

agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

(v) Y can recover the contribution of Rs. 17,000 from X and Rs. 4,300 [i.e. (Rs.60,000 × 1/3) + (3,000 × 1/2)] x 1/5 from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

Note: A legal representative is liable only to the extent of property of the deceased received by him as per Sec. 42.

(vi) If L releases X from his liability and sues Y and Z for payment neither Y and Z are released from their liability to L nor X is released from his liability to Y and Z for contribution since as per Sec. 44 a release of one of such joint promisors by the promisee, does not discharge the other joint promisors neither does it free the joint promisor so released from responsibility to the other joint promisors.

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Performance of reciprocal promises [Sec 51]

Question 6

In light of provisions of the Indian Contract Act, 1872 answer the following:

Mr. S and Mr. R made contract wherein Mr. S agreed to deliver paper cup manufacture machine to Mr. R and to receive payment on delivery. On the delivery date, Mr. R didn't pay the agreed price. Decide whether Mr. S is bound to fulfil his promise at the time of delivery? [Dec 20, 2 Marks] [RTP May 21]

Answer:

According to section 51 of Indian Contract Act, 1872. When a contract consists of Reciprocal Promises to be simultaneously performed, no promisor needs to perform his promise unless the promisee is ready & willing to perform his reciprocal promise.

Such promises constitute concurrent conditions & the performance of one of the promises is conditional on the performance of the other. If one of the promises is not performed the other too need not to be performed.

Example: A and B contract for delivery of goods by A on a certain day, and payment by B upon such delivery. A need not deliver unless B is ready and willing to pay, and B need not pay unless A is willing and ready to deliver.

In the light of the above provision and example in the instant case also, S is not bound to fulfil his promise at the the time of delivery because on the delivery date Mr. R didn't pay the agreed price. i.e., promisee is not ready & willing to perform his reciprocal promise.

Appropriation of payments [Sec 59, 60 & 61]

Question 7

Mr. Sonumal a wealthy individual provided a loan of Rs 80,000 to Mr. Datumal on 26.02.2019. The borrower Mr. Datumal asked for a further loan of Rs 1, 50,000. Mr. Sonumal agreed but provided the loan in parts at different dates. He provided Rs. 1, 00,000 on 28.02.2019 and remaining Rs. 50,000 on 03.03.2019.

On 10.03.2019 Mr. Datumal while paying off part Rs. 75,000 to Mr. Sonumal insisted that the lender should adjusted Rs 50,000 towards the loan taken on 03.03.2019 and balance as against the loan on 26.02.2019.

Mr. Sonumal objected to this arrangement and asked the borrower to adjust in the order of date of borrowal of funds.

Now you decide:

(i) Whether the contention of Mr. Datumal correct or otherwise as per the provisions of the Indian Contract Act, 1872?

(ii) What would be the answer in case the borrower does not insist on such order of adjustment of repayment?

(iii) What would the mode of adjustment/appropriation of such part payment in case neither Mr. Sonumal nor Mr. Datumal insist any order of adjustment on their part? [November 19, 6 Marks] RTP Dec 23

Answer:

Appropriation of payments made by the Debtor to the Creditor

1. Meaning: Appropriation of Payment = Application of Payment.
2. Rules as to Appropriation of Payments:

Situation: A Debtor owes several distinct debts to one Creditor and makes a payment to that Creditor

Situation 1	Situation 2	Situation 3
Appropriation by Debtor [Sec.59] Debt to be discharged is indicated	Appropriation by Creditor [Sec.60] Debt to be discharged is NOT indicated	Neither party Appropriates [Sec. 61]
(a) The payment is made with - • Express intimation, or under circumstances implying that, • Payment is to be applied to discharge off some particular debt. (b) Payment, if accepted by the Creditor, should be applied to the debt, which is intimated to be discharged.	(a) Debtor has - • Omitted to intimate, and • There are no other circumstances indicating to which debt the payment is to be applied. (b) Payment accepted by Creditor may be applied at his discretion to any lawful debt actually due and payable to him, irrespective of whether the recovery is barred by limitation.	(a) When neither party makes any appropriation, the payment shall be applied in the order of time, whether or not they are barred by limitation. (b) When debts are of equal standing, payment shall be applied in discharge of each proportionally. (c) Where moneys are received by Creditor without any definite appropriation, money

	(c) But, it cannot be applied to a disputed debt.	received must first be applied in payment of interest & then towards Principal. Conclusion: Hence in case where neither Mr. Datumal nor Mr. Sonumal specifies the manner of appropriation of debt on part repayment, the appropriation can be made in proportion of debts.
Example: 1. A owes B totally ₹ 25,000. He sends a cheque for ₹ 10,000 stating that it shall be appropriated towards the first sum of ₹ 10,000 he took from B. B shall appropriate it towards that amount only. 2. A owes B among other debts, a sum of ₹ 2,360. B writes to A demanding payment of this sum. A sends ₹ 2,360. Payment should be applied to discharge debt which B demanded.	Example: A obtains two loans of ₹ 20,000 & ₹ 10,000 from a Bank. Loan of ₹ 20,000 is guaranteed by B. A sends the Bank ₹ 5.000 but does not intimate the appropriation. Bank appropriates whole of ₹ 5,000 to loan of ₹ 10,000 (which is not guaranteed). Appropriation is valid and cannot be questioned either by A or B.	Example: A Trustee deposits ₹ 10,000 trust money with a bank. Later he deposits ₹ 50,000 his own money in the same account. Then, he withdraws ₹ 10,000 and misappropriates it. Withdrawal will not be appropriated against Trust amount, but against his own funds, leaving Trust Funds intact.

Related Question: T owes G, the following debts as per the table given below:

Amount of the Debt in Rs.	Position of Debt
5,000	Time barred on 01st July, 2023 as per the provisions of the Limitation Act, 1963
3,000	Time barred on 01st July, 2023 as per the provisions of the Limitation Act, 1963
12,500	Due on 1st April, 2022
10,000	Due on 15th July, 2023
7,500	Due on 25th November, 2023

G makes payment on 1st April, 2023 mentioned as below without any notice regarding how to appropriate the amount/ payment.
(i) A cheque of Rs. 12,500
(ii) A cheque of Rs. 4,000.
In such a situation how the appropriation of the payment is done against the debts as per the provisions of the Indian Contract Act, 1872 by assuming that T also has not appropriated the amount received towards any particular debt.
(Dec 23 - 4 Marks)

Answer:

Provision: Section 59 & 61 – Same as above

In the present case, G made two payments by way of two cheques. Also, neither G nor T said anything as to the appropriation of the amount towards any particular debt.

Since one of the issued cheques was exactly the amount of the debt due i.e. of Rs. 12,500, by applying the provisions of Section 59 we can say that this is a circumstance indicating for appropriation against that particular debt.

Cheque of Rs. 4,000 can be appropriated in terms of the provisions of Section 61 since neither of the parties, have made any appropriation. The amount will be appropriated in discharging of the debts in order of time against any lawful debt whether they are or are not barred by the law in force for the time being as to the limitation of suits.

Hence cheque of Rs.12,500 will be appropriated against the debt of Rs. 12,500 which is due on 1st April, 2022.

As per the scenario given in the question, since two debts are persisting in order of time which were treated as time barred on 1st July 2023, the amount of Rs. 4,000 will be appropriated proportionately, i.e. in proportion of 5,000:3,000. Therefore as per the provisions of the Indian Contract Act, 1872, Rs.2,500 will be appropriated for the first debt and Rs.1,500 will be appropriated towards the second debt.

Related Question: Mr. Murari owes payment of 3 bills to Mr. Girdhari as on 31St March, 2020. (i) Rs. 12,120 which was due in May 2016. (ii) Rs. 5,650 which was due in August 2018 (iii) Rs. 9,680 which was due in May 2019. Mr. Murari made payment on 1St April 2020 as below without any notice of how to appropriate them:
(i) A cheque of Rs. 9,680
(ii) A cheque of Rs. 15000
Advice under the provisions of the Indian Contract Act, 1872. [MTP Nov 21 – 6 Marks] [Module Back Question] [RTP June 23]

Answer:
If the performance consists of payment of money and there are several debts to be paid, the payment shall be appropriated as per provisions of Sections 59,60 and 61. The debtor has, at the time of payment, the right of appropriating the payment. In default of debtor, the creditor has option of election and in default of either the law will allow appropriation of debts in order of time.

In the present case, Mr. Murari had made two payments by way of two cheques. One cheque was exactly the amount of the bill drawn. It would be understood even though not specifically appropriated by Mr. Murari that it will be against the bill of exact amount. Hence cheque of Rs. 9,680 will be appropriated against the bill of Rs 9,680 which was due in May 2019.

Cheque of Rs. 15000 can be appropriated against any lawful debt which is due even though the same is time-barred.

Hence, Mr. Girdhari can appropriate the same against the debt of Rs. 12,120 which was due in 2016 and balance against Rs. 5650 which was due in August 2018.

Agreement to do impossible act [Sec 56]

Question 8

Examine the validity of the following contracts as per the Indian Contract Act, 1872, giving reasons.
J contracts to take in cargo for K at a foreign port. J's government afterwards declared war against the country in which the port is situated, and therefore the contract could not be fulfilled. K wants to file a suit against J. [Dec 21 – 3 Marks]

Answer:

Contract becomes Void [Sec. 56]: When the Contract was capable of performance at the time of making it, but subsequently due to some event beyond the control of the Promisor, performance becomes impossible or unlawful, the Contract becomes Void i.e. subsequently rendered void. The parties are discharged from their obligations. In England, it is called 'Doctrine of Frustration'.

In the instant case the contract between J and K was capable of performance until the declaration of war. However subsequently due to declaration of war performance of such contract becomes

impossible or unlawful and the contract becomes void. Therefore, k will not be successful in filing a suit against J.

Contracts which need not be performed [Sec 62 – 67]

Question 9

Explain any five circumstances under which contracts need not be performed with the consent of both parties. [Dec 21 7 Marks]

Answer:

1. Discharge by Mutual Agreement

(a) Novation:

(a) Novation means substitution of a new Contract in the place of the original contract.

(b) This may happen either between - (i) the same parties, or (ii) different parties.

(c) Novation implies that a New Contract comes into existence. So, there must be mutual consent of all the parties to the Original Contract.

(d) Sec. 62: When the parties agree to substitute a new Contract, the original Contract need not be performed.

(b) Rescission:

(a) A contract is also discharged by rescission. when the parties to a contract agree to rescind it, the contract need not be performed.

(b) In the case of rescission, only the old contract is cancelled and no new contract comes to exist in its place. It is needless to point out that novation also involves rescission. Both in novation and in rescission, the contract is discharged by mutual agreement.

(c) Alteration:

(a) As in the case of novation and rescission, so also in a case where the parties to a contract agree to alter it, the original contract is rescinded, with the result that it need not be performed.

(b) In other words, a contract is also discharged by alteration. The terms of contract may be so altered by mutual agreement that the alteration may have the effect of substituting a new contract for the old one. In other words, the distinction between novation and alteration is very slender.

2. Promisee may waive or remit performance of promise (Section 63): "Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for Such performance or may accept instead of it any satisfaction which he thinks fit". In other words, a contract may be discharged by remission.

3. Restoration of Benefit under a Voidable Contract (Section 64): The law on the subject is "When a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he has received any benefit thereunder from another party to such contract, restore such benefit, so far as may be, to the person from whom it was received".

4. Obligations of Person who has Received Advantage under Void Agreement or contract that becomes void (Section 65): When an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it."
5. Effects of neglect of promisee to afford promisor reasonable facilities for performance (Section 67): If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby.

Related Question: Differentiate between Novation and Alteration as per the Indian Contract Act, 1872. [Nov 22 - 5 Marks]

Answer:

Novation and Alteration: The law pertaining to novation and alteration is contained in Sections 62 to 67 of the Indian Contract Act, 1872. In both these cases, the original contract need not be performed. Still there is a difference between these two.

1. Meaning: Novation means substitution of an existing contract with a new one. But in case of alteration the terms of the contract may be altered by mutual agreement by the contracting parties.

2. Change in terms and conditions and parties: Novation may be made by changing in the terms of the contract or there may be a change in the contracting parties. But in case of alteration the terms of the contract may be altered by mutual agreement by the contracting parties but the parties to the contract will remain the same.

3. Substitution of new contract: In case of novation, there is altogether a substitution of new contract in place of the old contract. But in case of alteration, it is not essential to substitute a new contract in place of the old contract. In alteration, there may be a change in some of the terms and conditions of the original agreement.

Obligation of person who has received advantage under void agreement, or contract that becomes void. [Sec 65]

Related Question: Explain what is meant by Supervening impossibility as per the Indian Contract Act, 1872 with the help of an example. What is the effect of such impossibility? [July 21 – 5 Marks] [RTP May 22 – 5 Marks]

Answer:

Subsequent or Supervening impossibility (Becomes impossible after entering into contract)

1. When performance of promise become impossible or illegal by occurrence of an unexpected event or a change of circumstances beyond the contemplation of parties, the contract becomes void e.g. change in law etc.

2. In other words, sometimes, the performance of a contract is quite possible when it is made. But

subsequently, some event happens which renders the performance impossible or unlawful. Such impossibility is called the subsequent or supervening.

3. It is also called the post-contractual impossibility.

4. The effect of such impossibility is that it makes the contract void, and the parties are discharged from further performance of the contract.

Obligation of person who has received advantage under void agreement, or contract that becomes void – Section 65 in The Indian Contract Act, 1872

When an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it.

Related Question: Mr. Rich aspired to get a self-portrait made by an artist. He went to the workshop of Mr. C an artist and asked whether he could sketch the former's portrait on oil painting canvass. Mr. C agreed to the offer and asked for Rs. 50,000 as full advance payment for the above creative work. Mr. C clarified that the painting shall be completed in 10 sittings and shall take 3 months.

On reaching to the workshop for the 6th sitting, Mr. Rich was informed that Mr. C became paralyzed and would not be able to paint for near future. Mr. C had a son Mr. K who was still pursuing his studies and had not taken up his father's profession yet?

Discuss in light of the Indian Contract Act, 1872?

(i) Can Mr. Rich ask Mr. K to complete the artistic work in lieu of his father?

(ii) Could Mr. Rich ask Mr. K for refund of money paid in advance to his father? [May 19, 6 marks]

Answer:

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 of the Indian Contract Act, 1872). But their liability under a contract is limited to the value of the property they inherit from the deceased.

(i) In the instant case, since painting involves the use of personal skill and on becoming Mr. C paralyzed, Mr. Rich cannot ask Mr. K to complete the artistic work in lieu of his father Mr. C.

(ii) According to section 65 of the Indian Contract Act, 1872, when an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it.

Hence, in the instant case, the agreement between Mr. Rich and Mr. C has become void because of paralysis to Mr. C. So, Mr. Rich can ask Mr. K for refund of money paid in advance to his father, Mr. C.

Related Question: Mr. S promises Mr. M to paint a family picture for 20,000 and assures to complete his assignment by 15th March, 2023. Unfortunately, Mr. S died in a road accident on 1st March, 2023 and his assignment remains undone. Can Mr. M bind the legal representative of Mr. S for the promise made by Mr. S? Suppose Mr. S had promised to deliver some photographs to Mr. M on 15th March, 2023 against a payment of Rs. 10,000 but he dies before that day. Will his representative be bound to deliver the photographs in this situation? Decide as per the provisions of the Indian Contract Act, 1872. (4 Marks June 23)

Answer:

The parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or of any other law.

Promises bind the representatives of the promisors in case of the death of such promisors before performance, unless a contrary intention appears from the contract. (Section 37 of the Indian Contract Act, 1872).

As per the provisions of Section 40 of the Indian Contract Act, 1872, if it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it should be performed by the promisor himself, such promise must be performed by the promisor. In other cases, the promisor or his representative may employ a competent person to perform it.

In terms of the provisions of Section 40 stated above, in case where Mr. S has to paint a family picture for Mr. M, Mr. M cannot ask the legal representative of Mr. S to complete the painting work on Mr. S's death, since painting involves the use of personal skill.

In terms of the provisions of Section 37 stated above, in case where Mr. S had promised to deliver some photographs to Mr. M, the legal representatives of Mr. S shall be bound to deliver the photographs in this situation.

Related Question: 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 Rs. 50,000 towards advance as per the terms of the above contract. The mode of transportation available between their places is roadway 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 Rs. 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 Rs. 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 contention. [Nov 18, 4 Marks] [MTP March 19, 6 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 6262621438

Answer:

1. Subsequent or Supervening impossibility (Becomes impossible after entering into contract): When performance of promise become impossible or illegal by occurrence of an unexpected event or a change of circumstances beyond the contemplation of parties, the contract becomes void e.g. change in law etc.
2. Also, according to section 65 of the Indian Contract Act, 1872, when an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it.

In the given question

After Mr. X and Mr. Y have entered into the contract to supply 50 tons of sugar, the event of flood occurred which made it impossible to deliver the sugar within the stipulated time. Thus, the promise in question became void. Further, Mr. X has to pay back the amount of ` 50,000 that he received from Mr. Y as an advance for the supply of sugar within the stipulated time. Hence, the contention of Mr. Y is correct.

Related Question: Mr. JHUTH entered into an agreement with Mr. SUCH to purchase his (Mr. SUCH's) motor car for Rs. 5,00,000/- within a period of three months. A security amount of Rs. 20,000/- was also paid by Mr. JHUTH to Mr. SUCH in terms of the agreement. After completion of three months of entering into the agreement, Mr. SUCH tried to contract Mr. JHUTH to purchase the car in terms of the agreement. Even after lapse of another three-month period, Mr. JHUTH neither responded to Mr. SUCH, nor to his phone calls. After lapse of another period of six months. Mr. JHUTH contracted Mr. SUCH and denied to purchase the motor car. He also demanded back the security amount of Rs. 20,000/- from Mr. SUCH. Referring to the provisions of the Indian Contract Act, 1872, state whether Mr. SUCH is required to refund the security amount to Mr. JHUTH.
Also examine the validity of the claim made by Mr. JHUTH, if the motor car would have destroyed by an accident within the three month's agreement period. [MTP Aug 18, 4 Marks]

Answer: In terms of the provisions of Section 65 of the Indian Contract Act, 1872, when an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it.

Referring to the above provision, we can analyse the situation as under.

The contract is not a void contract. Mr. SUCH is not responsible for Mr. JHUTH's negligence. Therefore, Mr. SUCH can rescind the contract and retain the security amount since the security is not a benefit received under the contract, it is a security that the purchaser would fulfill his contract and is ancillary to the contract for the sale of the Motor Car.

Regarding the second situation given in the question, the agreement becomes void due to the destruction of the Motor car, which is the subject matter of the agreement here. Therefore, the security amount received by Mr. SUCH is required to be refunded back to Mr. JHUTH.

Related Question: Mr. J entered into an agreement with Mr. S to purchase his house for & 20 lakh, within three months. He also paid 50,000/- as token money. In the meanwhile, in an anti-encroachment drive of the local administration, Mr. S's house was demolished. When Mr. J was informed about the incident he asked for the refund of token money. Referring to the relevant provisions of the Indian Contract Act, 1872 state whether Mr. J is entitled to the refund of the amount paid. **(June 24 - 4 Marks)**

Answer: Refer above provisions

Discharge of Contract

Question 10

Grounds to Discharge Contract. [MTP April 19, 7 Marks] [MTP March 18, 7 Marks]

Answer:

A Contract may be discharged either by an act of parties or by an operation of law which may be enumerated as follows:

(1) Discharge by performance which may be actual performance or 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, 1872 provides that 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 to be performed. Novation, Rescission, Alteration and Remission are also the same ground of this nature.

(3) Discharge by impossibility of performance: The impossibility may exist from its initiation. Alternatively, it may be supervening impossibility which may take place owing to (a) unforeseen change in law (b) The destruction of subject matter (c) The non-existence or non- occurrence of particular state of things (d) the declaration of war (Section 56).

(4) Discharge by lapse of time: A contract should be performed within a specific period as prescribed in the Law of Limitation Act., 1963. If it is not performed the party is deprived of remedy at law.

(5) Discharge by operation of law: It may occur 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 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 promise may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance or may accept instead of it any satisfaction he thinks fit. In other words, a contract may be discharged by remission. (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).

Miscellaneous Question

Question 11

What will be rights with the promisor in following cases? Explain with reasons:

(a) Mr. X promised to bring back Mr. Y to life again.

(b) A agreed to sell 50 kgs of apple to B. The loaded truck left for delivery on 15th March but due to riots in between reached A on 19th March.

(c) An artist promised to paint on the fixed date for a fixed amount of remuneration but met with an accident and lost his both hands.

(d) Abhishek entered into contract of import of toys from China. But due to disturbance in the relation of both the countries, the imports from China were banned. [RTP May 21] [RTP Nov 22]

Answer:

(a) The contract is void because of its initial impossibility of performance.

(b) Time is essence of this contract. As by the time apples reached B they were already rotten. The contract is discharged due to destruction of subject matter of contract.

(c) Such contract is of personal nature and hence cannot be performed due to occurrence of an event resulting in impossibility of performance of contract.

(d) Such contract is discharged without performance because of subsequent illegality nature of the contract.

Unit– 5: Breach of Contract and its Remedies

Question 1

"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. [MTP March 19, 7 Marks] [Module Back Question] [MTP Oct 19, 7 Marks] [RTP Nov 18] [MTP Oct 20-7 Marks] [MTP Oct 21 – 7 Marks] [RTP May 22] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called Anticipatory Breach.

Section 39 of the Indian Contract Act, 1872 deals with anticipatory breach of contract and provides as follows: "When a party to a contract has refused to perform or disable himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, but words or conduct, his acquiescence in its continuance."

Effect of anticipatory breach: The promisee is excused from performance or from further performance. Further he gets an option:

(1) To either treat the contract as "rescinded and sue the other party for damages from breach of contract immediately without waiting until the due date of performance; or

(2) He may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in this case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides on re-consideration, may still perform his part of the contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract.

Compensation for loss or damage caused by breach of contract [Sec 73]

Question 2

"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. [Module Back Question]

Related Question: What is the law relating to determination of compensation, on breach of contract, contained in section 73 of the Indian Contract Act, 1872 [RTP Nov 19]

Related Question: 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 deliver 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 for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act, 1872. [May 18, 6 Marks] [MTP Aug 18 Direct Question 5 marks] [RTP May 18] [MTP Oct 19, 6 Marks] [RTP Nov 19 Direct Question] [MTP March 18, 6 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

1. Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract.
2. According to it, when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which
   - Naturally arose in the usual course of things from such breach

   or
   - Which the parties knew when they made the contract, to be likely to result from the breach of it.

Note: Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach.

3. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non- performance of the contract must be taken into account.

Conclusion

a. Applying the above principle of law to the given case, M Ltd. is obliged to compensate for the loss of Rs. 1.25 lakh (i.e., Rs. 12.75 minus Rs. 11.50 = Rs. 1.25 lakh) which had naturally arisen due to default in performing the contract by the specified date.
b. Regarding the amount of compensation which Shanti Traders were compelled to make to Zenith Traders, it depends upon the fact whether M Ltd., knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date. If so, M Ltd is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise, M Ltd is not liable.

Related Question: 'X' entered into a contract with 'Y' to supply him 1,000 water bottles @ Rs. 5.00 per water bottle, to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for the purchase of 1,000 water bottles @ Rs. 4.50 per water bottle, and at the same time told 'Z' that he did so for the purpose of performing his contract entered into with 'Y'. 'Z' failed to perform his contract in due course and market price of each water bottle on that day was Rs. 5.25 per water bottle. Consequently, 'X' could not procure any water bottle and 'Y' rescinded the contract. Calculate the amount of damages which 'X' could claim from 'Z' in the circumstances? What would be your answer if 'Z' had not informed about the 'Y's contract? Explain with reference to the provisions of the Indian Contract Act, 1872. [MTP Oct 2018, 6 Marks - Based on Bottles] [MTP March 18, 6 Marks- Based on Bottles] [MTP April 19] [MTP April 19, 6 marks] [RTP Nov 20] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Provision same as above i.e., Point 1 and Point 2.

The leading case on this point is "Hadley v. Baxendale" in which it was decided by the Court that the special circumstances under which the contract was actually made were communicated by the plaintiff to the defendant, and thus known to both the parties to the contract, the damages resulting from the breach of such contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from the breach of contract under these special circumstances so known and communicated.

In the instant case

'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y'. Thus, 'Z' had the knowledge of the special circumstances. Therefore, 'X' is entitled to claim from 'Z' Rs. 500/- at the rate of 0.50 paise i.e., 1000 water bottles x 0.50 paise (difference between the procuring price of water bottles (Rs4.50) and contracted selling price to 'Y' i.e (Rs.5) being the amount of profit 'X' would have made by the performance of his contract with 'Y'.

If 'X' had not informed 'Z' of 'Y's contract

Then the amount of damages would have been the difference between the contract price (Rs. 4.50) and the market price (Rs. 5.25) on the day of default. In other words, the amount of damages would be Rs. 750/- (i.e. 1000 water bottles x 0.75 paise).

Related Question: Seema was running a boutique in New Delhi. She has to deliver some cloth to her friend Kiran who was putting up an exhibition at Mumbai. Seema delivered the sewing machine and some cloth to a railway company to be delivered at a place where the exhibition was to be held. Seema expected to earn an exceptional profit from the sales made at this exhibition however she did not bring this fact to the notice of the railway's authorities. The goods were delivered at the place after the conclusion of the exhibition. On account of such breach of contract by railways authorities, can Seema recover the loss of profits under the Indian Contract Act, 1872? [RTP May 22] [MTP Nov 22 – 6 Marks]

Answer:

As per Section 73 to 75 of Indian Contract Act, 1872, Damage means a sum of money claimed or awarded in compensation for a loss or an injury. Whenever a party commits a breach, the aggrieved party can claim the compensation for the loss so suffered by him. General damages are those which arise naturally in the usual course of things from the breach itself. (Hadley Vs Baxendale). Therefore, when breach is committed by a party, the defendant shall be held liable for all such losses that naturally arise in the usual course of business. Such damages are called ordinary damages. However, special damages are those which arise in unusual circumstances affecting the aggrieved party and such damages are recoverable only when the special circumstances were brought to the knowledge of the defendant. If no special notice is given, then the aggrieved party can only claim the ordinary damages.

In the given case, Seema was to earn an exceptional profit out of the sales made at the exhibition, however she never informed about it to the railway authorities. Since the goods were delivered after the conclusion of the exhibition, therefore Seema can recover only the losses arising in the ordinary course of business. Since no notice about special circumstances was given to railways authorities, she could not recover the loss of profits.

Related Question: Mr. Murti was travelling to Manali with his wife by bus of Himalya Travels Pvt. Ltd. Due to some technical default in the bus, the driver has to stop the bus in a mid way in cold night. Driver advised the passenger to get the shelter in nearest hotel which was at a distance of only one kilometre from that place. The wife of Mr. Murti caught cold and fell ill due to being asked to get down and she had to walk in cold night to reach hotel. Mr. Murti filed the suit against Himalya Travels Pvt. Ltd. for damages for the personal inconvenience, hotel charges and medical treatment for his wife. Explain, whether Mr. Murti would get compensation for which he filed the suit? [MTP May 22 - 4 Marks]

Answer:

Section 73 of Indian Contract Act, 1872 provides that when a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. But such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

In the instant case, Mr. Murti filed the suit against Himalya Travels Pvt. Ltd. for damages for the personal inconvenience, hotel charges and medical treatment for his wife.

On the basis of above provisions and facts of the case, it can be said that Mr. Murti can claim damages for the personal inconvenience and hotel charges but not for medical treatment for his wife because it is a remote or indirect loss.

Expected case study on Compensation for loss or damage caused by breach of contract

Photographer's failure to appear at wedding: A photographer who had agreed to take photographs at a wedding, failed in breach of his contract to appear there. As a result the bride had no photographs of her wedding. She was allowed damages for resulting injury to her feelings.

Refusal to provide motel booked for wedding reception: Where a motel cancelled the wedding reception on booking 48 hours before the marriage, the plaintiffs had to suffer because the alternative agreement was very bad, the court held that marriage of an only daughter's wedding is a unique event for a parent and general damages of £750 were awarded for inconvenience and disappointment plus £265 special damages for the cancellation fee of the band and telephone calls to notify guests of the changed venue.

Quantum Meruit

Question 3

What do you mean by quantum Meruit and state the rules relating to such contracts. [RTP May 20]

Answer:

1. Meaning: Quantum Meruit means as much as is merited (earned).
2. Quantum Meruit - Exception to Normal Rule:
   (a) Unless a party has performed his promise in full, he cannot claim performance from the other party.
   (b) To this rule, there are certain exceptions based on "Quantum Meruit".
   (c) When a person has done some work under a contract, and other party either - (i) repudiates the Contract, or (ii) some unexpected event happens making further performance of contract impossible, then the party who performed the work, can claim remuneration for work done.
3. When and to whom right arises?
   (a) The Original Contract must have been discharged, by the breach of a party by non-performance. If the Original Contract exists, the aggrieved party can resort to damages, he cannot claim quantum meruit remedy.
   (b) The Right to sue on Quantum Meruit lies with the party who is not at fault, i.e. who has performed his part of the Contract.

4. The claim for quantum meruit arises in the following cases:

(a) When an agreement is discovered to be void or when a contract becomes void.

(b) When something is done without any intention to do so gratuitously.

(c) Where there is an express or implied contract to render services but there is no agreement as to remuneration.

(d) When one party abandons or refuses to perform the contract.

(e) Where a contract is divisible and the party not in default has enjoyed the benefit of part performance

Compensation for breach of contract where penalty stipulated for [Sec.74]

Question 4

"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 the statement by differentiating between liquidated damages and penalty with reference to provisions of the Indian Contract Act, 1872. [Module Back question] [RTP May 21] [May 22 – 6 Marks]

Answer:

Liquidated damage is a genuine pre-estimate of compensation of damages for certain anticipated breach of contract. This estimate is agreed to between parties to avoid at a later date detailed calculation and the necessity to convince outside parties.

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.

In terms of Section 74 of the Act "where a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damages or loss is proved to have been caused thereby, to receive from the other party who has broken the contract, a reasonable compensation not exceeding the amount so named, or as the case may be the penalty stipulated for.

Explanation to Section 74

A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

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.

Sri Chunni Lal vs. Mehta & Sons Ltd (Supreme Court)

Supreme Court laid down the ratio that the aggrieved party should not be allowed to claim a sum greater than what is specific in the written agreement. But even then the court has powers to reduce the amount if it considers it reasonable to reduce.

Difference between 'Liquidated Damages' and 'Penalty'

Basis	Liquidated Damages	Penalty
1. Meaning	It represents a sum fixed or ascertained by the parties to the Contract, being a fair and genuine estimate of the probable loss that may arise due to breach.	It is the sum mentioned in the contract at the time of its making, being disproportionate to, i.e. very high than the loss that might arise as a result of breach. It is usually a very high sum, to ensure performance of the contract.
2. Intention	The intention for liquidated damages is the recovery of damages that might arise due to breach.	The intention for penalty is to ensure performance of a Contract. Performance is better than paying penalty. It acts as a deterrent to avoid performance.
3. Basis for Classi-fication	An amount becomes Liquidated Damages, if it is found that the parties to Contract conscientiously tried to make a pre-estimate of loss which might happen to them if there is a Breach of contract.	An amount becomes penalty, if parties made no attempt to estimate the loss, but with the sole object of coercing the offending party to perform the Contract, which is not in proportion to the loss.
4. Example	A contracts with B to deliver possession of a house under construction within a period of 6 months, failing which he would pay the monthly rental of B. The monthly rental payable by B for A partakes the character of liquidated damages.	P contracts to deliver 50 Units of a Petrol Engine to Q on a stipulated day, failing which he shall pay ₹ 5 Lakhs. Neither the price of Engine nor loss on failure of delivery would amount to ₹ 5 Lakh. Hence it is a penalty.

Specific Performance

Question 5

A & B entered into a contract to supply unique item, alternate of which is not available in the market. A refused to supply the agreed unique item to B. What directions could be given by the court for breach of such contract? [Dec 20, 2 Marks] [RTP May 21]

Answer:

Specific Performance:

(a) For breach of certain contracts, monetary compensation by way of damages may not constitute adequate remedy. The aggrieved party may not be interested in monetary compensation.

(b) The Court may, in such cases, direct the defaulting party to carry out the promise according to the terms of the Contract. This is called "Specific Performance" of the Contract.

Example: X agreed to sell an old painting to Y fort 50,000. Subsequently, X refused to sell the painting. Here, Y may file a suit against X for the specific performance of the contract.

In the instant case

A refused to supply the agreed unique item to B, alternate of which is not available in the market. Therefore here, B may file a suit against A for the specific performance of the contract.

Vindictive or Exemplary damages

Question 6 Give the circumstances as to when "Vindictive or Exemplary Damages" may be awarded for breach of a contract. [RTP – Nov 22]

Answer:

Vindictive or Exemplary damages

These damages may be awarded only in two cases:

(a) for breach of promise to marry because it causes injury to his or her feelings; and

(b) for wrongful dishonour by a banker of his customer's cheque because in this case the injury due to wrongful dishonour to the drawer of cheque is so heavy that it causes loss of credit and reputation to him.

Unit – 6: Contingent and Quasi Contracts

Contingent Contracts [Sec 31–36]

Question 1

What is Contingent Contract? Discuss the essentials of Contingent Contract as per the Indian Contract Act, 1872. [Nov 18, 7 Marks] [RTP May 19] [RTP May 20] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8 [June 24 – 6 Marks]

Answer:

Contingent Contracts [Sec. 31]: A Contingent Contract is a Contract -

(a) to do, or not to do something,
(b) if some event, collateral to such Contract, does or does not happen.

Example: A contracts to pay B ₹ 10,000 if B's house is burnt. This is a Contingent Contract.
Example: Contracts of Insurance, indemnity and guarantee.

Essentials of a contingent contract

(a) The performance of a contingent contract would depend upon the happening or non-happening of some event or condition. The condition may be precedent or subsequent.
Example: 'A' promises to pay ` 50,000 to 'B' if it rains on first of the next month.
(b) The event referred to, is collateral to the contract. The event is not part of the contract. The event should be neither performance promised nor a consideration for a promise.
(c) The contingent event should not be a mere 'will' of the promisor. The event should be contingent in addition to being the will of the promisor.

Example 1: If A promises to pay B Rs. 100,000, if he so chooses, it is not a contingent contract. (In fact, it is not a contract at all). However, where the event is within the promisor's will but not merely his will, it may be contingent contract.

Example 2: If A promises to pay B Rs. 100,000 if A left Delhi for Mumbai on a particular day, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but is not merely his will.

(d) The event must be uncertain. Where the event is certain or bound to happen, the contract is due to be performed, then it is a not contingent contract.
Example: 'A' agreed to sell his agricultural land to 'B' after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfillment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.

Related Question: Explain the meaning of 'Contingent Contracts' and state the rules relating to such contracts. [MTP Oct 20 – 5 Marks] [July 21 – 7 Marks] [RTP May 22 – 7 Marks]

Answer:

Meaning: Same as above

Rules as to Enforcement of Contingent Contracts:

Contingent upon

Happening of Uncertain Future Event [Sec. 32]	Non-Happening of Uncertain Future Event [Sec. 33]	Future Conduct of a living person [Sec. 34]	Happening of Specified Uncertain Event within Fixed Time [Sec. 35]	Non-Happening of Specified Uncertain Event within Fixed Time [Sec. 35]	Impossible Events [Sec. 36]

These rules are explained below

Contingency	Enforcement	Example
Happening of an Uncertain Future Event [Sec.32]	• Cannot be enforced by law unless and until such an event has happened. • Where the event becomes impossible, such contracts become void.	• A makes a contract with B to buy B's horse if A survives C. This cannot be enforced by law unless and until C dies in A's life-time. • A makes a contract with B to sell a horse to B at a specified price, if C, to whom the horse had been earlier offered, refuses to buy. Contract cannot be enforced by law, unless & until C refuses to buy the horse. • A contracts to pay B a sum of money when B marries C. C dies without being married to B. Contract becomes void.
Non-Happening of an Uncertain Future Event [Sec.33]	Can be enforced when the happening of that event becomes impossible, and not before.	A agrees to pay B a sum of money if a certain ship does not return. The ship is sunk. Contract can be enforced when the ship sinks.
Happening of a Specified Uncertain Event within a fixed time [Sec.35]	Becomes void if - • at the expiry of time fixed, such event has not happened, or • before the time fixed, such event becomes impossible.	A promises to pay B a sum of money if a certain ship returns within a year. The Contract may be enforced if the ship returns within the year, and becomes void, if the ship is burnt within the year.
Non-happening of a Specified Uncertain	Can be enforced by law - • when time fixed has expired and such event has not happened, or	A promises to pay B a sum of money if a certain ship does not return within a year. The Contract may be enforced if the ship does not

Event within a fixed time [Sec.35]	• before expiry of the time fixed, it becomes certain that such event will not happen.	return within the year, or is burnt within the year.
Behaviour of a person at an unspecified time of future [Sec.34]	Event shall be considered to become impossible when such person does anything, which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies.	A agrees to pay B a sum of money if B marries C. But C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die and that C may afterwards marry B.
Impossible Event [Sec.36]	Void, irrespective of whether or not the parties know of the impossibility of the event, at the time of entering into the agreement.	• A agrees to pay B ₹ 1,000 if two parallel straight lines should enclose a space. Agreement is void. • A agrees to pay B ₹ 1,000 if B will marry A's daughter C and C was dead at the time of the agreement. Agreement is void.

Related Question: PQR, a hospital in Delhi, recruits Dr. A, on contract basis for a period of 3 months. The hospital management promises to pay Dr. A, a lumpsum amount of Rs. 1,00,000 if Dr. A test positive for noval corona virus (Covid 19) during the contract period of 3 months.

Identify the type of contract and highlight the rule of enforcement. Also, what will happen if Dr. A does not contract Covid 19. [RTP Nov 21]

Answer:

1. Section 31 of the Indian Contract Act, 1872 provides that "A contract to do or not to do something, if some event, collateral to such contract, does or does not happen" is a Contingent Contract.
2. Section 35 says that Contingent contracts to do or not to do anything, if a specified uncertain event happens within a fixed time, becomes void if, at the expiration of time fixed, such event has not happened, or if, before the time fixed, such event becomes impossible.
3. In the instant case, the contract between PQR hospital & Dr. A is a Contingent Contract because the promisor, PQR hospital need to perform his obligation of paying Dr. A, the lumpsum amount of ` 1,00,000, only if he contracts with Covid 19 within a span of 3 months.
4. In Case, if Dr. A does not contract Covid 19, then the contract stands void automatically.

Quasi Contract/Deemed Quasi Contract

Question 2

Explain the term 'Quasi Contracts' and state their Characteristics. [Back Question of Module] [RTP Nov 20] [MTP Nov 21 – 5 Marks] [MTP Nov 22 – 5 Marks]

Answer:

Quasi Contracts: Under certain special Circumstances obligation resembling those created by a contract are imposed by law although the parties have never entered into a contract. Such obligations imposed by law are referred to as 'Quasi-contracts'. Such a contract resembles with a contract so far as result or effect is concerned but it has little or no affinity with a contract in respect of mode of creation. These contracts are based on the doctrine that a person shall not be allowed to enrich himself unjustly at the expense of another. The salient features of a quasi-contract are:

1. It does not arise from any agreement of the parties concerned but is imposed by law.
2. Duty and not promise is the basis of such contract.
3. The right under it is always a right to money and generally though not always to a liquidated sum of money.
4. Such a right is available against specific person(s) and not against the whole world.\
5. A suit for its breach may be filed in the same way as in case of a complete contract.

Related Question: Explain the meaning of 'Quasi-Contracts.' State the circumstances which are identified as quasi contracts by the Indian Contract Act, 1872. [RTP Nov 19] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answers:

Meaning of Quasi Contract: Same as above

Circumstances which are identified as quasi contracts by the Indian Contract Act, 1872:

(a) Claim for necessaries supplied to persons incapable of contracting (Section 68): If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

Example: A supplies B, a lunatic, or a minor, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property.

(b) Payment by an interested person (Section 69): A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.

(c) Obligations of a person enjoying benefits under non-gratuitous act (Section 70): Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so

gratuitously, and such other person enjoys the benefits thereof, then he is bound to make compensation to the other in respect of, or to restore the thing so done or delivered.

Example: A, a tradesman, leaves goods at B's house by mistake. B treats the goods his own. He is bound to pay for them.

(d) Responsibility of finder of goods (Section 71 of the Indian Contract Act, 1872): Responsibility of finder of goods (Section 71 of the Indian Contract Act, 1872): A person who finds goods belonging to another and takes them into his custody is subject to same responsibility as if he were a bailee.

Thus, a finder of lost goods has:

(i) to take proper care of the property as man of ordinary prudence would take

(ii) no right to appropriate the goods and

(iii) to restore the goods if the owner is found.

(e) Money paid by mistake or under coercion (Section 72): "A person to whom money has been paid or anything delivered by mistake or under coercion, must repay or return it".

Example: A and B jointly owe ₹ 1,000 to C. A alone pays the full amount to C and B not knowing this fact, pays ₹ 1,000 again to C. C is bound to repay the amount to B. (ii) A Railway Company refuses to deliver certain goods to the Consignee except upon payment of an illegal charge for carriage. The Consignee pays the sum charged in order to take delivery of goods. He is entitled to recover so much of the charge as was illegally excessive.

Related Question: What is meant by Quasi-Contract? State any three salient features of a quasi- contract as per the Indian Contract Act. 1872. [Dec 21 – 5 Marks]

Answer:

Meaning of Quasi Contract: Same as above

Salient features of quasi contracts:

(a) In the first place, such a right is always a right to money and generally, though not always, to a liquidated sum of money.

(b) Secondly, it does not arise from any agreement of the parties concerned, but is imposed by the law, and

(c) Thirdly, it is a right which is available not against all the world, but against a particular person or persons only, so that in this respect it resembles a contractual right.

Related Question: Mr. Y aged 21 years, lost his mental balance after the death of his parents in an accident. He was left with his grandmother aged 85 years, incapable of walking and dependent upon him. Mr. M, their neighbour, out of pity, started supplying food and other necessaries to both of them. Mr. Y and his grandmother used to live in the house built by his parents. Mr. M also provided grandmother some financial assistance for her emergency medical treatment. After supplying necessaries to Mr. Y for four years, Mr. M approached the former asking him to payback Rs.15 Lakhs inclusive of Rs. 7 Lakhs incurred for the medical treatment of the lady (grandmother). Mr. Y pleaded that he has got his parent's jewellery to sell to a maximum value of Rs. 4 Lakhs, which may be adjusted against the dues. Mr. M refused and threatened Mr. Y of legal suit to be brought against for recovering the money.

Now, you are to decide upon based on the provisions of the Indian Contract Act, 1872:

(i) Will Mr. M succeed in filing the suit to recover money? Elaborate the related provisions?

(ii) What is the maximum amount- of money that can be recovered by Mr. M?

(iii) Shall the provisions of the above act also apply to the medical treatment given to the grandmother? [Nov 22 - 6 Marks]

Answer:

(i) Claim for necessaries supplied to persons incapable of contracting (Section 68 of the Indian Contract Act, 1872): If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

In the instant case, Mr. M supplied the food and other necessaries to Mr. Y (who lost his mental balance) and Mr. Y's grandmother (incapable of walking and dependent upon Mr. Y), hence, Mr. M will succeed in filing the suit to recover money.

(ii) Supplier is entitled to be reimbursed from the property of such incapable person. Hence, the maximum amount of money that can be recovered by Mr. M is Rs. 15 Lakhs and this amount can be recovered from Mr. Y's parent's jewellery amounting to Rs. 4 Lakhs and rest from the house of Y's Parents. (Assumption: Y has inherited the house property on the death of his parents)

(iii) Necessaries will include the emergency medical treatment. Hence, the above provisions will also apply to the medical treatment given to the grandmother as Y is legally bound to support his grandmother.

Related Question: P left his carriage on D's premises. Landlord of D seized the carriage against the rent due from D. P paid the rent and got his carriage released. Can P recover the amount from D? [Back question of module] [RTP June 23]

Answer:
Yes, P can recover the amount from D. Section 69 states a person who is interested in the payment of money which another person is bound by law to pay, and who therefore pays it, is entitled to get it reimbursed by the other.

In the present case, D was lawfully bound to pay rent. P was interested in making the payment to D's landlord as his carriage was seized by him. Hence being an interested party P made the payment and can recover the same from D.

Related Question: X found a wallet in a restaurant. He enquired of all the customers present there but the true owner could not be found. He handed over the same to the manager of the restaurant to keep till the true owner is found. After a week he went back to the restaurant to enquire about the wallet. The manager refused to return it back to X, saying that it did not belong to him.
In the light of the Indian Contract Act, 1872, can X recover it from the Manager? [Nov 19, 4 Marks] [RTP Dec 23]

Answer:
Provisions same as above as given under section 71
In the light of the above provisions, the manager must return the wallet to X, since X is entitled to retain the wallet found against everybody except the true owner.

Related Question: A, a gold dealer, regularly pays sales tax as per law. Subsequently, the government lowers down the tax rate. Without knowing this new law, A continues to pay the sales tax on higher rates. On becoming aware that the rate has been lowered down, he claims the excess payment from the government.

Answer:

Deemed Quasi Contract
Money paid by mistake or under coercion (Section 72): "A person to whom money has been paid or anything delivered by mistake or under coercion, must repay or return it".
In this case, A can claim the recovery of excess payment under Section 72 of the Indian Contract Act.

Related Question: A insured his goods with an insurance company against the risk of fire only. After sometimes, the goods were stolen from the godown, and A claimed the amount from the insurance company. The insurance company paid the amount under the mistake that goods had been destroyed by a peril insured against. On knowing that the goods were not insured against theft', the insurance company claimed the refund of money from A.

Answer:
Deemed Quasi Contract
Money paid by mistake or under coercion (Section 72): "A person to whom money has been paid or anything delivered by mistake or under coercion, must repay or return it".

In this case, the money Could be recovered by the insurance company under Section 72.

Unit 7 to 9

Contract of indemnity

Question 1A

Define 'Contract of Indemnity' as per the Indian Contract Act, 1872. What are the parties to a contract of indemnity? Give an example to explain the contract of indemnity.

Answer

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

There are two parties in this form of contract. The party who promises to indemnify/ save the other party from loss is known as 'indemnifier', where as the party who is promised to be saved against the loss is known as 'indemnified' or indemnity holder.

Example: A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of Rs. 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Question 1B

State the rights of the indemnity-holder when sued?

Answer

According to the **Section 125** of the Indian Contract Act,1872 the indemnity holder i.e., promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor:
(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
(2) all costs which he may be compelled to pay in any such suit, if in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.
(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

Section 125 is by no means exhaustive, which deals only with his rights in the event of his being sued. The indemnity holder has other rights besides those mentioned above. If he has incurred a liability and

that liability is absolute he is entitled to call upon his indemnifier to save him from that liability and to pay it off.

Contract of Guarantee

Question 1C

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

Answer

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

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

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

i. Guarantee obtained by means of misrepresentation.
ii. creditor obtained any guarantee by means of keeping silence as to material circumstances.

When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Question 1D

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

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

Answer

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

In the light of the given facts in the question, the guarantee was given by Mr. Ganesh (the surety) to Mr. Sohel that he would pay the dues in case Mr. Manish (the Principal Debtor) fails to pay the amount. However, later on it was contended by Mr. Ganesh that there was no consideration in the contract of

guarantee and also that Manish is a minor and therefore the contract of guarantee is not valid.

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

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

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

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

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

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

Question 1E

Mr. Salil purchased furniture of worth Rs. 1,00,000 from Mr. Pooran on credit. Mr. Raman entered in contract with Mr. Pooran for the guarantee of the payment by Mr. Salil. On due date, Mr. Salil could not make the payment due to his financial crisis. Mr. Pooran filed the suit against Mr. Raman for payment. Meanwhile father of Mr.Salil paid Rs. 20,000 to Mr. Pooran on behalf of his son. Mr. Raman, in ignorance of above payment, paid Rs. 1,00,000 to Mr. Pooran as surety. Afterwards, when Mr. Raman knew the facts, he asked Mr. Pooran for refund of Rs. 20,000. Mr. Pooran denied for refund with the words, that's only Mr. Salil who can claim the amount of ` 20,000. Explain, with reference to Indian Contract Act 1872, whether Mr. Raman (surety) can claim the refund of Rs. 20,000 from Mr. Pooran?

Answer

As per the provisions of **section 128** of the Indian Contract Act, 1872, the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract. In other words, the surety is liable for all those amounts, the principal debtor is liable for.

In the given question, before Mr. Raman makes the payment (on default of Mr. Salil), the father of Mr. Salil paid Rs. 20,000 to Mr. Pooran on behalf of his son. Unaware of the payment of Rs. 20,000, Mr. Raman paid the full amount to Mr. Pooran.

The liability of Mr. Raman (surety) is co-extensive with that of Mr. Salil (principal debtor). As the father of Mr. Salil made payment of Rs. 20,000 on Salil's behalf, Mr. Raman is liable only for Rs. 80,000 to Mr. Pooran (creditor). Mr. Raman made the full payment without the knowledge of facts. Therefore, he can claim the refund of Rs. 20,000 from Mr. Pooran.

Question 1F

Satya has given his residential property on rent amounting to Rs. 25,000 per month to Tushar. Amit became the surety for payment of rent by Tushar. Subsequently, without Amit's consent, Tushar agreed to pay higher rent to Satya. After a few months of this, Tushar defaulted in paying the rent.

(i) Explain the meaning of contract of guarantee according to the provisions of the Indian Contract Act, 1872.

(ii) State the position of Amit in this regard

Answer

i. Contract of guarantee: Same as above
Three parties are involved in a contract of guarantee:
Surety-person who gives the guarantee,
Principal debtor- person in respect of whose default the guarantee is given,
Creditor- person to whom the guarantee is given

ii. According to the provisions of **section 133** of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

In the instant case, Satya (Creditor) cannot sue Amit (Surety), because Amit is discharged from liability when, without his consent, Tushar (Principal debtor) has changed the terms of his contract with Satya (creditor). It is immaterial whether the variation is beneficial to the surety or does not materially affect the position of the surety.

Question 1G

Distinguish between a contract of Indemnity and a contract of Guarantee as per The Indian Contract Act, 1872.

Answer

Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of party/ Parties to the contract	There are only two parties namely the indemnifier [promisor] and the indemnified [promisee].	There are three parties creditor, principal debtor and surety.
Nature of liability	The liability of the indemnifier is primary and unconditional.	The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor.
Time of liability	The liability of the indemnifier arises only on the happening of a contingency.	The liability arises only on the non performance of an existing promise or non-payment of an existing debt.

Time to act	The indemnifier need not act at the request of indemnity holder	The surety acts at the request of principal debtor.
Right to sue third party	Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

Question 1H

Paul (minor) purchased a smart phone on credit from a mobile dealer on the surety given by Mr. Jack, (a major). Paul did not pay for the mobile. The mobile dealer demanded the payment from Mr. Jack because the contract entered with Paul (minor) is void. Mr. Jack argued that he is not liable to pay the amount since Paul (Principal Debtor) is not liable. Whether the argument is correct under the Indian Contract Act, 1872? What will be your answer if Jack and Paul both are minor?

Answer

In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

In the given question, the contract is a valid contract and Jack (major) shall be liable to pay the amount even if Paul (Principal debtor) is not liable (as Paul is minor).

If both Jack and Paul are minors then the agreement of guarantee is void because the surety as well as the principal debtor are incompetent to contract.

Revocation of Continuing Guarantee

Question 2A

Alpha Motor Ltd. agreed to sell a bike to Ashok under hire-purchase agreement on guarantee of Abhishek. The Terms were: hire-purchase price 96,000 payable in 24 monthly instalments of 78,000 each. Ownership to be transferred on the payment of last instalment. State whether Abhishek is discharged in each of the following alternative case under the provisions of the Indian Contract Act, 1872:

(i) Ashok paid 12 instalments but failed to pay next two instalments. Alpha Motor Ltd. sued Abhishek for the payment of arrears and Abhishek paid these two instalments i.e. 13th and 14h. Abhishek then gave a notice to Alpha Motor Ltd. to revoke his guarantee for the remaining months.
(ii) If after 15th months, Abhishek died due to COVID-19.

Answer

According to **section 130** of the Indian Contract Act, 1872, the continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors. Once the guarantee is revoked, the surety is not liable for any future transaction however he is liable for all the transactions that happened before the notice was given.

A specific guarantee can be revoked only if liability to principal debtor has not accrued.

(i) In the given question Ashok paid 12 instalments (out of total 24 monthly instalments), but failed to pay next two instalments. Abhishek (guarantor) paid the 13th and 14th instalments but then he revoked guarantee for the remaining months. Thus, Abhishek is not liable for instalments that was made after the notice, but he is liable for installments made before the notice (which he had paid i.e. 13th and 14th installments).

(ii) According to section 131 of the Indian Contract Act, 1872, in the absence of any contract to the contrary, the death of surety operates as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety. However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.

In the given question, Abhishek (guarantor) died after 15th month. This will operate as arevocation of a continuing guarantee as to the future transactions taking place after the death of surety (i.e. Abhishek). However, the Abhishek's estate remains liable for the past transactions (i.e. 15th month and before) which have already taken place before the death of the surety.

Question 2B

Manoj guarantees for Ranjan, a retail textile merchant, for an amount of Rs. 1,00,000, for which Sharma, the supplier may from time-to-time supply goods on credit basis to Ranjan during the next 3 months. After 1 month, Manoj revokes the guarantee, when Sharma had supplied goods on credit for Rs. 40,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether Manoj is discharged from all the liabilities to Sharma for any subsequent credit supply. What would be your answer in case Ranjan makes default in paying back Sharma for the goods already supplied on credit i.e., Rs. 40,000? (4 Marks) May 2019

Answer

Discharge of Surety by Revocation: As per **section 130** of the Indian Contract Act, 1872 a specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

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

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

Discharge of surety by variance in terms of contract

Question 3A

Y advances Z a loan of R 10,000 on the guarantee of X, at an interest of 10%. Subsequently, as Z was having some financial problems, Y reduced the rate of interest to 7% and also extended time for repayment of loan without the consent of X. Z becomes insolvent. Can Y sue X for recovery of amount?

Answer

According to **section 133** of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Accordingly, Y cannot sue X, because a surety (X) is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor (Z) no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety.

Question 3B

Mr. X agreed to give a loan to Mr. Y on the security of four properties. Mr. A gave guarantee against the loan. Actually Mr. X gave a loan of smaller amount on the security of three properties. Whether Mr. A is liable as surety in case Mr. Y failed to repay the loan?

Answer

As per the provisions of **section 133** of the Indian Contract Act, 1872, any variance, made without the surety's consent, in the terms of the contract between the principal [debtor] and the creditor, discharges the surety as to transactions subsequent to the variance. In the given instance, the actual transaction was not in terms of the guarantee given by Mr. A. The loan amount as well as the securities were reduced without the knowledge of the surety So, accordingly, Mr. A is not liable as a surety in case Y failed to repay the loan.

Question 3C

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

fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's Appointment?

Answer

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

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

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

Question 3D

'A' gives to 'M' a continuing guarantee to the extent of Rs. 8,000 for the fruits to be supplied by 'M' to 'S' from time to time on credit. Afterwards 'S' became embarrassed and without the knowledge of 'A', 'M' and 'S' contract that 'M' shall continue to supply 'S' with fruits for ready money and that payments shall be applied to the then existing debts between 'S' and 'M'. Examining the provision of the Indian Contract Act, 1872, decide whether 'A' is liable on his guarantee given to M.

Answer

Discharge of surety by variance in terms of contract:

The problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in **Section 133.** The section provides that any variance made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance

In the given problem, 'M' and 'S' entered into arrangement by entering into a new contract without knowledge of the Surety 'A'. Since, the variance made in the contract is without the surety's consent in the existing contract, as per the provision, 'A' is not liable on his guarantee for the fruits supplied after this new arrangement. The reason for such a discharge is that the surety agreed to be liable for a contract which is no more there now and he is not liable on the altered contract because it is different from the contract made by him.

Question 3E

Mr. Shashank, is employed as a cashier on a monthly salary of ` 10,000 by XYZ bank for a period of three years. Yash gave surety for Shashank's good conduct. After nine months, the financial position of the bank deteriorates. Then Shashank agrees to accept a lower salary of ` 5,000/- per month from Bank.

Two months later, it was found that Shashank has misappropriated cash since the time of his appointment. What is the liability of Yash? Decide your answer in reference to the provisions of the Contract Act, 1872. **[RTP June 24]**

Answer

According to **section 133** of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Thus, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. In the instant case Yash is liable as a surety for the loss suffered by the bank due to misappropriation of cash by Shashank during the first nine months but not for misappropriations committed after the reduction in salary.

Question 3F

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

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

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

Answer

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

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

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

taking place subsequent to such variance, shall discharge the surety for the loss suffered by the Swaraj company.

Discharge of surety by act of creditor

Question 4A

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

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

Answer

According to **Section 134** of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case, B does not supply the necessary material as per the agreement. Hence, C is discharged from his liability.

Question 4B

Mr. Sanjeev is dealing in high quality timber. Mr. Amit wants to purchase the timber from him on credit which is to be used in renovation of his house. Mr. Pramod gives a guarantee to Mr. Sanjeev for timber to be supplied by Mr. Sanjeev to Mr. Amit. Mr. Sanjeev supplied the required timber to Mr. Amit. Afterwards, Mr. Amit embarrassed and contracts with his creditors (including Mr. Sanjeev) to assign to them his property in consideration of their releasing him from their demands. On due date, Mr. Sanjeev filed the suit against Mr. Pramod for recovery of the payment of timber due to Mr. Amit. Explain, with reference to Indian Contract Act 1872, whether Mr. Sanjeev can claim the payment from Mr. Pramod?

Answer

Section 134 of the Indian Contract Act 1872 provides that the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In other words, if principal debtor is discharged surety will also be discharged.

On the basis of provisions and facts of the case, it is clear that on assigning his property to creditors, Mr. Amit is released from his liability against his creditors including Mr. Sanjeev. Now, by following the provisions of section 134, as Mr. Amit (principal debtor) is released, Mr. Pramod (surety) will be discharged. Hence, Mr. Sanjeev cannot claim the payment from Mr. Pramod.

Question 4C

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

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

Answer

According to **Section 136** of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged.

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

Rights of Surety

Surety's right to benefit of creditor's securities

Question 5A

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

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

Related Question: Explain in brief with reference to the provisions of The Indian Contract Act, 1872, what are the rights enjoyed by Surety against the Creditor, the Principal Debtor and Co-Sureties? **(June 24 - 6 Marks)**

Answer

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

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

Guarantee obtained by Misrepresentation

Question 5B

Rahul is the owner of electronics shop. Priyanka reached the shop to purchase an air conditioner whose compressor should be of copper. As Priyanka wanted to purchase the air conditioner on credit, Rahul demand a guarantor for such transaction. Mr. Arvind (a friend of Priyanka) came forward and gave the guarantee for payment of air conditioner. Rahul sold the air conditioner of a particular brand,

misrepresenting that it is made of copper while it is made of aluminium. Neither Priyanka nor Mr. Arvind had the knowledge of fact that it is made of aluminium. On being aware of the facts, Priyanka denied for payment of price. Rahul filed the suit against Mr. Arvind. Explain with reference to the Indian Contract Act 1872, whether Mr. Arvind is liable to pay the price of air conditioner?

Answer

As per the provisions of **section 142** of the Indian Contract Act 1872, where the guarantee has been obtained by means of misrepresentation made by the creditor concerning a material part of the transaction, the surety will be discharged. Further according to provisions of section 134, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

In the given question, Priyanka wants to purchase air conditioner whose compressor should be of copper, on credit from Rahul. Mr. Arvind has given the guarantee for payment of price. Rahul sold the air conditioner of a particular brand on misrepresenting that it is made of copper while it is made of aluminium of which both Priyanka & Mr. Arvind were unaware. After being aware of the facts, Priyanka denied for payment of price. Rahul filed the suit against Mr. Arvind for payment of price.

On the basis of above provisions and facts of the case, as guarantee was obtained by Rahul by misrepresentation of the facts, Mr. Arvind will not be liable. He will be discharged from liability.

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

What will be your answer, if R sold the water purifier misrepresenting it as having a copper filter, while it actually has a normal filter? Neither P nor S was aware of this fact and upon discovering the truth, P refused to pay the price. In response to P's refusal, R filed the suit against S, the guarantor. Explain with reference to the Indian Contract Act 1872, whether S is liable to pay the balance price of water purifier to R? **(June 24 - 7 Marks)**

Answer: Refer above provision

Guarantee obtained by silence

Question 5C

Mr. CB was invited to guarantee an employee Mr. BD who was previously dismissed for dishonesty by the same employer. This fact was not told to Mr. CB. Later on, the employee embezzled funds. Whether CB is liable for the financial loss as surety under the provisions of the Indian Contract Act, 1872?

Answer

As per **section 143** of the Indian Contract Act, 1872, any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid. In the given instance, Mr. CB was invited to give guarantee of an employee Mr. BD to the same employer who previously dismissed Mr. BD for dishonesty. This fact was not told to Mr. CB.

Here, keeping silence as to previous dismissal of Mr. BD for dishonesty is a material fact and if Mr. BD later embezzled the funds of the employer, Mr. CB will not be held liable for the financial loss as surety since such a contract of guarantee entered is invalid in terms of the above provisions.

Equality of burden is the basis of Co-suretyship

Question 6A

Due to urgent need of money amounting to 3,00,000, Pawan approached Raman and asked him for the money. Raman lent the money on the guarantee of Suraj, Tarun and Usha. Pawan makes default in payment and Suraj pays full amount to Raman. Suraj, afterwards, claimed contribution from Tarun and Usha refused to contribute on the basis that there is no contract between Suraj and him. Examine referring to the provisions of the Indian Contract Act, 1872, whether Tarun can escape from his liability.

Answer

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

Accordingly, on the default of Pawan in payment, Tarun cannot escape from his liability. All the three sureties Suraj, Tarun and Usha are liable to pay equally, in absence of any contract between them.

Question 6B

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

Answer

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

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

Bailment

State the essential elements of a contract of bailment. **(MTP 1 June 24 - 6 Marks)**

Question 7A

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

Answer

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

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

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

Related Question

Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:
(i) Vikas parks his car at a parking lot, locks it, and keeps the keys with himself.
(ii) Seizure of goods by customs authorities.

Answer:

For a bailment to exist, the bailor must give possession of the bailed property and the bailee must accept it.
(i) No. Mere custody of goods does not mean possession. In the given case, since the keys of the car are with Vikas, Section 148, of the Indian Contract Act, 1872 shall not be applicable.
(ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists, and section 148 is applicable.

Duty of bailor

Question 7B

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

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

Answer

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

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

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

Question 7C

A hires a carriage of B and agrees to pay Rs. 500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Decide the liability of B in reference to the provisions of the Indian Contract Act, 1872.

Answer

According to **section 150** of the Indian Contract Act, 1872, the bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Hence, in the given case B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

Bailee liable for negligence

Question 7D

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

Answer

According to **section 151** of the Indian Contract Act, 1872, in all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

According to **section 152** of the Indian Contract Act, 1872, the bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in section 151.

Thus, Barn is liable to compensate Ashley for his negligence to keep jewelry at his residence. Here, Ashley and Barn agreed to keep the jewelry at the Bank's safe locker and not at the latter's residence.

Unauthorised use of goods by bailee

Question 7E

What is the liability of a bailee making unauthorized use of goods bailed?

Answer

Liability of bailee making unauthorised use of goods bailed:
According to **section 154** of the Indian Contract Act, 1872, if the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

Mixing of goods by bailee

Question 7F

Mr. Truth deposited 100 bags of groundnut in the factory of Mr. False for safe keeping. Mr. False mixed the groundnut bags with the other groundnut bags in the factory with the consent of Mr. Truth and consumed it to produce edible oil.

(i) Whether Mr. Truth is entitled to claim his share in the edible oil produced under the provisions of the Indian Contact Act, 1872?
(ii) What will be the consequences in case the groundnut bags were mixed without the consent of Mr. Truth under the above said Act?

Answer

The given question is based on **section 155, 156 & 157** of the Indian Contract Act, 1872

(i) W.r.t. this part of the question, Mr. Truth deposited his ground nut bags for safe keeping in the factory of the Mr. False. He mixed the ground nut bags of Mr. Truth with the other ground nut bags lying in the factory with the consent of Mr. Truth and consumed the same for producing edible oils.

(ii) According to **section 155** of the Indian Contract Act, 1872, if the Bailee, mixes the goods bailed with his own goods, with the consent of the bailor, both the parties shall have an interest in proportion to their respective shares in the mixture thus produced.

Accordingly, Mr. Truth is entitled to claim his share in the edible oil produced

(iii) According to **section 156 & 157** of the Indian Contract Act, 1872, where the bailee, without the consent of the bailor, mixes the goods bailed with his own goods and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division and any damage arising from the mixture.

In the given case, the goods were mixed without consent of Mr. Truth, and if such mixture can be separated, then Mr. False will bear the expense of separation and the damage, if any, arising from mixture.

However, in the light of given facts, as mixture of goods were consumed to produce oil, and so it cannot be separated and therefore Mr. False shall be liable to compensate Mr. Truth.

Question 7G

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

Answer:

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

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

Duties of Bailee

Question 7H

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

Answer

The legal provisions which dealt with the return of goods under the Indian Contract Act, 1872 (the Act) is covered in **Sections 160 and 161** of the Act, whereby, it is the duty of bailee to return, or deliver according to the bailor's directions, the goods bailed withou t demand, as soon as the time for which they were bailed, has expired, or the purpose for which they were bailed has been accomplished.

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

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

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

Bailee's right of lien

Question 7I

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

Answer

It is the duty of bailee to return, or deliver according to the bailor's directions, the goods bailed without demand, as soon as the time for which they were bailed, has expired, or the purpose for which they were bailed has been accomplished. **[Section 160** of the Indian Contract Act, 1872]

If, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time. **[Section 161]**

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

Bailor entitled to increase or profit from goods bailed

Question 7J

Mr. Stefen owns a chicken firm near Gurgaon, where he breeds them and sells eggs and live chicken to retail shops in Gurgaon. Mr. Flemming also owns a similar firm near Gurgaon, doing the same business. Mr. Flemming had to go back to his native place in Australia for one year. He needed money for travel so he had pledged his firm to Mr. Stefen for one year and received a deposit of Rs.25 lakhs and went away. At that point of time, stock of live birds were 100,000 and eggs 10,000. The condition was that when Flemming returns, he will repay the deposit and take possession of his firm with live birds and eggs.

After one year Flemming came back and returned the deposit. At that time there were 109,000 live birds (increase is due to hatching of eggs out of 10,000 eggs he had left), and 15,000 eggs.

Mr. Stefen agreed to return 100,000 live birds and 10,000 eggs only.

State the duties of Mr. Stefen as Pawnee and advise Mr. Flemming about his rights in the given case.

[RTP Sep 24]

Answer

According to **section 163** of the Indian Contract Act, 1872, in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

In the given question, when Mr. Flemming returned from Australia there were 1,09,000 live birds and 15,000 eggs (1,00,000 birds and 10,000 eggs were originally deposited by Mr. Flemming). Mr. Stefen agreed to return 1,00,000 live birds and 10,000 eggs only and not the increased number of live birds and eggs.

In the light of the provision of law and facts of the question, following are the answers:

Duties of Mr. Stefen: Mr. Stefen (pawnee) is bound to deliver to Mr. Flemming (pawnor), any increase or profit (9,000 live birds and 5,000 eggs) which has occurred from the goods bailed (i.e the live birds and eggs).

Right of Mr. Flemmimg: Mr. Flemming is entitled to recover from Pawnee any increase in goods so pledged.

Question 7K

Megha lends a sum of Rs. 20,000 to Bhim, on the security of two shares of a Prema Limited on 1st April 2019. On 15th June, 2019, the company issued two bonus shares. Bhim returns the loan amount of Rs. 20,000 with interest but Megha returns only two shares which were pledged and refuses to give the two bonus shares. Advise Bhim in the light of the provisions of the Indian Contract Act, 1872.

Answer

Bailee's Duties and Liabilities: The problem as asked in the question is based on the provisions of **Section 163(4)** of the Indian Contract Act, 1872. As per the section, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed."

In the given question, Megha received 2 bonus shares on the 2 pledged shares of Prema Limited.

Applying the provisions of the Indian Contract Act, 1872, to the given case, the bonus shares are an increase on the shares pledged by Bhim to Megha. So, Megha is liable to return the shares along with the bonus shares. Hence Bhim the bailor, is entitled to receive the original shares as well as bonus shares (after he has repaid the loan amount).

Bailment on basis of reward

Question 7L

On the basis of reward, what are various categories of bailment?

Answer

On the basis of reward, bailment can be classified into two types:

(i) Gratuitous Bailment: The word gratuitous means free of charge. So, a gratuitous bailment) is one when the provider of service does it gratuitously i.e. free of charge. Such bailment would be either for the exclusive benefits of bailor or bailee.

(ii) Non-Gratuitous Bailment: Non gratuitous bailment means where both the parties get some benefit i.e. bailment for the benefit of both bailor & bailee.

Finder of lost goods

Question 8

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

Answer

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

(i) The finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner. But 'finder of lost goods can ask for reimbursement for expenditure incurred for preserving the goods and also for searching the true owner. If the real owner refuses to pay compensation, the 'finder' cannot sue but retain the goods so found.

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

(ii) The finder though has no right to sell the goods found in the normal course; he may sell the goods if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:

(a) when the article is in danger of perishing and losing the greater part of the value or
(b) when the lawful charges of the finder amounts to two-third or more of the value of the article found.

General lien of Bankers

Question 9

Radheshyam borrowed a sum of Rs. 50,000 from a Bank on the security of gold on 1.07.2019 under an agreement which contains a clause that the bank shall have a right of particular lien on the gold pledged with it. Radheshyam thereafter took an unsecured loan of Rs. 20,000 from the same bank on 1.08.2019 for three months. On 30.09.2019 he repaid entire secured loan of Rs. 50,000 and requested the bank to release the gold pledged with it. The Bank decided to continue the lien on the gold until the unsecured loan is fully repaid by Radheshyam. Decide whether the decision of the Bank is valid within the provisions of the Indian Contract Act, 1872?

Answer

General lien of bankers: According to **section 171** of the Indian Contract Act, 1872, bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to the effect.

Section 171 empowers the banker with general right of lien in absence of a contract whereby it is entitled to retain the goods belonging to another party, until all the dues are discharged. Here, in the first instance, the banker under an agreement has a right of particular lien on the gold pledged with it against the first secured loan of Rs. 50,000/-, which has already been fully repaid by Radheshyam. Accordingly, Bank's decision to continue the lien on the gold until the unsecured loan of Rs 20,000/- (which is the second loan) is not valid.

Definition of pledge pawn etc & characterstics

Question 10A

As per the Indian Contract Act, 1872, answer the following:
(i) Definition of Pledge, pawnor and pawnee
(ii) Essential characteristics of contract of pledge

Answer

(i) **"Pledge", "pawnor" and "pawnee" defined [Section 172]:** The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor is in this case called the "pawnor". The bailee is called the "pawnee".

(ii) Since Pledge is a special kind of bailment, all the essential of bailment are also essentials of Pledge. Apart from that, the characteristics of the pledge are:

(1) There shall be a bailment of security against payment or performance of the promise.

(2) The subject matter of pledge is goods.

(3) Goods pledged for shall be in existence

(4) There shall be delivery of goods from pledger to pledgee.

Right of retainer

Question 10B

Whether a Pawnee has a right to retain the goods pledged.

Answer

Yes, the pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Question 10C

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

(ii) Whether a Pawnee has a right to retain the goods pledged.

Answer

(i) **Pledge by person in possession under voidable contract [Section 178A of the Indian Contract Act, 1872]:**

When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title. Therefore, the pledge of diamond by Srushti with Mr. VK is valid.

(ii) **Right of retainer [Section 173 of the Indian Contract Act, 1872]:**

Yes, the pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Question 10D

Shyam, at the request of Govind, sells goods which were, in the possession of Govind. However, Govind had no right to dispose of such goods. Shyam did not know this and handed over the proceed of the sale

to Govind. Afterwards, Manohar, who was the true owner of the goods, sued Shyam and recovered the value of the goods. In the light of the provisions of the Indian Contract Act, 1872, answer the following questions:
(i) Is Govind liable to indemniity Shyam for his payment to Manohar?
(ii) What will be the liability of Govind if the goods is a prohibited drug?

Answer

According to **section 178** of the Indian Contract Act, 1872, where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the Pawnor has no authority to pledge.

It is also to be noted that:

1. The possession of goods must be with the consent of the owner. If possession has been obtained dishonestly or by a trick, a valid pledge cannot be effected.
2. The pledgee should have no notice of the pledger's defect of title. If the pledgee knows that the pledger has a defective title, the pledge will not be valid.

(i) In the given question, Shyam had no notice of the Govind's defect of title. He acted in ordinary course of business of a mercantile agent considering Govind as owner of the good and genuinely handed over the proceed of the sale to him. Therefore, said transaction is invalid. Thus, Govind shall be liable to indemnify Shyam for his payment to Manohar.

(ii) Govind shall not be liable to indemnify Shyam as selling of prohibited drugs is a prohibited act and against the public policy.

Pledge by Non - owners

Question 10E

It is the owner of the goods, or any person authorized by him in that behalf, who can pledge the goods. But in order to facilitate mercantile transactions, the law has recognised certain exceptions. Do you think bonafide pledge can be made by non - owners? If yes, explain the circumstances with reference to provisions of the Indian Contract Act, 1872.

Answer

Ordinarily, it is the owner of the goods, or any person authorized by him in that behalf, who can pledge the goods. But in order to facilitate mercantile transactions, the law has recognised certain exceptions. These exceptions are for bonafide pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left.

a. Pledge by mercantile agent [Section 178 of the Indian Contract Act, 1872]: A mercantile agent acting in the ordinary course of business, with the consent of the owner, is entitled to pledge the goods.

b. Pledge by person in possession under voidable contract [Section 178A]: When the pawnor has obtained possession of the goods pledged by him under a voidable contract and which has not been rescinded at the time of the pledge, can be pledged.

c. Pledge where pawnor has only a limited interest [Section 179]: Where a person pledges goods in which he has only a limited interest and is not the absolute owner of goods, the pledge is valid to the extent of that interest.

d. Pledge by a co-owner in possession: Where the goods are owned by many persons and with the consent of other owners, a co-owner may make a valid pledge of the goods in his possession.

e. Pledge by seller or buyer in possession: A seller, in whose possession, the goods have been left after sale or a buyer who with the consent of the seller, obtains possession of the goods, before sale, can make a valid pledge.

Agency

Minor as agent

Question 11A

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

Answer

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

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

Authority in an emergency

Question 11B

Rahul, a transporter was entrusted with the duty of transporting tomatoes from a rural farm to a city by Aswin. Due to heavy rains, Rahul was stranded for more than two days. Rahul sold the tomatoes below the market rate in the nearby market where he was stranded fearing that the tomatoes may perish. Can Aswin recover the loss from Rahul on the ground that Rahul had acted beyond his authority? (3 Marks)

Answer

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

In the instant case, Rahul, the agent, was handling perishable goods like 'tomatoes' and can decide the time, date and place of sale, not necessarily as per instructions of the Aswin, the principal, with the intention of protecting Aswin from losses.
Here, Rahul acts in an emergency as a man of ordinary prudence, so Aswin will not succeed against him for recovering the loss.

Question 11C

(a) R instructed S, a transporter, to send a consignment of apples to Chennai. After covering half the distance, Suresh found that the apples will perish before reaching Chennai. He sold the same at half the market price. R sued S. Decide will he succeed?
(b) Ramesh hires a carriage of Suresh and agrees to pay Rs. 1500 as hire charges. The carriage is unsafe, though Suresh is unaware of it. Ramesh is injured and claims compensation for injuries suffered by him. Suresh refuses to pay. Discuss the liability of Suresh.

Answer

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

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

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

Question 11D

Mr. Yadav, a cargo owner, chartered a vessel to carry a cargo of wheat from a foreign port to Chennai. The vessel got stranded on a reef in the sea 300 miles from the destination. The ship's managing agents signed a salvage agreement for Mr. Yadav. The goods (wheat) being perishable, the salvors stored it at their own expense. Salvors intimated the whole incident to the cargo owner. Mr. Yadav refuse to reimburse the Salvor, as it is the Ship owner, being the bailee of the cargo, who was liable to reimburse the salvor until the contract remained unterminated. Referring to the provision of The Indian Contract Act 1872, do you acknowledge or decline the act of Salvor, as an agent of necessity, for Mr. Yadav. Explain?

Answer

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

In certain circumstances, a person who has been entrusted with another's property may have to incur unauthorized expenses to protect or preserve it. This is called an agency of necessity. Hence, in the above case the Salvor had implied authority from the cargo owner to take care of the cargo. They acted as agents of necessity on behalf of the cargo owner. Cargo owner were duty-bound towards salvor. Salvor is entitled to recover the agreed sum from Mr. Yadav and not from the ship owner, as a lien on the goods

Bailment Vs pledge

Question 11E

Give four differences between Bailment and Pledge.

Answer

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

(a) As to purpose: Pledge is a variety of bailment. Under pledge goods are bailed as a security for a loan or a performance of a promise. In regular bailment the goods are bailed for other purpose than the two referred above. The bailee takes them for repairs, safe custody etc.

(b) As to right of sale: The pledgee enjoys the right to sell only on default by the pledgor to repay the debt or perform his promise, that too only after giving due notice. In bailment the bailee, generally, cannot sell the goods. He can either retain or sue for non-payment of dues.

(c) As to right of using goods: Pledgee has no right to use goods. A bailee can, if the terms so provide, use the goods.

(d) Consideration: In pledge there is always a consideration whereas in a bailment there may or may not be consideration.

(e) Discharge of contract: Pledge is discharged on the payment of debt or performance of promise whereas bailment is discharged as the purpose is accomplished or after specified time.

Sub Agent

Question 11F

Explain whether the agency shall be terminated in the following cases under the provisions of the Indian Contract Act, 1872:

A appoints B as A's agent to sell A's land. B, under the authority of A, appoints C as agent of B. Afterwards, A revokes the authority of B but not of C. What is the status of agency of C?

Answer

According to **section 191** of the Indian Contract Act, 1872, a "Sub-agent' is a person employed by, and acting under the control of, the original agent in the business of the agency.
Section 210 provides that, the termination of the authority of an agent causes the termination (subject to the rules regarding the termination of an agent's authority) of the authority of all sub-agents appointed by him.
In the given question, B is the agent of A, and C is the agent of B. Hence, C becomes a subagent.

Thus, when A revokes the authority of B (agent), it results in termination of authority of subagent appointed by B i.e., C (sub-agent).

Question 11G

Hari, authorises Bharat, a merchant in Mumbai, to recover dues from Bankey & Co. Bharat instructs Deepak, a solicitor, to take legal proceedings against Bankey & Co., for recovery of the money. Explain the legal position of Deepak, referring provisions of the Indian Contract Act, 1872, related to agency

Answer

As per **section 194** of the Indian Contract Act, 1872, where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person shall be an agent of the principal for such part of the business of the agency as is entrusted to him.

In the instant case, Hari, authorizes Bharat, a merchant in Mumbai, to recover dues from Bankey & Co. Bharat instructs Deepak, a solicitor, to take legal proceedings against Bankey & Co. for recovery of the money.

Here, Deepak, a solicitor, is a substituted agent to act for the principal in the business of the agency, to take legal proceedings for recovering of money.

Question 11H

Mr. Bhalla instructs Aman, a merchant, to buy a ship for him. Aman employs a ship surveyor of good reputation to choose a ship for Mr. Bhalla. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. Now, Mr. Bhalla holds Aman responsible for the same. Examine as per the provisions of the Contract Act, 1872, whether Aman is responsible to Mr. Bhalla.

Answer

According to **section 194** of the Indian Contract Act, 1872, where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has

named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him.

Further, as per **section 195**, in selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.
Thus. in the present case, Aman is not. but the surveyor is. responsible to Mr. Bhalla.

Question 11I

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

Answer

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

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

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

No ratification without knowledge

Question 11J

Ramu has given authority to Prem to buy certain goods at the market rate. Prem buys the goods at a higher rate than the market rate. However, Ramu accepted the purchase in spite of higher rate. Afterwards, Ramu comes to know that the goods purchased belonged to Prem himself. Decide, whether Ramu is bound by ratification done?

Answer

According to **section 198** of the Indian Contract Act, 1872, no valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.
In the instant case, Ramu has given authority to Prem to buy certain goods at the market rate. Prem buys the goods at a higher rate than the market rate. However, Ramu accepted the purchase inspite of higher rate. Afterwards, Ramu comes to know that the goods belonged to Prem himself. The ratification is not binding on Ramu.

Ratification of Authority

Question 11K

A rented his house to B on lease for 3 years. The lease agreement is terminable on 3 month notice by either party. C, the son of A, being in need of a separate house to live, served a notice on B, without any authority, to vacate the house within a month and requested his father A to ratify his action. Examine whether it shall be valid for A to ratify the action of C taking into account the provisions of the Indian Contract Act, 1872?

Answer

As per **section 200** of the Indian contract Act, 1872, an act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect.

In the given instance, A rented his house to B on lease for 3 years. The lease agreement was terminable on three months' notice. C, son of A, gives notice of termination to B, without any authority, to vacate the house within a month.

Also requested A to ratify his action. Here by the act of C, the interest of B is affected, therefore the principle of ratification does not apply. Hence, it's not valid for A to ratify the action of C, thereby causing the notice to be binding on B.

Agency coupled with interest

Question 11L

Akash is a famous manufacturer of leather goods. He appoints Prashant as his agent. Prashant is entrusted with the work of recovering money from various traders to whom Akash sells leather goods. Prashant is paid a monthly remuneration of Rs. 15,000. Prashant during a particular month recovers Rs. 40,000 from traders on account of Akash. Prashant gives back Rs. 25,000 to Akash, after deducting his salary.

Examine with reference to relevant provisions of the Indian Contract Act, 1872, whether act of Prashant is valid.

Answer

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

In the given instance, Akash appointed Prashant as his agent to recover money from various traders to whom Akash sold his leather goods, on a monthly remuneration of Rs. 15,000. Prashant during a month recovers Rs. 40,000 from traders on account of Akash. Prashant after deducting his salary give the rest amount to Akash. In the said case, interest was created in favour of Prashant and the said agency is not revocable, therefore, the act of Prashant is valid.

Question 11M

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

Answer

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

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

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

Related Question: Explain whether the agency shall be terminated in the following cases under the provisions of the Indian Contract Act, 1872:
(i) A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. Afterwards, A becomes insane.
(ii) A appoints B as A's agent to sell A's land. B, under the authority of A, appoints C as agent of B. Afterwards, A revokes the authority of B but not of C. What is the status of agency of C? **(MTP 1 June 24 - 6 Marks)**

Answer

(i) According to **section 202** of the Indian Contract Act, 1872, where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest. In other words, when the agent is personally interested in the subject matter of agency, the agency becomes irrevocable. In the given question, A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. As per the facts of the question and provision of law, A cannot revoke this authority, nor it can be terminated by his insanity.

(ii) According to **section 191** of the Indian Contract Act, 1872, a "Sub- agent" is a person employed by, and acting under the control of, the original agent in the business of the agency. Section 210 provides that, the termination of the authority of an agent causes the termination (subject to the rules regarding the termination of an agent's authority) of the authority of all sub-agents appointed by him. In the given question, B is the agent of A, and C is the agent of B. Hence, C becomes a sub- agent. Thus, when A revokes the authority of B (agent), it results in termination of authority of sub-agent appointed by B i.e. C (sub-agent).

Business according to principals direction

Question 11N

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

Answer

To conduct the business of agency according to the principal's directions (**Section 211** of the Indian Contract Act, 1872):

An agent is bound to conduct the business of his principal according to the direction given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

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

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

Agent concealing fact & acting dishonestly

Question 11O

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

Answer

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

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

(2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. A is entitled to recover & 30 lakhs from Mr. S being the amount of profit earned by Mr. S out of the transaction.

When agent exceeds its authority

Question 11P

X has made an agency agreement with Y to authorize him to purchase goods on the behalf of X for the year 2020 only. The agency agreement was signed by both and it contains all the terms and conditions for the agent. It has a condition that Y is allowed to purchase goods maximum upto the value of Rs. 10 lakhs only. In the month of April 2020, Y has purchased a single item of Rs. 12 lakhs from Z as an agent of X. The market value of the item purchased was Rs.14 lakhs but a discount of Rs.2 lakhs was given by Z. The agent Y has purchased this item due to heavy discount offered and the financially benefit to X.

After delivery of the item Z has demanded the payment from X as Y is the agent of X. But X denied to make the payment stating that Y has exceeded his authority as an agent therefore he is not liable for this purchase. Z has filed a suit against X for payment.

Decide whether Z will succeed in his suit against X for recovery of payment as per provisions of The Indian Contract Act, 1872.

Answer

An agent does all acts on behalf of the principal but incurs no personal liability. The liability remains that of the principal unless there is a contract to the contrary. An agent also cannot personally enforce contracts entered into by him on behalf of the principal. In the light of **section 226** of the Indian Contract Act, 1872, Principal is considered to be liable for the acts of agents which are within the scope of his authority. Further section 228 of the Indian Contract Act, 1872 states that where an agent does more than he is authorised to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognise the transaction.

In the given case, the agency agreement was signed between X and Y, authorizing Y to purchase goods maximum upto the value of Rs. 10 lakh. But Y purchased a single item of 12 lakh from Z as an agent of X at a discounted rate to financially benefit to X. On demand of payment by Z, X denied saying that Y has exceeded his authority therefore he is not liable for such purchase. Z filed a suit against X for payment.

As said above, liability remains that of the principal unless there is a contract to the contrary. The agency agreement clearly specifies the scope of authority of Y for the purchase of goods, however he exceeded his authority as an agent. Therefore, in the light of section 228 as stated above, since the transaction is not separable, X is not bound to recognize the transaction entered between Z and Y, and therefore may repudiate the whole transaction. Hence, Z will not succeed in his suit against X for recovery of payment.

Agent not liable

Question 11Q

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

(ii) What is the liability of a bailee making unauthorized use of goods bailed?

Answer

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

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

(1) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad/foreign principal;

(2) Where the agent does not disclose the name of his principal or undisclosed principal; and

(3) Where the principal, though disclosed, cannot be sued.

(ii) Liability of bailee making unauthorised use of goods bailed: According to section 154 of the Indian Contract Act, 1872, if the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

Agency by estoppel

Question 11R

What is the meaning of 'Agency by estoppel'? What are the essential conditions for creation of an agency by estoppel? Give your answer with respect to the provisions the Indian Contract Act, 1872.

Answer

An agency by estoppel is based on the principle of estoppel. The principle of estoppel lays down that "when one person by declaration (representation), act or omission has intentionally caused or permitted another person to believe a thing to be true and to act upon such belief, he shall not be allowed to deny his previous statement or he shall be stopped to deny his previous statement or conduct".

The agency by Estoppel is provided under **section 237** of the Indian Contract Act. Section 237 states: "When an agent has without authority done acts or incurred obligations to third persons on behalf of his principal the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority".

According to section 237 of the Contract Act, an agency by estoppel may be created when following essentials are fulfilled:

1. the principal must have made a representation;
2. the representation may be express or implied;
3. The representation must state that the agent has an authority to do certain act although really he has no authority;
4. The principal must have induced the third person by such representation; and
5. The third person must have believed the representation and made the contract on the belief of such representation.

Agency by legal presumption

Question 11S

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

Answer

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

(i) Where the goods purchased on credit are not necessaries.
(ii) Where the wife is given sufficient money for purchasing necessaries.
(iii) Where the wife is forbidden from purchasing anything on credit or contracting debts.

(iv) Where the trader has been expressly warned not to give credit to his wife. If the wife lives apart for no fault on her part, wife has authority to pledge her husband's credit for necessaries. This legal presumption can be rebutted only in cases (iii) and (iv) above.

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

Agreement void

Question 12

Megha lends a sum of Rs. 20,000 to Bhim, on the security of two shares of a Prema Limited on 1s April 2019. On 15th June, 2019, the company issued two bonus shares. Bhim returns the loan amount of Rs. 20,000 with interest but Megha returns only two shares which were pledged and refuses to give the two bonus shares. Advise Bhim in the light of the provisions of the Indian Contract Act, 1872.

Answer

According to section 65 of the Indian Contract Act, 1872, when an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore, it, or to make compensation for it, to the person from whom he received it.

In the given case, the contract for supply of machinery by Rajeev Ltd. to Mr. Gogia by 31st May, 2019 was frustrated due to the occurrence of an earthquake on 31st March, 2019 which has led to the break in the operations of Rajeev Ltd. for at least one year.

Since, Mr. Gogia obtains no benefit from the contract, and he has paid part of a sum before frustration, he can recover the money paid in advance because it can be said there has been total failure of consideration. Hence, Mr. Gogia can recover the amount of Rs. 2,00,000 from Rajeev Ltd.

Question 13

Rama directs Shyam to sell laptops for him and agrees to give Shyam eleven percent (11%) commission on the sale price fixed by Rama for each laptop. As Government of India put restrictions on import of Laptops, Rama thought that the prices of laptops might go up in near future and he revokes Shyam's authority for any further sale. Shyam, before receiving the letter at his end, sold 5 laptops at the price fixed by Rama. Shyam asked for 11% commission on the sale of 5 Laptops for Rs.1 lakh each. Explain under the provisions of The Indian Contract Act, 1872:
(1) Whether sale of laptops after revoking Shyam's authority is binding on Rama?
(2) Whether Shyam will be able to recover his commission from Rama, if yes, what will be the amount of such commission? **(June 24 - 3 Marks)**

Answer: Refer to module

Chapter – 3 The Sale of Goods Act, 1930

Unit 1: Formation of the Contract of Sale

Sale and agreement to sell – Sec 4

Contract of sale

(1) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between one part-owner and another.

(2) A contract of sale may be absolute or conditional.

(3) Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

(4) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

Question 1

State briefly the essential element of a contract of sale under the Sale of Goods Act, 1930. [Back Question of Module] [RTP May 19] [RTP Nov 18] [RTP May 20] [MTP Aug 18, 4 Marks]

Answer: [RTP May 21]

Essentials of Contract of Sale

The following elements must co-exist so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930.

(i) There must be at least two parties
(ii) The subject matter of the contract must necessarily be goods
(iii) A price in money (not in kind) should be paid or promised.
(iv) A transfer of property in goods from seller to the buyer must take place.
(v) A contract of sale must be absolute or conditional [section 4(2)].
(vi) All other essential elements of a valid contract must be present in the contract of sale

Related Question: A agrees to buy a new TV from a shop keeper for Rs. 30,000 payable partly in cash of Rs. 20,000 and partly in exchange of old TV set. Is it a valid Contract of Sale of Goods? Give reasons for your answer. [Module Back Question]

Answer:

It is necessary under the Sales of Goods Act, 1930 that the goods should be exchanged for money. If the goods are exchanged for goods, it will not be called a sale. It will be considered as barter. However, a contract for transfer of movable property for a definite price payable partly in goods and partly in cash is held to be a contract of Sale of Goods.

In the given case, the new TV set is agreed to be sold for Rs. 30,000 and the price is payable partly in exchange of old TV set and partly in cash of Rs. 20,000. So, in this case, it is a valid contract of sale under the Sales of Goods Act, 1930.

Related Question: Archika went to a jewellery shop and asked the shopkeeper to show the gold bangles with white polish. The shopkeeper informed that he has gold bangles with lots of designs but not in white polish rather if Archika select gold bangles in his shop, he will arrange white polish on those gold bangles without any extra cost. Archika select a set of designer bangles and pay for that. The shopkeeper requested Archika to come after two days for delivery of those bangles so that white polish can be done on those bangles. When Archika comes after two days to take delivery of bangles, she noticed that due to white polishing, the design of bangles has been disturbed. Now, she wants to avoid the contract and asked the shopkeeper to give her money back but shopkeeper has denied for the same.

(a) State with reasons whether Archika can recover the amount under the Sale of Goods Act, 1930.
(b) What would be your answer if shopkeeper says that he can repair those bangles but he will charge extra cost for same? [RTP Nov 21]

Related Question: Sonal went to a Jewellery shop and asked the sales girl to show her diamond bangles with Ruby stones. The Jeweller told her that we have a lot of designs of diamond bangles but with red stones if she chooses for herself any special design of diamond bangle with red stones, they will replace red stones with Ruby stones. But for the Ruby stones they will charge some extra cost. Sonal selected a beautiful set of designer bangles and paid for them. She also paid the extra cost of Ruby stones. The Jeweller requested her to come back a week later for delivery of those bangles. When she came after a week to take delivery of bangles, she noticed that due to Ruby stones, the design of bangles has been completely disturbed. Now, she wants to terminate the contract and thus, asked the manager to give her money back, but he denied for the same. Answer the following questions as per the Sale of Goods Act, 1930.

(i) State with reasons whether Sonal can recover the amount from the Jeweller.

(ii) What would be your answer if Jeweller says that he can change the design, but he will charge extra cost for the same? [May 22 - 6 Marks] [RTP Dec 23]

Answer:

As per Section 4(3) of the Sale of Goods Act, 1930, where under a contract of sale , the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell and as per Section 4(4), an

agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

(a) On the basis of above provisions and facts given in the question, it can be said that there is an agreement to sell between Archika and shopkeeper and not a sale. Even the payment was made by Archika, the property in goods can be transferred only after the fulfilment of conditions fixed between buyer and seller. As the white polish was done but original design is disturbed due to polishing, bangles are not in original position. Hence, Archika has right to avoid the agreement to sell and can recover the price paid.

(b) On the other hand, if shopkeeper offers to bring the bangles in original position by repairing, he cannot charge extra cost from Archika. Even he has to bear some expenses for repair; he cannot charge it from Archika.

Related Question: Explain the difference between Sale and Agreement to sell under the Sale of Goods Act, 1930. [MTP March / Aug 2018, 4 Marks] [MTP April 19, 4 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Basis of difference	Sale	Agreement to sell
Transfer of property	The property in the goods passes to the buyer immediately.	Property in the goods passes to the buyer on future date or on fulfilment of some condition.
Nature of contract	It is an executed contract. i.e., contract for which consideration has been paid.	It is an executory contract. i.e., contract for which consideration is to be paid at a future date.
Remedies for breach	The seller can sue the buyer for the price of the goods because of the passing of the property therein to the buyer.	The aggrieved party can sue for damages only and not for the price, unless the price was payable at a stated date.
Liability of parties	A subsequent loss or destruction of the goods is the liability of the buyer.	Such loss or destruction is the liability of the seller.
Burden of risk	Risk of loss is that of buyer since risk follows ownership.	Risk of loss is that of seller.
Nature of rights	Creates Jus in rem	Creates Jus in personam
Right of resale	The seller cannot resell the goods.	The seller may sell the goods since ownership is with the seller.

Sale Vs Hire Purchase

Related Question: In what ways does a "Sale" differ from "Hire-Purchase"? [Back Question of Module] [Dec 21 – 6 marks]

Answer:

Basis of difference	Sale	Hire- Purchase
Time of passing property	Property in the goods is transferred to the buyer immediately at the time of contract.	The property in goods passes to the hirer upon payment of the last installment.
Position of the party	The position of the buyer is that of the owner of the goods.	The position of the hirer is that of a bailee till he pays the last installment.
Termination of contract	The buyer cannot terminate the contract and is bound to pay the price of the goods.	The hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining installments.
Burden of Risk of insolvency of the buyer	The seller takes the risk of any loss resulting from the insolvency of the buyer.	The owner takes no such risk, for if the hirer fails to pay an installment, the owner has right to take back the goods.
Transfer of title	The buyer can pass a good title to a bona *fide purchaser* from him.	The hirer cannot pass any title even to a bona fide purchaser.
Resale	The buyer in sale can resell the goods	The hire purchaser cannot resell unless he has paid all the installments.

Goods & its types

Question 2

Explain the term goods and other related terms under the Sale of Goods Act, 1930. [MTP Oct 18, 4 Marks]

Answer:

"Goods" means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale. [Section 2(7) of the Sales of Goods Act, 1930]

'Actionable claims' are claims, which can be enforced only by an action or suit, e.g., debt. A debt is not a movable property or goods. Even the Fixed Deposit Receipts (FDR) are considered as goods under Section 176 of the Indian Contract Act read with Section 2(7) of the Sales of Goods Act.

Related Question: Differentiate between Ascertained and Unascertained Goods with example. [Nov 18, 4 Marks]

Answer:

Ascertained Goods

1. Those goods which are identified in accordance with the agreement after the contract of sale is made. This term is not defined in the Act but has been judicially interpreted. In actual practice the term 'ascertained goods' is used in the same sense as 'specific goods.'

2. When from a lot or out of large quantity of unascertained goods, the number or quantity contracted for is identified, such identified goods are called ascertained goods.

Unascertained goods

The goods which are not specifically identified or ascertained at the time of making of the contract are known as 'unascertained goods'. They are indicated or defined only by description or sample.

Delivery & its types

Question 3

What is meant by delivery of goods under the Sale of Goods Act, 1930? State various modes/forms of delivery. [May 18, 4 Marks] [RTP May 18] [MTP March 19, 4 Marks] [MTP Oct 19, 4 Marks] [MTP Nov 22, 6 Marks]

Answer:

Delivery of goods [section 2(2) of the Sale of Goods Act, 1930]: Delivery means voluntary transfer of possession from one person to another. As a general rule, delivery of goods may be made by doing anything, which has the effect of putting the goods in the possession of the buyer, or any person authorized to hold them on his behalf.

Modes of delivery: Following are the modes of delivery for transfer of possession:

(i) Actual delivery: When the goods are physically delivered to the buyer.

(ii) Constructive delivery: When it is effected without any change in the custody or actual possession of the thing as in the case of delivery by attornment (acknowledgement) e.g., where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request.

(iii) Symbolic delivery: When there is a delivery of a thing in token of a transfer of something else, i.e., delivery of goods in the course of transit may be made by handing over documents of title to goods, like bill of lading or railway receipt or delivery orders or the key of a warehouse containing the goods is handed over to buyer.

Related Question: Avyukt purchased 100 Kgs of wheat from Bhaskar at Rs. 30 per kg. Bhaskar says that wheat is in his warehouse in the custody of Kishore, the warehouse keeper. Kishore confirmed Avyukt that he can take the delivery of wheat from him and till then he is holding wheat on Avyukt's behalf. Before Avyukt picks the goods from warehouse, the whole wheat in the warehouse has flowed in flood. Now Avyukt wants his price on the contention that no delivery has been done by seller. Whether Avyukt is right with his views under the Sale of Goods Act, 1930. [MTP Nov 21 - 6 Marks] [RTP June 23]

Answer:

As per the provisions of the Sale of Goods Act, 1930 there are three modes of delivery, i) Actual delivery, ii) Constructive delivery and iii) Symbolic delivery. When delivery is affected without any change in the custody or actual possession of the things, it is called constructive delivery or delivery by acknowledgement. Constructive delivery takes place when a person in possession of goods belonging to seller acknowledges to the buyer that he is holding the goods on buyer's behalf.

In the instant case, Kishore acknowledges Avyukt that he is holding wheat on Avyukt's behalf. Before picking the wheat from warehouse by Avyukt, whole wheat was flowed in flood.

On the basis of above provisions and facts, it is clear that possession of the wheat has been transferred through constructive delivery. Hence, Avyukt is not right. He cannot claim the price back.

Goods perishing before making of contract | Goods perishing before sale but after agreement to sell [Sec 7 & 8]

Question 4

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. [Back Question of Module] [RTP May 18] [RTP NOV 20] (May 22 - 4 Marks) [RTP Dec 23]

Answer:

Destruction of Goods-Consequences: In accordance with the provisions of the Sale of Goods Act, 1930 as contained in Section 7, a contract for the sale of specific goods is void if at the time when the contract was made; the goods without the knowledge of the seller, perished or become so damaged as no longer to answer to their description in the contract, then the contract is void *ab initio*. This section is based on the rule that where both the parties to a contract are under a mistake as to a matter of fact essential to a contract, the contract is void.

In a similar way Section 8 provides that an agreement to sell specific goods becomes void if subsequently the goods, without any fault on the part of the seller or buyer, perish or become so damaged as no longer to answer to their description in agreement before the risk passes to the buyer. This rule is also based on the ground of impossibility of performance as stated above.

It may, however, be noted that section 7 and 8 apply only to specific goods and not to unascertained goods. If the agreement is to sell a certain quantity of unascertained goods, the perishing of even the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver the goods.

Related Practical Question:	Hint/ Answer:
With a view to boost the sales, Hanuman Automobiles sells a motorcar to Mr. A on trial basis for a period of three days with a condition that if Mr. A is not satisfied with the performance of the car, he can return back the car. However, the car was destroyed in a fire accident at the place of Mr. A before the expiry of three days. Decide whether Mr. A is liable for the loss suffered.	1. The subject matter of the contract i.e. Motor Car, was destroyed before the transfer of property from the Seller to the Buyer. Thus, the risk passes only when the ownership is transferred to the Buyer. 2. So, Mr. A is not liable for the loss suffered due to the fire accident over which A has no control and M/s Hanuman Automobiles will have to bear the loss arising due to the fire accident.

Related Question: Akansh purchased a Television set from Jethalal, the owner of Gada Electronics on the condition that first three days he will check its quality and if satisfied he will pay for that otherwise he will return the Television set. On the second day, the Television set was spoiled due to an earthquake. Jethalal demands the price of Television set from Akansh. Whether Akansh is liable to pay the price under the Sale of Goods Act,1930? If not, who will ultimately bear the loss? [RTP Nov 21] [RTP Nov 22]

Answer:

According to Section 24 of the Sale of Goods Act, 1930, "When the goods are delivered to the buyer on approval or on sale or return or other similar terms the property passes to the buyer:

(i) when he signifies his approval or acceptance to the seller,

(ii) when he does any other act adopting the transaction, and

(iii) if he does not signify his approval or acceptance to the seller but retains goods beyond a reasonable time".

Further, as per Section 8, where there is an agreement to sell specific goods, and subsequently the goods without any fault on the part of the seller or buyer perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided.

According to above provisions and fact, the property is not passes to Akansh i.e. buyer as no condition of Section 24 is satisfied. Hence, risk has not passed to buyer and the agreement is thereby avoided. Akansh is not liable to pay the price. The loss finally should be borne by Seller, Mr. Jethalal.

Related Question: A agrees to sell to B 100 bags of sugar arriving on a ship from Australia to India within next two months. Unknown to the parties, the ship has already sunk. Does B have any right against A under the Sale of Goods Act, 1930? [Module Back Question]

Answer:
In this case, B, the buyer has no right against A the seller. Section 8 of the Sales of Goods Act, 1930 provides that where there is an agreement to sell specific goods and the goods without any fault of either party perish, damaged or lost, the agreement is thereby avoided. This provision is based on the ground of supervening impossibility of performance which makes a contract void.
So, all the following conditions required to treat it as a void contract are fulfilled in the above case:
(i) There is an agreement to sell between A and E
(ii) It is related to specific goods
(iii) The goods are lost because of the sinking of ship before the property or risk passes to the buyer.
(iv) The loss of goods is not due to the fault of either party.

The price [Sec 9 & 10]

Ascertainment of price [Section 9(1)]

(1) The price in a contract of sale may be fixed by the contract or may be left to be fixed in manner thereby agreed or may be determined by the course of dealing between the parties.

Question 5

X contracted to sell his car to Y. They did not discuss the price of the car at all. X later refused to sell his car to Y on the ground that the agreement was void being uncertain about price. Can Y demand the car under the Sale of Goods Act, 1930? [RTP Nov 21] [Module Back Question]

Answer:
Payment of the price by the buyer is an important ingredient of a contract of sale. If the parties totally ignore the question of price while making the contract, it would not become an uncertain and invalid agreement. It will rather be a valid contract and the buyer shall pay a reasonable price. (Section 9 (2) of the Sale of Goods Act, 1930)

In the give case, X and Y have entered into a contract for sale of car but they did not fix the price of the car. X refused to sell the car to Y on this ground. Y can legally demand the car from X and X can recover a reasonable price of the car from Y.

Related Question: Mr. A contracted to sell his swift car to Mr. B. Both missed to discuss the price of the said swift car. Later, Mr. A refused to sell his swift car to Mr. B on the ground that the agreement was void being uncertain about the price. Does Mr. B have any right against Mr. A under the Sale of Goods Act, 1930? (4 Marks June 23)

Answer:
As per the provisions of Section 2(10) of the Sale of Goods Act, 1930, price is the consideration for sale of goods and therefore is a requirement to make a contract of sale. Section 2(10) is to be read with Section 9 of the Sale of Goods Act, 1930.

According to Section 9 of the Sale of Goods Act, 1930, the price in a contract of sale may be fixed by the contract or may be left to be fixed in manner thereby agreed or may be determined by the course of dealing between the parties.

Even though both the parties missed to discuss the price of the car while making the contract, it will be a valid contract, rather than being uncertain and void; the buyer shall pay a reasonable price in this situation.

In the given case, Mr. A and Mr. B have entered into a contract for sale of a motor car, but they did not fix the price of the same. Mr. A refused to sell the car to Mr. B on this ground. Mr. B can legally demand the car from Mr. A and Mr. A can recover a reasonable price of the car from Mr. B.

Agreement to sell at valuation [Section 10]

(1) Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party cannot or does not make such valuation, the agreement is thereby avoided:

Provided that, if the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price therefor.

(2) Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault.

Example: P is having two bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price. As such P ask S to return the bike already delivered while S claims for the delivery of the second bike too. In the given instance, buyer S shall pay reasonable price to P for the bike already taken. As regards the Second bike, the contract can be avoided.

Related Question: Sony, a friend of Priya wanted to buy her two-wheeler. Priya agreed to sell her two-wheeler to Sony and it was decided that price of her two-wheeler will be fixed by Priya's father, who is an auto dealer. Priya immediately handed over the keys to Sony. However, Priya's father refused to fix the price as he did not want Priya to sell her vehicle. Priya expressed her inability to sell the two-wheeler to Sony and asked for return, but Sony refused to return the same. Explain –
(i) Can Priya take-back the vehicle from Sony?
(ii) Will your answer be different, if Priya had not handed over the vehicle to Sony? **(June 24 - 7 Marks)**

Related Question: Kapil entered in a contract with Rahul to purchase 1000 litres of mustard oil at the price which should be fixed by Akhilesh. Rahul already delivered 600 litres out of 1000 litres to Kapil but when remaining 400 litres was ready to deliver, Akhilesh denied fixing the price

of mustard oil. Rahul asked Kapil to return the oil already delivered and avoid the delivery of 400 litres. Kapil sued Rahul for non-delivery of remaining 400 litres mustard oil. Advise in the light of the Sale of Goods Act, 1930. **(MTP 1 June 24 - 7 Marks)**

Answer:

Provision of section 9 and 10: Same as above

In the instant case, Kapil contracted Rahul to purchase 1000 litres of mustard oil at the price fixed by Akhilesh. After, Rahul delivered 600 litres Akhilesh denied fixing the price of mustard oil. Rahul demanded back the oil already delivered and cancel the delivery of 400 litres. Kapil sued Rahul for non-delivery of remaining 400 litres mustard oil.

On the basis of above provisions and facts, Kapil is liable to pay a reasonable price of 600 litres while for remaining 400 litres, contract may be avoided.

Miscellaneous

Question 6

Classify the following transactions according to the types of goods they are:

(i) A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside.

(ii) A agrees to sell to B one packet of salt out of the lot of one hundred packets lying in his shop.

(iii) T agrees to sell to S all the oranges which will be produced in his garden this year. [RTP Nov 19] [MTP Oct 20 – 4 Marks] [RTP May 22]

Answer:

(i) A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside. On selection the goods becomes ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract.

(ii) If A agrees to sell to B one packet of salt out of the lot of one hundred packets lying in his shop, it is a sale of unascertained goods because it is not known which packet is to be delivered.

(iii) T agrees to sell to S all the oranges which will be produced in his garden this year. It is contract of sale of future goods, amounting to 'an agreement to sell.'

Unit– 2: Conditions & Warranties – Very Important Unit

Condition and warranty [Sec 12]

Question 1

Ram consults Shyam, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Shyam suggests 'Maruti' and Ram accordingly buys it from Shyam. The car turns out to be unfit for touring purposes. What remedy Ram is having now under the Sale of Goods Act, 1930? [RTP Nov 18]

Answer:

Condition and warranty (Section 12)

[Sub- section (1)]

A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

[Sub-section (2)]

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

[Sub-section (3)]

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

[Sub-section (4)]

Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.

Example: A went to B, a horse dealer, and told him that he wanted a horse which could run at a speed of 45 m.p.h. B. pointed out at a particular horse and said that this will suit his purpose. A bought that particular horse. Subsequently, it was discovered that the horse runs at a speed of 20 m.p.h. only. In this case, the representation made by the seller is a condition as it is essential to the main purpose of the contract. A may reject the horse and get back the price.

In the instant case, the term that the 'car should be suitable for touring purposes' is a condition of the contract. It is so vital that its non-fulfilment defeats the very purpose for which Ram purchases the car. Ram is therefore entitled to reject the car and have refund of the price.

When condition to be treated as warranty [Sec 13]

Question 2

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. [RTP May 19] [RTP NOV 20] [Back Question of Module] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8 [RTP May 21] [Dec 21] [RTP May 22 – 4 Marks]

Answer: Difference between Condition and Warranty

Basis	Condition	Warranty
1. Meaning	A condition is a stipulation essential to the main purpose of the contract	Whereas a warranty is a stipulation collateral to the main purpose of the contract
2. Effect	Breach of condition gives rise to a right to treat the contract as repudiated	Whereas in case of breach of warranty, the aggrieved party can claim damage only
3. Interchangeability	Breach of condition may be treated as breach of warranty	Whereas a breach of warranty cannot be treated as breach of condition

According to Section 13 of the Sale of Goods Act, 1930 a breach of condition may be treated as breach of warranty in following circumstances:

(i) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition,

(ii) Where the buyer elects to treat the breach of condition as breach of a warranty.

(iii) Where the contract of sale is non-severable and the buyer has accepted the whole goods or any part thereof.

(iv) Where the fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.

Implied conditions

Sale by description [Sec 15]

Question 3

Mr. T was a retail trader of fans of various kinds. Mr. M came to his shop and asked for an exhaust fan for kitchen. Mr. T showed him different brands and Mr. M approved of a particular brand and paid for it. Fan was delivered at Mr. M's house; at the time of opening the packet he found that it was a table fan. He informed Mr. T about the delivery of the wrong fan. Mr. T refused to exchange the same, saying that the contract was complete after the delivery of the fan and payment of price.

(i) Discuss whether Mr. T is right in refusing to exchange as per provisions of Sale of Goods Act, 1930?

(ii) What is the remedy available to Mr. M? [Jan 21 – 6 Marks] [RTP May 21]

Answer:

Sale by description [Section 15]: Where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with the description. This rule is based on the principle that "if you contract to sell peas, you cannot compel the buyer to take beans. "The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods.

Thus, it has to be determined whether the buyer has undertaken to purchase the goods by their description, i.e., whether the description was essential for identifying the goods where the buyer had agreed to purchase. If that is required and the goods tendered do not correspond with the description, it would be breach of condition entitling the buyer to reject the goods.

It is a condition which goes to the root of the contract and the breach of it entitles the buyer to reject the goods whether the buyer is able to inspect them or not.

In the instant case

As Mr. M has specifically mentioned that he required exhaust fan for kitchen. Mr. M is entitled to get the money back or the right kind of fan as required serving his purpose. It is the duty of the seller to deliver such goods as described by the buyer.

(i) Therefore, Mr. T cannot refuse to exchange the goods as Mr. M specifically mentioned that he required exhaust fan for kitchen, not a table fan. But Mr. T delivered table fan. It is the duty of the seller to deliver such goods as described by the buyer.

(ii)Mr. M is entitled to get the money back or the right kind of fan as required serving his purpose.

Implied conditions as to quality or fitness [Sec 16(1)]

Question 4

For the purpose of making uniform for the employees, Mr. Yadav bought dark blue coloured cloth from Vivek, but did not disclose to the seller the purpose of said purchase. When uniforms were prepared and used by the employees, the cloth was found unfit. However, there was evidence that the cloth was fit for caps, boots and carriage lining. Advise Mr. Yadav whether he is entitled to have any remedy under the sale of Goods Act, 1930? [RTP May 19] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Fitness of Cloth: As per the provision of Section 16(1) of the Sale of Goods Act, 1930

An implied condition in a contract of sale that an article is fit for a particular purpose only arises when:

1. The purpose for which the goods are supplied is known to the seller,

   Note: This condition need not be fulfilled if the goods can be used only for a particular purpose.

   Example: X bought a refrigerator without asking the dealer whether it is fit to make ice. Refrigerator failed to make ice. The dealer is liable to refund the price because refrigerator was unfit for the purpose for which it was meant for and the buyer was not required to disclose this particular purpose. [Evens v. Stelle Benjamin]

2. The buyer relied on the seller's skills or judgement and
3. Seller deals in the goods in his usual course of business.

Circumstances under which Condition as to Fitness not Applicable [Provision to Section 16(1)]:

(i) Where the buyer fails to disclose to the seller any abnormal circumstances.

Example: X bought tweed coat and found unfit for her abnormally sensitive skin. The seller was not liable because the cloth was fit for anyone with a normal skin and she did not inform the seller about her abnormally sensitive skin. [Griffiths v. Peter Conway Ltd.]

(ii) Where the buyer buys a specified article under its patent or other trade name and does not rely upon the skill and judgement of the seller.

In the instant case

1. The cloth supplied is capable of being applied to a variety of purposes, the buyer should have told the seller the specific purpose for which he required the goods. But he did not do so.
2. Therefore, the implied condition as to the fitness for the purpose does not apply. Hence, the buyer will not succeed in getting any remedy from the seller under the Sale of Goods Act, 1930.

Related Question: Mrs. G bought a tweed coat from P. When she used the coat she got rashes on her skin as her skin was abnormally sensitive. But she did not make this fact known to the seller i.e., P. Mrs. G filled a case against the seller to recover damages. Can she recover damages under the Sale of Goods Act, 1930? [RTP May 21]

Answer:

According to Section 16(1) of Sales of Goods Act, 1930, normally in a contract of sale there is no implied condition or warranty as to quality or fitness for any particular purpose of goods supplied. The general rule is that of "Caveat Emptor" that is "let the buyer beware".

As per the provision of Section 16(1) of the Sale of Goods Act, 1930

An implied condition in a contract of sale that an article is fit for a particular purpose only arises when:

1. The purpose for which the goods are supplied is known to the seller,
2. The buyer relied on the seller's skills or judgement and
3. Seller deals in the goods in his usual course of business.

If all these conditions are fulfilled the buyer can make the seller responsible.

In the given case, Mrs. G purchased the tweed coat without informing the seller i.e., P about the sensitive nature of her skin. Therefore, she cannot make the seller responsible on the ground that the tweed coat was not suitable for her skin. Mrs. G cannot treat it as a breach of implied condition as to fitness and quality and has no right to recover damages from the seller.

Related Question: M/s Woodworth & Associates, a firm dealing with the wholesale and retail buying and selling of various kinds of wooden logs, customized as per the requirement of the customers. They dealt with Rose wood, Mango wood, Teak wood, Burma wood etc.

Mr. Das, a customer came to the shop and asked for wooden logs measuring 4 inches broad and 8 feet long as required by the carpenter. Mr. Das specifically mentioned that he required the

wood which would be best suited for the purpose of making wooden doors and window frames. The Shop owner agreed and arranged the wooden pieces cut into as per the buyers requirements.

The carpenter visited Mr. Das's house next day, and he found that the seller has supplied Mango Tree wood which would most unsuitable for the purpose. The: carpenter asked Mr. Das to return the wooden logs as it would not meet his requirements.

The Shop owner refused to return the wooden logs on the plea that logs were cut to specific requirements of Mr. Das and hence could not be resold.

(i) Explain the duty of the buyer as well as the seller according to the doctrine of "Caveat Emptor."
(ii) Whether Mr. Das would be able to get the money back or the right kind of wood as required serving his purpose? [May 19,6 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answers:

(i) Duty of the buyer according to the doctrine of "Caveat Emptor"

a) In case of sale of goods, the doctrine 'Caveat Emptor' means 'let the buyer beware'.
b) When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods.
c) If the goods turn out to be defective, he cannot hold the seller liable. The seller is in no way responsible for the bad selection of the buyer. The seller is not bound to disclose the defects in the goods which he is selling.

Duty of the seller according to the doctrine of "Caveat Emptor":

The following exceptions to the Caveat Emptor are the duties of the seller:

1. Fitness as to quality or use
2. Goods purchased under patent or brand name
3. Goods sold by description
4. Goods of Merchantable Quality
5. Sale by sample
6. Goods by sample as well as description
7. Trade usage
8. Seller actively conceals a defect or is guilty of fraud

(ii) As Mr. Das has specifically mentioned that he required the wood which would be best suited for the purpose of making wooden doors and window frames but the seller supplied Mango tree wood which is most unsuitable for the purpose. Mr. Das is entitled to get the money back or the right kind of wood as required serving his purpose. It is the duty of the seller to supply such goods as are reasonably fit for the purpose mentioned by buyer. [Section 16(1) of the Sale of Goods Act, 1930]

Related Question: AB Cloth House, a firm dealing with the wholesale and retail buying and selling of various kinds of clothes, customized as per the requirement of the customers. They dealt with Silk, Organdie, cotton, khadi, chiffon and many other different varieties of cloth.
Mrs. Reema, a customer came to the shop and asked for specific type of cloth suitable for making a saree for her daughter's wedding. She specifically mentioned that she required cotton silk cloth which is best suited for the purpose.

The Shop owner agreed and arranged the cloth pieces cut into as per the buyers' requirements. When Reema went to the tailor for getting the saree stitched, she found that seller has supplied her cotton organdie material, cloth was not suitable for the said purpose. It has heavily starched and not suitable for making the saree that Reema desired for. The Tailor asked Reema to return the cotton organdie cloth as it would not meet his requirements.

The Shop owner refused to return the cloth on the plea that it was cut to specific requirements of Mrs. Reema and hence could not be resold.

With reference to the doctrine of "Caveat Emptor' explain the duty of the buyer as well as the seller. Also explain whether Mrs. Reema would be able to get the money back or the right kind of cloth as per the requirement? [RTP May 22]

Answer:
Provision: Same as above answer
Based on the above provision and facts given in the question, it can be concluded that Mrs. Reema is entitled to get the money back or the right kind of cloth as required serving her purpose. It is the duty of the seller to supply such goods as are reasonably fit for the purpose mentioned by buyer. [Section 16(1) of the Sale of Goods Act, 1930].

Related Question: TK ordered timber of 1-inch thickness for being made into drums. The seller agreed to supply the required timber of 1 inch. However, the timber supplied by the seller varies in thickness from 1 inch to 1.4 inches. The timber is commercially fit for the purpose for which it was ordered. TK rejects the timber. Explain with relevant provisions of the Sales of Goods Act, 1930 whether TK can reject the timber. [Dec 21 – 3 Marks]

Answer:

Quality or Fitness Sec. 16(1): Generally, there is no implied condition as to quality or fitness of Goods for any particular purpose except if -

(a) The buyer should have made known to the seller the particular purpose for which goods are required.
(b) The buyer should rely on the skill and judgement of the seller.
(c) The goods must be of a description dealt in by the seller, whether he be a manufacturer or not. In other words, seller's business is to sell Goods of such description.

If all the above conditions are satisfied, there is an implied condition that the goods shall be "reasonably fit" for the purpose.

In the instant case, TK ordered timber of 1-inch thickness for being made into drums. The seller agreed to supply the required timber of 1 inch. However, the timber supplied by the seller varies in thickness from 1 inch to 1.4 inches.

As TK has specifically mentioned that he required timber of 1-inch thickness for being made into drums. It is the duty of the seller to supply such goods as are reasonably fit for the purpose mentioned by buyer. [Section 16(1) of the Sale of Goods Act, 1930]

Therefore, TK can reject the timber, avoid the contract and claim a refund.

Related Question: Mr. K visited M/s Makrana Marbles for the purchase of marble and tiles for his newly built house. He asked the owner of the above shop Mr. J, to visit his house prior to supply so that he can clearly ascertain the correct mix and measurements of marble and tiles. Mr. J agreed and visited the house on the next day. He inspected the rooms in the first floor and the car parking space. Mr. K insisted him to visit the second floor as well because the construction pattern was different, Mr. J ignored the above suggestion.

Mr. J. supplied 146 blocks of marble as per the size for the rooms and 16 boxes of tiles with a word of caution that the tiles can bear only a reasonable weight. Marble and Tiles were successfully laid except on second floor due to different sizes of the marble. The tiles fitted in the parking space also got damaged due to the weight of the vehicle came for unloading cement bags. Mr. K asked Mr. J for the replacement of marble and tiles to which Mr. J refused, taking the plea that the marble were as per the measurement and it was unsafe to fit tiles at the parking area as it cannot take heavy load. Discuss in the light of provisions of Sale of Goods Act 1930:

(i) Can Mr. J refuse to replace the marble with reference to the doctrine of Caveat Emptor? Enlist the duties of both Mr. K. and Mr. J.

(ii) Whether the replacement of damaged tiles be imposed on M/ s Makrana Marbles? Explain. [Nov 22 – 6 Marks]

Answer:

Yes, Mr. J can refuse to replace the marble as he has supplied the marble as per the requirement of the buyer i.e. Mr. K.

Duty of Mr. K (the buyer) is that he has to examine the marbles and tiles carefully and should follow the caution given by Mr. J i.e. the seller that tiles can bear only a reasonable weight before laying them in the parking space of his house.

Duty of Mr. J (the seller) is that the goods supplied (i.e. tiles and marbles) shall be reasonably fit for the purpose for which the buyer wants them.

According to the doctrine of Caveat Emptor, it is the duty of the buyer to satisfy himself before buying the goods that the goods will serve the purpose for which they are being bought.

In this case Mr. K has accepted the marbles without examination. Hence, there is no implied condition as regards to defects in marbles. Mr. J can refuse to replace the marble as he has supplied the marble as per the requirement of the buyer i.e., Mr. K.

Alternate Answer

(i) Quality or Fitness Sec. 16(1): Generally, there is no implied condition as to quality or fitness of Goods for any particular purpose except if -

(a) The buyer should have made known to the seller the particular purpose for which goods are required.

(b) The buyer should rely on the skill and judgement of the seller.

(c) The goods must be of a description dealt in by the seller, whether he be a manufacturer or not. In other words, seller's business is to sell Goods of such description.

If all the above conditions are satisfied, there is an implied condition that the goods shall be "reasonably fit" for the purpose.

In the instant case, Mr. K has made known to Mr. J the purpose of his purchase and relied on his skill and judgement. It was the duty of Mr. J to supply the marbles fit for that purpose including for second floor. Since the marbles supplied were not fit for second floor Mr. J is liable to replace the marbles to the extent not fit for that purpose.

Duty of Mr. K (the buyer) As per the above doctrine it was the duty of the buyer Mr. K to make known to Mr. J the purpose of his purchase of marbles. He has fully performed his part arranging the visit of Mr. J to the site.

Duty of Mr. J (the seller) is that the goods supplied (i.e. tiles and marbles) shall be reasonably fit for the purpose for which the buyer wants them. If Mr. K relied on the skill and judgement of Mr. J he failed to perform his duty by neglecting the request of Mr. K to visit second floor resulting in supplies of unfit marbles for the purpose of Mr. K.

Considering the above provisions Mr. J will be liable to replace the marbles not fit for the second floor as Mr. J is bound to the implied condition to supply the marbles as per the requirement of Mr, J when he has made him known about that and relied on his skill and judgement.

(ii) According to the doctrine of Caveat Emptor, it is the duty of the buyer to satisfy himself before buying the goods that the goods will serve the purpose for which they are being bought.

Here, Mr. J supplied the boxes of tiles with a word of caution that the tiles can bear only a reasonable weight. Even though the tiles were laid in the car parking space of Mr. K and got damaged later because of vehicle used for unloading of cement bags were beyond the reasonable weight. Hence, the seller i.e., M/ s Makrana Marbles is not liable as the buyer Mr. K as before laying down the tiles, has to satisfy himself that the tiles will serve the specific purpose i.e., can be used for car parking space only.

Therefore, the replacement of the damaged tiles cannot be imposed on M/s Makrana Marbles.

Implied conditions as to merchantability [Sec 16(2)]

Meaning of merchantability: Merchantability means goods shall be of such quality and condition that a man of ordinary prudence would accept them as good of that description.

Example: Generally, best before use of bread is 3 days from the date of manufacture. If seller is selling the bread which is 10 days old from the date of manufacture, it means that the bread is not merchantable (not saleable).

Conditions for claiming implied condition as to merchantability:

1. Goods must be bought by description.
2. Seller deals in description of that goods.
3. Goods must be free from any latent or hidden defects.

Proviso to section 16(2): There shall be no implied condition as regards defects where buyer could have discovered the defects if he has reasonably examined the goods. Which means buyer could have implied condition as to merchantability only if the defects are latent or hidden which could not be discovered by reasonable examination of goods.

Example: Thornett & Fehs v. Beers & Sons

X purchased glue from Y. The glue was packed in barrel & and every facility was given to X for its examination but X did not examine the contents. X could not reject the goods by saying that they are not merchantable because opportunity of examining the goods was given to X but he did not examine.

Mareli v Fitch and Gibbons

A buyer bought a Stone's Ginger Wine. While he was attempting to draw its cork with a corkscrew and with due care, the bottle broke off and injured the hand of the buyer. It was held that the bottle was not of merchantable quality, so the seller was liable.

Effect of buyer examining goods

If the buyer has examined the goods there shall be no implied condition with regard to defects, which such inspection ought to have revealed. However, the implied condition as to merchantability will continue to apply so far as latent defects in the goods are concerned, since such defects cannot be discovered by ordinary examination of the goods.

Godley V Perry

- A retailer bought a number of plastic toy catapults from a wholesaler under a contract of sale by sample.
- The retailer sold a toy catapult to a boy of 6 years when while trying to play was so seriously injured that his left eye had to be removed.
- As a result of this the retailer had to pay compensation to the boy because the accident had taken place due to a defect in the toy. The retailer sued the wholesaler to recover the compensation.
- In this case though the sample has been shown to the retailer yet the defect was a latent one and the retailer could not find it by seeing the sample.
- Therefore it was held that the goods were unmercantable and the wholesaler was liable to indemnify the retailer for the loss suffered by him.

Wilson v. Ricket, Cockerall & Co. Ltd (1954)

Furthermore, there is an implied condition as to merchantable quality although the goods are sold to buyers under their trade name or patent. However, the implied condition as to fitness for particular purpose is excluded in this extent. This can be shown in Plaintiff who is a housewife has ordered a trade name 'Coalite' coal from the defendant, coal merchants. When the coal was put on fire in an open grate in plaintiff's house, plaintiff was injured due to the explosion that occurred in plaintiff's house. So, plaintiff want to claim for the damages that caused by the breach of condition.

Therefore, the court held that the defendant was liable for this consignment where by the whole consignment including the explosive piece are not of merchantable quality.

Special note for condition as to merchantability:

It applies to goods whether or not the:

(i) Buyer relies on the skill and judgement of the seller

(ii) Goods are sold under patent or brand name.

Question 5

Explain the "condition as to Merchantability" and "condition as to wholesomeness" under the Sale of Goods Act, 1930. [RTP May 18] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Related Question: Mr. Amit was shopping in a self-service Super market. He picked up a bottle of cold drink from a shelf. While he was examining the bottle, it exploded in his hand and injured him. He files a suit for damages against the owner of the market on the ground of breach of condition. Decide under the Sale of Goods Act, 1930, whether Mr. Amit would succeed in his claim? [RTP May 20]

Answer:

Combined answer for both Question

Condition as to Merchantability [Section 16(2) of the Sale of Goods Act, 1930]:

Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality.

Provided that, if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed.

The expression "merchantable quality," though not defined, but it means goods of such a quality and in such a condition a man of ordinary prudence would accept them as goods of that description. It does not imply any legal right or legal title to sell.

Though the term 'merchantable quality' is not defined in the Act, it means that in the present case, the bottle must be properly sealed. In other words, if the goods are purchased for self-use, they should be reasonably fit for the purpose for which it is being used.

In the instant case, on an examination of the bottle of cold drink, it exploded and injured the buyer. Applying the provision of Section 16(2), Mr. Amit would succeed in claim for damages from the owner of the shop.

Condition as to wholesomeness: - This point is only for Question No.5 and not for Related Question

In the case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.

Example: A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

Related Question: A person purchased bread from a baker's shop. The piece of bread contained a stone in it which broke buyer's tooth while eating What are the rights available to the buyer against the seller under the Sale of Goods Act, 1930? [Module Back Question]

Answer:

This is a case related to implied condition as to wholesomeness which provides that the eatables and provisions must be wholesome that is they must be fit for human consumption. In this case, the piece of bread contained a stone which broke buyer's tooth while eating, thereby considered unfit for consumption. Hence, the buyer can treat it as breach of implied condition as to wholesomeness and can also claim damages from the seller.

Related Question: Mr. X, a retailer is running a shop dealing in toys for children. Once, he purchased from a wholesaler number of toy cars in a sale by sample. A boy came to the retailers shop to buy few toys. The retailer sold one of those toy cars to a boy. When the boy tried to play

with it, it broke into pieces because of a manufacturing defect therein and the boy was injured. Mr. X, the retailer was held bound to pay compensation to the boy because the child got injured due to the defective toy in his shop. Due to this incident, the retailer in his turn sued the wholesaler to claim indemnity from him.

With reference to the provisions of Sale of Goods Act, 1930 discuss if the retailer can claim compensation from wholesaler? [MTP Nov 22- 6 Marks]

Answer:

Condition as to merchantability (Section 16(2) of the Sale of Goods Act, 1930):

When goods are sold by description and the seller trades in similar goods, then the goods should be merchantable i.e. the goods should be fit to use or wholesome or for to consume. However, the condition as to merchantability shall consider the following points -

(i) Right to examine the goods by the buyer. The buyer should be given chance to examine the good.

(ii) The buyer should reject the goods, if there is any defect found in the good. But if the defect could not be revealed even after the reasonable examination and the buyer purchases such goods, then the seller is held liable. Such defects which cannot be revealed by examination are called latent defects.

The seller is liable to pay to the buyer for such latent defects in the goods. [Section 17]

In the instant case, the retailer can claim indemnity from the wholesaler because it was found that the retailer had examined the sample before purchasing the goods and a reasonable examination on his part could not reveal this latent defect. Under these circumstances, the wholesaler was bound to indemnify the retailer for the loss suffered by the latter.

Related Question: C bought a bun from a baker's shop. The piece of bun contained a stone in it which broke C's tooth while eating. What are the rights available to the buyer against the seller under the Sale of Goods Act, 1930? [RTP Nov 22]

Answer:

Condition as to wholesomeness: In the case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.

Hence, C could recover damages in light of the violation of said condition as regards to the consumption of goods i.e. the bun from the baker which is not of merchantable quality.

Related Question: Ankit needs a black pen for his exams. He went to a nearby stationery shop and told the seller for a black pen. Seller gives him a pen saying that it is a black pen but it was

clearly mentioned on the packet of pen that "Blue Ink Pen." Ankit ignore that and takes the pen. After reaching his house, Ankit finds that the pen is actually a blue pen. Now Ankit wants to return the pen with the words that the seller has violated the implied conditions of sale by description. Whether Ankit can do what he wants as per the Sale of Goods Act, 1930. [RTP Nov 22]

Answer:

According to Section 16(2) of the Sale of Goods Act, 1930, where the goods are bought by description from a seller who deals in goods of that description there is an implied condition that the goods shall be correspond with that quality. But where the buyer could find the defect of the goods by ordinary examination, this rule shall not apply. The rule of Caveat Emptor is not applicable.

In the instant case, Ankit orders a black pen to a stationery shop. Seller gives him a pen saying that it is a black pen. But on the pack of pen, it was clearly mentioned that it is Blue Ink Pen. Ankit ignores the instruction mention on the pack and bought it. On reaching at his house, he finds that actually the pen is blue ink pen. Now he wants to return the pen.

On the basis of above provisions and facts, it is clear that undoubtedly is case of sale by description but Ankit can find the defect using his ordinary diligence as instructions of blue ink pen was clearly mentioned on the pack of pen. Hence, the rule of Caveat Emptor will be applicable here and Ankit cannot return the pen.

Related Question: Priyansh orders an iron window to an Iron Merchant for his new house. Iron merchant sends his technician to take the size of windows. The technician comes at the site and takes size of area where window to be fitted. Afterwards, Iron merchant on discussion with his technician intimates Priyansh that cost of the window will be Rs. 5,000 and he will take Rs. 1,000 as advance. Priyansh gives Rs. 1,000 as advance and rest after fitting of window. After three days when technician try to fit the window made by him at the site of Priyansh, it was noticed that the size of window was not proper. Priyansh requests the Iron merchant either to remove the defect or return his advance. Iron merchant replies that the window was specifically made for his site and the defect cannot be removed nor can it be of other use. So, he will not refund the advance money rather Priyansh should give him the balance of Rs. 4,000. State with reason under the provisions of the Sale of Goods Act, 1930, whether Priyansh can take his advance back? [RTP June 23]

Answer:

By virtue of provisions of Section 16 of the Sale of Goods Act, 1930, there is an implied condition that the goods should be in merchantable position at the time of transfer ol property. Sometimes, the purpose for which the goods are required may be ascertained from the facts and conduct of the parties to the sale, or from the nature of description of the article purchased. In such a case, the buyer need not tell the seller the purpose for which he buys the goods.

On the basis of above provisions and facts given in the question, it is clear that as window size was not proper, window was not in merchantable condition. Hence, the implied condition as to merchantability was not fulfilled and Priyansh has the right to avoid the contract and recover his advance money back.

Sale by sample [Sec 17]

Question 6

What are the implied conditions in a contract of 'Sale by sample' under the Sale of Goods Act, 1930? State also the implied warranties operatives under the said Act. [MTP March 18, 6 Marks] [RTP Nov 19] [April 19, 6 Marks] [May 22, 6 Marks] [RTP Dec 23]

Answer:

The following are implied conditions in a contract of sale by sample in accordance with Section 17 of the Sale of Goods Act, 1930;

(a) that the bulk shall correspond with the sample in quality;
(b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample.
(c) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on a reasonable examination of the sample.

Regarding Implied Warranties: It is covered in answer to Question no.8

Related Question: Mrs. Geeta went to the local rice and wheat wholesale shop and asked for 100 kgs of Basmati rice. The Shopkeeper quoted the price of the same as Rs. 125 per kg to which she agreed. Mrs. Geeta insisted that she would like to see the sample of what will be provided to her by the shopkeeper before she agreed upon such purchase.

The shopkeeper showed her a bowl of rice as sample. The sample exactly corresponded to the entire lot.

The buyer examined the sample casually without noticing the fact that even though the sample was that of Basmati Rice but it contained a mix of long and short grains.

The cook on opening the bags complained that the dish if prepared with the rice would not taste the same as the quality of rice was not as per requirement of the dish.

Now Mrs. Geeta wants to file a suit of fraud against the seller alleging him of selling mix of good and cheap quality rice. Will she be successful?

Explain the basic law on sale by sample under Sale of Goods Act 1930?

Decide the fate of the case and options open to the buyer for grievance redressal as per the provisions of Sale of Goods Act 1930?

What would be your answer in case Mrs. Geeta specified her exact requirement as to length of rice? [Nov 19, 6 marks] [RTP Dec 23] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answers:

As per the provisions of Sub-Section (2) of Section 17 of the Sale of Goods Act, 1930, in a contract of sale by sample, there is an implied condition that:

(a) the bulk shall correspond with the sample in quality;
(b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample.

In the instant case, in the light of the provisions of Sub-Clause (b) of Sub-Section (2) of Section 17 of the Act, Mrs. Geeta will not be successful as she casually examined the sample of rice (which exactly corresponded to the entire lot) without noticing the fact that even though the sample was that of Basmati Rice but it contained a mix of long and short grains.

Related Question: Mr. Das, a general store owner went to purchase 200 kg. of Basmati Rice of specific length from a whole seller. He saw the samples of rice and agreed to buy the one for which the price was quoted as ₹50 per kg. While examining the sample Mr. Das failed to notice that the rice a mix of long and short grain of rice.
The whole seller supplied the required quantity exactly the same as shown in the sample. However, when Mr. Das sold the rice to one of his regular customers she complained that the rice contained two different qualities of rice and returned the rice.
With reference to the provisions of The Sales of Goods Act, 1930, discuss the options open to Mr. Das for-grievance redressal. What would be your answer in case Mr. Das specified his exact requirement as to the length of rice? [July 21- 6 Marks]

Answer:

Sale by sample – Section 17 (2) of Sale of Goods Act, 1930

In a contract of sale by sample, there is an implied condition that:
(a) the bulk shall correspond with the sample in quality;
(b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample.

Implied conditions as to quality or fitness – Section 16 of Sale of Goods Act,1930

An implied condition in a contract of sale that an article is fit for a particular purpose only arises when:

1. The purpose for which the goods are supplied is known to the seller,
2. The buyer relied on the seller's skills or judgement and
3. Seller deals in the goods in his usual course of business.

In the light of above provision and facts of the case:

(i) Mr. Das will not be having any grievance redressal as he casually examined the sample of rice (which exactly corresponded to the entire lot) without noticing the fact that even though the sample was that of Basmati Rice but it contained a mix of long and short grains.

(ii) If Mr. Das specified his exact requirement as to the length of rice, in that case there would be implied condition as to quality and fitness of rice and Mr. das may reject the rice, repudiate the contract & can also claim damages.

Related Question: Certain goods were sold by sample by A to B, who in turn sold the same goods by sample to C and C by sample sold the goods to D. The goods were not according to the sample. Therefore, D who found the deviation of the goods from the sample rejected the goods and gave

a notice to C. C sued B and B sued A. Advise B and C under the Sale of Goods Act, 1930. [RTP May 22] [4 Marks – June 23] [Module Back Question]

Answer:

In the instant case, D who noticed the deviation of goods from the sample can reject the goods and treat it as a breach of implied condition as to sample which provides that when the goods are sold by sample the goods must correspond to the sample in quality and the buyer should be given reasonable time and opportunity of comparing the bulk with the sample. Whereas C can recover only damages from B and B can recover damages from A. For C and B it will not be treated as a breach of implied condition as to sample as they have accepted and sold the goods according to Section 13(2) of the Sales of Goods Act, 1930.

Sale by sample as well as by description [Sec 15 & 17]

Question 7

Prashant reaches a sweet shop and ask for 1 Kg of 'Burfi' if the sweets are fresh. Seller replies' "Sir, my all sweets are fresh and of good quality." Prashant agrees to buy on the condition that first he tastes one piece of 'Burfi' to check the quality. Seller gives him one piece to taste. Prashant, on finding the quality is good, ask the seller to pack. On reaching the house, Prashant finds that 'Burfi' is stale not fresh while the piece tasted was fresh. Now, Prashant wants to avoid the contract and return the 'Burfi' to seller.

(a) State with reason whether Prashant can avoid the contract under the Sale of Goods Act, 1930?
(b) Will your answer be different if Prashant does not taste the sweet? [RTP Nov 21]

Answer:

According to Section 17 of the Sale of Goods Act, 1930, in the case of a contract for sale by sample there is an implied condition that the bulk shall correspond with the sample in quality and the buyer shall have a reasonable opportunity of comparing the bulk with the sample.

According to Section 15, where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description. If the goods do not correspond with implied condition, the buyer can avoid the contract and reject the goods purchased.

(a) In the instant case, the sale of sweet is sale by sample and the quality of bulk does not correspond with quality of sample. Hence, Prashant can return the sweet and avoid the contract.

(b) In the other case, the sale of sweet is the case of sale by description and the quality of goods does not correspond with description made by seller. Hence, answer will be same. Prashant can return the sweet and avoid the contract.

Related Question: Mr. P was running a shop selling good quality washing machines. Mr. Q came to his shop and asked for washing machine which is suitable for washing woollen clothes. Mr. P showed him a particular machine which Mr. Q liked and paid for it. Later on, when the machine was delivered at Mr. Q's house, it was found that it was wrong machine and also unfit for washing

woollen clothes. He immediately informed Mr. P about the delivery of wrong machine. Mr. P refused to exchange the same, saying that the contract was complete after the delivery of washing machine and payment of price. With reference to the provisions of Sale of Goods Act, 1930, discuss whether Mr. P is right in refusing to exchange the washing machine? [MTP Oct 21 - 6 Marks]

Answer:

According to Section 15 of the Sale of Goods Act, 1930, whenever the goods are sold as per sample as well as by description, the implied condition is that the goods must correspond to both sample as well as description. In case the goods do not correspond to sample or description, the buyer has the right to repudiate the contract.

Further under Sale of Goods Act, 1930 when the buyer makes known to the seller the particular purpose for which the goods are required and he relies on his judgment and skill of the seller, it is the duty of the seller to supply such goods which are fit for that purpose.

In the given case, Mr. Q has informed to Mr. P that he wanted the washing machine for washing woollen clothes. However, the machine which was delivered by Mr. P was unfit for the purpose for which Mr. Q wanted the machine.

Based on the above provision and facts of case, we understand that there is breach of implied condition as to sample as well as description, therefore Mr. Q can either repudiate the contract or claim the refund of the price paid by him or he may require Mr. P to replace the washing machine with desired one.

Implied Warranties

Question 8

Discuss the various types of implied warranties as per the Sales of Goods Act, 1930? [May 19, 4 Marks] [RTP May 20] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Related Question: "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. [RTP Nov 18] [Back Question of module]

Answer:

Implied Warranties: It is a warranty which the law implies into the contract of sale. In other words, it is the stipulation which has not been included in the contract of sale in express words. But the law presumes that the parties have incorporated it into their contract. It will be interesting to know that implied warranties are read into every contract of sale unless they are expressly excluded by the express agreement of the parties.

Sections 14 and 16 of the Sale of Goods Act, 1930 discloses the following implied warranties:

1. Warranty as to undisturbed possession [Section 14(b)]: An implied warranty that the buyer shall have and enjoy quiet possession of the goods. That is to say, if the buyer having got

possession of the goods, is later on disturbed in his possession, he is entitled to sue the seller for the breach of the warranty.

Example: X sold a second hand Radio to Y who spent Rs. 100 on the repairs of this radio. This radio was seized by the police as it was a stolen one. Y filed a suit against X for the recovery of damages for breach of warranty of quite possession including the cost of repairs. It was held that Y was entitled to recover the same. [Mason v. Burmingham]

2. Warranty as to non-existence of encumbrances [Section 14(c)]: An implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time the contract is entered into.

   Example: X borrowed Rs. 500 from Y and hypothecated his radio with Y as security. Later on X sold this radio to Z who bought in good faith. Here, Z can claim damages from X because his possession is disturbed by Y having a charge.

3. Warranty as to quality or fitness by usage of trade [Section 16(3)]: An implied warranty as to quality or fitness for a particular purpose may be annexed or attached by the usage of trade.
   Regarding implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied, the rule is 'let the buyer beware', i.e., the seller is under no duty to reveal unflattering truths about the goods sold, but this rule has certain exceptions.

4. Disclosure of dangerous nature of goods: Where the goods are dangerous in nature and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of warranty, the seller may be liable in damages.
   Example: X purchased a tin of disinfectant powder which required to be opened with special care. X's wife while opening the tin was injured as the powder flew into her eyes. Held, the seller was liable for the injury sustained by X's wife because of breach of warranty. [Clarke v. Army and Navy Cooperative Society Ltd. (1903) 1 KB 155]

Caveat Emptor

Question 9

What is the Doctrine of "Caveat Emptor"? What are the exceptions to the Doctrine of "Caveat Emptor"? [Nov 18, 6 Marks] [MTP Aug 18, 6 Marks] [RTP May 18] [Back Question of module] [Dec 20 - 4 Marks] [MTP Oct 21 – 4 Marks]

Answer:

1. The statement given in the question is the fundamental principle of law of sale of goods, sometime expressed by the maxim 'Caveat Emptor' meaning thereby 'Let the buyer beware.'
2. In other words, it is no part of the seller's duty in a contract of sale of goods to give the buyer an article suitable for a particular purpose, or of particular quality, unless the quality or fitness is made an express term of the contract.

3. The person who buys goods must keep his eyes open, his mind active and should be cautious while buying the goods. If he makes a bad choice, he must suffer the consequences of lack of skill and judgement in the absence of any misrepresentation or guarantee by the seller.

There are, however, certain exceptions to the rule which are stated as under:

i. Fitness as to quality or use: Where the buyer makes known to the seller the particular purpose for which the goods are required, so as to show that he relies on the seller's skill or judgment and the goods are of a description which is in the course of seller's business to supply, it is the duty of the seller to supply such goods as are reasonably fit for that purpose.

ii. Goods purchased under patent or brand name: In case where the goods are purchased under its patent name or brand name, there is no implied condition that the goods shall be fit for any particular purpose.

iii. Goods sold by description: Where the goods are sold by description there is an implied condition that the goods shall correspond with the description. If it is not so then seller is responsible.

iv. Goods of Merchantable Quality: Where the goods are bought by description from a seller who deals in goods of that description there is an implied condition that the goods shall be of merchantable quality. The rule of Caveat Emptor is not applicable. But where the buyer has examined the goods this rule shall apply if the defects were such which ought to have not been revealed by ordinary examination.

v. Sale by sample: Where the goods are bought by sample, this rule of Caveat Emptor does not apply if the bulk does not correspond with the sample.

vi. Goods by sample as well as description: Where the goods are bought by sample as well as description, the rule of Caveat Emptor is not applicable in case the goods do not correspond with both the sample and description or either of the condition.

vii. Trade Usage: An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade and if the seller deviates from that, this rule of Caveat Emptor is not applicable.

viii. Seller actively conceals a defect or is guilty of fraud: Where the seller sells the goods by making some misrepresentation or fraud and the buyer relies on it or when the seller actively conceals some defect in the goods so that the same could not be discovered by the buyer on a reasonable examination, then the rule of Caveat Emptor will not apply. In such a case, the buyer has a right to avoid the contract and claim damages.

Exclusion of implied terms and conditions [Sec 62]

Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negatived or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind both parties to the contract.

Expected question based on Sec 62

Question 10

A agreed to supply a 'new singer car' to B. In the agreement, the liability of the seller was excluded for "all conitions, warranties and liabilities". A supplied a 'used car' to B. The buyer (B) wanted to reject the car as it was not a new one. The seller A relied upon the express clause that the liability for all conditions and warranties has been excluded. Advice B [4 Marks]

Answer:

But it was held that the buyer could reject the car as the selller was bound to supply the "new car". In this case, the contract was not duly performed because the contract was to supply a 'new car and not an 'old car'.

In this connection the following observations are worth noting
(1) "If a man offers to buy peas of another, and he sends him beans, he does not perform his contract. The contract is to sell peas, and if he sends him anything else in their stead, it is non-performance of it. "

(2) "If a seller contract to sell a horse and expressly excluded all conditions and warranties, express or implied, could he escape liability if he delivered a pig? He would be met by the simple and sufficient answer that he had failed the one fundamental obligation.

Thus, the parties are bound to perform their respective part of the contract in its essential respects. And the seller cannot exclude the liability of performing his part of the contract in its essential parts.

Unit– 3: Transfer of Ownership and Delivery of Goods

Transfer of Property in Goods

Principle: The main object of Contract of Sale is, transfer of property in goods from the seller to the buyer. Transfer of Property means transfer of ownership of goods and not mere possession of goods. Once the ownership in goods is transferred, risk in the goods sold is also transferred.

Section 18 - Goods must be ascertained — Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

Section 19 - Transfer of Property in Ascertained/ Specific Goods

(1) Intention of parties: Where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

(2) Terms of contract: For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

(3) Time of passing of property: Unless a different intention appears, the rules contained in sections 20 to 24 are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

Specific Goods in a deliverable State [Sec. 20]	Specific Goods in deliverable state, but price not ascertained [Sec. 22]	Specific Goods not in a deliverable state [Sec. 21]
(a) Property passes at the time the contract is made. Contract is said to be made as soon as the offer is accepted. (b) Property passes immediately inspite of parties agreeing to postpone the time for payment or delivery of Goods.	(a) The Goods are specified, but the Seller has to weigh, measure, test or do some other act or thing with reference to the Goods for the purpose of ascertaining the price. (b) Property passes only after the Seller has weighed, measured, tested or does some other action or thing to ascertain the price and the Buyer has notice thereof.	(a) The Goods are specified, but the Seller has to do some act or process so as to put the Goods in a deliverable state. (b) Property passes only when the Seller has done such action and puts the goods into a deliverable state and the Buyer has notice thereof.

Question 1

X agreed to purchase 300 tons of wheat from Y out of a larger stock. X sent his men with the sacks and 150 tons of wheat were put into the sacks. Then there was a sudden fire and the entire stock was gutted. Who will bear the loss and why? [Module Back Question]

Answer:

According to Section 21 of the Sales of Goods Act, 1930, it the goods are not in a deliverable state and the contract is for the sale of specific goods, the property does not pass to the buyer unless:

(i) The seller has done his act of putting the goods in a deliverable state and
(ii) The buyer has knowledge of it.

Sometimes the seller is required to do certain acts so as to put the goods in deliverable state like packing, filling in containers etc. No property in goods passes unless such act is done and buyer knows about it.
In the given case, X has agreed to purchase 300 tons of wheat from Y out of a larger stock. X sent his men (agent) to put the wheat in the sacks. Out of 300 tones only 150 tons were put into the sacks. There was a sudden fire and the entire stock was gutted. In this case, according to the provisions of law, 150 tons sale has taken place. So, buyer X will be responsible to bear the loss. The loss of rest of the wheat will be that of the seller Y.

The wheat which was put in the sacks fulfils both the conditions that are:
(1) The wheat is put in a deliverable state in the sacks.
(2) The buyer is presumed to have knowledge of it because the men who put the wheat in the sacks are that of the buyer.

Section 18 & 23 Transfer of Property in unascertained Goods

Question 2 Mr. Samuel agreed to purchase 100 bales of cotton from Mr. Varun, out of his large stock and sent his men to take delivery of the goods. They could pack only 60 bales. Later on, there was an accidental fire and the entire stock was destroyed including 60 bales that were already packed. Referring to the provisions of the Sale of Goods Act, 1930 explain as to who will bear the loss and to what extent? [MTP Oct 18, 6 Marks] [MTP March 18, 6 Marks] [RTP May 20] [MTP March 19, 6 Marks]

Related Question: What is appropriation of goods under the Sale of Goods Act, 1930? State the essentials regarding appropriation of unascertained goods. [May 18, 6 Marks] [Nov 19, 4 Marks] [Nov 22, 4 Marks] [RTP Dec 23]

Answer

1. Section 26 of the Sale of Goods Act, 1930 provides that unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at buyer's risk whether delivery has been made or not.
2. Further Section 18 read with Section 23 of the Act provides that in a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer, unless and until the goods are

i. Ascertained [Section 18]

ii. Appropriation: For property to pass u/s 23, the following conditions must be satisfied -

(a) Goods of the description mentioned in the contract must be produced or obtained.

(b) They must be in a deliverable state

(c) They must be unconditionally appropriated to the contract. Unconditional appropriation is where, in pursuance of the contract, Seller –

(i) delivers the Goods to Buyer or to a carrier or other bailee for their transmission to Buyer and

(ii) does not reserve the right of disposal. [Sec. 23(2)]

(d) The assent of the parties may be given expressly or impliedly and can be given either before or after the appropriation.

(e) Example: A having a quantity of sugar in bulk, more than sufficient to fill 20 bags, contracts to sell to B 20 bags of it. After the contract A fills 20 bags with the sugar, gives notice to B that the bags are ready and requires him to take them away. B says he will take them as soon as he can. By this appropriation by A, and assent by B property in the sugar passes to B.

3. Applying the aforesaid law to the facts of the case in hand, it is clear that Mr. Samuel has the right to select the good out of the bulk and he has sent his men for same purpose.

Hence the problem can be answered based on the following two assumptions and the answer will vary accordingly.

(i) Where the bales have been selected with the consent of the buyer's representatives: In this case, the property in the 60 bales has been transferred to the buyer and goods have been appropriated to the contract. Thus, loss arising due to fire in case of 60 bales would be borne by Mr. Samuel. As regards 40 bales, the loss would be borne by Mr. Varun, since the goods have not been identified and appropriated.

(ii) Where the bales have not been selected with the consent of buyer's representatives: In this case the property in the goods has not been transferred at all and hence the loss of 100 bales would be borne by Mr. Varun completely.

Section 24 - Transfer of Property in case Goods sent on Approval or on Sale or Return basis

Question 3 Referring to the provisions of the Sale of Goods Act, 1930, state the circumstances under which 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.
M/s PREETI owned a motor car which she handed over to Mr. JOSHI on sale or return basis. After a week, Mr. JOSHI pledged the motor car to Mr. GANESH. Ms. PREETI now claims back the motor car from Mr. GANESH. Will she succeed" Referring to the provisions of the Sale of Goods Act, 1930, decide and examine what recourse is available to Ms. PREETI. [MTP Aug 18, 6 Marks] [RTP Nov 18]

Answer:
Goods sent on Approval or on Sale or Return basis [Sec. 24]: In case of Sale on "Sale or Return" basis, property in the goods passes to the buyer if -
(a) Approval: Buyer signifies his approval or acceptance to the Seller, or
(b) Retention of Goods: Buyer retains the Goods without giving notice of rejection within the agreed time frame or if no time frame has been agreed, within a reasonable time.
(c) Adopting the transaction: Buyer does any act adopting the transaction i.e. any act exercising domination over the goods showing an unequivocal intention to buy, e.g. if he pledges the goods with a third party.

Referring to the above provisions, we can analyse the situation given in the question.
Since, Mr. Joshi, who had taken delivery of the Motor car on Sale or Return basis and pledged the motor car to Mr. Ganesh, has attracted the third condition that he has done something to the good which is equivalent to accepting the goods e.g., he pledges or sells the goods.

Therefore, the property therein (Motor car) passes to Mr. Joshi. Now in this situation, Ms. Preeti cannot claim back her Motor Car from Mr. Ganesh, but she can claim the price of the motor car from Mr. Joshi only.

Related Question: Ms. R owns a Two-Wheeler which she handed over to her friend Ms. K on sale or return basis. Even after a week Ms. K neither returned the vehicle nor made payment for it. She instead pledged the vehicle to Mr. A to obtain a loan. Ms. R now wants to claim the Two-wheeler from Mr. A. Will she succeed?
(i) Examine with reference to the provisions of the Sale of Goods Act, 1930, what recourse is available to Ms. R?
(ii) Would your answer be different if it had been expressly provided that the vehicle would remain the property of Ms. R until the price has been paid? [Dec-20, 6 Marks] [RTP May 21]

Answer:
Goods sent on Approval or on Sale or Return basis [Sec. 24]: Same as above

Sale for cash only or Return: It may be noted that where the goods have been delivered by a person on "Sale or return" on the terms that the goods were to remain the property of the seller till they are paid for, the property therein does not pass to the buyer until the terms are complied with, i.e., cash is paid for.

Referring to the above provisions, we can analyse the situation given in the question.
Since, Mr. K, who had taken delivery of the Two-Wheeler on Sale or Return basis and pledged the motor car to Mr. A, has attracted the third condition that he has done something to the good which is equivalent to accepting the goods e.g., he pledges or sells the goods.

1. Therefore, the property therein (Two-Wheeler) passes to Mr. K. Now in this situation, Mr. R cannot claim back her Motor Car from Mr. A, but he can claim the price of the motor car from Mr. K only.

2. On the other hand if it had been expressly provided that the vehicle would remain the property of Ms. R until the price has been paid, no property will pass to Mr. A. Thus, the pledge was not valid and R could recover could recover the vehicle from Mr. A.

Related Question: The buyer took delivery of 20 tables from the seller on sale or return basis without examining them. Subsequently, he sold 5 tables to his customers. The customer lodged a complaint of some defect in the tables. The buyer sought to return tables to the seller. Was the buyer entitled to return the tables to the seller under the provisions of the Sale of Goods Act, 1930? [Module Back Question]

Answer:
Goods sent on Approval or on Sale or Return basis [Sec. 24]: Same as above

In the given case
Seller has delivered 20 tables to the buyer on sale or return basis. Buyer received the tables without examining them. Out of these 20 tables, he sold 5 tables to his customer. It implies that he has accepted 5 tables out of 20.

When the buyer received the complaint of some defect in the tables, he wanted to return all the tables to the seller. According to the provisions of law he is entitled to return only 15 tables to the seller and not those 5 tables which he has already sold to his customer. These tables are already accepted by him so the buyer becomes liable under the doctrine of "Caveat Emptor".

Related Question: A delivered a horse to B on sale and return basis. The agreement provided that B should try the horse for 8 days and return, if he did not like the horse. On the third day the horse died without the fault of B. A files a suit against B for the recovery of price. Can he recover the price? [Module Back Question]

Answer:
A delivered the horse to B on sale or return basis. It was decided between them that B will try the horse for 8 days and in case he does not like it, he will return the horse to the owner A. But on the third day the horse died without any fault of B. The time given by the seller A to the buyer B has not expired yet.
Therefore, the ownership of the horse still belongs to the seller A. B will be considered as the owner of the horse only when B does not return the horse to A within stipulated time of 8 days.

The suit filed by A for the recovery of price from B is invalid and he cannot recover the price from B. [Section 24]

Related Question: J, a wholesaler of premium Basmati rice delivered on approval 100 bags of rice of 10 kg each to a local retailer, on sale or returnable basis within a month of delivery. The next day the retailer sold 5 bags of rice to a regular customer K. A week later K informed the retailer that the quality of rice was not as per the price. The retailer now wants to return all the rice bags to J, including the 4 bags not used by K. Can the retailer do so? Also briefly describe the provisions underlying in this context of the Sale of Goods Act, 1930. **(June 24 - 7 Marks)**

Answer: Refer above provision.

Section - 25 Seller's reservation of the right to dispose of Goods

1. Conditional Appropriation [Sec. 25(1)]:
   (a) In a contract for sale of specific Goods or where Goods are subsequently appropriated, the Seller may, by the terms of contract or appropriation, reserve the right of disposal of Goods until certain conditions are fulfilled.
   (b) It makes no difference even if the goods have been delivered to the buyer, or carrier, or other bailee for the purpose of transmission to the buyer.
   (c) Example: K sent Goods by carrier to M on the condition that payment shall be made within one week of the date of receipt of Goods by M. The property in Goods does not pass to M until payment, even though he has taken custody of the Goods from the carrier.
2. Deemed right of reservation [Sec. 25]: The Seller may reserve the right of disposal under the following modes –
   By making the Goods deliverable to the order of the Seller or his agent.
   Example: X at Chennai took a bill of lading in the name of Z at Maldives, but sent it to J, X's agent at Maldives. The Goods were destroyed while in sea. X has to bear the loss, as the ownership has not passes on to Z.
3. By Seller drawing a bill for the price and making it acceptable by the Buyer.

The buyer is bound to return the Bill of Lading or Railway Receipt if he does not accept the Bill of Exchange. If the buyer wrongfully retains the Bill of Exchange the property in the goods does not pass to him.

Section-26 Risk prima facie passes with property

Question 4

"Risk Prima facie passes with the property" Elaborate in the Context to the Sale of Goods Act, 1930. [July 21 – 4 marks]

Answer:

1. Seller's risk: Unless otherwise agreed upon, goods remain only at the Seller's risk until the property therein is transferred to the Buyer. Hence, risk is borne by the Buyer, only when the property in the Goods passes over to him.

2. Risk passes with property: When the property in Goods is transferred to Buyer, goods are at the Buyer's risk, irrespective of whether delivery has been made or not. [Sec. 26]

3. Exceptions: The following are the exceptions to the general rule that risk passes with property-

(a) Delayed delivery: Where delivery of Goods has been delayed through the fault of either Buyer or Seller, goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

(b) Agreement between parties: The parties may by special agreement stipulate that 'risk' will pass sometime after or before passing of property.

(c) Usage of Trade: In some cases trade customs may put the ownership and risk separately in two parties.

4. Bailee's Duties: Nothing contained in Sec. 26 shall affect the duties or liabilities of either the Seller or Buyer as a bailee of Goods of the other party.

Transfer of title

Section-27 Sale by person not the owner

1. Meaning: Nemo dat quod non habet, i.e, No one can give or transfer what he does not himself possess. Hence only a true owner can transfer to another person, a good and valid title over the Goods. A Seller who himself does not have the ownership cannot confer the same upon the Buyer.
2. Transfer by non-owner [Sec. 27]: If any person who does not possess good title to the Goods and makes the sale, the Buyer would not acquire title even though he has acquired it bonafide and for value.

Question 5

"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. [May 19, 6 Marks] [RTP May 20] [MTP Oct 20 – 6 Marks] [Back Question of Module] [Dec 20, 6 Marks] [RTP Nov 21] [MTP Oct 21 – 6 Marks] [MTP Nov 21 – 4 Marks] [MTP Nov 22 – 4 Marks]

Answer:

1. Exceptions to the Rule "Nemo dat Quod Non Habet": The term means, "no one can give or transfer goods what he does not himself own".
2. Exceptions to the rule and the cases in which the Rule does not apply under the provisions of the Sale of Goods Act, 1930 are enumerated below:

(i) Effect of Estoppel (Section 27): Where the owner is stopped by the conduct from denying the seller's authority to sell, the transferee will get a good title as against the true owner. But before a good title by estoppel can be made, it must be shown that the true owner had actively suffered or held out the other person in question as the true owner or as a person authorized to sell the goods.

(ii) Sale by a Mercantile Agent [Sec. 27 Proviso]: Such sale is proper and transfers good title to Buyer only when -

a. The mercantile agent is in possession of the Goods or of a document of title to Goods with consent of the owner,
b. The agent sells those Goods in the ordinary course of business as a Mercantile Agent,
c. The Buyer buys them in good faith, for value, and
d. The Buyer does not have any notice at the time of contract, that the Seller has no authority to sell.

Example: F handed over his car to H for sale at an amount not less than £575. H sold the same for £140 to K, who bought in good faith and without knowledge of any fraud. H misappropriated the money. Held, H had possession of the car with the consent of F for sale and since he had acted in the capacity of a mercantile agent, K got good title for the car. [Folkes v. King]

(iii) Sale by one of the joint owners: If one of the several joint owners of goods has the sole possession of them with the permission of the others, the property in the goods may be transferred to any person who buys them from such a joint owner in good faith and does not at the time of the contract of sale have notice that the seller has no authority to sell. (Section 28)

(iv) Sale by a person in possession under voidable contract: A buyer would acquire a good title to the goods sold to him by seller who had obtained possession of the goods under a contract voidable on the ground of coercion, fraud, misrepresentation or undue influence provided that the contract had not been rescinded until the time of the sale (Section 29).

(v) Sale by one who has already sold the goods but continues in possession thereof: If a person has sold goods but continues to be in possession of them or of the documents of title to them, he may sell them to a third person, and if such person obtains the delivery thereof in good faith without notice of the previous sale, he would have good title to them, although the property in the goods had passed to the first buyer earlier. A pledge or other deposition of the goods or documents of title by the seller in possession are equally valid. [Section 30(1)]

(vi) Sale by buyer obtaining possession before the property in the goods has vested in him: Where

a buyer with the consent of seller obtains possession of the goods before the property in them has passed to him, he may sell, pledge or otherwise dispose of the goods to a third person, and if such person obtains delivery of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods, he would get a good title to them. [Section 30(2)]

(vii) Sale by an unpaid seller: Where an unpaid seller who had exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a good title to the goods as against the original buyer [Section 54(3)]

(viii) Sale under the provisions of other Acts:

(i) Sale by an official Receiver or liquidator of the company will give the purchaser a valid title.

(ii) Purchase of goods from a finder of goods will get a valid title under circumstances.

(iii) Sale by a pawnee under default of pawnor will give valid title to the purchaser.

Related Question: J the owner of a Fiat car wants to sell his car. For this purpose, he hands over the car to P, a mercantile agent for sale at a price not less than Rs. 50, 000. The agent sells the car for Rs. 40, 000 to A who buys the car in good faith and without notice of any fraud. P misappropriated the money also. J sues A to recover the Car. Decide given reasons whether J would succeed. [RTP May 18] [RTP Nov 19] [RTP Nov 20]

Answer:

(i) The problem in this case is based on the provisions of the Sale of Goods Act, 1930 contained in the proviso to Section 27.

(ii) Sale by a Mercantile Agent [Sec. 27 Proviso]: Same as above

In the instant case, P, the agent, was in the possession of the car with J's consent for the purpose of sale. A, the buyer, therefore obtained a good title to the car. Hence, J in this case, cannot recover the car from A.

Related Question: Mr. Shekhar wants to sell his car. For this purpose, he appoints Mr. Nadan, a minor as his agent. Mr. Shekhar instructs Mr. Nadan that car should not be sold at price less than Rs. 1,00,000. Mr. Nadan ignores the instruction of Mr. Shekhar and sells the car to Mr. Masoom for Rs. 80,000. Explain the legal position of contract under the Indian Contract Act, 1872 whether:
(i) Mr. Shekhar can recover the loss of Rs. 20,000 from Mr. Nadan?
(ii) Mr. Shekhar can recover his car from Mr. Masoom? [MTP Nov 21- 4 Marks] [RTP June 23]

Answer:

According to the provisions of Section 11 of the Indian Contract Act, 1872, a minor is disqualified from contracting. A contract with minor is void-ab-initio but minor can act as an agent. But he will not be liable to his principal for his acts.

In the instant case, Mr. Shekhar appoints Mr. Nadan, a minor as his agent to sale his car. Mr. Shekhar clearly instructed to Mr. Nadan that the minimum sale price of the car should be Rs. 1,00,000 yet Mr. Nadan sold the car to Mr. Masoom for Rs. 80,000.

(i) Considering the facts, although the contract between Mr. Shekhar and Mr. Nadan is valid, Mr. Nadan will not be liable to his principal for his acts. Hence, Mr. Shekhar cannot recover the loss of Rs. 20,000.

(ii) Further, Mr. Masoom purchased the car from agent of Mr. Shekhar, he got good title. Hence, Mr. Shekhar cannot recover his car from Mr. Masoom.

Section 28 - Sale by one of joint owners

Related Question: A, B and C were joint owner of a truck and the possession of the said truck was with B. X purchased the truck from B without knowing that A and C were also owners of the truck. Decide in the light of provisions of Sales of Goods Act 1930, whether the sale between B and X is valid or not? [Module Back Question]

Answer:

According to Section 28 of the Sales of Goods Act, sale by one of the several joint owners is valid if the following conditions are satisfied;

(i) One of the several joint owners has the sole possession of them.
(ii) Possession of the goods is by the permission of the co-owners.
(iii) The buyer buys them in good faith and has not at the time of contract of sale knowledge that the seller has no authority to sell.

In the above case, A, B and C were the joint owners of the truck and the possession of the truck was with B. Now B sold the said truck to X. X without knowing this fact purchased the truck from B.

The sale between B and X is perfectly valid because Section 28 of the Sales of Goods Act provides that in case one of the several joint owners has the possession of the goods by the permission of the co- owners and if the buyer buys them in good faith without the knowledge of the fact that seller has no authority to sell, it will give rise to a valid contract of sale.

Section - 29 Sale by person in possession under voidable contract.

Related Question: A went to B's shop and selected some jewellery. He falsely represented himself to be a man of credit and thereby persuaded B to take the payment by cheque. He further requested him to hand over the particular type of ring immediately. On the due date, when the seller, B presented the cheque for payment, the cheque was found to be dishonoured. Before B could avoid the contract on the ground of fraud by A, he had sold the ring to C. C had taken the ring in good faith and without any notice of the fact that the goods with A were under a voidable contract.

Discuss if such a sale made by non-owner is valid or not as per the provisions of Sale of Goods Act, 1930? [RTP May 22]

Answer:

Section 27 of Sale of Goods Act, 1930 states that no man can sell the goods and give a good title unless he is the owner of the goods. However, there are certain exceptions to this rule of transfer of title of goods.

One of the exceptions is sale by person in possession under a voidable contract (Section 29 of Sale of Goods Act, 1930)

1. If a person has possession of goods under a voidable contract.
2. The contract has not been rescinded or avoided so far
3. The person having possession sells it to a buyer
4. The buyer acts in good faith
5. The buyer has no knowledge that the seller has no right to sell.

Then, such a sale by a person who has possession of goods under a voidable contract shall amount to a valid sale and the buyer gets the better title.

Based on the provisions, Mr. A is in possession of the ring under a voidable contract as per provisions of Indian Contract Act, 1872. Also, B has not rescinded or avoided the contract, Mr. A is in possession of the ring and he sells it new buyer Mr. C who acts in good faith and has no knowledge that A is not the real owner. Since all the conditions of Section 29 of Sale of Goods Act, 1930 are fulfilled, therefore sale of ring made by Mr. A to Mr. C is a valid sale.

Section 30 - Seller or buyer in possession after sale

Sale by person in possession after sale

Related Question: Sohan is a trader in selling of wheat. Binod comes to his shop and ask Sohan to show him some good quality wheat. Binod is satisfied with the quality of wheat. Sohan agrees to sell 100 bags of wheat to Binod on 10th June 2021.

The delivery of wheat and the payment was to be made in next three months i.e. by 10 th September 2021 by Binod. Before the goods are delivered to Binod, Sohan gets another customer Vikram in his shop who is ready to pay higher price for the wheat. Sohan sells the goods of Binod (which were already lying in his possession even after sale) to Vikram. Vikram has no knowledge that Sohan is not the owner of goods. With reference to Sale of Goods Act,1930, discuss if such a sale made by Sohan to Vikram is a valid sale? [RTP May 22 - 6 Marks]

Answer:

The given question deals with the rule related to transfer of title of goods. Section 27 of the Sale of Goods Act ,1930 specify the general rule " No man can sell the goods and give a good title unless he is the owner of the goods". The latin maxim " NEMO DET QUOD NON HABET". However, there

are certain exceptions to this rule. One of the exceptions is given in Section 30 (1) of Sale of Goods Act,1930 wherein the sale by seller in possession of goods even after sale is made, is held to be valid. If the following conditions are satisfied, then it amounts to a valid sale although the seller is no more the owner of goods after sale.

(i) A seller has possession of goods after sale
(ii) with the consent of the other party (i.e. buyer)
(iii) the seller sells goods (already sold) to a new buyer
(iv) the new buyer acts in good faith
(v) The new buyer has no knowledge that the seller has no authority to sell.

In the given question, the seller Sohan has agreed to sell the goods to Binod, but delivery of the goods is still pending. Hence Sohan is in possession of the goods and this is with the consent of buyer i.e. Binod. Now Sohan sell those goods to Vikram, the new buyer. Vikram is buying the goods in good faith and also has no knowledge that Sohan is no longer the owner of goods.

Since all the above conditions given under Section 30 (1) of Sale of Goods Act, 1930 are satisfied, therefore the sale made by Sohan to Vikram is a valid sale even if Sohan is no longer the owner of goods.

Related Question: X, a furniture dealer, delivered furniture to Y under an agreement of sale, whereby Y had to pay the price of the furniture in three instalments. As per the terms of the agreement, the furniture will become the property of Y on payment of the last instalment. Before Y had paid the last instalment, he sold the furniture to Z, who purchased it in good faith. X brought a suit against Z for the recovery of the furniture on the ground that Z had no title to it. Decide the case on the basis of the provisions as per the Sale of Goods Act, 1930. **(Dec 23 -4- Marks)**

Answer

As per section 30(2) of the Sale of Goods Act, 1930, where a buyer with the consent of the seller obtains possession of the goods before the property in them has passed to him, he may sell, pledge or otherwise dispose of the goods to a third person, and if such person obtains delivery of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods, he would get a good title to them.

In the instant case, furniture was delivered to Y under an agreement that price was to be paid in three instalments; the furniture to become property of Y on payment of third instalment. Y sold the furniture to Z before the third instalment was paid. Here, Z acquired a good title to the furniture, since he purchased the furniture in good faith.

Hence, X will not succeed in his suit for the recovery of the furniture as Z acquired a good title of the furniture.

Section 37 - Delivery of wrong quantity

Question 6

A contract with B to buy 50 chairs of a certain quality. B delivers 25 chairs of the type agreed upon and 25 chairs of some other type. Under the circumstances, what are the rights of A against B under the Sale of Goods Act, 1930? [RTP Nov 22]

Answer:

Delivery of different description:

As per Section 37(3) of the Sale of Goods Act, 1930 where the seller delivers to the buyer the goods, he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest or may reject the whole.

Hence, A may accept 25 chairs of the type agreed upon and may reject the other 25 chairs of some other type not agreed upon or may reject all 50 chairs.

Related Question: Against B's tender, R agrees to sell and deliver 1,000 kg tomatoes @ 100 per kg which shall be delivered on 15th July, 2023. Due to the rise of the prices of tomatoes in the market, R delivered only 700 kg of tomatoes on 15th July, 2023 and agrees to deliver the balance quantity in the next month. B accepted 700 kg of tomatoes sent by R. Later, R failed to deliver the balance quantity and so B refused to pay the price of 700 kg of tomatoes to R as he had failed to fulfill the tender conditions stipulated in the contract of sale.

Can B refuse to pay R as per the provisions of the Sale of Goods Act, 1930? **(Dec 23 – 4 Marks)**

Answer:

According to Section 37(1) of the Sale of Goods Act, 1930, where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if he accepts the goods so delivered, he shall pay for them at the contract rate.

In the instant case, R delivered 700 kg of tomatoes on 15th July, 2023 and agrees to deliver 300 kg in the next month. Later R failed to deliver the balance quantity and B (buyer) refused to pay the price of 700 kg of tomatoes.

Considering the above provisions, we can conclude that B cannot refuse to pay for 700 kg of tomatoes to R.

Important Note: The answer can also be given as per Section 34 of the Sale of Goods Act, 1930, which provides that a delivery of part of goods, in progress of the delivery of the whole has the same effect, for the purpose of passing the property in such goods, as a delivery of the whole.

In the instant case, R delivered 700 kg of tomatoes on 15th July, 2023 and agrees to deliver 300 kg in the next month. Later R failed to deliver the balance quantity and B (buyer) refused to pay the price of 700 kg of tomatoes.

Considering the above provisions, we can conclude that B cannot refuse to pay for 700 kg of tomatoes to R.

Section 42 - Acceptance

Question 7

What are the rules related to Acceptance of Delivery of Goods? [RTP May 19]

Answer:

Rules related to acceptance of delivery: 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 (Section 42).

Ordinarily, a seller cannot compel the buyer to return the rejected goods; but the seller is entitled to a notice of the rejection. Where the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not take delivery within a reasonable time, he is liable to the seller for any loss occasioned by the neglect or refusal to take delivery, and also reasonable charge for the care and custody of the goods (Sections 43 and 44).

Section 44 Liability of buyer for neglecting or refusing delivery of goods.

Question 8

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? [Nov 18, 6 Marks] [MTP Oct 19, 6 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

1. According to section 44 of the Sales of Goods Act, 1930, Liability of the Buyer for refusal of delivery of Goods [Sec. 44]: The Buyer is liable to the Seller -
   (a) for any loss occasioned by his neglect or refusal to take delivery, and
   (b) for a reasonable charge for the care and custody of the Goods
2. When liable? The liability of the Buyer arises when -
   (a) the Seller is ready and willing to deliver the Goods and requests the Buyer to take delivery, and
   (b) the Buyer does not within a reasonable time after such request, take delivery of the Goods.

In the given case

Since Mr. G has already intimated Mr. H, that he wanted to store some other goods and thus Mr. H should take the delivery of goods kept in the godown of Mr. G, the loss of goods damaged should be borne by Mr. H.

If the price of the goods would not have settled in cash and some amount would have been pending

In that case Mr. G will be treated as an unpaid seller and he can enforce the following rights against the goods as well as against the buyer personally:

(a) Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods. [Section 55(1) of the Sales of Goods Act, 1930]

(b) Where under a contract of sale the price is payable on a day certain irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract. [Section 55(2) of the Sales of Goods Act, 1930].

Unit– 4: Unpaid Seller

"Unpaid seller" and his rights against goods

Question 1

Describe 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? [RTP May 18] [MTP March 19, 6 marks] [MTP Oct 19, 6 Marks]

Related Question: What are the rights of an unpaid seller against goods under the Sale of Goods Act, 1930? [Nov 19, 6 Marks]

Related Question: 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? [MTP Nov 21 - 6 Marks] [RTP Nov 22] [Module Back Question]

Related Question: What are the rights of unpaid seller in context to re-sale the goods under Sale of Goods Act, 1930? [Nov 22 - 6 Marks]

Related Question: 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." [MTP Oct 18, 6 marks] [RTP Nov 18]

Related Question: Can an unpaid seller who has possession of goods exercise the Right of lien? If yes, mention such circumstances. When does he lose his right of line as per the provisions of the Sale of Goods Act, 1930? (Dec 23 - 6 Marks)

Answer:

Unpaid Seller

According to Section 45 of the Sale of Goods Act, 1930 the seller of goods is deemed to be an 'Unpaid Seller' when-

(a) the whole of the price has not been paid or tendered.

(b) a bill of exchange or other negotiable instrument has been received as conditional payment, and it has been dishonoured.

Rights of an unpaid seller against the goods: As per the provisions of Section 46 of the Sale of Goods Act, 1930, Rights of an Unpaid Seller against the goods are as follows:

When Property in Goods has passed to the Buyer -	When property in Goods has NOT passed to the Buyer -
• Right of Lien on the Goods in his possession, • Right of stoppage of Goods in transit if the Buyer becomes insolvent, • Right of Resale.	In addition to those 3 remedies, the right of withholding delivery.

These rights can be exercised by the unpaid seller in the following circumstances:

(i) Right of lien (Section 47): According to sub-section (1), the unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases, namely: -

(a) Where the goods have been sold without any stipulation as to credit;
(b) Where the goods have been sold on credit, but the term of credit has expired;
(c) Where the buyer becomes insolvent.

Note: The unpaid seller can exercise 'his right of lien even if the property in goods has passed on to the buyer. He can exercise his right even if he is in possession of the goods as agent or bailee for the buyer.

According to Section 49 the unpaid seller loses his lien on goods:

1. When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
2. When the buyer or his agent lawfully obtains possession of the goods
3. By waiver thereof.

Note: The unpaid seller of the goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree to the price of the goods.

(ii) Right of stoppage in transit (Section 50): When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right by asking the carrier to return the goods back, or not to deliver the goods to the buyer and may retain them until paid or tendered price of the goods.

However, the right of stoppage in transit is exercised only when the following conditions are fulfilled:

(a) The seller must be unpaid.
(b) The seller must have parted with the possession of goods.
(c) The goods must be in the course of transit.
(d) The buyer must have become insolvent.
(e) The right is subject to provisions of the Act.

(iii) Right to re-sell the goods (Section 54): The unpaid seller can exercise the right to re-sell the goods under the following conditions:

(i) Where the goods are of a perishable nature: In such a case, the buyer need not be informed of the intention of resale.

(ii) Where he gives notice to the buyer of his intention to re-sell the goods: If after the receipt of such notice the buyer fails within a reasonable time to pay or tender the price, the seller may resell the goods.

It may be noted that in such cases, on the resale of the goods, the seller is also entitled to:
(a) Recover the difference between the contract price and resale price, from the original buyer, as damages.
(b) Retain the profit if the resale price is higher than the contract price.

It may also be noted that the seller can recover damages and retain the profits only when the goods are resold after giving the notice of resale to the buyer. Thus, if the goods are resold by the seller without giving any notice to the buyer, the seller cannot recover the loss suffered on resale. Moreover, if there is any profit on resale, he must return it to the original buyer, i.e. he cannot keep such surplus with him [Section 54(2)].

(iii) Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods: The subsequent buyer acquires the good title thereof as against the original buyer, despite the fact that the notice of re-sale has not been given by the seller to the original buyer.

(iv) A re-sale by the seller where a right of re-sale is expressly reserved in a contract of sale: Sometimes, it is expressly agreed between the seller and the buyer that in case the buyer makes default in payment of the price, the seller will resell the goods to some other person. In such cases, the seller is said to have reserved his right of resale, and he may resell the goods on buyer's default. It may be noted that in such cases, the seller is not required to give notice of resale. He is entitled to recover damages from the original buyer even if no notice of resale is given.

(v) Where the property in goods has not passed to the buyer: The unpaid seller has in addition to his remedies a right of withholding delivery of the goods. This right is similar to lien and is called "quasi-lien".

Right of Lien and Right to stoppage the goods in transit; distinction:

Basis of Difference	Right of Lien	Right of Stoppage in Transit
1. Essence	To retain possession	To regain possession
2. Essentials	Seller should be in possession of goods	(i) Seller should have parted with the possession (ii) possession should be with a carrier and (iii) Buyer has not acquired the possession.
3. Buyer Insolvency	Right of lien can be exercised even when the buyer is not insolvent	But it is not the case with right of stoppage in transit.
4. Begins/Ends	Right of stoppage in transit begins when the right of lien ends. Thus, the end of the right of lien is the starting point of the right of stoppage the goods in transit.	

Related Question: A agrees to sell certain goods to B on a certain date on 10 days credit. The period of 10 days expired and goods were still in the possession of A. B has also not paid the price of the goods. B becomes insolvent. A refuses to deliver the goods to exercise his right of lien on the goods. Can he do so under the Sale of Goods Act, 1930? [RTP June 23]

Answer:

Lien is the right of a person to retain possession of the goods belonging to another until claim of the person in possession is satisfied. The unpaid seller has also right of lien over the goods for the price of the goods sold.

Section 47(1) of the Sale of Goods Act, 1930 provides that the unpaid seller who is in the possession of the goods is entitled to exercise right of lien in the following cases: -

1. Where the goods have been sold without any stipulation as to credit
2. Where the goods have been sold on credit but the term of credit has expired
3. Where the buyer has become insolvent even though the period of credit has not yet expired.

In the given case, A has agreed to sell certain goods to B on a credit of 10 days. The period of 10 days has expired. B has neither paid the price of goods nor taken the possession of the goods. That means the goods are still physically in the possession of A, the seller. In the meantime, B, the buyer has become insolvent. In this case, A is entitled to exercise the right of lien on the goods because the buyer has become insolvent and the term of credit has expired without any payment of price by the buyer.

Related Question: Mr. Shankar sold 1000 Kgs wheat to Mr. Ganesh on credit of 3 months. Wheat was to be delivered after 10 days of contract. After 5 days of contract, a friend of Mr. Shankar secretly informed him that Mr. Ganesh may default in payment. On the information of

friend, Mr. Shankar applied the right to lien and withheld the delivery. With referring to the provisions of the Sale of Goods Act, 1930:
(i) State, whether Mr. Shankar was right in his decision?
(ii) What would be your answer if Mr. Ganesh became insolvent within five days of contract?

Answer:

According to Section 45(1) of the Sale of Goods Act, 1930 the seller of goods is deemed to be an 'Unpaid Seller' when-
(a) The whole of the price has not been paid or tendered.
(b) A bill of exchange or other negotiable instrument was given as payment, but the same has been dishonoured, unless this payment was an absolute, and not a conditional payment.

Further, Section 47 provides about an unpaid seller's right of lien. Accordingly, an unpaid seller can retain the possession of the goods and refusal to deliver them to the buyer until the price due in respect of them is paid or tendered. This right can be exercised by him in the following cases only:
(a) where goods have been sold without any stipulation of credit; (i.e., on cash sale)
(b) where goods have been sold on credit, but the term of credit has expired; or
(c) where the buyer becomes insolvent.

In the instant case, Mr. Ganesh purchased 1000 Kg wheat from Mr. Shankar on 3 month's credit which was to be delivered after 10 days of contract. But, after 5 days of contract, one friend of Mr. Shankar secretly informed him that Mr. Ganesh may default in payment. On the belief of friend, Mr. Shankar applied the right to lien and withheld the delivery.

(i) On the basis of above provisions and facts, it can be said that even Mr. Ganesh was an unpaid seller until the term of credit i.e. has expired, Mr. Shankar had to perform his promise of supplying 1000 Kg of wheat.
(ii) In case Mr. Ganesh became insolvent before the delivery of wheat, Mr. Shankar had the right to apply the lien and he could withhold the delivery.

Related Question: Ram sells 200 bales of cloth to Shyam and sends 100 bales by lorry and 100 bales by Railway. Shyam receives delivery of 100 bales sent by lorry, but before he receives the delivery of the bales sent by railway, he becomes bankrupt. Ram being still unpaid, stops the goods in transit. The official receiver, on Shyam's insolvency claims the goods. Decide the case with reference to the provisions of the Sale of Goods Act, 1930. [RTP May 19] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Right of stoppage of goods in transit: The problem is based on section 50 of the Sale of Goods Act, 1930 dealing with the right of stoppage of the goods in transit available to an unpaid seller. The section states that the right is exercisable by the seller only if the following conditions are fulfilled.

Same point as (a) to (e) above
Applying the provisions to the given case, Ram being still unpaid, can stop the 100 bales of cloth sent by railway as these goods are still in transit.

Related Question: AB sold 500 bags of wheat to CD. Each bag contains 50 Kilogramme of wheat AB sent 450 bags by road transport, and CD himself took the remaining 50 bags. Before CD receives delivery of 450 bags sent by road transport, he becomes bankrupt. AB being still unpaid stops the bags in transit. The official receiver, on CD's insolvency, claims the bags. Decide the case with reference to the provisions of the Sale of Goods Act, 1930. [Dec 21 – 3 Marks] RTP Dec 23

Answer:
Provision same as given in above answer
Applying the provisions to the given case, AB being still unpaid, can stop the 450 bags of wheat sent by road transport as these goods are still in transit.

Related Question: J sold a machine to K. K gave a cheque for the payment. The cheque was dishonoured. But handed over a delivery order to K. K sold the goods to R on the basis of the delivery order. J wanted to exercise his right of lien on the goods. Can he do so under the provisions of the Sale of Goods Act, 1930?

Answer:

The right of lien and stoppage in transit are meant to protect the seller. These will not be affected even when the buyer has made a transaction of his own goods which were with the seller under lien. But under two exceptional cases these rights of the seller are affected: -

1 When the buyer has made the transaction with the consent of the seller
2 When the buyer has made the transaction on the basis of documents of title such as bill of lading, railway receipt or a delivery order etc.

In the given case, J has sold the machine to K and K gave a cheque for the payment. But the cheque was dishonoured that means J, the seller is an unpaid seller. So, he is entitled to exercise the right of lien, but according to section 53(1) his right of lien is defeated because he has given the document of title to the buyer and the buyer has made a transaction of sale on the basis of this document. So R who has purchased the machine from K can demand the delivery of the machine.

Rights of an unpaid seller against the buyer

Question 2
Discuss the rights of an unpaid seller against the buyer under The Sales of Goods Act, 1930. [July 21- 6 Marks] [RTP May 22- 6 Marks]

Answer:

An Unpaid Seller has the following rights against the Buyer -

1. Suit for price [Sec. 55(1)]:

(a) Where under a contract of sale the property in Goods has passed to Buyer, and Buyer wrongfully neglects or refuses to pay the price, the Seller can sue the Buyer for the price of goods.

(b) When under the contract of sale, price is payable on a certain day irrespective of delivery and Buyer wrongfully neglects or refuses to pay the price, Seller may sue him for the price. Unpaid Seller has this right even though property has not passed to the Buyer and Goods have not been appropriated to the contract.

2. Damages for non-acceptance [Sec. 56]: Where the Buyer wrongfully neglects or refuses to accept and pay for goods, the Seller may sue him for damages for non-acceptance.

3. Repudiation of contract before due date [Sec. 60]: Where the Buyer repudiates a contract before the date of delivery, the Seller may (i) treat the contract as subsisting and wait till the date of delivery or (ii) treat the contract as rescinded and sue the Buyer for damages for the breach on his part.

4. Interest by way of damages and special damages [Sec. 61]:

(a) When under a contract of sale, the Seller tenders goods to the buyer who wrongfully refuses or neglects to accept and pay the price, the Seller has a further right to claim interest on the amount of price.

(b) Unpaid Seller can claim interest only when he can recover the price, i.e., if the Seller's remedy is to claim damages, then he cannot claim interest.

(c) The interest may be calculated from the date of tender of Goods or from the date on which the price was payable.

(d) The rate of interest to be awarded is at the discretion of the Court.

Related Question: 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. [May 18, 6 Marks] [MTP April 19, 6 marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Position of Mr. D: 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. So, Mr. D is an unpaid seller as according to section 45(1) of the Sale of Goods Act, 1930 the seller of goods is deemed to be an 'Unpaid Seller' when the whole of the price has not been paid or tendered and the seller had an immediate right of action for the price.

Rights of Mr. D: As the goods have parted away from Mr. D, therefore, Mr. D cannot exercise the right against the goods, he can only exercise his rights against the buyer i.e. Mr. E which are as under:

(i) Suit for price (Section 55): In the mentioned contract of sale, the price is payable after 15 days and Mr. E refuses to pay such price, Mr. D may sue Mr. E for the price.

(ii) Suit for damages for non-acceptance (Section 56): Mr. D may sue Mr. E for damages for non-acceptance if Mr. E wrongfully neglects or refuses to accept and pay for the goods. As regards measure of damages, Section 73 of the Indian Contract Act, 1872 applies.

(iii) Suit for interest (Section 61): If there is no specific agreement between the Mr. D and Mr. E as to interest on the price of the goods from the date on which payment becomes due, Mr. D may charge interest on the price when it becomes due from such day as he may notify to Mr. E.

Related Question: Suraj sold his car to Sohan for Rs.75,000. After inspection and satisfaction, Sohan paid Rs.25,000 and took possession of the car and promised to pay the remaining amount within a month. Later on, Sohan refuses to give the remaining amount on the ground that the car was not in a good condition. Advise Suraj as to what remedy is available to him against Sohan. [RTP Nov 20] [RTP Nov 19] [RTP Sep 24]

Answer: As per the section 55 of the Sale of Goods Act, 1930 an unpaid seller has a right to institute a suit for price against the buyer personally. The said Section lays down that

(i) Where under a contract of sale the property in the goods has passed to buyer and the buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for the price of the goods [Section 55(1)].

(ii) Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price. It makes no difference even if the property in the goods has not passed and the goods have not been appropriated to the contract [Section 55(2)].

This problem is based on above provisions. Hence, Suraj will succeed against Sohan for recovery of the remaining amount. Apart from this, Suraj is also entitled to: -

(1) Interest on the remaining amount
(2) Interest during the pendency of the suit.
(3) Costs of the proceedings.

Rights of buyer against the seller

Question 3

What are the rights of buyer against the seller, if the seller commits a breach of contract under the Sale of Goods Act, 1930? [RTP May 20] [6 Marks – June 23] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

If the seller commits a breach of contract, the buyer gets the following rights against the seller:

1. Damages for non-delivery [Section 57]: Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.
2. Suit for specific performance (Section 58): Where the seller commits of breach of the contract of sale, the buyer can appeal to the court for specific performance. The court can order for

specific performance only when the goods are ascertained or specific and where damages would not be an adequate remedy.

3. Suit for breach of warranty (section 59): Where there is breach of warranty on the part of the seller, or where the buyer elects to treat breach of condition as breach of warranty, the buyer is not entitled to reject the goods only on the basis of such breach of warranty. But he may –
   (i) set up against the seller the breach of warranty in diminution or extinction of the price;
   or
   (ii) sue the seller for damages for breach of warranty.
4. Repudiation of contract before due date (Section 60): Where either party to a contract of sale repudiates the contract before the date of delivery, the other may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.
5. Suit for interest: Nothing in this Act shall affect the right of the seller or the buyer to recover interest or special damages, in any case where by law interest or special damages may be recoverable, or to recover the money paid where the consideration for the payment of it has failed.

In the absence of a contract to the contrary, the court may award interest at such rate as it thinks fit on the amount of the price to the buyer in a suit by him for the refund of the price in a case of a breach of the contract on the part of the seller from the date on which the payment was made.

Auction Sale

Question 4

Referring to the provisions of the Sale of Goods Act, 1930, state the rules provided to regulate the "Sale by Auction." [RTP Nov 18] [Jan 21- 4 Marks]

Answer:

Rules of Auction sale: Section 64 of the Sale of Goods Act, 1930 provides following rules to regulate the sale by auction:

(a) Where goods are sold in lots: Where goods are put up for sale in lots, each lot is *prima facie* deemed to be subject of a separate contract of sale.

(b) Completion of the contract of sale: The sale is complete when the auctioneer announces its completion by the fall of hammer or in any other customary manner and until such announcement is made, any bidder may retract from his bid.

(c) Right to bid may be reserved: Right to bid may be reserved expressly by or on behalf of the seller and where such a right is expressly reserved, but not otherwise, the seller or any one person on his behalf may bid at the auction.

(d) Where the sale is not notified by the seller: Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person; and any sale contravening this rule may be treated as fraudulent by the buyer.

(e) Reserved price: The sale may be notified to be subject to a reserve or upset price; and
(f) Pretended bidding: If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

Related Question: Rachit arranges an auction to sale an antic wall clock. Megha, being one of the bidders, gives highest bid. For announcing the completion of sale, the auctioneer fall the hammer on table but suddenly hammer brakes and damages the watch. Megha wants to avoid the contract. Can she do so under the provisions of the Sale of Goods Act, 1930? [RTP Nov 21]

Answer:
According to Section 64 of the Sale of Goods Act, 1930, in case of auction sale, the sale is complete when the auctioneer announces its completion by the fall of the hammer or in some other customary manner.
In the instant case, Megha gives the highest bid in the auction for the sale of antic wall clock arranged by Rachit. While announcing the completion of sale by fall of hammer on the table, hammer brakes and damages the clock.
On the basis of above provisions, it can be concluded that the sale by auction cannot be completed until hammer comes in its normal position after falling on table. Hence, in the given problem, sale is not completed. Megha will not be liable for loss and can avoid the contract.

Related Question: An auction sale of the certain goods was held on 7th March, 2023 by the fall of hammer in favour of the highest bidder X. The payment of auction price was made on 8th March, 2023 followed by the delivery of goods on 10th March, 2023. Based upon on the provisions of the Sale of Goods Act, 1930, decide when the auction sale is complete. (2 Marks June 23)

Answer:
According to Section 64 of the Sale of Goods Act, 1930, the sale is complete when the auctioneer announces its completion by the fall of hammer or in any other customary manner.
In the given question, the auction sale is complete on 7th March, 2023.

Related Question: PTC Hotels in Bombay decided to sell their furniture by auction sale. For this purpose, they appointed RN & Associates as auctioneer. They invited top ten renowned Architects in Bombay for bidding. A right to bid was not notified by them. Furniture was put up in lots for sale. It was decided that for every lot of furniture there will be a reserve price. On 25th Feb 2024, Auction sale was started at 10.a.m in the lawn of PTC Hotels Bombay. For a special lot of furniture three parties came for bidding Mr. Neel, Mr. Raj and Mr. Dev on behalf of their respective companies.

Bidding was as follows:
Mr. Neel Rs. 5.70 lakh
Mr. Raj Rs. 4.85 lakh
Mr. Dev Rs. 6.10 lakh

The sale was completed in favour of Mr. Neel by RN & Associates by fall of hammer. Mr. Dev's Bid was rejected on ground that Right to bid was reserved and company of Mr. Dev was not invited to bid.

For another bid of Italian Furniture was made by two parties as follows:
Mr. Dheer Rs. 15 lakh
Mr. Madhu (on behalf of R N & Associates) Rs. 15.20 lakh
Sale was completed in favour of Mr. Dheer instead of Mr. Madhu.
Mr. Dev and Mr. Madhu argued that auction sale was not lawful. Give your opinion with reference to provisions of the sale of Goods Act, 1930 whether Auction Sale will be considered lawful or not? (June 24 - 7 Marks)

Chapter – 4 The Indian Partnership Act, 1932

Unit– 1: General Nature of a Partnership

Definition of Partnership & its essentials

Question 1

Define Partnership and name the essential elements for the existence of a partnership as per the Indian Partnership Act, 1932. Explain any two such elements in detail. [Dec 21, 6 Marks] [RTP May 22 – 4 Marks]

Related Question: "Whether a group of persons is or is not a firm, or whether a person is or not a partner in a firm." Explain the mode of determining existence of partnership as per the Indian Partnership Act, 1932? [May 19, 4 Marks]

Related Question: "Sharing in the profits is not conclusive evidence in the creation of partnership". Comment. [Dec 21 – 4 Marks]

Related Question: What is the conclusive evidence of partnership? State the circumstances when partnership is not considered between two or more parties. [May 18, 4 Marks] [MTP Oct 19, 4 Marks]

Related Question: "Business carried on by all or any of them acting for all." Discuss the statement under the Indian Partnership Act, 1932. [Jan 21 – 4 Marks]

Answer:

Definition — Sec. 4: Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

The essential elements for the existence of a partnership as per the Indian Partnership Act, 1932 are as follows:

1) Association of two or more person
2) Agreement between person
3) Business
4) Sharing of profit
5) A business carried on by all or any of them acting for all (Mutual Agency)

ASSOCIATION OF TWO OR MORE PERSONS: Partnership is an association of 2 or more persons. Again, only persons recognized by law can enter into an agreement of partnership. Therefore, a firm, since it is not a person recognized in the eyes of law cannot be a partner. Again, a minor cannot be a partner in a firm, but with the consent of all the patners, may be admitted to the benefits of partnership.

The partnership Act is silent about the maximum number of partners but section 464 of the Companies Act, 2013 has now put a limit of 50 partners in any association/partnership firm.

AGREEMENT BETWEEN PERSON: Partnership originates from an Agreement/Contract between persons. Agreement may be express (written or oral) or implied.

BUSINESS: Partnership can be formed only for the purpose of carrying on some business. 'Business' includes trade, occupation and profession. Associations created for charitable, religious and social purposes are not Partnerships.

SHARING OF PROFIT:

a) Sharing the profits of business is the essence of Partnership but it cannot be the conclusive evidence as to existence of Partnership.
b) Sharing of profits implies sharing of losses as well, unless agreed otherwise.
c) A person may become a Partner only in profits and not for losses by agreement between all Partners.
d) Ratio in which profits and losses will be shared is based on agreement amongst the Partners.
e) Though sharing of profits of a business is essential, it does not mean that everyone who participates in the profits of a business is necessarily a Partner, e.g. a Manager, as a part of his remuneration, may be given a share in profits of the business. He does not thereby become a Partner.

BUSINESS CARRIED ON BY ALL OR ANY OF THEM ACTING FOR ALL: The business must be carried on by all the partners or by anyone or more of the partners acting for all. This is the cardinal principle of the partnership Law. In other words, there should be a binding contract of mutual agency between the partners.

(a) A Partner is both an agent and a principal.
(b) He can, by his acts, bind other Partners and is in turn bound by acts of other Partners.
(c) It is not essential that all Partners should actively participate in business. Business may be managed by one or more Partners and remaining Partners will be bound by their acts provided such acts relate to carrying on Firm's business and have been done in the Firm's name.

It may be noted that the true test of partnership is mutual agency rather than sharing of profits. If the element of mutual agency is absent, then there will be no partnership.

True test of partnership

Mode of determining existence of partnership (Section 6 of the Indian Partnership Act, 1932): In determining whether-

a) a group of persons is or is not a firm, or
b) whether a person is or not a partner in a firm,

regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.

For determining the existence of partnership, it must be proved.

1. There was an agreement between all the persons concerned
2. The agreement was to share the profits of a business and
3. The business was carried on by all or any of them acting for all (Mutual Agency)

1. Agreement: Partnership is created by agreement and not by status (Section 5). The relation of partnership arises from contract and not from status; and in particular, the members of a Hindu Undivided family carrying on a family business as such are not partners in such business.
2. Sharing of Profit: Receipt by a person of a share of profits of a business or a payment contingent upon the earning of profits or varying with the profits earned by the business, does not by itself make him a Partner with the persons carrying on the business. [Sec. 6]
   Example: A trader carried on his business under the supervision of his creditors. The object of carrying on the business was to pay them off out of the profit of the business. Held no Partneship existed between the trader and the creditor. [Cox vs Hickman]
   Specific Exclusions from Partnership:
   (a) Joint owners sharing Gross Returns arising from property held by them are not Partners.
   (b) A Partnership is NOT created when share or payment is received by -
   - a lender of money - to any persons engaged or about to engage in any business,
   - a servant or agent - as remuneration,
   - a widow or child of a deceased Partner - as annuity.
   - a previous owner or part owner of the business, as consideration for sale of G/W or share thereof.
3. Agency: Existence of Mutual Agency which is the cardinal principle of partnership law, is very much helpful in reaching a conclusion in this regard. Each partner carrying on the business is the principal as well as an agent of other partners. So, the act of one partner done on behalf of firm, binds all the partners.
   - If the elements of mutual agency relationship exist
   - between the parties constituting a group
   - formed with a view to earn profits
   - by running a business,
   - a partnership may be deemed to exist.

Circumstances when partnership is not considered between two or more parties

BUSINESS CARRIED ON BY ALL OR ANY OF THEM ACTING FOR ALL: Same as above
Santiranjan Das Gupta Vs. Dasyran Murzamull (Supreme Court)
Circumstances when partnership is not considered between two or more parties: Various judicial pronouncements have laid to the following factors leading to no partnership between the parties:
(i) Parties have not retained any record of terms and conditions of partnership.

(ii) Partnership business has maintained no accounts of its own, which would be open to inspection by both parties (iii) No account of the partnership was opened with any bank (iv) No written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership.	
Related/Expected Question: State whether X and Y are Partners in the following circumstances	
1. X agrees with Y to carry passengers by taxi from Delhi to Gurgaon on following terms, viz., Y is to pay X ₹ 100 per mile, X and Y are to share costsof repairing and replacement of cars, and divide equally between them proceeds of fares received from passengers.	Yes
2. X and Y are co-owners of a house let-out to a tenant. X and Y divide the NetRents (after deduction of incidental taxes, etc.) between themselves.	No
3. X and Y, the co-owners of a house, use the house as a hotel managed eitherby themselves or by a duly appointed manager for their common profit.	Yes
4. X and Y buy 200 bales of cotton, agreeing to share the same between them.	No
5. X agrees with Y a goldsmith, to buy and furnish gold to Y to be worked up byhim and sold, and that they shall share in the resulting profit or loss.	Yes
6. X and Y agree to work together as carpenters but X shall receive all profitand shall pay wages to Y.	No
7. X and Y are joint owners of a ship.	No
8. X, a publisher, agrees to publish at his own expense a book written by Y andto pay Y half the Net Profit. [Dec 23 – 2 Marks] No, it is not a case of partnership **Reason:** Sharing of profit, which is prima facie evidence, exists but mutual agency among X and Y, which is an essential element, does not exist here. Since there is no partnership, the third party i.e. paper dealer cannot make Y liable for the paper supplied by him to X.	No
9. X, Y, and Z agree to divide the profits equally, but the loss, if any, is to be borne by X alone. Is it case of partnership? **(Dec 23 - 2 Marks)** **Yes, it is a case of partnership.** **Reason:** The sharing of profits is an essential feature of partnership. There can be no partnership where only one of the partners is entitled to the whole of the profits of the business. Partners must agree to share the profits in any manner they choose. But an agreement to share losses is not an essential requirement. It is open to one or more partners to agree to share all the losses.	Yes
10. A and B purchase a tea shop and incur additional expenses for purchasing utensils etc. each contributing half of the total expense. The shop is leased out on daily rent which is divided between both. Does this arrangement constitute a partnership between A and B? **(Dec 23 - 2 Marks)** **No, it is not a case of partnership**	No

Reason: Persons who share amongst themselves the rent derived from a piece of land are not partners, rather they are co-owners. Because, neither there is existence of business, nor mutual agency is there.

Related Question: State whether the following are a partnership: - [Jan 21 – 6 Marks] [1 Mark Each] [RTP Dec 23]

1. A and B jointly own a car which they used personally on Sundays and holidays and let it on hire as a taxi on other days and equally divide the earnings.
2. Two firms, each having 12 partners, combine by an agreement into one firm.
3. A and B, co-owners, agree to conduct the business in common for profit.
4. Some individuals form an association to which each individual contributes RS. 500 annually. The objective of the association is to produce clothes and distribute the clothes free to the war widows.
5. A and B, co-owners share between themselves the rent derived from a piece of land.
6. A and B buy commodity X and agree to sell the commodity with sharing the profits equally.

Answer:

1. No, this is not a case of partnership because the sharing of profits or of gross returns accruing from property holding joint or common interest in the property would not by itself make such persons partners.

   Alternatively, this part can also be answered as below:

   Yes, this is a case of partnership, as the car is used personally only on Sundays and holidays and used for most of the days as a Taxi. Hence, it is inferred that the main purpose of owning the car is to let it for business purpose. Also, there is an agreement for equally dividing the earnings.
2. No, two Partnership Firms cannot enter into Partnership, though all the Partners of the two Firms may form a Partnership.

   Alternatively, this part can also be answered as below:
3. Yes, this is a case of partnership because there is an agreement between two firms to combine into one firm.
4. No, Partnership can be formed only for the purpose of carrying on some business. Associations created for charitable, religious and social purposes are not Partnerships.
5. No, Joint owners sharing Gross Returns arising from property held by them are not Partners.
6. Yes, there is a partnership between A and B, as all the essential elements to form a valid partnership like association of two or more-person, agreement between person, business, sharing of profit and a business carried on by all or any of them acting for all (Mutual Agency) are present.

Related Question: Mr. Ram and Mr. Raheem are working as teacher in Ishwarchand Vidhyasagar Higher Secondary School and also are very good friends. They jointly purchased a flat which was given on rent to Mr. John. It was decided between landlords and tenant that the rent would be Rs. 10,000 per month inclusive of electricity bill. It means electricity bill will be paid by landlords. The landlords, by mistake, did not pay the electricity bill for the month of March 2021. Due to

this, the electricity department cut the connection. Mr. John has to pay the electricity bill of Rs. 2800 and Rs. 200 as penalty to resume the electricity connection. Mr. John claimed Rs. 3000 from Mr. Ram but Mr. Ram replied that he is liable only for Rs. 1500. Mr. John said that Mr. Ram and Mr. Raheem are partners therefore he can claim the full amount from any of the partner. Explain, whether under the provision of Indian Partnership Act, 1932, Mr. Ram is liable to pay whole amount of Rs. 3000 to Mr. John? [RTP June 23]

Answer:

According to Section 4 of the Indian Partnership Act, 1932, "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. Therefore, for determining the existence of partnership, it must be proved.

1. There must be an agreement between all the persons concerned;
2. The agreement must be to carry on some business;
3. The agreement must be to share the profits of a business and
4. The business was carried on by all or any of them acting for all.

On the basis of above provisons and facts provided in the question, Mr. Ram and Mr. Raheem cannot be said under partnership as they are teachers in a school and just purchased a flat jointly. By merely giving the flat on rent, they are not doing business. They are just earning the income from the property under their co-ownership. Hence, there is no partnership between them. Therefore, Mr. Ram is liable to pay his share only i.e. Rs. 1500. Mr. John has to claim rest Rs. 1500 from Mr. Raheem.

Kinds of partnership

Q.2 Explain the following kinds of partnership under the Indian Partnership Act, 1932:

(i) Partnership at will [Dec -20 2 Marks]

(ii) Particular partnership [RTP May 20] [Jan 21- 2 Marks] [MTP Nov 22- 2 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Related Question: What do you mean by 'Partnership for a fixed period' as per the Indian Partnership Act, 1932? [May 22 – 2 Marks] [RTP Dec 23]

Answer:

Partnership at will: According to Section 7 of the Indian Partnership Act, 1932, partnership at will is a partnership when:

1. no fixed period has been agreed upon for the duration of the partnership; and
2. there is no provision made as to the determination of the partnership.

   In simple words, there is no provision in the partnership deed as how partnership deed will come to end.

These two conditions must be satisfied before a partnership can be regarded as a partnership at will. But, where there is an agreement between the partners either for the duration of the partnership or for the determination of the partnership, the partnership is not partnership at will.

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

be treated as having become a partnership at will.

A partnership at will may be dissolved by any partner by giving notice in writing to all the other partners of his intention to dissolve the same.

Particular partnership: A partnership may be organized for the prosecution of a single adventure as well as for the conduct of a continuous business. Where a person becomes a partner with another person in any particular adventure or undertaking the partnership is called 'particular partnership'. A partnership, constituted for a single adventure or undertaking is, subject to any agreement, dissolved by the completion of the adventure or undertaking.

Partnership for a fixed period: Where a provision is made by a contract for the duration of the partnership, the partnership is called 'partnership for a fixed period'. It is a partnership created for a particular period of time. Such a partnership comes to an end on the expiry of the fixed period.

Nominal Partner

Related Question: Who is a nominal partner under the Indian Partnership Act, 1932? What are his liabilities? [Jan 21- 2 Marks]

Related Question: Mohan, Sohan and Rohan are partners in the firm M/s Mosoro & Company. They admitted Bohan as nominal partner and on agreement between all the partners, Bohan is not entitled to share profit in the firm. After some time, a creditor Karan filed a suit to Bohan for recovery of his debt. Bohan denied for same as he is just a nominal partner and he is not liable for the debts of the firm and Karan should claim his dues from the other partners. Taking into account the provisions of the Indian Partnership Act, 1932
(a) Whether Bohan is liable for the dues of Karan against the firm.
(b) In case, Karan has filed the suit against firm, whether Bohan would be liable? [RTP Nov 22]

Answer:

1. Nominal Partner is a partner only in name. The person's name is used as if he were a partner of the firm, though actually he is not.
2. He is not entitled to share the profits of the firm but is liable for all acts of the firm as if he were a real partner.
3. A nominal partner must give public notice of his retirement and his insanity is not a ground for dissolving the firm.

In the instant case, Bohan was admitted as nominal partner in the firm. A creditor of the firm, Karan has claimed his dues from Bohan as he is the partner in the firm. Bohan has denied for the claim by replying that he is merely a nominal partner.
(a) Bohan is a nominal partner. Even he is not entitled to share the profits of the firm but is liable for all acts of the firm as if he were a real partner. Therefore, he is liable to Karan like other partners.
(b) In case, Karan has filed the suit against firm, answer would remain same.

Partner by holding out

Related Question: Explain the provisions of the Indian Partnership Act, 1932 relating to the creation of Partnership by holding out. [RTP Nov 20]

Answer:

Partnership by holding out is also known as partnership by estoppel. Where a man holds himself out as a partner, or allows others to do it, he is then stopped from denying the character he has assumed and upon the faith of which creditors may be presumed to have acted.

A person may himself, by his words or conduct have induced others to believe that he is a partner or he may have allowed others to represent him as a partner. The result in both the cases is identical.

Example: X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. After expiry of credit period, Z did not get amount of T.V sets sold to the partnership firm. Z filed a suit against X and A for the recovery of price. Here, in the given case, A, the Manager is also liable for the price because he becomes a partner by holding out (Section 28, Indian Partnership Act, 1932).

It is only the person to whom the representation has been made and who has acted thereon that has right to enforce liability arising out of 'holding out.'

Related Question: Mr. M, Mr. N and Mr. P were partners in a firm, which was dealing in refrigerators. On 1st 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 Mr. 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 the Indian Partnership Act, 1932 and decide whether Mr. P is liable in this situation. [Nov 18, 3 Marks] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

1. A retiring partner continues to be liable to third party for acts of the firm after his retirement until public notice of his retirement has been given either by himself or by any other partner. But the retired partner will not be liable to any third party if the latter deals with the firm without knowing that the former was partner.
2. Also, if the partnership is at will, the partner by giving notice in writing to all the other partners of his intention to retire will be deemed to be relieved as a partner without giving a public notice to this effect.

3. Also, as per section 28 of the Indian Partnership Act, 1932, 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.

In the light of the provisions of the Act and facts of the case, Mr. P is also liable to Mr. X.

Related 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. 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. Advice Z whether he can recover the amount from X and A under the Indian Partnership Act, 1932. [RTP Nov 19]

Answer:

1. In the given case, along with X, the Manager (A) is also liable for the price because he becomes a partner by holding out (Section 28, Indian Partnership Act, 1932).
2. Partner by holding out (Section 28): Partnership by holding out is also known as partnership by estoppel. Where a man holds himself out as a partner, or allows others to do it, he is then stopped from denying the character he has assumed and upon the faith of which creditors may be presumed to have acted.
3. It is only the person to whom the representation has been made and who has acted thereon that has right to enforce liability arising out of 'holding out'.
4. You must also note that for the purpose of fixing liability on a person who has, by representation, led another to act, it is not necessary to show that he was actuated by a fraudulent intention.
5. The rule given in Section 28 is also applicable to a former partner who has retired from the firm without giving proper public notice of his retirement. In such cases, a person who, even subsequent to the retirement, give credit to the firm on the belief that he was a partner, will be entitled to hold him liable.

Related Question: P, Q and R are partners in a partnership firm. R retires from the firm without giving public notice. P approached S, an electronic appliances trader, for purchase of 25 fans for his firm. P introduced E, an employee of the firm, as his partner to S. S believing E and R as partners supplied 25 fans to the firm on credit. S did not receive the payment for the fans even after the expiry of the credit period. Advise S, from whom he can recover the payment as per the provisions of the Indian Partnership Act, 1932. (6 Marks June 23)

Answer:

According to sub-section (3) of Section 32 of the Indian Partnership Act, 1932, a retiring partner along with the continuing partners continue to be liable to any third party for acts of the firm after his retirement until public notice of his retirement has been given either by himself or by any other partner. But the retired partner will not be liable to any third party if the latter deals with the firm without knowing that the former was a partner.

As per the provisions of Section 28, where a man holds himself out as a partner or allows others to do it, when in fact he is not a partner, he is liable like a partner in the firm to anyone who on the faith of such representation has given credit to the firm.

In the instant case, since Mr. R has not given the public notice of his retirement from the partnership firm and Mr. S believes that Mr. R is a partner, Mr. R will be liable to Mr. S under the provisions of Section 32.

Also Mr. E, who has been introduced as a partner of the firm to which Mr. E has not presumably denied, will also be liable for the payment of 25 fans supplied to the firm on credit along with other partners in terms of the provisions of Section 28 as stated above.

Over and above R and E, P and Q being the partners of the firm along with the firm will also be held liable to S.

Therefore, S can recover the payment from the Firm, P, Q, R and E.

Related Question: X and Y were partners in a firm. The firm was dissolved on 12th June, 2022 but no public notice was given. Thereafter, X purchased some goods in the firm's name from Z. Z was ignorant of the fact of dissolution of firm. X became insolvent and Z filed a suit against Y for recovery of his amount. State with reasons whether Y would be liable under the provisions of the Indian Partnership Act, 1932? [RTP June 23] [RTP June 24]

Answer:

By virtue of provisions of Section 45 of the Indian Partnership Act, 1932, notwithstanding the 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 instant case, X and Y were partners in a firm which was dissolved but no public notice was given. After dissolution, X purchased some goods in the firm's name from Z who was ignorant of the fact of dissolution of firm. X became insolvent and Z filed a suit against Y for recovery of his amount.

Following the provisions of Section 45, X and Y are continuing liable against third party even after dissolution of firm until public notice is given. As in the given problem, X became insolvent, therefore, Y will be liable to Z.

Partnership Deed

Question 3

What is Partnership Deed and state the information contained therein? [MTP March 18, 4 Marks] [MTP Oct 18, 4 Marks] [MTP April 19] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Related Question: Ms. Lucy while drafting partnership deed taken care of few important points. What are those points? Also, give list of information to be included in partnership deed? [MTP Oct 20 - 6 Marks] [MTP Nov 21 – 6 Marks] [MTP Nov 22 – 4 Marks]

Answer:

1. Partnership is the result of an agreement. No particular formalities are required for an agreement of partnership.
2. It may be in writing or formed verbally. But it is desirable to have the partnership agreement in writing to avoid future disputes. The document in writing containing the various terms and conditions as to the relationship of the partners to each other is called the 'partnership deed'.
3. It should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899.
4. Where the partnership comprises immovable property, the instrument of partnership must be in writing, stamped and registered under the Registration Act.
5. Partnership deed may contain the following information: -
   - Name of the partnership firm.
   - Names of all the partners.
   - Nature and place of the business of the firm.
   - Date of commencement of partnership.
   - Duration of the partnership firm.
   - Capital contribution of each partner.
   - Profit Sharing ratio of the partners.
   - Admission and Retirement of a partner.
   - Rates of interest on Capital, Drawings and loans.
   - Provisions for settlement of accounts in the case of dissolution of the firm.
   - Provisions for Salaries or commissions, payable to the partners, if any.
   - Provisions for expulsion of a partner in case of gross breach of duty or fraud.
   - A partnership firm may add or delete any provision according to the needs of the firm.

Difference Between

Question 4

State the differences between Partnership and Hindu Undivided Family. [RTP May 18]

Related Question: Distinguish between Partnerships vs. Hindu Undivided Family. Write any two points. [MTP Oct 19] CS LLM Arjun Chhabra (Law Maven) Mo: 62 62 62 143 8

Answer:

Basis of difference	Partnership	Joint Hindu family
Mode of creation	Partnership is created necessarily by an agreement.	The right in the joint family is created by status means its creation by birth in the

		family.
Death of a member	Death of a partner ordinarily leads to the dissolution of partnership.	The death of a member in the Hindu undivided family does not give rise to dissolution of the family business.
Management	All the partners are equally entitled to take part in the partnership business.	The right of management of joint family business generally vests in the Karta, the governing male member or female member of the family.
Authority to bind	Every partner can, by his act, bind the firm.	The Karta or the manager, has the authority to contract for the family business and the other members in the family.
Liability	In a partnership, the liability of a partner is unlimited.	In a Hindu undivided family, only the liability of the Karta is unlimited, and the other co- partners are liable only to the extent of their share in the profits of the family business.

Related Question: Enumerate the differences between Partnership and Joint Stock Company. [MTP Oct 21 - 6 Marks]

Answer: Refer module

Miscellaneous

Question 5

"Partner indeed virtually embraces the character of both a principal and an agent." Describe the said statement keeping in view of the provisions of the Indian Partnership Act, 1932. [RTP May 20]

Answer:

1. "Partner indeed virtually embraces the character of both a principal and an agent"
2. A partnership is the relationship between the partners who have agreed to share the profits of the business carried on by all or any of them acting for all (Section 4). This definition suggests that any of the partners can be the agent of the others.
3. Section 18 clarifies this position by providing that, subject to the provisions of the Act, a partner is the agent of the firm for the purpose of the business of the firm. The partner indeed virtually embraces the character of both a principal and an agent. So far as he acts for himself and in

his own interest in the common concern of the partnership, he may properly be deemed as a principal and so far as he acts for his partners, he may properly be deemed as an agent.

4. The principal distinction between him and a mere agent is that he has a community of interest with other partners in the whole property and business and liabilities of partnership, whereas an agent as such has no interest in either.
5. The rule that a partner is the agent of the firm for the purpose of the business of the firm cannot be applied to all transactions and dealings between the partners themselves. It is applicable only to the act done by partners for the purpose of the business of the firm.

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

Unit– 2 Relations of partners – Very Important unit

Reconstitution of firm

Expulsion of a Partner [Sec. 33]

Question 1

Comment on 'the right to expel partner must be exercised in good faith' under the Indian Partnership Act, 1932. [Dec-20 2 Marks]

Answer:

(a) Expulsion of a Partner [Sec. 33]: A Partner cannot be expelled from a Firm by a majority of Partners except in the exercise in good faith of powers conferred by the contract between the Partners.

(b) Good Faith: Hence, for any expulsion by majority, it is necessary that -

- The power of expulsion must have existed in the contract between Partners,
- Such power has been exercised by a majority of the Partners, and
- Such power has been exercised in good faith for the interest of the Firm and not used as vengeance against a Partner.

(c) What constitutes Good Faith? An expulsion is said to be in good faith if -

- Such expulsion is done to protect the interests of Partnership and of the Firm,
- The Partner who is to be expelled had been served with a Notice,
- Such Partner has given an opportunity of being heard.

(d) Expulsion Void: When a Partner is otherwise expelled than in good faith, it is null and void. He continues to be a Partner, and can (a) claim reinstatement or (b) sue for the refund of his share of Capital and profits in the Firm.

(e) Position of Expelled Partner: The provisions of Sec. 32 regarding liability of a Retired Partner to Third parties and giving of public notices apply to an expelled Partner as well, as if he was a retired Partner.

Related Question: M/s XYZ & Associates, a partnership firm with X, Y, Z as senior partners were engaged in the business of carpet manufacturing and exporting to foreign countries. On 25th August, 2016, they inducted Mr. G, an expert in the field of carpet manufacturing as their partner. On 10th January 2018, Mr. G was blamed for unauthorized activities and thus expelled from the partnership by united approval of rest of the partners.

(i) Examine whether action by the partners was justified or not?

(ii) What should have the factors to be kept in mind prior expelling a partner from the firm by other partners according to the provisions of the Indian Partnership Act, 1932? [May 19 ,6 Marks] [MTP Oct 20- 6 Marks] [Nov 22 ,6 Marks]

Answer:

(i) Action by the partners of M/s XYZ & Associates, a partnership firm to expel Mr. G from the partnership was justified as he was expelled by united approval of the partners exercised in good faith to protect the interest of the partnership against the unauthorized activities charged against Mr. G. A proper notice and opportunity of being heard has to be given to Mr. G.

(ii) The following are the factors to be kept in mind prior expelling a partner from the firm by other partners: Same as point (b) in above answer.

Related Question: 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 circumstances? [May 18, 6 Marks] [MTP April 19, 6 Marks] CS LLM Arjun Chhabra (Law Maven)

OR

Related Question: Ram & Co., a firm consists of three partners A, B and C having one third share each in the firm. According to A and B, the activities of C are not in the interest of the partnership and thus want to expel C from the firm. Advise A and B whether they can do so quoting the relevant provisions of the Indian Partnership Act, 1932. [RTP Nov 18]

Answer: Provision same as given in answer no 1

Thus, according to the test of good faith as required under Section 33(1), expulsion of Partner Y is not valid.

OR

Thus, in the given case A and B the majority partners can expel the partner only if the above conditions are satisfied and procedure as stated above has been followed.

Related Question: X, Y and Z are partners in a Partnership Firm. They were carrying their business successfully for the past several years. Due to expansion of business, they planned to hire another partner Mr A. Now the firm has 4 partners X, Y, Z and A. The business was continuing at normal pace. In one of formal business meeting, it was observed that Mr. Y misbehaved with Mrs. A (wife of Mr. A). Mr. Y was badly drunk and also spoke rudely with Mrs. A.

Mrs. A felt very embarrassed and told her husband Mr. A about the entire incident. Mr. A got angry on the incident and started arguing and fighting with Mr. Y in the meeting place itself. Next day, in the

office Mr. A convinced X and Z that they should expel Y from their partnership firm. Y was expelled from partnership without any notice from X, A 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 circumstances? [MTP Nov 21 – 6 marks]

Answer: Provision same as given in answer no 1

According to the test of good faith as required under Section 33(1), expulsion of Partner Y is not valid as he was not served any notice and also he was not given an opportunity of being heard. Also the matter of fight between A and Y was on personal reasons, hence not satisfying the test of good faith in the interest of partnership. Since the conditions given under above provisions are not satisfied, the expulsion stands null and void.

Expected case study based on expulsion

A and B were carrying on a banking business in partnership. A had committed adultery with several women in the city, and his wife has left him on this ground. B applied to the court for the dissolution of the firm on this ground. But the court rejected B's application and held that the firm cannot be dissolved on this ground. The reason for the same is that the misconduct of A does not have any adverse effect on their business as bankers. In this case, the following observations of the court are worth noting:

"There are, no doubt, various cases in which moral conduct of a man would affect business, as where a medical man had entered into partnership with another and it was found that his conduct was very immoral towards some of his patients, of course, this a ground for putting an end to the partnership. But in the case of bankers, how can the court say that a man's money is less safe because one of the partners commits audultery" [Snow v Milform (1868)]

Death [Sec. 35]

Question 2

Mr. A. Mr. B and Mr. C were partners in a partnership firm M/s 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 letter-heads 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 Rs. 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.

Analyses 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. [Nov 18, 3 Marks]

Answer:

Liability of estate of deceased partner [Sec. 35]:

(a) The Firm is generally dissolved on the death of a Partner.

(b) However, the surviving partners are competent to agree that the death of one will not have the effect of dissolving the partnership firm and they may agree to continue the partnership business after death of partner unless the firm consists of only two partners.

(c) When under a contract between the Partners, the Firm is not dissolved by the death of a Partner,

- the estate of deceased Partner remains liable only for such acts as were done during the tenure of his Partnership, and
- His estate is NOT liable for any act of the Firm done after his death.

(d) No public notice is required on the death of a Partner.

In the light of the provisions of the Act and the facts of the question, Mr. X (creditor) can have only a personal decree against the surviving partners (Mr. A and Mr. B) and a decree against the partnership assets in the hands of those partners.

A suit for goods sold and delivered would not lie against the representatives of the deceased partner. Hence, the legal heirs of Mr. C cannot be held liable for the dues towards Mr. X.

Related Question: Ram, Mohan and Gopal were partners in a firm. During the course of partnership, the firm ordered Sunrise Ltd. to supply a machine to the firm. Before the machine was delivered, Ram expired. The machine, however, was later delivered to the firm. Thereafter, the remaining partners became insolvent and the firm failed to pay the price of machine to Sunrise Ltd.

Explain with reasons:

(i) Whether Ram's private estate is liable for the price of the machine purchased by the firm?

(ii) Against whom can the creditor obtain a decree for the recovery of the price? [RTP May 19] [RTP Nov 22]

Answer: Provision same as above

Therefore, considering the above provisions, the problem may be answered as follows:

(i) Ram's estate in this case will not be liable for the price of the Machinery purchased.

(ii) The creditors in this case can have only a personal decree against the surviving partners and decree against the partnership assets in the hands of those partners.

(iii) However, since the surviving partners are already insolvent, no suit for recovery of the debt would lie against them.

(iv) A suit for goods sold and delivered would not lie against the representative of the deceased partner. This is because there was not debt due in respect of the goods in Ram's life time.

Related Question: M, N and P were partners in a firm. The firm ordered JR Limited to supply the furniture. P dies, and M and N continues the business in the firm's name. The firm did not give any notice about P's death to the public or the persons dealing with the firm. The furniture was delivered to the firm after P's death. fact about his death was known to them at the time of delivery. Afterwards the firm became insolvent and failed to pay the price of furniture to JR Limited.

Explain with reasons:

(i) Whether P's private estate is liable for the price of furniture purchased by the firm?

(ii) Whether does it make any difference if JR Limited supplied the furniture to the firm believing that all the three partners are alive? [Jan 21 - 6 Marks] [RTP May 21]

Answer: Provision same as above

Therefore, considering the above provisions, the problem may be answered as follows:

(i) P's estate in this case will not be liable for the price of the furniture purchased by the firm because the furniture was delivered after p's death.

(ii) If JR Limited supplied the furniture to the firm believing that all three partners are alive would not make any difference. Still, P's private estate would not stand liable for the price of the furniture.

Related Question: Sohan, Rohan and Jay were partners in a firm. The firm is dealer in office furniture. They have regular dealings with M/s AB and Co. for the supply of furniture for their business. On 30 th June 2020, one of the partners, Mr. Jay died in a road accident. The firm has ordered M/s AB and Co. to supply the furniture for their business on 25th May 2020, when Jay was also alive.

Now Sohan and Rohan continue the business in the firm's name after Jay's death. The firm did not give any notice about Jay's death to the public or the persons dealing with the firm. M/s AB and Co. delivered the furniture to the firm on 25th July 2020. The fact about Jay's death was known to them at the time of delivery of goods. Afterwards the firm became insolvent and failed to pay the price of furniture to M/s AB and Co. Now M/s AB and Co. has filed a case against the firm for recovery of the price of furniture. With reference to the provisions of Indian Partnership Act, 1932, explain whether Jay's private estate is also liable for the price of furniture purchased by the firm? [MTP Oct 21 - 6 Marks] RTP May 22]

Answer: Provision same as above:

1. In the light of the facts of the case and provisions of law, since the delivery of furniture was made after Jay's death, his estate would not be liable for the debt of the firm.
2. A suit for goods sold and delivered would not lie against the representatives of the deceased partner.

This is because there was no debt due in respect of the goods in Jay's lifetime. He was already dead when the delivery of goods was made to the firm and also it is not necessary to give any notice either to the public or the persons having dealings with the firm on a death of a partner.

3. So, the estate of the deceased partner may be absolved from liability for the future obligations of the firm.

Transfer of interest [Sec. 29]

Question 3

State the modes by which a partner may transfer his interest in the firm in favour of another person under the Indian Partnership Act, 1932. What are the rights of such a transferee? [MTP March 18, 6 Marks] [MTP April 19, 6 Marks] [RTP June 23]

Related Question: M/s ABC Associates is a partnership firm since 1990. Mr. A, Mr. B and Mr. C were partners in the firm since beginning. Mr. A, being a very senior partner of aged 78 years transfers his share in the firm to his son Mr. Prateek, a Chartered Accountant. Mr. B and Mr. C were not interested that Mr. Prateek join them as partner in M/s ABC Associates. After some time, Mr. Prateek felt that the books of accounts were displaying only a small amount as profit despite a huge turnover. He wanted to inspect the book of accounts of the firm arguing that it is his entitlement as a transferee. However, the other partners believed that he cannot challenge the books of accounts. Can Mr. Prateek, be introduced as a partner if his father wants to get a retirement? As an advisor, help them resolve the issues applying the necessary provisions from the Indian Partnership Act, 1932. [May 22 - 6 Marks] [RTP Dec 23]

Answer:

(i) Introduction of a Partner (Section 31 of the Indian Partnership Act, 1932): Subject to contract between the partners and to the provisions of Section 30, no person shall be introduced as a partner into a firm without the consent of all the existing partners.

In the instant case, Mr. Prateek can be introduced as a partner with the consent of Mr. B and Mr. C, the existing partners.

(ii) Rights of Transferee of a Partner's interest [Section 29 (1)]: A transfer by a partner of his interest in the firm, either:

- absolute or
- by mortgage, or
- by the creation by him of a charge on such interest,

does not entitle the transferee, during the continuance of the firm,

- to interfere in the conduct of business, or
- to require accounts, or

- to inspect the books of the firm,

but entitles the transferee

- only to receive the share of profits of the transferring partner, and
- the transferee shall accept the account of profits agreed to by the partners.

Hence, here Mr. Prateek, the transferee in M/S ABC Associates cannot inspect the books of the firm and contention of the other partners is right that Mr. Prateek cannot challenge the books of accounts.

Related Question: Mr. A (transferor) transfer his share in a partnership firm to Mr. B (transferee). Mr. B is not entitled for few rights and privileges as Mr. A (transferor) is entitled therefor. Discuss in brief the points for which Mr. B is not entitled during continuance of partnership? [RTP May 21] [MTP Nov 22]

Answer: Provision same as above as given in section 29

However, Mr. B is only entitled to receive the share of the profits of the transferring partner and he is bound to accept the profits as agreed to by the partners, i.e. he cannot challenge the accounts.

Related Question: Mr. M is one of the four partners in M/s XY Enterprises. He owes a sum of ₹ 6 crore to his friend Mr. Z which he is unable to pay on due time. So, he wants to sell his share in the firm to Mr Z for settling the amount. In the light of the provisions of The Indian Partnership Act, 1932, discuss each of the following:

(i) Can Mr. M validly transfer his interest in the firm by way of sale?

(ii) What would be the rights of the transferee (Mr. Z) in case Mr. M wants to retire from the firm after a period of 6 months from the date of transfer? [July 21 – 6 marks] [RTP May 22 – 6 marks]

Answer:

Rights of transferee or a partner's interest [Section 29 of The Indian Partnership Act, 1932]

A share in a partnership is transferable like any other property, but as the partnership is based on a mutual agency, the transferee of a partner's interest by sale, mortgage or otherwise, cannot enjoy the same rights and privileges as the original partner.

In the light of the above provision and facts of the case Mr. M can validly transfer his interest in the firm by way of sale.

The rights of a transferee (Mr. Z) are as follows:

1. During the continuation of the partnership, such transferee is not entitled
   a) to interfere with the conduct of the business,
   b) to require accounts, or
   c) to inspect the books of the firm.

He is only entitled to receive the share of the profits of the transferring partner and he is bound to accept the profits as agreed to by the partners, i.e., he cannot challenge the accounts.

2. On dissolution of the firm or on the retirement of the transferring partner, the transferee partner is entitled [Section 29(2)]
   a) to receive the share of assets of the firm to which the transferring partner was entitled and
   b) for the purpose of ascertaining the share, he is entitled to an account from the date of the dissolution.

Related Question: Mr. A (transferor) transfers his share in a partnership firm to Mr. B (transferee). Mr. B felt that the book of accounts was displaying only a small amount as profit inspite of a huge turnover. He wanted to inspect the book of accounts of the firm arguing that it is his entitlement as a transferee. However, the other partners were of the opinion that Mr. B cannot challenge the books of accounts. As an advisor, help them solve the issue applying the necessary provisions from the Indian Partnership Act, 1932. [RTP Nov 21]

Answer: Provision same as Section 29(1) as given above

Keeping the above points, in the given case, since the partnership business is in continuance, Mr. B is bound to accept the profits as agreed to by the partners. He cannot challenge the accounts. He is only entitled to receive the share of profits of Mr. A (transferring partner).

Insolvency [Sec. 34]

Question 4

With reference to the provisions of Indian partnership Act, 1932 explain the various effects of insolvency of a partner. [Nov 19, 4 Marks] [RTP Dec 23] CS LLM Arjun Chhabra (Law Maven)

Answer:

Insolvency [Sec. 34]:

(a) When a Partner in a Firm is adjudicated insolvent, he ceases to be a Partner on the date of the order, irrespective of whether the Firm is dissolved or not.

(b) When under a contract between the Partners, the Firm is not dissolved by the insolvency of a Partner, the estate of such Partner is NOT liable for any act of the Firm.

(c) Also, further the Firm is NOT liable for any act of the insolvent, done after the date on which the order or adjudication is made.

Retirement [Sec. 32]

Question 5 State the legal consequences of the Retirement of a partner as per the provisions of the Indian Partnership Act, 1932: [RTP Nov 19]

Answer:

Retirement [Sec. 32]:

(a) Modes of Retirement: Partner may retire -

- With other Partner's consent,
- In accordance with an express agreement,
- By giving written notice of his intention to retire in a Partnership at will.

(b) Liability:

- Retiring Partner may be discharged from liability to any third party for acts of Firm done before his retirement by (a) an agreement made with such third party and the Partners of reconstituted Firm, or (b) implied from the course of dealing between the third party and reconstituted Firm after he had knowledge of the retirement.
- A retired Partner along with other Partners continues to be liable to third parties for acts done by any of them in the Firm name before retirement, until public notice is given of his retirement.
- A retired Partner is not liable to any third party who deals with the Firm without knowledge that he was a Partner.

(c) Public Notice: Can be given by - (a) Retired Partner, or (b) any Partner of reconstituted Firm.

Authority of Partner [Sec 19-22]

Implied authority of partner [Section 19 & 22]

Section 19 (1) - Implied Authority of partner as agent of the firm.

Subject to the provisions of section 22, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm.

Section 22 - Mode of doing act to bind firm.

In order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm-name, or in any other manner expressing or implying an intention to bind the firm.

Reading together Sections 19(1) and 22. Implied authority covers those acts of partners which fulfill the following three conditions:

Conditions for Partner's act to bind the Firm i.e. for Implied Authority:

1. Normal Business:
   (a) Act done by Partners must relate to normal business of the Firm.
   (b) If the act is of a nature that is not common in the type of business carried on by Firm, it will

not bind the Firm even if it has been done in the Firm's name.

(c) Example: Z, a Partner of a Firm dealing in readymade garments places an order for liquor worth ₹ 50,000 in the Firm's name. It does not relate to normal business of the Firm. The Firm will not be bound by it as it is not within Z's implied authority.

2. Usual way of carrying on business:

(a) Act must be done in the usual way of carrying on the Firm's business.

(b) What is usual and what is unusual in a business depends on (a) nature of business and (b) usage of trade.

(c) Example: Taking loan is considered as usual activity in case of a trading concern but unusual activity in case of a professional concern of solicitors.

3. In the Firm's name: The Act must be done in Firm's name or should, in some manner, imply an intention to bind the Firm.

Example: A and B are Partners in a stationery business. A buys pencils on credit from a wholesaler in Firm's name but gives them to his children. Taking goods on credit is normal in business, it is within A's implied authority. It will bind the Firm even though A had misappropriated it for his personal use.

Question 6

A, B and C are partners in a firm called ABC Firm. A, with the intention of deceiving D, a supplier of office stationery, buys certain stationery on behalf of the ABC Firm. The stationery is of use in the ordinary course of the firm's business. A does not give the stationery to the firm, instead brings it to his own use. The supplier D, who is unaware of the private use of stationery by A, claims the price from the firm. The firm refuses to pay for the price, on the ground that the stationery was never received by it (firm). Referring to the provisions of the Indian Partnership Act, 1932 decide:

(i) Whether the Firm's contention shall be tenable?

(ii) What would be your answer if a part of the stationery so purchased by A was delivered to the firm by him, and the rest of the stationery was used by him for private use, about which neither the firm nor the supplier D was aware? [MTP March 18, 6 Marks] [MTP Oct 18, 6 Marks]

Answer:

Provision: Same as above as given in section 19 read with section 22

Considering the above provisions, the questions as asked in the problem may be answered as under:

(i) The firm's contention is not tenable, for the reason that the partner, in the usual course of the business on behalf of the firm has an implied authority to bind the firm. The firm is, therefore, liable for the price of the goods.

(ii) In the second case also, the answer would be the same as above, i.e., the implied authority of the partner binds the firm.

In both the cases, however, the firm ABC can take action against A, the partner but it has to pay the price of stationery to the supplier D.

Related Question: Mahesh, Suresh and Dinesh are partners in a trading firm. Mahesh, without the knowledge or consent of Suresh and Dinesh borrows himself Rs.50,000 from Ramesh, a customer of the firm, in the name of the firm. Mahesh, then buys some goods for his personal use with that borrowed money. Can Mr. Ramesh hold Mr. Suresh & Mr. Dinesh liable for the loan? Explain the relevant provisions of the Indian Partnership Act, 1932. [MTP Oct 19, 6 Marks]

Answer:

Implied authority of a partner

Yes, as per sections 19 and 22 of the Indian Partnership Act,1932, every partner has an implied authority to bind every other partner for acts done in the name of the firm, provided the same falls within the ordinary course of business (within the implied authority of firm) and is done in a usual manner. Mahesh has a right to borrow the money of Rs. 50,000/- from Ramesh on behalf of his firm in the usual manner. Since, Ramesh has no knowledge that the amount was borrowed by Mahesh without the consent of the other two partners, Mr. Suresh and Mr. Dinesh, he can hold both of them (Suresh and Dinesh) liable for the re-payment of the loan.

Acts outside Implied Authority [Sec. 19(2)]

Question 7 In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to do certain acts. State the acts which are beyond the implied authority of a partner under the provisions of the Indian Partnership Act, 1932? [MTP Aug 18, 6 Marks] [July 21 – 6 Marks] CS LLM Arjun Chhabra (Law Maven)

Answer:

Acts outside Implied Authority [Sec. 19(2)]

In the absence of any usage or custom of trade to the contrary, implied authority of a Partner does not enable him to

(a) Submit to arbitration, a dispute relating to the business of the Firm,

(b) Open a bank account on behalf of the Firm in Partner's own name,

(c) Compromise or relinquish any claim or portion of claim by the Firm,

(d) Withdraw any suit or proceeding filed on behalf of the Firm,

(e) Admit any liability in a suit or proceeding against the Firm,

(f) Acquire immovable property on behalf of the Firm,

(g) Transfer immovable property belonging to the Firm,

(h) Enter into Partnership on behalf of the Firm.

Extension and restriction of partner's implied authority - Section – 20

Section – 20 Extension and restriction of partner's implied authority

(a) The Partners, by mutual agreement, can restrict or extend the Implied Authority of any Partner.

(b) Notwithstanding any restriction, any act done by a Partner on behalf of the Firm which falls within his implied authority, binds the Firm,

- unless the person with whom he is dealing knows of the restriction
- So, a third party is not affected by limitation of implied authority unless he has actual notice of it.

Example: X, Y and Z are partners in a trading firm. They decide that no partner shall have the right to borrow beyond Rs. 20,000 without the consent of other partners. X without consulting Y and Z borrows from W Rs. 25,000 in the name of the firm and utilised the same in paying of the firm's debts. The firm is liable to pay W if W is unaware of the restriction but it will not be liable to pay iMff W was aware of such restriction.

Question 8

A, B, and C are partners of a partnership firm ABC & Co. The firm is a dealer in office furniture. A was in charge of purchase and sale, B was in charge of maintenance of accounts of the firm and C was in charge of handling all legal matters. Recently through an agreement among them, it was decided that A will be in charge of maintenance of accounts and B will be in charge of purchase and sale. Being ignorant about such agreement, M, a supplier supplied some furniture to A, who ultimately sold them to a third party. Referring to the provisions of the Partnership Act, 1932, advise whether M can recover money from the firm.

What will be your advice in case M was having knowledge about the agreement? [MTP Aug 18, 6 Marks] [MTP March 19, 6 Marks] CS LLM Arjun Chhabra (Law Maven)

Answer: Provision: Same as above as given in section 20

Now, referring to the case given in the question, M supplied furniture to A, who ultimately sold them to a third party and M was also ignorant about the agreement entered into by the partners about the change in their role. M also is not aware that he is dealing with a partner in a firm. Therefore, M on the basis of knowledge of implied authority of A, can recover money from the firm. But in the second situation, if M was having knowledge about the agreement, he cannot recover money from the firm.

Partner's authority in an emergency - Section 21

Partner's authority in an emergency [Sec. 21]

In case of an emergency, a Partner has the authority to do all such acts so as to protect the Firm from loss, as would be done by a man of ordinary prudence under similar conditions. These acts bind the Firm even though they do not form part of the Partner's implied authority.

Question 9

What do you mean by "implied authority" of the partners in a firm? Point out the extent of partner's implied authority in case of emergency, referring to the provisions of the Indian Partnership Act, 1932. [RTP May 19]

Related/Expected Question: X and Y are Partners of a Trading Firm. They decide that no Partner shall have the right to buy or sell goods beyond the value of ₹ 10,000 without the consent of the other Partner. Owing to sudden slump in the market, the prices crashed.

X in order to save the Firm from loss, sold all the perishable stock worth ₹ 2, 00,000 without consulting Y. Is Firm bound by X's Act?

Answer:

Yes. The act has been done to protect the Firm from loss.

Related Question: Shyam, Mohan and Keshav were partners in M/s Nandlal Gokulwale and Company. They mutually decided that Shyam will take the responsibility to sell the goods, Mohan will do the purchase of goods for firm and Keshav will look after the accounts and banking department. No one will interfere in other's department. Once, when Shyam and Keshav were out of town, Mohan got the information that the price of their good is going down sharply due to some government policy which would result in heavy loss to firm if goods not sold immediately. He tried to contact Shyam who has authority to sell the goods. When Mohan couldn't contact to Shyam, he sold all goods at some reduced price to save the firm from heavy loss. Thereafter, Shyam and Keshav denied accepting the loss due to sale of goods at reduced price as it's only Shyam who has express authority to sell the goods. Discuss the consequences under the provisions of the Indian Partnership Act, 1932. [RTP June 23]

Answer:

According to Section 20 of Indian Partnership Act, 1932, the partners in a firm may, by contract between the partners, extend or restrict the implied authority of any partner. Notwithstanding any such restriction, any act done by a partner on behalf of the firm which falls within his implied authority binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.

Further, according to Section 21, a partner has authority, in an emergency to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own

case, acting under similar circumstances, and such acts bind the firm.

On the basis of provisions and facts provided in the question, though Shyam was expressly authorised to sell the goods, Mohan sold the goods at some loss. It was very much clear that Mohan has done what a person of ordinary prudence does in an emergency to protect the firm from heavy loss. Hence, this sale will bind the firm.

Liability To Third Parties (Section 25 To 27)

Question 10

Discuss the liability of a partner for the act of the firm and liability of firm for act of a partner to third parties as per Indian Partnership Act, 1932. [Jan 21 – 4 Marks]

Related Question: Explain in detail the circumstances which lead to liability of firm for misapplication by partners as per provisions of the Indian Partnership Act, 1932. [Dec 20 – 4 Marks] [RTP May 21]

Answer:

LIABILITY TO THIRD PARTIES (SECTION 25 TO 27)

The question of liability of partners to third parties may be considered under different heads. These are as follows:

1. LIABILITY OF A PARTNER FOR ACTS OF THE FIRM (SECTION 25): Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner.

Example: Certain persons were found to have been partners in a firm when the acts constituting an infringement of a trademark by the firm took place. it was held that they were liable for damages arising out of the alleged infringement, it being immaterial that the damages arose after the dissolution of the firm.

2. LIABILITY OF THE FIRM FOR WRONGFUL ACTS OF A PARTNER (SECTION 26): Were, by the wrongful act or omission of a partner in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefor to the same extent as the partner.

Example: One of the two partners in coal mine acted as a manager was guilty of personal negligence in omitting to have the shaft of the mine properly fenced. As a result, thereof, an injury was caused to a workman. The other partner was also held responsible for the same.

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

Where-

(a) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or

(b) a firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.

Example : A, B, and C are partners of a place for car parking P stands his car in the parking place but A sold out the car to a stranger. For this liability, the firm is liable for the acts of A.

Analysis of section 27:

It may be observed that the workings of the two clauses of Section 27 is designed to bring out clearly an important point of distinction between the two categories of cases of misapplication of money by partners.

Clause (a) covers the case where a partner acts within his authority and due to his authority as partner, he receives money or property belonging to a third party and misapplies that money or property. For this provision to the attracted, it is not necessary that the money should have actually come into the custody of the firm.

On the other hand, the provision of clause (b) would be attracted when such money or property has come into the custody of the firm and it is misapplied by any of the partners.

The firm would be liable in both the cases.

Minors admitted to the benefits of partnership - Section 30

Question 11

"Though a minor cannot be a partner in 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 rights which can be enjoyed by a minor partner. [Nov 18, 4 Marks]

(II) A. State the liabilities of a minor partner both:

(i) Before attaining majority and

(ii) After attaining majority. [Nov 18, 2 Marks] [MTP March 19, 6 Marks]

OR

B. State the legal position of a minor partner after attaining majority:

(i) When he opts to become a partner of the same firm.

(ii) When he decide not to become a partner. [Nov 18, 2 Marks]

Answer:

(i) Rights which can be enjoyed by a minor partner:

Share of Profits & Property	Inspection and copying of accounts	Filing of suit	Option to become Partner
(a) To share profits, and (b) To share property of the Firm.	(a) To have access to the accounts, and (b) To inspect and copy, any of the Firm's accounts. (c) He cannot inspect books other than account books that may contain confidential information restricted to Partners only.	(a) To file a suit for his share of profits of the Firm's property when he is not given his due share. (b) This can be exercised only when he decides to severe his connections with Firm.	(a) To opt to become a Partner in the Firm on attaining majority. (b) If he opts to become Partner, he shall be entitled to the same share, which he was getting as a minor.

(ii) Liabilities of a minor partner before attaining majority:

Before attaining majority	Position on attaining majority
(a) Liability is confined only to the extent of his share in profits and property of Firm. (b) He is neither personally liable nor is his private estate liable. (c) He cannot be declared insolvent, but if the Firm is declared insolvent, his share in the Arm vests in the Official Receiver or Official Assignee.	(a) Decision: Within 6 months of his attaining majority or his obtaining knowledge that he had been admitted to the benefits of the Arm, whichever date is later, the minor Partner has to decide whether he shall remain a Partner or leave the Arm. (b) Notice: He shall give a public notice of his intention, i.e. whether opting to become or not becoming a Partner. (c) Deemed Partner: Where he fails to give notice, he becomes a Partner in the Firm on the expiry of such period.

Liabilities of a minor partner after attaining majority:

Elects to become a Partner	Elects NOT to become a Partner
When the Minor becomes a Partner of his own volition or by his failure to give public notice within the specified time - • He becomes personally liable to third parties for all acts of the Firm done since he was admitted to the benefits of the Arm. • His share in the property and profits of the Arm remains the same as he was entitled as a Minor.	• His rights and liabilities continue to be those of a Minor up to the date of giving public notice. • His share is not liable for any acts of the Arm done after the date of the public notice. • He is entitled to sue the Partners for his share of the property and profits in the Firm.

Related Question: Whether a minor may be admitted in the business of a partnership firm? Explain the rights of a minor in the partnership firm. [RTP May 18] [MTP Oct 18, 6 Marks] CS LLM Arjun Chhabra (Law Maven) [RTP Nov 21]

Answer:

1. Minor cannot become Partner: Minor cannot enter in to a contract, and hence he generally cannot enter into Partnership.
2. Minor into benefits of Partnership: If all the Partners agree, a minor may be admitted to the benefits of an already existing Firm. There must be atleast two major Partners before a Minor is admitted into the benefits of Partnership.
3. Right of minor: Same as given in Above table.

Related Question: Master X was introduced to the benefits of partnership of M/s ABC & Co. With the consent of all partners. After attaining majority, more than six months elapsed and he failed to give a public notice as to whether he elected to become or not to become a partner in the firm. Later on, Mr. L, a supplier of material to M/s ABC & Co., filed a suit against M/s ABC & Co. for recovery of the debt due.

In the light of the Indian Partnership Act, 1932, explain:

(i) To what extent X will be liable if he failed to give public notice after attaining majority?

(ii) Can Mr. L recover his debt from X? [RTP Nov 20] [Nov 19, 6 Marks] [RTP Dec 23] CS LLM Arjun Chhabra (Law Maven)

Answer:

As per the provisions of Section 30(5) of the Indian Partnership Act, 1932

1. At any time within six months of his (Minor) attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, such person may give public notice that he has elected to become or that he has elected not to become a partner in the firm, and such notice shall determine his position as regards the firm.
2. However, if he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

If the minor becomes a partner by his failure to give the public notice within specified time, his rights and liabilities as given in Section 30(7) are as follows:

(A) He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

(B) His share in the property and the profits of the firm remains the same to which he was entitled as a minor.

(i) In the instant case, since, X has failed to give a public notice, he shall become a partner in the M/s ABC & Co. and becomes personally liable to Mr. L, a third party.

(ii) In the light of the provisions of Section 30(7) read with Section 30(5) of the Indian Partnership Act, 1932, since X has failed to give public notice that he has not elected to not to become a partner within six months, he will be deemed to be a partner after the period of the above six months and therefore, Mr. L can recover his debt from him also in the same way as he can recover from any other partner.

Personal profits earned by partners – Section 16

Subject to the contract between the partners, -

(a) if a partner derives any profits 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;

Example: R and K were Partners in a business as suppliers of leather goods and were regular contractors to Government. K, without knowledge of R, supplied to Government certain leather goods in which Firm was also dealing and made substantial profits. R in entitled to claim profit from K.

(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.

Example: A & B were Partners in a Firm dealing in purchase of cloth. B started cloth-manufacturing business individually. Manufacturing of cloth is a different activity and not similar to sale of cloth and hence sharing of profits by B from manufacturing cloth with A is not covered u/s 16(b).

Related Question: A, B and C are partners of a partnership firm carrying on the business of construction of apartments. B who himself was a wholesale dealer of iron bars was entrusted with the work of selection of iron bars after examining its quality. As a wholesaler, B is well aware of the market conditions. Current market price of iron bar for construction is Rs. 350 per Kilogram. B already had 1000 Kg of iron bars in stock which he had purchased before price hike in the market for Rs. 200 per Kg. He supplied iron bars to the firm without the firm realising the purchase cost. Is B liable to pay the firm the extra money he made, or he doesn't have to inform the firm as it is his own business and he has not taken any amount more than the current prevailing market price of Rs. 350? Assume there is no contract between the partners regarding the above. [RTP Nov 21]

Discuss the provisions regarding personal profits earned by a partner under the Indian Partnership Act, 1932? [May 19, 2 Marks] CS LLM Arjun Chhabra (Law Maven)

Answer: Provision same as above as given in section 16

In the given scenario, Mr. B had sold iron bar to the firm at the current prevailing market rate of Rs.350 per Kg though he had stock with him which he bought for Rs.200 per Kg. Hence, he made an extra profit of Rs. 150 per Kg. This is arising purely out of transactions with the firm. Hence, Mr. B is accountable to the firm for the extra profit earned thereby.

Related Question: X and Y are in Partnership for refining sugar. Y was appointed to buy sugar for the Firm. Without the knowledge of X, he supplied his own sugar to the Firm at Market Price and made a huge gain. Is he accountable for profit he makes?

Answer: Yes

Subject to Contract between the Partners, if a Partner derives any profit for himself from any transaction of the Firm, he must account for the profit and pay it to the Firm.

Effect of notice to acting partner – Section 24

Question 12

What is the provision related to the effect of notice to an acting partner of the firm as per the Indian Partnership Act, 1932? [May 19, 2 Marks] CS LLM Arjun Chhabra (Law Maven

Answer:

Effect of notice to an acting partner of the firm According to Section 24 of the Indian Partnership Act, 1932, 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.

Thus, the notice to one is equivalent to the notice to the rest of the partners of the firm, just as a notice to an agent is notice to his principal.

Related/Expected Question: X, Y and Z are Partners of a Trading Firm. X who actively participates in the Management of the business of the Firm, bought certain goods for the Firm. The Seller told X about the defect in the goods, (a) Is the Firm liable to the seller? (b) Would it make any difference if there was a collusion between X and the seller to conceal the defect from other Partners?

Answer:

(a) The Firm is liable to seller because notice to Working Partner operates as a notice to the Firm.

(b) The Firm is not liable to the seller because notice to a Working Partner does not operate as a notice to the Firm in case of fraud committed by a Partner and third party against the Firm.

Related Question: A and B operate a textile merchant business in partnership. Mr. A finances the business and is a sleeping partner. In the regular course of business, B acquires certain fabric goods belonging to C. However, B is aware that these goods are stolen property. Despite this knowledge, B proceeds to purchase and sell some of these stolen goods. Moreover, B records proceeds from these sales in the firm's books. Now, A wants to avoid the liability towards C, on the grounds of misconduct by B. In the light of the provisions of the Indian Partnership Act, 1932 discuss the liability of A and B towards C. **(June 24 - 3 Marks)**

Answer: Refer module

Remuneration to partners - Section 13(a)

Question 13

Moni and Tony were partners in the firm M/s MOTO & Company. They admitted Sony as partner in the firm and he is actively engaged in day-to-day activities of the firm. There is a tradition in the firm that all active partners will get a monthly remuneration of ` 20,000 but no express agreement was there. After admission of Sony in the firm, Moni and Tony were continuing getting salary from the firm but no salary was given to Sony from the firm. Sony claimed his remuneration but denied by existing partners by saying that there was no express agreement for that. Whether under the Indian Partnership Act, 1932, Sony can claim remuneration from the firm? [RTP May 22]

Answer:

By virtue of provisions of Section 13(a) of the Indian Partnership Act, 1932 a partner is not entitled to receive remuneration for taking part in the conduct of the business. But this rule can always be varied by an express agreement, or by a course of dealings, in which event the partner will be entitled to remuneration. Thus, a partner can claim remuneration even in the absence of a contract, when such remuneration is payable under the continued usage of the firm. In other words, where it is customary to pay remuneration to a partner for conducting the business of the firm, he can claim it even in the absence of a contract for the payment of the same.

In the given problem, existing partners are getting regularly a monthly remuneration from firm customarily being working partners of the firm. As Sony also admitted as working partner of the firm, he is entitled to get remuneration like other partners.

Right of outgoing partner in certain cases to share subsequent profits – Section 37

Question 14

A, B and C are partners in a firm. As per terms of the partnership deed, A is entitled to 20 percent of the partnership property and profits. A retires from the firm and dies after 15 days. B and C continue business of the firm without settling accounts. Explain the rights of A's legal representatives against the firm under the Indian Partnership Act, 1932? [RTP May 18] [RTP May 20] CS LLM Arjun Chhabra (Law Maven)

Answer:

Retirement / Death of Partner: Section 37 of the Indian Partnership Act, 1932 provides that where a partner dies or otherwise ceases to be a partner and there is no final settlement of account between the legal representatives of the deceased partner or the firms with the property of the firm, then, in the absence of a contract to the contrary, the legal representatives of the deceased partner or the retired partner are entitled to claim either.

(i) Such shares of the profits earned after the death or retirement of the partner which is attributable to the use of his share in the property of the firm; or

(ii) Interest at the rate of 6 per cent annum on the amount of his share in the property.

Based on the aforesaid provisions of Section 37 of the Indian Partnership Act, 1932, in the given problem, A shall be entitled, at his option to:

(i) the 20% shares of profits (as per the partnership deed); or

(ii) interest at the rate of 6 per cent per annum on the amount of A's share in the property.

Related Practical Question: Manisha, Madhuri, and Juhi are partners sharing profits and losses equally. Juhi dies on 1st October 2017. After making all the necessary adjustments for assets, liabilities, goodwill and Joint Life Policy, the capital accounts of the partners are ₹100000, ₹140000 and ₹240000 respectively. Manisha and Madhuri decide to continue the business. Juhi's account is not settled until 1st January 2018. The profit for the year is ₹180000. Assume the accounting year ends on 31st March every year. Determine the option that the legal representative of Juhi shall choose.

Answer

Option 1: Share in Subsequent Profits

Profit for the year = 180000

But, profit until 1st October 2017 is already adjusted. Therefore, we need to pay him only the profit from 1st October 2017 to 31st December 2017 i.e. for 3 months. We assume that profits are earned evenly during the year.

Hence, profit for 3 months = 180000 x 3/12

= 45000

Juhi's share=45000×240000/480000 = ₹22500

Option 2: Interest @ 6%

Interest=240000×6100×3/12 = ₹3600

Conclusion: Since, share in subsequent profits is more beneficial, he should go for Option 1.

Rights of outgoing Partner to Carry on competing business – Section 36

Share subsequent profits – Section 37

Question 15

P.Q.R. and S are the partners in M/S PQRS & Co., a partnership firm which deals in trading of Washing Machines of various brands.

Due to the conflict of views between partners, P & Q decided to leave the partnership firm and started competitive business on 31st July, 2019, in the name of M/S PQ & Co. Meanwhile, R & S have continued using the property in the name of M/S PQRS & Co. in which P & Q also has a share.

Based on the above facts, explain in detail the rights of outgoing partners as per the Indian Partnership Act, 1932 and comment on the following:

(i) Rights of P & Q to start a competitive business.

(ii) Rights of P & Q regarding their share in property of M/S PQRS & Co. [Dec 20, 6 Marks]

Answer: Rights of outgoing Partner

To carry on competing business [Section 36]	To share subsequent profits – [Section 37]
1. He may carry on business competing with that of the Firm and may also advertise such business but Subject to a contract to the contrary, he may not (a) use the Firm name or (b) represent himself as carrying on the Firm's business or (c) solicit the custom of persons who were dealing with the firm before he ceased to be a partner.	1. In the absence of contract to contrary, Outgoing Partner is entitled to such share of profits made since his cessation, as may be attributable to the use of his share of the Firm's property.
	2. Alternatively, he can claim interest at 6% p.a. on his share in the Firm's property.
	3. This right is available only when the Firm carries on the business with Firm's property without final settlement of accounts between them and outgoing Partner.
2. He may sometimes agree with his Partners that on his cessation, he will not carry on a business similar to that of Firm within - (a) a specified period or (b) specified local limits and notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such agreement shall be valid if the restrictions imposed are reasonable.	4. Even the representatives of a deceased Partner can claim share in subsequent profits.
• Outgoing Partner has the right to receive his share of the property of the Firm, including goodwill.	5. When by a contract between Partners, an option to purchase the interest of Outgoing Partner was exercised by other Partners, then, Outgoing Partner will not be entitled to any further share of the profits.

In the instant case

P & Q decided to leave the partnership firm and started competitive business on 31st July, 2019, in the name of M/S PQ & Co. Meanwhile, R & S have continued using the property in the name of M/S PQRS & Co. in which P & Q also has a share.

In the light of the above provision and facts of the case

(i) P & Q has the right to start a competitive business but subject to subsection (1) of section 36.

(ii) P & Q shall be is entitled to such share of profits made since their cessation, as may be attributable to the use of their share in the Firm's property or Alternatively, they can claim interest at 6% p.a. on their share in Firm's property.

Mode of settlement of accounts between partners – Section 48

Question 16

Subject to agreement by partners, state the rules that should be observed by the partners in settling the accounts of the firm after dissolution under the provisions of the Indian Partnership Act, 1932. [MTP Aug 18, 4 Marks] [July 21 – 4 Marks] [RTP May 22 – 4 Marks]

Answer:

Settlement of partnership accounts (Section 48)

In settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:

(i) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.

(ii) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, must be applied in the following manner and order:

(a) in paying the debts of the firm to third parties;

(b) in paying to each partner rateably what is due to him from capital;

(c) in paying to each partner rateably what is due to him on account of capital; and

(d) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Continuing guarantee & Goodwill [Section 38 & 14]

Question 17

When the continuing guarantee can be revoked under the Indian Partnership Act, 1932? [Nov 19, 2 Marks] [RTP Dec 23]

OR

What do you mean by Goodwill as per the provisions of Indian Partnership Act, 1932? [Nov 19, 2 Marks] [RTP Dec 23]

Answer:

Revocation of continuing guarantee (Section 38 of the Indian Partnership Act, 1932)

According to section 38, a continuing guarantee given to a firm or to third party in respect of the transaction of a firm is, in the absence of an agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm. Such change may occur by the death, or retirement of a partner, or by introduction of a new partner.

OR

Goodwill: The term "Goodwill" has not been defined under the Indian Partnership Act, 1932. Section 14 of the Act lays down that goodwill of a business is to be regarded as a property of the firm.

Goodwill may be defined as the value of the reputation of a business house in respect of profits expected in future over and above the normal level of profits earned by undertaking belonging to the same class of business.

Related Question: A became surety to the firm of 'NC Mookerji' for B's conduct as cashier to the firm. The constitution of the firm subsequently underwent a change. Two sons of N. Mookerji were admitted as partners and its name was altered to "N. Mookerji and Sons". Subsequently B defalcated. Is A liable for B's defalcation?

Answer: Section to which the given problem relates: Section 38.

Decision: No.

Reason: A continuing guarantee is revoked as to the future transactions from the date of any change in the constitution of the firm.

Difference between

Question 18

What is the difference between partnership and co-ownership as per the Indian Partnership Act, 1932? [Nov 22 - 4 Marks]

Answer:

Partnership Vs. Co-Ownership or joint ownership i.e. the relation which subsists between persons who own property jointly or in common.

Basis of difference	Partnership	Co-ownership
1. Formation	Partnership always arises out of a contract, express or implied.	Co-ownership may arise either from agreement or by the operation of law, such as by inheritance.

2. Implied agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.
3. Nature of interest	There is community of interest which means that profits and losses must have to be shared.	Co-ownership does not necessarily involve sharing of profits and losses.
4. Transfer of interest	A share in the partnership is transferred only by the consent of other partners.	A co-owner may transfer his interest or rights in the property without the consent of other co-owners.

Question 19

What are the rights of partners with respect to conduct of the business of a firm as prescribed under the Indian Partnership Act, 1932? (4 Marks)

Answer:

Conduct of the Business (Section 12 of the Indian Partnership Act, 1932): Subject to contract between the partners-

a) every partner has a right to take part in the conduct of the business;
b) every partner is bound to attend diligently to his duties in the conduct of the business;
c) any difference arising as to ordinary matters connected with the business may be decided by majority of the partners, and every partner shall have the right to express his opinion before the matter is decided, but no change may be made in the nature of the business without the consent of all partners; and
d) every partner has a right to have access to and to inspect and copy any of the books of the firm.
e) in the event of the death of a partner, his heirs or legal representatives or their duly authorised agents shall have a right of access to and to inspect and copy any of the books of the firm.

Unit 3 - Registration and dissolution of a firm

Dissolution of firm

Question 1

"Dissolution of a firm is different from dissolution of Partnership". Discuss. [Nov 19, 4 Marks] [Ma/y 18, 2 Marks]

Answer:

DISSOLUTION OF FIRM VS. DISSOLUTION OF PARTNERSHIP

S. NO.	BASIS OF DIFFERENCE	DISSOLUTION OF FIRM	DISSOLUTION OF PARTNERSHIP
1.	Continuation of business	It involves discontinuation of Business in partnership.	It does not affect continuation of business. It involves only reconstitution of the firm.
2.	Winding up	It involves winding up of the firm and requires realization of assets and settlement of liabilities.	It involves only reconstitution and requires only revaluation of assets and liabilities of the firm.
3.	Order of court	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
4.	Scope	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.
5.	Final closure of books	It involves final closure of books of the firm.	It does not involve final closure of the books.

Question 2

State any four grounds on which Court may dissolve a partnership firm in case any partner files a suit for the same. [Nov 18, 4 Marks] [RTP May 20] [May 22 - 4 Marks] CS LLM Arjun Chhabra (Law Maven)

Related Question: "Dissolution of partnership doesn't mean dissolution of firm". '. Do you agree with this statement? State any three situations where court can dissolve the partnership firm. **(June 24 - 7 Marks)**

Answer:

Dissolution by the Court (Section 44 of the Indian Partnership Act, 1932):

Court may, at the suit of the partner, dissolve a firm on any of the following ground:

(1) Insanity/unsound mind: Where a partner (not a sleeping partner) has become of unsound mind, the court may dissolve the firm on a suit of the other partners or by the next friend of the insane partner.

(2) Permanent incapacity: When a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner, then the court may dissolve the firm. Such permanent incapacity may result from physical disability or illness etc.

(3) Misconduct: Where a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of business, the court may order for dissolution of the firm, by giving regard to the nature of business.

(4) Persistent breach of agreement: Where a partner other than the partner suing, wilfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conduct himself in matters relating to the business that it is not reasonably practicable for other partners to carry on the business in partnership with him, then the court may dissolve the firm at the instance of any of the partners. Following comes in to category of breach of contract:

- Embezzlement,
- Keeping erroneous accounts
- Holding more cash than allowed
- Refusal to show accounts despite repeated request etc.

A, B and C were the three partners in a firm carrying on the business of importing salt from foreign countries and reselling the same. The partnership agreement provided that a continuing partner shall not carry on any personal business so long as he is a partner. A was given the charge of importing the salt. While importing salt for the firm, he was also importing sugar for himself and selling the same on his personal accounts. The restriction imposed in the agreement is valid. And thus, A may be restrained from carrying on the sugar business

Note: Where a partner carries on any personal business in breach of this kind of agreement, the other parnters may apply to the court for the dissolution of the firm on the ground of persistent breach of agreement. [Dean v. Macdowell]

(5) Transfer of interest: Where a partner other than the partner suing, has transferred the whole of his interest in the firm to a third party or has allowed his share to be charged or sold by the court, in the recovery of arrears of land revenue, the court may dissolve the firm at the instance of any other partner.

(6) Continuous/Perpetual losses: Where the business of the firm cannot be carried on except at a loss in future also, the court may order for its dissolution.

(7) Just and equitable grounds: Where the court considers any other ground to be just and equitable for the dissolution of the firm, it may dissolve a firm. The following are the cases for the just and equitable grounds-

I. Deadlock in the management.
II. Where the partners are not in talking terms between them.
III. Loss of substratum.

IV. Gambling by a partner on a stock exchange.

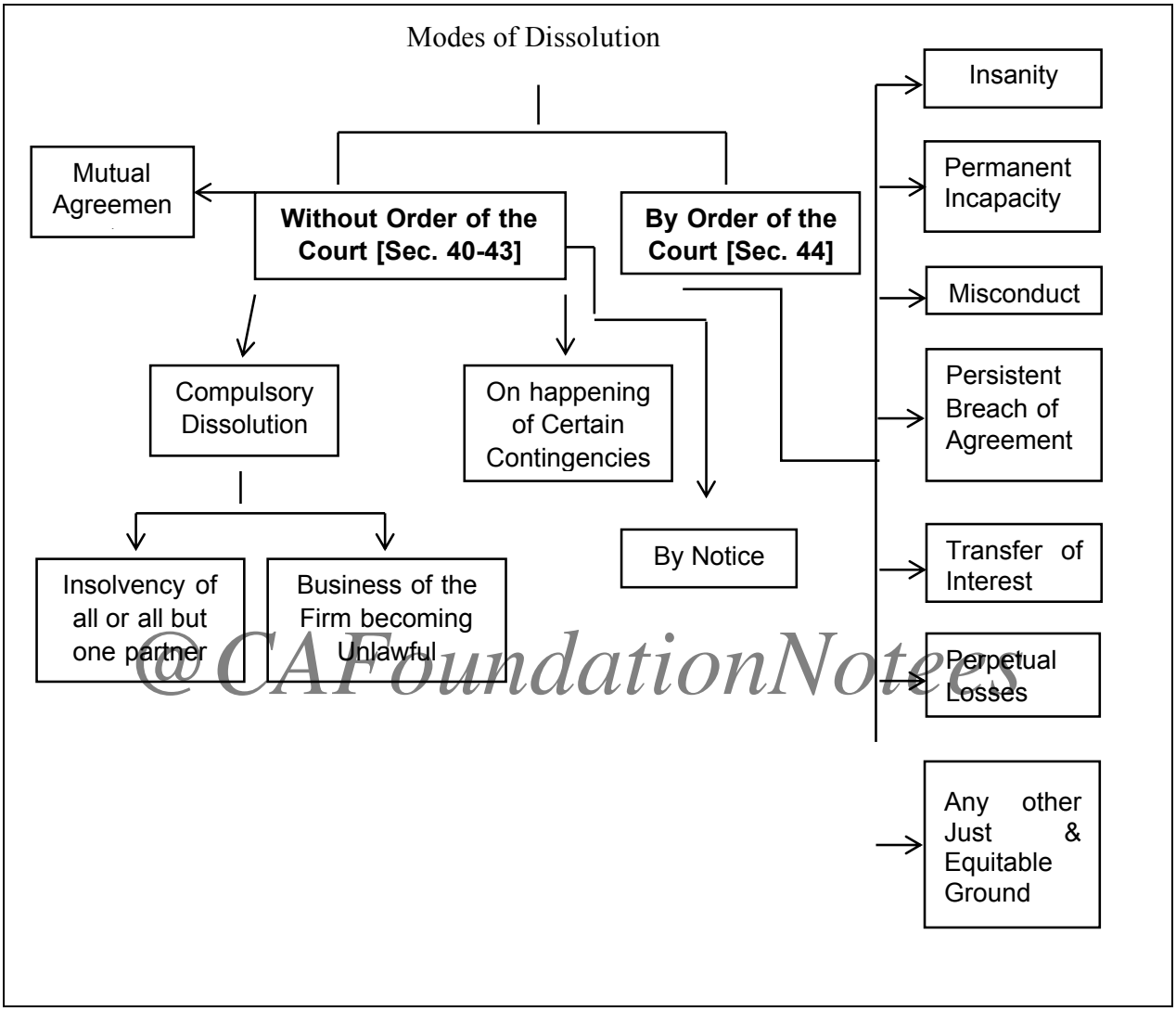
Question 3

When does dissolution of a partnership firm take place under the provisions of the Indian Partnership Act, 1932? Explain. [MTP March 19, 4 Marks] [MTP Oct 20, 4 Marks] [MTP Oct 21, 4 Marks]

Answer: Dissolution of Firm: The Dissolution of Firm means the discontinuation of the jural relation existing between all the partners of the Firm. But when only one of the partners retires or becomes in capacitated from acting as a partner due to death, insolvency or insanity, the partnership, i.e., the relationship between such a partner and other is dissolved, but the rest may decide to continue. In such cases, there is in practice, no dissolution of the firm. The particular partner goes out, but the remaining partners carry on the business of the Firm. In the case of dissolution of the firm, on the other hand, the whole firm is dissolved. The partnership terminates as between each and every partner of the firm.

Dissolution of a Firm may take place (Section 39 - 44)

(a) as a result of any agreement between all the partners (i.e., dissolution by agreement);
(b) by the adjudication of all the partners, or of all the partners but one, as insolvent (i.e., compulsory dissolution);
(c) by the business of the Firm becoming unlawful (i.e., compulsory dissolution);
(d) subject to agreement between the parties, on the happening of certain contingencies, such as: (i) effluence of time; (ii) completion of the venture for which it was entered into; (iii) death of a partner; (iv) insolvency of a partner.
(e) by a partner giving notice of his intention to dissolve the firm, in case of partnership at will and the firm being dissolved as from the date mentioned in the notice, or if no date is mentioned, as from the date of the communication of the notice; and
(f) by intervention of court in case of: (i) a partner becoming the unsound mind; (ii) permanent incapacity of a partner to perform his duties as such; (iii) Misconduct of a partner affecting the business; (iv) willful or persistent branches of agreement by a partner; (v) transfer or sale of the whole interest of a partner; (vi) improbability of the business being carried on save at a loss; (vii) the court being satisfied on other equitable grounds that the firm should be dissolved.



Related Question: MN partnership firm has two different lines of manufacturing business. One line of business is the manufacturing of Ajinomoto, a popular seasoning & taste enhancer for food. Another line of business is the manufacture of paper plates & cups. One fine day, a law is passed by the Government banning Ajinomoto' use in food and to stop its manufacturing making it an unlawful business because it is injurious to health. Should the firm compulsorily dissolve under the Indian Partnership Act, 1932? How will its other line of business (paper plates & cups) be affected? [RTP Nov 21]

Answer:

According to Section 41 of the Indian Partnership Act, 1932, a firm is compulsorily dissolved;

(a) by the adjudication of all the partners or of all the partners but one as insolvent, or

(b) by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

However, where more than one separate adventure or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

Here, MN has to compulsorily dissolve due to happening of law which bans the usage of ajinomoto. Else the business of the firm shall be treated as unlawful.

However, the illegality of ajinomoto business will in no way affect the legality or dissolution of the other line of business (paper plates & cups). MN can continue with paper plates and cup manufacture.

Related Question: P, Q, and R formed a partnership agreement to operate motor buses along specific routes for a duration of 12 years. After operating the business for four years, it was observed that the business incurred losses each year. Despite this, P is determined to continue the business for the remaining Period. Examine with reference to the Indian Partnership Act, 1932, Can P insist to continue the business? If so, what options are available to Q and R who are reluctant to continue operating the business? **(June 24 - 4 Marks)**

Answer: Refer module

Related Question: G, I and S were friends and they decided to form a partnership firm and trade in a particular type of chemicals. After three years of partnership, a law was passed which banned the trading of such chemicals. As per the provisions of the Indian Partnership Act, 1932 can G, I and S continue the partnership or will their partnership firm get dissolved? [RTP Nov 22]

Answer:

Compulsory dissolution of a firm (Section 41)

A firm is compulsorily dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

In this case, the firm is carrying on the business of trading in a particular chemical and a law is passed which bans the trading of such a particular chemical.

The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved in the light of Section 41 of the Indian Partnership Act, 1932.

Registration of firm

Question 4

What is the procedure of registration of a partnership firm under the Indian Partnership Act, 1932? [RTP May 20] [6 Marks June 23]

Answer:

APPLICATION FOR REGISTRATION (SECTION 58):

(1) The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating-

(a) The firm's name
(b) The place or principal place of business of the firm,
(c) The names of any other places where the firm carries on business,
(d) the date when each partner joined the firm,
(e) the names in full and permanent addresses of the partners, and
(f) the duration of the firm.

(2) The statement shall be signed by all the partners, or by their agents specially authorised in this behalf.

(3) Each person signing the statement shall also verify it in the manner prescribed.

(4) A firm name shall not contain any of the following words, namely: -

'Crown', Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or words expressing or implying the sanction, approval or patronage of Government except when the State Government signifies its consent to the use of such words as part of the firm-name by order in writing.

Question 5

"Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration." Explain. Discuss the various disabilities or disadvantages that a non-registered partnership firm can face in brief? [May 19, 4 Marks] [May 18, 4 Marks] [MTP Oct 19, 4 Marks] [Dec-20, 2Marks] CS LLM Arjun Chhabra (Law Maven) [RTP May 21] [MTP Nov 21, 4 Marks] [Nov-22, 6 Marks] [June 24 – 6 Marks]

Related Question: What are the consequences of Non-Registration of a Partnership Firm? Discuss. [May 18, 4 Marks] [MTP Oct 19, 4 Marks]

Answer:

Under the English Law, the registration of firms is compulsory. Therefore, there is a penalty for non-registration of firms. But the Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration. The registration of a partnership is optional and one partner cannot compel another partner to join in the registration of the firm. It is not essential that the firm should be registered from the very beginning.

However, under Section 69, non-registration of partnership gives rise to a number of disabilities which are as follows:

I. No suit in a civil court by firm or other co-partners against third party: The firm or any other person on its behalf cannot bring an action against the third party for breach of contract entered into by the firm, unless the firm is registered and the persons suing are or have been shown in

the register of firms as partners in the firm.

II. No relief to partners for set-off of claim: If an action is brought against the firm by a third party, then neither the firm nor the partner can claim any set-off, if the suit be valued for more than 100 or pursue other proceedings to enforce the rights arising from any contract.

III. Aggrieved partner cannot bring legal action against other partner or the firm: A Partner of an unregistered Firm cannot sue the Firm or any other Partner of the Firm to enforce a right (1) arising from a contract, or (2) conferred by the Partnership Act.

IV. Third party can sue the firm: In case of an unregistered firm, an action can be brought against the firm by a third party.

Related Question: What are the rights which won't be affected by Non-Registration of Partnership firm? [Dec-20, 2Marks] [Nov-22, 6 Marks]

Answer:

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

1. The right of third parties to sue the firm or any partner.
2. The right of partners to sue for the dissolution of the firm or for the settlement of the accounts of a dissolved firm, or for realization of the property of a dissolved firm.
3. The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.
4. The right to sue or claim a set-off if the value of suit does not exceed Rs. 100 in value.
5. The right to suit and proceeding instituted by legal representatives or heirs of the deceased partner of a firm for account s of the firm or to realise the property of the firm.

Question 6

A & Co. is registered as a partnership firm in 2015 with A, B and C partners. In 2016, A dies. In 2017, B and C sue X in the name and on behalf of A & Co., without fresh registration. Decide whether the suit is maintainable. Whether your answer would be same if in 2017 B and C had taken a new partner D and then filed a suit against X without fresh registration? [RTP May 18] CS LLM Arjun Chhabra

Answer:

As regards the question whether in the case of a registered firm (whose business was carried on after its dissolution by death of one of the partners), a suit can be filed by the remaining partners in respect of any subsequent dealings or transactions without notifying to the Registrar of Firms, the changes in the constitution of the firm, it was decided that the remaining partners should sue in respect of such subsequent dealings or transactions even though the firm was not registered again after such dissolution and no notice of the partner was given to the Registrar.

The test applied in these cases was whether the plaintiff satisfied the only two requirements of Section 69 (2) of the Act namely,

a) the suit must be instituted by or on behalf of the firm which had been registered;
b) the person suing had been shown as partner in the register of firms.

In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.

Now, in 2017, B and C had taken a new partner, D, and then filed a suit against X without fresh registration. Where a new partner is introduced, the fact is to be notified to Registrar who shall make a record of the notice in the entry relating to the firm in the Register of firms. Therefore, the firm cannot sue as D's (new partner's) name has not been entered in the register of firms.

It was pointed out that in the second requirement, the phrase "person suing" means persons in the sense of individuals whose names appear in the register as partners and who must be all partners in the firm at the date of the suit.

Related Question: P & Co. is registered as a partnership firm in 2018 with A, B and P as partners dealing in sale and purchase of motor vehicles. In April 2019, A dies. Now only B and P continue the firm and same business with same firm name P & Co.
In the month of December 2019, firm felt the need of expansion of business and sharing the burden of expenditure and investment. They thought of hiring a new partner with a mutual consent with each other. Hence in December 2019, the firm took a new partner S in the firm P & Co.

The firm has supplied large amount of material to one of the clients Mr. X for business purposes. In spite of regular reminders, X failed to pay the debts due to the firm.

In January 2020, firm filed a case against X in the name and behalf of P & Co. without fresh registration. With reference to Indian Partnership Act, 1932, discuss if the suit filed by the firm is maintainable? [MTP Nov 22 - 6 Marks]

Answer:
In the instant case, since the fresh registration has not been taken after introduction of new partner S, the firm P & Co. will be considered as unregistered firm. Hence the firm which is not registered cannot file a case against the third party. Hence the firm P & Co. cannot sue X.

Related Question: P, X, Y and Z are partners in a registered firm A & Co. X died and P retired. Y and Z filed a suit against W in the name and on behalf of firm without notifying to the Registrar of firms about the changes in the constitution of the firm. Is the suit maintainable? [RTP May 19] – Same answer as Above

Related/Expected Question: A, B and C are Partners of an Unregistered Firm. D owes this Firm. ₹ 1,000 on a contract. The Firm files a suit against D. The suit is dismissed for non-registration of Firm. The Firm is registered later on. Can the Firm now successfully bring the suit against D?

Answer:
Firm must be registered at the time of instituting the suit. Since in the given case, a fresh suit is contemplated and at this time the Firm is a Registered Firm, the Firm will be entitled to institute a valid suit.

Related/Expected Question: A & B purchased a taxi to ply in Partnership. They plied the taxi for a year when A, without the consent of B, disposed of the taxi which brought the Partnership to an end. B brought an action to recover his share in the sale proceeds. A resisted B's claim on the ground that the Firm was not registered. Will B succeed in his claim?

Answer: Yes
U/s 69, a Partner of an Unregistered Firm cannot enforce any of his contractual or legal rights against any other Partner. But non-registration of a Firm does not affect a Partner's right to seek settlement of accounts of a dissolved Firm.

Related/Expected Question: X, Y and Z are Partners in Unregistered Firm. X steals the property of the Firm. Y filed a suit against X. X registered Y's claim on the plea that the Firm was not registered. Will Y succeed?

Answer:
Sec.69(1) prohibits the institution of civil suit and not criminal suit.

Related Question: M/s XYZ & Company is a partnership firm. The firm is an unregistered firm. The firm has purchased some iron rods from another partnership firm M/s LMN & Company which is also an unregistered firm. M/s XYZ & Company could not pay the price within the time as decided. M/s LMN & Company has filed the suit against M/s XYZ & Company for recovery of price. State under the provisions of the Indian Partnership Act, 1932:

(a) Whether M/s LMN & Company can file the suit against M/s XYZ & Company?

(b) What would be your answer, in case M/s XYZ & Company is a registered firm while M/s LMN & Company is an unregistered firm?

(c) What would be your answer, in case M/s XYZ & Company is an unregistered firm while M/s LMN & Company is a registered firm?

Answer:
According to provisions of Section 69 of the Indian Partnership Act, 1932 an unregistered firm cannot file a suit against a third party to enforce any right arising from contract, e.g., for the recovery of the price of goods supplied. But this section does not prohibit a third party to file suit against the unregistered firm or its partners.

(a) On the basis of above, M/s LMN & Company cannot file the suit against M/s XYZ & Company as M/s LMN & Company is an unregistered firm.

(b) In case M/s XYZ & Company is a registered firm while M/s LMN & Company is an unregistered firm, the answer would remain same as in point a) above.

(c) In case M/s LMN & Company is a registered firm, it can file the suit against M/s XYZ & Company.

Expected case study on registration of firm

A and B were partners in an unregistered firm. A clause in the partnership deed provided that in case of any dispute between the partners, the matter will be referred to arbitration. After some time, a dispute arose between the partners, and A appointed an arbitrator. But B did not give his consent and refused to refer the dispute to the arbitrator. A filed a suit against B that he (B) should be compelled to refer the dispute to the arbitration as there was an arbitration clause in the partnership deed. B contended that the firm was not registered, and, therefore, the suit should be dismissed. It was held that the suit was not maintainable as the firm was unregistered. [Jagdish C. Gupta v. Kajaria Traders]

CS LLM Arjun Chhabra
(Law Maven)
Mo: 62 62 62 143 8 / 9552 52 143 8

CHAPTER – 5: The Limited Liability Partnership

Question 1 "LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership". Explain. [May 19, 5 Marks] [July 21 – 5 Marks] [MTP Oct 20 – 5 Marks] [MTP Oct 21 – 5 Marks] [RTP May 22 - Marks] *CS* LLM Arjun Chhabra

Related Question: A LLP is a new form of legal business entity with limited liability. It's an alternative corporate business vehicle that only gives the benefits of limited liability at low compliance cost but allows its partners the flexibility of organizing their internal structure as a traditional partnership. Keeping in view of above, define the following characteristics of LLP.
(i) Body Corporate
(ii) Mutual Agency
(iii) Foreign LLPs
(iv) Artificial legal person **(June 24 - 6 Marks)**

Answer:

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership

Limited Liability: Every partner of an LLP is, for the purpose of the business of LLP, the agent of the LLP, but not of other partners (Section 26 of the LLP Act, 2008). The liability of the partners will be limited to their agreed contribution in the LLP, while the LLP itself will be liable for the full extent of its assets.

Flexibility of a partnership: The LLP 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. Owing to flexibility in its structure and operation, the LLP is a suitable vehicle for small enterprises and for investment by venture capital.

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

(i) a limited liability partnership registered under this Act;

(ii) a limited liability partnership incorporated outside India; and

(iii) a company incorporated outside India,

but does not include

(i) a corporation sole;

(ii) a co-operative society registered under any law for the time being in force; and

(iii) any other body corporate (not being a company as defined in clause (20) of section 2 of the Companies Act, 2013 or a limited liability partnership as defined in this Act), which the Central Government may, by notification in the Official Gazette, specify in this behalf.

Business [Section 2(e)]: "Business" includes every trade, profession, service and occupation except any activity which the Central Government may, by notification, exclude.

Question 2

What is Small Limited Liability Partnership as per Limited Liability Partnership (Amendment) Act, 2021? [RTP Nov 22 - 5 Marks] [RTP June 23]

Answer:

"Small Limited Liability Partnership [Section 2(ta) of the Limited Liability Partnership Act, 2008]: It means a Limited Liability Partnership—

(i) the contribution of which, does not exceed twenty-five lakh rupees or such higher amount, not exceeding five crore rupees, as may be prescribed; and

(ii) the turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed; or

(iii) which meets such other requirements as may be prescribed and fulfils such terms and conditions as may be prescribed.

Question 3 Who are the individuals which shall not be capable of becoming a partner of a Limited Liability Partnership? [RTP Nov 19] CS LLM Arjun Chhabra

Answer:

Partners (Section 5 of Limited Liability Partnership Act, 2008): Any individual or body corporate may be a partner in a LLP.

However, an individual shall not be capable of becoming a partner of a LLP, if—

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending.

For knowledge: An Undischarged Insolvent or Undischarged Bankrupt is a person who has submitted a bankruptcy petition to the court of law and whose debts are still being assessed by the court. The court will allow the person to submit all the persons assets and liabilities, list of creditors, list of debtors and will evaluate the persons ability to pay off, which creditors to pay, how much to pay etc.

Until the court decides all of the above, the person is an undischarged bankrupt or insolvent. Once the court passes appropriate orders - the bankruptcy petition is disposed off and the person will be discharged by a court. Once this is done, the person becomes a discharged bankrupt or discharged insolvent.

Question 4

What do you mean by Designated Partner? Whether it is mandatory to appoint Designated partner in a LLP? [MTP Oct 19, 5 Marks] [RTP Nov 20] [RTP May 21] [MTP Nov 21 – 5 Marks]

Answer:

Designated partners (Section 7)

(1) Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India:

Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

Explanation. For the purposes of this section, the term resident in India means a person who has stayed in India for a period of not less than one hundred and twenty days during the financial year.

(2) Subject to the provisions of sub-section (1),

(i) if the incorporation document

(a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or

(b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;

(3) An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

(4) Every limited liability partnership shall file with the Registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

(5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

(6) Every designated partner of a limited liability partnership shall obtain a Designated Partners Identification Number (DPIN) from the Central Government and the provisions of sections 153 to 159 (both inclusive) of the Companies Act, 2013 shall apply mutatis mutandis for the said purpose.

Question 5

Explain the incorporation by registration of a Limited Liability Partnership and its essential elements under the LLP Act, 2008. [May 22- 5 Marks]

Explain the essential elements to incorporate a Limited Liability Partnership and the steps involved therein under the LLP Act, 2008. [Nov 18, 5 Marks] CS LLM Arjun Chhabra

Related Question: What are the essential elements to form a LLP in India as per the LLP Act, 2008? [May 18, 5 Marks] [RTP Nov 18]

Related Question: State the meaning of Limited Liability Partnership (LLP). What are the relevant steps to incorporate LLP? [MTP March 18, 5 Marks] [MTP Oct 18, 5 marks] [MTP April 19, 5 Marks]

Answer:

Meaning: A LLP is a new form of legal business entity with limited liability. It is an alternative corporate business vehicle that not only gives the benefits of limited liability at low compliance cost but allows its partners the flexibility of organising their internal structure as a traditional partnership.

The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of the partners will be limited.

Incorporation by registration (Section 12 of LLP Act, 2008):

(1) When the requirements imposed by clauses (b) and (c) of sub-section (1) of section 11 have been complied with, the Registrar shall retain the incorporation document and, unless the requirement imposed by clause (a) of that sub-section has not been complied with, he shall, within a period of 14 days—

(a) register the incorporation document; and

(b) give a certificate that the LLP is incorporated by the name specified therein.

(2) The Registrar may accept the statement delivered under clause (c) of sub-section (1) of section 11 as sufficient evidence that the requirement imposed by clause (a) of that sub section has been complied with.

(3) The certificate issued under clause (b) of sub-section (1) shall be signed by the Registrar and authenticated by his official seal.

(4) The certificate shall be conclusive evidence that the LLP is incorporated by the name specified therein.

Essential elements to incorporate Limited Liability Partnership (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. Atleast 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 Ministry of Corporate Affairs.
(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.

Steps to incorporate LLP:

1. Name reservation:
   - The first step to incorporate Limited Liability Partnership (LLP) is reservation of name of LLP.
   - Applicant has to file e-Form 1, for ascertaining availability and reservation of the name of a LLP business.

2. Incorporate LLP:
   - After reserving a name, user has to file e- Form 2 for incorporating a new Limited Liability Partnership (LLP).
   - e-Form 2 contains the details of LLP proposed to be incorporated, partners'/ designated partners' details and consent of the partners/designated partners to act as partners/ designated partners
3. LLP Agreement
   - 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-Form 3 within 30 days of incorporation of LLP.

Question 6

What do you mean by Limited Liability Partnership (LLP)? What are the advantages for forming a LLP for doing business? [RTP May 18] [RTP May 19] CS LLM Arjun Chhabra

Answer:

Meaning- Same as above.
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.
Characteristic/Salient Features of LLP
1. LLP is a body corporate: Section 2(1)(d) of the LLP Act, 2008 provides that a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its

partners and shall have perpetual succession. Therefore, any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP.

Section 3 of LLP Act provides that a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.

2. Perpetual Succession: The LLP can continue its existence irrespective of changes in partners. Death, insanity, retirement or insolvency of partners has no impact on the existence of LLP. It is capable of entering into contracts and holding property in its own name.

3. Separate Legal Entity: The LLP 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. 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.

6. 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.

7. 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. Such contribution may be of tangible or intangible nature or both.

8. 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.

9. 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.

10. Business for Profit Only: The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit. Thus, LLP cannot be formed for charitable or non-economic purpose.

Advantages of LLP form- LLP form is a form of business model which:

- is organized and operates on the basis of an agreement.
- Provide flexibility without imposing detailed legal and procedural requirements.
- Easy to form
- All partners enjoy limited liability
- Flexible capital structure
- Easy to dissolve

Question 7

State the rules regarding the registered office of a Limited Liability Partnership (LLP) and change therein as per provisions of the Limited Liability Partnership Act. 2008. [Dec 21 – 5 Marks]

Answer:

Registered office of LLP and change therein (Section 13):

1. Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received.
2. A document may be served on a limited liability partnership or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed, at the registered office and any other address specifically declared by the limited liability partnership for the purpose in such form and manner as may be prescribed.
3. A limited liability partnership may change the place of its registered office and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.
4. If any default is made in complying with the requirements of this section, the limited liability partnership and its every partner shall be liable to a penalty of five hundred rupees for each day during which the default continues, subject to a maximum of fifty thousand rupees for the limited liability partnership and its every partner.

Question 8

What are the effects of registration of LLP? [RTP Nov 19] CS LLM Arjun Chhabra

Answer:

Effect of registration (Section 14 of Limited Liability Partnership Act, 2008):

On registration, a LLP shall, by its name, be capable of—

(a) suing and being sued;

(b) acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
(c) having a common seal, if it decides to have one; and
(d) doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.

Name (Section 15):

(1) Every limited liability partnership shall have either the words limited liability partnership or the acronym LLP as the last words of its name.

(2) No limited liability partnership shall be registered by a name which, in the opinion of the Central Government is
a) undesirable; or
b) identical or too nearly resembles to that of any other limited liability partnership or a company or a registered trade mark of any other person under the Trade Marks Act, 1999.

Reservation of name (Section 16):

1. A person may apply in such form and manner and accompanied by such fee as may be prescribed tothe Registrar for the reservation of a name set out in the application as-
   a) the name of a proposed LP; or
   b) the name to which a LLP proposes to change its name.
2. Upon receipt of an application under sub-section (1) and on payment of the prescribed fee, the Registrar may, if he is satisfied, subject to the rules prescribed by the Central Government in the matter, that the name to be reserved is not one which may be rejected on any ground referred to in sub-section (2) of section 15, reserve the name for a period of 3 months from the date of intimation by the Registrar.

Question 9

What is the procedure for changing the name of Limited Liability Partnership (LLP) under the LLP Act, 2008? [RTP May 20] CS LLM Arjun Chhabra

Answer:

Change of name of LLP (Section 17):

(1) Notwithstanding anything contained in sections 15 and 16, if through inadvertence or otherwise, a limited liability partnership, on its first registration or on its registration by a new body corporate, its registered name;"name, is registered by a name which is identical with or too nearly resembles to—

(a) that of any other limited liability partnership or a company; or
(b) a registered trade mark of a proprietor under the Trade Marks Act, 1999, as is likely to be mistaken for it, then on an application of such limited liability partnership or proprietor referred to in clauses (a) and (b) respectively or a company, the Central Government may direct that such limited liability partnership to change its name or new name within a period of three months from the date of issue of such direction:

Provided that an application of the proprietor of the registered trade marks shall be maintainable within a period of three years from the date of incorporation or registration or change of name of the limited liability partnership under this Act.

(2) Where a limited liability partnership changes its name or obtains a new name under sub-section (1), it shall within a period of fifteen days from the date of such change, give notice of the change to Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and within thirty days of such change in the certificate of incorporation, such limited liability partnership shall change its name in the limited liability partnership agreement.

(3) If the limited liability partnership is in default in complying with any direction given under sub-section (1), the Central Government shall allot a new name to the limited liability partnership in such manner as may be prescribed and the Registrar shall enter the new name in the register of limited liability partnerships in place of the old name and issue a fresh certificate of incorporation with new name, which the limited liability partnership shall use thereafter:

Provided that nothing contained in this sub-section shall prevent a limited liability partnership from subsequently changing its name in accordance with the provisions of section 16.

Question 10

List the differences between the Limited Liability Partnership and the Limited Liability Company. [RTP May 18] [MTP March 19] CS LLM Arjun Chhabra

Related Question: "A LLP (Limited Liability Partnership) is a type of partnership in which participants' liability is fixed to the amount of money they invest whereas a LLC (Limited Liability Private/Public Company) is a tightly held business entity that incorporates the qualities of a corporation and a partnership".

In line of above statement clearly elaborate the difference between LLP and LLC. [Nov 22- 5 Marks]

Answer:

	Basis	LLP	Limited Liability Company (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 contract agreement between the partners.	The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).

4.	Name	Name of the LLP to contain the word "Limited Liability partnership" or "LLP" as suffix.	Name of the public company to contain the word "limited" and Pvt. Co. to contain the word "Private limited" as suffix.
5.	No. of members/partners	Minimum – 2 members Maximum – No such limit on the members in the Act. The members of the LLP can be individuals/or body corporate through the nominees.	Private company: Minimum – 2 members Maximum 200 members Public company: Minimum – 7 members Maximum – No such limit on the members. Members can be organizations, trusts, another business form or individuals.
6.	Liability of members/partners	Liability of a partners is limited to the extent of agreed contribution in case of intention is 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 by the shareholders.
8.	Minimum number of directors/designated partners	Minimum 2 designated partners.	Pvt. Co. – 2 directors Public co. – 3 directors

Question 11

Differentiate between a LLP and a partnership firm? [RTP Nov 18] [RTP Nov 21] CS LLM Arjun Chhabra

Answer:

	Basis	LLP	Partnership firm
1.	Regulating Act	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
2.	Body corporate	It is a body corporate.	It is not a body corporate,
3.	Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4.	Creation	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.
5.	Registration	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary. Only the registered partnership firm can sue the third parties.
6.	Perpetual succession	The death, insanity, retirement or insolvency of the partner(s) does not affect its existence of LLP. Members may join or leave but its existence continues forever.	The death, insanity, retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7.	Name	Name of the LLP to contain the word limited liability partners (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8.	Liability	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.
9.	Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10.	Designated partners	At least two designated partners and atleast one	There is no provision for such partners under the Indian partnership Act, 1932.

Chapter – 6: The Companies Act, 2013

Company and foreign Company [Section 2 (20)]

Question 1

Mike Limited company incorporated in India having Liaison office at Singapore. Explain in detail meaning of Foreign Company and analysis on whether Mike Limited would be called as Foreign Company as it established a Liaison office at Singapore as per the provisions of the Companies Act, 2013? [Dec 20 - 3 Marks]

Answers:

Foreign company [Section 2 (42)]	Company [Section2 (20)]
Means any company or body corporate incorporated outside India which, — (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner.	Means a company incorporated under this Act or under any previous company law.

In the instant case mike limited incorporated in India having liasion office at Singapore.

In the light of the above provision and facts of the case we conclude that Mike limited cannot be called as foreign company because the basic condition to be called as foreign company is that the company must be incorporated outside India. In the present case Mike limited is incorporated in India i.e. incorporated under this Act (Companies Act, 2013) or under any previous company law. Therefore, mike limited can be called as company but cannot be called as foreign company.

Related Question: Mike LLC incorporated in Singapore having an office in Pune, India. Analyse whether Mike LLC would be called as a foreign company as per the provisions of the Companies Act, 2013? Also explain the meaning of foreign company. [Nov 22 - 3 Marks]

Answer: Provision same as above

Mike LLC is incorporated in Singapore and having a place of business in Pune, India. Since, Mike LLC is incorporated outside India and having a Place of business in India, hence it is a foreign Company.

Private Company [Section 2(68)]

Question 2

Jagannath Oils Limited is a public company and having 220 members of which 25 members were employee in the company during the period 1st April, 2006 to 28th June 2016. They were allotted shares in Jagannath Oils Limited first time on 1st July, 2007 which were sold by them 1st August, 2016. After some time, on 1st December, 2016, each of those 25 members acquired shares in Jagannath Oils Limited which they are holding till date. Now company wants to convert itself into a private company. State with reasons:

(I) Whether Jagannath Oils Limited is required to reduce the number of members.

(II) Would your answer be different if above 25 members were the employee in Jagannath Oils Limited for the period from 1st April, 2006 to 28th June, 2017? [MTP Nov 21 - 4 Marks] [RTP May 22]

Answer:

According to Section 2(68) of Companies Act, 2013, "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles, —

(a) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that—

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company.

(I) Following the provisions of Section 2(68), 25 members were employees of the company but not during present membership which was started from 1st December 2016 i.e. after the date on which these 25 members were ceased to the employee in Jagannath Oils Limited. Hence, they will be considered as members for the purpose of the limit of 200 members. The company is required to reduce the number of members before converting it into a private company.

(II) On the other hand, if those 25 members were ceased to be employee on 28th June 2017, they were employee at the time of getting present membership. Hence, they will not be counted as members for the purpose of the limit of 200 members and the total number of members for the purpose of this sub-section will be 195. Therefore, Jagannath Oils Limited is not required to reduce the number of members before converting it into a private company.

Related Question: Flora Fauna Limited was registered as a public company. There are 230 members in the company as noted below: . [MTP March 19, 3 Marks] [RTP May 19] CS LLM Arjun Chhabra

Directors and their relatives	190
Employees	15
Ex-Employees (Shares were allotted when they were employees	10
5 couples holding shares jointly in the name of husband and wife (5*2)	10
Others	5

The Board of Directors of the company propose to convert it into a private company. Also advise whether reduction in the number of members is necessary

Answer: Provision same as above

In the instant case, Flora Fauna Limited may be converted into a private company only if the total members of the company are limited to 200.

Total Number of members

(i)	Directors and their relatives	190
(ii)	5 Couples (5x1)	5
(iii)	Others	5
	Total	200

Therefore, there is no need for reduction in the number of members since existing number of members are 200 which does not exceed maximum limit of 200.

Related Question: ABC Limited was registered as a public company. There were 245 members in the company. Their details are as follows:

Directors and their relatives	190
Employees	15
Ex — employees (shares were allotted when they were employees)	20
Others (Including 10 joint holders holding shares jointly in the name of father and son)	20

The Board of directors of the company propose to convert it into a private company. Advice whether reduction in the number of members is necessary for conversion. [Jan 21 – 4 Marks]

Answer: Provision same as above

In the instant case, ABC Limited may be converted into a private company only if the total members of the company are limited to 200. Total Number of members-

(i)	Directors and their relatives	190
(ii)	Others (10 joint holders holding shares in the name of father and son)	10
	Total	200

Therefore, there is no need for reduction in the number of members since existing number of members are 200 which does not exceed maximum limit of 200.

Holding & Subsidiary Company [Section 2 (46) & (87)

Question 3

Explain the classification of the companies on the basis of control as per The Companies Act, 2013? [July 21 – 6 Marks] [RTP June 23]

Answer:

The classification of the companies on the basis of control as per The Companies Act, 2013 are as follows:

(a) Holding and subsidiary companies:

Holding company [Section 2(46)]

A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies.

For the purposes of this clause, the expression "company" includes any body corporate.

Subsidiary company [Section 2(87)]

in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies

Status of private company, which is subsidiary to public company [Section 2(71)]

A Private company, which is subsidiary of a public company shall be deemed to be public company for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.

(b) Associate company [Section 2(6)]

In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation. — For the purpose of this clause —

(a) "Significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;

(b)" Joint venture'' means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

"Total Share Capital", means the aggregate of the -

(a) Paid-up equity share capital; and
(b) Convertible preference share capital.

Related Question: BC Private Limited and its subsidiary KL private limited are holding 90,000 and 70,000 shares respectively in PQ Private Limited. The paid-up share capital of PQ Private Limited is 30 Lakhs (3 Lakhs equity shares of 10 each fully paid). Analyse with reference to provisions of the Companies Act, 2013 whether PQ Private Limited is a subsidiary of BC Private Limited. What would be your answer if KL Private Limited is holding 1,60,000 shares in PQ Private Limited and no shares are held by BC Private Limited in PQ Private Limited? [Dec 21 – 3 Marks] [RTP Dec 23]

Answer: Provision same as above given u/s 2(87)

In the instant case, as BC private limited together with its subsidiary KL private limited holding more than one-half of the total paid up share capital (voting power) in PQ private limited i.e., 90000 equity shares are held by BC private limited plus 70000 equity shares are held by KL private limited respectively in PQ private limited amounting to 160000 equity share out of total equity shares of 300000.

In the light of the above provision and facts of the case:

1. PQ private limited is subsidiary of BC private limited.
2. In the second case also, the answer would be the same as above, i.e., PQ private limited is subsidiary of BC private limited irrespective of the fact that no shares are held by BC Private Limited in PQ Private Limited.

Related Question: The paid-up capital of Ram Private Limited is Rs.10 Crores in the form of 7,00,000 Equity Shares of Rs.100 each and 3,00,000 Preference Shares of Rs. 100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited. State with reason, Whether Ram Private Limited is subsidiary of Lakhan Private Limited? (MTP Oct 21 - 4 Marks)

Answer: Provision same as above given u/s 2(87)

It is to be noted that Preference share capital will also be considered if preference shareholders have same voting rights as equity shareholders.

As in the given problem it is not clear that whether Preference Shares are having voting rights or not, it can be taken that there is no voting right with these shares. On the basis of provisions of Section 2(87) and facts of the given problem, Lakhan Private Limited is holding 3,00,000 Equity Shares of total equity paid up share capital of Ram Private Limited.

Therefore, as Lakhan Private Limited does not exercises or controls more than one-half of the total voting power in Ram Private Limited, Ram Private Limited is not subsidiary of Lakhan Private Limited.

Related Question: A company, ABC limited as on 31.03.2023 had a paid-up capital of Rs. 1 lakh (10,000 equity shares of Rs. 10 each). In June 2023, ABC limited had issued additional 10,000 equity shares of Rs.10 each which was fully subscribed. Out of 10,000 shares, 5,000 of these shares were issued to XYZ private limited company. XYZ is a holding company of PQR private limited by having control over the composition of its board of directors.

Now, PQR private limited claims the status of being a subsidiary of ABC limited as being a subsidiary of its subsidiary i.e. XYZ private limited. Examine the validity of the claim of PQR private limited.

State the relationship if any, between ABC limited & XYZ private limited as per the provisions of The Companies Act, 2013. **(June 24 - 7 Marks)**

Related Question: The paid-up capital of Darshan Photographs Private Limited is Rs. 1 Crores in the form of 50,000 Equity Shares of Rs. 100 each and 50,000 Preference Shares (not carrying any voting rights) of Rs. 100 each. Shadow Evening Private Limited is holding 25,000 Equity Shares in Darshan Photographs Private Limited. State with reason,

(a) Whether Darshan Photographs Private Limited is subsidiary of Shadow Evening Private Limited?

(b) Whether your answer would be different in case Shadow Evening Private Limited is holding 25,000 Equity Shares and 5,000 Preference Shares in Darshan Photographs Private Limited? **(MTP 1 June 24 - 7 Marks)**

Answer: Provision same as above given u/s 2(87)

It is to be noted that Preference share capital will also be considered if preference shareholders have same voting rights as equity shareholders.

In the instant case, Darshan Photographs Private Limited is having paid-up capital of Rs. 1 Crores in the form of 50,000 Equity Shares of Rs. 100 each and 50,000 Preference Shares of Rs. 100 each. Shadow Evening Private Limited is holding 25,000 Equity Shares in Darshan Photographs Private Limited.

(a) On the basis of provisions of Section 2(87) and facts of the given problem, Shadow Evening Private Limited is holding one - half of total equity paid up share capital of Darshan Photographs Private Limited. Therefore, Darshan Photographs Private Limited cannot be considered as subsidiary company of Shadow Evening Private Limited as for being subsidiary company other company should control more than one - half of the total voting power.

(b) Answer would remain same even if Shadow Evening Private Limited is also holding 5,000 preference shares as they do not have voting rights.

Government Company [Section 2(45)]

Question 4

SK Infrastructure Limited has a paid-up share capital divided into 6,00,000 equity shares of INR 100 each 2,00,000 equity shares of the company are held by Central Government and 1,20,000

equity shares are held by Government of Maharashtra Explain with reference to relevant provisions of the Companies Act, 2013, whether SK Infrastructure Limited can be treated as Government Company. [Jan 21- 3 Marks] [RTP May 21]

Answer:

Government company [Section 2(45)]: Government Company means any company in which not less than 51% of the paid-up share capital is held by-

(i) the Central Government, or

(ii) by any State Government or Governments, or

(iii) partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

Explanation: For the purposes of this clause, the" paid up share capital" shall be construed as "total voting power," where shares with differential voting rights have been issued.

In the present case, SK Infrastructure Limited shall be treated as a Government Company because the Central Government and the Government of Maharashtra both are holding 53.33% equity shares of SK Infrastructure Limited (3,20,00,000/6,00,000×100 = 53.33%) which is more than 51% of the paid-up share capital SK Infrastructure Limited.

Related Question: Narendra Motors Limited is a government company. Shah Auto Private Limited is a private company having share capital of ten crores in the form of ten lacs shares of Rs. 100 each. Narendra Motors Limited is holding five lacs five thousand shares in Shah Auto Private Limited. Shah Auto Private Limited claimed the status of Government Company. Advise as legal advisor, whether Shah Auto Private Limited is government company under the provisions of Companies Act, 2013? [RTP Nov 21] [RTP Dec 23]

Answer: Provision – Section 2(45) & Section 2(87) as given above

By virtue of provisions of Section 2(87) of Companies Act, 2013, Shah Auto Private Limited is a subsidiary company of Narendra Motors Limited because Narendra Motors Limited is holding more than one-half of the total voting power in Shah Auto Private Limited.

Further as per Section 2(45), a subsidiary company of Government Company is also termed as Government Company. Hence, Shah Auto Private Limited being subsidiary of Narendra Motors Limited will also be considered as Government Company.

Related Question: The State Government of X, a state in the country is holding 48 lakh shares of Y Limited. The paid up capital of Y Limited is Rs. 9.5 crore (95 lakh shares of Rs. 10 each). Y Limited directly holds 2,50,600 shares of Z Private Limited which is having share capital of Rs. 5 crore in the form of 5 lakh shares of Rs. 100 each. Z Private Limited claimed the status of a

subsidiary company of Y Limited as well as a Government company. Advise as a legal advisor, whether Z Private Limited is a subsidiary company of Y Limited as well as a Government company under the provisions of the Companies Act, 2013? **(Dec 23 - 4 Marks)**

Answer: Provision – Section 2(45) & Section 2(87) as given above

In the instant case, the State Government of X, a state in the country is holding 48 Lakh shares in Y Limited which is below 51% of the paid up share capital of Y Limited i.e. 48.45 Lakh shares (51% of 95 Lakh shares). Hence Y Limited is not a Government Company-

Further, Y Limited directly holds 2,50,600 shares in Z Private Limited, which is more than one-half of the total shares of Z Limited i.e. 2,50,000 shares (50% of 5 Lakh shares). Thus, the Company controls more than one-half of the total voting power of Z Limited. Hence Z Private Limited is a subsidiary of Y Limited.

Therefore, we can conclude that Z Private Limited is a subsidiary of Y Limited but not a Government Company since Y Limited is not a Government Company.

Related Question: XYZ is a company incorporated under The Companies Act, 2013. The paid up share capital of the company is held by others as on 31.03.2024 is as under:

(1) Government of India **20%**

(2) Life Insurance Corporation of India (Public Institution) **8%**

(3) Government of Tamil Nadu **10%**

(4) Government of Rajasthan **10%**

(5) ABC Limited (owned by Government Company) **15%**

As per above shareholding, state whether XYZ limited be called a government company under the provisions of The Companies Act, 2013. (June 24 - 4 Marks)

Associate Company [Section 2(6)]

Question 5

ABC Limited has allotted swifts with voting rights to XYZ Limited worth Rs. 15 Crores and issued Non-Convertible Debentures worth Rs. 40 Crores during the Financial Year 2019-20. After that total Paid-up Equity Share Capital of the company is Rs. 100 Crores and Non-Convertible Debentures Stands at Rs. 120 Crores. Define the Meaning of Associate Company and comment on whether ABC Limited and XYZ Limited would be called Associate Company as per provisions of the Companies Act, 2013? [Dec 20 4 Marks] [RTP May 21]

Answer: Provision – Section 2(6) as given above

In the light of the above provision and facts of the case, as XYZ Ltd. hold 15 crore equity shares with voting right in total of 100 crore paid up equity of ABC Ltd. which is only 15 percent and

holding of non-convertible debenture of Rs. 40 crores in ABC Ltd. will not be taken into account for observing the relationship of associate company.

Therefore, ABC Limited and XYZ Limited cannot be called Associate Company as per provisions of the Companies Act, 2013.

Related Question: Manicar Limited has allotted equity shares with voting rights to Nanicar Limited worth Rs. 10 Crores and issued Non-Convertible Debentures worth Rs.30 Crores during the Financial Year 2017-18. After that total Paid-up Equity Share Capital of the company is Rs.100 Crores and Non-Convertible Debentures stands at Rs.150 Crores.
Define the Meaning of Associate Company and comment on whether Manicar Limited and Nanicar Limited would be called Associate Company as per the provisions of the Companies Act, 2013? [MTP Nov 21 – 3 Marks]

Answer: Provision – Section 2(6) as given above
In the given case, as Manicar Ltd. has allotted equity shares with voting rights to Nanicar Limited of Rs. 10 crores, which is less than requisite control of 20% of total share capital (i.e. 100 crore) to have a significant influence of Nanicar Ltd. Since the said requirement is not complied, therefore Manicar Ltd. and Nanicar Ltd. are not associate companies as per the Companies Act, 2013.

Further holding/allotment of non-convertible debentures has no relevance for ascertaining significant influence. Hence the issue of non-convertible debentures will not make both the companies Associate Company.

Related Question: ABC Limited has allotted equity shares with voting rights to XYZ Limited worth Rs. 15 crores and convertible preference shares worth Rs. 10 crores during the financial year 2022-23. After that the total share capital of the company is Rs. 100 crores. Comment on whether XYZ Limited would be called an Associate Company as per the provisions of the Companies Act, 2013? Also define an Associate Company. (June 23) (4 Marks)

Answer: Associate company [Section 2(6) of the Companies Act, 2013] 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 expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement.

The term "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

In the instant case, ABC Limited has allotted equity shares with voting rights to XYZ Limited worth & 15 crore and convertible preference shares worth Rs.10 crore during the financial year 2022-23 out of the total share capital of ABC Limited of & 100 crore.

Since XYZ Limited is holding only 15% significant influence R 15 crore equity shares with voting rights) in ABC Limited, which is less than twenty per cent, XYZ Limited is not an Associate company of ABC Limited.

Important Note: It can be assumed that the convertible preference shareholders are having voting rights and due to this, XYZ Limited is holding overall 25% paid up share capital in ABC Limited (with voting rights). Hence, XYZ limited is having significant control over ABC Limited and therefore XYZ is an Associate company of ABC Limited.

Small Company [Section 2(85)]

Small Company means a company, other than a public company—

- paid-up share capital of which does not exceed four crore rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees and
- turnover of which as per profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Limits	Till 31st March, 2021	1st April 2021 till 14th September, 2022	15th September 2022 onwards
Paid-up share capital	Maximum paid-up share capital can be Rs. 50 Lakhs	Maximum paid-up share capital is increased to Rs. 2 Crores	Maximum paid-up share capital is increased to Rs. 4 Crores
Turnover (In the immediately preceding financial year)	Maximum turnover for qualifying as a Small Company was Rs. 2 Crores	Maximum turnover for qualifying as a Small Company is increased to Rs. 20 Crores	Maximum turnover for qualifying as a Small Company is increased to Rs. 40 Crores

Provided that nothing in this clause shall apply to—
(A) a holding company or a subsidiary company;
(B) a company registered under section 8; or
(C) a company or body corporate governed by any special Act;

Related Question: ABC Private Limited is a registered company under the Companies Act, 2013 with paid up capital of Rs. 35 lakhs and turnover of Rs. 2.5 crores. Whether the ABC Private Limited can avail the status of a Small Company in accordance with the provisions of the Companies Act, 2013? Also discuss the meaning of a Small Company. (June 23 - 3 Marks)

Answer:
In the instant case, since the paid-up capital of ABC Private Limited is Rs. 35 Lakhs and turnover is Rs. 2.5 crore, it can avail the status of a small company as both the requirements with regard to paid-up share capital as well as turnover are fulfilled by the Company.

Classification of Companies on the basis of liability [Section 2 (21) (22) (92)]

Question 6

Explain the meaning of Guarantee Company? State the similarities and dissimilarities between a 'Guarantee Company' and 'Company Limited by Shares.' [MTP March 18, 6 Marks] [MTP April 19, 6 Marks] [July 21 – 3 Marks]

Answer:

Meaning of Guarantee Company: Section 2(21) of the Companies Act, 2013 defines a Company Limited by Guarantee as a company

- having the liability of its members
- limited by the memorandum
- to such amount
- as the members may respectively undertake
- to contribute
- to the assets of the company
- in the event of its being wound up.

Thus, the liability of the members of a guarantee company is limited to a stipulated amount in terms of individual guarantees given by members and mentioned in the memorandum. The members cannot be called upon to contribute more than such stipulated amount for which each member has given a guarantee in the memorandum of association.

Similarities and dis-similarities between the Guarantee Company and the Company limited by shares:

1. The common features between a "guarantee company" and the "company limited share" are legal entity and limited liability.
2. In case of a company limited by shares, the liability of its members is limited to the amount remaining unpaid on the shares held by them.
3. Both these types of companies have to state this fact in their memorandum that the members' liability is limited.

However, the dissimilarities between a 'guarantee company' and 'company limited by shares' is

1. In the former case the members will be called upon to discharge their liability only after commencement of the winding up of the company and only to the extent of amounts guaranteed by them respectively;
2. Whereas in the case of a company limited by shares, the members may be called upon to discharge their liability at any time, either during the life of the company or during the course of its winding up.

Related Question: Nolimit Private Company is incorporated as unlimited company having share capital of Rs. 10,00,000. One of its creditors, Mr. Samuel filed a suit against a shareholder Mr. Innocent for recovery of his debt against Nolimit Private Company. Mr. Innocent has given his plea in the court that he is not liable as he is just a shareholder. Explain, whether Mr. Samuel will be successful in recovering his dues from Mr. Innocent? [RTP Nov 22]

Answer:

Section 2(92) of Companies Act, 2013, provides that an unlimited company means

- a company not having any limit on the liability of its members.
- The liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members.
- In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share.
- So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company.
- The creditors can institute proceedings for winding up of the company for their claims.
- The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited.

On the basis of above, it can be said that Mr. Samuel cannot directly claim his dues against the company from Mr. Innocent, the shareholder of the company even the company is an unlimited company. Mr. Innocent is liable upto his share capital. His unlimited liability will arise when official liquidator calls the members for their contribution towards the liabilities and debts of the company at the time of winding up of company.

Listed & Unlisted Companies [Section 2 (52)]

Question 7

Explain listed company and unlisted company as per the provisions of the Companies Act, 2013. [Nov 22 - 2 Marks]

Listed company: As per the definition given in the section 2(52) of the Companies Act, 2013, it is a company which has any of its securities listed on any recognised stock exchange.

Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

Whereas the word securities as per the section 2(81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

Unlisted company means company other than listed company.

One Person Company [Section 2(62)]

Question 8

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? [RTP Nov 18] [May 18, 6 Marks] [MTP Oct 19, 6 Marks] [RTP Nov 20] CS LLM Arjun Chhabra

Related Question: Ram wants to incorporate a company in which he will be the only member. According to provisions of The Companies Act, 2013, what type of company can be incorporated? What are the salient features of this type of company? **(June 24 - 7 Marks)**

Answer:

One Person Company (OPC) [Section 2(62) of the Companies Act, 2013]: The Act defines one person company (OPC) as a company which has only one person as a member.

Rules regarding its membership:

- Only one person as member.
- 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 WHETHER RESIDENT IN INDIA (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) OR OTHERWISE
    - 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

Related Question: Naveen incorporated a "One Person Company" making his sister Navita as the nominee. Navita is leaving India permanently due to her marriage abroad. Due to this fact, she is withdrawing her consent of nomination in the said One Person Company. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below.

(a) If Navita is leaving India permanently, is it mandatory for her to withdraw her nomination in the said One Person Company?

(b) If Navita maintained the status of Resident of India after her marriage, then can she continue her nomination in the said One Person Company? [RTP May 20] [July 21- 4 Marks] CS LLM Arjun Chhabra

Answer:

Answer as per old Provision (Before Amendment)

(A) Yes, it is mandatory for Navita to withdraw her nomination in the said OPC as she is leaving India permanently as only a natural person who is an Indian citizen and resident in India shall be a nominee in OPC.

(B) Yes, Navita can continue her nomination in the said OPC, if she maintained the status of Resident of India after her marriage by staying in India for a period of not less than 182 days during the immediately preceding financial year.

Answer as per new Provision (After Amendment) – Students appearing in examinations shall write this answer in the exams if this question comes in exams.

Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA OR OTHERWISE

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

In the light of the above provision and facts of the case:

(a) Navita is not required to withdraw her nomination because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

(b) Navita is not required to maintain status of resident in India as per the amended provision of Companies Act, 2013. Therefore, she can continue to be nominee of OPC even after her marriage without maintaining the status of resident in India.

Related Question: Mr. A is an Indian citizen and his stay in India during immediately preceding financial year is for 115 days. He appoints Mr. B as his nominee who is a foreign citizen but has stayed in India for 130 days during immediately preceding financial year.

(i) Is Mr. A eligible to be incorporated as a One Person Company (OPC). If yes, can he give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member.

(ii) If Mr. A has contravened any of the provisions of the Act, what are the consequences? [RTP Nov 21]

Answer:

Institute's Answer in RTP Nov 21

As per the provisions of the Companies Act, 2013, only a natural person who is an Indian citizen and resident in India (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) –

- Shall be eligible to incorporate an OPC
- Shall be a nominee for the sole member.

(i) In the given case, though Mr. A is an Indian citizen, his stay in India during the immediately preceding previous year is only 115 days which is below the requirement of 120 days. Hence Mr. A is not eligible to incorporate an OPC.

Also, even though Mr. B's name is mentioned in the memorandum of Association as nominee and his stay in India during the immediately preceding financial year is more than 120 days, he is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

(ii) Since Mr. A is not eligible to incorporate a One Person Company (OPC), he will be contravening the provisions, if he incorporates one. He shall be punishable with fine which may extent to ten thousand rupees and with a further fine which may extent to One thousand rupees every day after the first during which such contravention occurs.

CS LLM Arjun Chhabra's Answer:

Students appearing in examinations shall write this answer in the exams if this question comes in exams.

As per the provisions of the Companies Act, 2013, Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) OR OTHERWISE

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

(i) In the given case, Mr. A being a natural person and Indian citizen is eligible to incorporate OPC even though he is not resident in India during immediately preceding financial year because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

Mr. A cannot give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member because Mr. B is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

(ii) If Mr. A has contravened any of the provisions of the Act, following are the consequences:

- He shall be punishable with fine which may extent to ten thousand rupees and
- with a further fine which may extent to One thousand rupees every day after the first during which such contravention occurs.

Related Question: Mr. R is an Indian citizen, and his stay in India during the immediately preceding financial year is for 130 days. He appoints Mr. S, a foreign citizen, as his nominee, who has stayed in India for 125 days during the immediately preceding financial year. Is Mr. R eligible to be incorporated as a One-Person Company (OPC)? If yes, can he give the name of Mr. S in the Memorandum of Association as his nominee? Justify your answers with relevant provisions of the Companies Act, 2013. [May 22 - 3 Marks]

Answer:

Institute's Answer

In the given case, Mr. R is an Indian citizen and his stay in India during the immediately preceding financial year is 130 days which is above the requirement of 120 days. Hence, Mr. R is eligible to incorporate an OPC.

Also, even though Mr. S's name is mentioned in the Memorandum of Association as nominee and his stay in India during the immediately preceding financial year is more than 120 days, he is a foreign citizen and not an Indian citizen. Hence, S's name cannot be given as nominee in the memorandum.

CS LLM Arjun Chhabra's Answer:

Students appearing in examinations shall write this answer in the exams if this question comes in exams.

Provision: Same as above

In the given case, Mr. R being an Indian citizen is eligible to incorporate an OPC irrespective of the fact whether he is resident in India (a person who has stayed in India for a period of not less than one hundred and twenty days during the immediately preceding financial year) or not because from 1st April 2021 i.e after Companies (Incorporation) Second Amendment Rules,2021:

Only a natural person who is an Indian citizen whether resident in India or otherwise
(a) shall be eligible to incorporate a One Person Company;
(b) shall be a nominee for the sole member of a One Person Company.

Mr. R cannot give the name of Mr. S in the memorandum of Association as his nominee to become the member after Mr. R's incapacity to become a member because Mr. S is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

Related Question: Rohan incorporated a "One Person Company". The memorandum of OPC indicates the name of his brother Vinod as the nominee of OPC. However, Vinod is starting his new business in abroad and needs to leave India permanently. Due to this fact, Vinod is withdrawing his consent of nomination in the said One Person Company. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below:-

I. If is it mandatory for Vinod to withdraw his nomination in the said OPC

II. Can Rohan make his 17-year-old son as a nominee in such a case. [MTP May 22 – 4 Marks]

Answer: Institute's Answer in MTP May 22

(A) Yes, it is mandatory for Vinod to withdraw his nomination in the said OPC as he is leaving India permanently as only a natural person who is an Indian citizen and resident in India or otherwise and has stayed in India for a period of not less than 120 days during the immediately preceding financial year shall be a nominee in OPC.

Since Vinod will not satisfy this condition, so he needs to withdraw his nomination.

(B) No, Rohan cannot make his 17 year old son as a nominee of his OPC as no minor shall become member or nominee of the OPC or can hold beneficial interest.

CS LLM Arjun Chhabra's Answer:

Students appearing in examinations shall write this answer in the exams if this question comes in exams.

As per the provisions of the Companies Act, 2013, Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) OR OTHERWISE

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

In the light of the above provision and facts of the case:

(a) Vinod is not required to withdraw his nomination because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

Vinod is not required to maintain status of resident in India as per the amended provision of Companies Act, 2013. Therefore he can continue to be nominee of OPC even after her marriage without maintaining the status of resident in India.

(b) No, Rohan cannot make his 17-year-old son as a nominee of his OPC as no minor shall become member or nominee of the OPC or can hold beneficial interest.

Related Question: Mr. Anil formed a One Person Company (OPC) on 16 April, 2018 for manufacturing electric cars. The turnover of the OPC for the financial year ended 31 March, 2019 was about Rs. 2.25 crores. His friend Sunil wanted to invest in his One Person Company (OPC), so they decided to convert it voluntarily into a private limited company. Can Anil do so, as per the provisions of the Companies Act, 2013? [Nov 22 - 4 Marks]

Answer:

Section 2(62) of the Companies Act, 2013 defines one person company as a company which has only one person as a member. However, a private company shall have minimum 2 members without any restriction on the share capital or turnover. If OPC is converted into private company Mr. Anil and Mr. Sunil both can be the members of the company and investment from Mr. Sunil can be accepted.

A One Person Company can voluntarily convert itself into a private company by following the compliances given under the Companies Act, 2013.

In the instant case, OPC formed by Mr. Anil can be voluntarily converted into a private company by following the compliances given under the Companies Act, 2013. Here, the information given relating to turnover for the financial year ended 31st March, 2019 is immaterial.

Formation of Companies with Charitable Objects, etc. – Section 8

Question 9

What do you mean by "Companies with charitable purpose" (section 8) under the Companies Act, 2013? Mention the conditions of the issue and revocation of the licence of such company by the government. [May 19, 6 Marks]

Related Question: State whether a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt? [RTP May 18] [RTP May 19] [MTP Nov 22 – 6 Marks] CS LLM Arjun Chhabra

Answer:

Formation of companies with charitable purpose etc. (Section 8 company):

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to

- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.

Such company intends to apply its profit in

- promoting its objects and
- prohibiting the payment of any dividend to its members.

Examples of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

Power of Central government to issue the license–

(i) Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.

(ii) The registrar shall on application register such person or association of persons as a company under this section.

(iii) On registration the company shall enjoy same privileges and obligations as of a limited company.

Revocation of license: The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

Related Question: What are the significant points of Section 8 Company which are not applicable for other companies? Briefly explain with reference to provisions of the Companies Act, 2013. [Dec-20, 6 Marks]

Answer:

Section 8 Company- Significant points

- Formed for the promotion of commerce, art, science, religion, charity, protection environment, sports, etc.
- Requirement of minimum share capital does not apply.
- Uses its profits for the promotion of the objective for which formed.
- Does not declare dividend to members.
- Operates under a special licence from Central Government.
- Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.
- Licence revoked if conditions contravened.
- On revocation, Central Government may direct it to
  - Converts its status and change its name
  - Wind – up
  - Amalgamate with another company having similar object.
- Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- Requirement of minimum number of directors, independent directors etc. does not apply.
- Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- A partnership firm can be a member of Section 8 company.

Related Question: A company registered under section 8 of the Companies Act, 2013, earned huge profit during the financial year ended on 31st March, 2018 due to some favorable 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. [Nov 18, 4 Marks] [MTP Oct 19, 4 Marks] CS LLM Arjun Chhabra

Answer: Provision same as above

Hence, a company that is registered under section 8 of the Companies Act, 2013, is prohibited from the payment of any dividend to its members.

In the present case, the company in question is a section 8 company and hence it cannot declare dividend. Thus, the contention of members is incorrect.

Related Question: A, B and C has decided to set up a new club with name of ABC club having objects to promote welfare of Christian society. They planned to do charitable work or social activity for promoting the art work of economically weaker section of Christian society. The company obtained the status of section 8 company and started operating from 1st April, 2017 onwards.

However, on 30th September 2019, it was observed that ABC club was violating the objects of its objective clause due to which it was granted the status of section 8 Company under the Companies Act 2013.

Discuss what powers can be exercised by the central government against ABC club, in such a case?

Answer:

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, education, sports etc. Such company intends to apply its profit in promoting its objects. Section 8 companies are registered by the Registrar only when a license is issued by the Central Government to them.

Since ABC Club was a Section 8 company and it was observed on 30 th September, 2019 that it had started violating the objects of its objective clause. Hence in such a situation the following powers can be exercised by the Central Government:

(i) 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.

(ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. However, no such order shall be made unless the company is given a reasonable opportunity of being heard.

(iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation 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.

Related Question: A Company registered under Section 8 of the Companies Act, 2013, has been consistently making profits for the past 5 years after a major change in the management structure. Few members contented that they are entitled to receive dividends. Can the company distribute dividend? If yes, what is the maximum percentage of dividend that can be distributed as per provisions of the Companies Act, 2013? Also, to discuss this along with other regular matters, the company kept a general meeting by giving only 14 days' notice. Is this valid? [RTP Nov 22]

Answer:

A company registered under Section 8 of the Companies Act, 2013 is prohibited from the payment of any dividends to its members.

Hence in the given case, the contention of the members to distribute dividend from the profits earned is wrong.

Also, Section 8 company is allowed to call a general meeting by giving 14 days instead of 21 days.

Classification of Capital

Question 10

What do you mean by the term capital? Describe its classification in the domain of Company Law. [Dec 21 – 6 Marks]

Answer:

The term capital has a variety of meanings. In relation to a company limited by shares, the word capital means share capital, i.e., the capital or figure in terms of so many rupees divided into shares of a fixed amount.

In other words, the contributions of persons to the common stock of the company form the capital of the company. The proportion of the capital to which each member is entitled is his share. A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.

In the domain of Company Law, the term 'capital' is used in the following senses:

1) "Authorised capital" or "Nominal capital": It means the Capital as is authorized by the MOA of a Company to be the maximum amount of Share Capital of the Company. [Sec.2(8)]

It is also known as registered capital of company upon which it pays the stamp duty.

It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

2) Issued capital: It means such Capital as the Company issues from time to time for subscription. [Sec.2(50)]. Issued Capital also includes Shares allotted for consideration other than cash.

It is that part of authorised capital which is offered by the company for subscription.

3) Subscribed capital: It means that part of the capital, which is for the time being subscribed by the members of a company.

It is the nominal amount of shares taken up by the public. Where any notice, advertisement or other social communication or any business letter, billhead or letter paper of a company states the authorised capital, the subscribed and paid-up capital must also be stated in equally conspicuous characters.

Default in this regard will make the company and every officer who is in default liable to pay the penalty extending ₹10,000 and ₹5,000, respectively.

4) Called-up capital: It means the capital that has been called for payment. It is the total amount called upon the shares issued.

5) Paid-up capital: Paid-up capital is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

Related Question: Explain the kinds of share capital as per the Companies Act, 2013. Also explain when the capital shall be deemed to be preference capital. **(Dec 23 - 6 Marks)**

Answer:

Kinds of share capital: Section 43 of the Companies Act, 2013 provides the kinds of share capital. According to the said provision, the share capital of a company limited by shares shall be of two kinds, namely: —

1. "Equity share capital", with reference to any company limited by shares, means all share capital which is not preference share capital;

Equity share capital— can be

(i) with voting rights; or

(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed;

2. "Preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(b) repayment, in the case of a winding up or repayment of capital, of the amount of the share

capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

Capital shall be deemed to be preference capital, despite that it is entitled to either or both of the following rights, namely: —

(a) that in **respect of dividends,** in addition to the preferential rights to the amounts specified as above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in **respect of capital,** in addition to the preferential right to the repayment, on a winding up, of the amounts specified above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Memorandum of Association

Question 11

"The Memorandum of Association is a charter of a company". Discuss. Also explain in brief the contents of Memorandum of Association. [Nov 19, 6 Marks] [MTP Oct 21 - 6 Marks] CS LLM Arjun Chhabra

Answer:

The Memorandum of Association of company is in fact its charter; it defines its constitution and the scope of the powers of the company with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

Object of registering a memorandum of association:

- It contains the object for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go.
- It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities it can engage in.
  A memorandum is a public document under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.
- The shareholders must know the purposes for which his money can be used by the company and what risks he is taking in making the investment.

A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum. If it does so, it would be *ultra vires* the company and void.

Contents of the memorandum: The memorandum of a company shall state—

(a) the name of the company (Name Clause) with the last word "Limited" in the case of 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.

(b) the State in which the registered office of the company (Registered Office clause) is to be situated;

(c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof (Object clause);

(d) the liability of members of the company (Liability clause), whether limited or unlimited

(e) the amount of authorized capital (Capital Clause) divided into share of fixed amounts and the number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.

(f) the desire of the subscribers to be formed into a company. The Memorandum shall conclude with the association clause. Every subscriber to the Memorandum shall take at least one share, and shall write against his name, the number of shares taken by him. (Association Clause)

Doctrine Of Constructive Notice [Negative Doctrine]

Applicability of doctrine

This doctrine operates in favour of the company, i.e. it creates a presumption in favour of the company. It operates against the persons dealing with the company.

Effect of the doctrine

Once registered the memorandum and articles become public documents (Sec. 399) Therefore, every person dealing with the company is presumed to have read the memorandum and articles. Further, it is presumed that he has understood the provisions of memorandum and articles correctly, i.e. in the right sense [T.R. Pratt (Bombay) Ltd. v E.D. Sassoon & Co. Ltd.]

- Thus, it is required of every person to apprise himself with the requirements of the memorandum and articles, before entering into any contract with a company.
- The doctrine prevents any person dealing with the company from alleging that he did not know the provisions contained in the articles or memorandum.
- If a person enters into a contract with the company in contravention of the provisions of the memorandum and articles, he cannot enforce such a contract.

Example: Kotla Venakataswamy v C Rammurthi

- The articles of a company required that all the documents and deeds of the company shall be signed by MD, the secretary and a working director of the company.
- A mortgage deed was signed by the secretary and a working director only.
- It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilised for the benefit of the company.

Doctrine Of Ultra Vires

Question 12

Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? [RTP Nov 18] [MTP Oct 18, 6 Marks] [RTP May 20] [MTP Nov 21 – 6 Marks]

Answer:

Meaning and effect of the doctrine

• Ultra means 'beyond' or 'in excess of' and vires means 'powers'. Thus, ultra vires means an act or transaction beyond or in excess of the powers of the company.

• An act or transaction shall be ultra vires if -

- it is not permitted or authorised by the Companies Act, 2013; and
- it falls outside the object clause of memorandum.

Ashbury Railway Carriage & Iron Company Ltd. v Richie

Extract of object clause. The object clause of an industrial company contained the following objects besides some other objects:

(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, work and sell mine, minerals, land and buildings.

Nature of contract made by company: The company entered into a contract with Richie, for the financing of a construction of a railway line in Belgium.

Decision of the Court: The Court held that the word 'general contractors' had to be given a restricted meaning.

- Only such contracts could be covered in the term 'general contractors' as are in some way related or connected with mechanical engineering.
- Therefore, the company could not finance the construction of a railway line by alleging that such a business falls under the business of general contractors.

Effects of ultra vires transactions:

1. The transaction is void ab initio: An act which is ultra vires the company is void and is of no legal effect.

   Neither the company nor the other contracting party derives any right under an ultra vires contract.

   Even ratification of an ultra vires contract by the whole body of shareholders does not make an ultra vires contract valid or enforceable.

2. No ratification or estoppel: An ultra vires contract cannot become valid by estoppel or ratification.
3. Injunction against the company: Any member may obtain an injunction order from the Court, i.e. an order of the Court restraining the company from proceeding with the ultra vires contract.

4. Personal liability of directors: If funds of the company are misapplied or wasted by entering into ultra vires transactions, the directors shall be personally liable to the company for breach of trust.

Effects of acts ultra vires the directors or articles:

- Acts ultra vires the directors or articles means those acts which are beyond the powers of the directors or powers given under the articles.
- Such acts are not altogether void and inoperative. Such acts may be ratified by the members.

Related Question: 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.? [May 18, 4 Marks] CS LLM Arjun Chhabra

Answer:

Meaning and effect of the doctrine

• Ultra means 'beyond' or 'in excess of' and vires means 'powers'. Thus, ultra vires means an act or transaction beyond or in excess of the powers of the company.

• An act or transaction shall be ultra vires if -

- it is not permitted or authorised by the Companies Act, 2013; and
- it falls outside the object clause of memorandum.

The transaction is void ab initio:

An act which is ultra vires the company is void and is of no legal effect.

Neither the company nor the other contracting party derives any right under an ultra vires contract.

So is being the act void in nature, there being no existence of the contract between the Ravi Private Ltd. and Mudra Finance Ltd. Therefore, the company Ravi Private Ltd. is liable to pay this debt amount upto the limit prescribed in the memorandum.

Remedy available to the Mudra Finance Ltd.: The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, a company which deals with the other, is deemed to know about the powers of the company.

So, Mudra Finance Ltd. can claim for the amount within the expressed limit prescribed in its memorandum.

Related Question: AK Private Limited has borrowed 36 crores from BK Finance Limited. However, as per the memorandum of AK Private Limited, the maximum borrowing power of the company is ₹30 crores. Examine whether AK Private Limited is liable to pay this debt? State the remedy, if any, available to BK Finance Limited. [Dec 21, 4 Marks] CS LLM Arjun Chhabra

Answer: Provision same as above

So, BK Finance Limited can claim for the amount within the expressed limit prescribed in its memorandum. i.e., ₹30 crores only.

Related Question: The Object Clause of Memorandum of Association of ABC Pvt. Ltd. authorized the company to carry on the business of trading in Fruits and Vegetables. The Directors of the company in recently concluded Board Meeting decided and accordingly, the company ordered for fish for the purpose of trading. FSH Limited supplied fish to ABC Pvt. Ltd. worth Rs. 36 Lakhs. The members of the company convened an extraordinary general meeting and negated the proposal of the Board of Directors on the ground of ultra vires acts. FSH Limited being aggrieved of the said decision of ABC Pvt Ltd. seeks your advice. Advise them. [MTP Aug 18, 4 Marks] [May 22 – 6 Marks]

Answer: Provision same as answer no.11 above

Therefore, the resolution passed by the Board of Director ABC Pvt. Limited for an ultra vires transaction is invalid. As a result of this, the transaction entered into the supply of fish with FSH Limited is not legal and is void.

Related Question: ABC Limited was into sale and purchase of iron rods. This was the main object of the company mentioned in the Memorandum of Association. The company entered into a contract with Mr. John for some finance related work. Later on, the company repudiated the contract as being ultra vires.

With reference to the same, briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? [RTP May 22 - 6 Marks] [RTP June 23]

Answer:

An act which is ultra vires the company being void, cannot be ratified even by the unanimous consent of all the shareholders of the company.

Hence in the given case, ABC Limited cannot enter into a contract outside the purview of its object clause of memorandum of association as it becomes ultra vires and thus null and void.

Expected Questions based on Doctrine of Ultra Vires

Related/Expected Question: The objects clause of the Memorandum of Association of the XYZ (Pvt.) Ltd., New Delhi, authorized to do trading in mangoes. The company, however, entered into partnership with Mr. A and traded in mangoes and incurred liabilities to Mr. A. The Company, subsequently, refused to admit the liability to 'A' on the ground of 'ultra vires' the Company'.

Advice whether stand of the company is legally valid and if so, gives reasons in support of your answer.

Answer:

- The company is not liable to A.
- Since the partnership agreement for trading in mangoes is an ultra vires contract, and an ultra vires contract is void ab initio, and is not binding on the company or the other party;
- Since such power can be legally exercised by the company only if the object clause of memorandum expressly authorises the company to enter into partnership.

Doctrine Of Indoor Management [Positive Doctrine]

Question 13

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'. [RTP Nov 20] [Jan 21- 6 Marks]

Related Question: State the limitations of the doctrine of indoor management under the Companies Act, 2013. [May 18, 3 Marks] CS LLM Arjun Chhabra

Answer

Purpose of doctrine

The doctrine of indoor management operates in favour of the outsiders, i.e. this doctrine creates a presumption in favour of the outsiders.

Meaning of the doctrine

- As per this doctrine, outsiders dealing with the company are not required to enquire into the internal management of the company.
- Outsiders dealing with the company are entitled to assume that as far as internal proceedings of the company are concerned, everything has been done regularly. It is a presumption and therefore rebuttable.
- Thus, the doctrine protects an innocent outsider from any irregularity present in the working of the company (provided he had actual knowledge of the memorandum and articles, and he complied with the requirements contained in the memorandum and articles).

Effect of the doctrine

If a contract is entered into on behalf of the company by any director or officer of the company, it is enforceable against the company, if provisions contained in the memorandum and articles have been complied with, even though while entering into such a contract, some internal irregularity had arisen of which the outsider was unaware.

Royal British Bank v Turquand

Facts of the case

- Mr Turquand was the official manager (liquidator) of the insolvent Railway Company.
- 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 the power to borrow up to an amount authorised by a company resolution.
- A resolution had been passed but did not specify how much the directors could borrow.

Judgment

- Bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed.
- Articles of association were registered, so there was constructive notice.
- But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable.
- The bond was valid because there was no requirement to look into the company's internal workings.
- This is the indoor management rule, that the company's indoor affairs are the company's problem.

Exceptions to the doctrine of indoor management

1. Knowledge of irregularity: Where the persons dealing with the company have knowledge of an internal irregularity, obviously the presumption that every internal proceeding has been conducted regularly shall stand rebutted, i.e. they cannot assume that everything has been done regularly. Therefore, the benefit of doctrine of indoor management shall not be available in such a case.

Howard v Patent Ivory manufacturing Company

- The directors of a company could borrow upto £1,000 without the sanction of members in GM.
- The consent of the shareholders was required to borrow in excess of £1,000.
- The directors themselves lent £3,500 to the company.
- It was held that the directors had the notice of the internal irregularity and therefore the company was liable to them only for £1,000.

2. Negligence - Suspicious circumstances: If there are suspicious grounds surrounding a transaction, but the person dealing with the company fails to make reasonable inquiry, the benefit of doctrine of indoor management will not be available.

Anand Bihari Lal v Dinshaw & company

- An accountant of the company entered into a contract on behalf of the company with a third party to sell the property of the company.
- It was held that the third party could not assume that the accountant was authorised by the company to sell the property of the company.
- Therefore, the third party could not enforce such a contract against the company even though the third party had acted bonafide.

3. Forgery: Ruben v Great Fingall Consolidated Company

- A share certificate was issued under the common seal of the company.
- The secretary of the company had signed on the share certificate.
- However, the signatures of two directors were also required on it, which were forged by the secretary.
- The holder of the share certificate contended that he was not aware of the fact of forgery, it was not possible for him to determine whether the signatures were genuine or forged and therefore,

the certificate issued to him should be held as valid.

- The Court held that in case of forgery, there is not a defect in consent, but absence of consent, and therefore the certificate issued by way of forgery is void. Thus, the certificate was held to be invalid.

Related Question: Sound Syndicate Ltd., a public company, its articles of association empowers the managing agents to borrow both short and long term loans on behalf of the company, Mr. Liddle, the director of the company, approached Easy Finance Ltd., a non-banking finance company for a loan of Rs. 25,00,000 in name of the company.
The Lender agreed and provided the above said loan. Later on, Sound Syndicate Ltd. refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and the lender should have enquired about the same prior providing such loan hence company not liable to pay such loan.
Analyse the above situation in terms of the provisions of Doctrine of Indoor Management under the Companies Act, 2013 and examine whether the contention of Sound Syndicate Ltd. is correct or not? [May 19, 4 Marks] [MTP Oct 20 – 6 Marks] (May 22 - 4 Marks)

Answer: Provision same as above as given in answer no 12 – till meaning of doctrine
Easy Finance Ltd. being external to the company, need not enquire whether the necessary resolution was passed properly. Even if the company claim that no resolution authorizing the loan was passed, the company is bound to pay the loan to Easy Finance Ltd.

Related Question: The Articles of Association of XYZ Ltd. provides that Board of Directors has authority to issue bonds provided such issue is authorized by the shareholders by a necessary resolution in the general meeting of the company. The company was in dire need of funds and therefore, it issued the bonds to Mr. X without passing any such resolution in general meeting. Can Mr. X recover the money from the company? Decide referring the relevant provisions of the Companies Act, 2013. [RTP May 18] CS LLM Arjun Chhabra

Answer: Provision same as above
Here in this case Mr. X can recover the money from the company considering that all required formalities for the passing of the resolution have been duly complied.

Related Question: 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 an 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. [Nov 18, 3 Marks] [MTP March 19, 4 Marks] [MTP Oct 19, 3 Marks] CS LLM Arjun Chhabra

Answer: Provision same as above as given in answer no 12 – till effect of doctrine

Mr. X has made payment to Mr. Z and he (Mr. Z) gave receipt of the same to Mr. X. Thus, it will be rightful on part of Mr. X to assume that Mr. Z was also authorised to receive money on behalf of the company.

Hence, Mr. X will be free from liability for payment of goods purchased from M/s ABC Limited, as he has paid amount due to an employee of the company.

Related Question: Mr. R, a manufacturer of toys approached MNO Private Limited for supply of raw material worth Rs. 1,50,000/-. Mr. R was offered a credit period of one month. Mr. R went to the company prior to the due date and met Mr. C, an employee at the billing counter, who convinced the former that the payment can be made to him as the billing -cashier is on leave.

Mr. R paid the money and was issued a signed and sealed receipt by Mr. C. After the lapse of due date, Mr. R received a recovery notice from the company for the payment of Rs. 1,50,000/-.

Mr. R informed the company that he has already paid the above amount and being an outsider had genuine reasons to trust Mr. C who claimed to be an employee and had issued him a receipt.

The Company filed a suit against Mr. R for non-payment of dues. Discuss the fate of the suit and the liability of Mr. R towards company as on current date in consonance with the provision of the Companies Act 2013? Would your answer be different if a receipt under the company seal was not issued by Mr. C after receiving payment? [Nov 22 - 4 Marks]

Answer: Provision same as above as given in answer no 12 – till effect of doctrine + reference of case law

(i) In the instant case, Mr. R is not liable to pay the amount of ` 1,50,000 to MNO Private Limited as he had genuine reasons to trust Mr. C, an employee of the company who had issued him a signed and sealed receipt.

(ii) Liability of Mr. R in case no receipt is issued by Mr. C: Exceptions to doctrine of indoor management: Suspicion of irregularity is an exception to the doctrine of indoor management. The doctrine of indoor management, in no way, rewards those who behave negligently. It is the duty of the outsider to make necessary enquiry, if the transaction is not in the ordinary course of business.

(iii) If a receipt under the company seal was not issued by Mr. C after receiving payment, Mr. R is liable to pay the said amount as this will be deemed to be a negligence on the part of Mr. R and it is his duty to make the necessary enquiry to check that whether Mr. C is eligible to take the payment or not.

Related Question: Articles of Association of XYZ Private Limited provides that Board of Directors can take the loan upto Rs. 50,00,000 for company by passing the Board Resolution. In the case where the loan amount is in excess of the said limit, Special Resolution is required to be passed in general meeting. Due to urgent need of funds, Board of Directors applied for loan in a reputed bank for Rs. 60,00,000 without passing the Special Resolution in the general meeting. Board of Directors gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lend the money. On demanding the repayment of loan, company denied the payment as the act was ultra vires to company. Advise. [RTP May 22 - 4 Marks] [RTP June 23]

Answer: Provision same as above as given in answer no 12 – till effect of doctrine + reference of case law.

In the instant case, Articles of Association of XYZ Private Limited have taken loan from reputed bank for Rs. 60,00,000 by passing Board Resolution while Special Resolution was necessary for such amount. Board of Directors gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lends the money.

On the basis of provisions of doctrine of Indoor Management, the bank can claim the amount of his loan from the company. The bank can believe on the undertaking given by board and no need to enquire further.

Features of Company

Question 14

When a company is registered, it is clothed with a legal personality. Explain. [RTP May 18]

Answer:

When a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. Its existence is distinct and separate from that of its members. A company can own property, have bank account, raise loans, incur liabilities and enter into contracts.

a) It is at law, a person different altogether from the subscribers to the memorandum of association. Its personality is distinct and separate from the personality of those who compose it.

b) Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members.

A company is capable of owning, enjoying and disposing of property in its own name. Although the capital and assets are contributed by the shareholders, the company becomes the owner of its capital and assets. The shareholders are not the private or joint owners of the company's property.

Question 15 Mr. Sunny sold his business of cotton production to a cotton production company CPL Private Limited in which he held all the shares except one which was held by his wife. He is also the creditor in the company for a certain amount. He also got the insurance of the stock of

cotton of CPL Private Limited but in his own name not in the name of company. After one month, all the stocks of the cotton of CPL Private Limited were destroyed by fire. Mr. Sunny filed the claim for such loss with the Insurance company. State with reasons that whether the insurance company is liable to pay the claim? [MTP Nov 22 - 3 Marks]

Answer:

According to the decision taken in case of Salomon v/s Salomon & Co. Ltd., a company has separate legal entity. A company is different from its members. Further, according to the decision taken in case of Macaura v/s Northern Assurance Co. Ltd., a member or creditor does not have any insurable interest in the property of company. Members or creditors of the company cannot claim ownership in the property of company.

On the basis of above provisions and facts, it can be said Mr. Sunny and CPL Private Limited are separate entities. Mr. Sunny cannot have any insurable interest in the property of CPL Private Limited neither as member nor as creditor. Hence, the insurance company is not liable to pay to Mr. Sunny for the claim for the loss of stock by fire.

Question 16

ABC Pvt. Ltd., is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 2013 whether existence of the company has also come to the end? [RTP Nov 18]

Answer:

Death of all members of a Private Limited Company, Under the Companies Act, 2013: The most distinguishing feature of a company is its being a separate entity from the shareholders and promoters who form it. This lends stability and perpetuity to the company form of business organization. In short, a company is brought into existence by a process of law and can be terminated or wound up or brought to an end only by a process of law. Its life is not impacted by the death, insolvency or retirement of any or all shareholder(s) or director(s).

The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company by allowing the constitution and identity of shareholders to change.

In the present case, ABC Pvt. Ltd. does not cease to exist even by the death of all its shareholders. The legal process will be for the successors of the deceased shareholders to get the shares registered in their names by way of the process which is called "transmission of shares". The company will cease to exist only when it is wound up by a due process of law.

Related Question: Five persons are the only members of a private company Flower Fans Limited. All of them go in a boat on a pleasure trip into an open sea. The boat capsizes and all the 5 die being drowned.

(a) Is the private company Flower Fans Limited no longer in existence?
(b) Further is it correct to say that a company being an artificial person cannot own property and cannot sue or be sued? Explain with reference to the provisions of Companies Act, 2013. [MTP Oct 21 – 3 Marks] [RTP Nov 18] [RTP June 23]

Answer:

(a) Perpetual Succession – A company on incorporation becomes a separate legal entity. It is an artificial legal person and have perpetual succession which means even if all the members of a company die, the company still continues to exist. It has permanent existence.

In the instant case, five persons who were the only members of private company and they have died being drowned in the sea. The existence of a company is independent of the lives of its members. It has a perpetual succession. In this problem, the company will continue as a legal entity. The company's existence is in no way affected by the death of all its members.

(b) The statement given is incorrect. A company is an artificial person as it is created by a process other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual. Further, the company being a separate legal entity can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. It can sue and be sued in its own name. It can do everything which any natural person can do except be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.

Related Question: M and N holding 70% and 30% of the shares in the company. Both died in an accident. Answer with reference to the provisions of the Companies Act, 2013, what will be the legal effect on the company as both the members have died? (June 24 - 3 Marks)

Answer: Refer above provision.

Related Question: A private limited company must have a minimum of two members, while a public limited company must have at least seven members. [MTP Oct 21 – 3 Marks] [RTP Nov 18]

Answer:

Correct: Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a private company.

Related Question: Affixing of Common seal on company's documents is compulsory. [MTP March 18, 3 Marks] [MTP Oct 18, 3 Marks] [MTP April 19, 3 Marks] CS LLM Arjun Chhabra

Answer:

Incorrect: The common seal is a seal used by a corporation as the symbol of its incorporation. The Companies (Amendment) Act, 2015 has made the common seal optional by omitting the words "and a common seal" from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. 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.

Concept of Separate Legal Entity

Question 17

Mr. Raj formed a company with a capital of Rs. 50,000. He sold his business to another company for Rs. 40,000. For the payment of sale, he accepted shares worth Rs. 30,000 (3000 shares of Rs. 10 each). The balance 10,000 was considered as loan and Mr. Raj secured the amount by issue of debentures. His wife and three daughters took one share each. Owing to strike the company was wound up. The assets of the company were valued at Rs. 6000. The debts due to unsecured creditors were Rs. 8000.

Mr. Raj retained the entire sum of Rs. 6000 as part payment of loan. To this, the other creditors objected. Their contention was that a man could not own any money to himself, and the entire sum of Rs. 6000 should be paid to them.

Examine the rights of Mr. Raj and other creditors. Who will succeed? [RTP May 22 - 3 Marks]

Answer:

Separate Legal Entity: Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

The term Corporate Veil refers to the concept that members of a company are shielded from liability connected to the company's actions. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors.
In other words, they enjoy corporate insulation.

Thus, the shareholders are protected from the acts of the company. The leading case law of Saloman Vs Saloman and Company Limited, laid the foundation of concept of corporate veil or independent corporate personality. A company is a person distinct and separate from its members.

Based on the above discussion and provisions, Mr. Raj was entitled to the assets of the company as he was a secured creditor of the company and the contention of the creditors that Mr. Raj and the company are one and same person is wrong.

Lifting of Corporate Veil

Question 18

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. [Nov 18, 6 Marks] [June 23 , 6 Marks]

Answer:

Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

However, this veil can be lifted which 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 are willing to lift the corporate veil and that too, when questions of control are involved rather than merely a question of ownership.

Lifting of Corporate Veil

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- Trading with enemy: If the public interest is likely to be in jeopardy, the Court may be willing to crack the corporate shell
- Where corporate entity is used to evade or circumvent tax, the corporate veil may be lifted
- Where companies form other companies as their subsidiaries to act as their agent
- Company is formed to circumvent welfare of employees
- Where the device of incorporation is adopted for some illegal or improper purpose: 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.

Related Question: A, an assessee, had large income in the form of dividend and interest. In order to reduce his tax liability, he formed four private limited company and transferred his investments to them in exchange of their shares. The income earned by the companies was taken back by him as pretended loan. Can A be regarded as separate from the private limited company he formed? [Nov19, 3 Marks]

Related Question: Krishna, 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 Krishna as a pretended loan. This way, Krishna 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. [March 18, 4 Marks] [MTP October 18, 4 Marks] [MTP March 19, 6 Marks] [MTP April 19, 4 Marks] [RTP May 19] CS LLM Arjun Chhabra

Answer:

1. The House of Lords in *Salomon Vs Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company.
2. But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate veil and hold the persons in control of the management of its affairs liable for the acts of the company.
3. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assesse.
4. In *Dinshaw Maneckjee Petit* case it was held that the company was not a genuine company at all but merely the assessee himself disguised that the legal entity of a limited company. The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan. The court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.
5. In the instant case, the four private limited companies were formed by A, the assesse, purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assesse himself. Therefore, the whole idea of Mr. A was simply to split his income into four parts with a view to evade tax. No other business was done by the company.
6. Hence, A cannot be regarded as separate from the private limited companies he formed.

Related Question: A transport company wanted to obtain licences for its vehicles but could not obtain licences 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 company. The vehicles were to be transferred to the subsidiary company. Will the parent and the subsidiary company be treated as separate commercial units? Explain in the light of the provisions of the Companies Act, 2013. [RTP Nov 22]

Answer:

If the subsidiary is formed to act as agent of the Principal Company, it may be deemed to have lost its individuality in favour of its principal. The veil of Corporate Personality is lifted and the principal will be held liable for the acts of subsidiary company.

The facts of the case are similar to the case of Merchandise Transport Limited vs. British Transport Commission (1982), wherein a transport company wanted to obtain licences for its vehicles but could not do so, if applied in its own name. It, therefore, formed a subsidiary company, and the application for the 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 held to be one commercial unit and the application for licences was rejected.

Hence, in this case the parent and the subsidiary company shall not be treated as separate commercial units.

Related Question: Mr. Dhruv was appointed as an employee in Sunmoon Timber Private Limited on the condition that if he was to leave his employment, he will not solicit customers of the company. After some time, he was fired from company. He set up his own business under proprietorship and undercut Sunmoon Timber Private Limited's prices. On the legal advice from his legal consultant and to refrain from the provisions of breach of contract, he formed a new company under the name Seven Stars Timbers Private Limited. In this company, his wife and a friend of Mr. Dhruv were the sole shareholders and directors. They took over Dhruv's business and continued it. Sunmoon Timber Private Limited files a suit against Seven Stars Timbers Private Limited for violation of contract. Seven Stars Timbers Private Limited argued that the contract was entered between Mr. Dhruv and Sunmoon Timber Private Limited and as company has separate legal entity, Seven Stars Timbers Private Limited has not violated the terms of agreement. Explain with reasons, whether separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited will be disregarded? [RTP Nov 21]

Answer:

It was decided by the court in the case of Gilford Motor Co. Vs. Horne, that if the company is formed simply as a mere device to evade legal obligations, though this is only in limited and discrete circumstances, courts can pierce the corporate veil. In other words, if the company is mere sham or cloak, the separate legal entity can be disregarded.

On considering the decision taken in Gilford Motor Co. Vs. Horne and facts of the problem given, it is very much clear that Seven Stars Timbers Private Limited was formed just to evade legal obligations of the agreement between Mr. Dhruv and Sunmoon Timber Private Limited. Hence, Seven Stars Timbers Private Limited is just a sham or cloak and separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited should be disregarded.

Related Question: An employee Mr. Karan signed a contract with his employer company ABC Limited that he will not solicit the customers after leaving the employment from the company. But after Mr. Karan left ABC Limited, he started up his own company PQR Limited and he started soliciting the customers of ABC Limited for his own business purposes.

ABC Limited filed a case against Mr. Karan for breach of the employment contract and for soliciting their customers for own business. Mr. Karan contended that there is corporate veil between him, and his company and he should not be personally held liable for this.

In this context, the company ABC Limited seek your advice as to the meaning of corporate veil and when the veil can be lifted to make the owners liable for the acts done by a company? [RTP May 22]

Answer:

Based on the above provisions and leading case law of Gilford Motor Co. Vs Horne, the company PQR Limited was created to avoid the legal obligation arising out of the contract, therefore that employee Mr. Karan and the company PQR Limited created by him should be treated as one and thus veil between the company and that person shall be lifted. Karan has formed the only for fraud/improper conduct or to defeat the law. Hence, he shall be personally held liable for the acts of the company.

Miscellaneous

Question 19

FAREB Limited was incorporated by acquisition of FAREB & Co., a partnership firm, which was earlier involved in many illegal activities. The promoters furnished some false information and also suppressed some material facts at the time of incorporation of the company. Some members of the public (not being directors or promoters of the company) approached the National Company Law Tribunal (NCLT) against the incorporation status of FAREB Limited. NCLT is about to pass the order by directing that the liability of the members of the company shall be unlimited.

Given the above, advice on whether the above order will be legal and mention the precaution to be taken by NCLT before passing order in respect of the above as per the provisions of the Companies Act, 2013. [MTP Aug 18, 3 Marks] CS LLM Arjun Chhabra

Answer:

As per section 7(7) of the Companies Act, 2013, 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, direct that liability of the members shall be unlimited.

Hence, the order of NCLT will be legal.

Precautions: Before making any order, —

a) the company shall be given a reasonable opportunity of being heard in the matter; and

b) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

Question 20

Explain the concept of "Dormant Company" as envisaged in the Companies Act, 2013. [RTP May 18]

Answer:

Dormant Company (Section 455 of the Companies Act, 2013)

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 dormant company.

"Inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

"Significant accounting transaction" means any transaction other than –

a. payment of fees by a company to the Registrar;
b. payments made by it to fulfil the requirements of this Act or any other law;
c. allotment of shares to fulfil the requirements of this Act; and
d. Payments for maintenance of its office and records.

Related Question: MTK Private Limited is a company registered under the Companies Act, 2013 on 5th January, 2021. The company has not started its business till now. On 7th April, 2023, a notice has been received from ROC for non-filing of FORM No-INC-20A. Identify under which category MTK Private Limited company is classified. Explain the definition of the category of the company in detail. **(Dec 23 - 3 Marks)**

Answer:

"Inactive company" – Provision same as above

In the instant case, MTK Private Limited was registered on 5th January, 2021 and has not started its business till now. On 7th April, 2023, a notice has been received from ROC for non-filing of Form No. INC-20A. Since the Company has not started its business and a period of more than two years have already elapsed, it will be treated as an inactive company.

Chapter 7 - The Negotiable Instruments Act, 1881

Question 1

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

Answer

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

Question 2

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

Answer

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

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

Question 3

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

Answer

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

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

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

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

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

Question 4

Mr. X draws a cheque in favour of Mr. R for payment of his outstanding dues of Rs. 5,00,000 on 26/07/2022 with date of 1/08/2022. At the time of issuing cheque, he was having sufficient balance in his account, but on 29/07/2022 he made payment for his taxes, now his bank account is left with only Rs. 4,50,000. So, Mr. X requested Mr. R not to present the cheque for payment, but he did not accept his request. So, Mr. X instructed the bank to stop payment of cheque issued for dated 01/08/2022 in favour of Mr. R.

Decide, under the provisions of the Negotiable Instruments Act, 1881 whether the said acts of Mr. X constitute an offence? (3 Marks)

Answer

As per the facts stated in the question, Mr. x (drawer) issued the cheque to Mr. R for outstanding dues of Rs. 5,00,000 on 26/07/2022 with the postdated cheque of 1/08/2022. But on 29/07/2022, he made payment for his taxes and left with bank balance of Rs 4,50,000. Mr. X requested Mr. R not to present the cheque for payment. Later, he gave a stop payment request to the bank in respect of the cheque issued to Mr. R. Where any cheque drawn by a person for consideration is returned by the bank unpaid because of the amount of money standing to the credit of that account is insufficient to honour the cheque such person shall be deemed to have committed an offence and shall be punishable. (Section 138)

Once a cheque is issued by the drawer, a presumption under section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under section 138. Also, section 140 of the Negotiable Instruments Act, 1881, specifies absolute liability of the drawer of the cheque for commission of an offence under section 138 of the Act.

Section 140 states that it shall not be a defence in a prosecution for an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

Accordingly, the act of Mr. X, for stop payment constitutes an offence under the provisions of the Negotiable Instruments Act, 1881.

Question 5

Mr. Harsha donated Rs. 50,000 to an NGO by cheque for sponsoring the education of one child for one year. Later on he found that the NGO was a fraud and did not engage in philanthropic activities. He gave a "stop payment" instruction to his bankers and the cheque was not honoured by the bank as per his instruction.
The NGO has sent a demand notice and threatened to file a case against Harsha. Advise Mr. Harsha about the course of action available under the Negotiable Instruments Act, 1881. (3 Marks)

Answer

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

Section 138 of the Negotiable Instruments Act, 1881 deals with dishonor of cheque which is issued for the discharge, in whole or in part, of any debt or other liability. However, any cheque given as gift or donation, or as a security or in discharge of a mere moral obligation, would be considered outside the purview of section 138.

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

Question 6

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

Answer

The promissory note is an unconditional promise in writing. In the above question the amount is certain but the date and name of payee is missing, thus making it a bearer instrument. As per Reserve Bank of India Act, 1934, a promissory note cannot be made payable to bearer - whether on demand or after certain days. Hence, the instrument is illegal as per Reserve Bank of India Act, 1934 and cannot be legally enforced.

Question 7

Mr. A made endorsement of a bill of exchange amounting Rs. 50,000 to Mr. B. But, before the same could be delivered to Mr. B, Mr. A passed away. Mr. S, son of Mr. A, who was the only legal

representative of Mr. A approached Mr. B and informed him about his father's death. Now, Mr. S is willing to complete the instrument which was executed by his deceased father. Referring to the relevant provisions of the Negotiable Instruments Act, 1881, decide, whether Mr. S can complete the instrument in the above scenario? (3 Marks)

Answer

According to Section 57 of the Negotiable Instruments Act, 1881, the legal representative of a deceased person cannot negotiate by delivery only, a promissory note, bill of exchange or cheque payable to order and indorsed by the deceased but not delivered.

An agent can complete the instrument if he is authorized by the principal to do so. But, a legal representative is not an agent of the deceased.

The rights in the instrument are not transferred to the indorsee unless after the indorsement, the same has been delivered. If a person makes the indorsement of instrument but before the same could be delivered to the indorsee, the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof.

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

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

Question 8

The concept of Noting', "Protest and "Protest for better security' as per theNegotiable Instruments Act, 1881. (3 Marks)

Answer

Noting: When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each. Such note must be made within a reasonable time after dishonour, and must specify the date of dishonor, the reason if any assigned for such dishonor, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured and the notary's charges.

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

Protest for better security: When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused, may with a

reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security.

Question 9

State giving reason whether, the following instruments are valid promissory note under the Negotiable Instruments Act, 1881:

(i) X promises to pay Y, by a promissory note, a sum of 5,000, fifteen days after the death of B.

(ii) X promises to pay Y, by a promissory note, a sum of 500 and all other sum, which shall be due. (4 Marks)

Answer

As per Section 4 of the Negotiable Instrument Act, 1881, a promissory note is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

In view of provisions of Section 4, answer to given problem is as follows:

(i) If "X promises to pay Y, by a promissory note, a sum of 5,000, fifteen days after the death of B" is a valid promissory note as event is certain i.e. death of B, even though date is uncertain.

(ii) If "X promises to pay Y, by a promissory note, a sum of 500 and all other sum, which shall be due" is not a valid promissory note as sum payable is not certain.

Question 10

State giving reason whether, the following instruments are valid promissory note under the Negotiable Instruments Act, 1881:

(i) I owe you a sum of Rs. 1,000. 'A' tell to 'B'.

(ii) 'X' promises to 'Y' a sum of ` 10,000, six month after ‘Y marriage with 'Z'.

Answer

As per Section 4 of the Negotiable Instrument Act, 1881, a promissory note is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

In view of provisions of Section 4, answer to given problem is as follows:

(i) If A tell to B that he owes ` 1,000 to him, it is acknowledgement of debt and not a promissory note. Second reason for not being a promissory note is that such acknowledgement is oral not in writing.

(ii) If 'X' promises to 'Y a sum of ` 10,000, six months after 'Y marriage with 'Z', it is not a valid promissory note as it depends upon condition/ event which may or may not happen.

Question 11

A promissory note, payable at a certain period after sight, must be presented to the maker thereof for payment. Under which scenarios presentment for payment is not necessary and the instrument is

dishonoured at the due date for presentment according to the provisions of The Negotiable Instrument Act, 1881? (June 24 - 7 Marks)

Question 12

Mr. Y issued a cheque for Rs. 10,000 to Mr. Z which was dishonoured by the Bank because Y did not have enough funds in his account and has no authority to overdraw. Examine as per the provisions of the Negotiable Instruments Act, 1881 whether-
(i) Mr. Y is liable for dishonour of cheque, if yes, what are the consequences for such an offence?
(ii) What would be your answer if Y issued a cheque as a donation to Mr. Z? **(June 24 - 7 Marks)**

Related Question: Shiva gave a gift of Rs. 21,000 to his sister through a cheque issued in her favour on the occasion of Raksha Bandhan. Afterwards, Shiva informed his sister not to present the cheque for payment and also informed the bank to stop the payment. Examining the provisions of the Negotiable Instruments Act, 1881, decide whether Shiva's acts constitute an offence under section 138 of the Act? **(MTP 1 June 24 - 3 Marks)**

Answer

Section 138 of the Negotiable Instruments Act, 1881 provides where any cheque drawn by a person for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid due to insufficiency of fund, the drawer is punishable with imprisonment upto 2 years or fine upto 2 times the amount of cheque or Both. In other words, the liability under section 138 arises only if the drawer had issued the cheque to discharge a legally enforceable debt or other liability. Thus, where the drawer issues a cheque as a gift or charity, he is not liable under section 138 even if cheque is dishonoured.

In the instant case, Shiva gifted a cheque of Rs. 21,000 to his sister. Afterwards, Shiva informed his sister not to present the cheque for payment and also informed the bank to stop the payment.

On the basis of above, as the cheque was given as gift, provisions of section 138 will not be apolicable on Shiva.

Question 13

Sachin bought 1000 Kg rice from Saurabh for Rs. 1,50,000 on three months credit. For this purpose, Sachin issued a promissory note to Saurabh on the same date payable after 3 months. On the date of maturity, the promissory note was dishonoured. Saurabh filed suit for the recovery of the amount plus fees of advocate paid by him for defending the suit. Referring to the provisions of the Negotiable Instruments Act, 1881, what amount could be recovered by Saurabh from Sachin? **(RTP June 24)**

Answer

According to section 117 of the Negotiable Instruments Act, 1881, the compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:

(a) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it;
(b) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;
(c) an endorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation thereof, together with all expenses caused by the dishonour and payment;

On the basis of the above provisions of law and facts of the case, Saurabh has right to claim price of rice plus fees of advocate plus interest @18% p.a. from the date of payment until tender or realisation thereof.

Question 14

A purchased a watch from B. He issued a promissory note to B which was payable on demand but no specific place for payment was mentioned on it. On maturity, B did not present the promissory note for payment. As the promissory note was not duly presented for payment, whether A would be discharged from liability under the provisions of the Negotiable Instruments Act, 1881? **(RTP June 24)**

Answer

Section 64 of the Negotiable Instruments Act, 1881 provides, Promissory notes, bill of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as hereinafter provided. In default of such presentment, the other parties thereto are not liable thereon to such holder. Provided that where a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker thereof.

On the basis of the above law provisions and facts of the case, although non-presentment of promissory note for payment results in discharge of maker from liability but the given case is covered under the exception to section 64. Hence, A would not be discharged from liability even if the non-presentment by B as the promissory note was payable on demand and no specific place for payment was mentioned.

Question 15

What are Negotiable Instruments? Explain its essential characteristics under the Negotiable Instruments Act, 1881.

Answer

Meaning of Negotiable Instruments: Negotiable Instruments is an instrument (the word instrument means a document) which is freely transferable (by customs of trade) from one person to another by mere delivery or by indorsement and delivery. The property in such an instrument is passed to a bonafide transferee for value.

The Act does not define the term 'Negotiable Instruments'. However, Section 13 of the Act provides for only three kinds of negotiable instruments, namely bills of exchange, promissory notes and cheques, payable either to order or bearer.

Essential Characteristics of Negotiable Instruments

1. It is necessarily in writing.
2. It should be signed.
3. It is freely transferable from one person to another.
4. Holder's title is free from defects.
5. It can be transferred any number of times till its satisfaction.
6. Every negotiable instrument must contain an unconditional promise or order to pay money. The promise or order to pay must consist of money only.
7. The sum payable, the time of payment, the payee, must be certain.
8. The instrument should be delivered. Mere drawing of instrument does not create liability.

Question 16

What are Inchoate and Ambiguous Instruments under the Negotiable Instruments Act, 1881? **(MTP 1 June 24 - 7 Marks)**

Answer

Inchoate Instrument: It means an instrument that is incomplete in certain respects. The drawer/ maker/ acceptor/ indorser of a negotiable instrument may sign and deliver the instrument to another person in his capacity leaving the instrument, either wholly blank or having written on it the word incomplete. Such an instrument is called an inchoate instrument and this gives the power to its holder to make it complete by writing any amount either within limits specified therein or within the limits specified by the stamp's affixed on it. The principle of this rule of an inchoate instrument is based on the principle of estoppel.

Ambiguous Instrument: According to Section 17 of the Negotiable Instruments Act, 1881, where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thenceforward treated accordingly. Thus, an instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note, is an ambiguous instrument. In other words, such an instrument may be construed either as a promissory note, or as a bill of exchange. Section 17 provides that the holder may, at his discretion, treat it as either and the instrument shall thereafter be treated accordingly.

Question 17

Explain the Rules as to compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee covered under the Negotiable Instruments Act, 1881. **(MTP 3 June 24 -7 Marks)**

Answer

As per section 117 of the Negotiable Instruments Act, 1881, the compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:

(i) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it;
(ii) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;
(iii) an endorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation thereof, together with all expenses caused by the dishonour and payment;
(iv) when the person charged and such endorser reside at different places, the endorser is entitled to receive such sum at the current rate of exchange between the two places;
(v) the party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him.

Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill.