CA FOUNDATION

BUSINESS LAW

CA Chaitanya Jain

Published By: Physicswallah Private Limited

Physics Wallah Publication

ISBN: 978-93-48446-43-5

MRP: 829/-

Mobile App: Physics Wallah (Available on Play Store)

Website: www.pw.live

Youtube Channels: CA Intermediate by PW (@CAintermediatebyPW)

CA Wallah by PW (@CAWallahbyPW)

Commerce Wallah by PW (@CommerceWallahPW)

E-mail: publication@pw.live

Rights

All rights are reserved with the Publisher. No part of this book may be used or reproduced in any manner whatsoever without written permission from the author or publisher.

In the interest of the student community:

Circulation of soft copy of Book(s) in PDF or other equivalent format(s) through any social media channels, emails, etc. or any other channels through mobiles, laptops or desktop is a criminal offense. Anybody circulating, downloading, or storing, a soft copy of the book on his device(s) is in breach of the Copyright Act. Further photocopying of this book or any of its material is also illegal. Do not download or forward in case you come across any such soft copy material.

Disclaimer

A team of PW CA Wallah faculties and experts with a deep understanding of the subject has worked hard for the creation and curation of this book.

While the content creators, editors and publisher have used their best efforts in preparing these books. The content has been checked for accuracy. As the book is intended for educational purposes, the author shall not be responsible for any errors contained in the book.

The publication has designed the content to provide accurate and authoritative information with regard to the subject matter covered.

This book and the individual contribution contained in it are protected under Copyright Act by the publisher.

(***This book shall only be used for educational purposes.***)

PREFACE

A highly skilled professional team of CA Wallah works arduously to ensure that the students receive the best content for their CA-Foundation exams.

A plethora of CA Study Material is available in the market but CA Wallah professionals at PW are continuously working to provide supreme quality study material for the CA-Foundation students.

From the beginning, the content team comprising Subject Matter Experts, Content Creators, Reviewers, DTP operators, Proofreaders, and others is involved in shaping the material to their best knowledge and experience to produce powerful content for the students.

CA Wallah Faculties have adopted a novel style of presenting the content in easy-to-understand language and have provided the content team with expert guidance and supervision throughout the creation and curation of this book.

PW's CA Wallah strongly believes in conceptual and fun-based learning. CA Wallah provides highly exam-oriented content to bring quality and clarity to the students.

This book adopts a multi-faceted approach to mastering and understanding the concepts by having a rich diversity of questions asked in the CA-Foundation examination and equipping the students with the knowledge for this highly competitive exam.

The main objective of this book is to provide an edge to your preparation with short & crisp yet high-quality content.

BOOK FEATURES

This book, especially designed & amended for CA-Foundation aspirants, contains:

- Syllabus coverage strictly as per ICAI study Material
- ICAI Study Material Questions
- Latest RTP & MTP Questions

ABOUT THE AUTHOR

Chaitanya Jain, also known as CJ Sir, is a Chartered Accountant with a B.Com degree from Sydenham College, Mumbai and completed his schooling from Delhi Public School. With over 7 years of teaching experience, he has taught 'Business Laws' at CA Foundation and 'Corporate and Other Laws' at CA Intermediate levels. His popular series "Kanoon Ka Junoon" at CA Wallah by PW has earned him a loyal following. CJ Sir has also led financial literacy programs in the USA and UK region, making law and finance accessible to students worldwide. CJ Sir strongly believes that Chartered Accountancy equips you with unparalleled credibility and the prefix 'CA' gives you the kind of confidence that is truly empowering.

He began his CA journey in 2012, and after thorough research, knew that he had made the right choice. After clearing his final exams in November 2016, he realized he had true passion for Law. He vividly remembers an intense study session when he started scribbling on chart papers stuck on the walls of his home, with one chart for each chapter.

He created concise summaries to simplify complex legal concepts, which he also used, to teach his friends and classmates. Their positive feedback further boosted his love for teaching, and he knew he wanted to make Law the most enjoyable part of the CA journey for others, as it can be dry and vast at the same time. And that's how his journey as an Educator began.

8 years in, and his passion continues to drive him as he teaches more students with each growing day.

About the Book

This book is a work of compilation, carefully assembled with ICAI's study material as the base for the respective attempt, combined with material from past years, RTPs & MTPs as well as my creative inputs conceptualised from scratch. I like to call this book 'Super Notes by CJ' and its key features are:

- **Overview:** A bird's eye view of each chapter for quick comprehension.
- **Mind Maps:** Case laws presented in mind map diagrams for simplified understanding.
- **Star-Marked Topics:** Important and expected topics highlighted with stars for focused study.
- **Bold Key Words:** Essential keywords and sentences in bold for easy recall.
- **Key Word Tables:** Summarized tables for quick learning of key terms.
- **Engaging Techniques:** Fun learning through mnemonics, acronyms and stories.
- **Question Bank Named "Problem Kya Hai?":** Featuring practice questions from ICAI's Study Material (SM), Mock Tests Paper (MTPs), Revision Tests Paper (RTPs) & Past Year Papers (PYPs).

Happy learning!

CONTENT

1 Indian Regulatory Framework 1.1-1.15

2 The Indian Contract Act, 1872 ..... 2.1-2.208

Unit-1: Nature of Contract 2.5-2.38
Unit-2: Consideration 2.39-2.52
Unit-3: Other Essential Elements of Contract 2.53-2.84
Unit-4: Performance of Contract 2.85-2.108
Unit-5: Breach of Contract and its Remedies 2.109-2.127
Unit-6: Contingent and Quasi Contract 2.128-2.140
Unit-7: Contract of Indemnity and Guarantee 2.141-2.162
Unit-8: Bailment and Pledge 2.163-2.182
Unit-9: Agency 2.183-2.208

3 The Sale of Goods Act, 1930 ..... 3.1-3.90

Unit-1: Formation of the Contract of Sale 3.3-3.22
Unit-2: Conditions and Warranties 3.23-3.47
Unit-3: Transfer of Ownership and Delivery of Goods 3.48-3.71
Unit-4: Unpaid Seller 3.72-3.90

4 The Indian Partnership Act, 1932 ..... 4.1-4.81

Unit-1: General Nature of Partnership 4.3-4.24
Unit-2: Relations of Partners 4.25-4.60
Unit-3: Registration and Dissolution of a Firm 4.61-4.81

5 The Limited Liability Partnership Act, 2008 ..... 5.1-5.22

6 The Companies Act, 2013 ..... 6.1-6.71

7 The Negotiable Instruments Act, 1881 ..... 7.1-7.43

CHAPTER 01

Indian Regulatory Framework

TABLE OF CONTENT FOR THE CHAPTER

- INTRODUCTION 1.1
- WHAT IS LAW? 1.3
- SOURCES OF LAW 1.3
- THE PROCESS OF MAKING A LAW 1.5
- TYPES OF LAWS IN THE INDIAN LEGAL SYSTEM 1.5
- ENFORCING THE LAW 1.7
- CONSTITUTION OF THE MINISTRY OF FINANCE 1.8
- MAJOR REGULATORY BODIES 1.10
- STRUCTURE OF THE INDIAN JUDICIAL SYSTEM 1.11
- *"PROBLEM KYA HAI?"* 1.13

WHAT ARE THE QUESTIONS WE ARE GOING TO ANSWER THROUGH THIS CHAPTER?

1. What is Law?
2. Why should we study law in CA Foundation?
3. What are the Sources of Law?
4. Who has the power to make Law in India and what is the process?
5. What are the types of Law?
6. How to enforce or implement law in the country?
7. What are the different Ministries and Departments in India?

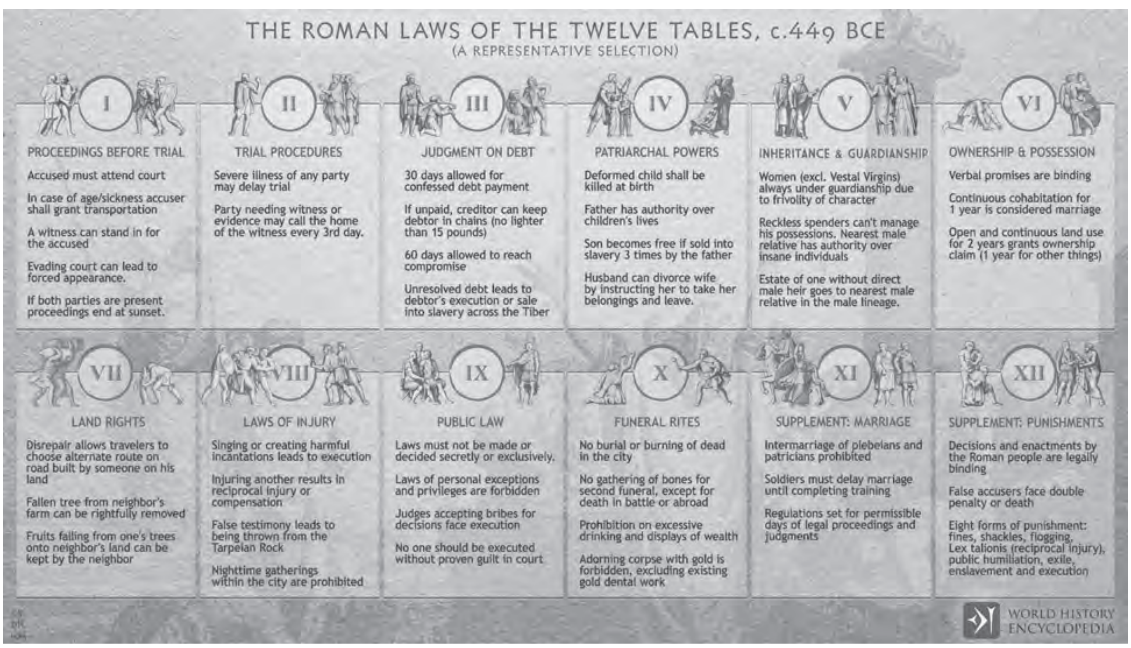
INTRODUCTION

Have you ever wondered why you are studying this subject called law?

- Awareness of law is essential to become a full-fledged Chartered Accountant.
- This is because a Chartered Accountant is the first level of contact on many legal matters.
- So, we should possess knowledge of law so that we can advise our management and clients on legal matters at a basic or threshold level.
- **Tax laws are also laws:** In order to become an expert in taxation you should possess a basic awareness of the **legal and regulatory framework of our country**.
- The **purpose** of a **regulatory framework** is to provide a **set** of **uniform rules** and **regulations** that will govern the **conduct** of **people** at **personal** as well as **business** relationships.

- Down the ages, mankind has evolved from a hunter-gatherer society through agriculture and industrial revolution to a complex social framework.
- If we talk about ancient law, on the basis of information available from different sources **"Code of Hammurabi" is known for oldest law in written form**. **King Hammurabi ruled Babylon** for the period from 1792 BC to 1758 BC.

- He carved the code on bulky stone slabs and ordered to place those stones on different places all over the city so that the public may have the knowledge of codes.
- He also appointed judges to check whether public is following the laws or not.
- In 450 BC, **a set of laws was engraved on 12 bronze tablets** in Rome which is considered as first most detailed code of any of the civilisations and called **Twelve Tables**.
- The purpose of these tables was to protect the rights of public and to provide remedy for wrongs. All the citizens of Rome were supposed to have the knowledge of these tables.



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.

SOURCES OF LAW

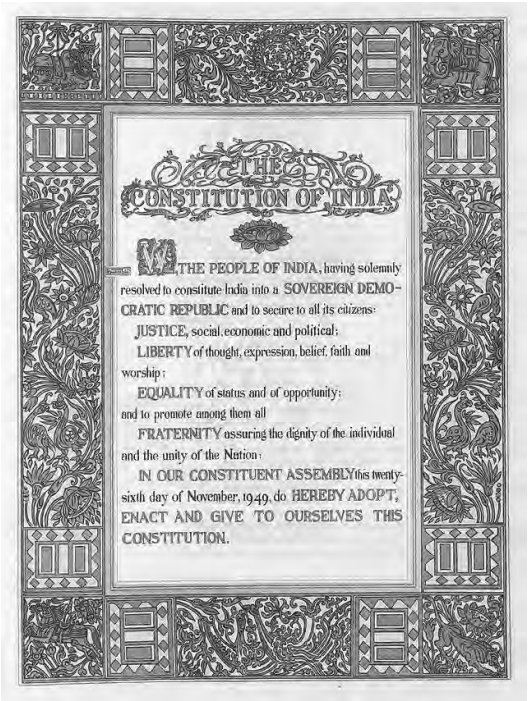
The main sources of law in India are:

The Constitution,

The statutes or laws made by Parliament and State Assemblies,

Precedents or the Judicial Decisions of various Courts and

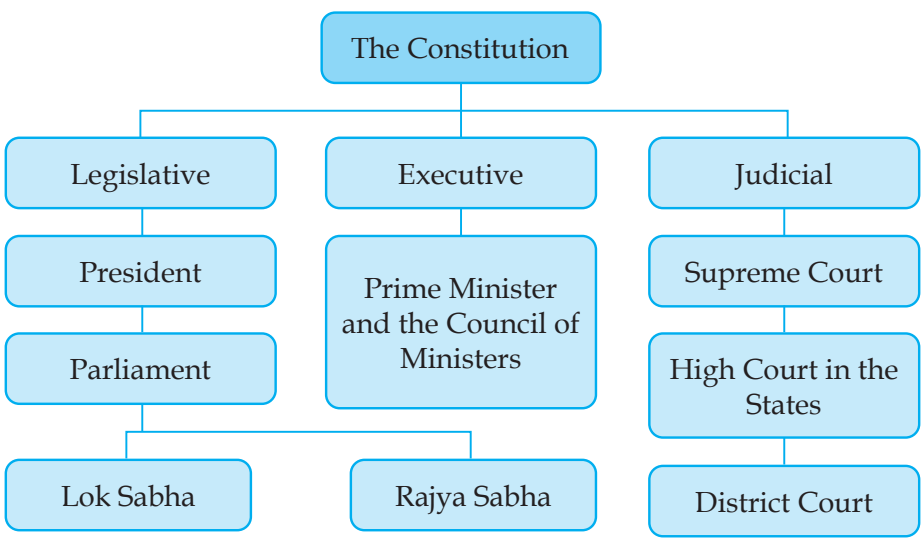
In some cases, established Customs and Usages.


THE CONSTITUTION OF INDIA

WE THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a SOVEREIGN DEMOCRATIC REPUBLIC and to secure to all its citizens:
JUSTICE, social, economic and political;
LIBERTY of thought, expression, belief, faith and worship;
EQUALITY of status and of opportunity;
and to promote among them all
FRATERNITY assuring the dignity of the individual and the unity of the Nation;
IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949, do HEREBY ADOPT, ENACT AND GIVE TO OURSELVES THIS CONSTITUTION.

India is a **parliamentary democracy. We have a constitution which is the basis and source for all laws**. We **elect** our **representatives** to the **parliament** as well as to the **legislative assemblies** of various **States**.

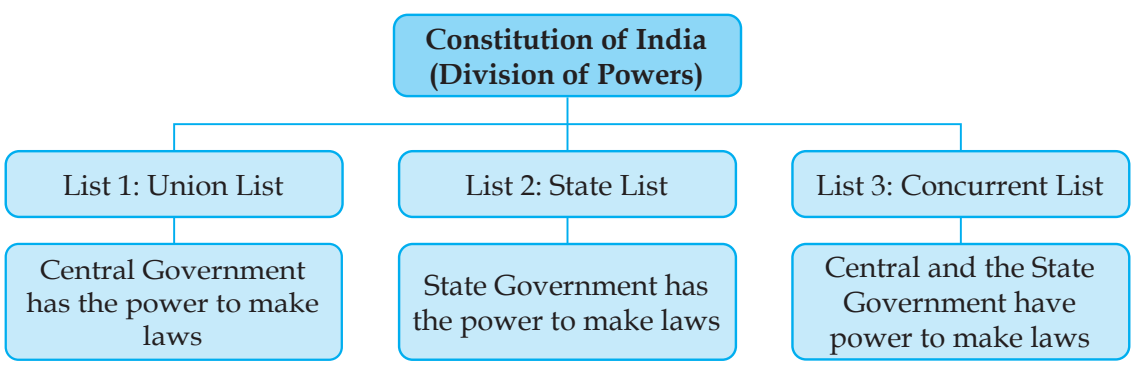
- These representatives of the people make laws in parliament or in their state assemblies as the case may be.
- **So, Parliament is the ultimate law-making body.**
- The laws passed by **parliament may apply throughout all or a portion of India**, whereas the **laws passed** by **state** legislatures apply only within the borders of the **states concerned**.



- India's government is federal in structure, but it also has some unitary features, and is sometimes called a quasi-federal system (A hybrid legal system).

FEDERAL GOVERNMENT	FEDERAL GOVERNMENT
2 LEVEL of Goverment [Central Government + States Governments]	**ONLY 1 LEVEL of Goverment** [Central Government / National Government]
Political Powers Shared by 2 level of Government	**Political Powers held by** Central Government ONLY
The **Constitution is RIGID & CODIFIED**	The **Constitution is FLEXIBLE & UNCODIFIED**
2 DIFFERENT types of LAW [Central + States Laws]	**ONLY 1 set of law (uniform)** for whole country

- **The Government of India Act, 1935**, passed by the Parliament of the United Kingdom is the precursor for the Constitution of India. It defined the characteristics of the Government from "unitary" to "federal".
- **In 1937, Federal Court was established** and had the jurisdiction of appellate, original and advisory. Powers were distributed between Centre and State to avoid any disputes.
- The Federal Court operated for 12 years and heard roughly 151 cases.
- The Federal Court → India's current **Apex Court - The Supreme Court of India**.
- **The Constitution of India, 1950** is the foremost law that deals with the framework within which our democratic system works, and our laws are made for the people, by the people.
- The Constitution also provides for and protects certain **Fundamental rights** of citizens. It also lays down **Fundamental duties** as well as the **powers** and **duties** of **Governments**, **both Central** and **State**.
- The people who wrote the Constitution decided to divide the law-making power between the Central Government and the various State Governments.
- So, the Indian Constitution has three lists Viz., **Central List, State List and Joint List**.



of Finance.

- Levy of stamp duty → both Central Government and State Government.

The Three Lists		
Union List	**State List**	**Concurrent List**
Defence and Armed Forces	Local Government bodies	Forests
Atomic Energy and Mineral Resources	Agriculture	Population Control
Foreign Affairs	Tourism of a State	Education
National Highways	Toll taxes and Land Revenue	Trade Unions
Railways	State Pension	Religious Institutes
Census	Public Debt of the State	Electricity
Banking	Elections of a Particular state	Inland Waterways
Currency	Salaries and Allowances to Ministers of State	Economic and Social Planning
Organisations such as RBI, CBI		

THE PROCESS OF MAKING A LAW

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

TYPES OF LAWS IN THE INDIAN LEGAL SYSTEM

A. Criminal Law

- 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.

offences under the law.

Before	Now	Nature of work
IPC 1860	भारतीय न्याय संहिता	Crime, Nature and Punishments
CRPC, 1973	भारतीय नागरिक सुरक्षता संहिता	Procedure for executing the punishment

B. 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.
- **Examples:** 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.

Key Words Table		
Primarily focuses on	**Dispute resolution rather than punishment**	**Matters of disputes between individuals or organisations**
Code of Civil Procedure, 1908 (CPC)		Law of Contract, Family Law, Property Law, and Law of Tort

C. 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.
- Where the facts are similar or "on all four legs" with the earlier decision.

Key Words Table		
A case law is common law.	**Article 141** Supreme Court will be binding upon the courts within the territory of India	**Stand by that which is decided.**
Courts to follow the same - Principle or judgement established by previous decisions		Where the facts are similar or "on all four legs" with the earlier decision.

D. Principles of Natural Justice

- Natural justice, often known as Jus Natural deals with certain fundamental principles of justice going beyond written law.

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.**

Key Words Table		
Fundamental principles of justice going beyond written law	**No one should be made A judge in his own cause**	**Hear the other party or give the other party a fair hearing**
A judgement can override or alter a common law, but it cannot override or change the statute (ACT)		

ENFORCING THE LAW

- After a law is passed in parliament it has to be **enforced (IMPLEMENT AND MONITOR)**.
- Depending on whether a law is a Central law or a State law the Central or State Government will be the enforcing authority.
- For this purpose government functions are distributed to various **ministries**.

Some of the popular Ministries are:

Ministry of Finance (F - First पहले)	Ministry of Corporate Affairs (Corporate - Office)	Ministry of Home Affairs (Home - घर)
Ministry of Law and Justice and so on. (यही जीवन का LAW है - क्या है JUSTICE है?)		
Ministries are headed by a minister and Run by officers of the Indian administrative and other services (Civil servants)		

- Most major Ministries are headed by a Cabinet Minister, who sits in the Union Council of Ministers, and is typically supported by a team of junior ministers called the Ministers of State.
- **Example:**
  - **ACT** - The Income Tax Act
  - **MINISTRY** - Implemented and enforced by the Ministry of Finance
  - **DEPT.** - Department of Revenue
  - **BODY** - the Central Board for Direct Taxes
  - **Administered by** - the officers of the Indian Revenue Service

1. The Ministry of Finance - Vitta Mantralaya

- The Ministry concerned with the economy of India.
- Serving as the Treasury of India.
- Concerns with:
  - taxation,
  - financial legislation,
  - financial institutions,
  - capital markets,

- The Union Budget - One of the important functions
- This annual event is eagerly awaited by professionals and the common man as it provides for the rates of taxes and budget allocations for the ensuing year.

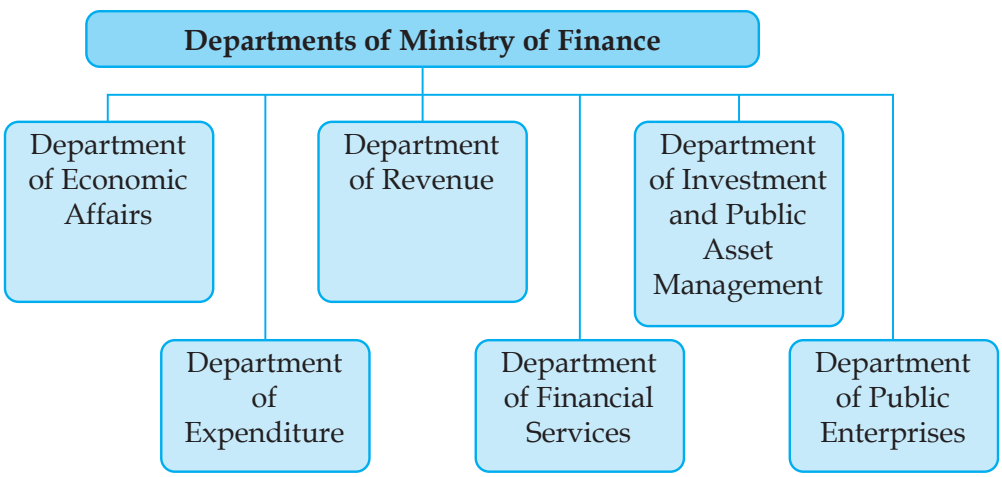
Who presented the Maximum number of Union Budgets as Finance Minister?

- **10** - Shri. Morarji Desai - As Finance Minister between 1962 and 1969 has
- **9** - Shri. P Chidambaram
- **8** - Shri. Pranab Mukherjee and Shri. Yashwant Sinha and
- **6** - Dr. Manmohan Singh

CONSTITUTION OF THE MINISTRY OF FINANCE

Apex controlling authority FOR CENTRAL CIVIL SERVICES			
Indian Revenue Service (Revenue)	**Indian Audit and Accounts Service** (Audit & Accounts)	**Indian Economic Service** (Economics)	**Indian Civil Accounts Service** (Accounts)
CENTRAL COMMERCE SERVICES **Indian Cost and Management Accounts Service.** (Cost & Management)			

Departments under the Ministry of Finance:

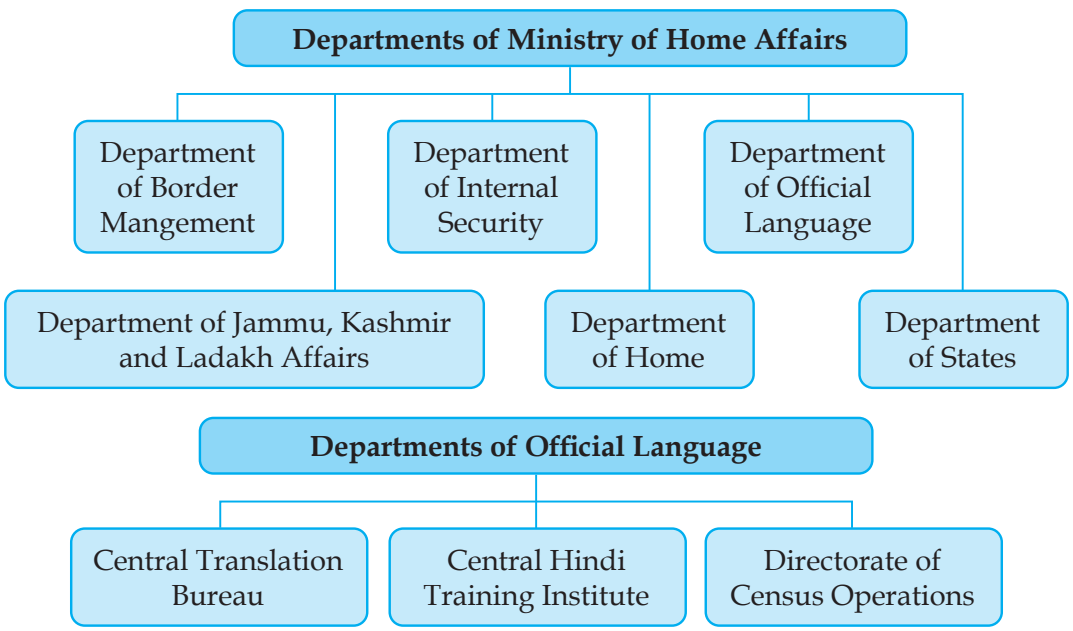


Key to learn Department names in Ministry of Finance
Economics - Finance में रहना है तो Economics पड़ो और समझो
Expenditure - खर्चे कम करो
Revenue - कमाओ ज़्यादा - कैसे?
Fin. Services - प्रोवाइड करो लोगो को
Investment / Assets - तब बनेंगे Assets
Public Enterprise (Co.) - और ऐसे बनती है बड़ी public companies

- Primarily concerned with administration of -
  - **The Companies Act 2013, (TCA)**
  - **The Companies Act 1956, (TCA)**
  - **The Limited Liability Partnership Act, 2008, (LLP)**
  - **The Insolvency and Bankruptcy Code, 2016. (IBC)**
- Responsible mainly for the **regulation** of **Indian** enterprises in the **industrial** and **services** sector.
- The Ministry is mostly run by civil servants of the **Indian Corporate Law Service (ICLS)** cadre.
- These officers are elected through the Civil Services Examination conducted by **Union Public Service Commission (UPSC)**.
- The **highest post, Director General of Corporate Affairs (DGCoA)**, is fixed at Apex Scale for the ICLS.

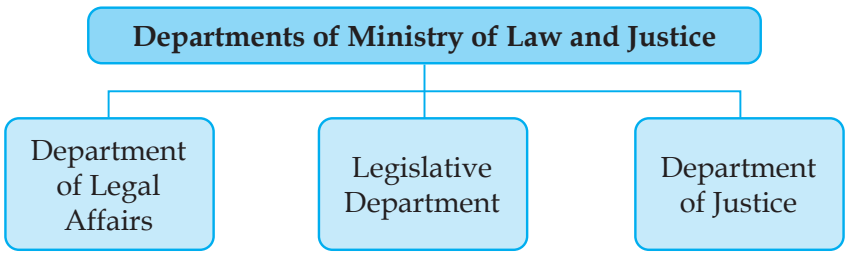
3. Ministry of Home Affairs (Grha Mantralaya)

- 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**.



Key to Learn Department names in Ministry of Home Affairs
❑ **Border** - HOME में अंदर आते ही
❑ **Internal Security** - Wife की Security के under
❑ **J&K** - जैसा माहोल - शांति का
❑ **Official language** - प्यार की - Translation की ज़रूरत नहीं / कुछ भी बोलो Hindi में ही सुनाई देता है / किसी से भी पूछ लो - Census (Vote करवालो)
❑ **States** - एकदम TWO States

- Ministry of Law and Justice is a Cabinet Ministry
- Deals with the -
  - ***Department of Legal Affairs*** - Managing legal affairs and Advising the various Ministries of the Central Government.
  - ***Legislative Department*** - Drafting of principal legislation for the Central Government.
  - ***Department of Justice*** - Administration of justice in India.



MAJOR REGULATORY BODIES

1. The Securities and Exchange Board of India (SEBI)

- The regulatory body.
- For securities and commodity market in India.
- Under the ownership of Ministry of Finance within the Government of India.
- It was established on 12 April, 1988 as an executive body and was given statutory powers on 30 January, 1992 through the SEBI Act, 1992.

Key Words			
Security & Commodity Market	ESTD. 1988	POWERS in 1992	SEBI Act, 1992

2. Reserve Bank of India (RBI)

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

Key Words
❑ **Central Bank** - सब काम एक जगह से centrally
❑ **Indian banking system** - पूरे Indian बैंकिंग का
❑ **Control, issue and maintaining supply of Indian rupee** - सब कंट्रोल इनके पास ही है
❑ **Payment systems - National Payments Corporation of India** - पेमेंट का
❑ **Bharatiya Reserve Bank Note Mudran (BRBNM) - prints and mints Indian currency** - यह तक की मुद्रण भी यही कर रहे है
❑ **Deposit Insurance and Credit Guarantee Corporation** - बताओ अब? deposit लेना है यह आओ - Insurance तो यह आओ - Credit के लिए भी ……

3. Insolvency and Bankruptcy Board of India (IBBI)

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

Key Words			
Insolvency proceeding For Individuals, Co. , P .Firms, LLP	Agency, Professional & Utilities	IBC, 2016	NCLT & DRT

STRUCTURE OF THE INDIAN JUDICIAL SYSTEM

When there is a dispute between citizens or between citizens and the Government, these disputes are resolved by the judiciary.

- The functions of judiciary system of India are:
  - Regulation of the **interpretation** of the Acts and Codes,
  - **Dispute Resolution**,
  - **Promotion** of **fairness** among the citizens of the land.
- The Supreme Court is at the top, followed by the High Courts and District Courts.
- **Decisions** of a **High Court** are **binding** in the **respective** state but are **only persuasive** in **other states**.
- Decisions of the Supreme Court are binding on all High Courts under Article 141 of the Indian Constitution.
- In fact, a Supreme Court decision is the final word on the matter.

1. 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.

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.

Key Words				
Apex Body	1950	Chief Justice of India Article - 126	7 members Now 34 Including CJI	File a writ under Article 32

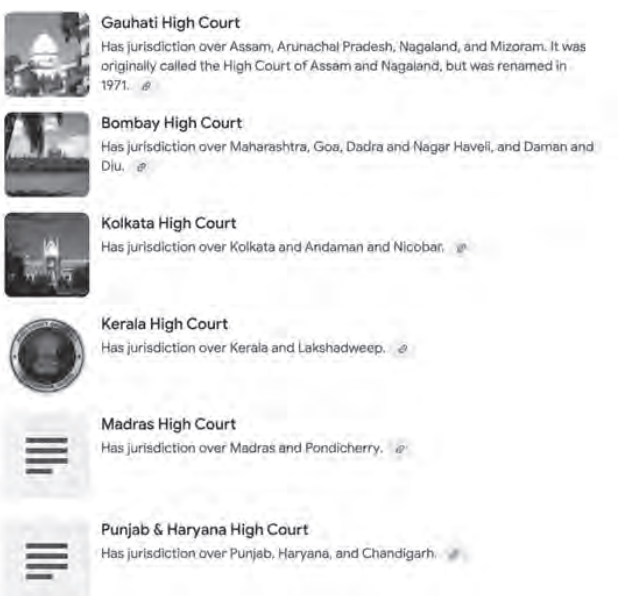
2. High Court

- 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. (Means it has the power only to oversee subordinate courts, no power to review or change the decisions).
- In India, there are twenty-five High Courts, 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.

Key Words				
Highest In each state and UT	Article 214 HC in each state	Article 227 Supervisory power only	25 HC	File a writ Under Article 226

Which is the oldest High Court in India?

*The oldest high court in the country is the **Calcutta High Court**, established on 2nd July, 1862.*



- Below the High Courts are the District Courts.
- The Courts of District Judge deal with Civil law matters i.e. contractual disputes and claims for damages etc.
- The Courts of Sessions deals with Criminal matters.
- Under pecuniary jurisdiction, a civil judge can try suits valuing not more than Rupees two crore.
- Courts get territorial Jurisdiction based on the areas covered by them.
- Cases are decided based on the local limits within which the parties reside or the property under dispute is situated.

Key Words				
Civil Law matter Contractual disputes Claim for damages	Criminal Matters in Session courts	Max - 2 Crores	Territorial Limits	Local limits where parties reside or property under dispute

4. Metropolitan Courts

- Metropolitan courts are established in **metropolitan cities** in consultation with the **High Court** where the population is **ten lakh or more**.
- Chief Metropolitan Magistrate has powers as **Chief Judicial Magistrate** and **Metropolitan Magistrate** has powers as the Court of a Magistrate of the first class.

INDICATIVE LIST OF ARTICLES COVERED IN THE CHAPTER

Article	Description
245	Power of parliament to make laws
246	Three list - Central, State and Joint
141 (SC)	SC - Final decision, binding on all
126 (SC)	CJI - Highest Authoirty
214 (HC)	There shall be HC in every state & UT
227 (HC)	HC has only Supervisory powers
32 (SC)	Writ in SC
226 (HC)	Writ in HC

"PROBLEM KYA HAI ?"

QUESTION BANK FOR THE CHAPTER

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter

- ICAI Study Material
- Previous year Question Papers (PYQPs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

1. What do you understand by Indian Judicial System and what are its various functions? **(RTP Jun'24)**

Ans. Indian Judicial System is a branch which through the enforcement of Law resolves dispute between citizens or between citizens and the Government.

The functions of judiciary system of India are:

- Regulation of the interpretation of the Acts and Codes,
- Dispute Resolution,
- Promotion of fairness among the citizens of the land.

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

MULTIPLE CHOICE QUESTIONS

1. A Chartered Accountant should be aware of law because

(a) He has to be an expert in law.

(b) He has to argue in High court and Supreme court.

(c) He has to advice management and clients on legal matters at a basic or threshold level.

(d) None of the above

2. Which of the following is not a MAIN source of law in India?

(a) Legal text books (b) The Parliament

(c) State Assemblies (d) The Constitution

3. In India we follow the federal system of Government. This means that

(a) All the power is with the President of India

(b) Powers are distributed between Centre and States

(c) All the power is with the Centre

(d) There are no restrictions on the power of States

4. The Constitution of India was adopted in

(a) 1947 (b) 1949

(c) 1950 (d) 1951

5. Income Tax Act, 1961 is a part of the

(a) Central list (b) State list

(c) Joint list (d) None of the above

6. The law concerned with violation of the rule of law and punishment of the same is called:

(a) Family law **(b) Criminal law**

(c) Civil law (d) Property law

(a) Breach of contract
(b) Non-delivery of goods
(c) Traffic offenses
(d) Non-payment of dues

8. When a law is proposed in Parliament it is called
(a) Act
(b) Statute
(c) Bill
(d) Notification

9. Which of the following is NOT a department of the Ministry of Finance?
(a) Department of Economic Affairs
(b) Department of Expenditure
(c) Department of States
(d) Department of Revenue

10. Courts get territorial limits based on
(a) The local limits within which the party resides
(b) The local limits within which the property under dispute is located
(c) Either (a) or (b)
(d) None of the above

02

CHAPTER

The Indian Contract Act, 1872

TABLE OF CONTENT FOR THE CHAPTER

UNIT-1 - NATURE OF CONTRACT

- WHAT IS A CONTRACT? 2.5
- ESSENTIALS OF A VALID CONTRACT 2.7
- TYPES OF CONTRACTS 2.10
- PROPOSAL/OFFER 2.14
- CLASSIFICATION OF OFFER 2.15
- ESSENTIALS OF A VALID OFFER 2.16
- ACCEPTANCE 2.19
- LEGAL RULES REGARDING A VALID ACCEPTANCE 2.19
- COMMUNICATION OF OFFER AND ACCEPTANCE 2.23
- COMMUNICATION OF PERFORMANCE 2.25
- REVOCATION OF OFFER AND ACCEPTANCE 2.26
- ***"PROBLEM KYA HAI? - UNIT 1"*** 2.29

UNIT-2 - CONSIDERATION

- WHAT IS CONSIDERATION? 2.39
- LEGAL RULES REGARDING CONSIDERATION 2.40
- SUIT BY A THIRD PARTY TO A CONTRACT 2.44
- VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION 2.45
- ***"PROBLEM KYA HAI? - UNIT 2"*** 2.47

UNIT-3 - OTHER ESSENTIAL ELEMENTS OF CONTRACT

- CAPACITY TO CONTRACT 2.53
- FREE CONSENT 2.56
- ELEMENTS VITIATING FREE CONSENT 2.57
- LEGALITY OF OBJECT AND CONSIDERATION 2.62
- VOID AGREEMENTS 2.65
- ***"PROBLEM KYA HAI? - UNIT 3"*** 2.68

- PERFORMANCE OF CONTRACT 2.85
- CONDITIONS FOR A VALID TENDER OR ATTEMPTED PERFORMANCE 2.86
- BY WHOM A CONTRACT MAY BE PERFORMED 2.86
- DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT 2.87
- LIABILITY OF JOINT PROMISOR & PROMISEE 2.88
- TIME AND PLACE FOR PERFORMANCE OF THE PROMISE 2.90
- PERFORMANCE OF RECIPROCAL PROMISE 2.90
- AGREEMENT TO DO IMPOSSIBLE ACT 2.92
- APPROPRIATION OF PAYMENTS 2.93
- CONTRACTS WHICH NEED NOT BE PERFORMED WITH THE CONSENT OF BOTH THE PARTIES 2.94
- DISCHARGE OF A CONTRACT 2.97
- ***"PROBLEM KYA HAI? - UNIT 4"*** 2.98

UNIT-5 - BREACH OF CONTRACT AND ITS REMEDIES

- ANTICIPATORY BREACH OF CONTRACT 2.110
- ACTUAL BREACH OF CONTRACT 2.110
- REMEDIES FOR BREACH OF CONTRACT 2.111
- SUIT FOR DAMAGES 2.111
- PENALTY AND LIQUIDATED DAMAGES (SECTION 74) 2.114
- REMEDIES OTHER THAN CLAIMING DAMAGES 2.115
- ***"PROBLEM KYA HAI? - UNIT 5"*** 2.117

UNIT-6 - CONTINGENT AND QUASI CONTRACT

- CONTINGENT CONTRACTS 2.128
- ESSENTIALS OF A CONTINGENT CONTRACT 2.129
- RULES RELATING TO ENFORCEMENT 2.130
- DIFFERENCE BETWEEN A CONTINGENT CONTRACT AND A WAGERING CONTRACT 2.130
- QUASI CONTRACTS 2.131
- ***"PROBLEM KYA HAI? - UNIT 6"*** 2.133

UNIT-7 - CONTRACT OF INDEMNITY AND GUARANTEE

- CONTRACT OF INDEMNITY 2.141
- CONTRACT OF GUARANTEE 2.143
- ESSENTIAL FEATURES OF A GUARANTEE 2.144
- TYPES OF GUARANTEES 2.145
- DISTINCTION BETWEEN A CONTRACT OF INDEMNITY & CONTRACT OF GUARANTEE 2.145
- SURETY'S LIABILITY 2.146
- DISCHARGE OF A SURETY 2.146
- CASES WHERE SURETY NOT DISCHARGED 2.149
- RIGHTS OF A SURETY 2.150
- ***"PROBLEM KYA HAI? - UNIT 7"*** 2.152

UNIT-8 - BAILMENT AND PLEDGE

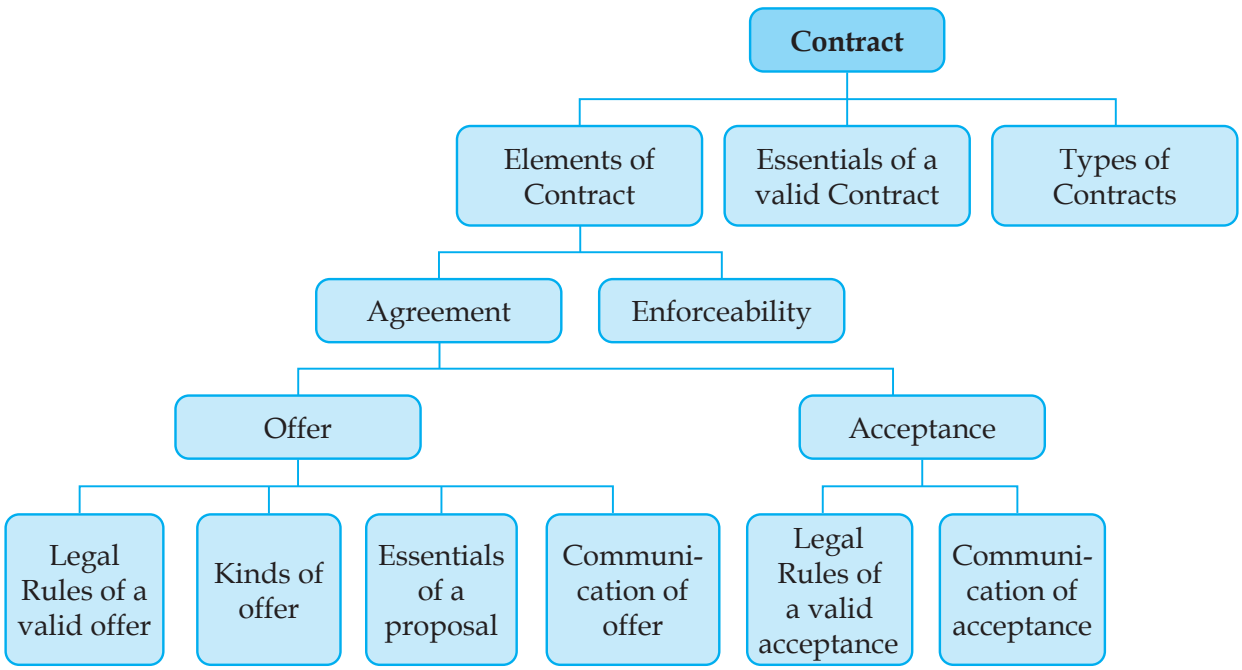
- WHAT IS BAILMENT? 2.163
- ESSENTIAL ELEMENTS 2.164
- TYPES OF BAILMENT 2.165
- DUTIES OF A BAILOR 2.165
- DUTIES OF A BAILEE 2.167
- RIGHTS OF A BAILOR 2.169
- RIGHTS OF A BAILEE 2.171
- RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY) 2.172
- TERMINATION OF BAILMENT 2.172
- FINDER OF LOST GOODS 2.173
- RIGHT OF LIEN 2.173
- PLEDGE 2.174
- ESSENTIALS OF CONTRACT OF PLEDGE 2.175
- RIGHTS OF A PAWNEE/PLEDGEE 2.175
- RIGHTS OF A PAWNOR 2.176
- DUTIES OF THE PAWNEE 2.176
- DUTIES OF A PAWNOR 2.176
- PLEDGE BY NON-OWNERS 2.176
- DISTINCTION BETWEEN BAILMENT AND PLEDGE 2.177
- ***"PROBLEM KYA HAI? - UNIT 8"*** 2.178

UNIT-9 - AGENCY

- WHAT IS AGENCY? - SECTION 182 2.184
- TEST OF AGENCY 2.184
- APPOINTMENT AND AUTHORITY OF AGENTS 2.184
- CREATION OF AGENCY 2.184
- RATIFICATION & ITS EFFECT 2.186
- EXTENT OF AGENT'S AUTHORITY 2.187
- SUB-AGENTS 2.188
- SUBSTITUTED AGENT 2.189
- DIFFERENCE BETWEEN A SUB-AGENT AND A SUBSTITUTED AGENT 2.189
- DUTIES AND OBLIGATIONS OF AN AGENT 2.190
- RIGHTS OF AN AGENT 2.192
- PRINCIPAL'S LIABILITY TO THIRD PARTIES 2.194
- PERSONAL LIABILITY OF AGENT TO THIRD PARTIES 2.196
- RIGHTS OF THIRD PARTIES 2.196
- REVOCATION OF AUTHORITY 2.197
- ***"PROBLEM KYA HAI? - UNIT 9"*** 2.199

UNIT 01

Nature of Contract



'Contract' is the most usual method of defining the rights and duties in a business transaction.

- The Act basically identifies the ingredients of a:
  - legally enforceable valid contract
  - in addition to dealing with certain special types of contractual relationships like indemnity and guarantee
  - Bailment and pledge,
  - contingent and quasi contracts etc.

All agreements are not covered under the Indian Contract Act, 1872, as some of those are not contracts. Only those agreements, which are enforceable by law, are contracts.

WHAT IS A CONTRACT?

Section 2(h) - "an agreement enforceable by law".

The contract consists of two essential elements:

1. An agreement, and
2. Its enforceability by law.

Every promise and every set of promises, forming the consideration for each other". Promise - Section 2 (b) "when the person to whom the proposal is made signifies his assent there to, the proposal is said to be accepted. Proposal when accepted, becomes a promise".

The following points emerge from the above definition:

1. when the person to whom the **proposal** is made
2. signifies his **assent** on that proposal which is made to him
3. the proposal becomes **accepted**
4. **accepted** proposal **becomes promise**

Thus we say that an agreement is the result of the proposal made by one party to the other party and that other party gives his acceptance thereto of course for mutual consideration.

Agreement = Offer/Proposal + Acceptance

I. Enforceability by law

An agreement to become a contract must give rise to a legal obligation which means a duly enforceable by law.

Thus from above definitions it can be concluded that:

Contract = Accepted proposal/Agreement + Enforceability by law

On elaborating the above two concepts, it is obvious that a contract comprises an agreement which is a promise or a set of reciprocal promises, that a promise is the acceptance of a proposal giving rise to a binding contract. Further, section 2(h) requires an agreement to be worthy of being enforceable by law before it is called 'Contract'. Where parties have made a binding contract, they created rights and obligations between themselves.

Example 1: A agrees with B to sell car for ₹2 lacs to B. Here A is under an obligation to give car to B and B has the right to receive the car on payment of ₹2 lacs and also B is under an obligation to pay ₹2 lacs to A and A has a right to receive ₹2 lacs.

Example 2: Father promises his son to pay him pocket allowance of ₹500 every month. But he refuses to pay later. The son cannot recover the same in court of law as this is a social agreement. This is not created with an intention to create legal relationship and hence it is not a contract.

Difference between Agreement and Contract

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

As given by Section 10 of Indian Contract Act, 1872	Not given by Section 10 but are also considered essential
1. Agreement	1. Two parties
2. Free consent	2. Intention to create legal relationship
3. Competency of the parties	3. Fulfilments of legal formalities
4. Lawful consideration	4. Certainty of meaning
5. Legal object	5. Possibility of performance
6. Not expressly declared to be void [as per Section 24 to 30 and 56]	

Section 10: 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".

Since section 10 is not complete and exhaustive, there are certain other sections which also contain requirements for an agreement to be enforceable.

Thus, in order to create a valid contract, the following elements should be present:

1. **Two Parties:**
   - One cannot contract with himself.
   - **A contract involves at least two parties- one party making the offer and the other party accepting it.**
   - A contract **may be made by natural persons and by other persons having legal existence** e.g., companies, universities etc.
   - It is necessary to remember that the identity of the parties be ascertainable.

   Example 3: To constitute a contract of sale, there must be two parties- seller and buyer. The seller and buyer must be two different persons, because a person cannot buy his own goods.

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

   Example 4: A husband agreed to pay to his wife certain amount as maintenance every month while he was abroad. Husband failed to pay the promised amount. Wife sued him for the recovery of the amount. Here, in this case, wife could not recover as it was a social agreement and the parties did not intend to create any legal relations. (Balfour v. Balfour)

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

days. Here A intended to create legal relationship with B. Hence the same is contract. On failure by B for making a payment on due date, A can sue him in the court of law.

3. **Other Formalities to be complied with in certain cases:**
   - **In case of certain contracts, the contracts must be in writing**, e.g. Contract of Insurance is not valid except as a written contract.
   - Further, in case of **certain contracts, registration of contract under the laws which was in force at the time, is essential for it to be valid**, e.g. in the case of immovable property.
4. **Certainty of meaning:** The agreement must be certain and not vague or indefinite.

   Example 7: A agrees to sell to B a hundred tons of oil. There is nothing certain in order to show what kind of oil was intended for.
   Example 8: XYZ Ltd. agreed to lease the land to Mr. A for indefinite years. The contract is not valid as the period of lease is not mentioned.
5. **Possibility of performance of an agreement:**
   - The terms of agreement should be capable of performance.
   - An agreement to do an act impossible in itself cannot be enforced.

     Example 9: A agrees with B to discover treasure by magic. The agreement cannot be enforced as it is not possible to be performed.

Essential elements of a valid contract

According to Section 10 of the Indian Contract Act, 1872, the following are the essential elements of a Valid Contract:

1. **Offer and Acceptance or an agreement:** An agreement is the first essential element of a valid contract. According to Section 2(e) of the Indian Contract Act, 1872, **"Every promise and every set of promises, forming consideration for each other, is an agreement" and according to Section 2(b) "A proposal when accepted, becomes a promise". An agreement is an outcome of offer and acceptance.**
2. **Free Consent:**
   - **Two or more persons are said to consent when they agree upon the same thing in the same sense.** This can also be understood as the identity of minds in understanding the terms **viz consensus ad idem**.
   - Further **such a consent must be free. Consent would be considered as free consent if it is not caused by coercion, undue influence, fraud or, misrepresentation or mistake**.

     Example 10: 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 no contract.
   - To determine 'consensus ad idem' the language of the contract should be clearly drafted. Thus, if A says B "Will you buy my red car for ₹3,00,000?". B says "yes" to it. There is said to be consensus ad idem i.e. the meaning is taken in same sense by both the parties.

     Example 11: A threatened to shoot B if he (B) does not lend him ₹2,00,000 and B agreed to it. Here the agreement is entered into under coercion and hence not a valid contract.

into a valid contract. **Section 11 of the Indian Contract Act specifies that every person is competent to contract who**

1. **is of the age of majority** according to the law to which he is subject and
2. is of **sound mind** and
3. is **not otherwise disqualified from contracting** by any law to which he is subject.

A person competent to contract must fulfil all the above **three qualifications**.

- **Qualification (a) - AGE**
  - Age of the contracting person i.e. **the person entering into contract must be of 18 years of age**.
  - Persons below 18 years of age are considered minor, therefore, incompetent to contract
- **Qualification (b) - SOUND MIND**
  - requires a person to be of sound mind i.e. he should be in his senses
  - **so that he understands the implications of the contract at the time of entering into a contract.**
  - A lunatic, an idiot, a drunken person or under the influence of some intoxicant is not supposed to be a person of sound mind.
- **Qualification (c) - NOT BE DISQUALIFIED**
  - A person entering into a contract should not be disqualified by his status, in entering into such contracts.
  - Such persons are: an alien enemy, foreign sovereigns, con- victs etc.
  - They are disqualified unless they fulfil certain formalities required by law.

Contracts entered by persons not competent to contract are not valid.

4. **Consideration:**
   - **It is referred to as 'quid pro quo' i.e. 'something in return'.**
   - A valuable consideration in the sense of law may consist either in some right, interest, profit, or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, surrendered or undertaken by the other.

   Example 12: A agrees to sell his books to B for ₹100. B's promise to pay ₹100 is the consideration for A's promise to sell his books. A's promise to sell the books is the consideration for B's promise to pay ₹100.

5. **Lawful Consideration and Object:**
   - **The consideration and object of the agreement must be lawful.**
   - **Section 23 -**
     - Consideration or object is not lawful it is prohibited by law, or it is such as would defeat the provisions of law, it is fraudulent or involves injury to the person or property of another or court regards it as immoral or opposed to public policy.

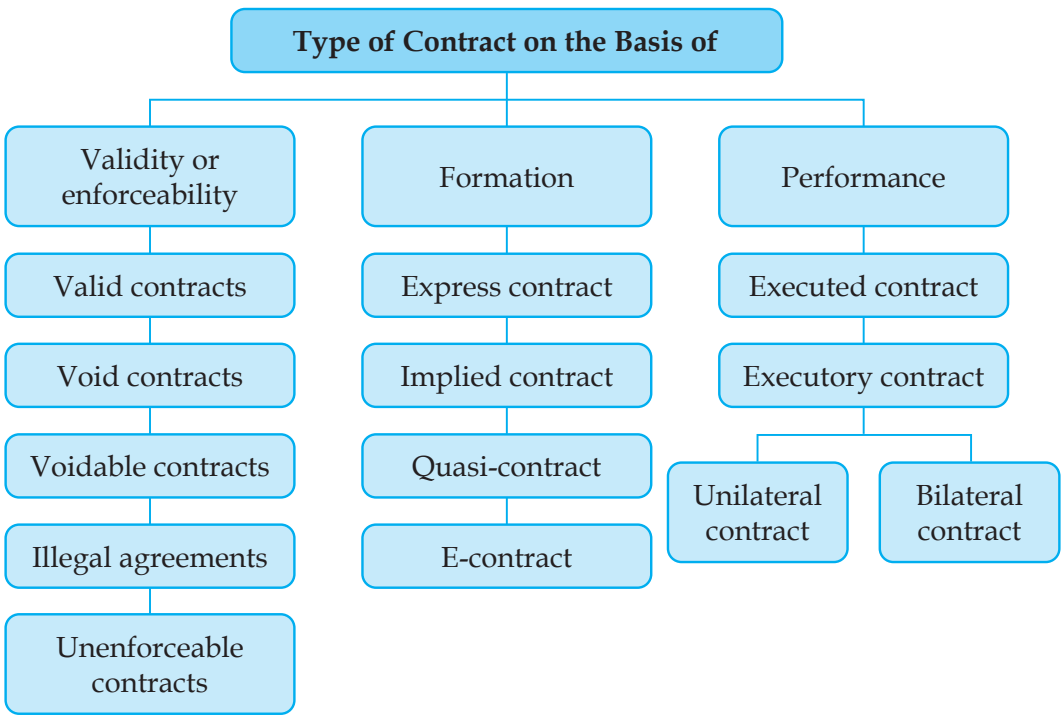
     Example 13: 'A' promises to drop prosecution instituted against 'B' for robbery and 'B' promises to restore the value of the things taken. The agreement is void, as its object is unlawful.

     Example 14: A agrees to sell his house to B against 100 kgs of cocaine (drugs). Such agreement is illegal as the consideration is unlawful.

- **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.

> ***Example 15:*** *Threat to commit murder or making/publishing defamatory statements or entering into agreements which are opposed to public policy are illegal in nature. Similarly, any agreement in restraint of trade, marriage, legal proceedings, etc. are classic examples of void agreements.*

TYPES OF CONTRACTS



I. On the Basis of the Validity

1. **Valid Contract:**
   - **An agreement which is binding and enforceable is a valid contract.**
   - It contains all the essential elements of a valid contract.

   > ***Example 16:*** *A ask B if he wants to buy his bike for ₹50,000. B agrees to buy bike. It is agreement which is enforceable by law. Hence, it is a valid contract.*

2. **Void Contract: Section 2 (j)**
   - **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.

Example 17: Mr. X agrees to write a book with a publisher. Such contract is valid. But after few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract. Thus, a valid contract when cannot be performed because of some uncalled happening becomes void.

Example 18: A contracts with B (owner of the factory) for the supply of 10 tons of sugar, but before the supply is effected, the fire caught in the factory and everything was destroyed. Here the contract becomes void.

When a contract is void, it is not a contract at all but for the purpose of identifying it, it has to be called a Void contract.

3. **Voidable Contract: Section 2(i)**

- **An agreement which is enforceable by law at the option of one or more parties thereto, but not at the option of the other or others is a voidable contract.**
- Means where one of the parties to the agreement is in a position or is legally entitled or authorised to avoid performing his part, then the agreement is treated and becomes voidable.

Following are the situations where a contract is voidable:

Situation where Contract is Voidable		
Situation	**Explanation**	**Example**
Consent Not Free	Contract is voidable if consent is obtained by coercion, undue influence, misrepresentation, or fraud.	X is forced by Y at gunpoint to sell his scooter for ₹1 lac. X can void the contract, but Y cannot.
Prevention of Performance	If one party prevents the other from fulfilling their promise, the contract becomes voidable.	A agrees to sell a car to B for ₹2,00,000. On the due date, A refuses to sell. B can void the contract.
Failure to Perform on Time	If a party fails to perform within the specified time, the contract is voidable at the promisee's option.	A agrees to build a house for B by 31-03-2022 but fails. B can void the contract.

Difference between a Void Contract and a Voidable Contract can be summarised as under:

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

4. **Illegal Contract : Section 2(g) -**
   - **It is a contract which the law forbids to be made.**
   - The court will not enforce such a contract but also the connected contracts.
   - All illegal agreements are void but all void agreements are not necessarily illegal.

   Example 19: Contract that is immoral or opposed to public policy are illegal in nature. Similarly, if R agrees with S, to purchase brown sugar, it is an illegal agreement.

   - **An agreement not enforceable by law is void".**
   - The Act has specified various factors due to which an agreement may be considered as void agreement.
   - One of these factors is unlawfulness of object and consideration of the contract i.e. illegality of the contract which makes it void.

Difference between Void Agreement and Illegal Agreement can be summarised as:

Basis	Void Agreement	Illegal Agreement
Definition	An agreement that is not enforceable by law from the beginning.	An agreement that is prohibited by law and involves unlawful acts.
Legality	Not necessarily illegal but cannot be enforced by law.	Illegal by nature and involves actions prohibited by law.
Effect on Collateral Agreements	Collateral agreements may still be valid.	Collateral agreements are also void and unenforceable.
Punishment	No punishment is imposed for entering into a void agreement.	Parties may face legal penalties or criminal charges for entering into an illegal agreement.
Example	An agreement to do an impossible act.	An agreement to commit a crime.

5. **Unenforceable Contract: Where a contract is good in substance but because of some technical defect** i.e. absence in writing, barred by limitation etc. **one or both the parties cannot sue upon it, it is described as an unenforceable contract**.

Example 20: A bought goods from B in 2018. But no payment was made till 2022. B cannot sue A for the payment in 2022 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.

1. **Express Contracts:**
   - A contract would be an express contract if the **terms are expressed by words or in writing**.
   - Section 9 of the Act provides that if a proposal or acceptance of any promise is made in words the promise is said to be express.

   Example 21: A tells B on telephone that he offers to sell his house for ₹20 lacs and B in reply informs A that he accepts the offer, this is an express contract.

2. **Implied Contracts:**
   - **Implied contracts in contrast come into existence by implication.**
   - Most often the implication is by law and or by action.
   - Section 9 of the Act - Implied contracts when it lays down that in so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied.

   Example 22: Where 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, it is an implied contract and A must pay for the services of the coolie detailed by him.

   Example 23: A drinks a coffee in restaurant. There is an implied contract that he should pay for the price of coffee.

   Tacit Contracts:
   - The word Tacit means silent.
   - **Tacit contracts are those that are inferred through the conduct of parties without any words spoken or written.**
   - A classic example of tacit contract would be when cash is withdrawn by a customer of a bank from the automatic teller machine [ATM].
   - Another example of tacit contract is where a contract is assumed to have been entered - when a sale is given effect to at the fall of hammer in an auction sale.
   - It is not a separate form of contract but falls within the scope of implied contracts.

3. **Quasi-Contract:**
   - A quasi-contract is not an actual contract but it resembles a contract.
   - It is created by law under certain circumstances.
   - **The law creates and enforces legal rights and obligations when no real contract exists. Such obligations are known as quasi-contracts.**
   - In other words, **it is a contract in which there is no intention on part of either party to make a contract but law imposes a contract upon the parties.**

   Example 24: Obligation of finder of lost goods to return them to the true owner or liability of person to whom money is paid under mistake to repay it back cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent. These are said to be quasi-contracts.

   Example 25: T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

4. **E-Contracts:**
   - **When a contract is entered into by two or more parties using electronic means, such as e-mails, it is known as e-commerce contracts.**

other networks through EDI - Electronic Data Interchange.

- This **helps in doing business transactions using electronic mode**.
- **These are known as EDI contracts or Cyber contracts or mouse click contracts.**

III. On the Basis of the Performance of the Contract

1. **Executed Contract:** The consideration in a given contract could be an act or forbearance. **When the act is done or executed or the forbearance is brought on record, then the contract is an executed contract.**

   Example 26: When a grocer sells a sugar on cash payment it is an executed contract because both the parties have done what they were to do under the contract.

2. **Executory Contract:**

   (i) In an executory contract the consideration is reciprocal promise or obligation.

   Such **consideration is to be performed in future only** and therefore these contracts are described as executory contracts.

   Example 27: Where G agrees to take the tuition of H, a pre-engineering student, from the next month and H in consideration promises to pay G ₹1,000 per month, the contract is executory because it is yet to be carried out.

   (ii) Unilateral or Bilateral are kinds of Executory Contracts and are not separate kinds.

   (a) Unilateral Contract: Unilateral contract is a **one-sided contract** in which **one party has performed his duty or obligation and the other party's obligation is outstanding**.

   Example 28: M advertises payment of award of ₹50,000 to any one who finds his missing boy and brings him. As soon as B traces the boy, there comes into existence an executed contract because B has performed his share of obligation and it remains for M to pay the amount of reward to B. This type of Executory contract is also called unilateral contract.

   (b) Bilateral Contract: A Bilateral contract is one where the **obligation or promise is outstanding on the part of both the parties**.

   Example 29: A promises to sell his plot to B for ₹10 lacs cash down, but B pays only ₹2,50,000 as earnest money and promises to pay the balance on next Sunday. On the other hand, A gives the possession of plot to B and promises to execute a sale deed on the receipt of the whole amount. The contract between the A and B is executory because there remains something to be done on both sides. Such Executory contracts are also known as Bilateral contracts.

PROPOSAL/OFFER

Essentials of a proposal/offer are:

1. The person making the proposal or offer is called the **'promisor'** or **'offeror'**:
   - The person to whom the offer is made is called the **'offeree'** and the person accepting the offer is called the **'promisee'** or **'acceptor'**.
2. For a valid offer, the party making it must **express his willingness 'to do' or 'not to do' something**.

Example 30: A willing to sell his good at certain price to B.
Example 31: A is willing to not to dance in a competition if B pays him certain sum of money.

3. **The willingness must be expressed with a view to obtain the assent** of the other party to whom the offer is made.

   Example 32: Where 'A' tells 'B' that he desires to marry by the end of 2022, it does not constitute an offer of marriage by 'A' to 'B'. Therefore, to constitute a valid offer expression of willingness must be made to obtain the assent (acceptance) of the other. Thus, if in the above example, 'A' further adds, 'Will you marry me', it will constitute an offer.

4. **An offer can be positive as well as negative:** Thus "doing" is a positive act and "not doing", or "abstinence" is a negative act; nonetheless both these acts have the same effect in the eyes of law.

   Example 33: A offers to sell his car to B for Rs. 3 lacs is an act of doing. So in this case, A is making an offer to B.
   Example 34: When A ask B after his car meets with an accident with B's scooter not to go to Court and he will pay the repair charges to B for the damage to B's scooter; it is an act of not doing or abstinence.

CLASSIFICATION OF OFFER

1. **General offer:** Carlill v. Carbolic Smoke Ball Co.
   - **It is an offer made to the public at large and hence anyone can accept and do the desired act.**
   - In terms of Section 8 of the Act, anyone performing the conditions of the offer can be considered to have accepted the offer.
   - Until the general offer is retracted or withdrawn, it can be accepted by anyone at any time as it is a continuing offer.
2. **Special/specific offer:** [Boulton v. Jones]
   - **When the offer is made to a specific or an ascertained person.**
   - Specific offer can be accepted only by that specified person to whom the offer has been made.

     Example 35: 'A' offers to sell his car to 'B' at a certain cost. This is a specific offer.
3. **Cross offer:**
   - **When two parties exchange identical offers in ignorance at the time of each other's offer.**

construed as acceptance of the other's offer.

Example 36: If A makes a proposal to B to sell his car for ₹2 lacs and B, without knowing the proposal of A, makes an offer to purchase the same car at ₹2 lacs from A, it is not an acceptance, as B was not aware of proposal made by A. It is only cross proposal (cross offer). And when two persons make offer to each other, it cannot be treated as mutual acceptance. There is no binding contract in such a case.

4. **Counter offer:**
   - **When the offeree offers qualified acceptance of the offer** subject to modifications and variations in the terms of original offer, he is said to have made a counter offer.
   - **Counter-offer amounts to rejection of the original offer.**
   - It is also called Conditional Acceptance.

   Example 37: 'A' offers to sell his plot to 'B' for ₹10 lakhs. 'B' agrees to buy it for Rs. 8 lakhs. It amounts to counter offer. It will result in the termination of the offer of 'A'. If later on 'B' agrees to buy the plot for ₹10 lakhs, 'A' may refuse.

5. **Standing or continuing or open offer:**
   - **An offer which is allowed to remain open for acceptance over a period of time is known as standing or continuing or open offer.**
   - Tenders that are invited for supply of goods is a kind of standing offer.

ESSENTIALS OF A VALID OFFER

1. **It must be capable of creating legal relations:** Offer must be such as in law is capable of being accepted and giving rise to legal relationship. **If the offer does not intend to give rise to legal consequences and create legal relations, it is not considered as a valid offer in the eyes of law.** A social invitation, even if it is accepted, does not create legal relations because it is not so intended.

   Example 38: A invited B on his birthday party. B accepted the proposal but when B reached the venue, he (B) found that A was not there. He filed the suit against A for recovery of travelling expenses incurred by him to join the birthday party. Held, such an invitation did not create a legal relationship. It is a social activity. Hence, B could not succeed.

2. **It must be certain, definite and not vague: If the terms of an offer are vague or indefinite, its acceptance cannot create any contractual relationship.**

   Example 39: A offers to sell B 100 quintals of oil, there is nothing whatever to show what kind of oil was intended. The offer is not capable of being accepted for want of certainty.

3. **It must be communicated to the offeree: An offer, to be complete, must be communicated to the person to whom it is made, otherwise there can be no acceptance of it.** Unless an offer is communicated, there can be no acceptance by it. An acceptance of an offer, in ignorance of the offer, is not acceptance and does not confer any right on the acceptor.
4. **It must be made with a view to obtaining the assent of the other party:** Offer must be made with a view to obtaining the assent of the other party addressed and not merely with a view to disclosing the intention of making an offer.
5. **It may be conditional: An offer can be made subject to any terms and conditions by the offeror.**

Example 40: Offeror may ask for payment by RTGS, NEFT etc. The offeree will have to accept all the terms of the offer otherwise the contract will be treated as invalid.

6. **Offer should not contain a term the non-compliance of which would amount to acceptance: Thus, one cannot say that if acceptance is not communicated by a certain time the offer would be considered as accepted.**
7. **The offer may be either specific or general:** Any offer can be made to either the public at large or to any specific person. (Already explained in the heading - Types of the Offer)
8. **The offer may be express or implied:** An offer can be made either by words or by conduct

Example 41: A boy starts cleaning the car as it stops on the traffic signal without being asked to do so, in such circumstances any reasonable man could guess that he expects to be paid for this, here boy makes an implied offer.

9. **Offer is Different from:**
   (a) a mere statement of intention,
   (b) an invitation to offer,
   (c) a mere communication of information,
   (d) Casual Equity,
   (e) A prospectus and
   (f) Advertisement.

   (a) A statement of **intention and announcement**.

   Example 42: 'A father wrote his son about his wish of making him the owner of all his property is mere a statement of intention.

   Example 43: An announcement to give scholarships to children scoring more than 95% in 12th board is not an offer.

   (b) Offer must be **distinguished from an answer to a question**.

   Case Law: Harvey vs. Facey [1893] AC 552

   Facts: The plaintiffs sent a telegram asking if the defendants would sell Bumper Hall Pen and to state the lowest cash price. The defendants replied with the lowest price of £900. The plaintiffs then agreed to buy at that price, but the defendants refused to sell.

   Issue: Whether the defendants' reply was an offer to sell.

   Decision: The Privy Council held that the defendants' reply was not an offer but merely a statement of the lowest price, which is an invitation to offer. There was no binding contract as the defendants had not expressed a willingness to sell.

   Follow-Up Case: In Mac Pherson vs Appanna [1951], a similar ruling was made where a statement of the minimum price was deemed an invitation to offer, not an actual offer.

   Key Point: Stating a price or minimum price is an invitation to offer, not an offer itself

   (c) **A statement of price is not an offer:** Quoting the price of a product does not constitute it as offer. (refer case of Harvey Vs. Facie as discussed above.

   Example 44: The price list of goods does not constitute an offer for sale of certain goods on the listed prices. It is an invitation to offer.

- **The person making the invitation does not make an offer rather invites the other party to make an offer.**
- His objective is to send out the invitation that he is willing to deal with any person who, on the basis of such invitation, is ready to enter into contract with him subject to final terms and conditions.

  Example 45: 'An advertisement for sale of goods by auction is an invitation to the offer. It merely invites offers/bids made at the auction.

- Similarly when goods are sold through auction, the auctioneer does not contract with any one who attends the sale.
- The auction is only an advertisement to sell but the items are not put for sale though persons who have come to the auction may have the intention to purchase.
- **Similar decision was given in the case of Harris vs. Nickerson (1873).**

10. **A statement of price is not an Offer**
    - An invitation to an offer is only a circulation of an offer, it is an attempt to induce offers and precedes a definite offer

Difference between offer and invitation to make an offer:

Difference between Offer and Invitation to Offer		
Basis	**Offer**	**Invitation to Offer**
Definition	A definite proposal that, if accepted, creates a binding contract.	A preliminary statement that seeks to induce offers.
Intention	The offeror intends to be bound by the terms of the offer upon acceptance.	The intention is to invite others to make offers or proposals.
Nature of Statement	Final expression of willingness to enter into a contract.	An attempt to start negotiations or receive offers.
Effect of Acceptance	Acceptance of the offer results in a contract.	Acceptance does not create a contract; it leads to further negotiation.
Examples	A specific proposal to sell a product at a particular price.	An advertisement of books for sale or houses to let.
Legal Position	Creates a legal obligation upon acceptance.	Does not create a legal obligation; it only leads to a request for offers.
Test for Determination	Whether the person making the statement intends to be bound immediately upon acceptance.	Whether the statement is meant to induce negotiation rather than bind immediately.
Acceptance Impact	Directly results in the formation of a contract.	Leads to negotiation; no contract is formed by mere acceptance.

Examples of invitation to offer to buy or sell:

1. A Prospectus by a company to the public to subscribe for its shares.
2. Display of goods for sale in shop windows.
3. Advertising auction sales and
4. Quotation of prices sent in reply to a query regarding price

I. **Definition of Acceptance:** In terms of **Section 2(b)** of the Act, 'the term acceptance' is defined as follows:

- **"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".**

> *Example:*
> **Proposal Made:** A offers to sell his car to B for ₹2,00,000. Here, A is making a proposal to B.
> **Acceptance:** B agrees to A's offer. When B shows he agrees to the proposal, he is accepting it.
> **Acceptance Turned into Promise:** Once B accepts A's offer, the proposal is accepted and becomes a promise.
> **In summary:** A makes a proposal, B accepts it, and the accepted proposal becomes a promise.

II. **Relationship between offer and acceptance:**

- **Sir William Anson**

  "Acceptance is to offer what a lighted match is to a train of gunpowder".

- The effect of this observation is that what acceptance triggers cannot be recalled or undone.
- But there is a choice to the person who had the train to remove it before the match is applied.
- It in effect means that the offer can be withdrawn just before it is accepted.
- Acceptance converts the offer into a promise and then it is too late to revoke it.
- This means as soon as the train of gunpowder is lighted it would explode.
- The significance of this is an offer in itself cannot create any legal relationship but it is the acceptance by the offeree which creates a legal relationship.

Once an offer is accepted it becomes a promise and cannot be withdrawn or revoked.

An offer remains an offer so long as it is not accepted but becomes a contract as soon as it is accepted.

LEGAL RULES REGARDING A VALID ACCEPTANCE

1. **Acceptance can be given only by the person to whom offer is made:** In case of a specific offer, it can be accepted only by the person to whom it is made. [Boulton vs. Jones (1857)]

> *Case Law:* **Boulton v. Jones (1857)**
> - Involves a dispute where Boulton, who had taken over a store, filled an order from Jones who was unaware of the change in ownership.
> - Jones refused to pay, arguing that he had contracted with the previous owner, not Boulton.
> - The court ruled that Boulton could not enforce the contract because there was no mutual agreement between him and Jones.
> - The case emphasizes that a contract requires mutual assent between the actual parties involved.

- As per section 7 of the Act, **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.

> ***Example 46:*** *'A' enquires from 'B', "Will you purchase my car for ₹2 lakhs?" If 'B' replies "I shall purchase your car for ₹2 lakhs, if you buy my motorcycle for 50,000/-, here 'B' cannot be considered to have accepted the proposal. If on the other hand 'B' agrees to purchase the car from 'A' as per his proposal subject to availability of valid Registration Certificate/book for the car, then the acceptance is in place though the offer contained no mention of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore, the acceptance in this case is unconditional.*

3. **The acceptance must be communicated:**
   - **To conclude a contract between the parties, the acceptance must be communicated in some perceptible form.**
   - *Conditional acceptance* = NO ACCEPTANCE
   - As it is acceptance with varying or too deviant conditions
   - It is a counter proposal and has to be accepted by the proposer, if the original proposal has to materialise into a contract.
   - Further **when a proposal is accepted, the offeree must have the knowledge of the offer made to him**.
   - **If he does not have the knowledge, there can be no acceptance.**
   - The acceptance must relate specifically to the offer made. Then only it can materialise into a contract. The above points will be clearer from the following examples:

> ***Brogden vs. Metropolitan Railway Co. (1877)***
>
> **Facts:**
> - B (a supplier) sent a draft agreement for the supply of coal to the Metropolitan Railway Co.
> - The manager of the railway company wrote "Approved" on the draft and put it in a drawer, intending to send it for formalization.
> - Due to an oversight, the draft remained in the drawer and was never sent to the company's solicitors.
>
> **Issue:** Whether a contract was formed between B and the Metropolitan Railway Co. despite the manager's approval not being communicated.
>
> **Decision:** The court held that no contract was formed because the manager's acceptance was not communicated to B.
>
> **Key Point:** For a contract to be valid, acceptance must be communicated to the offeror.

(Bhagwandas v. Girdharilal)

Facts:

- Bhagwandas sent a letter to Girdharilal offering to sell goods at a certain price.
- Girdharilal responded with a letter expressing acceptance but did not send the letter of acceptance back immediately.
- Bhagwandas, before receiving Girdharilal's acceptance, sold the goods to a third party.

Issue: Whether a binding contract was formed between Bhagwandas and Girdharilal despite Bhagwandas selling the goods to someone else before receiving the acceptance.

Decision: The court ruled that no contract was formed because acceptance must be communicated to the offeror.

Bhagwandas was justified in selling the goods to a third party as the acceptance was not communicated in time.

Key Point: For a contract to be valid, acceptance must be communicated to the offeror before the offer is revoked or the offeror undertakes a different action.

Heyworth v. Knight [1864]

Facts:

- Heyworth made an offer to sell goods to Knight.
- Knight accepted the offer and intended to communicate his acceptance.
- Before Knight could send his acceptance, Heyworth sold the goods to someone else.

Issue: Whether a binding contract was formed between Heyworth and Knight despite Heyworth selling the goods before receiving Knight's acceptance.

Decision: The court held that no contract was formed because the acceptance was not communicated to Heyworth before the offer was revoked.

Key Point: Acceptance must be communicated to the offeror to create a binding contract. If the offeror revokes the offer before receiving the acceptance, no contract is formed.

Example 47: 'A proposed B to marry him. B informed A's sister that she is ready to marry him. But his sister didn't inform A about the acceptance of proposal. There is no contract as acceptance was not communicated to A.

4. **Acceptance must be in the prescribed mode:**
   - Where the mode of acceptance is prescribed in the 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, i.e., not in the prescribed manner, the proposer is presumed to have consented to the acceptance.

   Example 48: 'If the offeror prescribes acceptance through messenger and offeree sends acceptance by email, there is no acceptance of the offer if the offeror informs the offeree that the acceptance is not according to the mode prescribed. But if the offeror fails to do so, it will be presumed that he has accepted the acceptance and a valid contract will arise.

5. **Time:**
   - Acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given within the reasonable time and before the offer lapses.

and circumstances of the particular case.

Example 49: 'A offered to sell B 50 kgs of bananas at ₹500. B communicated the acceptance after four days. Such is not a valid contract as bananas being perishable items could not stay for a period of week. Four days is not a reasonable time in this case.

Example 50: A offers B to sell his house at ₹20,00,000. B accepted the offer and communicated to A after 4 days. Held the contract is valid as four days can be considered as reasonable time in case of sell of house.

6. **Mere silence is not acceptance:** 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 acceptance.

Felthouse vs. Bindley (1862)

Facts:

- Felthouse offered to buy a horse from Bindley and stated that if he did not hear from Bindley, he would consider the horse as sold.
- Bindley did not explicitly accept or reject the offer but acted as if the horse was sold.
- Felthouse did not receive a direct acceptance from Bindley and later attempted to enforce the contract.

Issue: Whether a contract was formed when Bindley did not explicitly communicate acceptance of Felthouse's offer.

Decision:

- The court ruled that no contract was formed because silence or inaction cannot constitute acceptance.
- A contract requires clear and unequivocal communication of acceptance.

Key Point: Acceptance must be explicitly communicated to the offeror. Silence or failure to respond does not constitute acceptance.

Example 51: 'A' subscribed for the weekly magazine for one year. Even after expiry of his subscription, the magazine company continued to send him magazine for five years. And also 'A' continued to use the magazine but denied to pay the bills sent to him. 'A' would be liable to pay as his continued use of the magazine was his acceptance of the offer.

7. **Acceptance by conduct/Implied Acceptance:**
   - Section 8 of the Act - 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.
   - This section provides the acceptance of the proposal by conduct as against other modes of acceptance i.e. verbal or written communication.
   - When a person performs the act intended by the proposer as the consideration for the promise offered by him, the performance of the act constitutes acceptance.

Example 52: When a tradesman receives an order from a customer and executes the order by sending the goods, the customer's order for goods constitutes the offer, which has been accepted by the tradesman subsequently by sending the goods. It is a case of acceptance by conduct.

- Both 'offer' and 'acceptance' is their effective communication.
- Effective and proper communication prevents avoidable revocation and misunderstanding between parties.
- When face-to-face, instantaneous communication of offer and acceptance takes place. Bu when at a distance - problem occurs
- In such cases, it is very much relevant for us to know the exact time when the offer or acceptance is made or complete.

1. Communication of offer:

- In terms of Section 4 of the Act - The communication of offer is complete when it comes to the knowledge of the person to whom it is made

> *Example 53: 'Where 'A' makes a proposal to 'B' by post to sell his house for ₹5 lakhs and if the letter containing the offer is posted on 10th March and if that letter reaches 'B' on 12th March the offer is said to have been communicated on 12th March when B received the letter.*

- When a proposal is made by post, its communication - will be complete when the letter containing the proposal reaches the person to whom it is made.

Mere receiving of the letter is not sufficient, he must receive or read the message contained in the letter.

- He receives the letter on 12th March, but he reads it on 15th of March. In this case the offer is communicated on 15th of March, and not 12th of March.

2. Communication of acceptance: Two issues -

- The modes of acceptance and
- When is acceptance complete?

Let us first consider the **modes of acceptance**.

- Section 3 - Two modes of communication namely,
  1. **By any act and**
  2. **By omission**,
- **Communication by Act**
  1. **Expression of Words:** This includes written words (letters, telegrams, faxes, emails, advertisements) and oral words (telephone messages).
  2. **Conduct:** Positive acts or signs intended to convey a message. For example, delivering goods to a buyer signifies acceptance of the offer.
- **Communication by Omission**
  1. **Forbearance:** Failure to act or convey willingness can communicate acceptance, but mere silence is not considered communication by omission.

> *Example 54: 'A offers ₹50,000 to B if he does not arrive before the court of law as an evidence to the case. B does not arrive on the date of hearing to the court. Here omission of doing an act amounts to acceptance.*

- **Communication of acceptance by conduct.**

Examples:

1. Boarding a bus signifies acceptance of the offer to transport passengers.
2. Dropping a coin in a weighing machine signifies acceptance of the service offer.

1. **Indirect Communication:** Actions or omissions must effectively communicate acceptance. Mere internal assent or thought does not constitute communication.
2. **Case Example:** In Central Bank Yeotmal vs Vyankatesh (1949), a resolution to sell land was not communicated, so no contract was formed.

- **Completion of Communication of Acceptance**
  1. **As Against the Proposer:**
     - **Completion:** Communication is complete when the acceptance is put in the course of transmission and out of the acceptor's control (e.g., when a letter is posted).
  2. **As Against the Acceptor:**
     - **Completion:** Communication is complete when the acceptance comes to the proposer's knowledge (e.g., when the letter reaches the proposer).
  3. **Postal Acceptance Rule:**
     - **Proposer:** Bound when the letter is posted, even if delayed or lost in transit.
     - **Acceptor:** Bound only when the letter of acceptance reaches the proposer.
  4. **Practical Implications:**
     - **Proposer's Responsibility:** Must ensure the letter is correctly addressed, stamped, and posted.
     - **Acceptor's Responsibility:** Must ensure the letter reaches the proposer to be bound by the contract.
  5. **Acceptance over telephone or telex or fax:** When an offer is made of instantaneous communication like telex, telephone, fax or through email, **the contract is only complete when the acceptance is received by the offeree, and the contract is made at the place where the acceptance is received**.

Entores Ltd. v. Miles Far East Corporation

Facts:

- Entores Ltd., a company based in London, sent an offer by telex to Miles Far East Corporation in Amsterdam.
- Miles Far East Corporation sent an acceptance by telex in response.
- A dispute arose regarding the validity of the acceptance, particularly the exact moment when the acceptance was communicated.

Issue: When is the communication of acceptance complete in a contract involving instantaneous communication methods, such as telex?

Decision:

- The court ruled that for instantaneous communication methods like telex, the acceptance is complete when it is received by the offeror.
- In this case, the acceptance was not complete until it was received by Entores Ltd. in London.

Key Point:

- For instantaneous communication (e.g., telex, telephone), acceptance is effective when it is received by the offeror, not when it is sent by the acceptor.
- However, in case of call drops and disturbances in the line, there may not be a valid contract.

and the acceptance of these conditions are also conveyed by the offeree again tacitly or without him even realising it.

Example 55: For instance when a passenger undertakes a travel, the conditions of travel are printed at the back of the tickets, sometimes these special conditions are brought to the notice of the passenger, sometimes not. In any event, the passenger is treated as having accepted the special condition the moment he bought his ticket.

Mukul Datta vs. Indian Airlines [1962] AIR Cal. 314

Facts: The plaintiff, Mukul Datta, traveled from Delhi to Kolkata by air. The air ticket had special conditions printed in fine print on the back.

Issue: Whether these conditions, which were not prominently displayed, could still be considered communicated to and accepted by the passengers.

Decision: The court ruled that such conditions, even if printed in fine print or posted on a notice board, can be considered communicated to passengers. Passengers are deemed to have accepted these terms if they do not object to them.

Key Point: The terms and conditions must be reasonable to be enforceable.

Example 56: Where a launderer gives his customer a receipt for clothes received for washing. The receipt carries special conditions and are to be treated as having been duly communicated to the customer and therein a tacit acceptance of these conditions is implied by the customer's acceptance of the receipt [Lily White vs. R. Mannuswamy [1966] A. Mad. 13].

Lilly White vs. Mannuswamy (1970)

Facts:

- Lilly White, the plaintiff, and Mannuswamy, the defendant, were involved in a contract dispute.
- Mannuswamy claimed that certain terms were included in the contract but were not communicated or agreed upon by Lilly White.
- The terms in question were included in a document not seen or acknowledged by Lilly White

Issue: Whether terms included in a document not seen or acknowledged by one party can be considered part of the contract.

Decision:

- The court ruled that for terms to be enforceable, they must be communicated and agreed upon by all parties involved.
- Terms included in a document that was not seen or acknowledged by Lilly White could not be enforced as part of the contract.

Key Point: For terms to be binding, all parties must be aware of and agree to them. Terms hidden in documents not presented or acknowledged by one party are not enforceable.

COMMUNICATION OF PERFORMANCE

- Section 4 of the Act - **Communication** of a proposal is **complete when it comes to the knowledge of the person to whom it is meant**.

are:

1. From the **viewpoint of proposer** and
2. The other from the **viewpoint of acceptor** himself.

- From the viewpoint of the **proposer**, when the acceptance is put into a course of transmission, when it would be **out of the power of the acceptor**. From the viewpoint of the **acceptor**, it would be complete **when it comes to the knowledge of the proposer**.
- At times the offeree may be required to communicate the performance (or act) by way of acceptance. In this case it is not enough if the offeree merely performs the act but he should also communicate his performance unless the offer includes a term that a mere performance will constitute acceptance.

Carlill v. Carbolic Smoke Ball Co.

Facts:

- The Carbolic Smoke Ball Co., a sole proprietorship, manufactured a medicine known as the "carbolic smoke ball" intended to cure influenza, colds, and related ailments.
- The company issued an advertisement offering a reward of $100 to anyone who contracted influenza after using the smoke ball as directed.
- Mrs. Carlill purchased the smoke balls and used them according to the instructions but still contracted influenza.

Issue: Whether Mrs. Carlill was entitled to the $100 reward despite not communicating her compliance with the terms of the advertisement.

Decision:

- The court ruled in favor of Mrs. Carlill, holding that she was entitled to the $100 reward.
- It was determined that Mrs. Carlill had fulfilled the condition specified in the advertisement by contracting influenza after using the smoke balls.
- The advertisement did not require any formal communication of compliance, so it was not necessary for Mrs. Carlill to notify the company of her use of the product.

Key Point: In unilateral contracts (like reward offers), the performance of the condition constitutes acceptance, and formal communication of compliance is not always required.

- The court thus in the process laid down the following three important principles -

1. **An offer, to be capable of acceptance, must contain a definite promise by the offeror that he would be bound provided the terms specified by him are accepted;**
2. **An offer may be made either to a particular person or to the public at large, and**
3. **If an offer is made in the form of a promise in return for an act, the performance of that act, even without any communication thereof, is to be treated as an acceptance of the offer.**

REVOCATION OF OFFER AND ACCEPTANCE

- **Section 4** - Communication of revocation (of the proposal or its acceptance) is complete when -

1. **as against the person who makes it when it is put into a course of transmission to the person to whom it is made so as to be out of the power of the person who makes it**, and
2. **as against the person to whom it is made, when it comes to his knowledge**.

Revocation of Proposal:

- A proposal (offer) can be revoked by the offeror at any time before it is accepted.
- Completion: The revocation is complete for the offeror when the telegram (or communication) is dispatched. For the offeree, it is complete only when they receive the revocation.

Revocation of Acceptance:

- The offeree can revoke their acceptance of an offer by telegram.
- Completion: The revocation of acceptance is complete for the offeree when they dispatch the telegram, and for the offeror when they receive it.

Key Point:

- A proposal can be revoked at any time before acceptance. Once revoked, the offeree cannot create a contract by accepting the revoked offer.

  Example 57: The bidder at an auction sale may withdraw (revoke) his bid (offer) before it is accepted by the auctioneer by fall of hammer.

- **An offer may be revoked by the offeror before its acceptance, even though he had originally agreed to hold it open for a definite period of time. So long as it is a mere offer, it can be withdrawn whenever the offeror desires.**

  Example 58: X offered to sell 50 bales of cotton at a certain price and promised to keep it open for acceptance by Y till 6 pm of that day. Before that time X sold them to Z. Y accepted before 6 p.m., but after the revocation by X. In this case it was held that the offer was already revoked.

- In terms of Section 5 of the Act a proposal can be revoked - at any time before the communication of its acceptance is complete as against the proposer.
- An acceptance may be revoked at any time before the communication of acceptance is complete as against the acceptor.

  Example 59: A proposes, by a letter sent by post, to sell his house to B. B accepts the proposal by a letter sent by post. A may revoke his proposal at any time before or at the moment when B posts his letter of acceptance, but not afterwards. Whereas B may revoke his acceptance at any time before or at the moment when the letter communicating it reaches A, but not afterwards.

- An acceptance to an offer must be made before that offer lapses or is revoked.

The law relating to the revocation of offer is the same in India as in England, but the law relating to the revocation of acceptance is different.

- **English Law:** A contract is concluded and acceptance becomes irrevocable the moment it is communicated, whether orally or by post.
- **Indian Law:** Contract Through Post:
  - Acceptance cannot be revoked once the letter is properly posted.
  - However, in Indian law, an acceptor can revoke their acceptance any time before the letter reaches the offeror.
  - If a revocation telegram arrives before or at the same time as the acceptance letter, the revocation is valid.
- **Contract Over Telephone:**
  - Contracts can be made over the phone.
  - The rules for offer and acceptance are the same as for face-to-face meetings.

the acceptance is received by the offeror.

- If the telephone line disconnects during the conversation, the acceptor should confirm that their acceptance was heard by the offeror.

- **Revocation of Proposal:**
  - An offer can be revoked before it is accepted.
  - Revocation can occur through communication or by lapse of time

I. Modes of Revocation of Offer

1. **By notice of revocation**

   Example 60: A offered B to sell goods at ₹5,000 through a post but before B could accept the offer A received highest bid for the goods from C. So, A revoked the offer to B by informing B over the telephone and sold goods to C.

2. **By lapse of time:**
   - **Time for Acceptance:**
     - Acceptance must occur within the specified time or, if no time is specified, within a reasonable time.
     - The proposer should not be made to wait indefinitely.
   - **Case Law:**
     - Ramsgate Victoria Hotel Co. v. Montefiore (1866): An application for shares made in June was not binding when an allotment was made in November, due to the lapse of time.
     - Indian Case: India Cooperative Navigation and Trading Co. Ltd. v. Padamsey Premji followed the same principle.
   - **Current Relevance:** These decisions are less relevant now due to the Companies Act, 2013, which has specific provisions for share allotment.
3. **By non-fulfilment of condition precedent:**
   - **Principle:**
     - Under Section 6 of the Act, a proposal can be revoked if the acceptor fails to fulfill a condition precedent to acceptance.
     - A condition precedent is a requirement that must be satisfied before the acceptance and the contract become binding.

     Examples:
     - The offeror may impose conditions such as signing a document or depositing earnest money.
     - If the condition is not met, the proposal lapses and is considered revoked.
     - If A offers to sell his house to B for ₹5 lakhs on the condition that B leases his land to A, and B refuses to lease the land, A's offer is automatically revoked due to the unmet condition.
4. **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.
5. By **counter offer.**
6. By the **non-acceptance of the offer** according to the prescribed or usual mode.
7. By **subsequent illegality**.

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. A sends an offer to B to sell his second-car for ₹ 1,40,000 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? **(Module)**

Ans. Acceptance to an offer cannot be implied merely from the silence of the offeree, even if it is expressly stated in the offer itself. Unless the offeree has by his previous conduct indicated that his silence amount to acceptance, it cannot be taken as valid acceptance. So, in the given problem, if B remains silent, it does not amount to acceptance. The acceptance must be made within the time limit prescribed by the offer.

The acceptance of an offer after the time prescribed by the offeror has elapsed will not avail to turn the offer into a contract.

2. 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)**

Ans. (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.

3. 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 canceled. Can Miss Shakuntala claim for damages? **(Module)**

Ans. 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.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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 ₹ 72,00,000 and B agreed to it.

(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 May 23)

Ans.

(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 72,00,000 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 & 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.

2. Mr. Parth 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. Parth that he was appointed but official communication was not given by the school. Later, the management of the school decided to appoint someone else as a principal. Mr. Parth filed a suit against the school for cancellation of his appointment and claimed damages for loss of salary. State with reasons, will Mr. Parth be successful in suit filed against school under the Indian Contract Act, 1872? **(RTP Jun' 24, Nov 21)**

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

3. Mr. Joy owns two flats in a building. He wanted to sell flat no.101 to Mr. Roy. Mr. Joy offered to sell his flat no. 101 to Mr. Roy, but Mr. Roy thought that Mr. Joy wanted to sell flat no. 102 and said yes for the agreement. Considering the provisions of Indian Contract Act, 1872, discuss the validity of such a contract. **(MTP Jun'22 4 Marks)**

Ans. Section 10 of Indian Contract Act, 1872 laid done the essential elements of a valid contract. One of the essential elements of valid contract is free consent. Consent is an express willingness or giving voluntary permission or agreeing to something. Section 13 further clarify" two or more persons are said to consent when they agree upon the same thing in the same sense". In the present case, both the parties have given a free consent but they are not consenting for the same thing in the same sense. Mr. Joy wants to sell flat no. 101 and Mr. Roy has agreed the contract thinking that it's flat no. 102. Hence, the agreement would be invalidated at the inception (beginning) stage itself because both the parties did not agree about a thing (sale of

therefore it is not a valid contract.

4. "All contracts are agreements, but all agreements are not contracts". Comment.

(MTP Jun' 22 4 Marks) (SM) (MTP 4 Marks, Nov'21)

Ans. An agreement comes into existence when one party makes a proposal or offer to the other party and that other party gives his acceptance to it. A contract is an agreement enforceable by law. It means that to become a contract, an agreement must give rise to a legal obligation i.e. duly enforceable by law. If an agreement is incapable of creating a duly enforceable by law, it is not a contract. There can be agreements which are not enforceable by law, such as social, moral or religious agreements. The agreement is a wider term than the contract. All agreements need not necessarily become contracts but all contracts shall always be agreements. All agreements are not contracts: When there is an agreement between the parties and they do not intend to create a legal relationship, it is not a contract. All contracts are agreements: For a contract there must be two things (a) an agreement and (b) enforceability by law.

Thus, existence of an agreement is a prerequisite existence of a contract. Therefore, it is true to say that all contracts are agreements. Thus, we can say that there can be an agreement without it becoming a contract, but we can't have a contract without an agreement.

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

(a) 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.

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

(c) A contract with B (owner of the factory) for the supply of 10 tons of sugar, but before the supply is affected, the fire caught in the factory, and everything was destroyed.

(MTP Nov'22 4 Marks)(SM)

Ans.

(a) It is an implied contract and A must pay for the services of the coolie detailed by him.

Implied Contracts: Implied contracts come into existence by implication. Most often the implication is by law and or by action. Section 9 of the Act contemplates such implied contracts when it lays down that in so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied.

(b) 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 created by law under certain circumstances. The law creates and enforces legal rights and obligations when no real contract exists. Such obligations are known as quasi-contracts. In other words, it is a contract in which there is no intention on part of either party to make a contract, but law imposes a contract upon the parties.

(c) The above contract is a void contract.

Void Contract: Section 2 (i) 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.

having a price tag of ₹40,000 after a discount of ₹3000. Ashwin reaches at cash counter for making the payment, but cashier says, "Sorry sir, the discount was up-to yesterday. There is no discount from today. Hence you have to pay ₹43,000". Ashwin got angry and insists for ₹40,000. State with reasons whether under indian Contract Act, 1872, Ashwin can enforce the cashier to sell at discounted price i.e. ₹40,000.

(MTP Apr'23 4 Marks) RTP May'22 (PYQ Dec'23 3 Marks) (MTP 4 Marks, Oct'21)

Ans. 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, Ashwin reaches to super market and selects a Air Conditioner with a discounted price tag of 7 40,000 but cashier denied to sell at discounted price by saying that discount is closed from today and request to make full payment.

But Ashwin insists to purchase at discounted price. On the basis of above provisions and facts, the price tag with Air Conditioner was not offer. It is merely an invitation to offer. Hence, it is the Ashwin who is making the offer not the super market. Cashier has right to reject the Ashwin's offer. Therefore, Ashwin cannot enforce cashier to sell at discounted price.

7. Mr. Ayush is the principal in Modern Public School. He needs 2000 packets of Biscuits to be distributed to students in his school on the occasion of Republic Day celebration. For this purpose, he contracted with Yograj Biscuit Company. Mr. Ayush visited the workshop of Yograj Biscuit Company and was very much satisfied with the quality of biscuits. He also found that a large number of varieties of biscuits are manufactured in the workshop. He ordered 2000 packs of biscuits and gave the token money but did not specify the category of biscuits, he needed. Yograj Biscuit Company did not supply the biscuits on the due date. Mr. Ayush filed the suit against Yograj Biscuit Company for compensation. State with reasons, whether Yograj Biscuit Company is liable under Indian Contract Act, 1872? **(MTP Nov'23 4 Marks)**

Ans. According to the Indian Contract Act 1872, the meaning of agreement must be certain and not vague or indefinite. If the meaning of agreement is not certain, the agreement is not enforceable by law. In the instant case, Mr. Ayush is being principal in Modern Public School ordered 2000 packs of biscuits to Yograj Biscuit Company for the purpose of distribution on Republic Day among students.

He also gave the token money but did not specify the category of biscuits. Yograj Biscuit Company did not supply the biscuits on the due date and Mr. Ayush filed the suit for compensation. On the basis of above provisions and facts, it can be said that the agreement was not enforceable for want of certainty of meaning as Mr. Ayush did not specify the category of biscuits. Hence, Yograj Biscuit Company is not liable to pay any compensation to Mr. Ayush.

8. Mr. Nikhil has decided to get interior work for his new office. For this purpose, he entered into a contract with M/s Sherry Fine Interiors. It was agreed that M/s Sherry Fine Interiors will complete the interior work latest by 31st January, 2023. On 31st January, 2023, Mr. Nikhil observed that only 20% to 30% work has been completed. He decided to cancel the contract with M/s Sherry Fine Interiors.

On cancellation of the contract, M/s Sherry Fine Interiors filed a suit against Mr. Nikhil for recovery of the cost which it has incurred on the interior work. Mr. Nikhil argued that M/s Sherry Fine Interiors did not complete the work within the time as per contract and further

he has to appoint a new interior designer.

Explain, whether Mr. Nikhil is liable to pay the cost of work done by M/s Sherry Fine Interiors under the provisions of Indian Contract Act, 1872? **(MTP Dec'23 4 Marks)**

Ans. Section 2(i) of Indian Contract Act, 1872 provides that an agreement which is enforceable by law at the option of one or more parties thereto, but not at the option of the other or others is a voidable contract.

Further, when a party to a contract promise to perform a work within a specified time, could not perform with in that time, the contract is voidable at the option of the promisee. If promisee has received any benefit, he must return to promisor. In the given problem, the contract is voidable at the option of Mr. Nikhil as work is not completed within the time agreed in the contract. Further, Mr. Nikhil is not liable to pay the cost incurred by M/s Sherry Fine Interiors as that cost did not provide any benefit to him and he has to appoint a new interior designer.

9. (Includes concepts of 2.3- Other essential elements of a contract)

X agrees to pay Y ₹1,00,000/-, if Y kills Z. To pay Y, X borrows ₹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. **(PYQ Nov'22 4 Marks)**

1. Between X and Y.
2. Between X and W.

Ans. 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.

In the present case,

1. X agrees to give ₹1,00,000 to Y if Y kills Z. Thus, the agreement between X and Y is void agreement being illegal in nature.
2. X borrows ₹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.

10. 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? **(PYQ Jun'23 4 Marks)**

Ans. 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

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.

11. Distinguish between Void Contract and Voidable Contract according to the Indian Contract Act, 1872. **(PYQ Jun 23 5 Marks)**

Ans. The differences between void contract and voidable contract are as follows:

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

1. X promise to sell his scooter to Y for ₹1 Lac. However, the consent of X has been procured by Y at a gun point.
2. A bought goods from B in 2015. But no payment was made till 2019.
3. G agrees to give tuitions to H, a pre-engineering student, from the next month and H in consideration promises to pay G ₹5,000 per month. **(RTP May' 21)**

Ans.

1. 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.
2. 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.
3. Where, G agrees to give tuitions to H, a pre-engineering student, from the next month and H in consideration promises to pay G $ 5,000 per month, the contract is executory because it is yet to be carried out.

13. Mr. S aged 58 years was employed in a Government 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 of ₹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. **(PYQ 4 Marks, Jan' 21)**

Ans. Section 10 of the Indian Contract Act, 1872 provides for the legality of consideration and objects thereto.

Section 23 of the said Act also states that every agreement of which the object or consideration is unlawful is void. The given problem talks about entering into an agreement for traffic relating to public office, which is opposed to public policy. Public policy requires that there should be no money consideration for the appointment to an office in which the public is interested. Such consideration paid, being opposed to public policy, is unlawful. In the given case, Mr. S, who was going to be retired after two years was proposed by Mr. D, to apply for voluntary retirement from his post, in order that he can be appointed in his place. In lieu of that Mr. D offered Mr. S a sum of ₹10 lakh as consideration. Mr. S refused initially but later accepted the said offer to receive money to retire from his office. Here, Mr. S's promise of sale for Mr. D, an

Therefore, in terms of the above provisions of the Indian Contract Act, the said agreement is not valid. It is void, as the consideration being opposed to public policy, is unlawful.

14. Define the term acceptance under the Indian Contract Act, 1872. Explain the legal rules regarding a valid acceptance. **(PYQ 7 Marks, Jan 21)**

Ans. Definition of Acceptance: In terms of Section 2(b) of the Indian Contract Act, 1872 the term acceptance is defined as "When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted. The proposal, when accepted, becomes a promise"

Legal Rules regarding a valid acceptance:

1. Acceptance can be given only by the person to whom offer is made. In case of a specific offer, it can be accepted only by the person to whom it is made. In 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: As per section 7 of the Act, 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 a contract between the parties, the acceptance must be communicated in some perceptible form. Further when a proposal is accepted, the offeree must have the knowledge of the offer made to him. If he does not have the knowledge, there can be no acceptance. The acceptance must relate specifically to the offer made. Then only it can materialize into a contract.
4. Acceptance must be in the prescribed mode: Where the mode of acceptance is prescribed in the 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, i.e., not in the prescribed manner, the proposer is presumed to have consented to the acceptance.
5. Time: Acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given within the 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 acceptance.
7. Acceptance by conduct/Implied Acceptance: Section 8 of the Act lays down that "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. This section provides the acceptance of the proposal by conduct as against other modes of acceptance i.e. verbal or written communication.

Therefore, when a person performs the act intended by the proposer as the consideration for the promise offered by him, the performance of the act constitutes acceptance.

15. Mr. B makes a proposal to Mr. S by post to sell his house for 7 10 lakhs and posted the letter on 10th April 2020 and the letter reaches to Mr. S on 12th 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 19th April 2020.

1. On which date, the offer made by Mr. B will complete?
2. Discuss the validity of acceptance.
3. What would be validity of acceptance if letter of revocation and letter of acceptance reached together? **(PYQ 6 Marks, Jan'21)**

Ans.

1. According to Section 4 of the Indian Contract Act, 1872, "the communication of offer is complete when it comes to the knowledge of the person to whom it is made" When a proposal is made by post, its communication will be complete when the letter containing the proposal reaches the person to whom it is made. Further, mere receiving of the letter is not sufficient, he must receive or read the message contained in the letter.

   In the given question, Mr. B makes a proposal by post to Mr. S to sell his house. The letter was posted on 10th April 2020 and the letter reaches to Mr. Son 12th April 2020 but he reads the letter on 13th April 2020.

   Thus, the offer made by Mr. B will complete on the day when Mr. S reads the letter, i.e. 13th April 2020.
2. When communication of acceptance is complete: Where a proposal is accepted by a letter sent by the post, in terms of Section 4 of the Act, the communication of acceptance will be complete as against the proposer when the letter of acceptance is posted and as against the acceptor when the letter reaches the proposer.

   Revocation of Acceptance: The acceptor can revoke his acceptance any time before the letter of acceptance reaches the offeror, if the revocation telegram arrives before or at the same time with the letter of acceptance, the revocation is absolute. In the given question, when Mr. S accepts Mr. B's proposal and sends his acceptance by post on 16th April 2020, the communication of acceptance as against Mr. B is complete on 16th April 2020, when the letter is posted. As against Mr. S acceptance will be complete, when the letter reaches Mr. Bi.e. 20th April 2020. Whereas, acceptor, will be bound by his acceptance only when the letter of acceptance has reached the proposer.

   The telegram for revocation of acceptance reached Mr. B on 19th April 2020 i.e. before the letter of acceptance of offer (20th April 2020). Hence, the revocation is absolute. Therefore, acceptance to an offer is invalid.
3. It will not make any difference even if the telegram of revocation and letter of acceptance would have reached on the same day, i.e. the revocation then also would have been absolute. As per law, acceptance can be revoked anytime before the communication of acceptance is complete. Since revocation was made before the communication of acceptance was complete and communication can be considered as complete only when the letter of acceptance reaches the proposer i.e. Mr. B.

16. State with reason(s) whether the following agreements are valid or void:

1. A clause in a contract provided that no action should be brought upon in case of breach.
2. 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.
3. X offers to sell his Maruti car to Y. Y believes that X has only Wagon R Car but agrees to buy it.

for a term of two years and Y agrees not to practice as a surgeon and physician during these two years. **(PYQ 4 Marks, Jul'21)**

Ans.

1. The given agreement is void.

   Reason: As per Section 28 of the Indian Contract Act, 1872, this clause is in restraint of legal proceedings because it restricts both the parties from enforcing their legal rights.

   Note: Alternatively, as per Section 23 of the Indian Contract Act, 1872, this clause in the agreement defeats the provision of law and therefore, being unlawful, is treated as void.

2. The given agreement is valid.

   Reason: 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. A contract of this nature is void. However, in the given statement, no absolute restriction is marked on parties on filing of suit. As per the agreement suit may be filed in one of the courts having jurisdiction.

3. The said agreement is void.

   Reason: This agreement is void as the two parties are thinking about different subject matters so that there is no real consent and the agreement may be treated as void because of mistake of fact as well as absence of consensus.

4. The said agreement is valid

   Reason: An agreement by which any person is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void. But, as an exception, agreement of service by which an employee binds himself, during the term of his agreement, not to compete with his employer is not in restraint of trade.

17. 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 4 Marks, Apr'21) (SM) (MTP 3 Marks, Nov'21)**

Ans. Invitation to offer: The offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party chooses to accept it.

Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms.

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

18. 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 ₹1,00,000.

Explain the legal position of contract under the Indian Contract Act, 1872 whether:

1. Mr. Shekhar can recover the loss of ₹20,000 from Mr. Nadan?
2. Mr. Shekhar can recover his car from Mr. Masoom? **(MTP 4 Marks, Nov'21)**

Ans. 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.

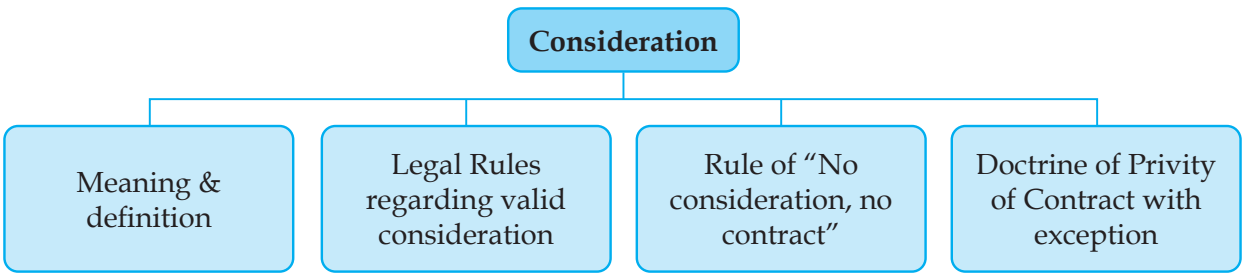
In the instant case, Mr. Shekhar appoints Mr. Nadan, a minor as his agent to sale his car. Mr. Shekhar clearly instructed to Mr. Nadan that the minimum sale price of the car should be ₹1,00,000 yet Mr. Nadan sold the car to Mr. Masoom for ₹80,000.

1. 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 ₹20,000.
2. 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.

02

UNIT

Consideration



Consideration is an essential element of a valid contract without which no single promise will be enforceable.

quid pro quo, i.e. - Something in return'.

WHAT IS CONSIDERATION?

- **Consideration is the price agreed to be paid by the promisee for the obligation of the promisor.**
- A very popular English case of Misa v. Currie as:
  - A valuable consideration in the sense of law may consist
  - either in **some right, interest, profit or**
  - **benefit** accruing to one party (i.e. **promisor**) or
  - **forbearance, detriment, loss or responsibility given,**
  - suffered or undertaken by the other (i.e., the **promisee**)".

Consideration - Section 2(d)

When at the **desire** of the **promisor**, the **promisee** or any other person has **done** or **abstained** from doing, or (PAST) **does** or **abstains** from doing or (PRESENT) **promises** to do or **abstain** from doing something, (FUTURE) such an act or abstinence or promise = Consideration for the promise

Analysis of Definition of Consideration

1. Consideration is an act- doing something.

Example 1: Ajay guarantees Bhuvan for payment of price of the goods which Bhuvan wanted to sell on one month credit to Chaitanya. Here selling of goods on credit by Bhuvan to Chaitanya is consideration for A's promise.

Example 2: A college promises students, who will score above 95% for the job in MNC. Consideration need not to be monetary. Here the promise for recruitment of candidate will be considered as consideration for the act of students scoring above 95%.

Example 3: Abhishek promises Bharti not to file a suit against him if she (Bharti) would pay him (Abhishek) ₹1,00,000. Here abstinence on the part of Abhishek would constitute consideration against Bharti's payment of ₹1,00,000 in favor of Abhishek.

Example 4: ABC has a shop of electric items. XYZ wishes to open another electric shop next to his shop. ABC offers ₹2,00,000 to XYZ for shifting the same away from 1 km of ABC's shop. Here, consideration is given for abstaining XYZ from opening his shop nearby.

3. Consideration must be at the desire of the promisor.
4. Consideration may move from promisee or any other person.
5. Consideration may be past, present or future.

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

Form of consideration = Some benefit, right or profit to one party/ some detriment, loss, or for- bearance to the other.

LEGAL RULES REGARDING CONSIDERATION

Sr. No.	Legal Rule	Brief Explanation	Example
1.	**Consideration must move at the desire of the promisor**	The act or forbearance constituting consideration must be done at the promisor's request.	A agrees to sell his car to B because B requested it
2.	**Consideration may move from the promisee or any other person**	Consideration can be provided by the promisee or by a third party.	C pays A for the house A sells to B.
3.	**Executed and executory consideration**	Consideration can be something already done (executed) or something to be done in the future (executory).	B pays A today (executed); A agrees to deliver goods next month (executory).
4.	**Consideration may be past, present, or future**	Consideration can refer to something done before, at the time of, or after the promise is made.	A helps B move (past), B pays him now (present), A promises to assist in a month (future).
5.	**Consideration need not be adequate**	The law does not require the consideration to be equal in value to the promise; it just needs to be legally sufficient	A sells his bike worth ₹50,000 to B for ₹5,000.
6.	**Performance of what one is legally bound to perform**	Doing something that one is already legally obligated to do cannot be valid consideration unless something extra is provided.	A police officer cannot claim a reward for catching a criminal as it's his legal duty.
7.	**Consideration must be real and not illusory**	The consideration must be tangible, certain, and not vague or impossible to fulfill.	A promises to give B ₹1,000 if it rains tomorrow—a vague condition.

8.	**Consideration must not be unlawful, immoral, or opposed to public policy**	The consideration should be legal and not involve actions that are illegal, immoral, or against public interest	A agrees to pay B ₹10,000 to harm C—this is unlawful consideration.

1. **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.**
   - This implies the "return" element of consideration.
   - Contract of marriage in consideration of the promise of settlement is enforceable.
   - An act done at the desire of a third party is not a consideration.

> ***Carlill v. Carbolic Smoke Ball Co.***
>
> **Facts:**
> - The Municipal Board of a town requested Durga Prasad to construct certain shops, which he did.
> - Later, shopkeepers, including Baldeo, who occupied these shops, promised to pay Durga Prasad a commission on the goods sold in these shops as a form of consideration for building the shops.
>
> **Issue:** The central issue was whether the promise made by the shopkeepers (Baldeo) to pay Durga Prasad a commission was enforceable, given that the consideration (construction of shops) was not provided at their request but at the request of the Municipal Board.
>
> **Decision:**
> - The court held that Durga Prasad could not enforce the promise made by the shopkeepers because the consideration for the promise (the construction of the shops) did not move at the request of the promisor (Baldeo and other shopkeepers).
> - Instead, it was done at the request of the Municipal Board. The promise by Baldeo to pay a commission lacked consideration and was, therefore, not enforceable.
>
> **Key Point:** If the act or forbearance is done at the desire of someone other than the promisor, it does not constitute valid consideration in the eyes of the law, making the promise unenforceable.

> ***Example 5:*** *R saves S's goods from fire without being asked to do so. R cannot demand any reward for his services, as the act being done voluntary.*

2. **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.**
   - When at the desire of the promisor, the promisee or any other person does something such an act is consideration.

There can be a stranger to a consideration but not stranger to a contract.

> ***Example 6:*** *An old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed a writing in favour of the brother agreeing to pay annuity. The daughter did not, however, pay the annuity and the uncle sued to recover it. It was held that there was sufficient consideration for the uncle to recover the money from the daughter. [Chinnayya vs. Ramayya (1882)]*

- 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.
- The promise by one party may be the consideration for an act by some other party, and vice versa.

> ***Example 7:*** *A pays ₹5,000 to B and B promises to deliver to him a certain quantity of wheat within a month. In this case A pays the amount, whereas B merely makes a promise. Therefore, the consideration paid by A is executed, whereas the consideration promised by B is executory.*

4. Consideration may be past, present or future:

- The words has done or abstained from doing are a recognition of the doctrine of past consideration.
- In order to support a promise, a past consideration must move by a previous request.
- It is a general principle that consideration is given and accepted in exchange for the promise.
- The consideration, if past, may be the motive but cannot be the real consideration of a subsequent promise.
- But in the event of the services being rendered in the past at the request or the desire of the promisor, the subsequent promise is regarded as an admission that the past consideration was not gratuitous.

> ***Examples:***
>
> ***Past Consideration:*** *Imagine you helped a friend, Alex, move into a new house last month. At that time, Alex didn't promise you anything in return.*
>
> ***Normal Rule:*** *Normally, if Alex later promises to give you ₹1,000 for the help you provided, your past help wouldn't count as valid consideration because it wasn't given in exchange for the promise.*
>
> ***Exception:*** *However, if Alex had asked you specifically to help him move last month, and then this month promises to pay you ₹1,000, your past help can be considered valid consideration. This is because you helped him at his request, and the promise to pay you later shows that your help wasn't just a free favor.*
>
> ***Example 8:*** *'A' performed some services to 'B' at his desire. After a week, 'B' promises to compensate 'A' for the work done by him. It is said to be past consideration and A can sue B for recovering the promised money.*
>
> ***Example 9:*** *A cash sale of goods is an example of present consideration. The consideration is immediately made against delivery of goods.*

Aspect	Past Consideration	Future Consideration
Timing	Done before the promise is made.	Will be done after the promise is made.
Definition	An action or benefit already provided before the promise.	A commitment to perform an action or provide something in the future.
Example	You helped Alex move last month; now he promises to pay you ₹1,000.	Alex promises to pay you ₹1,000 if you help him move next week.

Validity	Valid only if done at the request of the promisor.	Typically valid as part of an agreed exchange of promises.
Key Point	Shows that the past act wasn't just a free favor (if requested).	Involves a clear, forward-looking commitment.

5. **Consideration need not be adequate:**
   - Consideration **need not to be of any particular value**.
   - **It need not be** approximately **of equal value** with the promise for which it is exchanged but **it must be something** which the law would regard as having **some value**.

     Something in return need not be equal to something given. It can be con- sidered a bad bargain for the party.

     Explanation 2 to Section 25 -

     An agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate.
   - **But as an exception -**
     - If it is shockingly less and the other party alleges that his consent was not free then this inadequate consideration can be taken as evidence in support of this allegation.

       Example 10: X promises to sell a house worth ₹60 lacs for ₹10 lacs only, the adequacy of the price in itself shall not render the transaction void, unless the party pleads that transaction takes place under coercion, undue influence or fraud.

6. **Performance of what one is legally bound to perform:**

   (सही कार्य और कर्तव्य पूर्ण कार्य करने का क्या एक्स्ट्रा पैसा??)
   - **The performance of an act by a person who is legally bound to perform the same cannot be consideration for a contract.**
   - 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. Similarly, an agreement by a client to pay to his counsel after the latter has been engaged, a certain sum over and above the fee, in the event of success of the case would be void, since it is without consideration.

     Example 11: A promise to pay ₹2,000 to a doctor over the fees is invalid as it is the duty of a doctor to give a treatment for his normal fees.

(Extra कि या - कर्तव्य से ज़्यादा कि या - तो ठीक है बस public policy का ध्यान रखें)
   - But where a person promises to do more that he is legally bound to do or such a promise provided it is not opposed to public policy, is a good consideration.
   - It should not be vague or uncertain.

7. **Consideration must be real and not illusory:**
   - Consideration must be real and must not be illusory.
   - **It must be something to which the law attaches some value.**

     If it is legally or physically impossible it is not considered valid consideration.

     Example 12: A man promises to discover treasure by magic, bringing the dead person to live again. This transaction can be said to be void as it is illusory.

8. **Consideration must not be unlawful, immoral, or opposed to public policy.**

   सिर्फ़ होना नहीं, सही (Lawful) होना आवश्यक है

immoral or opposed to public policy also cannot be valued as valid consideration.

Example 13: ABC Ltd. promises to give job to Mr. X in a Government bank against payment of ₹50,000 is void as the promise is opposed to public policy.

SUIT BY A THIRD PARTY TO A CONTRACT

Though -

- 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.

DOCTRINE OF PRIVITY

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

Example 14: P who is indebted to Q, sells his property to R and R promises to pay off the debt amount to Q. If R fails to pay, then in such situation Q has no right to sue, as R is a stranger to contract.

BUT subject to certain exceptions.

- In other words, even a stranger to a contract may enforce a claim in the following cases:

  Bachelor in **FAM**ily - No **CAT** fights

  - *B: Beneficiary (Trust)*
  - *F: Family Settlement (Family Settlement)*
  - *A: Assignment (Assignment of a contract)*
  - *M: Marriage (Certain marriage contracts/assignments)*
  - *C: Covenant (Covenant running with the land)*
  - *A: Acknowledgement or Estoppel (Acknowledgement or estoppel)*
  - *T: Trusted Agent (Contracts entered into through an agent)*

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.

   Example 15: Two brothers X and Y agreed to pay an allowance of ₹20,000 to mother on partition of joint properties. But later they denied to abide by it. Held their mother although stranger to contract can require their sons for such allowance in the court of law.

3. **In the case of certain marriage contracts/assignments**, a provision may be made for the benefit of a person. He may file the suit though he is not a party to the agreement.

   Example 16: Mr. X's wife deserted him for ill-treating her. Mr. X promised his wife's father Mr. Puri that he will treat her properly or else pay her monthly allowance. But she was again ill-treated by her husband. Held, she has all right to sue Mr. X against the contract made between Mr. X and Mr. Puri even though she was stranger to contract.

4. **In the case of assignment of a contract**, when the benefit under a contract has been assigned, the assignee can enforce the contract but such assignment should not involve any personal skill.

Example 17: Mr. Ankit Sharma has assigned his insurance policy to his son. Now son can claim even if he was not a party to contract.

5. **Acknowledgement or estoppel –** where the promisor by his conduct acknowledges himself as an agent of the third party, it would result in a binding obligation towards the third party.

   Example 18: If L gives to M ₹20,000 to be given to N, and M informs N that he is holding the money for him, but afterwards M refuses to pay the money. N will be entitled to recover the same from the former i.e. M.

6. **In the case of a 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.

   Example 19: One owner of the land having two land adjacent to each other. One was agricultural land. He sold the other land containing a condition that it can never be used for Industrial purpose so as to protect the other agricultural land from pollution. Such condition is attached with the land so who so ever is the successor of land has to abide by it. Such are called restrictive covenants and all successor are bind to it.

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.

   Example 20: Prashant appoints Abhinav as his agent to sell his house. Abhinav sells house to Tarun. Now Prashant has right to recover the price from Tarun.

VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION

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

- In every valid contract, consideration is very important.
- A contract may only be enforceable when consideration is there.
  However, the Indian Contract Act contains certain exceptions to this rule.
- In the following cases, the agreement though made without consideration, will be valid and enforceable.

Kaam 25 hai (Section 25) - Bina Paise ka Ishq			
Natural Love and Affection (प्यार)	Compensation for past voluntary services (Pक st क ी बातें है)		Promise to pay time barred debt (Iझ mङ ने रोक रखा है)
Agency ([gङ - हमारी उ म्र)	Completed gift (उ नके लिए है)	Bailment (Jक झ l से बाहर आ जाते)	Charity (सब कु छ दान क र देते)

1. **Natural Love and Affection:** Conditions to be fulfilled under section 25(1)
   (a) It must be made out of **natural love and affection** between the parties.
   (b) Parties must stand in **near relationship** to each other.
   (c) It must be **in writing**.
   (d) It must also be **registered under the law**.

Example 21: A husband, by a registered agreement promised to pay his earnings to his wife. Held the agreement though without consideration, was valid.

Example 22: A out of natural love and affection promises to give his newly wedded daughter-in -law a golden necklace worth ₹5,00,000. 'A' made the promise in writing and signed it and registered. The agreement is valid.

2. **Compensation for past voluntary services:**
   - A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable under Section 25(2).
   - In order that a promise to pay for the past voluntary services be binding, the following essential factors must exist:
     (a) The services should have been rendered **voluntarily**.
     (b) The **services** must have been rendered **for the promisor**.
     (c) The **promisor must be in existence** at the time when services were rendered.
     (d) The **promisor must have intended to compensate the promisee**.

Example 23: P finds R's wallet and gives it to him. R promises to give P ₹10,000. This is a valid contract.

Example 24: Mr. X had helped his nephew Mr. Y to fight a case in the court of law using his knowledge and intellect. After Mr. Y won the case, he promised Mr. X to pay ₹10,000. Held, this is a valid contract as it is compensation to past services.

3. **Promise to pay time barred debt:** Where a **promise in writing signed** by the person making it or by his authorised agent, is made **to pay a debt barred by limitation it is valid without consideration** [Section 25(3)].

Example 25: A is indebted to C for ₹60,000 but the debt is barred by the Limitation Act. A sign a written promise now to pay ₹50,000 in final settlement of the debt. This is a contract without consideration, but enforceable for ₹50,000 only.

4. **Agency:** According to Section 185 of the Indian Contract Act, 1872, **no consideration is necessary to create an agency**.
5. **Completed gift:**
   - In case of completed gifts, the rule no consideration no contract does not apply.
   - Explanation (1) to Section 25 states "nothing in this section shall affect the validity as between the donor and donee, of any gift actually made". Thus, gifts do not require any consideration.
6. **Bailment:** No consideration is required to effect the contract of bailment (Section 148).

Example 26: Mr. A hand over the keys of his godown to Mr. Y as Mr. Y had deposited his goods in the same. Mr. Y gets possession of godown but not the ownership. As soon as Mr. Y lifts his goods from godown he is liable to hand over the keys back to Mr. A.

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

Example 27: Mr. G promised Mr. K, the secretary of committee of temple to donate ₹1,00,000 for renovation of that temple. On the faith of his promise, secretary has incurred some cost for renovation. Now secretary can claim from Mr. G even the contract was without consideration.

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. Mr. Sohanlal sold 10 acres of his agricultural land to Mr. Mohanlal on 25th September 2022 for ₹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, 2022, Mr. Sohanlal died leaving behind his son and life. On 15th October, 2022 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 redressal. Discuss the above in light of provisions of Indian Contract Act, 1872 and decide upon Mr. Chotelal's plan of action? **(Module)**

Ans. 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'. Consideration is one of the essential elements to make a contract valid and it can flow from the promisee or any other person. In view of 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. A promise is enforceable if there is some consideration for it and it is quite immaterial whether it moves from the promisee or any other person.

The leading authority in the decision of the Chinnaya Vs. Ramayya, held that the consideration can legitimately move from a third party and it is an accepted principle of law in India.

In the given problem, Mr. Sohanlal has entered into a contract with Mr. Mohanlal, butMr. Chotelal has not given any consideration to Mr. Mohanlal but the consideration did flow 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. 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.

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".

In such a case, third party to a contract can file the suit although it has not moved the consideration.

Hence, Mr. Chotelal is entitled to file a petition against Mr. Mohan!" for execution of contract.

1. Mr. Shyam Mundra was a big businessman having one son and one married daughter. He decided to gift his 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 died. Later, the 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 May 23) (MTP Nov'22 4 Marks)**

Ans. 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 other words, a written and registered agreement based on natural love and affection between the parties standing in near relation to each other is enforceable even without consideration.

In the given problem, the transfer of house made by Mr. Shyam Mundra 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.

2. Mr. Sanjay Kothari was a big businessman having two sons and one married daughter. He decided to gift his 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 an accident, and both died. Later, the 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 Jun' 24)**

Ans. Section 25 of the 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. Sanjay Kothari on account of natural love and affection between the parties standing in a 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.

3. "To form a valid contract, consideration must be adequate". Comment.

(MTP Nov'22 3 Marks) (SM) (RTP May' 21)

Ans. The law provides that a contract should be supported by consideration. So long as consideration exists, the Courts are not concerned to its adequacy, provided it is of some value. The adequacy of the consideration is for the parties to consider at the time of making the agreement, not for the Court when it is sought to be enforced (Bolton v. Modden). Consideration must, however, be something to which the law attaches value though it need not be equivalent in value to the promise made. According to Explanation 2 to Section 25 of the Indian Contract Act, 1872, an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate, but the inadequacy of the

the consent of the promisor was freely given.

4. Define consideration. State the characteristics of a valid consideration under the Indian Contract Act, 1872. **(MTP Apr'23 5 Marks) (MTP 5 Marks, Apr'21)**

Ans. Consideration [Section 2(d) of the Indian Contract Act, 1872]

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

The essential characteristics of a valid consideration are as follows:

1. Consideration must move at the desire of the promisor.
2. It may proceed from the promisee or any other person on his behalf.
3. It may be executed or executory. It may be past, present or future.
4. It must be real and have some value in the eyes of law.
5. It must not be something which the promisor is already legally bound to do.
6. It must not be unlawful, immoral or opposed to public policy.
7. Inadequacy of consideration does not invalidate the contract. Thus, it need not be proportionate to the value of the promise of the other.
8. It may comprise of some benefit, profit, right or interest accruing to one or some loss, detriment, obligation or responsibility undertaken by the other.

5. Explain the following statements in the light of provisions of Indian Contract Act, 1872:

1. "Agreements made out of love and affection are valid agreements".
2. "Promise to pay a time barred debt cannot be enforced".

(MTP Nov'23 5 Marks) (PYQ Nov'22 7 Marks)

Ans.

1. Agreements made out of love and affection are valid agreements: A written and registered agreement based on natural love and affection between the parties standing in near relation (e.g., husband and wife to each other is enforceable even without consideration. The various conditions to be fulfilled as per Section 25(1) of the Indian Contract Act, 1872:
   (a) It must be made out of natural love and affection between the parties.
   (b) Parties must stand in near relationship to each other.
   (c) It must be in writing.
   (d) It must also be registered under the law.

   Hence, the agreements made out of love and affection, without consideration, shall be valid, if the above conditions are fulfilled.
2. Promise to pay a time barred debt cannot be enforced: According to Section 25(3) of the Indian Contract Act, 1872, where a promise in writing signed by the person making it or by his authorised agent, is made to pay a debt barred by limitation is valid without consideration.

   Hence, this statement is not correct.

   Note: The above statement can be correct also on the basis of the "Discharge of Contract by Lapse of time" as per Limitation Act, 1963, and accordingly it can be mentioned that contract should be performed within a specified period as prescribed by the Limitation

limitation, he is deprived of remedy at law.

6. As per the general rule, "Stranger to a contract cannot file a suit in case of breach of contract". Comment and explain the exceptions to this rule as per the provisions of the Indian Contract Act, 1872. **(MTP Dec'23 7 Marks) (PYQ Jun'23 7 Marks)**

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

The aforesaid rule, that stranger to a contract cannot sue is known as a "doctrine of privity of contract", is however, subject to certain exceptions. 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/arrangements, a provision may be made for the benefit of a person, who may file a suit though he is not a party to the agreement.
4. In the case of assignment of a contract, when the benefit under a contract has been assigned, the assignee can enforce the contract but such assignment should not involve any personal skill.
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.

7. "The general rule is that an agreement made without consideration is void". State the exceptions of this general rule as per the Indian Contract Act, 1872.
(PYQ 7 Marks, May 22) (PYQ 5 Marks, Jan 21)

Ans. An agreement made without consideration is void (Section 25 of the Indian Contract Act, 1872): In every valid contract, consideration is very important. A contract may only be enforceable when consideration is there. However, the Indian Contract Act contains certain exceptions to this rule. In the following cases, the agreement though made without consideration, will be valid and enforceable.

Exceptions:

1. Natural Love and Affection: Conditions to be fulfilled under section 25(1)
   (a) It must be made out of natural love and affection between the parties.
   (b) Parties must stand in near relationship to each other.
   (c) It must be in writing.
   (d) It must also be registered under the law.

parties standing in near relation (e.g., husband and wife) to each other is enforceable even without consideration.

2. Compensation for past voluntary services: A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable under Section 25(2).

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

   (a) The services should have been rendered voluntarily.
   (b) The services must have been rendered for the promisor.
   (c) The promisor must be in existence at the time when services were rendered.
   (d) The promisor must have intended to compensate the promisee.

3. Promise to pay time barred debt: Where a promise in writing signed by the person making it or by his authorised agent, is made to pay a debt barred by limitation it is valid without consideration [Section 25(3)].
4. Agency: According to Section 185 of the Indian Contract Act, 1872, no consideration is necessary to create an agency.
5. Completed gift: In case of completed gifts, the rule no consideration no contract does not apply.

   Explanation (1) to Section 25 states "nothing in this section shall affect the validity as between the donor and done, of any gift actually made". Thus, gifts do not require any consideration.
6. Bailment: No consideration is required to affect the contract of bailment. Section 148 of the Indian Contract Act, 1872, defines bailment as the delivery of goods from one person to another for some purpose. This delivery is made upon a contract that post accomplishment of the purpose, the goods will either be returned or disposed of, according to the directions of the person delivering them. No consideration is required to affect a contract of bailment there the contract shall be valid. (Kadarnath v. Gorie Mohammad)
7. Charity: If a promisee undertakes the liability on the promise of the person to contribute to charity,

8. Mr. Y has given loan to Mr. G of ₹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? **(RTP May 21)**

Ans. 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 binding even though there is no consideration.

In the given case, the loan given by Mr. Y to Mr. G has become time barred. Thereafter, G agreed to make payment of full amount to Mr. Y Referring to above provisions of the Indian Contract Act, 1872 contract entered between parties post time barred debt is valid so, Mr. G is bound to pay the agreed amount to Mr. Y provided the above mentioned conditions of section 25 (3) are fulfilled

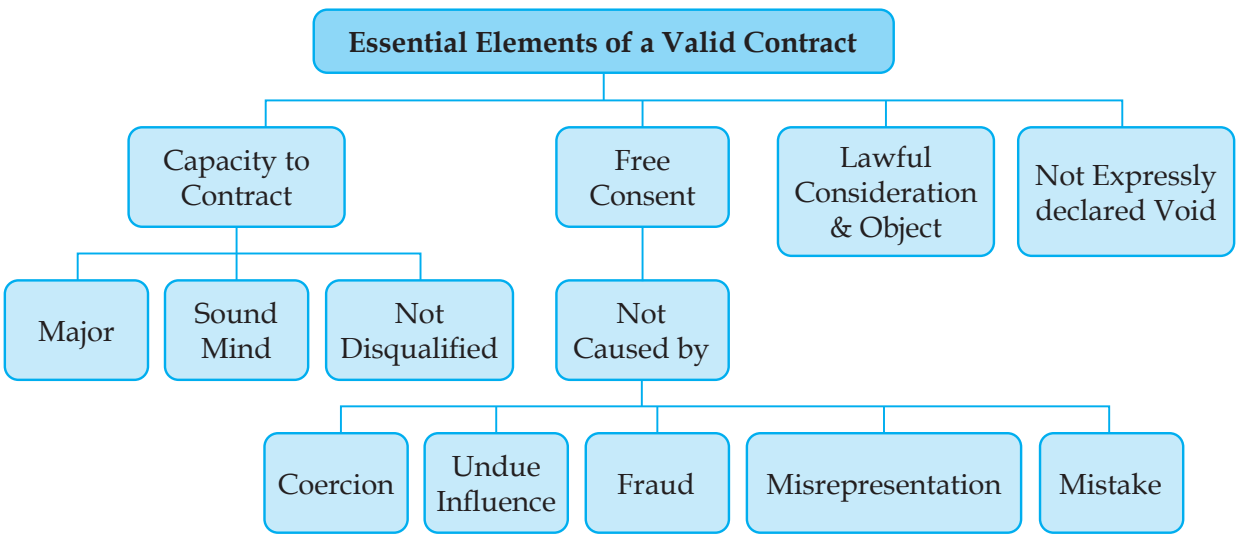
9. Mr. Ram Lal Birla was a big businessman of city Pune having two sons and one married daughter. He decided to gift his one house to his daughter. For this purpose, he called his lawyer at his house and made a written document for such gift. The lawyer advised him to

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)**

Ans. 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.

UNIT 03

Other Essential Elements of Contract



CAPACITY TO CONTRACT

Capacity refers to the competence of the parties to make a contract.
It is one of the essential elements to form a valid contract.

11 - Who is Competent to Contract?

Every person is competent to contract who-

A. has attained the **age of majority**,
B. is of **sound mind** and
C. is **not disqualified** from contracting **by any law** to which he is subject.

A. Age of Majority

Law Relating to Minor's Agreement/Position of Minor		
❑ **A person domiciled in India attains majority upon completing 18 years of age.** ❑ A person less than that age even by a day would be minor for the purpose of contracting.		
Sr. No.	**Law OR Concept**	**Explanation**
1.	Position of Minor in Contracts	A contract with or by a minor is void ab initio (invalid from the beginning).
	Mohori Bibi vs. Dharmo Das Ghose (1903): A minor's mortgage contract was held void; minor not liable to pay.	

	No ratification after attaining majority	A minor cannot ratify a contract made during minority after attaining majority.
	Example 1: *Minor cannot ratify a promissory note made during minority, and any new note made after majority is also void.*	
3.	Minor as Beneficiary	❑ Nothing in the Contract Act prevents him from making the other party bound to the minor. ❑ 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. ❑ A minor cannot become a 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)
	Example 2: *A mortgage was executed in favour of a minor. Held, he can get a decree for the enforcement of the mortgage.*	
4.	Pleading Minority	❑ A minor can plead minority even if they entered into a contract by falsely representing themselves as a major. ❑ Rule of estoppel cannot be applied against a minor. It means he can be allowed to plead his minority in defence.
	Example 3: *A minor who falsely took a loan (induced himself as major) cannot be held liable, but if the money is unspent, it may be recoverable but the minor shall not be liable for any amount which he has already spent even though he received the same by fraud.*	
5.	Liability for Necessaries	Section 68 - Necessaries supplied to a minor can be recovered, but only from the minor's property, not personally. For a minor's estate to be liable for necessaries - ❑ The goods must be essential for the minor's support, based on their standard of living. ❑ The minor should not already have a sufficient supply of these goods. ❑ Necessaries refer to basic needs like food, clothing, education, or expenses related to important life events, such as funerals. Luxuries or non-essential items are excluded. The focus is on utility, not extravagance.
	★ *Expenses on minor's education, on funeral ceremonies come within the scope of the word 'necessaries'.* ★ *The whole question turns upon the minor's status in life. Utility rather than ornament is the criterion.*	
	Example 4: *Shruti being a minor purchased a laptop for her online classes of ₹70,000 on credit from a shop. But her assets could pay only ₹20,000. The shop keeper could not hold Shruti personally liable and could recover only amount recoverable through her assets i.e. upto ₹20,000.*	

6.	Contract by Guardian	A minor's agreement is void, but a guardian can make a valid contract on behalf of the minor if - ❑ The guardian is acting within their authority. ❑ The contract benefits the minor. ❑ However, not all guardian-made contracts are valid. For example, a guardian cannot bind the minor in a contract to buy immovable property. ❑ But, if a certified guardian (appointed by the court) enters into a contract to sell the minor's property with court approval, the contract can be enforced by either party.
7.	No specific performance	A minor's agreement being absolutely void, there can be no question of the specific performance of such an agreement.
8.	No insolvency	A minor cannot be declared insolvent since they are not personally liable for debts
9.	Minor can be an agent	A minor can act as an agent but is not personally liable for their acts
	Example 5: A minor can operate a bank account and draw cheques, but is not liable for bounced cheques.	
10.	Minor cannot bind parent or guardian	A minor cannot bind their parent or guardian to a contract unless acting as their agent
	Example 6: A minor buying a scooty cannot hold their parents liable for payment without their knowledge or consent.	
11.	Joint Contract by Minor and Adult	A minor cannot bind their parent or guardian to a contract unless acting as their agent
12.	Surety for a Minor	An adult surety for a minor is liable for the contract if the minor defaults.
	Example 7: Mr. X guarantees the purchase of a phone by Krish (a minor); if Krish fails to pay, Mr. X is liable.	
13.	Minor as Shareholder	A minor cannot be a shareholder, but may acquire fully paid shares through their guardian.
14.	Liability for torts	A minor is liable for torts (civil wrongs) unless the tort is essentially a breach of contract.
	Example 8: A minor lent a borrowed horse to a friend who killed it; minor was held liable.	

B. 12 - Person of Sound Mind

- A person is said to be of sound mind for purpose of making a contract if -
  - At the time when he makes it -
    - is capable of understanding it and
    - of forming a rational judgement as to its effect upon his interests.

Position of unsound mind person making a contract:
A contract by a person who is not of sound mind is void.

USUALLY OF	OCCASIONALLY OF	CAN MAKE A CONTRACT :
Unsound mind	Sound mind	May make a contract when he is of sound mind
Sound mind	Unsound mind	May NOT make a contract when he is of unsound mind

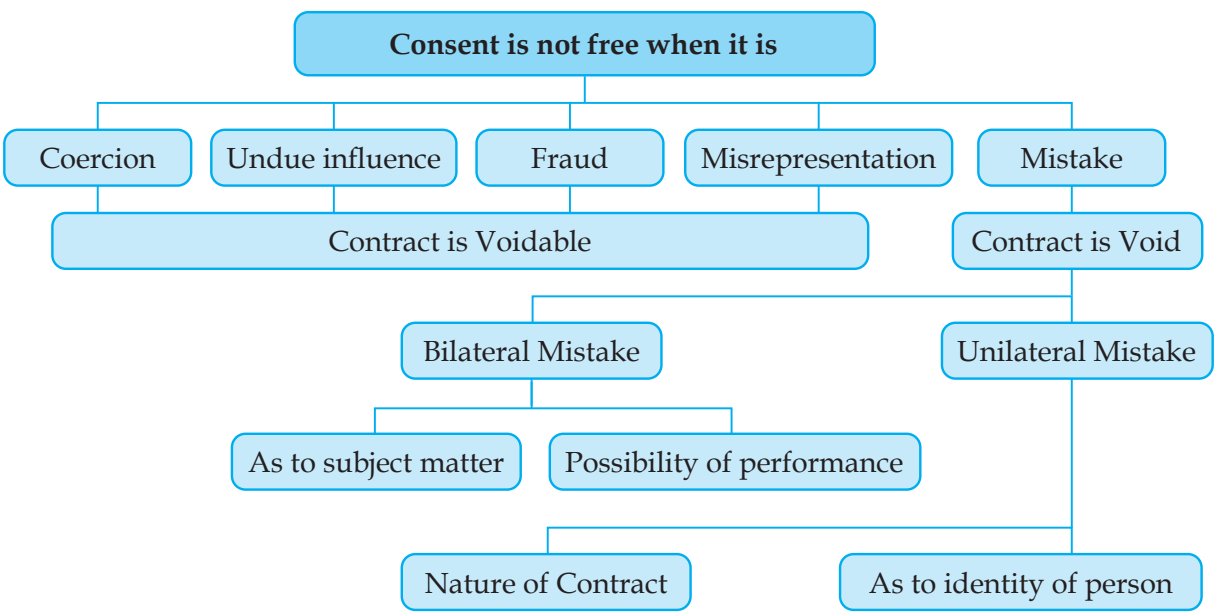
Example 9: *A patient in a lunatic asylum, who is at intervals, of sound mind, may contract during those intervals.*

Example 10: *A sane man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgement as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts.*

C. Contract by Disqualified Persons

- Besides minors and persons of unsound mind, there are also other persons who are disqualified from contracting, partially or wholly, the contracts by such persons **are void**.
- Incompetency to contract may arise from-
  - political status,
  - corporate status,
  - legal status, etc.
- The following persons fall in this category: **Foreign Sovereigns and Ambassadors, Alien enemy, Corporations, Convicts, Insolvent etc.**

FREE CONSENT



13 - Definition of Consent

Two or more persons are said to consent when they agree upon the same thing in the same sense

- Consent means both parties agree to the same thing in the same sense.

The same thing in the same sense. Same thing must be understood as the whole content of the agreement.

- The nature of the transaction.
- The person involved.
- The subject matter of the agreement.

- **Example:** If two parties enter into a contract about a person or ship, but each has a different person or ship in mind due to a similar name, no contract exists because they were not "ad idem" (of the same mind).
- **Ambiguity Terms or Mistake**
  - If the terms are unclear or there's an error about the transaction or subject matter, consent may be absent.
  - In case of fundamental error or mistake, real consent is missing.
- **Consent is essential for a contract and only free consent is necessary for the validity of a contract.**

14 - Definition of Free Consent

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

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

- When consent to an agreement is caused by
  - coercion, fraud, misrepresentation, or undue influence,
  - the agreement is a contract voidable at the option of the party
  - whose consent was so caused
- When the consent is vitiated by mistake, the contract becomes void.

ELEMENTS VITIATING FREE CONSENT

15 - Coercion	
Definition of Coercion	Committing or threatening to commit any act forbidden by the Indian Penal Code or unlawfully detaining property to compel someone to enter into an agreement.
Source of Coercion	Coercion can come from any person, not necessarily a party to the contract.
Target of Coercion	Coercion can be directed at anyone, not just the contracting party.
Effect on Contract (Section 19)	A contract induced by coercion is voidable at the option of the party whose consent was obtained by coercion.
Return of Benefits (Section 71)	Any money paid or property delivered under coercion must be returned or repaid by the person who received it.
Example 11: Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code.	

liabilities. The principal had to give the release deed. Held, the contract was under coercion by unlawful detaining of the principal's property.

16 - Undue Influence

A contract is said to be induced by 'undue influence' where -

- The relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and he uses that position to obtain an unfair advantage over the other

Example 13: A having advanced money to his son, B, during his minority, upon B's coming of age obtains, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance. A employs undue influence.

The essential ingredients under this provision are:	
Relation Between the Parties	A person can influence another if there is a close relationship between them.
Position to Dominate the Will One party is in a position to dominate the will of the other due to:	
1.	**Real and Apparent Authority** - Authority exists, e.g., master-servant, doctor-patient.
2.	**Fiduciary Relationship** - Trust-based relations, e.g., father-son, solicitor-client, husband-wife.
3.	**Mental Distress** - Consent given under mental or bodily distress, illness, or old age. Example: A doctor dominating a sick patient.
4.	**Unconscionable Bargains** - If the contract appears unfair, it is presumed undue influence was used (e.g., money-lender with unfair loan terms).
Example 14: A, being in debt to B, the money-lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence. *Example 15: A applies to a banker for a loan at a time when there is a stringency in money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence.*	
Object to Take Undue Advantage	Influence must be used to unfairly benefit from the contract (e.g., spiritual guru promising salvation for property).
Example 16: A teacher asks her daughter to get marry to one of his brilliant students. Both the girl and boy were smart, settled and intelligent. Here the teacher had a relation which can have influence on both of them. But as no undue advantage of such influence was taken such contract of marriage is said to be made by free consent.	
Burden of Proof - The influenced party must prove:	
1.	The other party had power to dominate
2.	The other party used undue influence

Effect of Undue Influence (Section 19A)	The agreement is a contract voidable at the option of the party whose consent was so caused

Example 17: A, a money lender advances ₹1,00,000 to B, an agriculturist, and by undue influence induces B to execute a bond for ₹2,00,000 with interest at 6% per month. The court may set aside the bond, ordering B to repay ₹1,00,000 with such interest as may seem just.

17 - FRAUD

Means and includes any of the following acts -

- Committed by a party to a contract, or
- with his connivance, or
- by his agent,
- with an intent to deceive another party thereto or his agent, or to induce him
- to enter into the contract -

1. the **suggestion, as a fact, of that which is not true**, by one who does not believe it to be true;
2. the active **concealment of a fact** by one having knowledge or belief of the fact;
3. a **promise made without any intention of performing** it;
4. any other **act fitted to deceive**;
5. any **such act** or omission **as the law specially declares** to be fraudulent.

The essential elements of Fraud under this provision are:	
Representation or Assertion	There must be a false representation or assertion. Silence may amount to fraud in certain cases (duty to speak or active concealment).
Silence as Fraud	Silence is fraud when:
1.	**Duty to Speak:** When there is a relationship where it's obligatory to disclose information. *Example 18: A sells a horse to B (his daughter) and hides its unsoundness (Fraud).*
2.	**Silence Equals to Speech:** When silence creates a misleading impression. *Example 19: A says goods cost ₹50,000 (fact), but says they're worth ₹50,000 (opinion).*
Representation Related to a Fact	Fraudulent statements must be about facts, not opinions.
Example 20: A who is about to sell goods says that goods cost him ₹50,000. This is statement of fact. But if he says the goods are worth ₹50,000, it is a statement of opinion.	
Timing & Intent of Representation	The false statement must be made before the contract to induce the other party to act on it. Example: A misleading prospectus about a company's director.
Knowledge of Falsity or Recklessness	The party making the representation must know it's false, or be reckless about its truth.

Inducement to Act	The false representation must have induced the other party to act. Example: A false statement about a director was irrelevant to A's decision to buy shares.
Example 21: 'A' bought shares in a company on the faith of a prospectus which contained an untrue statement that 'B' was a director of the company. 'A' had never heard of 'B' and, therefore, the statement was immaterial from his point of view. A's claim for damages in this case was dismissed because the untrue statement had not induced 'A' to buy the shares.	
Reliance on Representation	The party must rely on the representation and be deceived by it.
Loss Due to Fraud	The deceived party must suffer a loss as a result of the fraudulent statement.
Effect on Contract **Fraud renders the contract voidable at the option of the defrauded party.**	
Remedies for Fraud - The defrauded party can -	
1. Rescind the contract - Cancel the contract within a reasonable time.	
2. Sue for Damages - Claim compensation for losses suffered.	
3. Insist on Performance - Demand contract fulfillment, ensuring they are put in the position they would have been if the representation was true.	
Exceptions (When Contract is Not Voidable) - Contract not voidable if:	
1. Ordinary Diligence Could Discover the Truth - If the defrauded party could have discovered the truth through ordinary care.	
2. Fraud Did Not Cause Consent - If the fraudulent statement did not lead the party to consent to the agreement.	

18 - Misrepresentation

Situations Leading to Misrepresentation:

- **False Statement of Fact:** If a person makes a false statement believing it to be true, but the information they have doesn't justify their belief, it's misrepresentation.
- **Breach of Duty Without Intent to Deceive:** When someone breaches a duty unintentionally but gains an advantage from it, it can still be misrepresentation.
- **Innocent Mistake About Subject Matter:** If one party unintentionally causes the other party to misunderstand the subject matter of the contract, it's also considered misrepresentation.

Example 22: A tells B that C will become a director of a company, based on second-hand information from M. B buys shares based on A's statement, which turns out to be false. This is misrepresentation because A shouldn't have made a firm statement based on unreliable information.

Example 23: A tells B that his motorcycle is in excellent condition, without getting it checked. B buys the motorcycle, but the engine turns out to be defective. This is misrepresentation as A's statement was false.

Example 24: A sells a mare to B, claiming it is in perfect health, genuinely believing it but without enough reason. Later, B finds the mare is unsound. A's statement is misrepresentation due to lack of proper knowledge.

Example 25: A buys an item thinking it's worth ₹1000 but it's actually worth ₹500. Since the seller didn't misrepresent anything, the contract is valid.

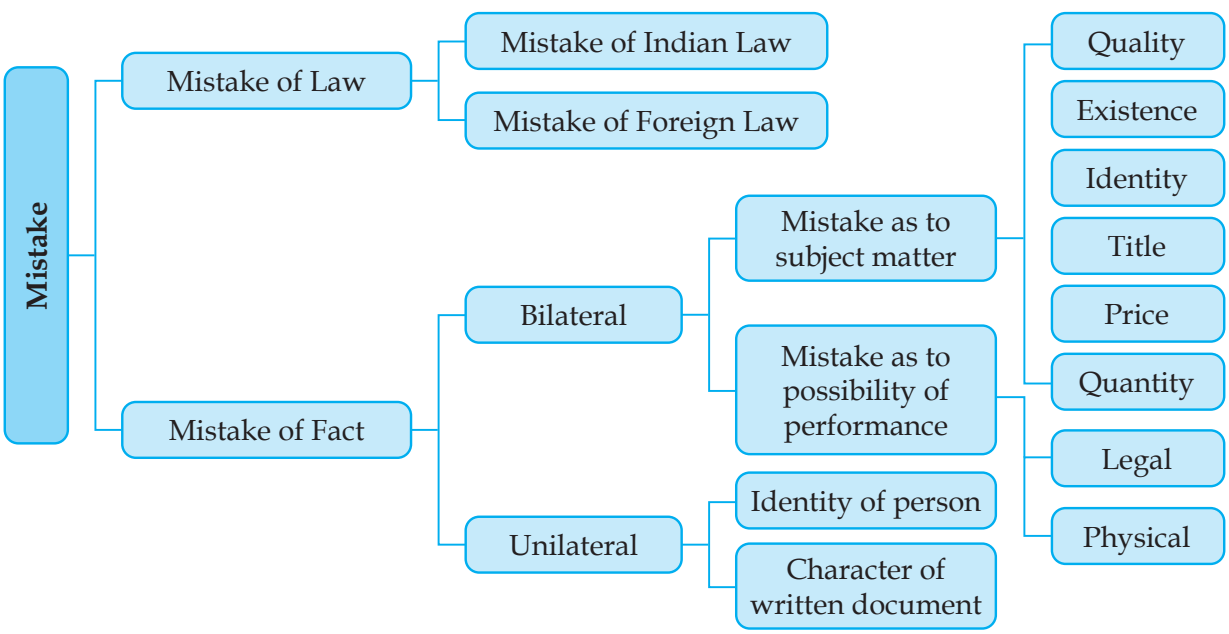
Basis of Difference	Coercion	Undue Influence
Nature of action	It involves the physical force or threat. The aggrieved party is compelled to make the contract against its will.	It involves moral or mental pressure.
Involvement of criminal action	It involves committing or threatening to commit and act forbidden by Indian Penal Code or detaining or	No such illegal act is committed or a threat is given.

Distinction between fraud and misrepresentation:

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

Innocent or erroneous belief which leads the party to misunderstand the others → (Mistake of Law or mistake of Fact)



Type of Mistake	Sub Types	Explanation	Examples	Effect on Contract
MISTAKE OF LAW	Indian Law	A person cannot claim relief for an act done in ignorance of Indian law.	*Example 26: A and B enter a contract, mistakenly thinking a debt is barred by limitation law. Contract is valid.*	Contract is not voidable.
	Foreign Law	Treated as a mistake of fact. Ignorance of foreign law is considered a mistake of fact, and the agreement is void.	N/A	Treated like a mistake of fact.
MISTAKE OF FACT	Bilateral Mistake 20	Both parties are mistaken about a fact essential to the agreement.	Mistake towards the subject matter about - ❑ Quality, ❑ Existence, ❑ Identity, ❑ Title, ❑ Price, or ❑ Quantity	Contract is void.
	Unilateral Mistake 22	Only one party is mistaken about a fact.	One party believes something incorrect but the other party does not.	Contract is not voidable (Section 22).

LEGALITY OF OBJECT AND CONSIDERATION

23 - In these **cases the consideration or object of an agreement is said to be UNLAWFUL**:

1. **When consideration or object is forbidden by law:** Acts forbidden by law are those which are **punishable under any statute as well as** those prohibited by regulations or orders made in exercise of the authority conferred by the legislature.

Example 27: A father had arranged for marriage of his 17 years boy and took dowry from the girl's parents. Such marriage contract cannot take place as in India the minimum age for boy marriage is 21 years and dowry is not permissible in Indian law. Such is not a valid contract as the consideration and object both are forbidden by law.

object of an agreement is of such a nature that not **directly but indirectly**, it would defeat the provisions of the law, the agreement is **void**.

Example 28: A's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law.

3. **When it is fraudulent: Agreements which are entered into to promote fraud are void.**

Example 29: A, B and C enter into an agreement for the division among them of gains acquired, or to be acquired, by them by fraud. The agreement is void, as its object, viz., acquisition of gains by fraud is unlawful.

4. **When consideration involves injury to the person or property of another:**
   - **The general term 'injury' means criminal or wrongful harm.**
   - In the following examples, the object or consideration is unlawful as it involves injury to the person or property of another.

Example 30: An agreement to print a book in violation of another's copyright is void, as the object is to cause injury to the property of another. It is also void as the object of the agreement is forbidden by the law relating to copyright.

Example 31: A promises to repay his debt by doing manual labour daily for a special period and agrees to pay interest at an exorbitant rate in case of default. Here A's promise to repay by manual labour is the consideration for the loan, and this consideration is illegal as it imposes what, in substance, amounts to slavery on the part of A. In other words, as the consideration involves injury to the person of A, the consideration is illegal. Here, the object too is illegal, as it seeks to impose slavery which is opposed to public policy. Hence, the agreement is void.

5. **When consideration is immoral:** The following are the examples of agreements where the object or consideration is unlawful, Being immoral.

Example 32: Where P had advanced money to D, a married woman to enable her to obtain a divorce from her husband and D had agreed to marry him as soon as she could obtain the divorce, it was held that P was not entitled to recover the amount, since the agreement had for its object the divorce of D from her husband and the promise of marriage given under these circumstances was against good morals.

Example 33: A asks B, "If you arrange a girl for marriage with me, I will give ₹50,000". Here contract is void as it is immoral.

6. **When consideration is opposed to public policy:**
   - The expression 'public policy' can be interpreted either in a wide or in a narrow sense.
   - The freedom to contract may become illusory, unless the scope of 'public policy' is restricted.
   - In the name of public policy, **freedom of contract is restricted by law only for the good for the community**.

Type	Description	Example
Trading with Enemy	Agreements with a person affiliated with a country at war with India are void, as they compromise national security.	***Example 34:*** *India faces a war-like situation with China. Mr. A enters a contract with China for toy imports. The contract is void as China is considered an enemy state.*
Stifling Prosecution	Agreements to prevent legal proceedings from following their normal course are void. They hinder the administration of justice and are considered illegal unless the offence is compoundable.	A agrees to sell land to B in exchange for B dropping criminal charges against A for a compoundable offence. This agreement is legal, but if the offence were non-compoundable, it would be void.
Maintenance & Champerty	Maintenance involves funding someone's lawsuit with no interest, while champerty is funding in exchange for a share of the proceeds. These agreements are void if motivated by malice or injustice.	***Example 35:*** *A offers B ₹2000 to sue C just to annoy C, despite the issue being solvable mutually. This is a maintenance agreement and is void.* ***Example 36:*** *A agrees to pay expenses to B if he sues C and B agrees to pay half of the amount received from result of such suit. This is an agreement of champerty.*
The agreement for supplying funds by way of Maintenance or Champerty is valid unless: ❑ It is unreasonable so as to be unjust to other party or ❑ It is made by a malicious motive like that of gambling in litigation or oppressing other parties by encouraging unrighteous suits and not with the bonafide object of assisting a claim believed to be just.		
Trafficking in Public Offices	Agreements involving the sale of public offices or appointments are void, as they corrupt public service and undermine the merit system.	***Example 37:*** *Harish pays ₹15,000 to an officer to secure a job for his son in the Forest Department. The contract is void as it involves trafficking in public office.*
Creating Monopolies	Agreements intended to create monopolies or control market prices are void, as they harm public interest and fair competition.	***Example 38:*** *XYZ and ABC, the only oxygen cylinder manufacturers in West Bengal, enter into a contract to supply at high rates during the COVID-19 crisis, intending to create a monopoly. This contract is void.*
Marriage Brokerage	Contracts that involve paying someone to arrange or negotiate a marriage are void as they violate public policy.	A offers B ₹50,000 to arrange a marriage. The contract is void as it involves marriage brokerage, which is opposed to public policy.

with Justice	executive officers to act corruptly or partially are void, as they interfere with the justice system and governance.	against A, to stay absent from the trial. This contract is void due to interference with the justice system.
Interest Against Obligation	Contracts creating personal interest contrary to one's duty or obligations are void.	A manager agrees to pass a contract to X if X pays him ₹2,00,000 privately. This agreement is void as it creates a personal interest against the manager's obligation to the company.
Consideration Unlawful in Part	If any part of the consideration is unlawful, the entire agreement is void unless the illegal part can be severed.	A agrees to sell land to B, but part of the consideration involves illegal activities. If the illegal part cannot be separated, the entire contract is void.

VOID AGREEMENTS

VOID AGREEMENTS	
Section	**Title**
26	Agreement in restraint of marriage
27	Agreement in restraint of trade
28	Agreement in restraint of legal proceedings
29	Default in Reciprocal Promises (It's Effect)
30	Failure to Perform on Time When Time is Essential

26 - Agreement in Restraint of Marriage

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

27 - Agreement in Restraint of Trade

General Rule: Agreements in Restraint of Trade are Void: Any agreement that restrains a person from practicing a lawful profession, trade, or business is void.

- **Exception 1: Sale of Goodwill**
  - **Goodwill Definition:** The advantage a business gains from its public reputation and loyal customers.
  - **Valid Agreement:** When a person sells the goodwill of a business, they can agree not to start a similar business within reasonable local limits.
  - **Condition:** The restriction is valid as long as the buyer or their successors continue the same business within the agreed local area.
- **Exception 2: Outgoing Partner in a Firm (Indian Partnership Act, 1932)**
  - **Section 36:** An outgoing partner can agree with continuing partners not to start a similar business within a specified area or time period.
  - **Reasonable Restrictions:** This agreement is valid only if the time and local limits are reasonable.

- **Section 11 (Indian Partnership Act, 1932):** Partners can agree not to run a competing business while the partnership is active. This restriction is valid.

- **Employee Agreements Not in Restraint of Trade**
  - **Service Agreements:** An employee agreeing not to compete with the employer during the term of employment is not considered restraint of trade and is valid.

Example 39: B, a physician and surgeon, employs A as an assistant for a term of three years and A agrees not to practice as a surgeon and physician during these three years. The agreement is valid and A can be restrained by an injunction if he starts independent practice during this period.

Example 40: An agreement by a manufacturer to sell during a certain period his entire production to a wholesale merchant is not in restraint of trade.

Example 41: Agreement among the sellers of a particular commodity not to sell the commodity for less than a fixed price to maintain the quality of the product, is not an agreement in restraint of trade.

28 - Agreement in Restraint of Legal Proceedings

General Rule: Contracts Restricting Legal Rights are Void

Invalid Contracts: Any contract that completely prevents a party from enforcing their rights through the court or shortens the usual time to start legal action is void.

- **Exceptions to the Rule:**
  - **Arbitration Agreement:** A contract where parties agree to resolve disputes through arbitration is valid. Only the amount awarded in arbitration can be recovered.
  - **Future Arbitration Clause:** A written agreement to refer future or existing disputes to arbitration is also valid.

29 - Agreement the Meaning of which is Uncertain

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**.

Example 42: 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.

30 - Wagering Agreement

- **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**.
- 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.

Example 43: A agrees to pay ₹50,000 to B if it rains, and B promises to pay a like amount to A if it does not rain, the agreement will be by way of wager. But if one of the parties has control over the event, agreement is not a wager.

1.	Promise of Payment	There must be a promise to pay money or something of value
2.	Conditional Event	The promise depends on whether a specific event happens or not.
3.	Uncertainty	The event's outcome must be uncertain
4.	Two Parties	There must be two parties, each standing to win or lose
5.	Intention to Bet	Both parties must intend to bet when making the agreement
6.	No Other Interest	The parties should have no interest in the event except for the money at stake

Transactions similar to Wager (Gambling)		
Transaction Type	**Description**	**Nature & Legality**
Lottery Transactions	A game of chance where participants gamble by purchasing tickets with a chance to win a prize.	Considered a wager. Even if sanctioned by the Government, lotteries are illegal under Section 294A of the Indian Penal Code.
Crossword Puzzles & Competitions	Prizes are awarded based on the match between a participant's solution and a pre-prepared solution.	Considered a lottery and wagering transaction, as it relies on chance rather than skill.
Speculative Transactions	Agreements to settle differences between the contract price and market price of goods or shares without actual delivery of goods or shares.	Gambling in nature. These speculative transactions are void because they are based on price differences rather than real trade.
Horse Race Transactions	Betting on horse races, with a prize awarded to the winner based on the race outcome. Considered a wager if the prize is less than ₹500.	*Example 44: A and B enter into an agreement in which A promises to pay ₹2,00,000 provided 'Chetak' wins the horse race competition. This is not a wagering transaction.*
	However, Section 30 is not applicable in an agreement to contribute toward plate, prize or sum of money of the value of ₹5,00,000 or above to be awarded to the winner of a horse race.	

Transactions resembling with wagering transaction but are not void		
Transaction	**Description**	**Why it is not a Wager**
Chit Fund	A group of individuals contribute a fixed sum for a specified period, and the collected amount is awarded to the lucky winner of a draw at the end of each cycle.	Chit funds are not wagers because they involve mutual contributions for savings and do not depend solely on chance.
Commercial or Share Market Transactions	Transactions involving the purchase or sale of goods or shares, where delivery is intended.	These are not wagers as they involve real transactions and the actual transfer of goods or shares, rather than gambling.

Games of Skill and Athletic Competitions	Competitions like crossword puzzles or athletic events where prizes are awarded based on skill, intelligence, or ability.	These involve skill rather than chance, and are valid under the Prize Competition Act, 1955, as long as prize money ≤ □1,000.
Contract of Insurance	Insurance contracts provide financial protection against contingencies (e.g., life, health, property) and involve the payment of premiums in exchange for compensation upon certain events.	Insurance contracts are considered contingent contracts, not wagers, as they protect against risk rather than depend on luck.

Distinction between Contract of Insurance and Wagering Agreement:

Sr. No.	Basis	Contracts of Insurance	Wagering Agreement
1.	**Meaning**	It is a contract to indemnify the loss.	It is a promise to pay money or money's worth on the happening or non- happening of an uncertain event.
2.	**Consideration**	The crux of insurance contract is the mutual consideration (premium and compensation amount).	There is no consideration between the two parties. There is just gambling for money.
3.	**Insurable Interest**	Insured party has insurable interest in the life or property sought to be insured.	There is no property in case of wagering agreement. There is betting on other's life and properties.
4.	**Contract of Indemnity**	Except life insurance, the contract of insurance indemnifies the insured person against loss.	Loser has to pay the fixed amount on the happening of uncertain event.
5.	**Enforceability**	It is valid and enforceable	It is void and unenforceable agreement.

"PROBLEM KYA HAI? - UNIT 3"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. "An agreement, the meaning of which is not certain, is void". Discuss. **(Module)**

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

in such a case its meaning would be capable of being made certain.

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. **(Module)**

Ans. 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.

Thus, 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. A minor cannot become a 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).

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

3. A student was induced by his teacher to sell his brand new car to the later 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 whether the student can sue the teacher? **(Module)**

Ans. Yes, A can sue his teacher on the ground of undue influence under the provisions of Indian Contract Act, 1872.

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".

A person is deemed to be in 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 relationship 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 for example, an old illiterate person.

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.

4. Explain the concept of 'misrepresentation' in matters of contract. 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 few days, the motorcycle did not work at all. Now Suraj wants to rescind the contract. Decide giving reasons whether Suraj can rescind the contract? **(Module)**

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

1. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
2. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.

mistake as to the substance of the thing which is the subject of the agreement.

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it.

Accordingly, in the given case, Suraj could not rescind the contract, as his acceptance to the offer of Sohan to bear 40% of the cost of repairs impliedly amount to final acceptance of the sale.

5. Mr. SAMANT owned a motor car. He approached Mr. CHHOTU and offered to sell his motor car for 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 7 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. **(Module)**

Ans. 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.

A party to contract, whose consent was caused by fraud or misrepresentation, may, if he thinks 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.

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 in the above ground.

6. Ishaan, aged 16 years, was studying in an engineering college. On 1st March, 2018 he took a loan of R 2 lakhs from Vishal for the payment of his college fee and agreed to pay by 30th May, 2019. Ishaan possesses assets worth & 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. **(Module)**

Ans. 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.

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].

Section 68 of the Indian Contract Act, 1872 however, prescribes the liability of a minor for the supply of the things which are the necessaries of life to him. It says that though minor

the purpose, the supplier or lender will be entitled to claim the money/price of goods or services which are necessaries suited to his condition of life provided that the minor has a property. The liability of minor is only to the extent of the minor's property. 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.

MTPs, RTPs AND PYQPs QUESTIONS

1. A enters into a contract with B that he (A) sells his house for $ 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 $ 50,000 for it. B agreed to this, however after a year of sale, B started gambling business in that house. Can A claim ₹50,000 from B? Discuss with reference to the provisions of Indian Contract Act, 1872. **(RTP May 22)**

Ans. 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. 7,10,00,000 is valid and enforceable. However, the agreement to pay $ 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.

2. Chandan was suffering from some disease and was in great pain. He went to Dr. Jhunjhunwala whose consultation fee was ₹300. The doctor agreed to treat him but on the condition that Chandan had to sign a promissory note of $ 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)**

Ans. 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

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.

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

A student was induced by his teacher to sell his brand-new bike to the latter at a price less than the purchase price to secure more marks in the examination. Accordingly, the bike was sold. However, the father of the student persuaded him to sue his teacher. Whether the student can sue the teacher? If yes, on what grounds? **(RTP Nov'22)**

Ans. 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. The relation of teacher and student is as such that the teacher is in a position to dominate the will of the student. As a result, the consent of the student is caused by an undue influence. Hence, the contract between them is voidable at the option of the student, and therefore, he can sue the teacher.

4. "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 Nov'22)**

Ans. 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.

Thus, 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. 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).

5. Mr. Mukund wants to sell his car. For this purpose, he appoints Mr. Parth, a minor as his agent. Mr. Mukund instructs Mr. Parth that car should not be sold at price less than ₹2,00,000. Mr. Parth ignores the instruction of Mr. Mukund and sells the car to Mr. Naman for ₹1,50,000. Explain the legal position of contract under Indian Contract Act, 1872 whether:

(a) Mr. Mukund can recover the loss of ₹50,000 from Mr. Parth?

(b) Mr. Mukund can recover his car from Mr. Naman? **(RTP May 23)**

Ans. According to the provisions of Section 11 of 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. Mukund appoints Mr. Parth, a minor as his agent to sale his car. Mr. Mukund clearly instructed to Mr. Parth that the minimum sale price of the car should be ₹2,00,000 yet Mr. Parth sold the car to Mr. Naman for ₹1,50,000.

(a) Considering the facts, although the contract between Mr. Mukund and Mr. Parth is valid, Mr. Parth will not be liable to his principal for his acts. Hence, Mr. Mukund cannot recover the loss of ₹50,000.

(b) Further, Mr. Naman purchased the car from agent of Mr. Mukund, he got good title. Hence, Mr. Mukund cannot recover his car from Mr. Naman.

worth $1,00,000 to Rohit for a sum of $ 5,00,000. After the sale of goodwill, Rohit made an agreement with Mukesh. As per this agreement, Mukesh cannot open another grocery store (similar kind of business) in the whole of India for next ten years. However, Mukesh opens another store in the same city two months later. What are the rights available with Rohit regarding the restriction imposed on Mukesh with reference to Indian Contract Act, 1872? **(RTP May'23)**

Ans. According to Section 27 of the Indian Contract Act, 1872, any agreement that restrains a person from carrying on a lawful trade, profession or business is a 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:

1. Where the restraint is to refrain from carrying on a similar business,
2. The restrain should be within the specified local limits,
3. The restraint should be not to carry on the similar business after sale of goodwill to the buyer for a price,
4. The restriction should be reasonable. Reasonableness of restriction will depend upon number of factors as considered by court.

In the given case, Mukesh has sold the goodwill and there is restraint for not carrying on the same business of grocery store. However, the restriction imposed on Mukesh 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.

Hence, Rohit cannot take any legal action against Mukesh as the restriction is unreasonable as per Section 27 of Indian Contract Act, 1872. Hence, the agreement made between in restraint of trade between Mukesh and Rohit is void agreement.

7. Paridhee, a minor, falsely representing her age, enters into an agreement with an authorised Laptop dealer Mr. Mittal, owner of MP Laptops, for purchase of Laptop on credit amounting ₹60,000/- on 1st August 2022. She promised to pay back the outstanding amount with interest @16% p.a. by 31st July 2023. 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 Paridhee 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 a major on 1st January 2025 and only after that agreement can be ratified. Explain by which of the following ways, Mr. Mittal will succeed in recovering the outstanding amount with reference to the Indian Contract Act, 1872.

1. By filing a case against Paridhee, a minor for recovery of outstanding amount with interest?
2. By filing a case against Mr. Ram, father of Paridhee for recovery of outstanding amount?
3. By filing a case against Paridhee, a minor for recovery of outstanding amount after she attains majority? **(RTP Nov'23)**

Ans. A contract made with or by a minor is void ab-initio: Pursuant to Section 11 of the Indian Contract Act, 1872, a minor is not competent to contract and any agreement with or by a minor is void from the very beginning.

1. By following the above provision, Mr. Mittal will not succeed in recovering the outstanding amount by filing a case against Paridhee, a minor.

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. Mittal will not succeed in recovering the outstanding amount by filing a case against Mr. Ram, father of Paridhee.

3. 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. Mittal will not succeed in recovering the outstanding amount by filing a case against Paridhee, after she attains majority

8. State with reason(s) whether the following agreements are valid or void as per the Indian Contract Act, 1872:

1. 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.
2. X offers to sell his Maruti car to Y. Y believes that X has only Wagon R Car but agrees to buy it.
3. 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. **(RTP Nov'23)**

Ans.

1. **The given agreement is valid.**

   Reason: 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 (Section 28 of the Indian Contract Act, 1872). A contract of this nature is void. However, in the given statement, no absolute restriction is marked on parties on filing of suit. As per the agreement, suit may be filed in one of the courts having jurisdiction.

2. **The said agreement is void.**

   Reason: This agreement is void as the two parties are thinking about different subject matters so that there is no real consent, and the agreement may be treated as void because of mistake of fact as well as absence of consensus.

3. **The said agreement is valid.**

   Reason: 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). But, as an exception, agreement of service by which an employee binds himself, during the term of his agreement, not to compete with his employer is not in restraint of trade.

9. Mr. Seth (an industrialist) has been fighting a long-drawn litigation with Mr. Raman (another industrialist). To support his legal campaign, Mr. Seth enlists the services of Mr. X, a legal expert stating that an amount of $ 5 lakhs would be paid, if Mr. X does not take up the case of Mr. Raman. Mr. X agrees, but at the end of the litigation, Mr. Seth refused to pay. Decide whether Mr. X can recover the amount promised by Mr. Seth under the provisions of the Indian Contract Act, 1872. **(RTP Nov 23)**

Ans. According to Section 27 of indian Contract Act, 1872 an agreement by which any person is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

services of Mr. X a legal expert stating that an amount of ₹5 lakhs would be paid, if Mr. X does not take up the case of Mr. Raman. Mr. X agrees, but at the end of the litigation, Mr. Seth refused to pay.

As section 27 makes the contracts in restraint of trade, void, the contract between Mr. Seth and Mr. X is also void. Hence, Mr. X cannot recover the amount promised by Mr. Seth.

10. Mr. Ayush, the employer induced his employee Mr. Bobby to sell his one room flat to him at less than the market value to secure promotion. Mr. Bobby sold the flat to Mr. Ayush. Later on, Mr. Bobby changed his mind and decided to sue Mr. Ayush. Examine the validity of the contract as per the provisions of the Indian Contract Act, 1872. **(RTP Jun 24) (PYQ Jun 23 2 Marks)**

Ans. 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. Ayush and Mr. Bobby is voidable at the option of Mr. Bobby as it was induced by undue influence by Mr. Ayush and therefore Mr. Bobby can sue Mr. Ayush.

11. 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? **(MTP Mar'22 6 Marks)**

Ans. Section 17 of Indian Contract Act, 1872 defines 'Fraud'. According to section, "Fraud" means and includes any of the following acts committed by a party to a contract or by his agent with intent to deceive or to induce a person to enter into the contract:

1. the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
2. the active concealment of a fact by one having knowledge or belief of the fact;
3. a promise made without any intention of performing it;
4. any other act fitted to deceive;
5. any such act or omission as the law specially declares to be fraudulent.

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.

12. 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 ₹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?
(MTP Jun'22 3 Marks) (RTP Nov'22)

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). If the aggrieved party has obtained some benefits in such a contract (caused by fraud), then all such benefits should be restored or returned back. And if aggrieved party has suffered any losses, it should be compensated by the other party.

On the basis of above provisions and facts of the case, in case a fraud is committed by one party, the contract becomes voidable at the option of the aggrieved party. Hence, Karan can rescind the contract and claim compensation for the loss suffered due to fraud done by Mr. X.

13. Rohan is running a grocery store in Delhi. He sells his grocery business, including goodwill worth ₹1,00,000 to Rohit for a sum of ₹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 Jun'22 6 Marks) (MTP 6 Marks, Oct'21)

Ans. 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-

1. Where the restraint is to refrain from carrying on a similar business
2. The restrain should be within the specified local limits
3. The restraint should be not to carry on the similar business after sale of goodwill to the buyer for a price

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.

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

1. X aged 16 years borrowed a loan of ₹50,000 for his personal purposes. Few months later he had become major and could not pay back the amount borrowed, on due date. The lender wants to file a suit against X.
2. J contracts to take in cargo for K at a foreign port. 's government afterwards declares 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. **(MTP Nov'22 6 Marks)**

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 therefore, a minor is not competent to contract and any agreement with or by a minor is void from the very beginning. A minor cannot ratify it on attaining the majority as the original agreement is void ab initio.

   According to Section 68 of the Act, a claim for necessaries supplied to a minor is enforceable by law.

   Necessaries mean those things that are essentially needed by a minor. They cannot include luxuries or costly or unnecessary articles.

   In the present case, X, the borrower, was minor at the time of taking the loan, therefore, the agreement was void ab initio. Attaining majority thereafter will not validate the contract nor X can ratify it. The loan was for personal purposes and not for necessaries supplied to him. Hence, the lender cannot file a suit against X for recovery of the loan as it is not enforceable by law.

2. As per Section 56 of the Indian Contract Act, 1872 the subsequent or supervening impossibility renders the contract void. Supervening impossibility may take place owing to various circumstances as contemplated under that section, one of which is the declaration of war subsequent to the contract made. In the instant case the contract when made between J and K was valid but afterwards J's government declares war against the country in which the port is situated as a result of which the contract becomes void. Hence, K cannot file a suit against I for performance of the contract.

15. Whether a minor may be admitted in the business of a partnership firm? Explain the rights of a minor in the partnership firm. **(MTP Apr'23 6 Marks)**

Ans. A minor cannot be bound by a contract because a minor's contract is void and not merely voidable. Therefore, a minor cannot become a partner in a firm because partnership is founded on a contract.

Though a minor cannot be a partner in a firm, he can nonetheless be admitted to the benefits of partnership under Section 30 of the indian Partnership Act, 1932. In other words, he can be validly given a share in the partnership profits. When this has been done and it can be done with the consent of all the partners then the rights of such a partner will be governed under Section 30 as follows:

Rights:

1. A minor partner has a right to his agreed share of the profits and of the firm.
2. He can have access to, inspect and copy the accounts of the firm.
3. He can sue the partners for accounts or for payment of his share but only when severing his connection with the firm, and not otherwise.
4. On attaining majority he may within 6 months elect to become a partner or not to become a partner. If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor. If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

16. Pradeep sells by auction to Rakesh a horse which Pradeep knows to be unsound. The horse appears to be sound, but Pradeep knows about the unsoundness of the horse. Is this contract valid in the following circumstances:

1. If Pradeep says nothing about the unsoundness of the horse to Rakesh.
2. If Pradeep says nothing about it to Rakesh who is Pradeep's son.

Pradeep says nothing. **(MTP May 23 3 Marks)**

Ans. According to section 17 of the Indian Contract Act, 1872, mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silence is, in itself, equivalent to speech. Hence, in the instant case,

1. 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.
2. This contract is not valid since as per section 17, it becomes Pradeep's duty to tell Rakesh about the unsoundness of the horse because a fiduciary relationship exists between Pradeep and his son Rakesh. Here, Pradeep's silence is equivalent to speech and hence amounts to fraud.
3. This contract is not valid since as per section 17, Pradeep's silence is equivalent to speech and hence amounts to fraud.

17. Rahul induced Neeraj to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Neeraj complained that there were many defects in the motorcycle. Rahul proposed to get it repaired and promised to pay 45% of the cost of repairs. After a few days, the motorcycle did not work at all. Now Neeraj wants to rescind the contract. Decide giving reasons under the provisions of Indian Contract Act, 1872. **(MTP May 23 3 Marks)**

Ans. In the instant case, the aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contractor in some way affirms it.

Accordingly, in the given case, Neeraj could not rescind the contract, as his acceptance to the offer of Rahul to bear 45% of the cost of repairs impliedly amount to final acceptance of the sale.

18. Chhotu of 17 years has purchased a mobile of ₹25,000 for his online classes from Mobile Sales Centre on credit. On due date, he did not make the payment of mobile. Mobile Sales Centre sued Chhotu and his parents for the price of mobile. Chhotu has ₹15,000 as his cash balance but his father has enough money to pay the price of mobile. Who will be liable to pay the price of mobile under the provisions of indian Contract Act, 1872? **(MTP Nov'23 6 Marks)**

Ans. Section 11 of the Indian Contract Act, 1872 provides that a minor is not capable to enter into a contract.

A contract with minor is void-ab-initio. A minor cannot be enforced to pay off his liabilities. Parents or guardians of minor are also not liable for any contract entered by minor. However, a minor is liable for supplies of necessaries out of his assets. Minor is not personally liable even for necessaries.

In the instant case, parents of Chhotu are not liable for price of mobile. Chhotu's assets are liable to make the payment of price. Hence, Mobile Sales Centre can recover only ₹15,000 from Chhotu. i.e. equal to his assets.

19. Ayush, who is a minor, purchased 10 fancy coats for the wedding ceremony of his sister on credit from M/s Surjewala & sons. The cost of all coats was ₹80,000. Not even a single coat was a necessity. Ayush has assets of worth of ₹1,00,000. M/s Surjewala & sons file a suit against Ayush for recovery of ₹80,000 out of his assets. Following the provisions of Indian Contract Act, 1872, whether Ayush is liable to pay ₹80,000 to M/s Surjewala & sons?

(MTP Dec'23 6 Marks)

A minor cannot be enforced to pay off his liabilities. Parents or guardians of minor are also not liable for any contract entered by minor. However, a minor is liable for supplies of necessaries out of his assets. Minor Is not personally liable even for necessaries.

In the instant case, M/s Surjewala & sons file a suit against Ayush for recovery of ₹80,000 out of his assets who purchased 10 fancy coats for the wedding ceremony of his sister on credit from M/s Surjewala & sons.

On the basis of the facts of the problem, coats were not necessary items for Ayush. Hence, his assets cannot be attached for payment of price of coats. Therefore, M/s Surjewala & sons cannot claim ₹80,000 from Ayush.

20. 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. Few months later he had become major and could not pay back the amount borrowed, on due date. The lender wants to file a suit against X. **(PYQ Dec'21 3 Marks)**

Ans. 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 therefore, a minor is not competent to contract and any agreement with or by a minor is void from the very beginning. A minor cannot ratify it on attaining the majority as the original agreement is void ab initio.

According to Section 68 of the Act, a claim for necessaries supplied to a minor is enforceable by law.

Necessaries mean those things that are essentially needed by a minor. They cannot include luxuries or costly or unnecessary articles.

In the present case, X, the borrower, was minor at the time of taking the loan, therefore, the agreement was void ab initio. Attaining majority thereafter will not validate the contract nor X can ratify it. The loan was for personal purposes and not for necessaries supplied to him. Hence, the lender cannot file a suit against X for recovery of the loan as it is not enforceable by law.

21. 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 ₹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.

1. By filing a case against Srishti, a minor for recovery of outstanding amount with interest?
2. By filing a case against Mr. Ram, father of Srishti for recovery of outstanding amount?
3. By filing a case against Srishti, a minor for recovery of outstanding amount after she attains maturity? **(PYQ May 22 6 Marks)**

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

1. By following the above provision, Mr. Gupta will not succeed in recovering the outstanding amount by filing a case against Srishti, a minor.
2. 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.
3. 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.

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

Ans. 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.

23. "Mere silence does not amount to fraud". Explain the statement as per the provisions contained in the Indian Contract Act, 1872. **(PYQ Dec'23 5 Marks)**

Ans. Mere silence not amounting to fraud: Mere silence as to facts likely to affect the willingness of a person to enter into a contract is no fraud; but where it is the duty of a person to speak, or his silence is equivalent to speech, silence amounts to fraud.

bound to disclose the whole truth to the other party or to give him the whole information in his possession affecting the subject matter of the contract.

The rule is contained in explanation to Section 17 of the Indian Contract Act which clearly states the position that mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud.

Exceptions to this rule:

1. Where the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak. Duty to speak arises when one contracting party reposes trust and confidence in the other or where one party has to depend upon the good sense of the other (e.g. Insurance Contract).
2. Where the silence is, in itself, equivalent to speech.

24. Mr. SHYAM owned a motor car. He approached Mr. HARISH and offered to sell his motor car for □ 3,00,000. Mr. SHYAM told Mr. HARISH that the motor car is running at the rate of 20 KMs per litre of petrol. Both the fuel meter and the speed meter of the car were working perfectly. Mr. HARISH agreed with the proposal of Mr. SHYAM and took delivery of the car by paying $ 3,00,000/- to Mr. SHYAM.

After 10 days, Mr. HARISH came back with the car and stated that the claim made by Mr. SHYAM 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. HARISH can rescind the contract on the above ground. **(RTP May'21)**

Ans. 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.

A party to contract, whose consent was caused by fraud or misrepresentation, may, if he thinks 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.

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. HARISH had the means of discovering the truth with ordinary diligence. Therefore, the contract is not voidable. Hence, Mr. HARISH cannot rescind the contract on the above ground.

25. Mr. S, aged 58 years was employed in a Government 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 of ₹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 the Indian Contract Act, 1872? **(RTP May'21)**

objects thereto.

Section 23 of the said Act also states that every agreement of which the object or consideration is unlawful is void.

The given problem talks about entering into an agreement for sale of public office, which is opposed to public policy. Public policy requires that there should be no money consideration for the appointment to an office in which the public is interested. Such consideration paid, being opposed to public policy, is unlawful.

In the given case, Mr. S, who was going to be retired after two years was proposed by Mr. D, to apply for voluntary retirement from his post, in order that he can be appointed in his place. In lieu of that, Mr. D offered Mr. S a sum of ₹10 lakh as consideration. Mr. S refused initially but later accepted the said agreement to receive money to retire from his office.

Here, Mr. S's promise to sale for Mr. D, an employment in the public services i s the consideration for Mr. D's promise to pay ₹10 lakh. Therefore, in terms of the above provisions of the Indian Contract Act, the said agreement is not valid. It is void, as the consideration being opposed to public policy, is unlawful.

26. 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?

1. Examine with reference to the provisions of the Sale of Goods Act, 1930, what recourse is available to Ms. R?
2. 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? **(RTP May'21)**

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

(a) when the buyer signifies his approval or acceptance to the seller or does any other act adopting the transaction;

(b) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time; or

(c) he does something to the good which is equivalent to accepting the goods e.g. he pledges or sells the goods.

Referring to the above provisions, we can analyse the situation given in the question:

1. In the instant case, Ms. K, who had taken delivery of the two wheeler on Sale or Return basis pledged the two wheeler to Mr. A, has attracted the third condition that she has done something to the good which is equivalent to accepting the goods e.g. she pledges or sells the goods. Therefore, the property therein (two wheeler) passes to Mr. A. Now in this situation, Ms. R cannot claim back her two wheeler from Mr. A, but she can claim the price of the two wheeler from Ms. K only.
2. 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

with, i.e., price is paid for.

Hence, in this case, it is held that at the time of pledge, the ownership was not transferred to Ms. K. Thus, the pledge was not valid and Ms. R could recover the two wheeler from Mr. A.

27. 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 ₹40,000. He was very happy to get ₹40,000 and quickly went to the market and purchased a laptop worth ₹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)**

Ans. 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. 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. 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. Hence, in the present case, Rahul is not liable to repay ₹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.

28. "An agreement, the meaning of which is not certain, is void". Discuss. **(RTP Nov 21)**

Ans. 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.

29. 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 under the Indian Contract Act, 1872:

(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.

(MTP 3 Marks, Mar'21)

Ans. According to Section 17 of the Indian Contract Act, 1872, mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silence is, in itself, equivalent to speech. Hence, in the instant case,

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.

30. Shyam induced Ram to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Ram complained that there were many defects in the motorcycle. Shyam proposed to get it repaired and promised to pay 45% cost of repairs. After a few days, the motorcycle did not work at all. Now Ram wants to rescind the contract. Decide giving reasons.

(MTP 3 Marks, Mar 21)

Ans. In the instant case, the aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872).

The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it.

Accordingly, in the given case, Ram could not rescind the contract, as his acceptance to the offer of Shyam to bear 45% of the cost of repairs impliedly amount to final acceptance of the sale.

31. Explain the term "Coercion" and what are the effects of coercion under Indian Contract Act, 1872. **(MTP 5 Marks, Oct'21)**

Ans. Coercion (Section 15)

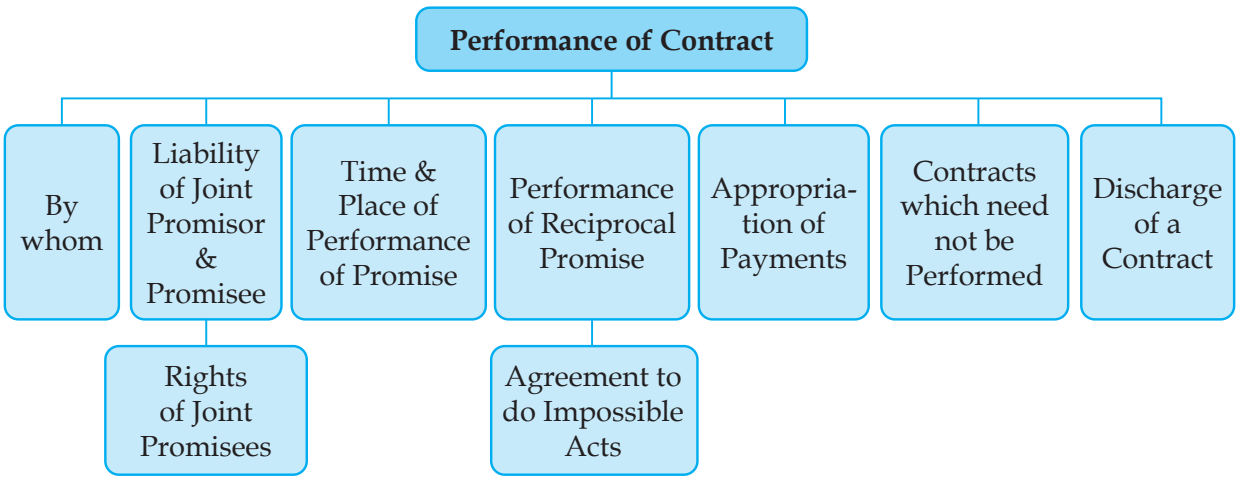
"Coercion' is the committing, or threatening to commit, any act forbidden by the Indian Penal Code or the unlawful detaining, or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement".

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

1. Contract induced by coercion is voidable at the option of the party whose consent was so obtained.
2. 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.
3. A person to whom money has been paid or anything delivered under coercion must repay or return it. (Section 72)

UNIT 04

Performance of Contract



PERFORMANCE OF CONTRACT

37

Fulfilment of obligations to the contract. "Performance of Contract" may be actual or attempted.

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.

Actual Performance	Offer to perform or attempted performance or tender of performance
❑ Where a party to a contract has done what he had undertaken to do or either of the parties have fulfilled their obligations under the contract **within the time and in the manner prescribed.**	❑ It may happen sometimes, when the performance becomes due, the promisor offers to perform his obligation but the **promisee refuses to accept the performance**.
Example 1: X borrows ₹5,00,000 from Y with a promise to be paid after 1 month. X repays the amount on the due date. This is actual performance.	*Example 2: A promises to deliver certain goods to B. A takes the goods to the appointed place during business hours but B refuses to take the delivery of goods. This is an attempted performance as A the promisor has done what he was required to do under the contract.*

38

Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, then the **promisor is not responsible for non-performance**, nor does he thereby lose his rights under the contract.

Every such offer must fulfil certain conditions which are as follows, namely

unconditional	proper time and place	reasonable opportunity to examine the goods	whole obligation

1. It must be **unconditional**;

   Example 3: A offers to B to repay only the principal amount of the loan. This is not a valid tender since the whole amount of principal and interest is not offered.

2. It must be made at a **proper time and place**

   Example 4: If the promisor wants to deliver the goods at 2 a.m., this is not a valid tender unless it was so agreed.

3. **Reasonable opportunity to examine the goods**

   Example 5: A contract's to deliver B at his warehouse 1000 Kgs of wheat on certain date. A must bring the wheat to B's warehouse on the appointed day, under such circumstances that B may have reasonable opportunity of satisfying himself that the thing offered is wheat of the quality contracted for, and that there are 1000 Kgs.

4. It must be for **whole obligation**

   Example 6: X, a singer enters into a contract with Y, the manager of a theatre to sing at his theatres two nights in every week during the next two months, and Y engaged to pay her ₹10,000 for each night's performance. On the sixth night, X willfully absents herself from the theatre. Y is at liberty to put an end to the contract.

   Example 7: A promises to deliver 100 bales of cotton on a certain day. On the agreed day and place 'A' offers to deliver 80 bales only. This is not a valid tender.

BY WHOM A CONTRACT MAY BE PERFORMED

40 - 41 - 42

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
- Third person
- Joint promisors

By Whom a Contract May be Performed		
Category	**Description**	**Example**
Promisor Himself	If the contract specifies that the promisor must personally perform the promise, it must be done by the promisor. This typically involves personal skill, diligence, or trust between the parties.	***Example 8:*** *A promises to paint a picture for B, and this must be performed by A himself.*
Agent	When personal skill or trust isn't crucial, the promisor or their representative can assign a competent person to perform the contract.	
Legal Representatives	❑ If personal skill or trust is involved, the contract ends on the promisor's death.	***Example 9:*** *A promises to pay B ₹100,000 on delivery of goods. If A dies before payment, his representative must pay.*
	❑ For other contracts, legal representatives are bound to fulfill the promise but only up to the value of the inherited property.	***Example 10:*** *A promises to paint a picture for B. A must do it himself and can't ask another painter to do it. If A dies before painting, the contract ends and cannot be enforced by A's representative or B.*
Third Persons 41	If the promisee accepts performance from a third person, they cannot later enforce the promise against the promisor, even if the promisor was unaware of or did not authorize the third party's action.	***Example 11:*** *A owes B ₹100,000. C, without A's knowledge, pays ₹60,000 to B. B can now only claim the remaining ₹40,000 from A.*
Joint Promisors 42	When two or more persons make a joint promise, they must jointly fulfill it. If one dies, their representatives, along with the surviving promisors, must fulfill the promise. If all die, the legal representatives of all must fulfill it.	***Example 12:*** *A, B, and C jointly promise to pay D ₹6,00,000. If A dies, his representatives must perform the promise with B and C, and so on.*

DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT

Basis	Succession	Assignment
Definition	Transfer of both benefits and burdens of a contract by law (usually after death).	Transfer of the benefits of a contract to another person. Liabilities cannot be assigned.
Involvement of Liabilities	Both benefits and liabilities may pass to the legal heir.	Only the benefits are assigned; liabilities remain with the original party.
Example	A son inherits his father's estate, including debts and liabilities.	A creditor can assign the right to collect a debt to another person, but the debtor cannot assign their obligation.

Limitation	property inherited. If debts exceed the estate, the heir is not responsible for the excess.	original debtor remains responsible for repayment.
When Not Applicable	N/A	Cannot assign benefits if personal consideration is involved or if the benefit is coupled with a liability.

LIABILITY OF JOINT PROMISOR & PROMISEE

Liability of Joint Promisor & Promisee	
42	Joint liabilities of Joint Promisors
43	Any one of joint promisors may be compelled to perform
44	Effect of release of one joint promisor
45	Rights of Joint Promisees

42 - Devolution of Joint Liabilities

- If two or more persons have made a joint promise, ordinarily all of them during their life-time must **jointly fulfil the promise**.
- After the death of any one of them, **his legal representative jointly with the survivor** or survivors should do so.
- After the death of the last survivor the legal representatives of all the original co- promisors must fulfil the promise.

Example 13: X, Y and Z who had jointly borrowed money must, during their life-time jointly repay the debt. Upon the death of X his representative, say, S along with Y and Z should jointly repay the debt and so on. If in an accident all the borrowers X, Y and Z dies then their legal representatives must fulfil the promise and repay the borrowed amount. This rule is applicable only if the contract reveals no contrary intention.

Why 43?

- **Section 42 deals with voluntary discharge of obligations by joint promisors.**
- If joint promisors do not discharge their obligation on their own volition, what will happen? This is why…

43 - Any one of joint promisors may be compelled to perform –

- **Liability of Joint Promisors**
  - **Performance by Any Joint Promisor:** If two or more persons make a joint promise, the promisee can require any one or more of them to perform the entire promise unless stated otherwise in the contract.
- **Contribution Among Joint Promisors**
  - **Equal Contribution:** Each joint promisor can ask the other joint promisors to equally contribute to the performance of the promise unless the contract specifies otherwise.
  - **Right to Contribution:** If one joint promisor fulfills the whole contract, they can ask the others to contribute their share.

- **Sharing of Loss:** If one joint promisor fails to contribute, the remaining promisors must share the defaulted amount equally.

- **Explanation to Section 43**
  - **Surety's Right to Recover:** A surety can recover from the principal any payments made on the principal's behalf.
  - **Principal's Limitation:** The principal cannot claim recovery from the surety for payments the principal has made

Example 14: A, B and C jointly promise to pay D ₹3,00,000. D may compel either A or B or C to pay him ₹3,00,000.

Example 15: A, B and C are under a joint promise to pay D ₹3,00,000. C is unable to pay anything A is compelled to pay the whole. A is entitled to receive ₹1,50,000 from B.

Example 16: X, Y and Z jointly promise to pay ₹6,000 to A. A may compel either X or Y or Z to pay the amount. If Z is compelled to pay the whole amount; X is insolvent but his assets are sufficient to pay one-half of his debts. Z is entitled to receive ₹1,000 from X's estate and ₹2,500 from Y.

43 - Conclusion - This section talks on -
- how to make the liability in the event of a joint contract,
- both joint & several,
- in so far as the promisee may, in the absence of a contract to the contrary,
- compel anyone or more of the joint promisors
- to perform the whole of the promise.

44 - Effect of Release of One Joint Promisor

Where two or more persons have made a joint promise, a **release of one** of such joint promisors by the promisee **does not discharge the other joint promisor** or joint promisors, neither does it free the joint promisors so released from responsibility to the other joint promisor or promisors.

Example 17: 'A', 'B' and 'C' jointly promised to pay ₹9,00,000 to 'D'. 'D' released 'A' from liability. In this case, the release of 'A' does not discharge 'B' and 'C' from their liability. They remain liable to pay the entire amount of ₹9,00,000 to 'D'. And though 'A' is not liable to pay to 'D', but he remains liable to pay to 'B' and 'C' i.e. he is liable to make the contribution to the other joint promisors.

45 - Rights of Joint Promisees

When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract:

The right to claim Performance rests between PROMISOR and JOINT PROMISEES	
During their joint lives	With the Joint Promisees
After the death of any of them	With the representative of such deceased person jointly with the survivor or survivors
After the death of the last survivor	With the representatives of all jointly

Example 18: A, in consideration of ₹5,00,000 rupees lent to him by B and C, promises B and C jointly to repay them that sum with interest on a specified day but B dies. In such a case right to demand payment shall rest with B's legal representatives, jointly with C during C's life-time, and after the death of C, with the legal representatives of B and C jointly.

Time and Place for Performance of the Promise	
46	No Time Specified, No Application Needed
47	Time and Place for Performance, Where Time is specified
48	Application for Performance on a Specific Day
49	Place for Performance, No Place Fixed

46 - No Time Specified, No Application Needed

- **No time is mentioned in the contract:** The promisor must perform without the promisee's request, the promise must be performed within a reasonable time.
- **Explanation:** "Reasonable time" depends on the facts and circumstances of each case.

47 - Time and Place for Performance, Where Time is Specified

- **Time Specified, No Application Needed:** If a promise is to be performed on a specific day without the promisee's request, the promisor can perform it during business hours at the agreed location on that day.

48 - Application for Performance on a Specific Day

- **Promisee Must Apply:** If the promisor hasn't agreed to perform the promise without the promisee's request, it's the promisee's duty to apply for performance at a reasonable place and time during business hours.
- **Explanation:** What constitutes a "proper time and place" is a question of fact for each case.

49 - Place for Performance, No Place Fixed

- **No Place Specified, No Application Needed:** If no place is mentioned and the promisee doesn't need to request performance, the promisor must ask the promisee to appoint a reasonable place for the performance.

50 - Performance as Prescribed by the Promisee

- **Manner or Time Specified by Promisee:** The promise can be performed in the manner or at the time prescribed or approved by the promisee.

Section 47 -

Example 19: If the delivery of goods is offered say after 8.30 pm, the promisee may refuse to accept delivery, for the usual business hours are over. Moreover, the delivery must be made at the usual place of business.

Section 48 -

Example 20: A undertakes to deliver a thousand maunds of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

PERFORMANCE OF RECIPROCAL PROMISE

Performance of Reciprocal Promise	
Section	Title
51	No Obligation if Promisee Not Ready
52	Order of Performance

	Preventing Performance (Contract Voidable if Prevented)
54	Default in Reciprocal Promises (It's Effect)
55	Failure to Perform on Time When Time is Essential
57	Reciprocal Promises (Legal and Illegal Promises)
58	Alternative Promise (One Legal, One Illegal)
56	Agreement to do Impossible Act

Reciprocal Promises

- **51 - No Obligation if Promisee Not Ready:** If two promises must be performed simultaneously, the promisor isn't required to perform unless the promisee is ready and willing to perform their reciprocal promise.

  Example 21: A and B contract that A shall deliver the goods to B to be paid for by B on delivery. A need not deliver the goods, unless B is ready and willing to pay for the goods on delivery.

- **52 - Order of Performance:** If the order of performance is fixed by the contract, promises must be performed in that order. If no order is specified, the promises should be performed in the order required by the nature of the transaction.

  Example 22: A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.

- **53 - Preventing Performance:**
  - **Contract Voidable if Prevented:** If one party prevents the other from performing their promise, the contract becomes voidable at the option of the party prevented, who is also entitled to compensation for any resulting loss.

    Example 23: A and B contract that B shall execute some work for A for a thousand rupees. B is ready and willing to execute the work accordingly, but A prevents him from doing so. The contract is voidable at the option of B; and if he elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.

    Example 24: In a contract for the sale of standing timber, the seller is to cut and cord it, whereupon buyer is to take it away and pay for it. The seller cords only a part of the timber and neglects to cord the rest. In that event the buyer may avoid the contract and claim compensation from the seller for any loss which he may have sustained for the non-performance of the contract.

- **54 - Default in Reciprocal Promises**
  - **Effect of Default:** When promises are dependent on each other, if the promisor who must perform first fails to do so, they cannot demand the other's performance and are liable for compensation due to non-performance.

    Example 25: A hires B's ship to take in and convey, from Kolkata to the Mauritius, a cargo to be provided by A, B receiving a certain freight for its conveyance. A does not provide any cargo for the ship. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non- performance of the contract.

for making the shoe rack. B arrived on the appointed day and time but A could not arrange for the required materials. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non-performance of the contract.

- **55 - Failure to Perform on Time When Time is Essential**
  - **When Time is Essential:** If time is essential and the promisor fails to perform at the specified time, the contract becomes voidable at the option of the promisee.
  - **When Time is Not Essential:** If time is not crucial, failure to perform on time doesn't make the contract voidable, but the promisee can claim compensation for any loss caused by the delay.
  - **Acceptance of Delayed Performance:** If the promisee accepts performance after the agreed time, they can't claim compensation for the delay unless they notify the promisor at the time of acceptance of their intent to do so.
- **57 - Reciprocal Promises:**
  - **Legal and Illegal Promises:** If parties make reciprocal promises, where one part is legal and the other part is illegal, the legal part is valid, but the illegal part is void.
  - **Example:** If A and B agree to do something lawful under normal circumstances and something illegal if certain conditions arise, only the legal part of the contract is enforceable.

    Example 27: A and B agree that A will sell a house to B for 50,00,000 and also that if B uses it as a gambling house, he will pay a further sum of ₹75,00,000. The first set of reciprocal promises, i.e. to sell the house and to pay ₹50,00,000 for it, constitutes a valid contract. But the object of the second, being unlawful, is void.
- **58 - Alternative Promise:**
  - **One Legal, One Illegal:** If an alternative promise has one legal option and one illegal option, only the legal option can be enforced.
  - **Example:** If A promises to either sell a car (legal) or smuggle goods (illegal), only the legal option to sell the car is enforceable.

    Example 28: A and B agree that A shall pay B ₹1,00,000, for which B shall afterwards deliver to A either rice or smuggled opium. This is a valid contract to deliver rice, and a void agreement as to the opium.

AGREEMENT TO DO IMPOSSIBLE ACT

56 - Types of Impossibility of Performance

- **Initial Impossibility:** Impossibility existing at the time of contract formation.
- **Subsequent Impossibility:** Impossibility arising after the contract is formed.

A. Initial Impossibility (At the Time of Contract)

- **Agreement to Do Something Impossible:** If the contract is to perform something that is inherently impossible (impossible by nature),
- The agreement is void.

Scenarios of Initial Impossibility	
Known to Both Parties	If both the promisor and promisee are aware of the impossibility, the contract is void

Unknown to Both Parties	If both parties are unaware of the impossibility, the contract is still void
Known Only to the Promisor	If the promisor alone knows or should have known (with reasonable diligence) about the impossibility, the promisee can claim compensation for any loss due to non-performance

Example 29: 'A', a Hindu, who was already married, contracted to marry 'B', a Hindu girl. According to law, 'A' being married, could not marry 'B'. In this case, 'A' must make compensation to 'B' for the loss caused to her by the non-performance of the contract.

If known to the parties:

Example 30: B promises to pay a sum of ₹5,00,000 if he is able to swim across the Indian Ocean from Mumbai to Aden within a week. In this case, there is no real agreement, since both the parties are quite certain in their mind that the act is impossible of achievement. Therefore, the agreement, being impossible in itself, is void.

If unknown to the parties:

Example 31: A contracted B to sell his brown horse for ₹2,50,000 both unaware that the horse was dead a day before the agreement.

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

- **Definition:** This occurs when the performance of a promise becomes impossible or illegal after the contract has been entered into due to unforeseen events or changes in circumstances.
- **Characteristics of Subsequent Impossibility:**
  - **Unexpected Events:** The impossibility arises from an unexpected event that was not contemplated by the parties at the time of the contract.
  - **Examples:** Changes in law, natural disasters, or other significant alterations in circumstances that make performance impossible or unlawful.
- **Effects of Subsequent Impossibility:**
  - **Void Contract:** The contract becomes void due to the impossibility of performance.
  - **Discharge from Performance:** Both parties are released from their obligations under the contract, and no further performance is required.

Example 32: 'A' and 'B' contracted to marry each other. Before the time fixed for the marriage, 'A' became mad. In this case, the contract becomes void due to subsequent impossibility, and thus discharged.

APPROPRIATION OF PAYMENTS

Why this Scenario?

Sometimes a debtor owes several debts to the same creditor and makes payment, which is not sufficient to discharge all the debts.

Appropriation of Payments		
Section	**Situation**	**Description**
59	Payment Indicating Specific Debt	When a debtor makes a payment with a clear indication of which specific debt it discharges, the creditor must apply the payment accordingly.

60	Payment Not Indicating Specific Debt	If the debtor does not indicate which debt the payment applies to, the creditor can apply it at their discretion to any lawful debt owed by the debtor.
61	Neither Party Appropriates Payment	If neither party specifies the application of the payment, it will be applied to discharge debts in the order of time. If debts are of equal standing, payments will be applied proportionately.

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

Contracts which need not be Performed	
Section	**Title**
62	Effect of novation, rescission, and alteration of contract
63	Order of Performance
64	Preventing Performance (Contract Voidable if Prevented)
65	Default in Reciprocal Promises (It's Effect)
66	Failure to Perform on Time When Time is Essential
67	Reciprocal Promises (Legal and Illegal Promises)

62 - EFFECT of Novation, Rescission, and Alteration of Contract

- **Overview:** When parties agree to substitute a new contract, rescind, or alter an existing contract, the original contract is no longer required to be performed.

Analysis of Section 62

Novation & its Effect		
Definition	**Outcome**	**Conditions**
Novation is the replacement of an old contract with a new one.	Discharge of Original (OLD) Contract: Upon novation, the original contract is discharged, meaning the parties are no longer bound by it.	❑ Requires mutual agreement between the parties involved. ❑ Can occur with either the same or different parties, depending on the agreement.

Example 33: A owes B ₹100,000. A, B and C agree that C will pay B and he will accept ₹100,000 from C in lieu of the sum due from A. A's liability thereby shall come to an end, and the old contract between A and B will be substituted by the new contract between B and C.

Recission & its Effect		
Definition	**Outcome**	**Conditions**
Rescission refers to the cancellation of an existing contract.	The original contract is nullified, and no new contract is created.	❑ Involves a mutual agreement to cancel the contract. ❑ Results in the parties being released from their obligations.

Alteration & its Effect		
Definition	**Outcome**	**Conditions**
Alteration involves modifying the terms of an existing contract.	The original contract is altered but still exists.	❑ Requires mutual consent to change specific terms. ❑ The original parties remain the same, although the terms may change

COMPARISON = Novation & Alteration	
In both these cases the original contract need not be performed	
Novation	**Alteration**
❑ Substitutes a completely new contract. ❑ May change the parties involved in the contract.	❑ Modifies existing terms without creating a new contract. ❑ The original parties to the contract continue unchanged.

63 - Promisee may Waive or Remit Performance of Promise

Overview	Implication
The promisee can choose to: ❑ Waive or remit the performance of the promise, either wholly or partially. ❑ Extend the time for performance. ❑ Accept an alternative satisfaction that they deem appropriate.	This means a contract can be discharged by remission.
Example 34: A owes B ₹100,000. A, B and C agree that C will pay B and he will accept ₹100,000 from C in lieu of the sum due from A. A's liability thereby shall come to an end, and the old contract between A and B will be substituted by the new contract between B and C.	

64 - Restoration of Benefit under a Voidable Contract

Overview	Key point
If a voidable contract is rescinded by the party who has the option to do so: ❑ The other party is not required to fulfill their promises. ❑ The rescinding party must restore any benefits received under the contract to the other party.	Restoration is required only if benefits were received.
Analysis of Section 64: Such a contract can be terminated at the option of the party who is empowered to do so. If he has received any benefit under the contract, he must restore such benefit to the person from whom he has received it.	
Example 35: An insurance company may rescind a policy on the ground that material fact has not been disclosed. When it does so, the premium collected by it in respect of the policy reduced by the amount of expenses incurred by it in this connection must be repaid to the policy holder.	

Contract that becomes Void

Overview	Key point
If a contract is discovered to be void: ❑ Any person who has received an advantage must restore it or provide compensation to the party from whom it was received.	❑ The aim is to return the parties to their pre-contract position. ❑ A party must give back whatever he has received under the contract. The benefit to be restored received under the contract (and not any other amount)

Analysis of Section 65: From the language of the Section, it is clear that in such a case either the advantage received must be restored back or compensation, sufficient to put the position prior to contract, should be paid.

Example:

- *If a plaintiff paid rent (12 months) for a godown that was later (In 7 months) destroyed by fire (without fault or negligence on plaintiff part), plaintiff are entitled to a refund for the unexpired term of the contract.*
- *A agrees to sell land to B for ₹4,00,000, and B pays ₹40,000 as a deposit. The contract states that if B fails to complete the sale within a specified time, the deposit will be forfeited.*
- *B does not complete the sale on time and is not ready or willing to do so even after a reasonable period.*
- *In this case, A has the right to cancel the contract and keep the ₹40,000 deposit. The deposit isn't considered a benefit under the contract but serves as security to ensure B would fulfill the agreement. It is related to the contract but not considered a benefit to be returned.*

Example 36: A pays B ₹1,00,000, in consideration of B's promising to marry C, A's daughter. C is dead at the time of the promise. The agreement is void, but B must repay A ₹1,00,000.

66 - Communication of Rescission

Overview and Key Point
❑ Rescission of a voidable contract must be communicated to the other party.
❑ The communication must follow the same rules as proposals under Sec. 4
❑ Rescission can also be revoked using the same communication method

67 - Effects of Neglect of Promisee to Afford Promisor Reasonable Facilities for Performance

Overview	Implication
If the promisee fails to provide reasonable facilities for the promisor to perform their promise, the promisor is excused from any non-performance that results from this neglect.	The promisor cannot be held liable for failing to perform if the promisee has not facilitated the performance.

Example 37: If an apprentice refuses to learn, the teacher cannot be held liable for not teaching.

Example 38: A contracts with B to repair B's house. B neglects or refuses to appoint out to A the places in which his house requires repair. A is excused for the non- performance of the contract, if it is caused by such neglect or refusal.

A contract is discharged when the obligations created by it come to an end. A contract may be discharged in any one of the following ways:

Discharge of Contract	Explanation	Examples
By Performance	When both parties fulfill their obligations under the contract. This can be Actual or Attempted performance.	***Example 39:*** *A sells his car to B, and B pays the agreed price. The contract ends by performance.*
	Actual performance = 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, it amounts to attempted performance or tender.	***Example 40:*** *A offers timber to B at the agreed time and place, but B refuses to accept it (attempted performance).*
By Mutual Agreement	The contract can be discharged by novation, rescission, or alteration, where the original contract need not be performed. (CONNECT SECTION 62)	***Example 41:*** *A owes B ₹1,00,000, but they agree to mortgage A's estate for ₹50,000 instead.*
		Example 42: *A pays B ₹3,00,000 for a ₹5,00,000 debt, and B accepts it in full satisfaction.*
By Impossibility of Performance	A contract is discharged when it becomes impossible to perform either from the start (ab initio) or due to subsequent impossibility.	***Example 43:*** *A agrees to discover a treasure by magic (initial impossibility).*
	A contract can be discharged due to: ❑ Unforeseen change in law: If a new law makes the contract illegal. ❑ Destruction of subject-matter: If the essential item for the contract is destroyed. ❑ Non-existence of certain conditions: If a specific situation or condition expected to fulfill the contract no longer exists. ❑ Personal incapacity: If a person involved becomes incapable, such as due to a serious illness. ❑ Declaration of war: If war breaks out, making the contract impossible to perform	***Example 44:*** *A and B contract to marry, but A goes mad before the wedding (supervening impossibility).*
		Example 45: *A agrees to act at a theatre for six months, with B paying in advance. However, on several occasions, A is too sick to perform. The contract for those missed performances becomes void.*
		Example 46: *X agrees to sell his horse to Y for ₹5,000. The horse dies in an accident, making it impossible to complete the sale. A valid contract becomes void due to the impossibility of performance.*

By Lapse of Time	if a contract is not performed within a specified time, as prescribed by the Limitation Act, 1963, it may become time-barred and unenforceable.	*Example 47: If a creditor does not sue for the price within three years, the debt becomes irrecoverable.*
By Operation of Law	A contract may be discharged by law through events like the death of the promisor or insolvency.	*Example 48: A contract terminates upon the death of the promisor.*
By Breach of Contract	Breach may be actual (failure to perform on the due date) Or anticipatory (repudiation before performance is due) A party injured has a right of action for damages AND he is also discharged from performing his part of the contract.	*Example 49: A failed to supply rice to B on the agreed date, resulting in an actual breach.*
By Waiver or Remission	The promisee may choose to waive or remit performance, or accept alternative satisfaction in place of the original promise.	*Example 50: A owes B ₹5,00,000, but B accepts ₹1,00,000 from C as full satisfaction of A's debt.*
By Neglect of Promisee	If the promisee neglects or refuses to provide reasonable facilities for the performance, the promisor is excused from performance.	**Section 67:** If B prevents A from performing a task, A is excused from performing due to B's neglect.
By Merger of Rights	Inferior rights merge into superior rights when they coincide in the same person, eliminating the need to enforce the inferior rights.	*Example 51: A leases land from B but later buys the land. The lease is terminated as A's ownership rights take precedence.*

"PROBLEM KYA HAI? - UNIT 4"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. X, Y and Z jointly borrowed ₹50,000 from A. The whole amount was repaid to A by Y. Decide in the light of the Indian Contract Act, 1872 whether:
   1. Y can recover the contribution from X and Z,
   2. Legal representatives of X are liable in case of death of X,
   3. Y can recover the contribution from the assets, in case Z becomes insolvent. **(Module)**

a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfil the promise. 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 fulfil the promise. Section 43 allows the promisee to seek performance from any of the joint promisors. The liability of the joint promisors has thus been made not only joint but "joint and several". Section 43 provides that 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.

Section 43 deals with the contribution among joint promisors. The promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract). 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.

As per the provisions of above sections,

1. Y can recover the contribution from X and Z because X, Y and Z are joint promisors.
2. Legal representative of X are 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.
3. Y also can recover the contribution from Z's assets.

2. Mr. Rich aspired to get a self-portrait made by an artist. He went to the workshop of Mr. Can artist and asked whether he could sketch the former's portrait on oil painting canvas. Mr. C agreed to the offer and asked for $ 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. 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 vet?

Discuss in light of the Indian Contract Act, 1872?

1. Can Mr. Rich ask Mr. K to complete the artistic work in lieu of his father?
2. Could Mr. Rich ask Mr. K for refund of money paid in advance to his father? **(Module)**

Ans. 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.

1. 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.
2. 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.

3. Mr. JHUTH entered into an agreement with Mr. SUCH to purchase his (Mr. SUCH's) motor car for ₹5,00,000/- within a period of three months. A security amount of ₹20,000/- was also paid by

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 ₹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. **(Module)**

Ans. 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

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 fulfil 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.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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 $ 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?

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)**

Ans. 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.

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.

2. 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 15 th 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 Nov'22, May' 21) (SM)

Ans.

(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.

3. Mr. Harish owes payment of 3 bills to Mr. Ashish as on 31st March, 2022. (i) ₹12,120 which was due in May 2018. (ii) ₹5,650 which was due in August 2020. (iii) ₹9,680 which was due in May 2021. Mr. Harish made payment on 1st April 2022 as below without any notice of how to appropriate them:

A cheque of ₹9,680

A cheque of ₹15,000

Advice under the provisions of the Indian Contract Act, 1872.

(RTP May'23) (SM) (MTP 6 Marks, Nov' 21)

Ans. 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 of the Indian Contract Act, 1872. 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. Harish 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. Harish that it will be against the bill of exact amount. Hence cheque of ₹9,680 will be appropriated against the bill of ₹9,680 which was due in May 2021.

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

Hence, Mr. Ashish can appropriate the same against the debt of ₹12,120 which was due in 2018 and balance against ₹5650 which was due in August 2020.

4. Mr. Sohan, a wealthy individual provided a loan of ₹80,000 to Mr. Mukesh on 26th February, 2021. The borrower, Mr. Mukesh asked for a further loan of $ 1,50,000. Mr. Sohan agreed but

and remaining ₹50,000 on 3rd March, 2021. On 10th March, 2021 Mr. Mukesh while paying off part ₹75,000 to Mr. Sohan insisted that the lender should adjusted $ 50,000 towards the loan taken on-3rd March, 2021 and balance as against the loan on 26th February, 2021. Mr. Sohan objected to this arrangement and asked the borrower to adjust in the order of date of borrowal of funds.

Now you decide:

1. Whether the contention of Mr. Mukesh correct or otherwise as per the provisions of the Indian Contract Act, 1872?
2. What would be the answer in case the borrower does not insist on such order of adjustment of repayment?
3. What would be the mode of adjustment/appropriation of such part payment in case neither Mr. Sohan nor Mr. Mukesh insist any order of adjustment on their part? **(RTP Nov'23)**

Ans. Appropriation of Payments: In case where a debtor owes several debts to the same creditor and makes payment, which is not sufficient to discharge all the debts, the payment shall be appropriated (i.e. adjusted against the debts) as per the provisions of Section 59 to 61 of the Indian Contract Act, 1872.

1. As per the provisions of 59 of the Act, where a debtor owing several distinct debts to one person, makes a payment to him either with express intimation or under circumstances implying that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied accordingly.

   Therefore, the contention of Mr. Mukesh is correct, and he can specify the manner of appropriation of repayment of debt.
2. As per the provisions of 60 of the Act, where the debtor has omitted to intimate and there are no other circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor, where its recovery is or is not barred by the law in force for the time being as to the limitation of suits.

   Hence in case Mr. Mukesh fails to specify the manner of appropriation of debt on part repayment, Mr. Sohan the creditor, can appropriate the payment as per his choice.
3. As per the provisions of 61 of the Act, where neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are or are not barred by the law in force for the time being as to the limitation of suits. If the debts are of equal standing, the payments shall be applied in discharge of each proportionately.

   Hence in case where neither Mr. Mukesh nor Mr. Sohan specifies the manner of appropriation of debt on part repayment, the appropriation can be made in proportion of debts.

5. Mr. Sooraj promises Mr. Manoj to paint a family picture for $ 20,000 and assures to complete his assignment by 15th March, 2023. Unfortunately, Mr. Sooraj died in a road accident on 1* March, 2023 and his assignment remains undone. Can Mr. Manoj bind the legal representative of Mr. Sooraj for the promise made by Mr. Sooraj? Suppose Mr. Sooraj had promised to deliver some photographs to Mr. Manoj on 15th March, 2023 against a payment of $ 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.

(RTP Jun'24) (PYQ Jun'23 4 Marks)

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. Sooraj has to paint a family picture for Mr. Manoj, Mr. Manoj cannot ask the legal representative of Mr. Sooraj to complete the painting work on Mr. Sooraj's death, since painting involves the use of personal skill.

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

6. 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? **(MTP Mar 22 5 Marks) (MTP Nov'22 5 Marks) (MTP May'23 5 Marks) (PYQ 5 Marks, Jul'21)**

Ans. According to Section 56 of the Indian Contract Act, 1872, the impossibility of performance may be of the two types, namely (a) initial impossibility, and (b) subsequent impossibility.

Subsequent impossibility is also known as Supervening impossibility i.e. 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. 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. It is also called the post-contractual impossibility.

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

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

7. 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.

(MTP Nov'22 4 Marks) (PYQ Dec'21 4 Marks)

Ans. Joint promisors (Section 42 of the Indian Contract Act, 1872)

When two or more persons have made a joint promise, then unless a contrary intention appears by the contract, all such persons must jointly fulfil the promise.

Any one of joint promisors may be compelled to perform (Section 43)

promise, the promisee may, in the absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise.

If any one of two or more joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

In the instant case, A, B, C and D have jointly promised to pay $ 6,00,000 to F. B and C 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. Hence, A is entitled to receive 7 50,000 from C and $ 2,75,000 from D, as worked out below:

From C ₹50,000 = (C's Liability ₹1,50,000 Less: Amount he could not pay ₹1,00,000).

From D ₹2,75,000 = (D's Liability ₹1,50,000+ 1/2 of liability of B (Loss) (1,50,000*1/2) i.e. ₹75,000 + 1/2 of C's liability (Loss) (1,00,000 × 1/2) i.e. ₹50,000) in other words, equal proportion i.e., ₹5,50,000 (i.e. ₹6,00,000 – ₹50,000)/2.

Thus, total amount A can receive from C and D comes to ₹3,25,000 (50,000 + 2,75,000).

8. Mr. Gaurav and Mr. Vikas entered into a contract on 1st July, 2022, according to which Mr. Gaurav had to supply 100 tons of sugar to Mr. Vikas at a certain price strictly within a period of 10 days of the contract. Mr. Vikas also paid an amount of ₹70,000 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 July, 2022 and the only road connecting their places was damaged and could not be repaired within fifteen days. Mr. Gaurav offered to supply sugar on 20th July, 2022 for which Mr. Vikas did not agree. On 1st August, 2022, Mr. Gaurav claimed compensation of $ 20,000 from Mr. Vikas for refusing to accept the supply of sugar, which was not there within the purview of the contract. On the other hand, Mr. Vikas claimed for refund of $ 70,000, 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 Mr. Vikas contention. **(MTP Apr'23 6 Marks) (MTP 6 Marks, Apr'21)**

Ans. 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.

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. Gaurav and Mr. Vikas have entered into the contract to supply 100 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. Gaurav has to pay back the amount of 7 70,000 that he received from Mr. Vikas as an advance for the supply of sugar within the stipulated time.

Hence, the contention of Mr. Vikas is correct.

9. Explain any five circumstances under which contracts need not be performed with the consent of both the parties. **(MTP Nov'23 7 Marks) (MTP Nov'22 7 Marks) (PYQ Dec'21 7 Marks)**

Ans. Under following circumstances, the contracts need not be performed with the consent of both the parties:

1. **Novation:** Where the parties to a contract substitute a new contract for the old, it is called novation. A contract in existence may be substituted by a new contract either between

discharge of old contract. Novation can take place only by mutual agreement between the parties. On novation, the old contract is discharged and consequently it need not be performed. (Section 62 of the Indian Contract Act, 1872)

2. **Rescission:** A contract is also discharged by recission. When the parties to a contract agree to rescind it, the contract need not be performed. (Section 62)
3. **Alteration:** Where the parties to a contract agree to alter it, the original contract is rescinded, with the result that it need not be performed. In other words, a contract is also discharged by alteration. (Section 62)
4. **Remission:** 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 is discharged by remission. (Section 63)
5. **Rescinds voidable contract:** 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.
6. **Neglect of promisee:** 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 nonperformance caused thereby. (Section 67)

10. 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 declares 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. **(PYQ Dec'21 6 Marks)**

Ans. As per Section 56 of the Indian Contract Act, 1872 the subsequent or supervening impossibility renders the contract void. Supervening impossibility may take place owing to various circumstances as contemplated under that section, one of which is the declaration of war subsequent to the contract made. In the instant case the contract when made between J and K was valid but afterwards I's government declares war against the country in which the port is situated as a result of which the contract becomes void. Hence, K cannot file a suit against I for performance of the contract.

11. Differentiate between Novation and Alteration as per the Indian Contract Act, 1872.
(PYQ Nov'22 5 Marks)

Ans. **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.

Amount of Debt (In ₹)	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 ₹12,500

(ii) A cheque of ₹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. **(PYQ Dec 23 4 Marks)**

Ans. As per the provisions of Section 59 of the indian Contract Act, 1872, where a debtor, owing several distinct debts to one person, makes a payment to him, either with express intimation, or under circumstances implying that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied accordingly.

As per the provisions of Section 61 of the Indian Contract Act, 1872, where neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are or are not barred by the law in force for the time being as to the limitation of suits. If the debts are of equal standing, the payment shall be applied in discharge of each proportionably.

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 ₹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 ₹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 ₹12,500 will be appropriated against the debt of & ₹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 ₹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, ₹2,500 will be appropriated for the first debt and ₹1,500 will be appropriated towards the second debt.

13. 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? **(RTP May'21)**

promises to be simultaneously performed, no promisor needs to perform his promise unless the promisee is ready and willing to perform his reciprocal promise. Such promises constitute concurrent conditions and the performance of one of the promise is conditional on the performance of the other. If one of the promises is not performed, the other too need not be performed

Referring to the above provisions, in the given case, Mr. S is not bound to deliver goods to Mr. R since payment was not made by him at the time of delivery of goods.

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

1. Whether L can compel only Y to pay the entire loan of ₹90,000?
2. Whether L can compel only the legal representatives of Y to pay the loan of ₹90,000, if X, Y and Z died?
3. 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?

(PYQ 6 Marks, Jul'21)

Ans.

1. Yes, L can compel only Y to pay ₹90,000/- since as per Section 43 of the Indian Contract Act, 1872, 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.
2. As per Section 42, when two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives and after the death of any of them, his representative jointly with the survivor or survivors and after the death of last survivor, the representatives of all jointly must fulfill the promise

   In the instant case, if X, Y and Z died then the legal representatives of all (i.e. X, Y and Z) shall be liable to pay the loan jointly. L cannot compel only the legal representatives of Y to pay the loan of ₹90,000.
3. According to Section 44, where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or joint promisors, neither does it free the joint promisors so released from responsibility to the other joint promisor or promisors.

   In this case, the release of X does not discharge Y and Z from their liability. Y and 2 remain liable to pay the entire amount of ₹90,000 to L. And though X is not liable to pay to L, but he remains liable to pay to Y and Z i.e. he is liable to make the contribution to the other joint promisors.

15. Krish, Kamya and Ketan are partners in a firm. They jointly promised to pay ₹6,00,000 to Dia. Kamya become insolvent and her private assets are sufficient to pay 1/5 of her share of debts. Krish is compelled to pay the whole amount to Dia. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which Krish can recover the amount from Ketan. **(MTP 4 Marks, Mar'21)**

Ans. As per section 43 of the Indian Contract Act, 1872, when two or more persons make a joint promise, the promisee may, in the absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise.

equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

If any one of two or more joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares. In the instant case, Krish, Kamya and Ketan jointly promised to pay ₹6,00,000 to Dia. Kamya become insolvent and her private assets are sufficient to pay 1/5 of her share of debts. Krish is compelled to pay the whole amount. Krish is entitled to receive ₹40,000 from Kamya's estate, and ₹2,80,000 from Ketan.

16. State the grounds upon which a contract may be discharged under the provisions of the Indian Contract Act, 1872. **(MTP 7 Marks, Mar 21)**

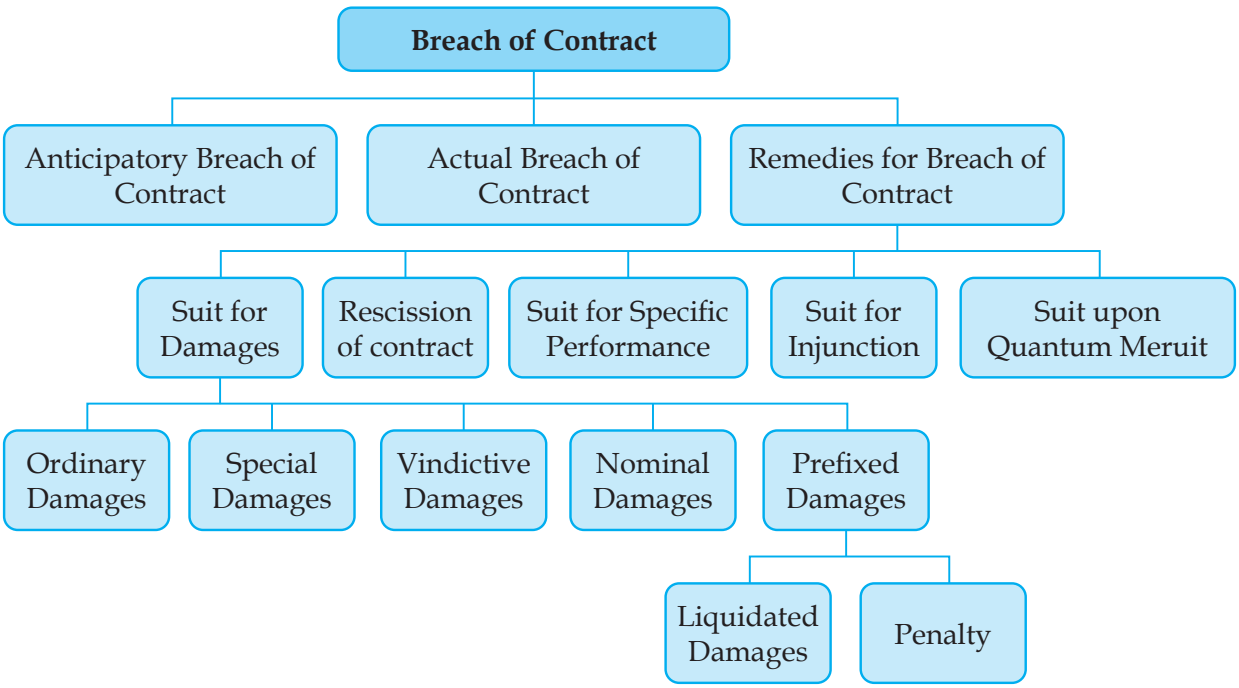
Ans. **Discharge of a Contract:**

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).

UNIT 05

Breach of Contract and its Remedies



Already done -

- How a contract is made, the essential of a valid contract and also how a contract is to be performed as well as how a contract may be put to an end.
- We shall now discuss the breach of contract and the mode in which compensation for breach of contract is estimated.

Breach means -

- **Failure of**
- **A party**
- **to perform his or her obligation**
- **under a contract.**

Breach of contract may arise in two ways:

1. Actual breach of contract
2. Anticipatory breach of contract

Section 39

- 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**.

Anticipatory breach of a contract may take either of the following two ways:

1. Expressly by words spoken or written, and
2. Impliedly by the conduct of one of the parties.

Example 1: Where A contracts with B on 15th July, 2022 to supply 10 bales of cotton for a specified sum on 14th August, 2022 and on 30th July informs B, that he will not be able to supply the said cotton on 14th August, 2022, there is an express rejection of the contract.

Example 2: Where A agrees to sell his white horse to B for ₹50,000/- on 10th of August, 2022, but he sells this horse to C on 1st of August, 2022, the anticipatory breach has occurred by the conduct of the promisor.

Explanation: 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**:
   (a) **Sue** the other party for **damages** from breach of contract **immediately**
   (b) **without** waiting until the due date of performance;

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

ACTUAL BREACH OF CONTRACT

- In contrast to anticipatory breach, it is a case of refusal to perform the promise **on the scheduled date**.
- The parties to a lawful contract are bound to perform their respective promises.
- But when one of the parties breaks the contract by refusing to perform his promise, he is said to have committed a breach.

refused to perform his promise.

- Actual breach of contract may be committed:

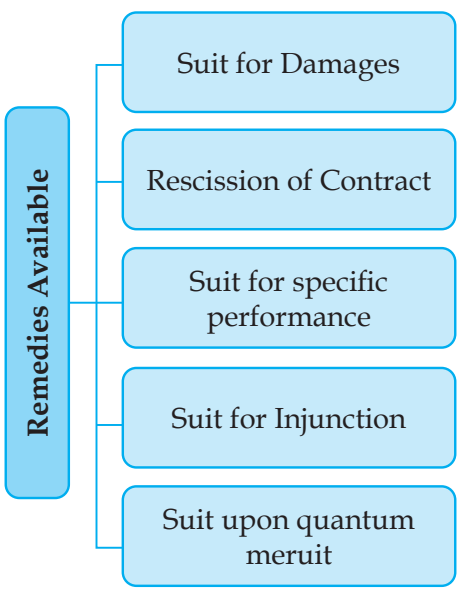
1. **At the time when the performance of the contract is due.**

Example 3: A agrees to deliver 100 bags of sugar to B on 1st February 2022. On the said day, he failed to supply 100 bags of sugar to B. This is actual breach of contract. The breach has been committed by A at the time when the performance becomes due.

2. **During the performance of the contract:** Actual breach of contract also occurs when during the performance of the contract, **one party fails or refuses to perform his obligation** under it by express or implied act.

Aspect	Anticipotory Breach	Actual Breach
Definition	Breach **before** performance dote	Breach **on** the due date or during **performance**
Types	Express and Implied	At Due Date and During Performance
Effect on Promisee	Can sue immediately or wait and hold liable	Can take action for breach on the due dote
Example	Informing inability to perform in advance	Failing to deliver goods on the agreed date

REMEDIES FOR BREACH OF CONTRACT

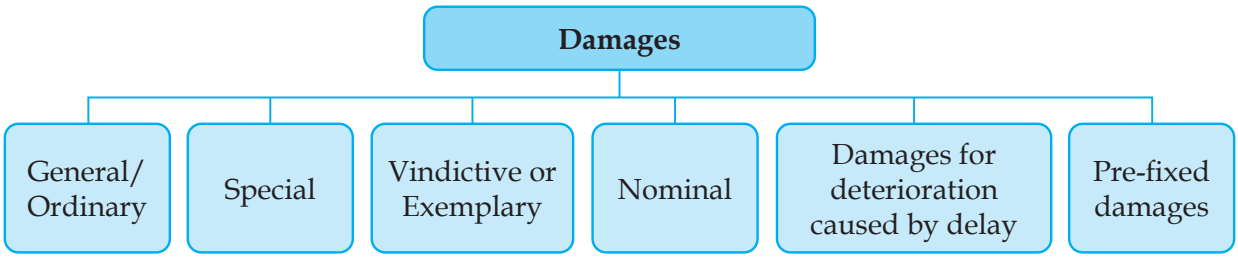


SUIT FOR DAMAGES

Section 73,

- How the amount of compensation is to be determined.
- On the breach of the contract, the party who sues from such a breach is **entitled to receive**, from the party who has broken the contract, **compensation for any loss or damage caused to him by breach**.

- Any **loss or damage which naturally arises** in the usual course of events.
- A compensation can also be claimed for any loss or damage **which the party knew** when they entered into the contract, as likely to result from the breach.
- That is to say, special damage can be claimed **only on a previous notice**. But the party suffering from the breach is bound to take reasonable steps to minimise the loss.
- **No compensation is payable** for any remote or indirect loss.



Types of Damages		
Type of Damages	**Definition**	**Example**
Ordinary Damages	Compensation for loss naturally arising from the breach or known to the parties at the time of contract.	B can claim ₹500 from A for the difference in rice price due to A's refusal to deliver.
Special Damages	Compensation for losses arising from special circumstances known to the breaching party at the time of contract.	A can claim lost profits from B due to the delay of a machine, but not for the lost Government contract.
Vindictive or Exemplary Damages	Awarded for breach of promise to marry or wrongful dishonor of a cheque, often for emotional distress or reputational harm.	A businessman can claim exemplary damages for loss of credit due to wrongful cheque dishonor.
Nominal Damages	Awarded when there is a breach but no actual damage suffered; establishes the right to a decree.	Awarded a small sum like ₹1 or 10 paise when no real damage is proven.
Damages for Deterioration	Compensation for deterioration of goods due to delay, includes physical damage and loss of sale opportunity.	Carrier liable for damages if goods deteriorate due to delay, even without notice.
Pre-fixed Damages	Damages stipulated in the contract, either as liquidated damages (reasonable estimate) or a penalty (arbitrary amount).	If the penalty is ₹1,00,000 but actual loss is ₹70,000, only ₹70,000 is recoverable.

1. **Ordinary damages:**
   - When a contract has been broken, the party who suffered by such breach is **entitled to receive**, from the party who has broken the contract, **compensation for any loss or damage** cause to him thereby, which naturally arose in the usual course of things from such breach, or which the parties know, when they made the contract, to be likely to result from the breach of it
   - Such compensation **is not to be given** for **any remote and indirect loss or damage** sustained by reasons of the breach.

Example 4: A agrees to sell to B bags of rice at ₹5,000 per bag, delivery to be given after two months. On the date of delivery, the price of rice goes up to ₹5,500 per bag. A refuse to deliver the bags to B. B can claim from A ₹500 as ordinary damages arising directly from the breach.

2. **Special damages:** Where a party to a contract receives a notice of special circumstances affecting the contract, he will be liable not only for damages arising naturally and directly from the breach but also for special damages.

Example 5: 'A' delivered a machine to 'B', a common carrier, to be conveyed to 'A's mill without delay. 'A' also informed 'B' that his mill was stopped for want of the machine. 'B' unreasonably delayed the delivery of the machine, and in consequence 'A' lost a profitable contract with the Government. In this case, 'A' is entitled to receive from 'B', by way of compensation, the average amount of profit, which would have been made by running the mill during the period of delay. But he cannot recover the loss sustained due to the loss of the Government contract, as 'A's contract with the Government was not brought to the notice of 'B'.

3. **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. A business man whose credit has suffered will get exemplary damages even if he has sustained no pecuniary loss. But a non-trader cannot get heavy damages in the like circumstances, unless the damages are alleged and proved as special damages. (Gibbons v West Minister Bank)
4. **Nominal damages:**
   - Nominal damages are awarded where the plaintiff has proved that there has been a **breach of contract** but he has not in fact suffered any real damage.
   - It is awarded just to establish the **right to decree** for the breach of contract.
   - The amount may be a rupee or even 10 paise.
5. **Damages for deterioration caused by delay:**
   - In the case of deterioration caused to **goods by delay**, damages can be recovered from the carrier even **without notice**.
   - The word 'deterioration' not only implies physical damages to the goods but it may also mean loss of special opportunity for sale.
6. **Pre-fixed damages:**

Basis	Liquidated Damages	Penalty
Definition	A pre-estimated amount agreed upon by the parties to cover potential losses from a breach.	An excessive amount set to coerce performance, not a fair estimate of loss.
Effectiveness	Valid and recoverable if it represents a genuine estimate of loss.	Not enforceable; the injured part} can only recover actual loss.
Purpose	To compensate for the breach based on a reasonable forecast of potential damages.	To penalize the breaching party, which is deemed unreasonable.

Example 6: If the penalty provided by the contract is ₹1,00,000 and the actual loss because of breach is ₹70,000, only ₹70,000 shall be available as damages, i.e., the amount of actual loss and not the amount stipulated. But if the loss is, say, ₹1,50,000, then only, ₹1,00,000 shall be recoverable.

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

PENALTY AND LIQUIDATED DAMAGES (SECTION 74)

The parties to a contract may provide beforehand the amount of compensation payable in case of failure to perform the contract. In such cases, the question arises whether the courts will accept this figure as the measure of damage.

English Law

According to English law, The sum so fixed in the contract may be interpreted either as liquidated damages or as a penalty.

- If the sum fixed in the contract represents **a genuine pre-estimate** by the parties of the loss, which would be caused by a future breach of the contract, it is **liquidated damages**.
- It is an assessment of the amount which in the opinion of the parties will compensate for the breach.
- Such a clause is effective and the amount is recoverable.
- But where the sum fixed in the contract is **unreasonable** and is used to force the other party to perform the contract; it is a **penalty**.
- Such a clause is **disregarded** and the **injured** party **cannot recover** more than the **actual loss**.

Indian Law

Indian law makes no distinction between 'penalty' and liquidated damages

- The Courts in India award only a reasonable compensation not exceeding the sum so mentioned in the contract.
- Section 74 of the Contract Act lays down if the parties have fixed what the damages will be, the courts will **never allow more**. But the court **may allow less**.
- A decree is to be passed only for reasonable compensation **not exceeding the sum** named by the parties.
- Thus, Section 74 entitles a person complaining of breach of contract to get **reasonable compensation and does not entitle him to realise anything by way of penalty**.

Exception

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

Example 8: A contracts with B, that if A practices as a surgeon in Kolkata, he will pay B ₹50,000. A practice as a surgeon at Kolkata, B is entitled to such compensation not exceeding ₹50,000 as the court considers reasonable.

Example 9: A borrows ₹10,000 from B and gives him a bond for ₹20,000 payable by five yearly instalments of ₹4,000 with a stipulation that in default of payment, the whole shall become due. This is a stipulation by way of penalty.

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

Distinction between Liquidated Damages and Penalty

Difference B/W Liquidation Damages and Penalty		
Basis	**Liquidated Damages**	**Penalty**
Common Feature	Both are payable upon breach of contract.	Both are payable upon breach of contract.
Amount	Reflects a genuine pre-estimate of potential damages.	Excessive amount, far beyond probable damages.
Additional Sums	Not generally applicable.	Additional sums for default may indicate a penalty.
Court's Role	Courts assess if the sum is a reasonable estimate of loss.	Courts will disregard if the sum is extravagant or excessive, even if labeled as liquidated damages.
Essence	A genuine pre-estimate of damage.	A sum to intimidate or coerce the offending party.
Treatment in India	No distinction; courts award actual loss up to the fixed sum.	Courts award reasonable compensation, not exceeding the fixed sum.

REMEDIES OTHER THAN CLAIMING DAMAGES

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

"Really Quick Solution Incoming"

- **R - Rescission of contract**
- **Q - Quantum Meruit**
- **S - Specific Performance**
- **I - Injunction**

A. Rescission of contract:

- When a contract is broken by one party, the other party may treat the contract as rescinded.
- In such a case he is absolved of all his obligations under the contract and is entitled to compensation for any damages that he might have suffered.

Example 11: A promises B to deliver 50 bags of cement on a certain day. B agrees to pay the amount on receipt of the goods. A failed to deliver the cement on the appointed day. B is discharged from his liability to pay the price.

B. Quantum Meruit:

- Where one person has rendered service to another in circumstances which indicate an understanding between them that it is to be paid for although no particular remuneration has been fixed, the law will infer a promise to pay.

Quantum Meruit i.e. as much as the party doing the service has deserved.

not all of the work which he is bound to do under the contract and seeks to be compensated for the value of the work done.

- For the application of this doctrine, two conditions must be fulfilled:
  1. **It is only available if the original contract has been discharged.**
  2. **The claim must be brought by a party not in default.**
- The object of allowing a claim on quantum meruit is to **recompensate the party** or person for value of work which he has done.
- Damages are **compensatory in nature** while quantum merit is **restitutory**.
- It is but reasonable compensation awarded on implication of a contract to remunerate.
- Where a person orders from a wine merchant 12 bottles of a whiskey and 2 of brandy, and the purchaser accepts them, the purchaser must pay a reasonable price for the brandy.

The claim for quantum meruit arises in the following cases:

1. **Void Agreement or Void Contract:** When an agreement is found to be void, or a valid contract becomes void later.
2. **Gratuitous Work:** When someone does something without intending to do it for free, they can claim payment.
3. **No Fixed Remuneration:** If services are provided with no clear agreement on payment, the person providing the service can still claim payment.
4. **Contract Abandonment:** When one party refuses to continue or abandons the contract.
5. **Divisible Contract:** If part of a divisible contract is performed, the party not in breach can enjoy that benefit.
6. **Bad Work in an Indivisible Contract:** If a lump-sum contract is completed poorly, the performing party can claim the payment, but the other party may deduct for poor quality.

Example 12: X wrongfully revoked Y's (his agent) authority before Y could complete his duties. Held, Y could recover, as a quantum meruit, for the work he had done and the expenses he had incurred in the course of his duties as an agent.

Example 13: A agrees to deliver 100 bales of cottons to B at a price of ₹1000 per bale. The cotton bales were to be delivered in two instalments of 50 each. A delivered the first instalment but failed to supply the second. B must pay for 50 bags.

C. **Suit for specific performance:** Where damages are **not an adequate remedy** in the case of breach of contract, the court may in its discretion on a suit for a specific performance direct party in breach, to carry out his promise **according to the terms of the contract**.

D. **Suit for injunction:** Where a party to a contract is negating the terms of a contract, the court may by issuing an **'injunction orders'**, restrain him from doing what he promised not to do.

Example 14: N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer. Held, she could be restrained by an injunction.

Example 15: A, a singer, agreed with B to perform at his theatre for two months, on a condition that during that period, he would not perform anywhere. In this case, B could move to the Court for grant of injunction restraining A from performing in other places.

A person who rightfully rescinds a contract **is entitled to compensation** for any damage which he has sustained through non-fulfilment of the contract

Example 16: A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹10000 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non- fulfilment of the contract.

"PROBLEM KYA HAI? - UNIT 5"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQPs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. "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.

(Module)

Ans. 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 ChunniLal 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.

to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for the purchase of 1,000 water bottles @ ₹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 & 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.

Ans. Breach of Contract-Damages: Section 73 of the Indian Contract Act, 1872 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.

The leading case on this point is "Hadley vs. 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.

The problem asked in this question is based on the provisions of Section 73 of the Indian Contract Act, 1872.

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' ₹500/- at the rate of 0.50 paise i.e. 1000 water bottles × 0.50 paise (difference between the procuring price of water bottles and contracted selling price to Y) 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 and the market price on the day of default. In other words, the amount of damages would be ₹750/- (i.e. 1000 water bottles × 0.75 paise).

MTPs, RTPs AND PYQPs QUESTIONS

1. 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)**

Ans. 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

(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.

2. "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.

(RTP May' 22) (SM) (MTP 7 Marks, Oct'21)

Ans. 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. The law in this regard has very well summed up in Frost v. Knight and Hochster v. DelaTour.

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.

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

Give the circumstances as to when "Vindictive or Exemplary Damages" may be awarded for breach of a contract. **(RTP Nov 22)**

Ans. Vindicative or Exemplary damages

These damages may be awarded only in two cases?

1. for breach of promise to marry because it causes injury to his or her feelings; and
2. 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.

no pecuniary loss. But a non-trader cannot get heavy damages in the like circumstances, unless the damages are alleged and proved as special damages. (Gibbons v West Minister Bank)

4. Shital was a classical dancer. She entered into an agreement with Sharad Vidya Mandir for 50 dance performances. As per the contract, she was supposed to perform every weekend and she will be paid $ 8,000/- 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.

1. Whether the management of Sharad Vidya Mandir has right to terminate the contract?
2. If the management of Sharad Vidya Mandir informed Shital about its continuance, can the management still rescind the contract after a month on this ground subsequently?
3. Can the Sharad Vidya Mandir claim damages that it has suffered because of this breach in any of the above cases? **(RTP Nov 23)**

Ans. Section 39 of the indian Contract Act, 1872 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 terms 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,

1. Since, Shital could not perform as per. the terms of contract, Sharad Vidya Mandir can terminate the contract.
2. In the second situation, the management of Sharad Vidya Mandir informed Shital about the continuance of the contract. Hence, the management cannot rescind the contract after a month on this ground subsequently.
3. As per Section 75, Shard Vidya Mandir can claim damages that it has suffered because of this breach in part (i).

5. Rahul was a Disk Jockey at a five-star hotel. As per the contract, he is supposed to perform every weekend. (i.e. twice a week). Rahul will be paid Rs. 2,500 per day. However, after a month, Rahul willfully absents himself from the performance. Taking into account the provisions of the Indian Contract Act, 1872, answer the following:

1. Does the hotel have the right to end the contract?
2. If the hotel sends out a mail to Rahul that they are interested to continue the contract and Rahul accepts, can the hotel rescind the contract after a month on this ground subsequently?
3. In which of the case - (termination of contract or continuance of contract) can the hotel claim damages that it had suffered as a result of this breach? **(RTP Jun'24)**

Ans. By analysing 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,

2. The hotel has the right to continue the contract with Rahul. But once this right is exercised, it cannot subsequently rescind the contract on this ground subsequently.
3. In both the cases, the hotel (promisee) is entitled to claim damages that has been suffered as a result of breach.

6. 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 Put. 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 Mar'22 4 Marks)**

Ans. 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.

7. Seema was running a boutique in New Delhi. She was 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? **(MTP Nov'22 6 Marks)**

Ans. Section 73-75 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 defendant. If no special notice is given, then the aggrieved party can only claim the ordinary damages.

In the instant case, the goods were delivered after the conclusion of the exhibition, therefore Seema can recover only the losses arising in the ordinary course of business. Special damages are allowed only when the special circumstances are made aware. Since no notice about special circumstances was given to railways authorities, she could not recover the loss of profits.

performance has arrived". Also, discuss the effect of anticipatory breach of contracts under the Indian Contract Act, 1872. **(MTP Apr 23 7 Marks)**

Ans. 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.

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 for 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.

9. Mr. Harish was travelling to Shimla 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. The driver advised the passengers to get to the shelter in the nearest hotel which was at a distance of only one kilometer from that place. The wife of Mr. Harish caught cold and fell ill due to being asked to get down and she had to walk in cold night to reach hotel. Mr. Harish 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. Harish would get compensation for which he filed the suit under the Indian Contract Act, 1872? **(MTP May' 23 4 Marks)**

Ans. 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. Harish 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. Harish 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.

10. "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. **(MTP Dec'23 5 Marks)**

Ans. Liquidated damages is a genuine pre-estimate of compensation of damage 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.

and has no comparison to the loss suffered by the parties.

Distinction between liquidated damages and penalty

Penalty and liquidated damages have one thing in common that both are payable on the occurrence of a breach of contract. It is very difficult to draw a clear line of distinction between the two but certain principles as laid down below may be helpful.

1. If the sum payable is so large as to be far in excess of the probable damage on breach, it is certainly a penalty.
2. Where a sum is expressed to be payable on a certain date and a further sum in the event of default being made, the latter sum is a penalty because mere delay in payment is unlikely to cause damage.
3. The expression used by the parties is not final. The court must find out whether the sum fixed in the contract is in truth a penalty or liquidated damages. If the sum fixed is extravagant or exorbitant, the court will regard it is as a penalty even if, it is termed as liquidated damages in the contract.
4. The essence of a penalty is payment of money stipulated as a terrorem of the offending party. The essence of liquidated damages is a genuine pre-estimate of the damage.
5. English law makes a distinction between liquidated damages and penalty, but no such distinction is followed in India. The courts in India must ascertain the actual loss and award the same which amount must not, however exceed the sum so fixed in the contract. The courts have not to bother about the distinction but to award reasonable compensation not exceeding the sum so fixed.

11. 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 $ 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.

1. Whether the management of Shital Vidya Mandir has right to terminate the contract?
2. 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?
3. Can the Shital Vidya Mandir claim damages that it has suffered because of this breach in any of the above cases? **(PYQ May 22 4 Marks)**

Ans. 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,

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

the continuance of the contract. Hence, the management cannot now rescind the contract after a month on this ground subsequently.

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

12. "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. **(PYQ May'22 5 Marks)**

Ans. Liquidated damages is a genuine pre-estimate of compensation of damage 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.

Distinction between liquidated damages and penalty

Penalty and liquidated damages have one thing in common that both are payable on the occurrence of a breach of contract. It is very difficult to draw a clear line of distinction between the two but certain principles as laid down below may be helpful.

1. If the sum payable is so large as to be far in excess of the probable damage on breach, it is certainly a penalty.
2. Where a sum is expressed to be payable on a certain date and a further sum in the event of default being made, the latter sum is a penalty because mere delay in payment is unlikely to cause damage.
3. The expression used by the parties is not final. The court must find out whether the sum fixed in the contract is in truth a penalty or liquidated damages. If the sum fixed is extravagant or exorbitant, the court will regard it is as a penalty even if, it is termed as liquidated damages in the contract.
4. The essence of a penalty is payment of money stipulated as a terrorem of the offending party. The essence of liquidated damages is a genuine pre-estimate of the damage.
5. English law makes a distinction between liquidated damages and penalty, but no such distinction is followed in India. The courts in India must ascertain the actual loss and award the same which amount must not, however exceed the sum so fixed in the contract. The courts have not to bother about the distinction but to award reasonable compensation not exceeding the sum so fixed.

13. 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' @₹900; '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 ₹1,000; ₹1,100 and ₹1,200 for 'S', 'M' and 'L' sizes respectively.

the Indian Contract Act, of 1872. **(PYQ Dec 23 3 Marks)**

Ans. As per the provisions of Section 39 of the Indian Contract Act, 1872, 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 in its continuance.

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

1. 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
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.

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 ₹90,000 [300 piece @ ₹100 (Small), 300 piece @ ₹100 (Medium) and 300 piece ₹100 (Large)].

14. "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. **(RTP May' 21)**

Ans. 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.

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.

15. 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? **(RTP May'21)**

Ans. Where there is a breach of contract for supply of a unique item, mere monetary damages may not be an adequate remedy for the other party. In such a case the court may give order for specific performance and direct the party in breach to carry out his promise according to the terms of contract. Here, in this case, the court may direct A to supply the item to B because the refusal to supply the agreed unique item cannot be compensated through money.

16. 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 & 1500 per day. However, after a month, Mr. X willfully absents himself from the performance. Does the hotel have the right to end the contract? 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? 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)**

Ans. 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,

1. Yes, the hotel has the right to end the contract with Mr. X, the DJ.
2. 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.
3. In both the cases, the hotel (promisee) is entitled to claim damages that has been suffered as a result of breach.

17. "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. **(MTP 5 Marks, Mar'21)**

Ans. 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 in its continuance.

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.

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.

18. "An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived". Explain and also discuss the effect of anticipatory breach on contracts.

(MTP 7 Marks, Apr'21)

Ans. Section 39 of the Indian Contract Act 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".

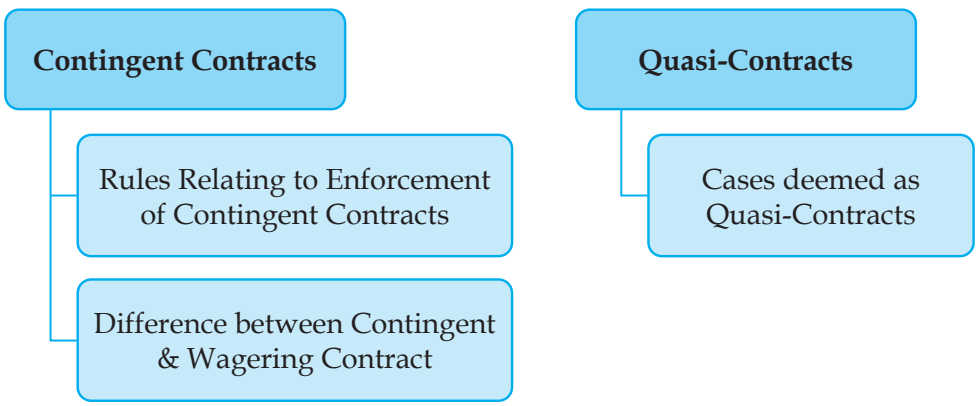
Effect of anticipatory breach: The promisee is excused from performance or from further performance.

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 reconsideration, 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.

UNIT 06

Contingent and Quasi Contract



CONTINGENT CONTRACTS

The Contract Act recognises certain cases in which an obligation is Created without a contract.

Such obligations arise out of certain relations which cannot be called contracts in the strict sense.

- **There is no offer, no acceptance, no *consensus ad idem* and in fact neither agreement nor promise** and yet the law imposes an obligation on one party and confers a right in favour of the other. We shall have a look at these cases of 'Quasi-contracts'.
- A contract may be absolute or a contingent.

An Absolute contract is one where the promisor undertakes to perform the contract in any event without any condition.

Definition of 'Contingent Contract' (Section 31)

- A contract to do or not to do something, if some event, collateral to such contract, does or does not happen".

Contracts of Insurance, indemnity and guarantee fall under this category.

Example 1: A contracts to pay B ₹10,00,000 if B's house is burnt. This is a contingent contract.

Example 2: A makes a contract with B to buy his house for ₹50,00,000 if he is able to secure to bank loan for that amount. The contract is a contingent contract.

Meaning of collateral Event: *Pollock and Mulla* defined collateral event as:

- An event which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise".

Example 3: A contracts to pay B ₹10,00,000 if B's house is burnt. This is a contingent contract. Here the burning of the B's house is neither a performance promised as part of the contract nor it is the consideration obtained from B. The liability of A arises only on the happening of the collateral event.

Example 4: A agrees to transfer his property to B if her wife C dies. This is a contingent contract because the property can be transferred only when C dies.

ESSENTIALS OF A CONTINGENT CONTRACT

1. 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 5: 'A' promises to pay ₹50,000 to 'B' if it rains on the first of the next month.

2. The event is referred to **as 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.

   Example:

   (i) where A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards, the contract is a conditional contract and not contingent; because the event on which B's obligation is made to depend is part of the promise itself and not a collateral event.

   (ii) Similarly, where A promises to pay B ₹1,00,000 if he marries C, it is not a contingent contract.

   (iii) 'A' agreed to construct a swimming pool for 'B' for ₹20,00,000. And 'B' agreed to make the payment only on the completion of the swimming pool. It is not a contingent contract as the event (i.e. construction of the swimming pool) is directly connected with the contract.

3. 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 6: If A promises to pay B ₹100,000, if he so chooses, it is not a contingent contract. (In fact, it is not a contract at all). However, where the event is within the promisor's will but not merely his will, it may be contingent contract.

   Example 7: If A promises to pay B ₹100,000 if it rains on 1st April and A leave Delhi for Mumbai on a particular day, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but raining is not merely his will.

4. **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 8: 'A' agreed to sell his agricultural land to 'B' after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfilment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.

Sections 32-36 of the Act.

Rules Relating to Enforcement			
Section	**Title**	**Description**	**Examples**
32	Enforcement of contracts contingent on an event happening	A contract contingent on an uncertain future event cannot be enforced unless the event happens. If the event becomes impossible, the contract becomes void.	A agrees to pay B if B marries C. C dies without marrying B, so the contract becomes void.
33	Enforcement of contracts contingent on an event not happening	A contract contingent on an event not happening can only be enforced when it becomes impossible for the event to occur.	P agrees to pay Q if a ship does not return. The contract is enforceable if the ship sinks and cannot return. If the ship returns, the contract becomes void.
34	Contingent on a person's conduct	A contract contingent on a person's actions becomes impossible if the person docs something that makes the event impossible.	A agrees to pay B if B marries C. C marries D, making it impossible for B to marry C (unless there's a divorce).
35	Contingent on an event happening within a fixed time	A contract contingent on an event happening within a fixed time becomes void if the event doesn't happen or becomes impossible within that time.	A agrees to pay B if a ship returns within a year. The contract is enforceable if the ship returns within the year, but void if the ship is burnt within the year.
35	Contingent on an event NOT happening within a fixed time	A contract contingent on an event not happening within a fixed time is enforceable if the event doesn't happen or becomes impossible within that time.	A agrees to pay B if a ship does not return within a year. The contract is enforceable if the ship doesn't return or is destroyed during that time.
36	Contingent on an impossible event	A contract contingent on an impossible event, whether known or not at the time of agreement, is void.	A agrees to pay B if the sun rises in the west. The contract is void.

DIFFERENCE BETWEEN A CONTINGENT CONTRACT AND A WAGERING CONTRACT

Basis of Difference	Contingent Contract	Wagering Contract
Meaning	A contingent contract is a contract to do or not to do something with reference to a collateral event happening or not happening.	A wagering agreement is a promise to give money or money's worth with reference to an uncertain event happening or not happening.
Reciprocal promises	Contingent contract may not contain reciprocal promises.	A wagering agreement consists of reciprocal promises.
Uncertain event	In a contingent contract, the event is collateral.	In a wagering contract, the uncertain event is the core factor.

Nature of contract	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.
Interest of contracting parties	Contracting parties have interest in the subject matter in contingent contract.	The contracting parties have no interest in the subject matter.
Doctrine of mutuality of lose and gain	Contingent contract is not based on doctrine of mutuality of lose and gain.	A wagering contract is a game, losing and gaining alone matters.
Effect of contract	Contingent contract is valid.	A wagering agreement is void.

QUASI CONTRACTS

Based on a maxim -"No man must grow rich out of another person's loss".

- A valid contract must contain:
  - Certain essential elements, such as
  - **offer and acceptance, capacity to contract, consideration and free consent.**
- But sometimes the law implies a promise imposing obligations on one party and conferring right in favour of the other
  - even when there is
  - no offer, no acceptance,
  - no genuine consent,
  - lawful consideration, etc.
  - and in fact neither agreement nor promise.
- Such cases **are not contract in the strict sense**, but the Court recognises them as **relations resembling those of contracts** and enforces them as if they were contracts.

  Hence the term Quasi –contracts (i.e. resembling a contract).
- Even in the absence of a contract, certain **social relationships** give rise to certain specific obligations to be performed by certain persons.
- **These are known as quasi contracts** as they create the same obligations as in the case of regular contracts.

Quasi contracts are based on principles of equity, justice and good conscience.

Example 9: T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

Example 10: A pays some money to B by mistake. It is really due to C. B must refund the money to A.

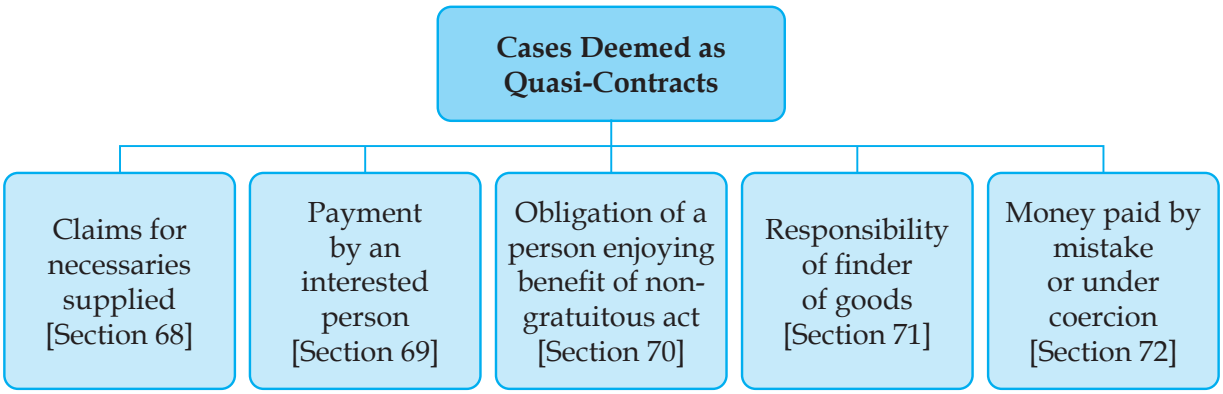
Example 11: A fruit parcel is delivered under a mistake to R who consumes the fruits thinking them as a birthday present. R must return the parcel or pay for the fruits. Although there is no agreement between R and the true owner, he is bound to pay as the law regards it a Quasi-contract.

- These relations are called **quasi-contractual obligations**.
- In India it is also called **a 'certain relation resembling those created by contracts**.

Salient features of quasi contracts:

1. In the first place, such **a right is always a right to money** and generally, though not always, to a liquidated sum of money.
2. Secondly, **it does not arise from any agreement of the parties** concerned, but is imposed by the law.

person or persons only, so that in this respect it resembles a contractual right.



5 different circumstances where contract is deemed to have come to exist in which we shall presently dilate upon.

Cases Deemed as Quasi Contract			
Section	**Section**	**Description**	**Examples**
68	Claim for necessaries supplied to persons incapable of contracting	If someone incapable of contracting (like a minor or lunatic) is provided with necessaries suited to their life, the supplier can claim reimbursement from the incapable person's property.	A supplies necessaries to B, a lunatic or minor. A is entitled to be reimbursed from B's property.
69	Payment by an interested person	A person who is interested in paying off a debt that another person is legally bound to pay is entitled to be reimbursed by that person.	No specific example provided.
70	Obligation of a person enjoying benefits of a non-gratuitous act	When a person lawfully does something for another without intending it to be a free service, and the other person benefits, the beneficiary must pay compensation or return the thing.	A leaves goods at B's house by mistake. B uses the goods as his own. B must pay A for them.
71	Responsibility of finder of goods	A person who finds someone else's goods and takes them into custody must take care of them like a prudent person and return them if the owner is found.	H finds a diamond and gives it to F for safekeeping. When the owner isn't found, F must return the diamond to H.
72	Money paid by mistake or under coercion	Any money paid or goods delivered by mistake or under coercion must be repaid or returned.	T was fined for not having a tram ticket. He later sued for recovery, claiming the fine was extorted. The suit was decided in his favor.

Section	Case Law	Key Points	Facts	Judgment
70	Shyam Lal vs. State of U.P.	1. Non-gratuitous act 2. Enjoyment of benefit 3. Compensation for benefit enjoyed	K, a government servant, was reinstated after being compulsorily retired. He was paid a salary without any work while the government appealed.	The appeal favored the government, and K was directed to return the salary received during the reinstatement period.
71	Hollins vs. Howler	1. Finder of goods 2. Responsibility of finder 3. Return of goods to finder when owner is not found	H found a diamond in Fs shop and gave it to F for safekeeping until the owner was found, the true owner could not be traced.	F was required to return the diamond to H, as H had the right to retain it against everyone except the true owner.
72	Shivprasad vs. Sirish Chandra	1. Money paid by mistake 2. Recoverability of money paid under mistaken belief	Payment was made under a mistaken belief concerning a municipal tax.	The payment was deemed recoverable.
	Sales Tax Officer vs. Kanhaiyalal		Payment of sales tax made under a mistaken understanding of the lease terms.	The Supreme Court affirmed that the payment was recoverable.
	Trikamdas vs. Bombay Municipal Corporation	1. Money paid under coercion 2. Interpretation of coercion (including extortion)	T was fined for traveling without a ticket on a tram. He claimed the fine was extorted and filed a suit for recovery'.	The suit was decreed in favor of T, and the court ruled the fine as extortion.

Difference between quasi contracts and contract:

Basis of Distinction	Quasi-Contract	Contract
Essential for the valid contract	The essentials for the formation of a valid contract are absent	The essentials for the formation of a valid contract are present
Obligation	Imposed by law	Created by the consent of the parties

"PROBLEM KYA HAI? - UNIT 6"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

1. Explain the-term 'Quasi Contracts' and state their characteristics. **(Module)**

Ans. 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.

2. X, a minor was studying in M.Com. in a college. On 1st July, 2021 he took a loan of ₹1,00,000 from B for payment of his college fees and to purchase books and agreed to repay by 31st December, 2021. X possesses assets worth 79 lakhs. On due date, fails to pay back the loan to B. B now wants to recover the loan from X out of his (X's) assets. Referring to the provisions of Indian Contract Act, 1872 decide whether B would succeed. **(Module)**

Ans. Yes, B can proceed against the assets of X. According to section 68 of Indian Contract Act, 1872, if a person, incapable of entering into a contract, or any one 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.

Since the loan given to X is for the necessaries suited to the conditions in life of the minor, his assets can be sued to reimburse B.

Yes, P can recover the amount from D. Section

3. 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? **(Module)**

Ans. 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.

■ MTPs, RTPs AND PYQPs QUESTIONS

1. 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 ₹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)**

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.

2. 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? **(RTP May 23)**

Ans. Section 69 of the Indian Contract Act, 1872 states that 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.

3. Rohan found a wallet in a restaurant. He enquired 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 the wallet till the true owner is found. After a week, Rohan went back to the restaurant to enquire about the wallet. The manager refused to return it to Rohan, saying that it did not belong to him. In the light of the Indian Contract Act, 1872, can Rohan recover the wallet from the Manager? **(RTP Nov'23)**

Ans. **Responsibility of finder of goods (Section 71 of the Indian Contract Act, 1872):** A person who find 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:

1. to take proper care of the property as man of ordinary prudence would take
2. no right to appropriate the goods and
3. to restore the goods if the owner is found

In the light of the above provisions, the manager must return the wallet to Rohan, since Rohan is entitled to retain the wallet found against everybody except the true owner.

4. Explain the term 'Quasi Contracts' and state their characteristics. **(RTP Jun'24)**

Ans. **Quasi Contracts:** Under certain special circumstances, obligations 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 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.

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.

5. Explain the term Contingent Contract with reference to the Indian Contract Act, 1872 with the help of an example. Also discuss the rules relating to enforcement of a contingent contract. **(MTP Mar'22 7 Marks)**

Ans. **Definition of 'Contingent Contract' (Section 31 of the Indian Contract Act, 1872):** A contract to do or not to do something, if some event, collateral to such contract, does or does not happen.

Example: A contracts to pay B ₹1,00,000 if B's house is burnt. This is a contingent contract.

Rules Relating to Enforcement: The rules relating to enforcement of a contingent contract are laid down in sections 32, 33, 34, 35 and 36 of the Act.

1. **Enforcement of contracts contingent on an event happening:** Where a contract identifies happening of a future contingent event, the contract cannot be enforced until and unless the event 'happens. If the happening of the event becomes impossible, then the contingent contract is void.
2. **Enforcement of contracts contingent on an event not happening:** Where a contingent contract is made contingent on non-happening of an event, it can be enforced only when its happening becomes impossible.
3. A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does something to make the 'event' or 'conduct' as impossible of happening.
4. **Contingent on happening of specified event within the fixed time:** 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.
5. **Contingent on specified event not happening within fixed time:** Section 35 also says that "Contingent contracts to do or not to do anything, if a specified uncertain event does not happen within a fixed time, may be enforced by law when the time fixed has expired, and such event has not happened or before the time fixed has expired, if it becomes certain that such event will not happen".
6. **Contingent on an impossible event (Section 36):** Contingent agreements to do or not to do anything, if an impossible event happens are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

6. Explain the-term 'Quasi Contracts' and state their characteristics. **(MTP Jun'22 5 Marks)**

Ans. **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.

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.

7. What is Quasi Contract? Elaborate the cases which are deemed as Quasi Contract.

(MTP Nov'22 5 Marks)

Ans. **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 following are the cases which are deemed as Quasi Contract:

A. 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.

To establish his claim, the supplier must prove not only that the goods were supplied to the person who was minor or a lunatic but also that they were suitable to his actual requirements at the time of the sale and delivery.

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. Obligation of person enjoying benefits of non-gratuitous act (Section 70): In term of section 70 of the Act 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 benefit thereof, the latter is bound to pay compensation to the former in respect of, or to restor e, the thing so done or delivered".

D. Responsibility of finder of goods (Section 71): '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:

1. to take proper care of the property as man of ordinary prudence would take
2. no right to appropriate the goods and
3. 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".

8. Explain the term Contingent Contract with reference to the Indian Contract Act, 1872 with the help of an example. Also discuss the rules relating to enforcement of a contingent contract.

(MTP May'23 7 Marks)

Ans. Definition of 'Contingent Contract' (Section 31 of the Indian Contract Act, 1872): A contract to do or not to do something, if some event, collateral to such contract, does or does not happen.

Example: A contracts to pay B ₹1,00,000 if B's house is burnt. This is a contingent contract.

laid down in sections 32, 33, 34, 35 and 36 of the Act.

1. **Enforcement of contracts contingent on an event happening:** Where a contract identifies happening of a future contingent event, the contract cannot be enforced until and unless the event 'happens'. If the happening of the event becomes impossible, then the contingent contract is void.
2. **Enforcement of contracts contingent on an event not happening:** Where a contingent contract is made contingent on non-happening of an event, it can be enforced only when it's happening becomes impossible.
3. A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does something to make the 'event' or 'conduct' as impossible of happening.
4. **Contingent on happening of specified event within the fixed time:** 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.
5. **Contingent on specified event not happening within fixed time:** Section 35 also says that "Contingent contracts to do or not to do anything, if a specified uncertain event does not happen within a fixed time, may be enforced by law when the time fixed has expired, and such event has not happened or before the time fixed has expired, if it becomes certain that such event will not happen".
6. **Contingent on an impossible event (Section 36):** Contingent agreements to do or not to do anything, if an impossible event happens are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

9. What is meant by 'Quasi-Contract'? State any three salient features of a quasi-contract as per the Indian Contract Act, 1872. **(PYQ Dec'21 5 Marks)**

Ans. Meaning of 'Quasi Contract': Under certain special circumstances obligation resembling those created by a contract is 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 Quasi-contract:

1. It does not arise from any agreement of the parties concerned but it is imposed by law.
2. The right under it is always a right to money and generally though not always to a liquidated sum of money.
3. 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.

10. 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

₹15 Lakhs inclusive of ₹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 ₹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:

1. Will Mr. M succeed in filing the suit to recover money? Elaborate the related provisions?
2. What is the maximum amount of money that can be recovered by Mr. M?
3. Shall the provisions of the above act also apply to the medical treatment given to the grandmother? **(PYQ Nov' 22 6 Marks)**

Ans.

1. 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.
2. 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 & 15 Lakhs and this amount can be recovered from Mr. Y's parent's jewellery amounting to & 4 Lakhs and rest from the house of Y's Parents. (Assumption: Y has inherited the house property on the death of his parents)
3. 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.

11. 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 ₹1,00,000 if Dr. A test positive for novel 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)**

Ans. 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.

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. 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. In Case, if Dr. A does not contract Covid 19, then the contract stands void automatically.

12. Explain the term Contingent Contract with reference to the Indian Contract Act, 1872 with the help of an example. Also discuss the rules relating to enforcement of a contingent contract. **(PYQ 7 Marks, Jul'21)**

to do or not to do something, if some event, collateral to such contract, does or does not happen.

Example: A contracts to pay B ₹1,00,000 if B's house is burnt. This is a contingent contract.

Rules Relating to Enforcement: The rules relating to enforcement of a contingent contract are laid down in sections 32, 33, 34, 35 and 36 of the Act.

1. **Enforcement of contracts contingent on an event happening:** Where a contract identifies happening of a future contingent event, the contract cannot be enforced until and unless the event 'happens. If the happening of the event becomes impossible, then the contingent contract is void.
2. **Enforcement of contracts contingent on an event not happening:** Where a contingent contract is made contingent on non-happening of an event, it can be enforced only when its happening becomes impossible.
3. A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does something to make the 'event' or 'conduct' as impossible of happening
4. **Contingent on happening of specified event within the fixed time:** 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.
5. **Contingent on specified event not happening within fixed time:** Section 35 also says that "Contingent contracts to do or not to do anything, if a specified uncertain event does not happen within a fixed time, may be enforced by law when the time fixed has expired, and such event has not happened or before the time fixed has expired, if it becomes certain that such event will not happen".
6. **Contingent on an impossible event (Section 36):** Contingent agreements to do or not to do anything, if an impossible event happens are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

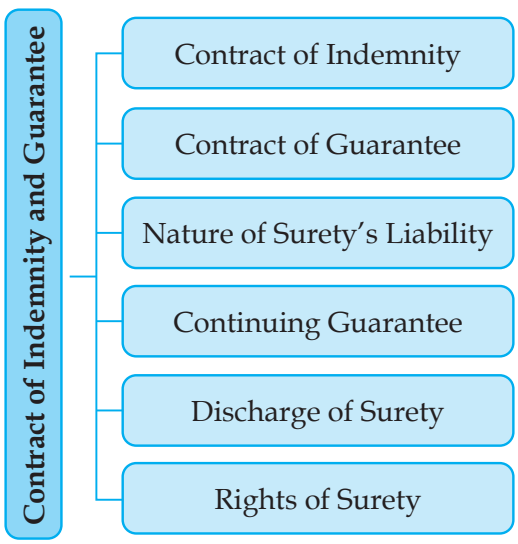
13. Explain the-term 'Quasi Contracts' and state their characteristics. **(MTP 5 Marks, Nov'21)**

Ans. 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.

UNIT 07

Contract of Indemnity and Guarantee



Sections 124 to 147 of the Indian Contract Act, 1872.

CONTRACT OF INDEMNITY

Indemnity

- Security against loss or
- to make good the loss or
- to compensate the party who has suffered some loss

124 - Contract of Indemnity

- It is a contract by which one party PROMISES to save the other from LOSS caused to him -
- LOSS HOW ?? - By the conduct of the promisor himself or by the conduct of any other person".

Example 1: Mr. X contracts with the Government to return to India after completing his studies (which were funded by the Government) at University of Cambridge and to serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

CONTRACT OF INDEMNITY

The party who promises to indemnify/save the other party from loss	→	The party who is promised to be saved against the loss
INDEMNIFIER PROMISOR	→	INDEMNIFIED INDEMNITY HOLDER PROMISEE

Example 2: *A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ₹5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.*

Example 3: *X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighboring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.*

Thus - Contract of Indemnity - Restricts the loss caused by:

(i) the conduct of the promisor himself, or

(ii) the conduct of any other person.

(Not covered) Loss by -
An accident not caused by any person or
Act of God/ natural event

Gajanan Moreshwar v/s Moreshwar Madan (1942),

Decision is taken on the basis of English Law.

As per English Law: Indemnity means promise to save another harmless from the loss. Here it covers every loss whether due to negligence of promisee or by natural calamity or by accident.

Mode of contract of indemnity:

- **Express or Implied.**
  1. Expressed when a person expressly promises to compensate the other from loss.
  2. Implied when it is to be inferred from the conduct of the parties or from the circumstances of the case.
- A contract of indemnity is like any other contract and must fulfil all the essentials of a valid contract.

Example 4: *A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fineD ₹1000, B cannot claim this amount from A because the object of the agreement is unlawful.*

Life Insurance - NO
Fire Insurance - YES
Marine Insurance - YES

125 - Rights of Indemnity-holder when sued

The promisee acting within the scope of his authority, is entitled to recover from the promisor/ indemnifier:

1. All damages which he may be compelled to pay in any suit,
2. All costs which he may have been compelled to pay in bringing/defending the suit, and
3. All sums which he may have paid under the terms of any compromise of suit.

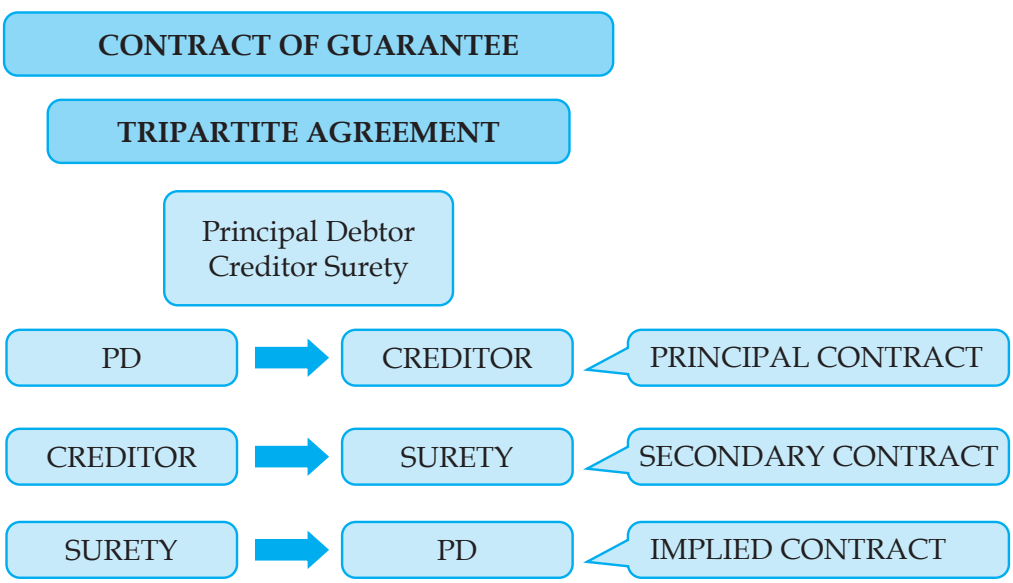
When does the liability of an indemnifier commence?

- Although the Indian Contract Act, 1872, is silent on the time of commencement of liability of indemnifier, however, on the basis of judicial pronouncements it can be stated that -
- The liability of an indemnifier commences - as soon as the liability of the indemnity-holder becomes absolute and certain.
- This principle has been followed by the courts in several cases.

Example 5: A promises to compensate X for any loss that he may suffer by filling a suit against Y. The court orders X to pay Y damages of ₹10000. As the loss has become certain, X may claim the amount of loss from A and pass it to Y.

CONTRACT OF GUARANTEE

126 - Contract of Guarantee - Surety, Principal Debtor and Creditor



Contract of guarantee:

- A contract of guarantee is a contract - to perform the **promise** made or discharge the **liability** of a **third** person in case of his **default**.

Example 6: When A requests B to lend ₹10,000 to C and guarantees that C will repay the amount within the agreed time and that on C failing to do so, he (A) will himself pay to B, there is a contract of guarantee. Here, B is the creditor, C the principal debtor and A the surety.

Example 7: X and Y go into a car showroom where X says to the dealer to supply the latest model of Wagon R to Y, and agrees that if Y fails to pay he will. In case of Y's failure to pay, the car showroom will recover its money from X. This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

The right of surety is not affected by the fact that -
The creditor has refused to sue the principal debtor or that he has not demanded the sum due from him

ESSENTIAL FEATURES OF A GUARANTEE

The following are the requisites of a valid guarantee:

Requisite	Explanation
Purpose	A guarantee is to secure payment of a recoverable debt. **No principal debt means no valid guarantee.**
Consideration Section 127	A guarantee must have some consideration. No direct consideration is needed between surety and creditor. Consideration given to the principal debtor is enough. However, **past consideration is not valid**. The surety must be competent to contract for a valid guarantee (Even if PD is incompetent)
Existence of Liability	There must be an **existing liability** or enforceable promise. The liability must be **legally enforceable, not time-barred**.
No Misrepresentation Section 142	Guarantee obtained by misrepresentation concerning a **material part of the transaction is invalid**.
No Concealment Section 143	Guarantee obtained by keeping **silence as to material facts** is invalid.
Written or Oral Section 126	A guarantee can be either oral or written; writing is not necessary.
Joining of Co-Sureties Section 144	If a guarantee is given on the condition that another person must join as a co-surety, **the guarantee is not valid if that other person does not join**.

All the related examples are shown here:

Example 8: B requests A to sell and deliver to him goods on credit. A agrees to do so provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A 's promise to deliver the goods. As per Section 127, there is a sufficient consideration for C's promise. Therefore, the guarantee is valid.

Example 9: A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

Example 10: A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with his previous conduct. B afterwards make default. The guarantee is invalid.

B and C have privately agreed that B should pay rupee five per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

TYPES OF GUARANTEES

Guarantee may be classified under two categories:

Type of Guarantee	Explanation	Surety's Liability
Specific Guarantee	A guarantee that applies to a single debt or specific transaction.	Ends when the debt is discharged or the promise is performed.
Continuing Guarantee Section 129	A guarantee that applies to a series of transactions. It continues until revoked by the surety. It covers any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.	Continues until the guarantee is revoked.

SPECIFIC GUARNATEE:

Example 12: *A guarantees payment to B of the price of the five bags of rice to be delivered by B to C and to be paid for in a month. B delivers five bags to C. C pays for them. This is a contract for specific guarantee because A intended to guarantee only for the payment of price of the first five bags of rice to be delivered one time [Kay v Groves]*

CONTINUING GUARNATEE:

Example 13: *On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5th of every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.*

Example 14: *A guarantees payment to B, a tea-dealer, to the amount of ₹10,000, for any tea he may from time-to-time supply to C. B supplies C with tea to above the value of ₹10,000, and C pays B for it. Afterwards B supplies C with tea to the value of ₹20,000. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of ₹10,000.*

DISTINCTION BETWEEN A CONTRACT OF INDEMNITY & CONTRACT OF GUARANTEE

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.

SURETY'S LIABILITY

128 - Nature and Extent of Surety's Liability

The liability of the surety is:

1. **Co-extensive with that of the principal debtor** unless it is otherwise provided by the contract.
2. **Secondary nature** as he is liable only on default of principal debtor.
3. **Where a debtor cannot be held liable on account of any defect in the** document, the liability of the surety also ceases.
4. **A creditor may choose to proceed against a surety first**, unless there is an agreement to the contrary.

Example 15: A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

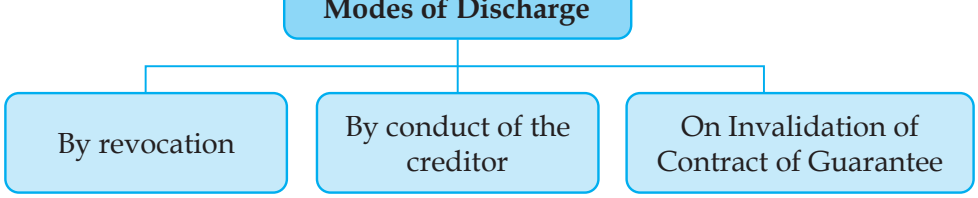
132 - Liability of two Persons, Primarily Liable, not affected by Arrangement between them - that one shall be Surety on other's Default

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such a third person may have been aware of its existence.

Example 16: A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

DISCHARGE OF A SURETY

- A surety is said to be discharged - when his liability as surety comes to an end.
- The various modes of discharge of surety are discussed below:
  - **(i) By revocation of the contract of guarantee.**
  - **(ii) By the conduct of the creditor, or**
  - **(iii) By the invalidation of the contract of guarantee.**



By revocation of the contract of guarantee -

- 130 - CG by Notice
- 131 - CG by Death
- 62 - Novation

130 - Revocation of Continuing Guarantee by Notice

- *The surety can revoke a continuing guarantee by giving notice to the creditor.*
- *The surety is liable for all transactions before the notice but not for future transactions.*
- *A specific guarantee can only be revoked if liability to the principal debtor has not accrued.*

Example 17: *Arun promises to pay Rama for all groceries bought by Carol for a period of 12 months if Carol fails to pay. In the next three months, Carol buys ₹2000/- worth of groceries. After 3 months, Arun revokes the guarantee by giving a notice to Rama. Carol further purchases ₹1000 of groceries. Carol fails to pay. Arun is not liable for ₹1000/- of purchase that was made after the notice but he is liable for ₹2000/- of purchase made before the notice.*

131 - Revocation of Continuing Guarantee by Surety's death

- *In the absence of an agreement to the contrary, the surety's death revokes the continuing guarantee for future transactions.*
- *The surety's estate remains liable for transactions before the death.*
- *However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.*

Example 18: *'S' guarantees 'C' for the transaction to be done between 'C' & 'P' for next month. After 5 days 'S' died. Now the guarantee is revoked for future transactions but 'S's estate is still liable for transactions done during the previous five days.*

62 - Revocation by Novation

If a new or fresh contract replaces the old one (either between the same or different parties), the surety is discharged from the original contract.

Example 19: *'S' guarantees 'C' for the payment of the supply of wheat to be done by 'C' & 'P' for next month. After 5 days, the contract is changed. Now 'S' guarantees 'C' for the payment of the supply of rice to be done by 'C' & 'P' for the rest of next month. Here, the guarantee is revoked for the supply of wheat. But 'S' is still liable for the supply of wheat done during the previous five days.*

By Conduct of the Creditor -

- 133 - Variance in the terms of the contract
- 134 - Release or Discharge of the PD
- 135 - Creditor compromises with the PD (Extra time etc.)

Discharge of Surety by Conduct of the Creditor			
Section	**Condition for Discharge of Surety**	**Explanation**	**Example**
Section 133 Variance in Terms of Contract	Surety is discharged if the principal debtor and creditor vary the contract terms without the surety's consent.	The surety is no longer liable for transactions occurring after the variation.	A becomes surety for B's conduct as a manager in C's bank. Without A's consent, B's salary is increased, and B is made liable for overdraft losses. B allows an overdraft, resulting in a loss. A is discharged as surety.
Section 134 Release or Discharge of Principal Debtor	Surety is discharged if: 1. The creditor enters into a new contract with the principal debtor releasing the latter, or 2. The creditor's action or omission leads to the legal discharge of the principal debtor.	Once the principal debtor is released or discharged, the surety is also released from liability.	Example 1: B fails to supply timber for a house, so C, who guaranteed A's performance, is discharged. Example 2: B assigns property to C in lieu of debt, discharging B and also A, the surety.
Section 135 Compounding, Giving Time, or Agreement Not to Sue	Surety is discharged if: 1. The creditor makes a composition (settlement) with the PD or 2. The creditor gives time or 3. Promises not to sue the debtor, unless the surety consents.	Composition with the principal debtor without consulting the surety discharges the surety. The surety's right to demand payment is violated if the creditor gives the debtor more time or agrees not to sue.	If a creditor gives more time to pay or promises not to sue, the surety is discharged unless they agree to it.

Some important point to keep in mind:

1. Composition inevitably involves variation of the original contract, and, therefore, the surety is discharged.
2. It is one of the duties of the creditor towards the surety not to allow the principal debtor more time for payment.
3. Surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt when it is due and this right is positively violated when the creditor promises not to sue the principal debtor.

136 - Surety not discharged when agreement is made with third person to give time to principal debtor

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**.

Example 20: *C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.*

137 - Creditor's forbearance to sue does not discharge surety

Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not in the absence of any provision in the guarantee to the contrary, discharge the surety.

Example 21: *B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.*

139 - Discharge of surety by creditor's act or omission impairing surety's eventual remedy

If the creditor does any act which is inconsistent with the rights of the surety or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

State bank of Saurashtra V Chitranjan Rangnath Raja (1980) 4 SCC 516

In a case before the Supreme Court of India,

- "A bank granted a loan on the security of the stock in the godown.
- The loan was also guaranteed by the surety.
- The goods were lost from the godown on account of the negligence of the bank officials.
- The surety was discharged to the extent of the value of the stock so lost".

Example 22: *A puts M as apprentice to B and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.*

By the invalidation of the contract of guarantee:

- 142- Guarantee obtained by misrepresentation
- 143- Guarantee obtained by concealment
- 144- Guarantee on contract that creditor shall not act on it until co-surety joins

Discharge of Surety by the Invalidation of the Contract of Guarantee			
Section	**Condition for Invalidity of Guarantee**	**Explanation**	**Example**
Section 142 Misrepresentation by Creditor	A guarantee obtained by misrepresentation from the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.	The guarantee is invalid if the creditor misrepresents material facts and the surety is unaware.	C sells an AC to P, falsely claiming it is made of copper, but it is made of aluminum. S guarantees the sale, unaware of the misrepresentation. S is not liable.

Section 143 Concealment of Material Facts	A guarantee obtained by keeping silence about material circumstances is invalid.	If the creditor fails to disclose important facts that would affect the surety's decision, the guarantee is invalid.	not inform C about B's past misconduct as a clerk, and C guarantees B. The guarantee is invalid. Example 2: B agrees to pay more than the market price to C for iron to settle an old debt. This is concealed from A, the surety. A is not liable.
Section 144 Condition for Co-surety	If a person gives a guarantee on the condition that another person will also act as a co-surety, the guarantee is invalid if the other person does not join.	The guarantee is only valid if the other person joins as co-surety as agreed.	S1 guarantees payment by P to C, but only if S2 also joins as a co-surety. S2 does not join, so S1 is not liable.

RIGHTS OF A SURETY

The surety enjoys the following rights against the creditor:

1. **Rights against the creditor** (141, Set off and Reduction)
2. **Rights against the principal debtor** (140 and 145)
3. **Rights against co-sureties** (146 and 147)

Right against the principal debtor

- **140- Rights of subrogation:** Where, a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

  This right is known as the right of subrogation.

  It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of the creditor.

  Example 23: 'Raju' has taken a housing loan from Canara Bank. 'Pappu' has given guarantee for repayment of such loan. Besides, there was a condition that if 'Raju' does not repay the loan within time, the bank can auction his property by giving 15 days notice to 'Raju'. On due date 'Raju' does not repay, hence Pappu being a surety has to repay the loan. Now 'Pappu' can take the house from the bank and has a right to auction the house by giving 15 days notice to 'Raju'.

- **145 - Implied promise to indemnify surety:**
  - In every contract of guarantee there is an **implied promise** by the principal debtor to **indemnify the surety**.
  - The surety is entitled to **recover** from the principal debtor whatever sum he has **rightfully paid** under the guarantee, but **not sums** which he **paid wrongfully**.

suit on reasonable grounds but is compelled to pay the amount. A is entitled to recover from B the cost as well as the principal debt. In the same case above, if A did not have reasonable grounds for defence, A would still be entitled to recover principal debt from B but not any other costs.

Right against the Creditor

- **141 - Surety's right to benefit of creditor's securities:** 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.

Example 25: C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. 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.

Right to set off: If the creditor sues the surety, for payment of principal debtor's liability, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor.

Example 26: 'X' took a loan of ₹50,000 from 'Y' which was guaranteed by 'Z'. There was one another contract between 'X' and 'Y' in which 'Y' had to pay ₹10,000 to 'X'. On default by 'X', 'Y' filed suit against 'Z'. Now 'Z' is liable to pay ₹40,000 (₹50,000 – ₹10,000).

Right to share reduction: The surety has the right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

Example 27: 'X' took a loan of ₹50,000 from 'Y' which was Guaranteed by 'Z'. 'X' became insolvent & only 25% is realised from his property against liabilities. Now 'Y' will receive ₹12,500 from 'X' and Now 'Z' is liable to pay 37,500 (50,000 – 12,500).

Rights Against Co-Sureties

Co-sureties means -

When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties".

- **146 - Co-sureties liable to contribute equally:** Unless otherwise agreed, each surety is liable to contribute equally for discharge of whole debt or part of the debt remains unpaid by debtor.

Example 28: A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.

Example 29: A, B and C are sureties to D for the sum of 1,00,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one- half. E makes default in payment. As between the sureties, A is liable to pay 25,000 rupees, B 25,000 rupees, and C 50,000 rupees.

- **147 - Liability of co-sureties bound in different sums:**
  - The principal of equal contribution is however subject to the maximum limit fixed by a surety to his liability.
  - Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.

Example 31: *A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.*

Example 32: *A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.*

"PROBLEM KYA HAI? - UNIT 7"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. What are the rights of the indemnity-holder when sued? **(Module)**

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

(a) all damages which he may be compelled to pay in any suit

(b) all costs which he may have been compelled to pay in bringing/defending the suit and

(c) all sums which he may have paid under the terms of any compromise of suit.

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

2. Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid? **(Module)**

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

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

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

1. Guarantee obtained by means of misrepresentation.
2. Guarantee obtained by means of keeping silence as to material circumstances.

act upon it until another person has joined in it as co-surety and that other party fails to join as such.

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

Ans. According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

In the instant case, the creditor has made variance (i.e. change in terms) without the consent of surety.

Thus, surety is discharged as to the transactions subsequent to the change.

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

4. A contracts with B for a fixed price to construct a house for B within a stipulated time 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. IsC discharged from his liability.

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

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

5. Mr. D was in urgent need of money amounting to $ 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? **(Module)**

Ans. **Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872):** Equality of burden is the basis of Co-suretyship. This is contained in section146 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 are liable to pay equally, in absence of any contract between them.

6. Mr. Chetan was appointed as Site Manager of ABC Constructions Company on a two years' contract at a monthly salary of ₹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 ₹50,000 to Mr. Chetan because of financial constraints.

to Mr. Pawan. Three months afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's appointment.

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

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

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

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

Case-1: If A is a Minor

Case-2: If B is a Minor

Case-3: If C is a minor. **(Module)**

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

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

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

8. S asks R to beat T and promises to indemnify R against the consequences. R beats T and is fined 50,000. Can R claim ₹50,000 from S. **(Module)**

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

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

After 1 month, Manoj revokes the guarantee, when Sharma had supplied goods on credit for ₹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. ₹40,000? **(Module)**

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

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

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

for the same borrowing by mortgage of B's furniture worth ₹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 ₹80,000, under the Indian Contract Act, 1872. **(Module)**

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

In the instant case, C advances to B, ₹2,00,000 rupees on the guarantee of A. C has also taken a further security for ₹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. $80,000 and will remain liable for balance ₹1,20,000.

MTPs, RTPs AND PYQPs QUESTIONS

1. Sarthak is employed as a cashier on a monthly salary of $ 50,000 by ABC bank for a period of three years. Mohit gave surety for Sarthak's good conduct. After nine months, the financial position of the bank deteriorates. Then Sarthak agrees to accept a lower salary of $ 40,000per month from the Bank. Two months later, it was found that Sarthak had misappropriated cash from the time of his appointment.

What is the liability of Mohit taking into account the provisions of the Indian Contract Act, 1872? **(RTP Jun'24)**

Ans. According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

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

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

2. Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid? **(Nov'21, Apr' 19, Oct'19,4 Marks) (SM)**

Ans. 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:

1. Guarantee obtained by means of misrepresentation.
2. Creditor obtained any guarantee by means of keeping silence as to material circumstances.

act upon it until another person has joined in it as co-surety and that other party fails to join as such.

3. Enumerate the following as per the provisions of the Indian Contract Act, 1872:

1. Meaning of contract of guarantee
2. Parties to a contract of guarantee. **(MTP 4 Marks March 22)**

Ans.

1. **Contract of guarantee:** As per the provisions of section 126 of the Indian Contract Act, 1872, a contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.
2. **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.

4. Distinguish between a contract of Indemnity and a contract of Guarantee as per the Indian Contract Act, 1872. **(4 Marks) (Oct 22)**

Ans.

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.

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. Explain the meaning of contract of guarantee according to the provisions of the Indian Contract Act, 1872. State the position of Amit in this regard. **(4 Marks Jan 21)**

Ans.

1. **Contract of guarantee:** As per the provisions of section 126 of the Indian Contract Act, 1872, a contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

   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

2. 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.

6. 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? **(PYQ 4 Marks Nov'22)**

Ans.

1. **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.

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.

2. **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.

7. 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? **(PYQ July 21,4 Marks)**

Ans. 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.

8. Y advances Z a loan of ₹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? **(4 Marks Oct 21) (SM)**

Ans. According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

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 (2), no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety.

9. Ricky is the owner of electronics shop. Prisha reached the shop to purchase an air conditioner whose compressor should be of copper. As Prisha wanted to purchase the air conditioner on credit, Ricky demand a guarantor for such transaction. Mr. Shiv (a friend of Prisha) came forward and gave the guarantee for payment of air conditioner. Ricky sold the air conditioner of a particular brand, misrepresenting that it is made of copper while it is made of aluminium. Neither Prisha nor Mr. Shiv had the knowledge of fact that it is made of aluminium. On being aware of the facts, Prisha denied for payment of price. Ricky filed the suit against Mr. Shiv. Explain with reference to the Indian Contract Act 1872, whether Mr. Shiv is liable to pay the price of air conditioner? **(Oct'22)(RTP Nov 21)**

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, Prisha wanted to purchase air conditioner whose compressor should be of copper, on credit from Ricky. Mr. Shiv has given the guarantee for payment of price. Ricky 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 Prisha & Mr. Shiv were unaware. After being aware of the facts, Prisha denied for payment of price. Ricky filed the suit against Mr. Shiv for payment of price.

On the basis of above provisions and facts of the case, as guarantee was obtained by Ricky by misrepresentation of the facts, Mr. Shiv will not be liable. He will be discharged from liability.

10. Examine the validity of the following statements under the provisions of the Indian Contract Act, 1872.

1. Creditor should proceed legal action first against the Principal Debtor and later against the surety.
2. A guarantee which extends to a single debt/specific transaction is called continuing Guarantee. **(4 Marks April 23)**

Ans.

1. Creditor should proceed legal action first against the Principal Debtor and later against the surety: Invalid

   Reasoning: As per Section 128 of the Indian Contract Act, 1872, the surety's liability is co- extensive with that of Principal debtor. It's not mandatory that creditor should proceed legal action in case of default, first against the Principal debtor and later against the su rety. It is on creditor to start action first either against the Principal debtor or the surety.
2. A guarantee which extends to a single debt/specific transaction is called continuing Guarantee: Invalid

   Reasoning: Continuing Guarantee [Section 129 of the Indian Contract Act, 1872) - A guarantee which extends to a series of transaction is called a continuing guarantee. It applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

11. Explain the following as per the provisions of the Indian Contract Act, 1872

1. Specific Guarantee
2. General Guarantee. **(4 Marks Apr'23)**

Ans. **Specific Guarantee:** A guarantee which extends to a single debt/specific transaction is called a specific guarantee. The surety's liability comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

Continuing Guarantee: A guarantee which extends to a series of transaction is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

12. 'Surendra' guarantees 'Virendra' for the transactions to be done between 'Virendra' & 'Jitendra' during the month of March, 2021. 'Virendra' supplied goods of $ 30,000 on 01.03.2021 and of $ 20,000 on 03.03.2021 to 'Jitendra'. On 05.03.2021, 'Surendra' died in a road accident. On 10.03.2021, being ignorant of the death of 'Surendra', 'Virendra' further supplied goods of ₹40,000. On default in payment by "Jitendra' on due date, 'Virendra' sued on legal heirs of 'Surendra' for recovery of ₹90,000. Describe, whether legal heirs of 'Surendra' are liable to pay ₹90,000 under the provisions of Indian Contract Act 1872. What would be your answer, if the estate of 'Surendra' is worth of ₹45,000 only? **(May 22)**

Ans. According to section 131 of Indian Contract Act 1872, in the absence of a contract to contrary, a continuing guarantee is revoked by the death of the surety as to the future transactions. The estate of deceased surety, however, liable for those transactions which had already taken place during the lifetime of deceased. Surety's estate will not be liable for the transactions taken place after the death of surety even if the creditor had no knowledge of surety's death.

In this question, 'Surendra' was surety for the transactions to be done between 'Virendra ' & 'Jitendra' during the month of March 2021. "Virendra' supplied goods of ₹30,000, ₹20,000 and of ₹40,000 on 01.03.2021, 03.03.2021 and 10.03.02021 respectively. 'Surendra' died in a road accident but this was not in the knowledge of 'Virendra'. When 'Jitendra' defaulted in payment, 'Virendra' filed suit against legal heirs of 'Surendra' for recovery of full amount i.e. ₹90,000. On the basis of above, it can be said in case of death of surety ("Surendra'), his legal heirs are liable only for those transactions which were entered before 05.03.2021 i.e. for ₹50,000. They are not liable for the transaction done on 10.03.2021 even though Virendra had no knowledge of death of Surendra.

Further, if the worth of the estate of deceased is only ₹45,000, the legal heirs are liable for this amount only.

13. Mr. Salil purchased furniture of worth ₹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 ₹20,000 to Mr. Pooran on behalf of his son. Mr. Raman, in ignorance of above payment, paid ₹1,00,000 to Mr. Pooran as surety. Afterwards, when Mr. Raman knew the facts, he asked Mr. Pooran for refund of ₹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 ₹20,000 from Mr. Pooran? **(May 23)**

Ans. As per the provisions of section 128 of the Indian Contract Act, 1872, the liability of the surety is coextensive 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 ₹20,000 to Mr. Pooran on behalf of his son. Unaware of the payment of ₹20,000, Mr. Raman paid the full amount to Mr. Pooran.

As the father of Mr. Salil made payment of ₹20,000 on Salil's behalf, Mr. Raman is liable only for ₹80,000 to Mr. Pooran (creditor). Mr. Raman made the full payment without the knowledge of facts. Therefore, he can claim the refund of ₹20,000 from Mr. Pooran.

14. 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? **(Nov' 23)**

Ans. 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.

15. 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. **(4 Marks Dec 21)**

Ans. 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.

16. 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 ₹8,000 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:

sued Abhishek for the payment of arrears and Abhishek paid these two instalments i.e. 13th and 14th. Abhishek then gave a notice to Alpha Motor Ltd. to revoke his guarantee for the remaining months.

2. If after 15th months, Abhishek died due to COVID-19. **(4 Marks Dec 21)**

Ans. 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.

1. 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 installments but then he revoked guarantee for the remaining months. Thus, Abhishek is not liable for installments 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).
2. 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 a revocation 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.

17. 'S' guarantees 'V' for the transactions to be done between 'V' & 'B' during the month of March, 2022. "V' supplied goods of ₹30,000 on 01.03.2022 and of Rs. 20,000 on 03.03.2022 to 'B'. On 05.03.2022, 'S' died in a road accident. On 10.03.2022, being ignorant of the death of 'S', 'V' further supplied goods of 40,000. On default in payment by 'B' on due date, 'V' sued on legal heirs of 'S' for recovery of 90,000. Describe, whether legal heirs of 'S' are liable to pay ₹90,000 under the provisions of Indian Contract Act, 1872.

What would be your answer, if the estate of 'S' is worth of ₹45,000 only? **(4 Marks, May 23)**

Ans. Revocation of continuing guarantee by surety's death (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.

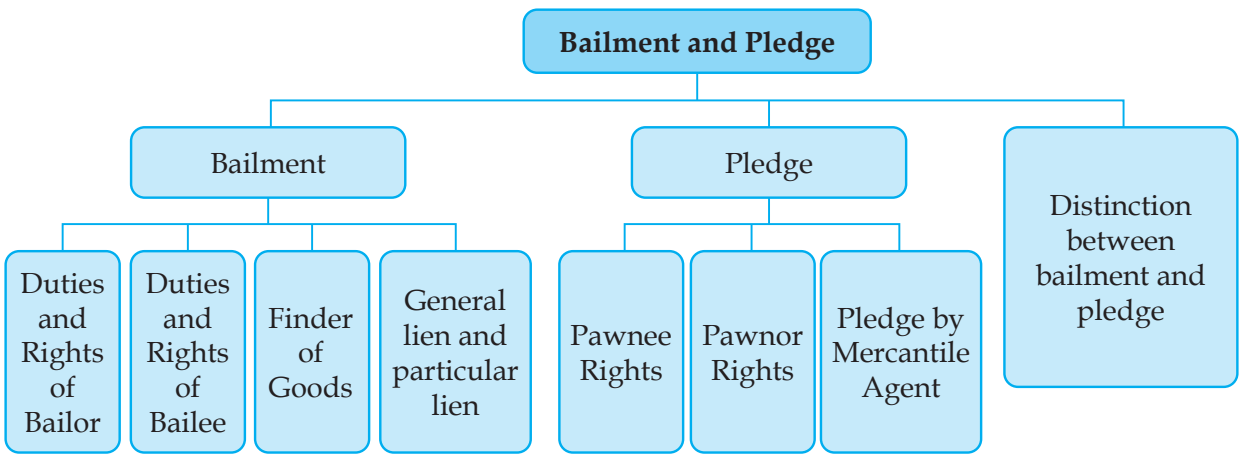
Accordingly, in the given instance, legal heirs of S are not liable to pay ₹90,000 but for ₹50,000 as death of surety operates as a revocation of a continuing guarantee as to the future transactions, i.e., ₹40,000 in this case, taking place after the death of surety.

Further, surety's estate remains liable for the transactions taken place before the death of the surety.

Legal heirs of surety will be obliged to perform the contract on behalf of surety to the extent of share inherited. V shall be entitled to recover ₹45,000 only from the estate of S.

UNIT 08

Bailment and Pledge



WHAT IS BAILMENT?

- The word "Bailment" has been derived from the **French word "ballier"** which means "to deliver".
- Bailment etymologically means **'handing over' or 'change of possession'**.

As per Section 148 of the Act:

Delivery	Contract	Purpose	After the purpose is accomplished	Return or Dispose	As per the instruction

- Bailment is the **delivery of goods by one person to another** for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, **be returned or otherwise disposed of** according to the directions of the person delivering them.

Parties to Bailment

- **Bailor:** The person **delivering the goods**.
- **Bailee:** The person **to whom the goods are delivered**.

Example 1: Where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.
Example 2: X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is a contract for bailment.
Example 3: Goods given to a friend for his own use, without any charge.
Example 4: X delivers goods to the blue dart for carriage.

The essential elements of a contract of bailment are:

1. **Contract:** Bailment is based upon a contract. The contract may be **express or implied**.

   No consideration is necessary to create a valid contract of bailment.

2. **Delivery of goods:** It involves the **delivery of goods from one person to another for some purposes**.

   Bailment is only for moveable goods and never for immovable goods or money.

3. The delivery of the possession of goods is of the following kinds:
   (i) **Actual Delivery:** When goods are **physically handed** over to the bailee by the bailor. Eg: delivery of a car for repair to workshop
   (ii) **Constructive Delivery:** Where delivery is **made by doing anything that has the effect of putting goods in the possession of the bailee** or of any person authorized to hold them on his behalf. Eg: Delivery of the key of the car to a workshop dealer for repair of the car.
4. **Purpose:** The goods are **delivered for some purpose**. The purpose may be express or implied.
5. **Possession:**
   - In bailment, **possession of goods changes**.
   - Change of possession can happen by **physical delivery or by any action which has the effect of placing the goods in the possession of bailee**. (Means Actual or Constructive)
   - The change of possession **does not lead to change of ownership**.
   - In bailment, the bailor **continues to be the owner of goods**.
   - Where a **person is in custody without possession** he does not become a bailee.

   For example,
   1. *Servant of a master who is in custody of goods of the master does not become a bailee.*
   2. *Depositing ornaments in a bank locker is not bailment because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in possession of the owner though kept in a locker at the bank.*

6. **Return of goods:**

SAME FORM	SAME GOODS	No exchange	ANY OTHER GOOD - OF HIGHER VALUE NO

   - **Bailee is obliged to return the goods physically** to the bailor.
   - The goods **should be returned in the same form** as given or may be altered as per bailor's direction.
   - It should be noted that **exchange of goods should not be allowed**.
   - The bailee **cannot deliver some other goods**, even not those of higher value.

   Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Types of Bailment			
Type of Bailment	**Definition**	**Benefit**	**Example**
Gratuitous Bailment	Bailment where the service is provided free of charge, i.e., no payment or reward is involved.	Benefit is either for bailor or bailee (not both).	A friend lends his car to another friend for personal use without expecting any payment. In this case, the benefit is solely for the bailee (the friend borrowing the car).
Non-Gratuitous Bailment	Bailment where both the bailor and bailee gain some benefit.	Benefit is for both bailor and bailee.	A person gives their car to a mechanic for repairs. The bailor (car owner) benefits by getting the car fixed, and the bailee (mechanic) gets paid for the service.
Gratuitous Bailment	Bailment where the service is provided free of charge, i.e., no payment or reward is involved.	Benefit is either for bailor or bailee (not both).	A friend lends his car to another friend for personal use without expecting any payment. In this case, the benefit is solely for the bailee (the friend borrowing the car).

1. **On the basis of benefit, Bailment can be classified into three types:**
   - **(a) For the exclusive benefit of bailor:**

     Example 5: The delivery of some valuables to a neighbour for safe custody without charge.
   - **(b) For the exclusive benefit of bailee:**

     Example 6: The lending of a bicycle to a friend for his use, without charge.
   - **(c) For mutual benefit of bailor and bailee:**

     Example 7: Giving of a watch for repair.
2. **On the basis of reward, Bailment can be classified into two types:**
   - **(a) Gratuitous Bailment:**
     - The word **gratuitous means free of charge**.
     - So, a gratuitous bailment is one when the provider of service does it gratuitously i.e. free of charge.
     - Such bailment would be either for the exclusive benefits of bailor or bailee.
   - **(b) Non-Gratuitous Bailment:** Where **both the parties get some benefit** i.e. bailment for the benefit of both bailor & bailee.

DUTIES OF A BAILOR

Duties of a Bailor		
Section	**Duty**	**Description**
Section 150	Duty to disclose faults in goods bailed	Bailor must inform the bailee of known faults in the goods; failure to do so makes him liable.

158	expenses	expenses incurred by the bailee for maintenance.
Section 159	Duty to indemnify for premature termination	If the bailor terminates the bailment early, he must compensate the bailee for any loss caused.
Section 164	Bailor's responsibility to bailee	Bailor must compensate bailee for any loss caused by defective title of the goods bailed and duty to take delivery of the good when returned

1. Bailor's duty to disclose faults in goods bailed [Section 150]:

(a) In case of gratuitous bailment: 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**.

Example 8: A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

(b) In case of non-gratuitous bailment: 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.

Example 9: A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

1. Hyman & Wife v. Nye & Sons (1881)

Key Facts:

- *A hired a carriage, a pair of horses, and a driver from B for a specific journey.*
- *During the journey, a bolt in the under-part of the carriage broke, causing the carriage to overturn.*
- *A was injured as a result of the accident.*

Judgment:

- *The court ruled that B (the bailor) was liable for A's injuries.*
- *It was established that the bailor's duty is to provide goods that are fit for the purpose they were hired for.*
- *Since the carriage was defective, B was responsible for the damages.*

2. Great Northern Railway Case (1932)

Key Facts:

- *The case involved the bailment of dangerous goods (such as explosives).*
- *The bailor failed to disclose the dangerous nature of the goods to the bailee.*
- *This omission led to a dangerous situation.*

Judgment:

- *The court ruled that it is the duty of the bailor to inform the bailee about the dangerous nature of the goods.*
- *If the bailor fails to disclose this, they are held liable for any damage or injury caused.*
- *In this case, the bailor was found responsible due to the failure to warn about the danger.*

(a) In case of Gratuitous bailment: Where, by the conditions of the bailment, the goods are to be **kept** or to be **carried**, or to **have work done** upon them by the **bailee** for the bailor, and the bailee is to **receive no** remuneration (**gratuitous bailment**), the bailor shall **repay** to the bailee the **necessary expenses** incurred by him and any **extraordinary expenses** incurred by him for the **purpose** of the bailment.

(b) In case of non-gratuitous bailment the **bailor is liable to pay the extraordinary expenses** incurred by the bailee.

Example 10: A hired a taxi from B for the purpose of going to Gurgaon from Noida. During the journey, a major defect occurred in the engine. A had to pay ₹5000 as repair charges. These are the extraordinary expenses and it is the bailor's duty to bear such expenses. However, the usual and ordinary expenses for petrol, toll tax etc. are to be borne by the bailee itself.

3. **Duty to indemnify the Bailee for premature termination [Section 159]:** The **bailor must compensate the bailee for the loss or damage suffered by the bailee** that is in excess of the benefit received, where he had lent the goods gratuitously and decides to terminate the bailment **before the expiry of the period of bailment**.
4. **Bailor's responsibility to bailee [Section 164]:** The bailor is responsible to the bailee for the following:

(a) **Indemnify for any loss which the bailee may sustain - by reason that the bailor was not entitled -**
- (i) to make the bailment, or
- (ii) to receive back the goods or
- (iii) to give directions, respecting them (defective title in goods).

(b) It is the duty of the **bailor -**
- (i) **to receive back the goods**
- (ii) **when the bailee returns**
- (iii) **after the time of bailment has expired or**
- (iv) **the purpose of bailment has been accomplished.**
- (v) If the bailor refuses to take delivery of goods when it is offered at the proper time
- (vi) the bailee can claim compensation for
- (vii) all necessary expenses incurred for the safe custody.

Example 11: X delivered his car to S for five days for safe keeping. However, X did not take back the car for one month. In this case, S can claim the necessary expenses incurred by him for the custody of the car.

DUTIES OF A BAILEE

Duties of a Bailee		
Section	**Duty**	**Description**
Section 151 & 152	Take reasonable care of the goods	Bailee must take care of the goods as a reasonable person would.
Section 153 & 154	Not to make inconsistent use of goods	Bailee should use the goods as agreed upon; any misuse will make him liable for damages.

Section 155, 156, 157	Not to mix goods	Bailee must not mix the bailor's goods with his own; if mixed, they should be separated at bailee's expense.
Section 160 & 161	Return the goods	Bailee must return the goods when the bailment term ends, failing which, he is liable for any loss.
Section 163	Return accretion from the goods	Any increase or profit from the bailed goods must be returned along with the goods.
Common Law	Not to set up adverse title	Bailee should not deny the bailor's ownership of the goods during the bailment period.

1. **Take reasonable care of the goods (Section 151 & 152):** 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 care of his own goods of the same bulk, quality and value**, as the goods bailed.

   Example 12: If X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss caused on account of riot.

   Example 13: A deposited his goods in B's warehouse. On account of unprecedented floods, a part of the goods were damaged. It was held that B is not liable for the loss (Shanti Lal V. Takechand).

   Exception:

   Bailee when not liable for loss, etc., of thing bailed [Section 152]: The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken reasonable care as required under section 151.

2. **Not to make inconsistent use of goods (section 153 & 154):** As per Section 154, **if the bailee makes any use** of the goods bailed, which is **not according to the terms and conditions of the bailment**, **he is liable to compensate the bailor** for any loss or destruction of goods.

   Example 14: A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

   Example 15: 'A' hires a horse in Kolkata from B expressly to march to Varanasi. 'A' rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'A' is liable to make compensation to B for the injury to the horse. As per Section 153, a contract of bailment is voidable at the option of the bailor, if the bailee does not use the goods according to the terms and conditions of bailment.

   Example 16: A lends to B, a horse for his own riding. B gives the horse to C for riding. This contract is voidable at the option of A, bailor.

3. **Not to mix the goods (Section 155, 156 and 157):**
   (a) **Section 155 - (WITH CONSENT):** 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.
   (b) **Section 156 - (WITHOUT THE CONSENT & SEPERABLE): If the bailee, without the consent of the bailor**, mixes the goods bailed with his own goods and **the goods can**

but the **bailee is bound to bear the expense of separation** or division and any damage arising from the mixture.

Example 17: A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark; A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

(c) **Section 156 - (WITHOUT THE CONSENT & NOT SEPERABLE): 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 to deliver them back, the **bailor is entitled to be compensated by the bailee for loss of the goods**.

Example 18: A bails a barrel of Cape flour worth ₹4500 to B. B, without A's consent, mixes the flour with country flour of his own, worth only ₹2500 a barrel. B must compensate A for the loss of his flour.

4. **Return the goods (Section 160 & 161):**
   - **Section 160:** 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 161:** 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.

   Example 19: X delivered books to Y to be bound. Y promised to return the book within a reasonable time. X pressed for the return of the book. But Y, failed to deliver them back even after the expiry of reasonable time. Subsequently the books were burnt in an accidental fire at the premises of Y. In this case Y was held liable for the loss.

5. **Return an accretion from the Goods [Section 163]: 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.

   Example 20: A leaves a cow in the custody of B. The cow gives birth to a calf. B is bound to deliver the calf along with the cow, to A.

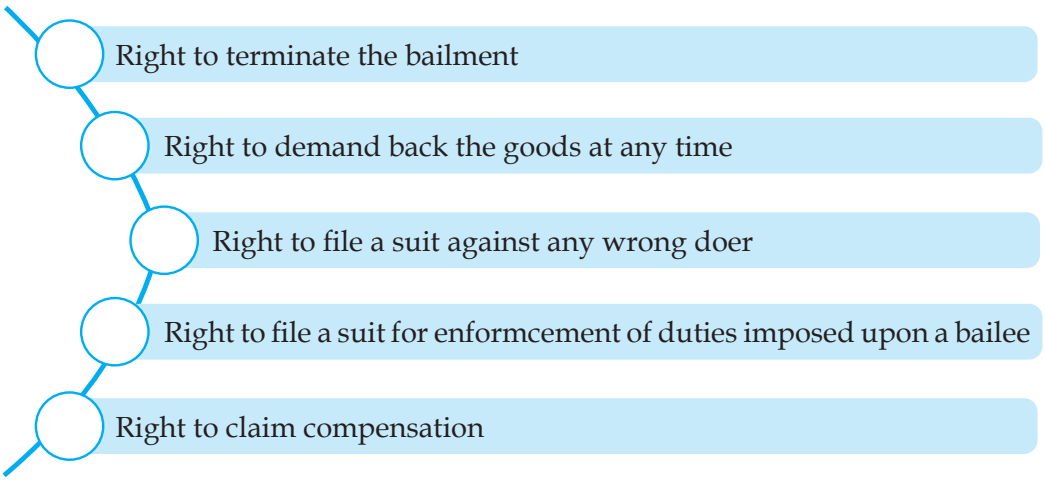
6. **Not to set up Adverse Title:**
   - **Bailee must not set up a title adverse to that of the bailor.**
   - He must **hold the goods on behalf of and for the bailor**.
   - He cannot deny the title of the bailor.

RIGHTS OF A BAILOR

Rights of Bailor: The following are the rights of bailor:

Rights of a Bailor		
Section	**Rights**	**Description**
Section 153	Right to terminate the bailment	Bailor can terminate the bailment if the bailee misuses the goods.

159	goods	time unless it's a gratuitous bailment.
Section 180 & 181	Right to file a suit against a wrongdoer	If a third party wrongfully takes the goods, the bailor can sue them directly.
Common Law	Right to sue the bailee	Bailor can sue the bailee if the bailee violates the terms of bailment or fails in their duty.
Common Law	Right to compensation	Bailor can claim compensation for any loss caused by the bailee's negligence or breach of duty.



1. **Right to terminate the bailment [Section 153]:**
   - **A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed**, inconsistent with the conditions of the bailment.
   - Termination of bailment has been discussed in the next pages.
2. **Right to demand back the goods (Section 159): When the goods are lent gratuitously, the bailor can demand back the goods at any time** even before the expiry of the time fixed or the achievement of the object.

   Example 21: A, while going out of station delivered his ornaments to B for safe custody for one month. But A returned to station after one week. He may demand the return of his ornaments even though the time of one month has not expired. However, due to the premature return of the goods, if the bailee suffers any loss, which is more than the benefit actually obtained by him from the use of the goods bailed, the bailor has to compensate the bailee.
3. **Right to file a suit against a wrongdoer [Section 180 and section 181]** (discussed in next pages)
4. **Right to sue the bailee:** The bailor has a **right to sue the bailee for enforcing all the liabilities and duties of him**.
5. **Right to compensation:** If any **damage** is caused to the goods bailed because of the **unauthorised use** of the goods or unauthorised **mixing** of the goods, the **bailor** has a right to **claim compensation** for the same.

Rights of bailee: The following are the rights of the bailee:

Rights of a Bailee		
Section	**Rights**	**Description**
Section 165	Right to deliver to any one of joint bailors	Bailee can deliver the goods to any of the joint bailors unless otherwise instructed.
Section 166	Right to indemnity	Bailee is entitled to compensation for losses suffered due to bailor's defective title.
Section 150	Right to claim compensation for faulty goods	Bailee can seek damages if the goods were faulty and not disclosed by the bailor.
Section 158	Right to claim necessary expenses	Bailee can recover expenses incurred in preserving or maintaining the goods.
Section 167	Right to apply to court for title decision	Bailee can approach the court to determine the rightful owner of the goods if there's a dispute.
Section 170	Right of particular lien	Bailee can retain goods until the payment for services related to those goods is made.
Section 171	Right of general lien	Bailee can retain any goods until all claims (unpaid debts or services) are satisfied.

1. **Right to Deliver the Goods to any one of the joint bailors [Section 165]:** If several **joint owners** bailed the goods, the **bailee** has **a right to** deliver them to any one of the **joint owners** unless there was a contract to the contrary.

   Example 22: A, B and C are the joint owners of a harvesting combine. They delivered it on hire to D for one month. After the expiry of one month, D may return the "combine" to any one of the joint owners namely, A, B or C.

2. **Right to indemnity (Section 166):**
   - **Bailee is entitled to be indemnified by the bailor** for any loss arising to him by reasons that the bailor **was not entitled to make the bailment or to receive back the goods or to give directions in respect to them**.
   - **If the bailor has no title to the goods, and the bailee in good faith, delivers them back to**, or according to the directions of the bailor, the **bailee shall not be responsible to the owner in respect of such delivery**.
   - Bailee can also **claim all the necessary expenses** incurred by him for the purpose of gratuitous bailment.
3. **Right to claim compensation in case of faulty goods (Section 150):**
   - A bailee is **entitled to receive compensation from the bailor** or any loss **caused to him due to the failure of the bailor to disclose any faults in the goods known to him**.
   - If the bailment is for hire, the bailor will be liable to compensate even though he was not aware of the existence of such faults.
4. **Right to claim necessary expenses (Section 158):** In case of gratuitous bailment, the **bailor shall repay to the bailee the necessary expenses incurred by him** and any extraordinary expenses incurred by him for the purpose of the bailment.

are **claimed by the person other than the bailor, the bailee may apply to the court to stop its delivery** and to decide the title to the goods.

Example 23: A, a dealer in T.V. delivered a T.V. to B for using in summer vacation. Subsequently, C claimed that the T.V. belonged to him as it was delivered only for repairs, to A and thus, B should deliver it to him. In this case, B may apply to the Court to decide the question of ownership of the T.V. so that he may deliver it to the right owner.

6. **Right of particular lien for payment of services [Section 170]:** (Discussed in next pages)
7. **Right of general lien (Section 171):** (Discussed in next pages)

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

Suit by Bailor & Bailee against wrong Doers [Section 180]

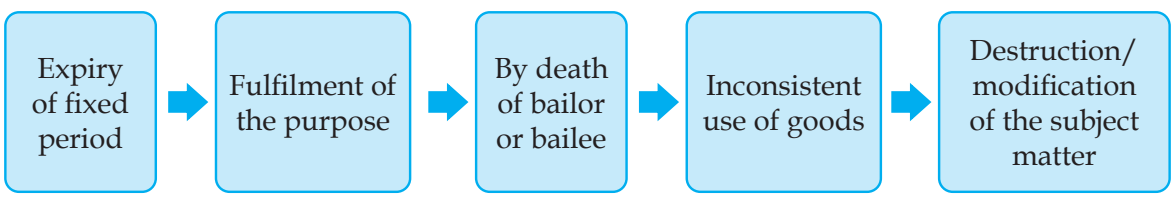
If a **third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies** as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

Apportionment of Relief or Compensation Obtained by such Suits [Section 181]

Whatever is obtained **by way of relief or compensation in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests**.

TERMINATION OF BAILMENT

A contract of bailment shall terminate in the following circumstances:



E - P **Expire ho uske pahale**	**F - P** **Purpose ko fullfill kar le**	**Death - OR/EE** **Ka bharosa nahi hai**	**I - USE** **Isiliye I Use**	**D/M - SM** **Dim Sums (MOMOS)** **As stress burster**

1. **On expiry of stipulated period:** If the goods were given for a stipulated period, the contract of bailment shall terminate **after the expiry of such period**.

   Example 24: X gives his motorcycle to Y for a month. The bailment terminates after 1 month.

2. **On fulfilment of the purpose:** If the goods were delivered for a specific purpose, a bailment shall terminate on the **fulfilment of that purpose**.

   Example 25: X hires certain tents and crockery on marriage of his daughter. The bailment terminates after marriage.

3. **By Notice:**
   (a) Where the bailee **acts in a manner which is inconsistent with the terms of the bailment** - the bailor can always terminate the contract of bailment by giving a **notice to the bailee**.

to the bailee. However, the termination should not cause loss to the bailee in excess of the benefit derived by him. In case the loss exceeds the benefit derived by the bailee, the bailor must compensate the bailee for such a loss (Section 159).

4. **By death:** A gratuitous bailment terminates **upon the death of either the bailor or the bailee**.
5. **Destruction of the subject matter:** A bailment is terminated if the **subject matter of the bailment is destroyed or there is a change is in the nature of goods** which makes it impossible to be used for the purpose of bailment.

Example 26: X gives his cycle to Y on hire. Cycle damaged beyond repairs. Bailment ends.

FINDER OF LOST GOODS

Right of finder of lost goods- may sue for specific reward offered [Section 168]

- A person who finds **some goods which do not belong to him, is called the finder of the goods**.
- It is the duty of the finder of goods **to find the true owner and surrender the goods to him**.
- However, the **finder of goods has no right to sue the owner for compensation** for trouble and expense voluntarily incurred by him in finding the owner and preserving the goods found.
- But **he has a right to retain the goods against the owner until he receives such compensation**; and, where the owner has offered a specific reward on the lost goods, the finder may sue the owner for such reward, and may retain the goods until then.

When finder of thing commonly on sale may sell it [Section 169]

When a thing which is **commonly the subject of sale if lost, if the owner cannot with reasonable diligence be found, or** if he refuses, upon demand, **to pay the lawful charges** of the finder, the finder **may sell it—**

(a) when the thing is in **danger of perishing or of losing the greater part of its value**, or

(b) when the **lawful charges of the finder in respect of the thing found amount to two thirds of its value**.

RIGHT OF LIEN

Lien is the right of a person to retain the goods belonging to another until his claim is satisfied or some debt due to him is repaid.

Types of Lien: Lien may be of two types:

1. Particular Lien
2. General Lien

A. Particular Lien : Section 170

- It is a **right to retain only the particular goods in respect of which the claim is due**.
- Where the bailee has, in accordance with the purpose of the bailment, **rendered any service involving the exercise of labour or skill in respect of the goods bailed,** he has, in the **absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services** he has rendered in respect of them.

Example 27: 'A' gives cloth to 'B', a tailor, to make into a coat. 'B' is entitled to retain the coat until he is paid.

applicable after 15 days.

Example 29: *A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.*

B. General Lien : Section 171

- It is a **right to retain the goods not only for demands arising out of the goods retained but for a general balance of account** in favour of certain persons (in the absence of a contract to the contrary).
- This right is available to Bankers, factors, wharfingers, policy brokers and attorneys of law.

Example 30: *'A' borrows ₹500/- from the bank without security and subsequently again borrows another ₹1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned ₹1000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid. Under the right of general lien the goods cannot be sold but can only be retained for dues. The right of lien can be waived through a contract.*

General Lien	Particular Lien
Section 171 of the Indian Contract Act, 1872 confer on Bailee the right of General Lien.	Section 170 of the Indian Contract Act, 1872 confers on the Bailee, the right of particular lien.
General lien alludes to the right to keep possession of goods belonging to other against general balance of account.	Particular lien implies a right of the bailee to retain specific goods bailed for non-payment of amount.
A general lien is not automatic but is recognized through on agreement. It is exercised by the bailee only by name.	It is automatic.
It can be exercised against goods even without involvement of labor or skill.	It comes into play only when some labor or skill is involved has been expended on the goods, resulting in an increase in value of goods.
Only such persons as are specified under section 171, e.g., Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien.	Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc. are entitled to particular lien.

PLEDGE

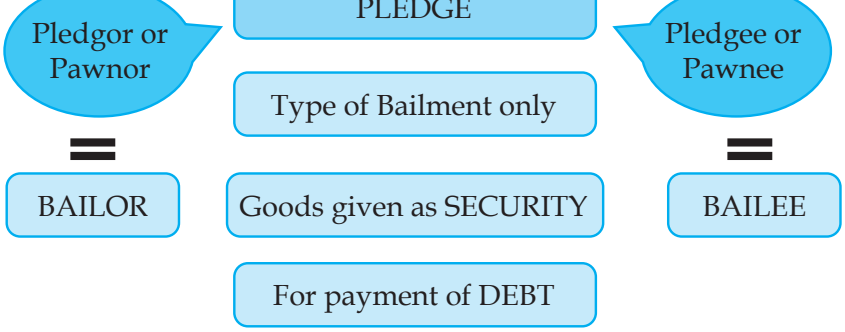
"Pledge", "pawnor" and "pawnee" defined [Section 172]:

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".

Section 172 to 182 of the Indian Contract Act, 1872 deal with the contract of pledge.



Example 31: A lends money to B against the security of jewellery deposited by B with Him. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor/pledger and A is a pawnee/ pledgee.

ESSENTIALS OF CONTRACT OF PLEDGE

Since pledge is a **special kind of bailment**, therefore all the **essentials of bailment are also the essentials of the pledge**.

Apart from that, the other essentials of the pledge are:

- There shall be a bailment for security against payment or performance of the promise,
- The subject matter of pledge is goods,
- Goods pledged for shall be in existence,
- There shall be the delivery of goods from pledger to pledgee

RIGHTS OF A PAWNEE/ PLEDGEE

Rights of Pawnee can be classified as under the following headings:

Rights of a Pawnee / Pledgee			
Sec.	**Rights**	**Description**	**Example**
173	Right to Retain Pledged Goods	The pawnee can retain the goods for: ❑ Payment of the debt, ❑ Performance of the promise ❑ Interest, and ❑ Necessary expenses incurred for possession or preservation of the goods.	Bank retains pledged stock for loan + interest.
174	Right to Retain for Subsequent Debts	Pawnee can retain goods for debts other than the original one only if there's a contract allowing this.	Retention allowed if a contract permits it.

	Right to Extraordinary Expenses	Pawnee can claim reimbursement for extraordinary expenses (e.g., preservation of goods), but can't retain goods for these expenses—can sue instead.	Pawnee sues for repair or preservation costs.
176	Right in Case of Pawnor's Default	If the pawnor defaults, the pawnee may: 1. Retain the goods as collateral security and sue the pawnor. 2. Sell the goods after giving notice. 3. Proceeds from such sale - Less then pawnor liable for the balance and if More then pay surplus to the pawnor.	Bank sells pledged stock if loan isn't repaid.

RIGHTS OF A PAWNOR

As the bailor of goods, **pawnor has all the rights of the bailor**.

Along with that he also has the **right of redemption to the pledged goods** which is enumerated under section 177 of the Act.

Right to redeem [Section 177]: (Redemption means to recover back the goods by making the payment of debt or performance of promise)

If a **time is stipulated for the payment of the debt**, or **performance of the promise**, for which the pledge is made, and the **pawnor makes default in payment** of the debt or performance of the promise at the stipulated time, **he may redeem the goods pledged at any subsequent time before the actual sale of them**; but he must, in that case, **pay, in addition, any expenses which have arisen from his default**.

DUTIES OF THE PAWNEE

Pawnee has the following duties:

Take reasonable care	**Not to make unauthorised use**	**Return the goods when the debt has been repaid**
Not to mix his own goods	**Not to do any act which is inconsistent with the terms**	**Return accretion to the goods,**

DUTIES OF A PAWNOR

Pawnor has the following duties:

Liable to pay the debt or perform the promise	**Compensate the pawnee for any extraordinary expenses**	**Disclose all the faults which may put the pawnee under extraordinary risks.**
Pawnor must indemnify the pawnee. (LOSS DUE TO DEFECT IN THE PAWNOR'S TITLE)	**Due to default by the pawnor's DEFAULT - If Pawnee sells the goods - Pawnor must pay the deficit**	

PLEDGE BY NON-OWNERS

Connect the topic to - Section 27 to 30 - Sale by NON Owners from SOGA, 1930.

Ordinarily, it is the owner of the goods, or any person authorised by him on that behalf, who can pledge the goods.

- 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]

- **A mercantile agent**, who is in the possession of goods or document of title, with the consent of the owner, **can pledge them while acting in the ordinary course of business as a Mercantile Agent**.
- Such **Pledge shall be valid as if it were made with the authority of the owner of goods.**
- Provided, pawnee acted in **good faith** and had no notice that Pawnor has no authority to pledge.

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 contract voidable under section 19 or section 19A (contracts where consent has been obtained by fraud, coercion, misrepresentation, undue influence), **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.

C. Pledge where Pawnor has only a Limited Interest [Section 179]

Where a **person pledges goods in which he has only a limited interest** i.e. pawnor is not the absolute owner of goods, the pledge is valid to the extent of that interest.

Example 32: Mr. X finds a defective mobile phone lying on the road. He picks it up, gets it repaired for ₹5000. He later pledges the mobile phone for ₹2,000. The true owner can recover the mobile phone only on paying ₹5,000.

Example 33: 'A' pledges his jewellery worth ₹1,00,000 with 'B' for a advance of ₹70,000. 'B' pledges the same for ₹90,000 with 'C'. Now this pledge is valid upto ₹70,000 plus interest due thereon.

D. Pledge by a Co-owner in Possession

- Where the **goods are owned by many person and with the consent of other owners**, the goods are left in the possession of one of the co-owners.
- Such 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, **provided the pawnee acts in good faith and he has no knowledge of the defect in title of the pawnor.**

Example 34: A buys a cycle from B. But leaves the cycle with the seller. B then pledges the cycle with C, who does not know of sale to A, and acted in good faith. This is a valid pledge.

DISTINCTION BETWEEN BAILMENT AND PLEDGE

Basis of Distinction	Bailment	Pledge
Meaning	Transfer of goods by one person to another for some specific purpose is known as bailment.	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.

Parties	contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee".	good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "pawnee".
Purpose	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods).	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise.
Consideration	The bailment may be made for consideration or without consideration.	Pledge is always made for a consideration.
Right to sell the goods	The bailee has no right to sell the goods even if the charges of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed.	The pawnee has right to sell the goods if the pawnor fails to redeem the goods.
Right to use of goods	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledgee or Pawnee cannot use the goods pledged.

"PROBLEM KYA HAI? - UNIT 8"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. State the essential elements of a contract of bailment. **(Module)**

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

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

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

1. **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.
2. **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.
3. **As to right of using goods:** Pledgee has no right to use goods. A bailee can, if the terms so provide, use the goods.
4. **Consideration:** in pledge there is always a consideration whereas in a bailment there may or may not be consideration.
5. **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.

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

1. V parks his car at a parking lot, locks it, and keeps the keys with himself.
2. Seizure of goods by customs authorities. **(Module)**

Ans. As per Section 148 of the Act, bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

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

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

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

Ans. Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Accordingly, applying the above provisions in the given case, B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

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

special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken reasonable care as required under section 151.

Here, A and B agreed to keep the jewellery at the Bank's safe locker and not at the latter's residence (i.e. B's residence). Thus, B is liable to compensate A for his negligence to keep jewellery at his (B's) residence.

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

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

7. Amar bailed 50 kg of high quality sugar to Srijith, who owned a kirana shop, promising to give ₹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? **(Module)**

Ans. According to section 157 of the Contract Act, 1872, if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods. In the given question, Srijith's employee mixed high quality sugar bailed by Amar and then packaged it for sale. The sugars when mixed cannot be separated. As Srijith's employee has mixed the two kinds of sugar, he (Srijith) must compensate Amar for the loss of his sugar.

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

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

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

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

9. 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? **(Module)**

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.

MTPs, RTPs AND PYQPs QUESTIONS

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

1. Vikas parks his car at a parking lot, locks it, and keeps the keys with himself.
2. Seizure of goods by customs authorities. **(RTP Jun'24)**

Ans. As per Section 148 of the Indian Contract Act, 1872, bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

For a bailment to exist, the bailor must give possession of the bailed property and the bailee must accept it.

1. 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.
2. Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists, and section 148 is applicable.

2. Mrs. Shivani delivered her old silver jewellery to Mr. Y a Goldsmith, for the purpose of making anklet out of it. Every evening she used to receive the unfinished good (anklet) to put it into box kept at Mr. Y's Shop. She kept the key of that box with herself. One night, the anklet 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? Give your answer as per the provisions of the Indian Contract Act, 1872.

(4 Marks March 21, May'20, Nov'21, March' 21)(SM)

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

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

Thus, the mere keeping of the box at Y's shop, when Mrs. Shivani 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. Shivani did not deliver the complete possession of the good by keeping the keys with herself.

3. As per the Indian Contract Act, 1872, answer the following:

1. Definition of Pledge, pawnor and pawnee
2. Essential characteristics of contract of pledge **(4 Marks April 21)**

1. "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".

2. 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:
   (a) There shall be a bailment of security against payment or performance of the promise.
   (b) The subject matter of pledge is goods.
   (c) Goods pledged for shall be in existence
   (d) There shall be delivery of goods from pledger to pledgee.

4. On the basis of reward, what are various categories of bailment? **(4 Marks Oct 21)**

Ans. On the basis of reward, bailment can be classified into two types:

1. **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.
2. **Non-Gratuitous Bailment:** Non gratuitous bailment means where both the parties get some benefit i.e. bailment for the benefit of both bailor & bailee

5. As per the provisions of the Indian Contract Act, 1872, what is the meaning of:

1. Continuing guarantee
2. Gratuitous Bailment **(4 Marks)(Sep'22)**

Ans.

1. **Continuing guarantee:** A guarantee which extends to a series of transaction is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

   The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.
2. **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.

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

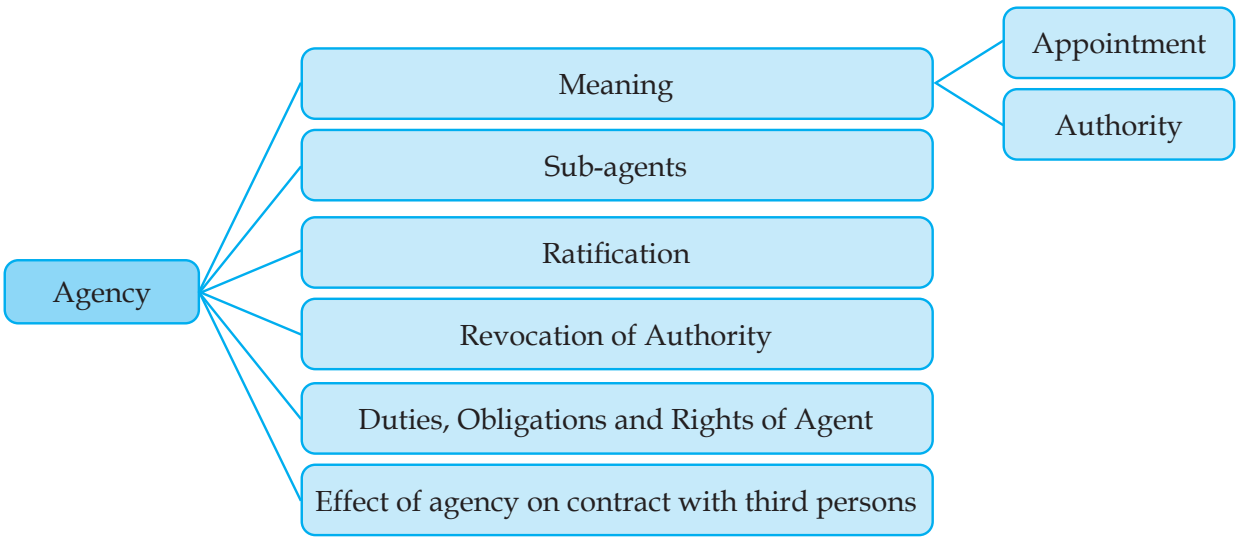
1. Golu parks his car at a parking lot, locks it, and keeps the keys with himself.
2. Seizure of goods by customs authorities. **(4 Marks March '23)**

Ans. As per Section 148 of the Act, bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

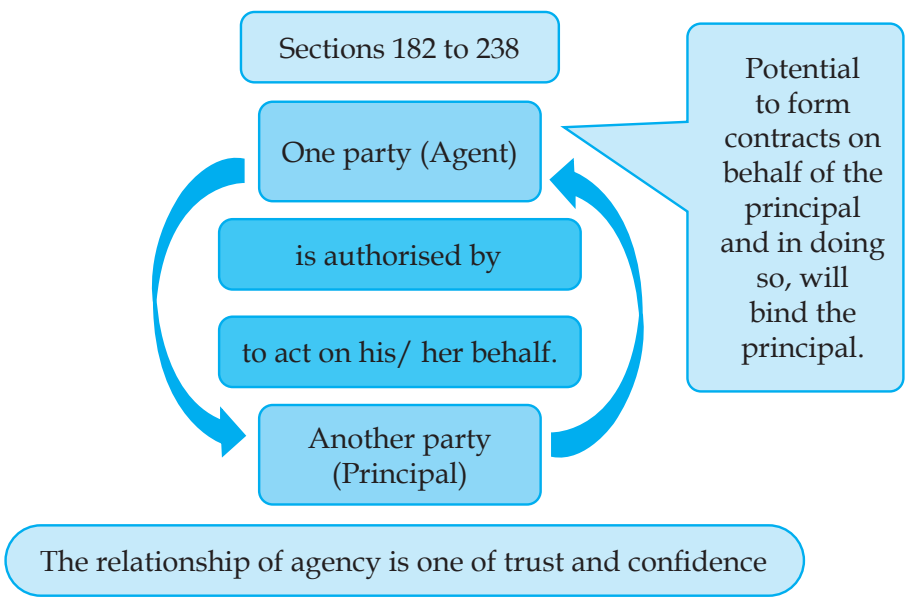
For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it. There must be a transfer in ownership of the goods.

1. Mere custody of goods does not mean possession. In the given case, since the keys of the car are with Golu, section 148, of the Indian Contract Act, 1872 shall not applicable. Hence, it is not bailment.
2. Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists and section 148 is applicable.

Agency



A relationship of agency is established when -



- Such relationships are initiated when one party **desires to extend his/her activities** beyond his/her present limits or capacity.

- The Indian Contract Act, 1872 does not define the word 'Agency'.
- Agent means a person employed **to do any act for another or to represent another** in dealing with the third persons.
- The principal means a person **for whom such an act is done or who is so represented**.

TEST OF AGENCY

1. Whether the person has the **capacity to bind the principal and make him answerable** to the third party.
2. Whether he can **establish privity of contract between the principal and third parties**. If the answer to these questions is in **affirmative (Yes)**, then **there is a relationship of agency**.

'Agency' is a comprehensive word used to describe the relationship between - one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim "*Qui facit per alium, facit per se*" i.e., he who acts through an agent is himself acting.

APPOINTMENT AND AUTHORITY OF AGENTS

183 - Who may Employ an Agent

- **Any person who has attained majority** according to the law to which he is subject, and **who is of sound mind**, may employ an agent.
- **Thus, a minor or a person of unsound mind cannot appoint an agent.**

184 - Who may be an Agent

- **Any** person may become an agent i.e. **even a minor or a person of unsound mind may become an agent and the principal shall be bound by his acts**.
- But as a rule of caution, a minor or a person of unsound mind should not be appointed as an agent because he is incompetent to contract.

Example 1: P appoints Q, a minor, to sell his car for not less than ₹2,50,000. Q sells it for ₹2,00,000. P will be held bound by the transaction and further shall have no right against Q for claiming the compensation for having not obeyed the instructions, since Q is a minor and a contract with a minor is 'void-ab-initio'. and in case of his misconduct or negligence, the principal shall not be able to proceed against him.

184 - Consideration not Necessary

No consideration is necessary to create an agency.

The acceptance of the office of an agent is regarded as a sufficient consideration for the appointment.

CREATION OF AGENCY

- In the words of Desai J, of the Supreme Court of India, "The relation of agency arises whenever one person called the agent has the authority to act on behalf of another called the principal and consents to act. The relationship has genesis in a contract".

- The authority may be express or implied: According to Section 186, the authority of an agent may be express or implied.

187 - Express and Implied Authority

Express Authority: An authority is said to be express when it is given by words, spoken or written:

Example 2: A is residing in Delhi and he has a house in Kolkata. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.

Example 3: If a customer of a bank wishes to transact his banking business through an agent, the bank will require written evidence of the appointment of the agent and will normally ask to see the registered power of attorney appointing the agent.

Implied Authority:

An authority is said to be implied when it is to be **inferred from the circumstances of the case, conduct of the parties and things spoken or written, or in the ordinary course of dealing**, may be accounted from the circumstances of the case.

If a person realises rent and gives it to the landlord, he impliedly acts for the landlord as an agent.

Example 4: A owns a shop in Selampur, living himself in Kolkata and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

Implied Agency includes:

Agency by Estoppel [Section 237]:	**Agency by Necessity:**
Where the principal by his **conduct** or statement **willfully induces** another person to **believe** that a certain person is his **agent**, he is **subsequently prevented** or **estopped** from **denying** the fact of agency. 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.	❑ An agency of necessity arises due to **some emergent circumstances**. ❑ In an emergency, a person is **authorised to do what he cannot do in ordinary circumstances**. ❑ Thus, where an agent is authorised to do a certain act, and while doing such an act, an emergency arises, **he acquires an extra-ordinary or special authority to prevent his principal from loss**.

Example 5: A consigns goods to B for sale and gives him instructions not to sell below a fixed price. C being ignorant of B's instruction enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract. A cannot plead that he had given instructions to B to not sell the goods below a certain price. An agency by estoppel is, consequently, deemed between A and B.

Prasad and has paid for the goods bought by Sunil, Piyal cannot later refuse to pay Prasad who had supplied goods on credit to Sunil in the belief that he was Piyal's agent and was buying the goods on behalf of Piyal. Piyal is estopped from now asserting that Sunil is not his agent because on earlier occasions he permitted Prasad to believe that Sunil was his agent and Prasad had acted in that belief

Example 7: *Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire and save the farm from destruction during Raja's absence from the country.*

Agency by Operation of Law: When the law treats one person as an agent of another, for example, a partner is the agent of the firm for the purposes of the business of the firm.

Example 8: *X who is Y's agent has on 10th January 2022 purchases goods from Z on credit without Y's permission. After the purchase, on 20th January 2022, Y tells X that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit. Y's subsequent statement on 20th January 2022 amounts to a ratification of the agent's (X's) purchase of goods on 10th January 2022.*

RATIFICATION & ITS EFFECT

196 - Rights of person as to acts done for him without his authority,

"Ratification" means approving a previous act or transaction.

- Where acts are done by one person on behalf of another, **but without his knowledge or authority, he may elect to ratify or to disown such acts**.
- If he ratifies them, the same effects will follow **as if they had been performed by his authority**.
- **May be express or implied by the conduct** of the person on whose behalf the act was done.

Essentials of a valid Ratification		
Sec.	**Concept**	**Description**
197	Ratification may be expressed or implied	Ratification can either be explicitly stated or implied from the conduct of the person on whose behalf the acts were performed.
198	Knowledge requisite for valid ratification	A person cannot make a valid ratification if their knowledge of the facts of the case is materially defective.
199	Whole transaction must be ratified	The entire act must be ratified or rejected in full. Partial ratification (ratifying beneficial parts and rejecting others) is not allowed.
200	Ratification cannot injure third persons	Ratification cannot apply if it affects the rights of third parties. It cannot relate back to the contract date if a third party acquires rights in between.
	Ratification within reasonable time	Ratification must be done within a reasonable period.
	Communication of ratification	The ratification must be communicated to the other party involved.
	Act to be ratified must be valid	The act must not be void, illegal, or prohibited by law (e.g., forgery, payment of dividends from capital, or criminal activities).

Example 9: A, without authority, buys goods for B. Afterwards, B sells them to C on his own account, B's conduct implies a ratification of the purchase made for him by A.

Example 10: A, without B's authority, lends B's money to C. Afterwards, B accepts interest on the money from C. B's conduct implies a ratification of the loan.

Example 11: A has an authority from P to buy certain goods at the market rate. He buys at a higher rate, but P accepts the purchase. Afterwards, P comes to know that the goods purchased by A for P belonged to A himself. The ratification is not binding on P

Example 12: A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

Example 13: A holds a lease from B, terminable on three months' notice. C, an unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A

EXTENT OF AGENT'S AUTHORITY

The agent's authority is governed by two principles, namely -

(a) in normal circumstances and

(b) in emergency.

188 - Agent's authority in normal circumstances	**189 - Agent's authority in an emergency -**
❑ An agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act. ❑ An agent having an authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course, of conducting such business.	❑ 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.Conditions for Valid agency in an emergency- 1. **No communication possible:** The agent couldn't contact the principal within the available time. 2. **Urgent need:** There was a real and clear commercial need for the agent to act quickly. 3. **Acting in good faith:** The agent acted honestly and in the best interest of the principal. 4. **Reasonable actions:** The agent took the most practical and sensible steps based on the situation. 5. **Possession of goods:** The agent had control of the principal's goods related to the contract.

Example 14: A is employed by B, residing in London, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt and may give a valid discharge for the same.

Example 15: A constitutes B as his agent to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on the business

Example 16: An agent who has authority for sale of goods may repair it if necessary.

Example 17: A consigns perishable goods to B at Srinagar, with directions to send them immediately to C at Tamandu. B may sell the good if they begin to perish before reaching its destination

Provisions Related to Sub Agents		
Sec.	**Concept**	**Description**
190	**When an agent cannot delegate**	An agent **cannot lawfully** employ another to perform acts which he has expressly or impliedly undertaken to perform personally, **unless by the ordinary custom** of trade a sub-agent may, or from the **nature** of the **agency**, a sub- agent must, be employed.
191	**Sub-agent**	A person employed by, and acting under the control of, the **original agent** in the business of the agency. **Analysis:** ❑ Where an agent appoints another agent. ❑ The appointment of sub agent is **not lawful**, because the agent is a delegatee and a **delegatee cannot further delegate**. ❑ This is based on the Latin principle "delegatus non-potest delegare". ❑ A contract of agency is of a **fiduciary character**. ❑ It is based on the confidence reposed by the principal in the agent and that is why a **delegatee cannot further delegate**.
	Exception where an agent can appoint Sub-agent **(In both these cases the sub agent would be treated as the agent of the principal)**	The appointment of a sub agent would be valid - ❑ If the terms of **appointment originally** contemplated it sometimes **customs** of the trade may provide for appointment of sub agents. ❑ Where in the course of the agent's employment, **unforeseen emergency** arise making it necessary for him to delegate the authority that was given to him by the principal.
192	**Representation of principal by sub-agent properly appointed**	Where a sub-agent is properly appointed - ❑ **Principal is liable to third parties** for the acts of the sub-agent. ❑ **Agents responsibility for sub agents:** The agent is responsible to the principal for the acts of the sub-agent. ❑ **Sub-agents liability to principal:** The sub-agent is responsible for his acts to the agent, **but not to the principal, except in case of fraud** or willful wrong.
193	**Agent's responsibility for sub-agent appointed without authority**	Where an agent, **without having authority** to do so - ❑ Has appointed a person to act as a sub-agent, the **agent is responsible** for his acts **both** to the **principal** and to **third** persons the **principal** is responsible for the acts of the **sub agent**, the **sub agent is not responsible** to the **principal** at all. ❑ He is **answerable** only to the **agent**.

Example 18: A, a carrier, agreed to carry 60 bags of cotton waste from Morvi to Bhavnagar by a truck. A asked B, another carrier, to carry the goods. The goods were damaged in transit. Held, A was liable even though it was proved that B was the carrier.

SUBSTITUTED AGENT

A person appointed by the agent to act for the principal, in the business of agency, with the knowledge and consent of the principal.

Substituted agents are not sub agents. They are agents of the principal.

194 - Relation between principal and person duly appointed by agent to act in business of agency (Substituted Agent): Where an agent **(Agent 1)** 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 **(Agent 2)** such person **(Agent 2)** 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.

Example 19: A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub- agent, but is A's agent for the conduct of the sale.

Example 20: A authorizes B, a merchant in Kolkata, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co. for the recovery of the money. D is not a sub-agent, but is a solicitor for A.

195 - Agent's duty in naming such person: 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**.

Example 21: A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

Example 22: A consigns goods to B, a merchant, for sale. B in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

DIFFERENCE BETWEEN A SUB-AGENT AND A SUBSTITUTED AGENT

Both a sub-agent and a substituted agent are appointed by the agent. But, however, the following are the points of distinction between the two:

Sr. No.	Sub-Agent	Substituted Agent
1.	A sub-agent does his work under the control and directions of agent.	A substituted agent works under the instructions of the principal.
2.	The agent not only appoints a sub-agent but also delegates to him a part of his own duties.	The agent does not delegate any part of his task to a substituted agent.
3.	There is no privity of contract between the principal and the sub-agent.	Privity of contract is established between a principal and a substituted agent.

	alone and is not generally responsible to the principal.	principal and not to the original agent who appointed him
5.	The agent is responsible to the principal for the acts of the subagent.	The agent is not responsible to the principal for the acts of the substituted agent.
6.	The sub-agent has no right of action against the principal for remuneration due to him.	The substituted agent can sue the principal for remuneration due to him.
7.	Sub-agents may be improperly appointed.	Substituted agents can never be improperly appointed.
8.	The agent remains liable for the acts of the sub-agent as long as the sub-agency continues.	The agent's duty ends once he has named the substituted agent.

DUTIES AND OBLIGATIONS OF AN AGENT

Duties and Obligations of an Agent		
Sec.	**Duty/Concept**	**Description**
211	**Duty to follow instructions or customs**	❑ The agent must follow the **principal's directions** or **local business customs**. If there's a loss, the agent compensates; if there's a profit, they must give it to the principal.
212	**Duty of reasonable care and skill**	❑ The agent must act with the **expected skill** of others in the field. If **negligent** or **unskilled**, the agent must **compensate** for direct losses but not indirect ones.
213	**Duty to render proper accounts**	❑ The agent must provide **detailed** and **supported accounts** to the principal when requested.
214	**Duty to communicate with the principal**	❑ The agent must **diligently communicate** with the principal in case of difficulties and seek instructions.
215	**Duty not to deal on their own account**	❑ The agent **cannot make personal deals without the principal's consent**. The principal can cancel the transaction or claim the benefit from the agent.
216	**Duty not to make secret profits**	❑ The agent **must not earn undisclosed profits** from the agency. They must act in **good faith** and disclose all benefits beyond agreed remuneration.
190	**Duty not to delegate**	❑ The agent **cannot delegate tasks** unless allowed by trade customs or the nature of the agency.
218	**Duty to pay sums received for the principal**	❑ The agent must **hand over all money received** on behalf of the principal, after any permitted deductions.
	Duty not to misuse confidential information	❑ The agent must **not use confidential information** obtained during agency against the principal's interest.

211 - Duty to follow instructions of customs:

Example 23: *A, an agent is engaged for managing the business of B, in which it is a custom to invest money at hand for interest. If A omits to make such investment he must indemnify B for the losses i.e. for the interest B would have obtained for such investment.*

Example 24: *B, a broker, in whose business it is not the custom to sell on credit, sells goods of A on credit to C. C, before payment, becomes insolvent. B will have to indemnify A for the losses.*

212 - Duty of reasonable care and skill:

Example 25: *A, a merchant in Kolkata, has an agent, B, in London, to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss- e.g. by variation of rate of exchange-but not further.*

Example 26: *A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. A must compensate his principal for the loss sustained by him.*

Example 27: *A, an insurance-broker, employed by B to effect an insurance on a ship, omits to see that the "usual clauses" are inserted in the policy. The ship is afterwards lost. In consequence of the omission nothing can be recovered from the underwriters. A is bound to make good the loss to B.*

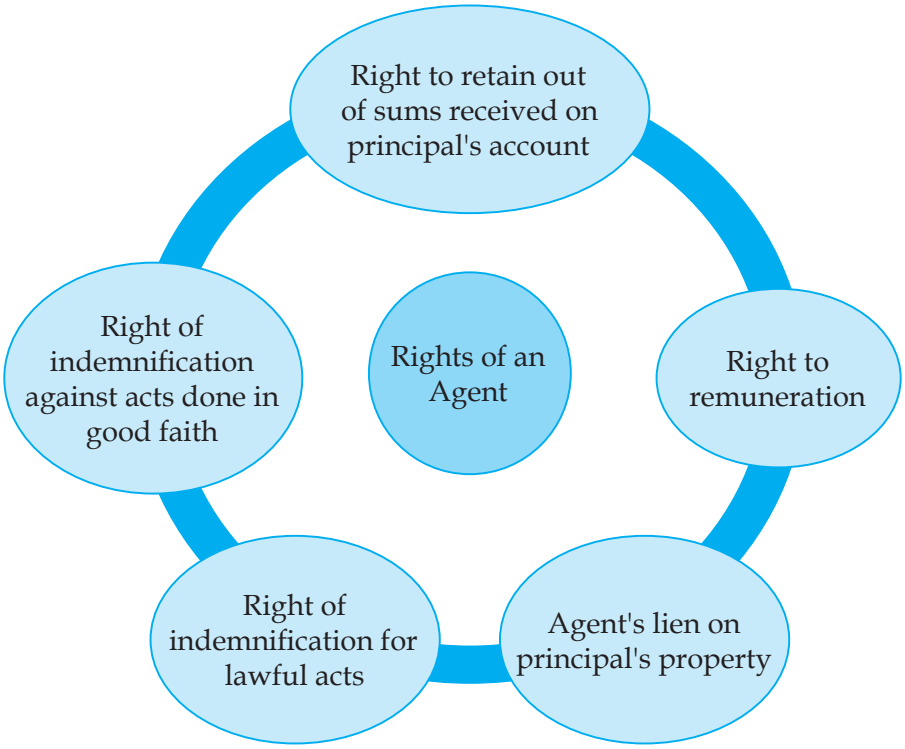
Example 28: *A, a merchant in England, directs B, his agent at Mumbai, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.*

213 - Duty to render proper accounts:

Example 29: *A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.*

Example 30: *A directs B to sell A's estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allow B to buy, in ignorance of the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either repudiate or accept the sale at his option.*

Example 31: *A directs B, his agent, to buy a certain house for him. B tells A it cannot be bought and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.*

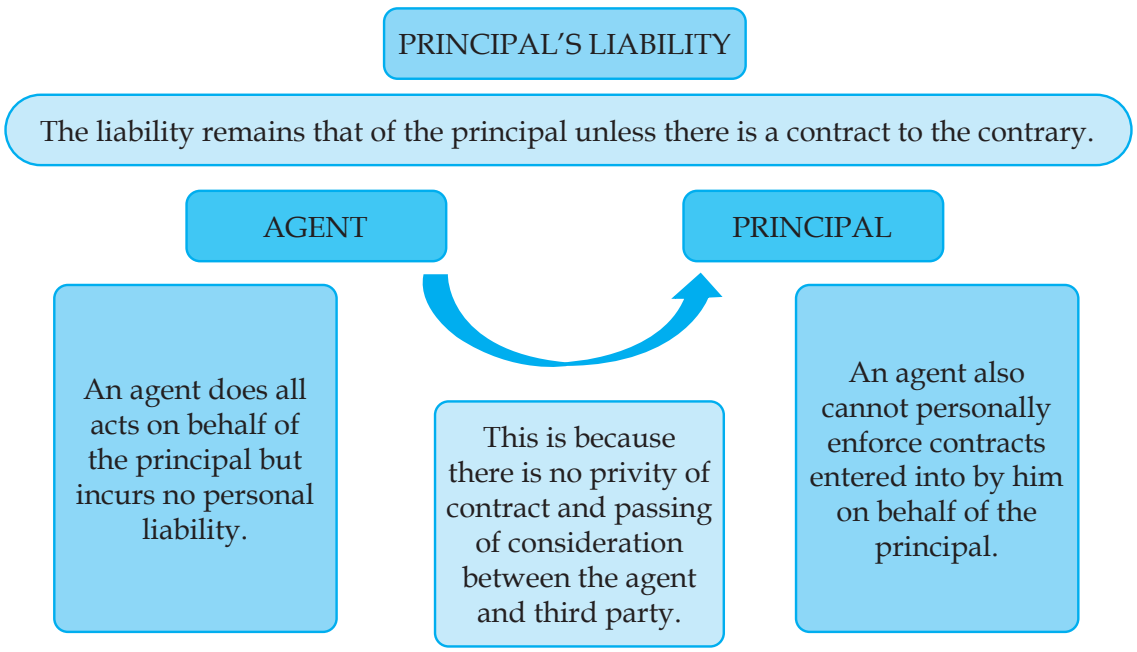


Rights of an Agent			
Sec.	**Right/Concept**	**Description/Detail**	**Examples**
217	**Right to retain sums received**	The agent has the right to retain, out of sums received on account of the principal, payments for - ❑ any money due for advances made, ❑ expenses properly incurred, and ❑ remuneration for their services. This right applies to any sums received in the course of agency business.	
219	**Right to remuneration**	❑ The agent is entitled to remuneration as agreed upon in the contract, or, if not specified, the usual remuneration customary in the business. ❑ However, if the agent is guilty of misconduct, they lose the right to remuneration for the part of the business they mishandled.	*Example 32: B recovers ₹1,00,000, invests ₹90,000 wisely, but invests ₹10,000 poorly, causing A a loss of ₹2,000. B is entitled to remuneration for recovering the ₹1,00,000 and investing ₹90,000, but not for the ₹10,000 poorly invested.*

	remuneration in case of misconduct	❑ If the agent's misconduct leads to a loss in the business of the agency, they forfeit their right to remuneration for that part of the work.	*recover ₹1,00,000 due to his own misconduct. B is entitled to no remuneration and must make good the loss.*
221	**Agent's lien on principal's property**	❑ An agent is entitled to retain goods, papers, and other property belonging to the principal until they are paid for their commission, disbursements, or services rendered in the proper conduct of the agency business. ❑ This lien is lost if the agent loses possession of the property or waives the right to the lien.	-
222	**Right of indemnification for lawful acts**	❑ The principal is bound to indemnify the agent for all consequences of lawful actions done in the exercise of their authority. ❑ If the agent faces litigation or expenses due to such lawful actions, the principal must bear the costs.	***Example 34:*** *A in Delhi appoints B in Mumbai to sell his merchandise. B enters into contracts to deliver the goods, but A fails to send them, and B faces legal actions. A must protect B from all legal costs.*
223	**Right of indemnification for acts done in good faith**	❑ If the agent acts in good faith on the principal's instructions, the principal must indemnify the agent for any resulting loss or damage. ❑ However, the agent cannot claim indemnity for losses arising from acts done in violation of penal laws.	***Example 35:*** *P instructs A to sell certain goods, but they turn out not to belong to P. If A is sued by a third party, A is entitled to indemnification for acting in good faith.*
224	**Non-liability of principal for criminal acts**	❑ If the agent is employed to perform a criminal act, the principal is not liable to indemnify the agent, even if there was an express or implied promise to do so.	***Example 36:*** *A asks B to beat C and promises to indemnify B. B beats C and has to pay damages. A is not liable to indemnify B for those damages.*
			Example 37: *A asks B to publish a libel against C. B is sued for the libel and has to pay damages and costs. A is not liable to indemnify B.*

225	**Right to compensation for injury due to principal's neglect**	❑ The principal must compensate the agent for any injury caused due to the principal's neglect or lack of skill. ❑ The principal owes the agent a duty of care and should not expose the agent to unreasonable risks.	*Example 38: A hires B to work as a bricklayer. A puts up faulty scaffolding, which causes B to get injured. A must compensate B for the injury.*

PRINCIPAL'S LIABILITY TO THIRD PARTIES



I. 226 - Principal's liability for the Acts of the Agent

Principal liable for the acts of agents which are **within the scope of his authority**.

Example 39: A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set off against that claim a debt due to himself from

Example 40: A, being B's agent with authority to receive money on his behalf, receives from C, a sum of money due to B. C is discharged of his · obligation to pay the sum in question to B.

II. 227 -Principal's liability when agent exceeds authority

When an agent does more than he is authorised to do, and when the part of what he does, which is **within his authority**, **can be separated** from the part which is beyond his authority, so much only of what he does as is within his authority **is binding as between him and his principal**.

Example 41: A, being owner of a ship and cargo, authorizes B to procure an insurance for ₹4,00,000 on the ship. B procures a policy for ₹ 4,00,000 on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority **cannot be separated** from what is within it, the principal is **not bound to recognize the transaction**.

Example 42: A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of ₹6,00,000. A may repudiate the whole transaction.

Example 43: A authorizes B to draw bills to the extent ₹200 each. B draws bills in the name of A for ₹1,000 each. A may repudiate the whole transaction.

237 - Exception : Liability of principal inducing belief that agent's unauthorized acts were authorized

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.

Example 44: A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

Example 45: A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A. The sale is good.

IV. 229 -Consequences of notice given to agent

Any notice given to or **information obtained by the agent**, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the **same legal** consequence **as if it had been given to or obtained by the principal**.

Example 46: A is employed by B to buy certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for sale, A learns that the goods really belonged to D, but B is ignorant of the fact. B is not entitled to set off a debt owing to him from C against the price of the goods. Thus, the knowledge of the agent is treated as the knowledge of the principal

V. 238 -Principal's liability for the agent's fraud, misrepresentation or torts

Misrepresentations made, or **frauds** committed, **by agents** acting in the course of their business for their principals, **have the same effect on agreements made by such agents** as if such misrepresentations or frauds had been made, or committed, by the principals; **but misrepresentations made, or frauds committed, by agents**, in matters which **do not fall within their authority**, **do not affect their principals**.

Example 47: A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

Example 48: A, the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended consignor.

230 - Agent cannot personally enforce, nor be bound by, contracts on behalf of principal

- 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**.
- **He can neither sue nor be sued** on contracts made by him on his principal's behalf.

EXCEPTIONS: In the following exceptional cases, the agent is presumed to have agreed to be personally bound:

Exceptional Case	Concept	Details
Foreign Principal (Merchant abroad)	**Personally liable for foreign transactions**	When an agent contracts for the sale or purchase of goods on behalf of a foreign principal, the agent is presumed to be personally liable.
Undisclosed Principal	**Principal unnamed**	If the agent does not disclose the name of the principal, it is presumed that the agent undertakes personal liability.
Non-existent or Incompetent Principal	**Liability when principal cannot be sued**	If the principal is disclosed but cannot be sued (e.g., is non-existent or incompetent), the agent is personally liable.
Pretended Agent (Section 235)	**Liability when pretending to be an agent**	If someone acts as an agent without actual authority and the principal disowns the act, the agent becomes personally liable.
Exceeding Authority	**Liability for breach of authority**	If the agent exceeds their authority and misleads a third party into believing they have the authority, the agent is liable for breach of warranty.

Example 49: An agent who contracts for a minor, the minor being not liable, the agent becomes personally liable. This result, may not, however, follow where the other party already knows that the principal is a minor.

RIGHTS OF THIRD PARTIES

1. **231 - Rights of parties to a contract made by undisclosed agent:**
   - If an agent makes a contract with someone who doesn't know (or suspect) that they are dealing with an agent, the principal can still require the contract to be fulfilled.
   - However, the other party has the same rights against the principal as they would have had against the agent if they thought the agent was the principal.
   - If the principal reveals themselves before the contract is completed, the other party can refuse to fulfill the contract — if they can prove that they wouldn't have entered into the contract had they known who the real principal was.

   Example 50: SS bought for himself a ticket of IPL match at Wankhede Stadium through AB because on personal grounds Stadium management would not have issued the ticket to SS. Stadium management may repudiate the contract and refuse SS to enter the stadium.

2. **232 - Performance of contract with agent supposed to be principal:** When agent does not disclose that he is acting as an agent and the principal requires the performance of the contract then the principal can obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example 51: A, who owes ₹50,000 rupees to B, sells ₹1,00,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

3. **Option to Third Person- sue the Agent or the Principal:**

(a) **233 - Right of person dealing with agent personally liable:** In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them, liable

Example 52: A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

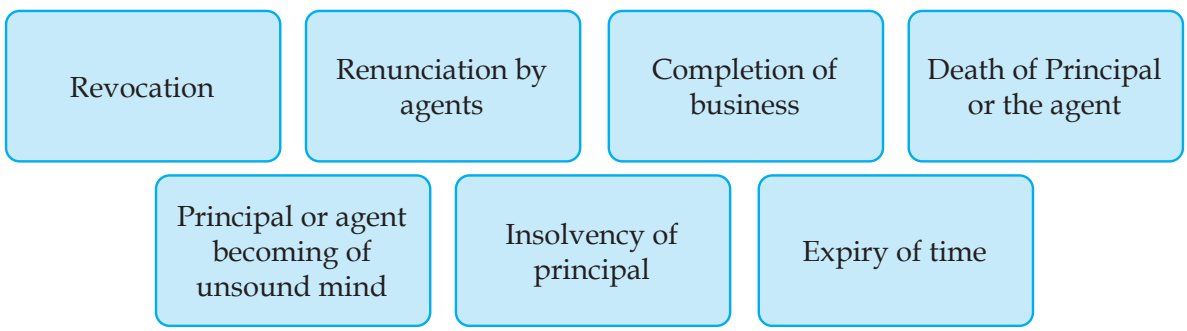
(b) **234 - Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable:** When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively.

REVOCATION OF AUTHORITY

201 - Termination of agency

Termination of agency means putting an end to the legal relationship between principal and agent.

Modes of termination:



1. **Revocation:**

203 - An agency can be terminated if the principal revokes the agent's authority. The principal can do this anytime before the agent acts in a way that legally binds the principal

204 - However, once the agent has partly used their authority, the principal cannot revoke it for actions and obligations already carried out

Example 53: A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

Example 54: A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in A's name, and so as not to render himself personally liable for the price. A can revoke B's authority to pay for the cotton.

205 - Compensation for revocation: If the principal revokes the agency without a valid reason before its completion, they must compensate the agent for the loss.

206 - Notice of revocation: If the principal has a valid reason to revoke the agency, they must give reasonable notice to the agent. Failure to do so may result in the principal being liable for compensation for any damage caused.

207 - Revocation and Renunciation: The termination of agency can be either expressed clearly or implied through the principal's actions.

Example 55: A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

2. **206 - Renunciation by agent:**
   (a) An agent can renounce the business of the agency in the same way a principal can revoke it.
      (i) **205 -** If the agency is for a fixed period, the agent must compensate the principal for premature renunciation without a valid reason.
      (ii) The agent must give reasonable notice before renouncing. The duration of the notice should be based on the same principles that apply to the principal's revocation.
   (b) If the agent renounces without giving proper notice, they will be responsible for compensating the principal for any damages caused.
3. **Completion of business:**
   - An agency is automatically and by operation of law terminated **when its business is completed**.
   - Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed.
4. **Death or insanity:**
   - An agency is terminated **automatically on the death** or **insanity** of the principal or the agent.
   - Winding up of a company or dissolution of partnership has the same effect.
   - **Act done by agent before death would remain binding.**
5. **Principal's insolvency:** An agency ends on the principal being adjudicated insolvent.
6. **On expiry of time:**
   - Where an agent has been appointed for a fixed term, the **expiration** of the term **puts an end** to the agency, **whether the purpose** of agency has been accomplished or not.
   - An agency comes to an **automatic end on expiry of its term**.

When the Agency is Irrevocable?

When the agent is personally interested in the subject matter of agency the agency becomes irrevocable.

202 -

- 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

Example 56: A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

Example 57: A consigns 1000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself, out of the price, the amount of his own advances. A cannot revoke this authority, nor it is terminated by his insanity or death

208 - When termination of agent's authority takes effect as to agent, and as to third persons

- The termination of the authority of an agent does not, so far as regards the agent, take effect before **it becomes known to him** or so far as regards third persons, **before it becomes known to them**.

Example 58: A directs B to sell goods for him and agrees to give B five per cent commission on the price fetched by the goods. A afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it sells the goods for ₹1,00,000. The sale is binding on A, and B is entitled to ₹5,000 as his commission.

Example 59: A, at Chennai, by letter directs B to sell for him some cotton lying in a warehouse in Mumbai, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C's payment is good as against A.

Example 60: A directs B, his agent, to pay certain money to C. A dies, and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

209 - Agent's duty on termination of agency by principal's death or insanity

- When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take on behalf of the representatives of his late principal, **all reasonable steps for the protection and preservation of the interests entrusted to him.**

210 - Termination of Sub-agent's Authority:

- The termination of the authority of an agent causes the termination **of the authority of all sub-agents** appointed by him. (subject to the rules herein contained regarding the termination of an agent's authority)

"PROBLEM KYA HAI? - UNIT 9"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - ICA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

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

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

liable to the third party for the acts of the agent. Thus, in the given case, D gets a good title to the watch. M is not liable to A for his negligence in the performance of his duties.

2. State with reason whether the following statement is correct or incorrect: Ratification of agency is valid even if knowledge of the principal is materially defective. **(Module)**

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

3. 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? **(Module)**

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

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

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

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

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

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

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

5. Comment on the statement 'Principal is not always bound by the acts of a sub-agent. **(Module)**

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

Act, 1872 the principal is bound by and is held responsible for the acts of the sub-agent. Their relationship is treated to be as if the sub-agent is appointed by the principal himself.

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

6. 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? **(Module)**

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

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

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

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

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

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

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

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

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

said agency by Bhupendra is lawful. **(Module)**

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

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

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

MTPs, RTPs AND PYQPs QUESTIONS

1. 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. **(MTP 4 Marks March 21)**

Ans. 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.

2. Shiva appoints Ganesh as Shiva's agent to sell Shiva's land. Ganesh, under the authority of Shiva, appoints Gauri as agent of Ganesh. Afterwards, Shiva revokes the authority of Ganesh but not of Gauri.

What is the status of agency of Gauri? Advise whether the said agency shall be terminated as per the provisions of the Indian Contract Act, 1872. **(MTP 4 Marks Mar'22)**

Ans. 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

Ganesh. Hence, Gauri becomes a sub-agent. Thus, when Shiva revokes the authority of Ganesh (agent), it results in termination of authority of sub-agent appointed by Ganesh i.e. Gauri (sub-agent).

3. Explain whether the agency shall be terminated in the following cases under the provisions of the Indian Contract Act, 1872:

1. 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.
2. 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?

(4 Marks) (Oct 22) (PYQ 4 Marks Jan 21)

Ans.

1. 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, gives authority to B to sell'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.
2. 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 Bi.e. C (sub-agent).

4. 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 ₹15,000. Prashant during a particular month recovers ₹40,000 from traders on account of Akash. Prashant gives back ₹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. **(RTP May 21)**

Ans. 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.

traders to whom Akash sold his leather goods, on a monthly remuneration of ₹15,000. Prashant during a month recovers ₹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.

5. 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. **(PYQ 2 Marks) (May '22)**

Ans. 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.

6. 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? **(PYQ 4 Marks Nov 22)**

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

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

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

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

Revocation of authority under the Indian Contract Act, 1872: An agency may be terminated by the principal revoking the authority of the agent. Principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal [Section 203]. However, the principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations as arise for acts already done in the agency. [Section 204]

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

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

Mr. S.K Jain appointed Mr. Satish as his agent. Mr. Satish is entrusted with the work of recovering money from various traders to whom firm sells its products. Satish has earned commission of ₹1,15,000 for his work. He recovers money from clients on behalf of Akashia Steels. During a particular month he collects ₹4,00,000 but deposited in the firm's account only ₹2,85,000 after deducting his commission.

Examine with reference to relevant provisions of the Indian Contract Act, 1872, whether act of Mr. Satish is valid? **(PYQ 4 Marks, May'23)**

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

In the instant case, the rule of agency is coupled with interest.

Here, Mr. S.K. Jain appointed Mr. Satish as his agent for recovering money from various traders to whom firm sells its products.

From the collection of ₹4,00,000, he deposited in the firm's account remaining amount (₹2,85,000) after deductions of his share of commission that he has earned for work.

Here, the agency created is coupled with interest. When the agent is personally interested in the subject matter of agency, such an agency becomes irrevocable. and the act of Mr. Satish will be considered as valid.

Alternate answer:

Right to retain out of sums received on principal's account (Section 217): This section empowers the agent to retain, out of any sums received on account of the principal in the business of the agency for the following payments:

(a) all moneys due to himself in respect of advances made

(b) in respect of expenses properly incurred by him in conducting such business

(c) such remuneration as may be payable to him for acting as agent.

The right can be exercised on any sums received on account of the principal in the business of agency.

Here, Mr. S.K. Jain appointed Mr. Satish as his agent for recovering money from various traders to whom firm sells its products.

As per section 217, Mr. Satish has a statutory right to deduct his remuneration (i.e., commission) of ₹1,15,000 from the total amount of ₹4,00,000 collected on behalf of his principal and remit the remaining amount of ₹2,85,000 to Mr. S.K. Jain. Hence, the act of Mr. Satish will be considered as valid.

8. Rajesh obtained a loan of ₹10 lakh from Mahesh. Following this, Rajesh appointed Mahesh as his agent to facilitate the sale of his land, granting him the authority to deduct the loan amount from the proceeds of the sale. Later on, Rajesh wants to withdraw or cancel this agency arrangement. Assess the lawfulness of Rajesh's decision to revoke the above mentioned agency, taking into account the provisions of the indian Contract Act, 1872.

(PYQ 4 Marks Nov'23)

Ans. According to section 202 of the Indian Contract Act, 1872, an agency becomes irrevocable where the agent has himself an interest in the property which forms the subject-matter of the

be terminated to the prejudice of such interest.

In the instant case, the rule of agency coupled with interest applies.

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

Alternate Answer:

Revocation of authority under the Indian Contract Act, 1872: An agency may be terminated by the principal revoking the authority of the agent. Principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal [Section 203). However, the principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations as arise for acts already done in the agency. [Section 204]

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

Hence, Rajesh can revoke his authority delegated to Mahesh if he (Mahesh) has not exercised any authority towards mentioned agency and no obligation arises out of it.

9. A appoints M, a minor, as his agent to sell his watch for cash at a price not less than ₹700. M sells it to D for ₹350. Is the sale valid? Explain the legal position of M and D, referring to the provisions of the Indian Contract Act, 1872. **(Nov'21, March 19,4 Marks) (SM)**

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

10. A 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 A Ltd. to Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. A Ltd. sued Mr. Pintu for compensation towards the loss caused due to sale of products to Parul Pvt. Ltd. Will A Ltd. succeed in its claim?

(4 Marks April 22)

Ans. According to 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 A Ltd. to Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale.

Also, it is not the custom in A Ltd. to sell the products on credit. Hence, Mr. Pintu must make good the loss to A Ltd.

1. What is the meaning of 'Agent" and 'Principal'?
2. Who can appoint an agent. **(4 Marks April 22 & March '23)**

Ans.

1. **Agent:** means a person employed to do any act for another or to represent another in dealing with the third persons.

   The principal: means a person for whom such act is done or who is so represented.
2. **Who may employ an agent:** According to section 183 of the Indian Contract Act, 1872, "any person who has attained majority according to the law to which he is subject, and who is of sound mind, may employ an agent". Thus, a minor or a person of unsound mind cannot appoint an agent.

12. Mr. Shiv, a cargo owner, chartered a vessel to carry a cargo of wheat from a foreign port to Tuticorin. 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. Shiv. The goods (wheat) being perishable, the salvors stored it at their own expense. Salvors intimated the whole incident to the cargo owner. Mr. Shiv 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. Shiv. Explain? **(4 Marks) (Sep'22)**

Ans. Section 189 of the 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 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. Shiv and not from the ship owner, as a lien on the goods.

13. 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? **(Nov '21)**

Ans. 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.

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.

14. Both a sub-agent and a substituted agent are appointed by the agent. But, however, there are some points of distinction between the two. Explain any three points.

(PYQ 3 Marks Nov'23)

Ans. Following are the points of distinction between a sub-agent and a substituted agent:

Sr. No.	Sub Agent	Substituted Agent
1.	A sub-agent does his work under the control and directions of agent.	A substituted agent works under the instructions of the principal.
2.	The agent not only appoints a sub- agent but also delegates to him a part of his own duties.	The agent does not delegate any part of his task to a substituted agent.
3.	There is no privity of contract between the principal and the sub-agent.	Privity of contract is established between a principal and a substituted agent.
4.	The sub-agent is responsible to the agent alone and is not generally responsible to the principal.	A substituted agent is responsible to the principal and not to the original agent who appointed him.
5.	The agent is responsible to the principal for the acts of the sub-agent.	The agent is not responsible to the principal for the acts of the substituted agent.
6.	The sub-agent has no right of action against the principal for remuneration due to him.	The substituted agent can sue the principal for remuneration due to him.
7.	Sub-agents may be improperly appointed.	Substituted agents can never be improperly appointed.
8.	The agent remains liable for the acts of the sub-agent as long as the sub- agency continues.	The agent's duty ends once he has named the substituted agent.

03 CHAPTER

The Sale of Goods Act, 1930

TABLE OF CONTENT FOR THE CHAPTER

UNIT-1 - FORMATION OF THE CONTRACT OF SALE

- INTRODUCTION 3.3
- SCOPE OF THE ACT 3.3
- DEFINITIONS 3.4
- CLASSIFICATION OF GOODS 3.5
- DELIVERY - ITS FORMS AND DERIVATIVES 3.7
- SALE AND AGREEMENT TO SELL (SECTION 4) 3.10
- DISTINCTION BETWEEN SALE AND AN AGREEMENT TO SELL 3.11
- SALE DISTINGUISHED FROM OTHER SIMILAR CONTRACTS 3.12
- CONTRACT OF SALE HOW MADE (SECTION 5) 3.13
- SUBJECT MATTER OF CONTRACT OF SALE 3.14
- ASCERTAINMENT OF PRICE (SECTION 9 & 10) 3.14
- ***"PROBLEM KYA HAI? - UNIT 1"*** 3.15

UNIT-2 - CONDITIONS AND WARRANTIES

- STIPULATION AS TO TIME (SECTION 11) 3.23
- INTRODUCTION - CONDITIONS AND WARRANTIES 3.24
- DIFFERENCE BETWEEN CONDITIONS AND WARRANTIES 3.25
- WHEN CONDITION IS TO BE TREATED AS WARRANTY (SECTION 13) 3.25
- EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES (SECTION 14-17) 3.26
- CAVEAT EMPTOR 3.32
- ***"PROBLEM KYA HAI? - UNIT 2"*** 3.34

UNIT-3 - TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

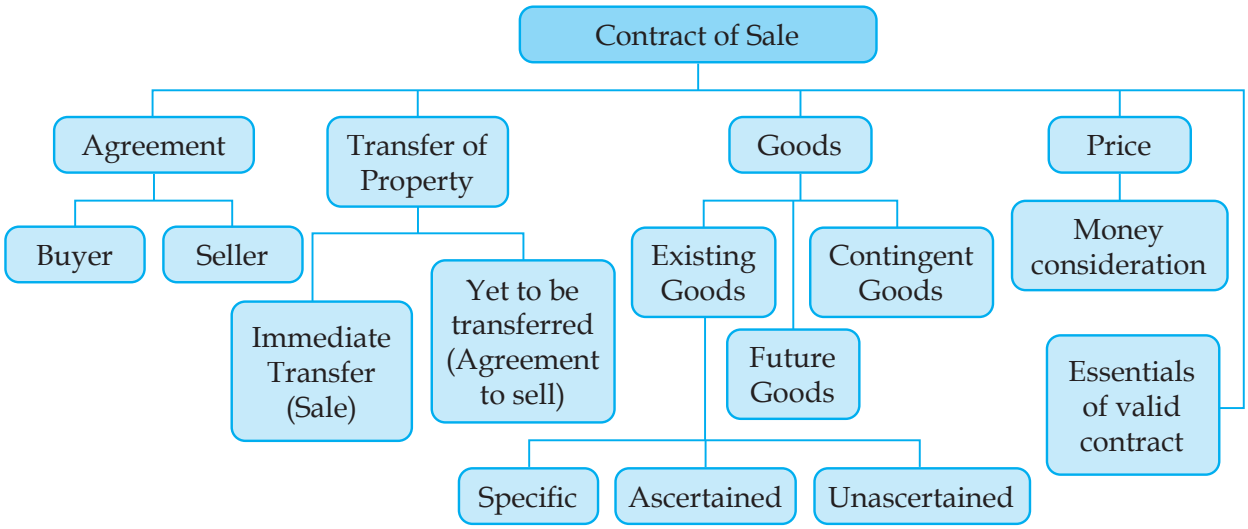
- INTRODUCTION 3.48
- PASSING OF PROPERTY (SECTIONS 18-26) 3.48
- SECTION 26 - RISK PRIMA FACIE PASSES WITH PROPERTY 3.53
- TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27-30) 3.54
- PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31-44) 3.57
- RULES REGARDING DELIVERY OF GOODS (SECTION 33-41) 3.58
- ***"PROBLEM KYA HAI? - UNIT 3"*** 3.61

UNIT 4 : UNPAID SELLER

- UNPAID SELLER 3.72
- RIGHTS OF AN UNPAID SELLER 3.73
- RIGHT OF UNPAID SELLER AGAINST THE GOODS 3.73
- RIGHTS OF UNPAID SELLER AGAINST THE BUYER (SECTIONS 55-61) 3.78
- REMEDIES OF BUYER AGAINST THE SELLER 3.79
- AUCTION SALE (SECTION 64) 3.80
- INCLUSION OF INCREASED OR DECREASED TAXES IN CONTRACT OF SALE (SECTION 64A) 3.81
- ***"PROBLEM KYA HAI? - UNIT 4"*** 3.81

UNIT 01

Formation of the Contract of Sale



- Deals with the laws relating to sale of goods in India.
- This Act is mainly based on **English Sale of Goods Act, 1893**.
- Before the Sale of Goods Act, 1930 - all the provisions relating to sale of goods was covered under the **Chapter VII of Indian Contract Act, 1872**.
- A strong need was felt to have an independent Sale of Goods Act and consequently a new act called the Sale of Goods Act, 1930 was passed.
- The Act came into force from **1st July 1930 and extends to whole of India**.

INTRODUCTION

- Sale is a typical bargain between the buyer and the seller.
- The Sale of Goods Act, 1930 allows the parties to modify the provisions of the law by express **stipulations** (Term to be explained in detail in Unit 2).
- However, in some cases, this freedom is severely restricted.
- Sale of Goods Act, 1930 is an **Act to define and amend the law** relating to the **sale of goods**.

SCOPE OF THE ACT

- Applicable to the contracts related to the sale of goods which means **movable properties**.
- The Act is **not applicable for the sale of immovable properties** like land, fields, shop or house etc.

- Sale of Goods Act, 1930 deals only with movable property.

The Indian Contract Act, 1872 and The Sale of Goods Act:

- The **general provisions** of the Indian Contract Act, 1872 apply to a Contract of Sale of Goods as far as **they are not inconsistent** with the express provisions of the Sale of Goods Act.
- The **expressions used but not defined** in the Sales of Goods Act, 1930 and defined in the Indian Contract Act, 1872 have the meanings **assigned to them in that Act**.

- The customs and usages will bind both the parties if these are reasonable and are known to the parties at the time of entering the contract of sale.

DEFINITIONS

A. Buyer and Seller

- '*Buyer*' means a person who buys or agrees to buy goods [Section 2(1)].
- '*Seller*' means a person who sells or agrees to sell goods [Section 2(13)].

The two term 'buyer' and 'seller' are complementary and represent the two parties to a contract of sale of goods.

Both the terms are, however, used in a sense wider than their common meaning.

Not only the person who buys but also the one who agrees to buy is a buyer. Similarly, a 'seller' means not only a person who sells but also a person who agrees to sell.

B. Goods and Other Related Terms

- "*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/separated from the land before sale or under the contract of sale. [Section 2(7)]

Actionable claims:

- Claims, which can be enforced only by an action or suit.
- Claim or debt that can be enforced through legal action.
- It typically involves a right to a future benefit or payment that is not secured by physical possession but can be claimed through a court.

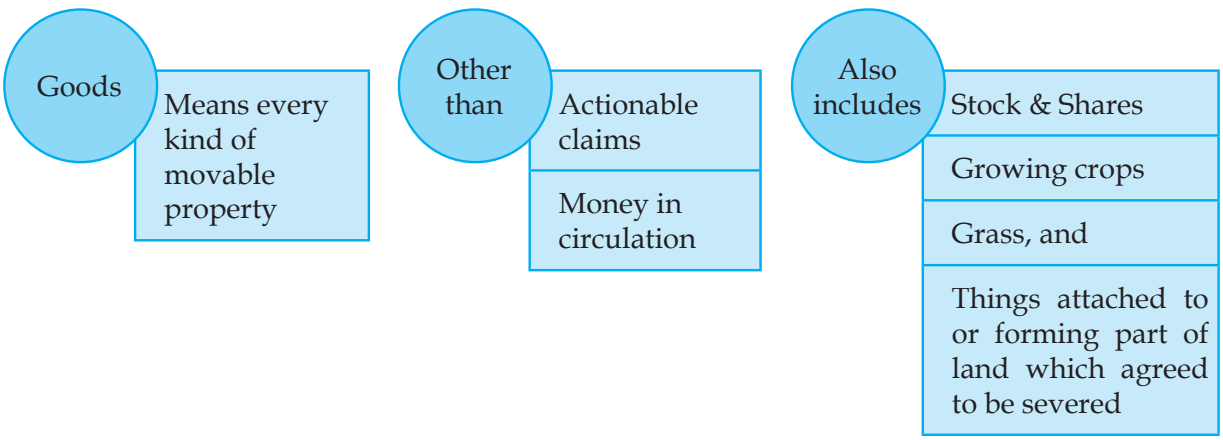
Example: A lends ₹10,000 to Person B. The loan agreement states that Person B will repay the amount in six months. During this period, Person A has an actionable claim against Person B for the repayment of ₹10,000. If Person B fails to repay, Person A can take legal action to enforce this claim and recover the debt.

Key characteristic of actionable claims: Uncertainty or condition attached to the claim that would require enforcement through legal action.

Item	Actionable Claim?
Unsecured debt	Yes
Future rent due from a tenant	Yes
Money deposited in a bank savings account	No

legal action)	No
Ownership of physical goods (e.g., a car)	No
Insurance policy proceeds (before maturity)	Yes
Beneficiary's right under a will	Yes
Dividend declared but not yet paid	Yes
Money owed for goods sold on credit	Yes

- "Goods" include both **tangible** goods and **intangible** goods like **goodwill**, **copyrights**, patents, trademarks etc.
- **Stock** and **shares**, **gas**, **steam**, **water**, **electricity** and **decree** of the court are also considered to be **goods**.
- Since the **decree** itself is enforceable directly & doesn't represent an uncertain or future right → NOT an actionable claim.



CLASSIFICATION OF GOODS

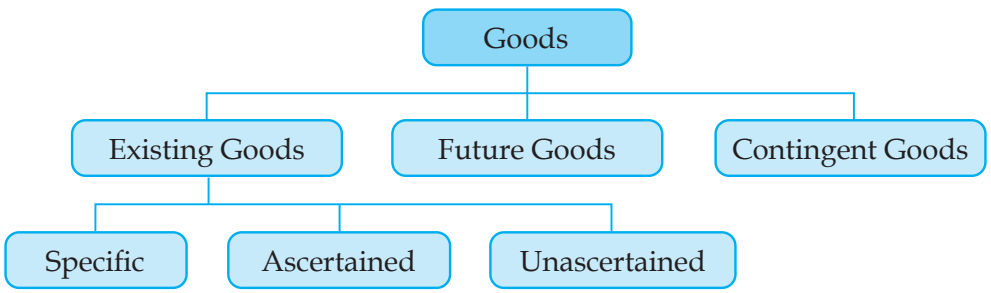
Type of Goods	Definition	Example
Existing Goods	Goods that are owned or possessed by the seller at the time of the contract of sale.	A laptop that a seller has in stock and is ready to sell immediately.
Future Goods	Goods that are yet to be manufactured, acquired, or produced by the seller at the time of the contract of sale.	A car that is yet to be manufactured or assembled, which will be delivered in a few months.
Contingent Goods	Goods that are subject to the occurrence or non-occurrence of a specific event before they can be sold.	A consignment of mangoes that will only be sold if they pass quality inspection upon arrival.

1. Existing Goods

- Goods which are in existence at the time of the contract of sale, those **owned** or **possessed** or **acquired** by the seller **at the time of contract of sale** (Section 6).

Type of Existing Goods	Description	Example
Specific Goods	Goods that are **identified** and **agreed** upon at the time of the contract.	A specific car with a unique number that a buyer agrees to purchase.
Ascertained Goods	Goods that are **identified out of a larger** set after the contract is made.	10 bags of rice selected from a stock of 100 bags.
Unascertained Goods	Goods that are **not specifically identified or agreed upon** at the time of the contract.	50 bags of wheat to be drawn from a large warehouse.

The existing goods may be of following kinds:



A. **Specific goods** mean goods identified and agreed upon at the time a contract of sale is made [Section 2(14)].

Example 1: Any specified and finally decided goods like a Samsung Galaxy S7 Edge, Whirlpool washing machine of 7 kg etc.

Example 2: 'A' had five cars of different models. He agreed to sell his 'Santro' car to 'B' and 'B' agreed to purchase the same 'Santro' car. In this case, the sale is for specific goods as the car has been identified and agreed at the time of the contract of sale.

B. **Ascertained Goods:**

(i) Which are identified in accordance with the agreement **after the contract of sale is made**.

(ii) This term is not defined in the Act but has been judicially interpreted.

(iii) In actual practice, the term 'ascertained goods' is used in the same sense as 'specific goods'.

(iv) **When out of 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.

Example 3: A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside. On selection, the goods become ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract. It may be noted that before the ascertainment of the goods, the contract was for the sale of unascertained goods.

C. **Unascertained goods are the goods:**

(i) **Which are not specifically identified or ascertained at the time of making of the contract.**

(ii) They are indicated or defined only by **description or sample**.

his shop, it is a sale of unascertained goods because it is not known which packet is to be delivered. As soon as a particular packet is separated from the lot, it becomes ascertained or specific goods.

Example 5: X has ten horses. He promises to sell one of them but does not specify which horse he will sell. It is a contract of sale of unascertained goods.

2. Future Goods

- Goods to be manufactured or produced or acquired by the seller **after making the contract of sale** [Section 2(6)].
- **A contract for the sale of future goods is always an agreement to sell.**
- It is **never actual sale** because a person cannot transfer what is not in existence.

Example 6: 1,000 quintals of potatoes to be grown on A's field is an example of agreement to sell.

Example 7: P agrees to sell to Q all the milk that his cow may yield during the coming year. This is a contract for the sale of future goods.

Example 8: 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'.

3. Contingent Goods

- The acquisition of goods which depends upon an **uncertain contingency (uncertain event)**.
- Contingent goods also operate as **'an agreement to sell'** and not a 'sale' so far as the question of passing of property to the buyer is concerned.
- In other words, like the future goods, in the case of contingent goods also, **the property does not pass to the buyer at the time of making the contract**.

Example 9: A agrees to sell to B a Picasso painting provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

Example 10: P contracts to sell 50 pieces of particular article provided the ship which is bringing them reaches the port safely. This is an agreement for the sale of contingent goods.

DELIVERY - ITS FORMS AND DERIVATIVES

- Delivery means **voluntary transfer of possession** from one person to another [Section 2(2)].
- 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.

Forms of delivery:

Voluntary Transfer of Possession by One Person to Another		
Actual delivery	Constructive delivery	Symbolic delivery

1. **Actual delivery:**
   - When the goods are physically delivered to the buyer.
   - Actual delivery takes place when the seller transfers the physical possession of the goods to the buyer or to a third person authorised to hold goods on behalf of the buyer.
   - This is the most common method of delivery.

- When transfer of goods is effected without any change in the custody or actual possession of the thing as in the case of delivery by attornment (acknowledgement)

  Example 11: Where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request

- Constructive delivery takes place when a person in possession of the goods belonging to the seller acknowledges to the buyer that he holds the goods on buyer's behalf.

3. **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.
   - **Where actual delivery is not possible**, there may be delivery of the means of getting possession of the goods.

     Goods are said to be in a deliverable state when they are in such a condition that the buyer would, under the contract, be bound to take delivery of them [Section 2(3)].

     Example 12: When A contracts to sell timber and make bundles thereof, the goods will be in a deliverable state after A has put the goods in such a condition.

C. Document of Title to Goods

- **Includes:**
  (i) bill of lading,
  (ii) dock-warrant,
  (iii) warehouse keeper's certificate,
  (iv) wharfingers' certificate,
  (v) railway receipt,
  (vi) multimodal transport document,
  (vii) warrant or

  order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods or is for authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented. [Section 2(4)].

  Example 13: Bill of lading, dock warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, warrant, an order of delivery of goods.

- The list is only **illustrative** and not **exhaustive**. Any other **document** which has the **above characteristics** also will fall under the **same category**.
- Though a bill of lading is a document of title, a mate's receipt is not; it is regarded at law as merely an acknowledgement for the receipt of goods.
- **Document of Title:** Must show an unconditional promise to deliver goods to the holder.

Document showing title VS Document of title

- A share certificate is a 'document' showing title but not a document of title.

by it, but it does not allow that person to transfer the share mentioned therein by mere endorsement on the back of the certificate and the delivery of the certificate.

D. Mercantile Agent [Section 2(9)]

- It means an agent who in the customary course of business has, as such agent, authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of the goods.
- Mercantile agent can borrow money by pledging the goods.

Example 14: Such kind of agents are auctioneers or brokers, etc.

E. Property [Section 2(11)]

- 'Property' here means 'ownership' or general property.
- In every contract of sale, the ownership of goods must be transferred by the seller to the buyer, or there should be an agreement by the seller to transfer the ownership to the buyer.
- It means the general property (right of ownership-in-goods) and not merely a special property.

Aspect	General Property	Special Property
Definition	Full ownership rights.	Limited rights, often conditional.
Scope	Complete rights, including transfer and sale.	Specific rights, not full ownership.
Example	Owning a car.	Pledged item (e.g., pawned goods).
Transferability	Can be fully transferred.	Transfer of special rights doesn't affect general ownership.
Legal Rights	Total control and responsibility.	Control limited to specific conditions.

Now let's understand the concept with an example of Pledge:

Example 15: If A who owns certain goods pledges them to B, A has general property in the goods, whereas B has special property or interest in the goods to the extent of the amount of advance he has made. In case A fails to repay the amount borrowed on pledging the goods, then B may sell his goods but not otherwise.

Aspect	General Property (Pledgor)	Special Property (Pledgee)
Rights	Full ownership rights, can sell or transfer.	Limited rights, can retain the property until loan repayment.
Example	Owner of the gold necklace.	Lender holding the gold necklace as security.
Transferability	Can transfer ownership, including the pledged item.	Cannot transfer ownership, only retains possession for security.

F. Insolvent

- A person is said to be insolvent when he ceases to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not.

G. Price

- Price means the money consideration for a sale of goods.
- It is the value of goods expressed in monetary terms.

H. Quality of Goods includes their State or Condition [Section 2(12)]

SALE AND AGREEMENT TO SELL (SECTION 4)

- **Contract of Sale (Section 4(1)):** A contract where the seller transfers or agrees to transfer ownership of goods to the buyer for a price. It can even occur between part-owners.
- **Types of Contracts (Section 4(2)):**
  - **Sale:** When ownership of goods is **immediately** transferred from seller to buyer.
  - **Agreement to Sell:** When ownership is set to transfer at a **future date** or upon fulfilling certain conditions.
- **Conversion (Section 4(4)):** An agreement to sell turns into a sale when the **agreed time passes or conditions are met**.
- **Sale:**
  - Property in goods is transferred immediately from seller to buyer.
  - A sale occurs when the property in goods is transferred under a contract.
- **Agreement to Sell:**
  - Ownership of goods is not transferred immediately.
  - Transfer is intended at a future date or upon completion of certain conditions.
  - An agreement to sell is when the transfer is to take place later or after fulfilling conditions.
- **Key Distinction:**
  - A contract is a sale if it involves immediate transfer.
  - It is an agreement to sell if the transfer is set for a future time.
- **When Agreement to Sell Becomes a Sale:** An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled for the transfer of property.
- Whether a contract of sale of goods is an absolute sale or an agreement to sell, _____ ???
  Depends on the fact whether it contemplates immediate transfer from the seller to the buyer or the transfer is to take place at a future date.

Example 16: X agrees with Y on 10th October, 2022 that he will sell his car to Y on 10th November, 2022 for a sum of ₹7 lakhs. It is an agreement to sell.

elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

- **The following Elements:** Must co-exist so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930:

Element	Explanation
Two Parties	Must be a seller and a buyer (different persons).
Goods	Subject matter must be movable property (existing or future goods).
Price	Consideration must be in money (can be partly money and partly in kind).
Transfer of Property	Ownership must be transferred from seller to buyer.
Absolute or Conditional	Contract can be absolute or conditional.
Contract Essentials	Must include all elements of a valid contract (free consent, legality, etc.).

DISTINCTION BETWEEN SALE AND AN AGREEMENT TO SELL

The differences between the two are as follows:

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 means right against the whole world.	Creates Jus in personam means rights against a particular party to the contract
Right of resale	The seller cannot resell the goods.	The seller may sell the goods since ownership is with the seller.
In case of insolvency of seller	The official assignee will not be able to take over the goods but will recover the price from the buyer.	The official assignee will acquire control over the goods but the price will not be recoverable.
In case of insolvency of buyer	The official assignee will have control over the goods.	The official assignee will not have any control over the goods.

Aspect	Sale	Bailment	Hire Purchase
Ownership	Ownership transfers immediately to the buyer.	Ownership docs not transfer, only possession does.	Ownership transfers after the final installment is paid.
Possession	Possession and ownership are transferred.	Only possession is transferred; ownership remains with the bailor.	Possession is transferred immediately, ownership later.
Consideration	One-time payment or full payment is made.	No payment for ownership; only for the use or care of goods.	Payment is made in installments until full ownership.
Termination	No option for termination by buyer after sale.	Bailee can terminate by returning goods to bailor.	Buyer can terminate anytime before ownership transfer.
Purpose	To own the goods.	To use, store, or care for the goods.	To eventually own the goods after paying in installments.
Risk	Buyer bears the risk after sale.	Risk generally remains with the owner (bailor).	Buyer bears the risk once they take possession.

1. Sale and Hire Purchase

- Hire purchase agreements are governed by the Hire-purchase Act, 1972.
- An agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which—
  - **(a) Delivery:** The owner gives possession of goods to someone on the condition that they pay in installments.
  - **(b) Transfer of Ownership:** Ownership passes to the person only after they pay the final installment.
  - **(c) Right to Cancel:** The person can end the agreement anytime before they gain ownership.

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 instalment.
Position of the party	The position of the buyer is that of the owner of the goods.	The position of the hirer is that of a bailee till he pays the last instalment.
Termination of contract	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 instalments.
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 instalment, the owner has right to take back the goods.

Transfer of title	a bona fide purchaser from him.	to a bona fide purchaser untill he pays the last instalment.
Resale	The buyer in sale can resell the goods.	The hire purchaser cannot resell unless he has paid all the instalments.

2. Sale and Bailment

Basis of Difference	Sale	Bailment
Transfer of property	The property in goods is transferred from the seller to the buyer. So, it is transfer of general property.	There is only transfer of possession of goods from the bailor to the bailee for any of the reasons like safe custody, carriage etc. So, it is transfer of special property.
Return of goods	The return of goods in contract of sale is not possible.	The bailee must return the goods to the bailor on the accomplishment of the purpose for which the bailment was made.
Consideration	The consideration is the price in terms of money.	The consideration may be gratuitous or non-gratuitous.

3. Sale and Contract for Work and Labour

(a) A contract of sale of goods is one in which some goods are sold or are to be sold for a price.

(b) But where no goods are sold, and there is only the doing or rendering of some work of labour, then the contract is only of work and labour and not of sale of goods.

Example 17: Where gold is supplied to a goldsmith for preparing an ornament or when an artist is asked to paint a picture. Here, the basic substance of the contract is the exercise of skill and labour, therefore it is contract for work and labour.

CONTRACT OF SALE HOW MADE (SECTION 5)

Mode	Description
Offer and Acceptance	The sale begins with an offer to buy or sell goods for a price and the acceptance of that offer.
Immediate Delivery	Goods arc delivered immediately, but payment may be deferred.
Immediate Payment, Future Delivery	Payment is made immediately, but delivery is scheduled for a future date.
Immediate Delivery and Payment	Both goods are delivered and payment is made immediately.
Delivery or Payment in Installments	Delivery, payment, or both are done in installments.
Future Delivery or Payment	Delivery', payment, or both are scheduled for a future date.

Example 18: R agrees to deliver his old motorcycle valued at ₹55,000 to S in exchange for a new motorcycle and agrees to pay the difference in cash, it is a Contract of Sale.

Existing or future goods (section 6):

1. The goods which form the subject matter of a contract of sale:
   (i) may be either existing goods that are acquired, owned or possessed by the seller, or
   (ii) future goods.
2. There may be a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen.

   Example 19: A contract for sale of certain cloth to be manufactured by a certain mill is a valid contract. Such contacts are called contingent contracts.

3. There may be a contract of sale - where the seller purports to effect
   (i) a present sale of future goods,
   (ii) such contract operates as an agreement to sell the goods.

Goods Perishing and Contract Void

- **Before Contract (Section 7):** If specific goods perish or get damaged (unbeknownst to the seller) before a sale contract is made, the contract is void.
- **Before Sale but After Agreement (Section 8):** If specific goods perish or get damaged (without fault of buyer/seller) after an agreement but before the risk passes to the buyer, the agreement becomes void.
- **Future Goods Perishing:** If future specific goods perish, the contract becomes void due to supervening impossibility.

Example 20: A agrees to sell B 50 bags of wheat stored in the A's godown. Due to water logging, all the goods stored in the godown were destroyed. At the time of agreement, neither parties were aware of the fact. The agreement is void.

Example 21: A agrees to sell B 100 tons of tomatoes grown on his land next year. But the crop failed due to some disease in plants and A could only deliver 80 tons of tomatoes to B. It was held A was not liable as the performance of contract became impossible due to supervening impossibility.

ASCERTAINMENT OF PRICE (SECTION 9 & 10)

Ascertainment of Price (Section 9)

- Price can be **fixed in the contract**.
- Price can be **agreed to be fixed** later (e.g., by a valuer).
- Price can be **determined by previous dealings** between the parties.

Agreement to Sell at Valuation (Section 10)

Section 10 provides for the determination of price by a third party.

1. If a third party is to set the price but doesn't or can't, the agreement is void.
2. If a party prevents the third party from setting the price, that party is liable for damages.
3. If the buyer has already received and used the goods, they must pay a reasonable price regardless.

Example 22: P is having two bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price. As such P ask S to return the bike already delivered while S claims for the delivery of the second bike too. In the given instance, buyer S shall pay reasonable price to P for the bike already taken. As regards the Second bike, the contract can be avoided as the third party Q refuses to fix the price

"PROBLEM KYA HAI? - UNIT 1"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - SOGA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. A agrees to buy a new TV from a shop keeper for ₹30,000 payable partly in cash of ₹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)**

Ans. 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 ₹30,000 and the price is payable partly in exchange of old TV set and partly in cash of ₹20,000. So, in this case, it is a valid contract of sale under the Sales of Goods Act, 1930.

2. 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)**

Ans. 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:

1. There is an agreement to sell between A and B.
2. It is related to specific goods.
3. The goods are lost because of the sinking of ship before the property or risk passes to the buyer.
4. The loss of goods is not due to the fault of either party.

3. 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? **(Module)**

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:

1. There is an agreement to sell between A and B.
2. It is related to specific goods.
3. The goods are lost because of the sinking of ship before the property or risk passes to the buyer.
4. The loss of goods is not due to the fault of either party.

MTPs, RTPs AND PYQPs QUESTIONS

1. Classify the following transactions according to the types of goods they are:

1. A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside.
2. A agrees to sell to B one packet of sugar out of the lot of one hundred packets lying in his shop.
3. T agrees to sell to sell the apples which will be produced in his garden this year.

(RTP May'22)(SM) (MTP Apr' 23 4 Marks)

Ans.

1. A wholesaler of cotton has 100 bales in his godown. So, the goods are existing goods. He agrees to sell 50 bales and these bales were selected and set aside. On selection, the goods become ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract.
2. If A agrees to sell to B one packet of sugar out of the lot of one hundred packets lying in his shop, it is a sale of existing but unascertained goods because it is not known which packet is to be delivered.
3. T agrees to sell to S all the apples which will be produced in his garden this year. It is contract of sale of future goods, amounting to 'an agreement to sell.

2. Avyukt purchased 100 Kgs of wheat from Bhaskar at 730 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. **(RTP May'23)**

Ans. 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.

transferred through constructive delivery. Hence, Avyukt is not right. He cannot claim the price back.

3. State the difference between Sale and Agreement to sell. **(RTP May'23)**

Ans. Not given

4. What are the consequences of the destruction of specified goods, before making of contract and after the agreement to sell under the Sale of Goods Act, 1930.

(RTP Nov'23) (PYQ May 22 4 Marks)

Ans. **Goods perishing before making of Contract (Section 7 of the Sale of Goods Act, 1930):**

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.

Goods perishing before sale but after agreement to sell (Section 8 of the Sale of Goods Act, 1930):

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 or becomes void.

5. Shubhangi went to a Jewellery shop and asked the salesgirl to show her diamond necklace with Sapphire stones. The Jeweller told her that we have a lot of designs of diamond necklace but with blue stones. If she chooses for herself any special design of diamond necklace with blue stones, they will replace blue stones with Sapphire stones. But for the Sapphire stones they will charge some extra cost.

Shubhangi selected a beautiful designer necklace and paid for it. She also paid the extra cost of Sapphire stones. The Jeweller requested her to come back a week later for delivery of that necklace.

When she came after a week to take delivery of necklace, she noticed that due to Sapphire stones, the design of necklace had 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.

1. State with reasons whether Shubhangi can recover the amount from the Jeweller.
2. What would be your answer if Jeweller says that he can change the design, but he will charge extra cost for the same?

(RTP Nov'23) (MTP Nov'22 6 Marks) (PYQ May'22 6 Marks)

Ans. 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.

1. On the basis of above provisions and facts given in the question, it can be said that there is an agreement to sell between Shubhangi and Jeweller and not a sale. Even though the

the fulfilment of conditions fixed between the buyer and the seller. As due to Sapphire Stones, the original design is disturbed, necklace is not in original position. Hence, Shubhangi has right to avoid the agreement to sell and can recover the price paid.

2. If Jeweller offers to bring the necklace in original position by repairing, he cannot charge extra cost from Shubhangi. Even though he has to bear some expenses for repair; he cannot charge it from Shubhangi.

6. Mr. Arun contracted to sell his swift car to Mr. Nikhil. Both missed to discuss the price of the said swift car. Later, Mr. Arun refused to sell his swift car to Mr. Nikhil on the ground that the agreement was void, being uncertain about the price. Does Mr. Nikhil have any right againstMr. Arun under the Sale of Goods Act, 1930? **(RTP Jun'24) (PYQ Jun'23 4 Marks)**

Ans. 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 a manner thereby agreed or may be determined by the course of dealing between the parties.

Even though both the parties missed discussing 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. Arun and Mr. Nikhil have entered into a contract for the sale of a swift car, but they did not fix the price of the same. Mr. Arun refused to sell the car to Mr. Nikhil on this ground. Mr.

Nikhil can legally demand the car from Mr. Arun and Mr. Arun can recover a reasonable price for the car from Mr. Nikhil.

7. 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 Jun 22 6 Marks)

Ans. 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.

(MTP Nov'22 6 Marks)

Ans. **Delivery - its forms:** Delivery means voluntary transfer of possession from one person to another [Section 2(2) of the Sale of Goods Act, 1930]. 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.

Forms of delivery: Following are the kinds of delivery for transfer of possession:

1. **Actual delivery:** When the goods are physically delivered to the buyer. Actual delivery takes place when the seller transfers the physical possession of the goods to the buyer or to a third person authorised to hold goods on behalf of the buyer. This is the most common method of delivery.
2. **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). Constructive delivery takes place when a person in possession of the goods belonging to the seller acknowledges to the buyer that he holds the goods on buyer's behalf.
3. **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. Where actual delivery is not possible, there may be delivery of the means of getting possession of the goods.

9. Ram Bilas Yadav is a farmer. Anna Chips Company approached him and entered in a contract to supply 100 quintals of potatoes which to be grown in the fields belonging to Ram Bilas Yadav @₹1000/- per quintal. Anna Chips Company made the payment of price but delivery to be made after six months.

Before the time of delivery, the whole crop of potatoes was destroyed due to flood. Anna Chips Company demanded the payment of price which is already made by it. Ram Bilas Yadav denied returning the price by saying that contract of sale was already entered and hence crop belongs to Anna Chips Company. Hence loss of crop must be borne by it. Referring to the provisions of the Sale of Goods Act, 1930, whether Anna Chips Company recover amount from Ram Bilas Yadav? **(MTP Nov'23 6 Marks)**

Ans. 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.

Further Section 2(6) defines "future goods" means goods to be manufactured or produced or acquired by the seller after making of the contract of sale.

In the instant case, on the basis of above provisions and facts, it can be said that there was an agreement to sell between Ram Bilas Yadav and Anna Chips Company because the goods under agreement was future goods. Even the payment was made by Anna Chips Company, the property in goods can be transferred only after the goods is ascertained. As the goods was not ascertained, property is not passed to buyer. Hence, Ram Bilas Yadav must return the price to Anna Chips Company.

dealer in pre-owned cars. The sales manager of "Car Wala 007" showed him three cars which were standing in the parking lane just outside the office. Samar finalised red Wagon R car. After completing the documenting formalities and receiving the price of car, sales manager of "Car Wala 007" handed over the key of car to Samar. But when Samar was coming to parking area for picking the car, the electric poll fell on the car which badly damaged the car. Samar claimed that repair expenses of the car should be borne by "Car Wala 007" as car was not delivered to him. Referring to the provisions of the Sales of Goods Act 1930, state who will be liable to get the car repaired? **(MTP Dec'23 6 Marks)**

Ans. According to 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.**

Symbolic delivery 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.

In the instant case, Samar purchased a pre-owned car from "Car Wala 007" which was standing in the parking lane just outside of office. After completing the documenting formalities, he received the key of car from sales manager of "Car Wala 007". But when he was coming to parking area for picking the car, the car which badly damaged due to fall of the electric poll on the car.

On the basis of above provisions and facts, it is clear that handing over the key of car is the symbolic delivery of car. Hence, Samar being owner of the car must bear the repair expenses of car.

11. Distinguish between Sale' and 'Hire Purchase' under the Sale of Goods Act, 1930. **(PYQ Dec' 21 6 Marks)**

Ans. Not given

12. Discuss the essential elements regarding the sale of unascertained goods and its appropriation as per the Sale of Goods Act, 1930. **(PYQ Nov'22 4 Marks)**

Ans. **Sale of unascertained goods and Appropriation:**

Where there is a contract for the sale of unascertained goods by description and goods of that description are in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer.

Whereas, Appropriation of goods involves selection of goods with the intention of using them in performance of the contract and with the mutual consent of the seller and the buyer.

The essentials elements are:

(a) There is a contract for the sale of unascertained or future goods.

(b) The goods should conform to the description and quality stated in the contract.

(c) The goods must be in a deliverable state.

(d) The goods must be unconditionally (as distinguished from an intention to appropriate) appropriated to the contract either by delivery to the buyer or his agent or the carrier.

(e) The appropriation must be made by:

  (i) the seller with the assent of the buyer; or

  (ii) the buyer with the assent of the seller.

(g) The assent may be given either before or after appropriation.

13. State briefly the essential element of a contract of sale under the Sale of Goods Act, 1930. **(RTP May 21)**

Ans. **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

1. There must be at least two parties.
2. The subject matter of the contract must necessarily be goods.
3. A price in money (not in kind) should be paid or promised.
4. A transfer of property in goods from seller to the buyer must take place.
5. A contract of sale must be absolute or conditional [Section 4(2)].
6. All other essential elements of a valid contract must be present in the contract of sale.

14. 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

1. State with reasons whether Archika can recover the amount under the Sale of Goods Act, 1930.
2. 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)**

Ans. 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

1. 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
2. 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

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)**

Ans. 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 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.

16. Explain the term "Delivery and its forms" under the Sale of Goods Act, 1930.
(MTP 4 Marks, Apr'21)

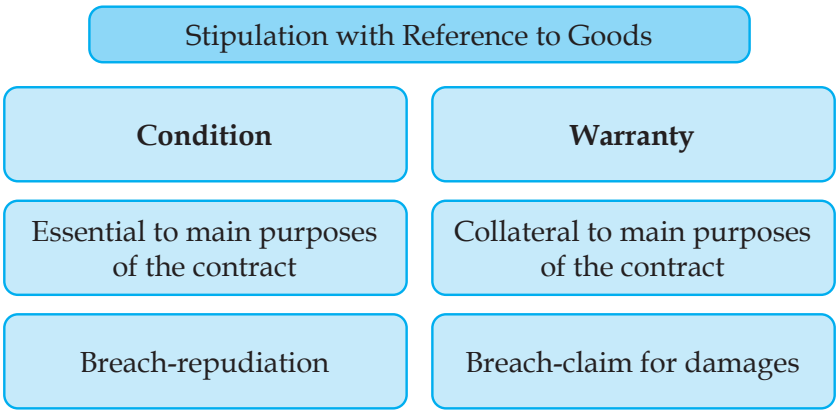
Ans. **Delivery - its forms and derivatives:** Delivery means voluntary transfer of possession from one person to another [Section 2(2) of the Sale of Goods Act, 1930]. As a general rule, delivery of goods may be made by doing anything, which has the effect of putting the goods in the possession of the buyer, or any person authorized to hold them on his behalf.

Forms of delivery: Following are the kinds of delivery for transfer of possession:

1. **Actual delivery:** When the goods are physically delivered to the buyer.
2. **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.
3. **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.

UNIT 02

Conditions and Warranties



- **Let's understand the word "Stipulation"**

  अनुबंध या शर्त

STIPULATION
A representation which forms a part of the contract of sale and affects the contract.
However, every stipulation is not of equal importance.
Some of these may be very vital while others may be of somewhat lesser significance.
CONDITIONS
The more significant stipulations contained in a contract of sale of goods.
WARRANTIES
The less significant stipulation have been given the name "Warranties".

STIPULATION AS TO TIME (SECTION 11)

- **Time for Payment:** Unless the contract states otherwise, **the timing of payment is generally not** considered critical in a contract of sale.
- **Delivery of Goods: Delivery must be made without delay.** The importance of delivery timing depends on the terms agreed upon in the contract.
- **Price Fixing:** The price may be set in the contract or agreed to be determined later in a specific way.
- **Time of Delivery: Usually, the timing of delivery is crucial in the contract.**

- At the time of selling the goods, a seller usually makes **certain statements or representations** with a view to induce the intending buyer to purchase the goods.
- Such representations are generally about the **nature and quality of goods**, and about their **fitness** for buyer's purpose.
- **When** these statements or representations **do not form** a part of the contract of sale, **they are not relevant** and **have no legal effects** on the contract.
- But **when these form part** of the contract of sale and the **buyer relies** upon them, they are **relevant** and have **legal effects** on the contract of sale.

Condition and warranty (Section 12)

1. A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.
2. **Condition - (2)**
   - 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

   Example 1: P wants to purchase a car from Q, which can have a mileage of 20 km/litre. Q pointing at a particular vehicle says "This car will suit you". Later P buys the car but finds out later on that this car only has a top mileage of 15 km/litre. This amounts to a breach of condition because the seller made the stipulation which forms the essence of the contract. In this case, the mileage was a stipulation that was essential to the main purpose of the contract and hence its breach is a breach of condition.
3. **Warranty - (3)**
   - 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
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 2: Ram consults Shyam, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Shyam suggests 'Maruti' and Ram accordingly buys it from Shyam. The car turns out to be unfit for touring purposes. Here, the term that the 'car should be suitable for touring purposes' is a condition of the contract. It is so vital that its 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.

   Example:
   - Ram buys a new Maruti car with a one-year warranty against manufacturing defects.
   - Six months later, the horn stops working.
   - Ram cannot cancel the contract but can have the horn repaired or replaced under the warranty.
   - He can also claim damages if he suffered any loss, but he doesn't have the right to cancel the purchase.

Point of Differences	Condition	Warranty
Meaning	A condition is a stipulation essential to the main purpose of the contract.	A warranty is a stipulation collateral to the main purpose of the contract.
Right in case of breach	The aggrieved party can repudiate the contract or claim damages or both in the case of breach of condition.	The aggrieved party can claim only damages in case of breach of warranty.
Conversion of stipulations	A breach of condition may be treated as a breach of warranty.	A breach of warranty cannot be treated as a breach of condition.

WHEN CONDITION IS TO BE TREATED AS WARRANTY (SECTION 13)

थी तो condition पर अब warrranty मानेंगे → contract को ख़त्म करने का right गया अब बस damages

- Section 13 specifies cases where a breach of condition be treated as a breach of warranty. As a result of which the buyer loses his right to rescind the contract and can claim damages only.
- A contract is not avoided even on account of a breach of a condition:

(a) Where the **buyer altogether waives** the **performance of the condition**. A party may for his own benefit, waive a stipulation. It should be a **voluntary waiver by buyer**.

(b) Where the **buyer elects** to **treat** the **breach** of the conditions, as one of a **warranty**. That is to say, he may **claim only damages instead of repudiating** the contract. Here, the buyer has not waived the condition but decided to treat it as a warranty.

Example 3: A agrees to supply B 10 bags of first quality sugar @ ₹625 per bag but supplies only second quality sugar, the price of which is ₹600 per bag. There is a breach of condition and the buyer can reject the goods. But if the buyer so elects, he may treat it as a breach of warranty, hence he may accept the second quality sugar and claim damages @ ₹25 per bag.

(c) Where the contract is **non-severable** and the **buyer** has **accepted** either the **whole** goods or any **part** thereof.

For Eg. If basmati rice and lower quality rice mixed together, the contract becomes non severable.

(d) Where the fulfilment of any condition or warranty is **excused by law** by **reason of impossibility or otherwise**.

Scenario	Outcome	Key Point	Example
Buyer Waives Condition	Buyer chooses to ignore the issue	Condition is not enforced.	Ram buys a phone with a tiny scratch and decides to keep it as it is.
Treating Condition as Warranty	Buyer asks for a fix or compensation	No contract cancellation.	Shyam buys a bike with a small paint flaw and asks for a discount instead of returning it.
Non-Severable Contract	Buyer keeps all or part of the goods	Contract stays valid.	Sita buys a mix of good and lower quality rice and keeps the whole batch.
Excused by law	Issue is out of everyone's control	Condition is excused.	Ramesh orders goods from abroad, but they get delayed due to customs rules.

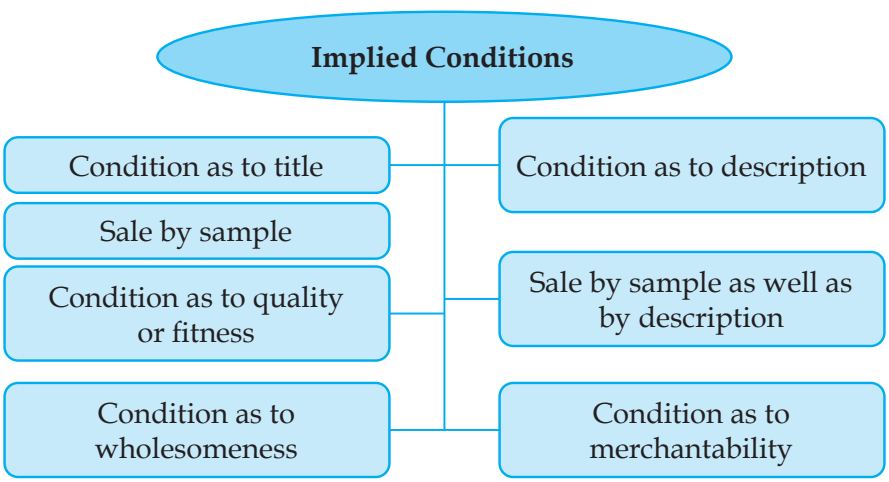
Voluntary Waiver
- Waives performance of contract
- Elect to treat condition as warranty

Compulsory Waiver
- Non-severability of contract
- Fulfilment of condition excused by law

EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES (SECTION 14-17)

'Conditions' and 'Warranties' may be either express or implied.

- **Express conditions:** Which are agreed upon between the parties at the time of contract and are expressly provided in the contract.
- **Implied conditions:** Implied conditions are incorporated by law in the contract of sale. Those, which are presumed by law to be present in the contract. It should be noted that an implied condition may be negated or waived by an express agreement.
- Following conditions are implied in a contract of sale of goods **unless the circumstances of the contract show a different intention**.



KEY TABLE for IMPLIED CONDITIONS

Section	Condition	Simplified Explanation	Example
Section 14 Condition as to Title	Seller's Right to Sell	The seller must legally own the goods at the time of sale. If not, the buyer can return the goods and get a refund.	***Example 4:*** *A buys a tractor from B. If B doesn't own it and the real owner asks for it back, A can get a refund from B.*
Section 15: Sale by Description	Goods Must Match Description	The goods sold must match the agreed description. If not, the buyer can reject them.	***Example 5:*** *A sells B "waste silk". If it's not waste silk, B can reject the goods.*

by Sample	Must Match Sample	the sample provided.	*of wheat but the larger parcel differs. B can reject it.*
Section 15: Sale by Sample & Description	Must Match Both	Goods must match both the sample and description.	***Example 7:*** *Shoes sold for the French Army match the sample but not the description. The buyer can get a refund.*
Section 16(1): Condition as to Quality/Fitness	Fit for Purpose	Goods should be fit for the buyer's stated purpose if the seller was informed and relied on.	***Example 8:*** *A buys false teeth from B, but they don't fit. A can return them and get a refund.*
Section 16(2): Condition as to Merchantability	Goods Must Be Merchantable	Goods should be of a quality that a reasonable person would accept.	***Example 9:*** *Scratched motor horns due to poor packing can be rejected as unmerchantable.*
Condition as to Wholesomeness	Fit for Consumption	In the case of food, it must be safe to consume.	***Example 10:*** *A supplies milk with germs. F's wife gets sick. A must pay damages.*

1. **Section 14 (a) - Condition as to title:** Unless there is an agreement to the contrary, the first implied condition on the part of the seller-

   Seller's Right to Sell:

   (a) The seller must have the **right to sell the goods at the time of sale**.

   (b) In the case of an **agreement to sell**, he will have right to sell the goods at the time **when the property is to pass**.

   (c) If the seller's ownership is **defective**, the buyer must **return** the goods to the true owner and **recover the purchase price**.

   Example 11: *A buys a tractor from B, who doesn't own it. The true owner demands the tractor back, and A can sue B, the seller without title, for the refund and recovery of the purchase price.*

   Example 12: *If A sells to B tins of condensed milk labelled 'C.D.F. brand', and this is proved to be an infringement of N Company's trade mark, it will be a breach of implied condition that A had the right to sell. B in such a case will be entitled to reject the goods or take off the labels, and claim damages for the reduced value. If the seller has no title and the buyer has to make over the goods to the true owner, he will be entitled to refund of the price.*

2. **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.

     If you agree to buy peas, the seller can't make you take beans instead.
   - The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods.
   - **Importance of Description:** The description is **key to identifying the goods**. If the goods don't match the description, it's a breach of condition.
   - **Determine this first:**

     Whether the description was essential for identifying the goods where the buyer had agreed to purchase.

would be breach of condition **entitling the buyer to reject the goods**.

- The buyer can reject the goods if they don't match the description, **even if they didn't inspect them beforehand**.

> ***Example 13: Waste Silk:*** *A sells B twelve bags of "waste silk." If the goods aren't actually waste silk, B can reject them.*
>
> ***Example 14: Copper-Fastened Ship:*** *A ship sold as "copper-fastened" is only partly copper-fastened. The buyer can reject it or claim damages because it doesn't match the description.*

- The Act, however, does not define 'description'.
  - (a) where the class or kind to which the goods belong has been specified, e.g., 'Egyptian cotton', "java sugar", etc., defining the category of good
  - (b) where the goods have been described by certain characteristics essential to their identification, e.g., jute bales of specified shipment, steel of specific dimension, etc.
- **Understanding 'Description':**
  - **Class/Kind:** The description might specify the class or kind of goods, like "Egyptian cotton" or "Java sugar".
  - **Characteristics:** The description might include specific characteristics like the size, origin, or packaging of the goods.
  - **Fact-Based:** Whether the description is essential to identifying the goods depends on the contract and the facts of the case.

3. **Sale by sample [Section 17]:** In a contract of sale by sample, there is an implied condition that-

(a) the **bulk** shall **correspond** with the **sample** in quality;

(b) the buyer shall have a **reasonable opportunity** of **comparing** the **bulk** with the sample

> ***Example 15:*** *In a case of sale by sample of two parcels of wheat, the seller allowed the buyer an inspection of the smaller parcel but not of the larger parcel. In this case, it was held that the buyer was entitled to refuse to take the parcels of wheat.*

(c) the goods shall be-

- **Free** from any **defect** rendering them **un-merchantable**, which would not be apparent on reasonable examination of the sample.
- This condition is by an ordinary examination of the goods.
- If the defects are latent, then the buyer can avoid the contract.
- This simply means that the goods shall be **free from any latent defect i.e. a hidden defect**.

> ***Example 16:*** *A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of the price plus damages.*

4. **Sale by sample as well as by description [Section 15]:**
   - Where the goods are sold by sample as well as by description the implied condition is that the **bulk** of the goods supplied shall **correspond both with the sample and the description**.
   - In case the goods correspond with the sample **but do not tally** with **description or vice versa or both, the buyer can repudiate the contract**.

Example 17: A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of the price plus damages.

5. **Condition as to quality or fitness [Section 16(1)]:** Ordinarily, there is no implied condition as to the quality or fitness of the goods sold for any particular purpose.
   - However, the condition as to the reasonable fitness of goods for a particular purpose may be implied - **if the buyer had made known to the seller** the **purpose** of his purchase and **relied** upon the **skill** and **judgment** of the **seller** to select the **best** goods and the seller has ordinarily been dealing in those goods.
   - This implied condition will not apply if the goods have been sold under a trademark or a patent name.
   - There is implied condition of the part of the seller that the goods supplied - **shall be reasonably fit for the purpose** for which the buyer wants them, provided the following conditions are fulfilled:
     (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 some cases, the purpose may be ascertained from the conduct of the parties or from the nature of the goods sold.
   - Where the goods can be used for only one purpose, the buyer need not tell the seller the purpose for which he requires the goods.

   Example 18: 'A' bought a set of false teeth from 'B', a dentist. But the set was not fit for 'A's mouth. 'A' rejected the set of teeth and claimed the refund of price. It was held that 'A' was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled.

   Example 19: 'A' went to 'B's shop and asked for a 'Merrit' sewing machine. 'B' gave 'A' the same and 'A' paid the price. 'A' relied on the trade name of the machine rather than on the skill and judgement of the seller 'B'. In this case, there is no implied condition as to fitness of the machine for buyer's particular purpose.

   As a general rule, it is the duty of the buyer to examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable for his purpose for which he is buying them.

   This is known as rule of caveat emptor which means "Let the buyer beware".

6. **Condition as to Merchantability [Section 16(2)]:**
   - 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**.
   - There are two requirements for this condition to apply:
     (a) Goods should be bought **by description**.
     (b) The seller should **be a dealer in goods** of that description.
   - **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.

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.

Example 20: If a person orders motor horns from a manufacturer of horns, and the horns supplied are scratched and damaged owing to bad packing, he is entitled to reject them as unmerchantable.

Example 21: A bought a black velvet cloth from C and found it to be damaged by white ants. Held, the condition as to merchantability was broken.

7. **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**.

Example 22: A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

Implied Warranties:

- It is a warranty which the law implies into the contract of sale.
- 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. These may also be excluded by the course of dealings between the parties or by usage of trade (Section 62).

(Option 1 - ऐसा लिखा है agreement में की implied को नहीं मानेंगे)

(Option 2 - dealing के तरीक़े से भी या अधिकतर trade में ऐसा होता है तब)

The examination of Sections 14 and 16 of the Sale of Goods Act, 1930 discloses the following implied warranties:

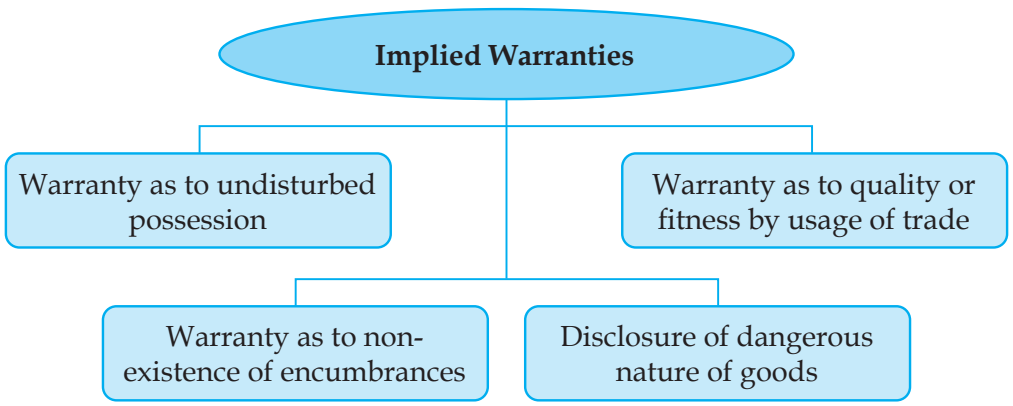
KEY TABLE for IMPLIED WARRANTIES

Section	Implied Warranty	Explanation	Example
Section 14(b)	Warranty as to Undisturbed Possession	Buyer is assured of quiet possession of the goods. If possession is disturbed, buyer can claim damages.	*Example 23: X buys a laptop, but it turns out to be stolen. X can claim damages from Y, the seller.*
Section 14(c)	Warranty as to Non-Existence of Encumbrances	Goods should be free from any third-party claims or charges unknown to the buyer at the time of the contract.	*Example 24: A sells a car to B without telling him it's pledged. B can ask A to clear the loan or pay it and sue A.*
Section 16(3)	Warranty as to Quality/Fitness by Usage of Trade	Implied warranty based on trade usage that goods are fit for a particular purpose.	A buys curtain fabric from B, but the cloth fades quickly in sunlight. Since this cloth should be suitable for curtains by trade usage, A can claim a breach of warranty from B.

Disclosure of Dangerous Nature	Obligation to Warn About Danger	Seller must inform the buyer if the goods are dangerous, otherwise they may be liable for damages.	A sells B a corrosive cleaning solution without warning. B suffers bums from using it. A is liable for not disclosing the product's dangerous nature.

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 25: X buys a laptop from Y. After the purchase, X spends some money on its repair and uses it for some time. Unknown to the parties, it turns out that the laptop was stolen and was taken from X and delivered to its rightful owner. Y shall be held responsible for a breach and X is entitled to damages of not only the price but also the cost of repairs.



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 26: A pledges his car with C for a loan of ₹5,0000 and promises him to give its possession the next day. A, then sells the car immediately to B, who purchased it on good faith, without knowing the fact. B, may either ask A to clear the loan or himself may pay the money and then, file a suit against A for recovery of the money with interest.

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**.

- **Let the buyer beware:**
  - When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods.
  - 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.
  - 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.
  - If the goods turn out to be defective or do not serve his purpose or if he depends on his own skill or judgment, the buyer cannot hold the seller responsible.
  - There is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale".
- **Following are the conditions to be satisfied:**
  - if the buyer had **made known to the seller** the purpose of his purchase, and
  - the buyer **relied on the seller's skill and judgement**, and
  - seller's business to supply goods of that **description** (Section 16).

Example 27: A sold pigs to B. These pigs being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy. The rule of the law being "Caveat Emptor".

Example 28: A purchases a horse from B. A needed the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the carriage. Caveat emptor rule applies here and so A can neither reject the horse nor can claim compensation from B.

Exceptions: The doctrine of Caveat Emptor is subject to the following exceptions:

1. **Fitness as to quality or use:** Section 16 (1)
   - 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.

Example 29: An order was placed for some trucks to be used for heavy traffic in a hilly country. The trucks supplied by the seller were unfit for this purpose and broke down. There is a breach of condition as to fitness.In Priest vs. Last, P, a draper, purchased a hot water bottle from a retail chemist, P asked the chemist if it would stand boiling water.

The Chemist told him that the bottle was meant to hold hot water. The bottle burst when hot water was poured into it and injured his wife. It was held that the chemist shall be liable to pay damages to P, as he knew that the bottle was purchased for the purpose of being used as a hot water bottle.

   - Where the article can be used for only **one particular purpose**, the buyer need not tell the seller the purpose for which he required the goods.
   - But where the article can be used for a **number of purposes**, the buyer should tell the seller the purpose for which he requires the goods, if he wants to make the seller responsible.

*In **Bombay Burma Trading Corporation Ltd. vs. Aga Muhammad**, timber was purchased for the express purpose of using it as railways sleepers and when it was found to be unfit for the purpose, the Court held that the contract could be avoided.*

- 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**.
- Here, the buyer is **relying** on the **particular brand** name.

3. **Goods sold by description:** Section 15
   - 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.
4. **Goods of Merchantable Quality:** Section 16(2)
   - 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 for latent defects.
   - **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.
5. **Sale by sample:** Section 17
   - Where the goods are bought by sample, this rule of Caveat Emptor does not apply if the bulk does not correspond with the sample.
6. **Goods by sample as well as description:** Section 15
   - 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.
7. **Trade Usage:** Section 16(3)
   - 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**.
8. **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 damage

Example 30: In readymade garment business, there is an implied condition by usage of trade that the garments shall be reasonably fit on the buyer.

Key Table for Exemption on Caveat Emptor		
Exception	**Description**	**Example**
Fitness as to Quality or Use	Goods must be fit for the specific purpose communicated by the buyer.	Trucks for hilly terrain broke down; not fit for purpose.
Goods Purchased Under Patent/Brand Name	No guarantee of fitness for a particular purpose when buying a patented or branded product	A branded laptop not suited for gaming seller is not liable.
Goods Sold by Description	Goods must match the description given by the seller.	A "leather" sofa turns out to be synthetic.

Merchantable Quality	latent defects not covered.	shortly after purchase.
Sale by Sample	Goods must match the provided sample.	Fabric ordered is faded compared to the sample shown.
Goods by Sample and Description	Goods must match both the sample and the description.	Shirts ordered as "blue cotton" turn out to be dull polyester.
Trade Usage	Goods must meet trade standards; deviation means Caveat Emptor does not apply.	Readymade garments must fit reasonably well; poorly fitting garments breach trade usage.
Seller Conceals Defect/Fraud	Seller liable for concealing defects or misrepresenting goods.	Priest vs. Last: Hot water bottle burst as it wasn't meant for boiling water.

"PROBLEM KYA HAI? - UNIT 2"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - SOGA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. X consults Y, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Y suggests 'Santro' and X accordingly buys it from Y. The car turns out to be unfit for touring purposes. What remedy X is having now under the Sale of Goods Act, 1930? **(Module)**

Ans. **Condition and warranty (Section 12):** 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 (1)] "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 (2)] 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 X purchases the car. X is therefore entitled to reject the car and have refund of the price.

2. 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)**

Ans. 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.

Mr. P showed him a particular machine which Mr. Q liked and paid for it. Later on, machine delivered and was found 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? **(Module)**

Ans. 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. 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. 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. Therefore, Mr. Q can either repudiate the contract or claim the refund of the price paid by him.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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) (SM)**

Ans. Duty of the buyer according to the doctrine of "Caveat Emptor": In case of sale of goods, the doctrine 'Caveat Emptor means 'let the buyer beware'. When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. 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

6. Goods by sample as well as description
7. Trade usage
8. Seller actively conceals a defect or is guilty of fraud

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].

2. 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)(SM)**

Ans. 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.

3. 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)**

Ans. 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.

4. 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 $ 5,000 and he will take $ 1,000 as advance. Priyansh gives $ 1,000 as advance and rest after fitting of window. After three days when

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 $ 4,000. State with reason under the provisions of the Sale of Goods Act, 1930, whether Priyansh can take his advance back?

(RTP May 23)

Ans. 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 of 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.

5. What are the implied conditions in a contract of 'Sale by sample' under the Sale of Goods Act, 1930? Also state the implied warranties operative under the Act.

(RTP Nov'23) (PYQ May 22 6 Marks) (MTP 6 Marks, Mar'21)

Ans.

1. **Sale by sample [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,
   (c) the goods shall be free from any defect rendering them un-merchantable, which would not be apparent on reasonable examination of the sample. This condition is applicable only with regard to defects, which could not be discovered by an ordinary examination of the goods. If the defects are latent, then the buyer can avoid the contract. This simply means that the goods shall be free from any latent defect i.e. a hidden defect.
2. **The following are the implied warranties operative under the Act:**
   A. **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.
   B. **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.
   C. **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.

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.

6. Mrs. Kanchan 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 * 125 per kg to which she agreed. Mrs. Kanchan insisted that she would like to see the sample of what would 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. Mrs. Kanchan 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. Kanchan wants to file a suit of fraud against the seller alleging him of selling a mix of good and cheap quality rice. Will she be successful? Decide the fate of the case and options open to Mrs. Kanchan for grievance redressal as per the provisions of Sale of Goods Act 1930? What would be your answer in case Mrs. Kanchan specified her exact requirement as to length of rice? **(RTP Nov'23) (SM) (PYQ 6 Marks, Jul'21)**

Ans.

1. 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. Kanchan 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.
2. In the instant case, Mrs. Kanchan does not have any option available to her for grievance redressal.
3. In case Mrs. Kanchan specified her exact requirement as to length of rice, then there is an implied condition that the goods shall correspond with the description. If it is not so, the seller will be held liable.

7. Prakash reaches a sweet shop and asks for 1 Kg of 'Burfi' if the sweetsare fresh. Seller replies' "Sir, my all sweets are fresh and of good quality." Prakash agrees to buy on the condition that first he tastes one piece of 'Burf' to check the quality. The seller gives him one piece to taste. Prakash, on finding the quality is good, ask the seller to pack. On reaching the house, Prakash finds that 'Burfi' is stale not fresh while the piece tasted was fresh. Now Prakash wants to avoid the contract andreturn the 'Burfi' to the seller.

(a) State with reason whether Prakash can avoid the contract underthe Sale of Goods Act, 1930?

(b) Will your answer be different if Prakash does not taste the sweets?

(RTP Jun'24) (RTP Nov'21)

Ans. By virtue of provisions of 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

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, Prakash can return the sweets 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. Prakash can return the sweets and avoid the contract.

8. "A breach of condition can be treated as a breach of warranty". Explain this statement as per relevant provisions of the Sale of Goods Act, 1930.

(MTP Mar'22 4 Marks) (PYQ Dec'21 4 Marks)

Ans. Section 13 of the Sale of Goods Act, 1930 specifies cases where a breach of condition be treated as a breach of warranty. As a result of which the buyer loses his right to rescind the contract and can claim damages only.

In the following cases, a contract is not avoided even on account of a breach of a condition:

1. Where the buyer altogether waives the performance of the condition. A party may for his own benefit, waive a stipulation. It should be a voluntary waiver by buyer.
2. Where the buyer elects to treat the breach of the conditions, as one of a warranty. That is to say, he may claim only damages instead of repudiating the contract. Here, the buyer has not waived the condition but decided to treat it as a warranty.
3. Where the contract is non-severable and the buyer has accepted either the whole goods or any part thereof. Acceptance means acceptance as envisaged in Section 72 of the Indian Contract Act, 1872.
4. Where the fulfilment of any condition or warranty is excused by law by reason of impossibility or otherwise.

9. Write any four exceptions to the doctrine of Caveat Emptor as per the Sale of Goods Act, 1930.

(MTP Jun' 22 4 Marks) (MTP 4 Marks, Oct'21)

Ans. **Caveat Emptor:** In case of sale of goods, the doctrine 'Caveat Emptor' means 'let the buyer beware'. When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. 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.

The doctrine of Caveat Emptor is subject to the following exceptions:

1. **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 [Section 16 (1) of the Sale of Goods Act, 1930).
2. **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 [Section 16(1)].
3. **Goods sold by description:** Where the goods are sold by description there is an implied condition that the goods shall correspond with the description [Section 15]. If it is not so, then seller is responsible.

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 [Section 16(2)].

5. **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 [Section 17].
6. **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 [Section 15].
7. **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 [Section 16(3)].
8. **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.

10. 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)**

Ans. **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:

1. Right to examine the goods by the buyer. The buyer should be given chance to examine the good.
2. 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.

11. Mr. Dheeraj was running a shop selling good quality washing machines. Mr. Vishal came to his shop and asked for washing machine which is suitable for washing woollen clothes.

on, when the machine was delivered at Mr. Vishal's house, it was found that it was wrong machine and also unfit for washing woollen clothes. He immediately informed Mr. Dheeraj about the delivery of wrong machine. Mr. Dheeraj 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. Dheeraj is right in refusing to exchange the washing machine? **(MTP Apr 23 6 Marks) (MTP 6 Marks, Oct'21)**

Ans. 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. Vishal has informed Mr. Dheeraj that he wanted the washing machine for washing woollen clothes. However, the machine which was delivered by Mr. Dheeraj was unfit for the purpose for which Mr. Vishal wanted the machine.

Based on the above provision and facts of case, there is breach of implied condition as to sample as well as description, therefore Mr. Vishal can either repudiate the contract or claim the refund of the price paid by him or he may require Mr. Dheeraj to replace the washing machine with desired one.

12. 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. **(MTP May'23 4 Marks) (MTP 4 Marks, Mar'21)**

Ans. **Difference between Condition and Warranty:**

1. 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. 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. 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:

   (a) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition.

   (b) Where the buyer elects to treat the breach of condition as breach of a warranty.

   (c) Where the contract of sale is non-severable and the buyer has accepted the whole goods or any part thereof.

   (d) Where the fulfilment of any condition or warranty is excused by law by reason of impossibility or otherwise.

13. 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 Sale of Goods Act, 1930 whether TK can reject the timber. **(PYQ Dec'21 3 Marks)**

The condition as to the reasonable fitness of goods for a particular purpose may be implied if the buyer had made known to the seller the purpose of his purchase and relied upon the skill and judgment of the seller to select the best goods and the seller has ordinarily been dealing in those goods.

There is implied condition on the part of the seller that the goods supplied shall be reasonably fit for the purpose for which the buyer wants them, provided the following conditions are fulfilled:

(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 the instant case, as the timber supplied by the seller is commercially fit for the purposes for which it was ordered, it means the implied condition on the part of the seller is fulfilled.

Hence, TK cannot reject the timber.

Alternatively, the above answer can also be provided as under:

According to Section 15 of the Sale of Goods Act, 1930 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. 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.

In the instant case, as the timber supplied by seller varies in thickness from 1 inch to 1.4 inches, it does not correspond with the description ordered by TK i.e. of 1 inch, TK may reject the timber.

14. 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:

1. 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.
2. Whether the replacement of damaged tiles be imposed on M/s Makrana Marbles? Explain. **(PYQ Nov'22 6 Marks)**

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. Ji.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

1. According to doctrine of caveat emptor the buyer cannot hold the seller responsible for defect in goods supplied as it is the duty of the buyer to make a proper selection or choice of the goods.

   Section 16(1) also provides that there is no implied condition as to quality of fitness of the goods sold for any particular purpose. However, as an exception to this doctrine, the section further provides that if the buyer had made known to the seller the purpose of his purchase; relied on the seller's skill and judgement; and Seller's business is to supply goods of that description then it shall be the duty of the seller to supply such goods as are reasonably fit for that 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, 1 when he has made him known about that and relied on his skill and judgement.

2. 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

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.

15. Certain goods were sold by sample by / to K, who in turn sold the same goods by sample to L and L by sample sold the same goods to M. M found that the goods were not according to the sample and rejected the goods and gave a notice to L. L sued K and K sued J. Can M reject the goods? Also advise K and Las per the provisions of the Sale of Goods Act, 1930.

(PYQ Jun'23 4 Marks)

Ans. 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 this case, M received the goods by sample from L but since the goods were not according to the sample, M can reject the goods and can sue L.

With regard to K and L, L can recover damages from K and K can recover damages from J. But, for both K and L, 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 Sale of Goods Act, 1930.

16. Discuss the various types of implied warranties as per the Sale of Goods Act, 1930.

(PYQ Dec' 23 4 Marks)

Ans. Various types of implied warranties are covered under Sections 14 and 16 of the Sale of Goods Act, 1930 which are as follows:

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.
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.
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.
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.

17. 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) (SM)**

Ans. 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". But

for which the goods are required and also relies on the seller's skill and judgement and that this is the business of the seller to sell such goods in the ordinary course of his business, 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.

18. What are the differences between a 'Condition' and 'Warranty' in a contract of sale? Also explain, when shall a breach of condition' be treated as 'breach of warranty' under the provisions of the Sale of Goods Act, 1930? **(RTP May 21) (PYQ 6 Marks, Jan'21)**

Ans. Difference between conditions and warranties:

The following are important differences between conditions and warranties.

Point of Differences	Condition	Warranty
Meaning	A condition is essential to the main purpose of the contract.	It is only collateral to the main purpose of the contract.
Right in case of breach	The aggrieved party can repudiate the contract or claim damages or both in the case of breach of condition.	The aggrieved party can claim only damages in case of breach of warranty.
Conversion of stipulations	A breach of condition may be treated as a breach of warranty.	A breach of warranty cannot be treated as a breach of condition.

Section 13 of the Sales of Goods Act, 1930, specifies cases where a breach of condition be treated as a breach of warranty. As a result of which the buyer loses his right to rescind the contract and can claim for damages only.

In the following cases, a contract is not avoided even on account of a breach of a condition:

1. Where the buyer altogether waives the performance of the condition. A party may for his own benefit, waive a stipulation.
2. Where the buyer elects to treat the breach of the conditions, as one of a warranty. That is to say, he may claim only damages instead of repudiating the contract.
3. Where the contract is non-severable and the buyer has accepted either the whole goods or any part thereof.
4. Where the fulfilment of any condition or warranty is excused by law by reason of impossibility or otherwise.

19. Mr. T was a retailer 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.

A. Discuss whether Mr. T is right in refusing to exchange as per provisions of the Sale of Goods Act, 1930?

B. What is the remedy available to Mr. M? **(RTP May'21)**

as well as by description, the implied condition is that the goods supplied shall correspond to both with the sample and the description. In case, the goods do not correspond with the sample or with description or vice versa or both, the buyer can repudiate the contract.

Further, as per Section 16(1) of the Sales 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 the judgment or skill of the seller, it is the duty of the seller to supply such goods as are reasonably fit for that purpose.

A. In the given case, Mr. M had revealed Mr. T that he wanted the exhaust fan for the kitchen. Since the table fan delivered by Mr. T was unfit for the purpose for which Mr. M wanted the fan, therefore, T cannot refuse to exchange the fan.

B. When one party does not fulfill his obligation according to the agreed terms, the other party may treat the contract as repudiated or can insist for performance as per the original contract. Accordingly, the remedy available to Mr. M is that he can either rescind the contract or claim refund of the price paid by him or he may require Mr. T to replace it with the fan he wanted.

20. 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.

1. Discuss whether Mr. T is right in refusing to exchange as per provisions of Sale of Goods Act, 1930?
2. What is the remedy available to Mr. M? **(PYQ 6 Marks, Jan'21)**

Ans.

1. According to Section 15 of the Sale of Goods Act, 1930, where the goods are sold by sample as well as by description, the implied condition is that the goods supplied shall correspond to both with the sample and the description. In case, the goods do not correspond with the sample or with description or vice versa or both, the buyer can repudiate the contract.

   Further, as per Section 16(l) of the Sales 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 the judgment or skill of the seller, it is the duty of the seller to supply such goods as are reasonably fit for that purpose.

   In the given case, Mr. M had revealed Mr. T that he wanted the exhaust fan for the kitchen. Since the table fan delivered by Mr. T was unfit for the purpose for which Mr. M wanted the fan, therefore, T cannot refuse to exchange the fan.

2. When one party does not fulfill his obligation according to the agreed terms, the other party may treat the contract as repudiated or can insist for performance as per the original contract. Accordingly, the remedy available to Mr. M is that he can either rescind the contract or claim refund of the price paid by him or he may require Mr. T to replace it with the fan he wanted.

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.

A. Explain the duty of the buyer as well as the seller according to the doctrine of "Caveat Emptor'.

B. Whether Mr. Das would be able to get the money back or the right kind of wood as required serving his purpose? **(MTP 6 Marks, Mar 21)**

Ans.

A. Duty of the buyer according to the doctrine of "Caveat Emptor": In case of sale of goods, the doctrine "Caveat Emptor' means 'let the buyer beware'. When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. 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

B. 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].

UNIT 03

Transfer of Ownership and Delivery of Goods

A contract of sale of goods involves transfer of ownership in three stages:

INTRODUCTION

Sale of goods involves transfer of ownership of property from seller to buyer.

It is essential to determine → कब ?? **Time**
At which the ownership passes from the seller to the buyer.

Importance of the Time of Transfer

The general rule is that risk prima facie passes with the property.

In case where goods are **lost or damaged**,

- The **burden of loss will be borne** by the person who is the **owner** at the time when the goods are lost or damaged.
- Where the goods are damaged **by the act of the third party**, it is the **owner** who **can take action**.
- **Suit** for **price** by the seller can be filed **only** when the **property** has **passed** to the **buyer**.

PASSING OF PROPERTY (SECTIONS 18-26)

Passing of Property (Section 18-26)		
Section	**Topic**	**Key Points**
Sections 18-19	Passing of Property	❑ Transfer of ownership (property) determines legal rights and liabilities. ❑ Property passes to the buyer when the goods are specific/ ascertained and the parties intend it to be transferred.

Section 20	Specific Goods in Deliverable State	Property passes when the contract is made if the goods are in a deliverable state.
Section 21	Specific Goods to be Made Deliverable	Property passes only when the goods are put in a deliverable state, and the buyer is notified.
Section 22	Goods in Deliverable State; Seller to Ascertain Price	Property passes after the seller takes actions like weighing or measuring to ascertain the price, and the buyer is notified.
Section 23	Sale of Unascertained Goods by Description and Appropriation	❑ Property passes when goods are appropriated to the contract with mutual consent. ❑ Delivery to the carrier without reserving the right of disposal counts as appropriation.
Section 24	Goods on Approval or Sale or Return	Property passes when the buyer approves or keeps the goods beyond a reasonable time.
Section 25	Reservation of Right of Disposal	❑ Seller can reserve the right of disposal until certain conditions are met. ❑ Property doesn't pass even after delivery if the seller retains this right.
Section 26	Risk Prima Facie Passes with Property	❑ Risk generally passes with ownership. ❑ Exceptions: Risk lies with the party at fault if delivery is delayed.

Why ??

We have to Decide - Legal Right and Liabilities

Of sellers and buyers.

Passing of property = Passing of ownership.

- If the property has passed to the buyer, the risk in the goods sold is that of buyer and not of seller, **though the goods may still be in the seller's possession.**
- The rules regarding transfer of property in goods from the seller to the buyer depend on two basic factors:

1. **Identification of Goods:**
   - Section 18 provides that where there is a contract of safe for **unascertained goods,** the property in goods cannot pass to the buyer **unless and until** the goods are ascertained.
   - The buyer can get the ownership right on the goods **only when the goods are specific and ascertained.**
2. **Intentions of parties:** Section 19(1)

   The property in goods is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

   Section 19(2) - HOW TO ASCERTIAN INTENTION OF THE PARTIES?:

   1. To the terms of the contract
   2. To the conduct of the parties and
   3. To the circumstances of the case

Passing of property

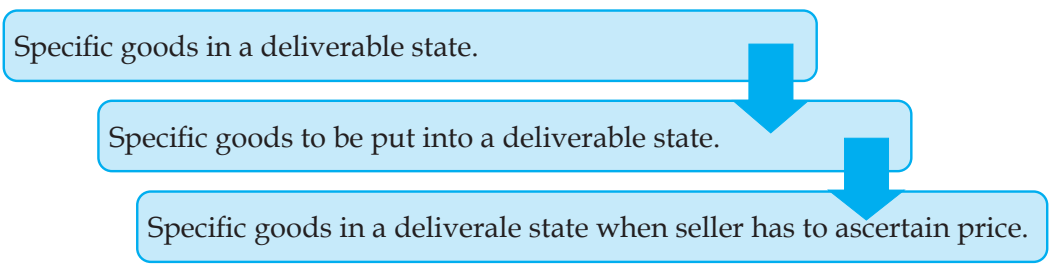
- Specific or Ascertained Goods
- Passing of Unascertained Goods
- Goods sent on approval or "on sale or return"
- Transfer of property in case of reservation of right to disposal.

A. SECTION 19 - SPECIFIC OR ASCERTAINED GOODS - Property passes when intended to pass

Where there is a contract for the sale of specific or ascertained goods -

1. The property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.
2. 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. 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.

Stages of goods while passing of property



A. Specific goods in a deliverable state (Section 20):

- Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed.

Here, the condition is goods must be ready for delivery.

Example 1: X goes into a shop and buys a television and asks the shopkeeper for its home delivery. The shopkeeper agrees to do it. The television immediately becomes the property of X.

B. Specific goods to be put into a deliverable state (Section 21):

- Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, **the property does not pass until such thing is done and the buyer has notice thereof**.

Example 2: Peter buys a laptop from an electronics store and asks for a home delivery. The shopkeeper agrees to it. However, the laptop does not have a Windows operating system installed. The shopkeeper promises to install it and call Peter before making the delivery. In this case, the property transfers to Peter only after the shopkeeper has installed the OS making the laptop ready for delivery and intimated the buyer about it.

order to ascertain price (Section 22):

- Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

> *Example 3: A sold carpets to the Company which were required to be laid. The carpet was delivered to the company's premises but was stolen before it could be laid. It was held that the carpet was not in deliverable state as it was not laid, which was part of the contract and hence, the property had not passed to the buyer company.*

B. Unascertained Goods

- Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained. [Section 18]
- The rules in respect of passing of property of unascertained goods are as follows:

1. Sale of unascertained goods by description and Appropriation

(i) Section 23(1): Appropriation of goods involves - selection of goods with the intention of using them in performance of the contract and with the mutual consent of the seller and the buyer.

The essentials are:

(a) There is a contract for the sale of unascertained or future goods.

(b) The goods should **conform to the description and quality** stated in the contract.

(c) The goods must be in a **deliverable state**.

(d) The goods must be **unconditionally** (as distinguished from an intention to appropriate) **appropriated** to the contract either by delivery to the buyer or his agent or the carrier.

(e) The appropriation must be made by:

  (a) the **seller** with the assent of the buyer; or

  (b) the **buyer** with the **assent** of the seller.

(f) The assent may be **express** or **implied**.

(g) The assent may be given either **before** or **after** appropriation.

(ii) Section 23(2) - Delivery of the goods to the carrier

Where, in pursuance of the **contract**, the seller **delivers** the goods to the **buyer** or to a **carrier** or other **bailee** (whether named by the buyer or not) for the purpose of **transmission** to the buyer, and **does not reserve** the right of **disposal**, he is **deemed** to have **unconditionally appropriated** the goods to the contract.

> *Example 4: A bill of lading of railway parcel is made out in the name of the buyer and is sent to him, the ownership in the goods passes from the seller to the buyer. In case the goods are subjected to accidental loss or by theft, the seller will not be liable.*
>
> *Example 5: M places an order for book with a book seller in Mumbai. He asks him to send the book by courier. Payment of the book was to be made by cheque. The seller sends the book by courier. The book is lost in the way. The seller wants the buyer to bear the loss. According to Section 23(2), it is an unconditional appropriation of goods because of which buyer M has become the owner of the goods. Therefore, he will bear the risk of loss of the book in the way.*

When goods are delivered to the buyer on approval or "on sale or return" or other similar terms, the property therein passes to the buyer-

(a) when he signifies his **approval or acceptance to the seller** or does any other act adopting the transaction;

(b) if he **does not signify his approval or acceptance to the seller** -

- but **retains** the goods **without giving notice** of rejection, then,
- if a time has been fixed for the return of the goods, on the expiration of such time, and
- if no time has been fixed, on the expiration of a reasonable time; OR

(c) **he does something to the good** which is **equivalent** to **accepting** the goods e.g. he pledges or sells the goods.

Example 6: P brought a musical instrument from a musical shop on a condition that he will purchase it, if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument. The ownership is transferred when he has decided to purchase the instrument as his own.

A buyer under a contract on the basis of 'sale or return' is deemed to have exercised his option -

- when he does any act exercising domination over the goods\showing an unequivocal intention to buy,
- Example - If he pledges the goods with a third party.

Failure or inability to return the goods to the seller does not necessarily imply selection to buy.

Example 7: 'A' delivered some jewellery to 'B' on sale or return basis. 'B' pledged the jewellery with 'C'. It was held that the ownership of the jewellery had been transferred to 'B' as he had adopted the transaction by pledging the jewellery with 'C'. In this case, 'A' has no right against 'C'. He can only recover the price of the jewellery from 'B'.

Example 8: A sends to B a water motor on approval or return in March, 2020. B to return it after trial in August, 2020. The water motor has not been returned within a reasonable time, and therefore, A is not bound to accept it and B must pay the price.

Sale for cash only or Return: 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.

Example 9: 'A' delivered his jewellery to 'B' on sale for cash only or return basis. It was expressly provided in the contract that the jewellery shall remain 'A's property until the price is paid. Before the payment of the price, 'B' pledged the jewellery with 'C'. It was held that at the time of pledge, the ownership was not transferred to 'B'. Thus, the pledge was not valid and 'A' could recover the jewellery from 'C'.

D. Reservation of Right of Disposal (Section 25)

This section preserves the right of disposal of goods to secure that the price is paid before the property in goods passes to the buyer.

- Where there is contract of sale of specific goods or where the goods have been subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, as the case may be, reserve the right to dispose of the goods, until certain conditions have been fulfilled.
- In such a case in spite of the fact that the goods have already been delivered to the buyer or to a carrier or other bailee for the purpose of transmitting the same to the buyer, the property therein will not pass to the buyer till the condition imposed, if any, by the seller has been fulfilled.

Example 10: X sends furniture to a company by a truck and instructs the driver not to deliver the furniture to the company until the payment is made by company to him. The property passes only when the payment is made.

Circumstances under which the right to disposal may be reserved:

In the following circumstances, seller is presumed to have reserved the right of disposal:

1. **Sub section 2:** If the goods are shipped or delivered to a railway administration for carriage and by the bill of lading or railway receipt, as the case may be, the goods are deliverable to the order of the seller or his agent, then the seller will be prima facie deemed to have reserved to the right of disposal.
2. **Sub section 3:** Where the seller draws a bill on the buyer for the price and sends to him the bill of exchange together with the bill of lading or (as the case may be) the railway receipt to secure acceptance or payment thereof, the buyer must return the bill of lading, if he does not accept or pay the bill. And if he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him.

It should be noted that Section 25 deals with "conditional appropriation" as distinguished from 'unconditional appropriation' dealt with under Section 23 (2).

SECTION 26 - RISK PRIMA FACIE PASSES WITH PROPERTY

- 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 the buyer's risk whether delivery has been made or not".

An exception to the rule - 'risk follows ownership'

- It provides that where delivery of the goods has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

Thus, in ordinary circumstances, risk is borne by the buyer only when the property in the goods passes over to him.

However, the parties may by special agreement stipulate that 'risk' will pass sometime after or before the 'property' has passed.

Risk Prima Facie Passes with Ownership

The **owner** of goods must bear the loss or damage of goods unless otherwise is agreed to. Under Section 26 of the Sale of Goods Act, **unless otherwise agreed, the goods remain at the seller's risk until property therein has passed to the buyer**. After that event they are at the buyer's risk, whether delivery has been made or not.

Seller's risk - until the property passes to the buyer

Buyer's risk - after the property passes from the seller

Example 11: A bids for an antique painting at a sale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the antique which gets damaged. The loss will have to be borne by the seller, because the ownership of goods has not yet passed from the seller to the buyer.

The aforesaid rule is, however, subject to two qualifications:

1. If delivery has been delayed by the fault of the seller or the buyer - the goods shall be at the risk of the party in default, as regards loss which might not have arisen but for the default.
2. The duties and liabilities of the seller or the buyer as bailee of goods - for the other party remain unaffected even when the risk has passed generally.

Example 12: A contracted to sell 100 bales of cotton to B to be delivered in February. B took the delivery of the part of the cotton but made a default in accepting the remaining bales. Consequently, the cotton becomes unfit for use. The loss will have to be borne by the buyer. It should, however, be remembered that the general rule shall not affect the duties or liabilities of either seller or buyer as a bailee of goods for the other, even when the risk has passed. It is their duty to take care of the goods as a man of ordinary prudence would have done.

As noted above, the risk (i.e., the liability to bear the loss in case property is destroyed, damaged or deteriorated) passes with ownership.

The parties may, however, agree to the contrary.

For instance, the parties may agree that risk will pass sometime after or before the property has passed from the seller to the buyer.

TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27-30)

In general, the seller can sell only such goods of which he is the absolute owner. The seller cannot transfer a better title to the buyer for goods than he himself has.

But sometimes a person may sell goods of which he is not the owner,

Then the question arises as to what is the position of the buyer who has bought the goods by paying price??

- **If the seller is not the owner of goods, then the buyer also will not become the owner i.e. the title of the buyer shall be the same as that of the seller.**
- **This rule is expressed in the Latin maxim *"Nemo dat quad non habet"* which means that no one can give what he has not got.**

> ***Example 13:*** *If A sells some stolen goods to B, who buys them in good faith, B will get no title to that and the true owner has a right to get back his goods from B*
>
> ***Example 14:*** *P, the hirer of vehicle under a hire purchase agreement, sells them to Q. Q, though a bona fide purchaser, does not acquire the ownership in the vehicle. At the most he acquires the same right as that of the hirer.*

- If this rule is enforced rigidly then the innocent buyers may be put to loss in many cases. SO Exceptions:
  - To protect the interests of innocent buyers: In the following cases, a non-owner can convey better title to the bona fide purchaser of goods for value.

1. **Sale by a Mercantile Agent:** A sale made by a mercantile agent of the goods for document of title to goods **would pass a good title to the buyer** in the following circumstances; namely;
   - If he was in possession of the goods or documents with the **consent of the owner**;
   - If the sale was made by him when acting in the **ordinary course of business** as a mercantile agent; and
   - If the buyer had acted in **good faith** and has at the time of the contract of sale, **no notice of the fact** that the seller had no authority to sell (Proviso to Section 27).

   Mercantile **Agent** means an agent having in the **customary course** of business as such **agent authority** either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)].
2. **Sale by one of the joint owners (Section 28):** If **one of several joint owners** of goods has the sole possession of goods by permission of the co-owners, the property in the goods is transferred to any person who buys them from such joint owner in **good faith** and has not at the time of the contract of sale notice that **the seller has no authority to sell**.

   > ***Example 15:*** *A, B, and C are three brothers and joint owners of a T.V and VCR and with the consent of B and C, the VCR and T.V was kept in possession of A. A sells the T.V and VCR to P who buys it in good faith and without notice that A had no authority to sell. P gets a good title to VCR and T.V.*

3. **Sale by a person in possession under voidable contract:** A buyer would acquire a **good title** to the goods sold to him by a 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).

   > ***Example 16:*** *X fraudulently obtains a diamond ring from Y. This contract is voidable at the option of Y. But before the contract could be terminated, X sells the ring to Z, an innocent purchaser. Z gets the good title and Y cannot recover the ring from Z even if the contract is subsequently set aside.*

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 and without notice of the previous sale, he would have good title to them, although the property in the goods had passed to the first buyer earlier. A pledge or other disposition of the goods or documents of title by the seller in possession are equally valid [Section 30(1)].

Example 17: During IPL matches, P buys a TV set from R. R agrees to deliver the same to P after some days. In meanwhile R sells the same to S, at a higher price, who buys in good faith and without knowledge about the previous sale. S gets a good title.

5. **Sale by buyer obtaining possession before the property in the goods has vested in him:** 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** [Section 30(2)].

Example 18: Furniture was delivered to B under an agreement that price was to be paid in two instalments, the furniture to become property of B on payment of second instalment. B sold the furniture before second instalment was paid. It was held that the buyer acquired a good title. (Lee Vs Butler)

However, a person in possession of goods under a **'hire-purchase' agreement** which gives him only an **option** to **buy** is **not covered** within the section unless it amounts to a sale.

Example 19: A took a car from B on this condition that A would pay a monthly instalment of Rs. 5,000 as hire charges with an option to purchase it by payment of Rs. 1,00,000 in 24 instalments. After the payment of few instalments, A sold the car to C. B can recover the car from C since A had neither bought the car, nor had agreed to buy the car. He had only an option to buy the car.

6. **Effect of Estoppel:** Where the owner is estopped 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.

Example 20: 'A' said to 'B', a buyer, in the presence of 'C' that he (A) is the owner of the horse. But 'C' remained silent though the horse belonged to him. 'B' bought the horse from 'A'. Here the buyer (B) will get a valid title to the horse even though the seller (A) had no title to the horse. In this case, 'C', by his own conduct, is prevented from denying 'A's authority to sell the horse. Here, 'C''s silence has induced 'B' to believe that 'A' is the owner of the horse.

7. **Sale by an unpaid seller:** 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)].
8. **Sale under the provisions of other Acts:** Sale by an **Official Receiver or Liquidator of the Company** will give the purchaser a valid title. Purchase of goods from **a finder of goods will get a valid title** under circumstances [Section 169 of the Indian Contract Act, 1872]. **A sale by pawnee** can convey a good title to the buyer [Section 176 of the Indian Contract Act, 1872].

TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27 - 30) No one can give what he has not			
S. No.	**Section**	**Scenario**	**Key Points**
1.	Section 27	General Rule	Seller can only transfer the title they have. Buyer docs not gain better title than seller. Latin Maxim: "Nemo dat quad non habet" (No one can give what they do not have).
2.	Proviso to Section 27	Sale by Mercantile Agent	Mercantile agent can transfer good title if: ❑ Possesses goods/documents with owner's consent ❑ Acts in ordinary course of business ❑ Buyer acts in good faith and is unaware of lack of authority
3.	Section 28	Sale by One of Joint Owners	If one joint owner sells goods in possession with consent of co-owners, the buyer in good faith gets a valid title.
4.	Section 29	Sale by Person in Possession Under Voidable Contract	Buyer gets good title if seller obtained possession under voidable contract and contract was not rescinded before sale.
5.	Section 30(1)	Sale by Seller with Previous Sale	Seller who has sold goods but remains in possession can sell them to a third party. The third party gets a good title if they are in good faith and unaware of the previous sale.
6.	Section 30(2)	Sale by Buyer with Possession Before Property Transfer	Buyer who receives goods before property transfer can resell them. The new buyer gets a good tide if they act in good faith and arc unaware of any lien or other rights.
	Effect of Estoppel		Owner is estopped from denying seller's authority if the owner's conduct leads the buyer to believe the seller is authorized.
7.	Section 54(3)	Sale by Unpaid Seller	Unpaid seller who resells goods after exercising lien or stoppage in transit gives the new buyer a good tide against the original buyer.
8.	Sale Under Other Acts		Sales by Official Receiver, Liquidator, finder of goods, or pawnee can convey a good tide under specified circumstances.

PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31-44)

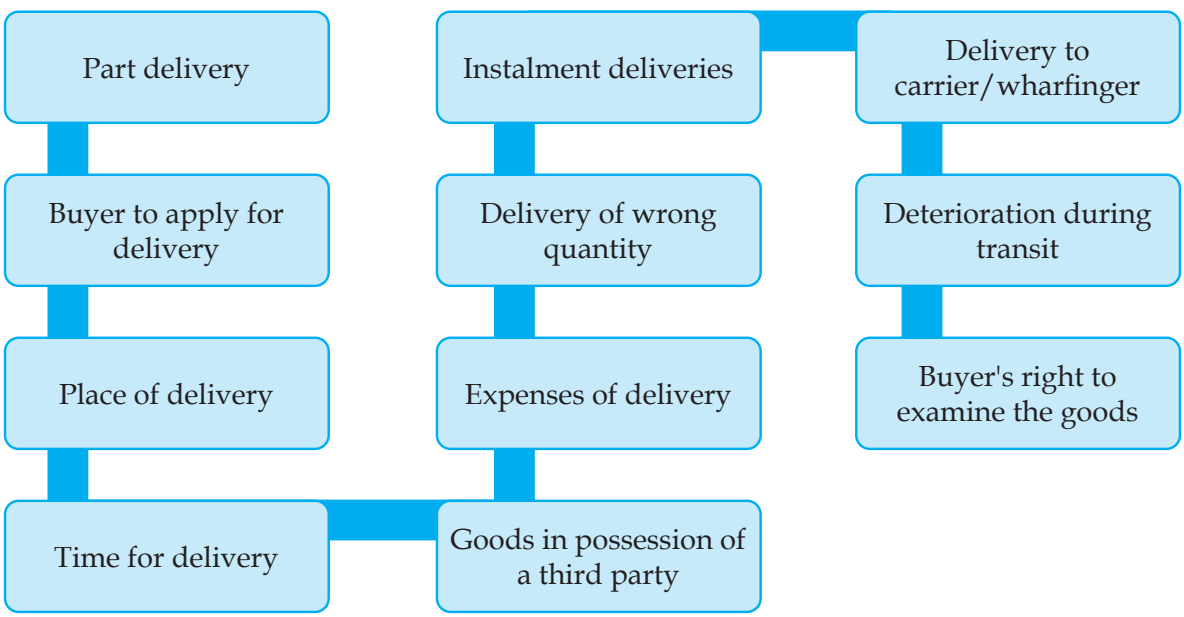
The performance of a contract of sale implies:

- **Delivery** of goods by the **seller** and **acceptance** of the **delivery** of goods and payment of price for them by the **buyer** in accordance of the terms of the **contract**.
- **Definition of Delivery [Section 2(2)]:**
  - Delivery means voluntary transfer of possession from one person to another.

- The buyer should be placed in a position so that he can exercise his right over the goods.

- When the possession is taken **through unfair means - there will be no delivery** of the goods.
- Delivery of goods sold may be made **by doing anything which the parties agree, shall be treated as delivery** or putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.
- Delivery of goods is of three types:
  1. Actual Delivery
  2. Symbolic delivery
  3. Constructive Delivery
- **Duties of seller and buyer (Section 31):** It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale.
- **Payment and delivery are concurrent conditions (Section 32):** Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.

RULES REGARDING DELIVERY OF GOODS (SECTION 33-41)



RULES FOR DELIVERY - SECTION 33 TO 41			
Section	**Topic**	**Key Points**	**Example**
SECTION 33	Delivery of Goods	Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorized to hold them on his behalf.	E buys a laptop from F. They agree that handing over the laptop along with its warranty papers will constitute delivery.

34	Delivery	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. A delivery of part of the goods with an intention of severing it from the whole does not operate as a delivery of the remainder.	wharf were sold in a lot. The seller instructed the wharfinger to deliver them to the buyer who had paid for them. The buyer accepted them and took away part. It was held that there was delivery of the whole.
SECTION 35	Buyer to Apply for Delivery	Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery.	Example: G agrees to buy furniture from H. G must inform H when he wants the furniture delivered. If G does not ask for delivery, H is not obligated to deliver the furniture.
SECTION 36(1)	Place of Delivery	The place of delivery depends on the contract. If the goods are sold, they are to be delivered at the place where they were at the time of the sale. If goods are agreed to be sold, they are to be delivered at the place where they were at the time of the agreement or where they are manufactured or produced.	I purchases a custom-built machine from J. The contract specifies that J will deliver the machine to I's factory once it's ready. Since the machine was not in existence at the time of sale, it will be delivered from J's factory.
SECTION 36(2)	Time of Delivery	If the seller is bound to send the goods to the buyer, but no time is fixed, the seller is bound to send them within a reasonable time.	K sells agricultural equipment to L and agrees to deliver it. No specific date is mentioned in the contract. K must deliver the equipment within a reasonable time, considering the season and urgency of L's requirement.
SECTION 36(3)	Goods in Possession of a Third Party	When goods are in possession of a third person, there is no delivery unless and until such third person acknowledges to the buyer that he holds the goods on his behalf.	M sells goods to N that are stored in a warehouse. The warehouse manager must acknowledge that he holds the goods on behalf of N for the delivery to be considered complete.
SECTION 36(4)	Time for Tender of Delivery	The demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.	O agrees to sell goods to P and says delivery will be at 2 AM. P can argue that this is not a reasonable hour, and the tender for delivery could be considered ineffectual.

36(5)	Expenses for Delivery	putting the goods into a deliverable state must be borne by the seller in the absence of a contract to the contrary.	Before delivery, Q needs to repair the car to make it roadworthy. The cost of repairs will be borne by Q unless agreed otherwise.
SECTION 37	Delivery of Wrong Quantity	If the seller delivers less than the contracted quantity, the buyer may reject them. If the buyer accepts, he must pay at the contract rate.	S contracts to buy 50 bags of cement from T. T delivers only 40 bags. S may reject the delivery or accept the 40 bags and pay for them.
		If the seller delivers more than the contracted quantity, the buyer may accept the contracted quantity and reject the rest, reject the whole, or accept all and pay at the contract rate.	S contracts to buy 50 bags of cement from T. T delivers 60 bags. S may reject the extra 10 bags or accept them and pay at the contract rate.
		If the seller delivers goods mixed with goods of a different description, the buyer may accept the goods that are in accordance with the contract and reject the rest or reject the whole.	S contracts to buy 50 bags of cement from T. T delivers 40 bags of cement and 10 bags of sand. S may reject the sand or reject the entire delivery.
SECTION 38	Instalment Deliveries	Unless otherwise agreed, the buyer is not bound to accept delivery in instalments. Rights and liabilities in such cases may be determined by the contract.	U contracts to buy 100 chairs from V. V starts delivering 10 chairs every week. U can reject the instalments unless the contract specifies that instalment deliveries are allowed.
SECTION 39	Delivery to Carrier	Subject to the terms of the contract, delivery of goods to a carrier for transmission to the buyer is deemed to be delivery to the buyer.	W orders electronics from X, who ships them via a courier service. Once X hands the goods to the courier, it is considered that delivery has been made to W.
SECTION 40	Deterioration During Transit	If goods are delivered at a distant place, the liability for deterioration necessarily incidental to transit falls on the buyer, even if the seller agrees to deliver at his own risk.	Y buys fresh produce from Z to be delivered over a long distance. By the time the produce reaches Y, it has wilted. If the deterioration was unavoidable and incidental to transit, Y must accept the goods.
SECTION 41	Buyer's Right to Examine the Goods	The buyer, who has not previously examined the goods, is entitled to a reasonable opportunity to examine them to ascertain if they conform to the contract. The seller must afford this opportunity on request.	AA orders textiles from BB but has not seen the samples before. Upon delivery, AA has the right to inspect the textiles before accepting them.

Example 21: Certain goods lying at wharf were sold in a lot. The seller instructed the wharfinger to deliver them to the buyer who had paid for them and the buyer, thereafter, accepted them and took away part. Held, there was delivery of the whole.

Example 22: A agrees to sell 100 quintals of wheat to B at ` 1,000 per quintal. A delivers 1,100 quintals. B may reject the whole lot or accept only 1,000 quintals and reject the rest or accept the whole lot and pay for them at the contract of sale.

Example 23: There was sale of 100 tons of paper to be shipped in November. The seller shipped 80 tons in November and 20 tons in December. The buyer was entitled to reject the whole 100 tons.

Example 24: P sold to Q a certain quantity of iron rods which were to be sent by proper vessel. It was rusted before it reached the buyer. The rust of the rod was so minimal and was not effecting the merchantable quality and the deterioration was not necessarily incidental to its transmission. It was held that Q was bound to accept the goods.

Rule Related to Acceptance of Delivery of Goods (Section 42)

Acceptance is deemed to take place when the buyer:

(a) **intimates** to the **seller** that he had **accepted** the goods or

(b) **does** any act to the **goods**, which is **inconsistent** with the **ownership** of the seller; or

(c) **retains** the **goods after** the **lapse** of a **reasonable time**, **without intimating to the seller** that he has rejected them.

Buyer not Bound to Return Rejected Goods (Section 43)

Unless otherwise agreed, where goods are delivered to the buyer and **he refuses to accept them**, having the **right** so to do, **he is not bound to return** them to the seller, but it is **sufficient** if he **intimates** to the **seller** that he **refuses** to accept them.

Liability of Buyer for Neglecting or Refusing Delivery of Goods (Section 44)

When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer **does not take delivery** of the goods within a **reasonable time** after such request **he is liable to the seller for any loss** occasioned by his **neglect** or **refusal** to take **delivery** and also for a **reasonable charge** for the care and custody of the goods.

Provided further that nothing in this section shall affect the rights of the seller where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.

"PROBLEM KYA HAI? - UNIT 3"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - SOGA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

1. J the owner of a Fiat car wants to sell his car. For this purpose, he hand over the car to P, a mercantile agent for sale at a price not less than $ 50,000. The agent sells the car for & 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 giving reasons whether 1 would succeed. **(Module)**

Ans. The problem in this case is based on the provisions of the Sale of Goods Act, 1930 contained in the proviso to Section 27. The proviso provides that a mercantile agent is one who in the customary course of his business, has as such agent, authority either to sell goods, or to consign goods, for the purpose of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)]. The buyer of goods from a mercantile agent, who has no authority from the principal to sell, gets a good title to the goods if the following conditions are satisfied

1. The agent should be in possession of the goods or documents of title to the goods with the consent of the owner.
2. The agent should sell the goods while acting in the ordinary course of business of a mercantile agent.
3. The buyer should act in good faith.
4. The buyer should not have at the time of the contract of sale notice that the agent has no authority to sell.

In the instant case, P, the agent, was in the possession of the car with I's consent for the purpose of sale. We assume the agent P acted in the ordinary course of business and sold the car to buyer A in good faith.

Therefore A, the buyer obtained a good title to the car. Hence, I in this case, cannot recover the car from A.

2. Ms. 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. **(Module)**

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

(a) when the buyer signifies his approval or acceptance to the seller or does any other act adopting the

(b) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time; or

(c) he does something to the good which is equivalent to accepting the goods e.g. he pledges or sells the goods.

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.

motor car from Mr. Joshi only.

3. 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)**

Ans. 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:

One of the several joint owners has the sole possession of them.

1. Possession of the goods is by the permission of the co-owners.
2. 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.

4. 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)**

Ans. According to Section 21 of the Sales of Goods Act, 1930, if 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:

1. The seller has done his act of putting the goods in a deliverable state and
2. 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, for 150 tons of wheat, 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

5. 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)**

approval basis, the property in goods passes from seller to the buyer:

1. When the person to whom the goods are given either accepts them or does an act which implies adopting the transaction.
2. When the person to whom the goods are given retains the goods without giving his approval or giving notice of rejection beyond the time fixed for the return of goods and in case no time is fixed after the lapse of reasonable time.

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 5 tables are already accepted by him so the buyer becomes liable under the doctrine of "Caveat Emptor".

6. 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 file a suit against B for the recovery of price. Can he recover the price? **(Module)**

Ans. 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].

Had the horse died after the expiry of given time i.e. 8 days, then B would have been held liable (if the horse was still with him) but not before that time period.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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)**

Ans. 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

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.

2. 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)**

Ans. 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.

3. Ayushman is the owner of a residential property situated at Indraprastha Marg, New Delhi. He wants to sell this property and for this purpose he appoints Ravi, a mercantile agent with a condition that Ravi will not sell the house at a price not less than $ 5 crores. Ravi sells the house for $ 4 crores to Mudit, who buys in good faith. Ravi misappropriated the money received from Mudit. Ayushman files a suit against Mudit to recover his property. Decide with reasons, can Ayushman do so under the Sale of Goods Act, 1930? **(RTP May 23)**

Ans. As per the Proviso to Section 27 of the Sale of Goods Act, 1930, a sale made by a mercantile agent of the goods would pass a good title to the buyer in the following circumstances; namely;

A. If he was in possession of the goods or documents with the consent of the owner;
B. If the sale was made by him when acting in the ordinary course of business as a mercantile agent; and
C. If the buyer had acted in good faith and has at the time of the contract of sale, no notice of the fact that the seller had no authority to sell.

On the basis of above, it can be said that Ravi, the mercantile agent, sells property to Mudit who bought in good faith. Mudit obtained a good title of that residential property. Hence, Ayushman cannot recover his property from Mudit. Rather, Ayushman can recover his loss from Ravi.

4. State the various essential elements involved in the sale of unascertained goods and its appropriation as per the Sale of Goods Act, 1930. **(RTP Nov'23)**

Ans. Sale of unascertained goods and Appropriation (Section 23 of the Sale of Goods Act, 1930):

Appropriation of goods involves selection of goods with the intention of using them in performance of the contract and with the mutual consent of the seller and the buyer.

The essentials are:

A. There is a contract for the sale of unascertained or future goods.
B. The goods should conform to the description and quality stated in the contract.

D. The goods must be unconditionally appropriated to the contract either by delivery to the buyer or his agent or the carrier.

E. The appropriation must be made by:
   (a) the seller with the assent of the buyer; or
   (b) the buyer with the assent of the seller

F. The assent may be express or implied.

G. The assent may be given either before or after appropriation.

5. Akansh purchased a Television set from Arvind, the owner of Gada Electronics on the condition that first three days he 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. Arvind demands the price of a Television set from Akansh. Whether Akansh is liable to pay the price under the Sale of Goods Act, 1930? Who will ultimately bear the loss?

(RTP Jun'24) (RTP Nov'22) (RTP Nov'21)

Ans. 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:

1. when he signifies his approval or acceptance to the seller,
2. when he does any other act adopting the transaction, and
3. 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 the above provisions and fact, the property is not passed 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. Akanshis not liable to pay the price. The loss finally should be borne by Seller, Mr. Arvind.

6. 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?

(MTP Mar'22 6 Marks)

Ans. 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

amounts to a valid sale although the seller is no more the owner of goods after sale.

1. A seller has possession of goods after sale
2. With the consent of the other party (i.e. buyer)
3. The seller sells goods (already sold) to a new buyer
4. The new buyer acts in good faith
5. 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.

7. Explain any six circumstances in detail in which a non-owner can convey better title to the bona fide purchaser of goods for value under the Sale of Goods Act, 1930.

(MTP Apr'23 6 Marks) (MTP 6 Marks, Oct'21)

Or

"Nemo Dat Quad 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.

(MTP Nov'22 4 Marks) (SM) MTP May'23 6 Marks) (RTP Nov 21) (MTP 4 Marks, Nov'21)

Ans. In the following cases, a non-owner can convey better title to the bona fide purchaser of goods for value:

1. **Sale by a Mercantile Agent:** A sale made by a mercantile agent of the goods for document of title to goods would pass a good title to the buyer in the following circumstances; namely;
   (a) if he was in possession of the goods or documents with the consent of the owner;
   (b) If the sale was made by him when acting in the ordinary course of business as a mercantile agent, and
   (c) if the buyer had acted in good faith and has at the time of the contract of sale, no notice of the fact that the seller had no authority to sell (Proviso to Section 27).

   Mercantile Agent means an agent having in the customary course of business as such agent has authority either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)].
2. **Sale by one of the joint owners (Section 28):** If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them from such joint owner in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell.
3. **Sale by a person in possession under voidable contract:** A buyer would acquire a good title to the goods sold to him by a seller who had obtained possession of the goods under a contract voidable on the ground of coercion, fraud, misrepresentation or undue

(Section 29).

4. **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 and without notice of the previous sale, he would have good title to them, although the property in the goods had passed to the first buyer earlier. A pledge or other disposition of the goods or documents of title by the seller in possession are equally valid [Section 30(1)].
5. **Sale by buyer obtaining possession before the property in the goods has vested in him:** 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 [Section 30(2)].

   However, a person in possession of goods under a 'hire-purchase' agreement which gives him only an option to buy is not covered within the section unless it amounts to a sale.
6. **Effect of Estoppel:** Where the owner is estopped 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.
7. **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)].
8. **Sale under the provisions of other Acts:**
   (a) Sale by an Official Receiver or Liquidator of the Company will give the purchaser a valid title.
   (b) Purchase of goods from a finder of goods will get a valid title under circumstances [Section 169 of the Indian Contract Act, 1872.
   (c) A sale by pawnee can convey a good title to the buyer [Section 176 of the Indian Contract Act, 1872].

8. "Risk Prima Facie passes with property." Elaborate in the context of the Sale of Goods Act, 1930. **(MTP Nov'23 4 Marks) (MTP Nov'22 4 Marks)**

Ans. Risk prima facie passes with property (Section 26 of the Sale of Goods Act, 1930)

According to Section 26, 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 the buyer's risk whether delivery has been made or not.

It is provided that, where delivery has been delayed because of the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as bailee of the goods of the other party.

as per the Sale of Goods Act, 1930. **(MTP Dec'23 4 Marks)**

Ans. **Sale of unascertained goods and Appropriation [Section 23(1) of the Sale of Goods Act, 1930]**

Where there is a contract for the sale of unascertained goods by description and goods of that description are in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer.

Whereas, Appropriation of goods involves selection of goods with the intention of using them in performance of the contract and with the mutual consent of the seller and the buyer.

The essentials elements are:

(a) There is a contract for the sale of unascertained or future goods.

(b) The goods should conform to the description and quality stated in the contract.

(c) The goods must be in a deliverable state

(d) The goods must be unconditionally (as distinguished from an intention to appropriate) appropriated to the contract either by delivery to the buyer or his agent or the carrier.

(e) The appropriation must be made by:

1. the seller with the assent of the buyer; or
2. the buyer with the assent of the seller.

(f) The assent may be express or implied

(g) The assent may be given either before or after appropriation.

10. 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 2 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.

(PYQ Dec'23 4 Marks)

Ans. 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, 2 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.

11. Against B's tender, R agrees to sell and deliver 1,000 kg tomatoes @ 7100 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

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?

(PYQ Dec' 23 2 Marks)

Ans. 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 15 th 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.

12. "Risk Prima Facie passes with property". Elaborate in the context of the Sales of Goods Act, 1930. **(PYQ 4 Marks, Jul'21)**

Ans. Risk prima facie passes with property (Section 26 of the Sales of Goods Act, 1930)

According to Section 26, 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 the buyer's risk whether delivery has been made or not.

It is provided that, where delivery has been delayed because of the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as bailee of the goods of the other party.

13. 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 6 Marks, Apr'21) (SM)**

Ans. 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. 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 ascertained and where there is contract for the sale of unascertained or future goods by description, and goods of that description and

with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be express or implied. 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.

1. 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.
2. 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.

14. 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 6 Marks, Nov'21)**

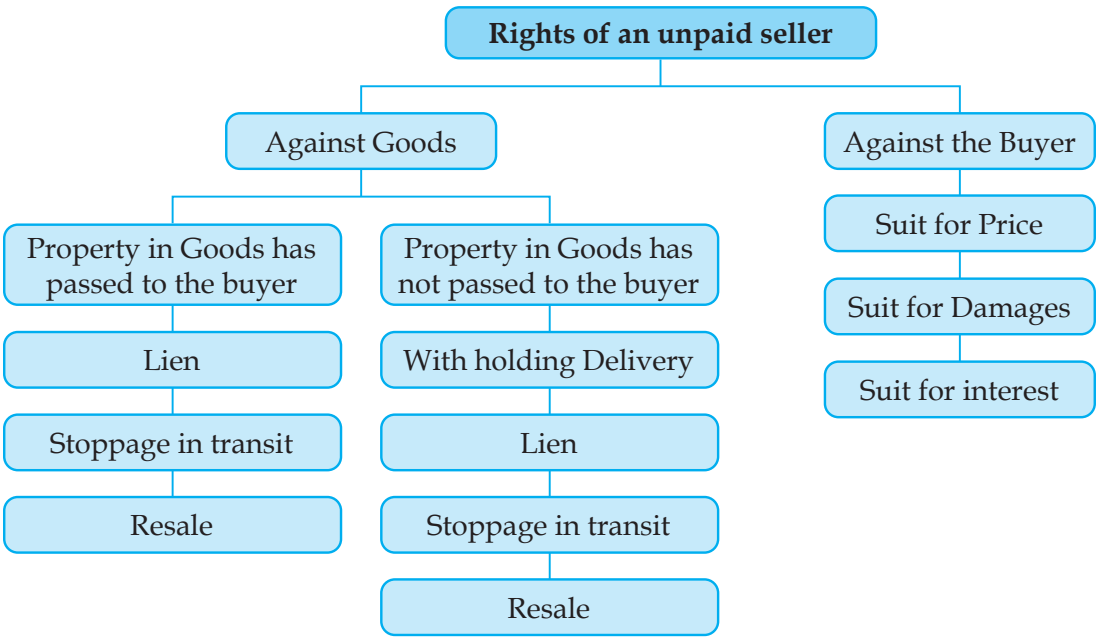
Ans. As per the provisions of the Sale of Goods Act, 1930 there are three modes of delivery— (i) Actual delivery, (ii) Constructive delivery and (iii) Symbolic delivery. When delivery is affected without any change in the custody or actual possession of the things, it is called constructive delivery 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.

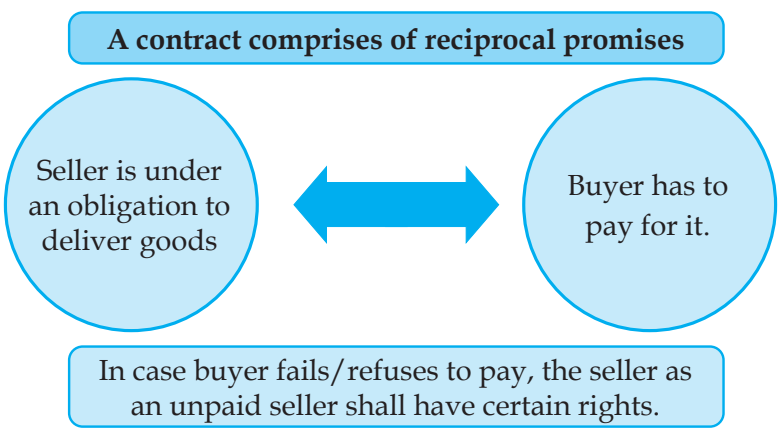
In the instant case, Kishore acknowledges Avyukt that he is holding wheat on Avyukt's behalf. Before picking the wheat from warehouse by Avyukt, whole wheat was flowed in flood.

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.

Unpaid Seller



UNPAID SELLER



Section 45(1) - 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.

payment, and the condition on which it was received has **not been fulfilled** by reason of the **dishonour** of the instrument or otherwise.

Section 45(2)

- Seller = **Includes** any person:
  - who is in the position of a seller, as, for instance,
  - an **agent** of the seller to whom the bill of lading has been endorsed, or
  - a **consignor** or
  - **agent** who has himself paid, or
  - is directly **responsible** for the **price**

Example 1: X sold certain goods to Y for Rs. 50,000. Y paid Rs. 40,000 but fails to pay the balance. X is an unpaid seller.

Example 2: P sold some goods to R for Rs. 60,000 and received a cheque for a full price. On presentment, the cheque was dishonoured by the bank. P is an unpaid seller.

RIGHTS OF AN UNPAID SELLER

Section 46

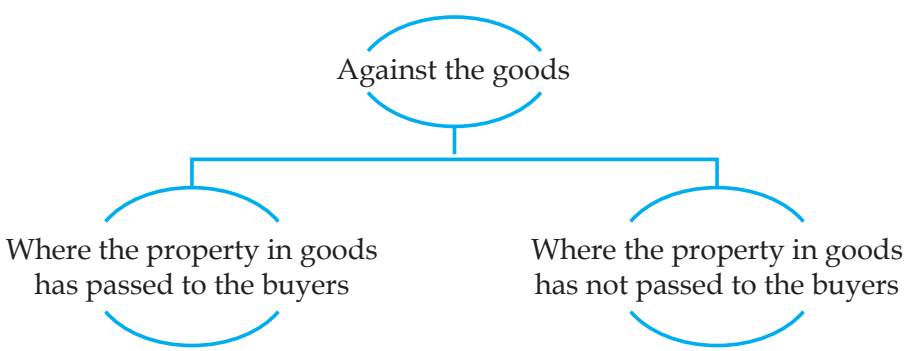
- **Sub-section (1):** Subject to the provisions of this Act and of any law for the time being in force, notwithstanding that:

  The property in the goods may have passed to the buyer, the unpaid seller of goods, as such, has by implication of law (buyer के पास property चली भी गई हो तो भी Unpaid Seller के पास ये rights है)
  - a **lien** on the **goods for** the **price** while he is in **possession** of them;
  - in case of the **insolvency** of the **buyer** a **right of stopping the goods in transit** after he has parted with the possession of them;
  - **a right of re-sale** as limited by this Act.
- **Sub-section (2):** Where the **property in goods has not passed** to the buyer, the unpaid seller has, **in addition to his other remedies, a right of withholding delivery** similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer.

  An unpaid seller has been expressly given the rights against:
  - The **goods** as well as
  - The **buyer** personally

RIGHT OF UNPAID SELLER AGAINST THE GOODS

The unpaid seller has the following rights against the goods:



Rights of lien:

- An unpaid seller has a right of **lien** on the goods for the price **while he is in possession**, until the payment or tender of the price of such goods.
- It is the right to **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.

The unpaid seller's lien is a possessory lien i.e. the lien can be exercised as long as the seller remains in possession of the goods.

Exercise of right of lien: This right can be exercised by him in the following cases only:

1. where goods have been sold **without** any stipulation of **credit**; **(i.e., on cash sale)**
2. where goods have been sold **on credit but** the **term** of credit has **expired**; or
3. where the **buyer becomes insolvent**.

Example 3: A sold certain goods to B for a price ₹50,000 and allowed him to pay the price within one month. B becomes insolvent during this period of credit. A, the unpaid seller, can exercise his right of lien.

Seller may exercise his right of lien even where he is in possession of the goods as agent or bailee for the buyer.

Insolvent means a person:

- who has ceased to pay his debts in the ordinary course of business, or
- cannot pay his debts as they become due,
- whether he has committed an act of insolvency or not".

Part delivery (Section 48)

Where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien.

Termination of lien (Section 49)

The unpaid seller loses his right of lien under the following circumstances:

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. Where the **buyer or his agent lawfully** obtains **possession** of the goods.
3. Where seller has **waived the right of lien**.
4. **By Estoppel** i.e., where the **seller so conducts himself** that he leads third parties to believe that the lien does not exist.

Exception:

- The unpaid seller of the goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree for the price of the goods.
- This means even if the seller has taken a price for the goods under a court case, he can still exercise his right to lien on those goods.

Example 4: A, sold a car to B for 1,00,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now A cannot exercise the right of lien.

Maggi Table (Revise in just 2 minutes)	
Topic - LIEN ON GOODS as a right of an US	
Section	**Key Points**
Section 47 Seller's Lien	Rights of Lien: Retain possession until payment. Possessory Lien: Active while in possession. Exercise of Lien: Conditions for exercise - Cash sale, Expired credit, Buyer's insolvency.
Section 48 Part Delivery	Part Delivery: Right of lien on remaining goods. Waiver: Lien waived if part delivery shows agreement.
Section 49 Termination of Lien	Loss of Lien: Delivery to carrier/bailee without disposal rights. Possession: Buyer/agent lawfully obtains goods. Waiver: Seller waives the lien. Estoppel: Seller's conduct indicates no lien. Exception: Lien retained despite court decree.

2. Right of Stoppage in Transit (Section 50 to 52)

Meaning of right of stoppage in transit (Section 50):

- The right of stoppage in transit means the right of stopping the goods while they are in transit, to regain the possession and to retain them till the full price is paid.
- When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right of asking the carrier to return the goods back, or not to deliver the goods to the buyer.
- This right is the extension of the right of lien: As it entitles the seller to regain possession even when the seller has parted with the possession 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) He must have parted with the possession of goods.
  (c) The goods are in transit.
  (d) The buyer has become insolvent.
  (e) The right is subject to provisions of the Act. [Section 50]

> *Example 5: A of Mumbai sold certain goods to B of Delhi. He delivered the goods to C, a common carrier for the purpose of transmission of these goods to B. Before the goods could reach him, B became insolvent and A came to know about it. A can stop the goods in transit by giving a notice of it to C.*

Duration of transit (Section 51)

- The goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent on that behalf takes delivery of them from such carrier or other bailee.
- When does the transit come to an end?

  The right of stoppage in transit is lost when transit comes to an end.

  Transit comes to an end in the following cases:

  1. When the **buyer** or other bailee **obtains delivery**.
  2. Buyer **obtains delivery before the arrival of goods at destination**. It is also called interception by the buyer which can be with or without the consent of the carrier.

goods as soon as the **goods are loaded on the ship**, unless the seller has reserved the right of disposal of the goods.

4. If the carrier **wrongfully refuses to deliver** the goods to the buyer.
5. Where goods are **delivered to the carrier hired by the buyer**, the transit comes to an end.
6. Where the **part delivery of the goods has been made to the buyer**, the transit will come to an end **for the remaining goods** which are yet in the course of transmission.
7. Where the **goods are delivered to a ship** chartered by the **buyer**, the transit comes to an end. [section 51]

How stoppage in transit is effected (Section 52): (Notice to be given)

1. The unpaid seller may exercise his right of stoppage in transit either by
   (a) taking actual possession of the goods, or
   (b) by giving notice of his claim to the carrier or other bailee
   (c) in whose possession the goods are.
   (d) Such notice may be given either to the person in actual possession of the goods or to his principal.

   When given to the principal: The notice, to be effectual, shall be given at such time and in such circumstances, that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.
2. When notice of stoppage in transit is given by the seller
   (a) to the carrier or other bailee in possession of the goods,
   (b) he shall re-deliver the goods to, or
   (c) according to the directions of, the seller.
   (d) The expenses of such re-delivery shall be borne by the seller.

Maggi Table (Revise in just 2 minutes)	
Topic - STOPPAGE IN TRANSIT as a right of an US	
Section	**Key Points**
Section 50: Right of Stoppage in Transit	Meaning: Right to stop goods in transit and regain possession. Conditions: Unpaid seller, Goods in transit, Buyer's insolvency. Extension of Lien: Right applies even after possession is parted.
Section 51: Duration of Transit	Transit Period: From delivery to carrier until buyer/agent takes delivery. End of Transit: Delivery obtained by buyer/bailee, Interception, Acknowledgment by carrier, Wrongful refusal by carrier, Part delivery, Delivery to chartered ship.
Section 52: Effecting Stoppage in Transit	Exercise: Take possession or give notice to carrier/bailee. Notice: Effective if communicated in time. Re-delivery: Carrier must return goods as directed by seller. Expenses: Borne by the seller.

Distinction between Right of Lien and Right of Stoppage in Transit

Aspect	Right of Lien	Right of Stoppage in Transit
Possession	Seller retains possession of goods.	Seller regains possession after sending goods.
Conditions	Seller has the goods.	Seller sent the goods; goods with carrier; buyer hasn't received them.

Insolvency	Can be exercised even if the buyer isn't insolvent.	Applies only if the buyer is insolvent.
Timing	Ends when goods leave the seller's possession.	Starts when lien ends; ends when buyer gets the goods.

Sometimes it is said that right of stopping the goods in transit is nothing but an extension of right of lien.

Effects of sub-sale or pledge by buyer (Section 53)

The right of lien or stoppage in transit is not affected by the buyer selling or pledging the goods unless the seller has assented to it.

This is based on the principle that a second buyer cannot stand in a better position than his seller. (The first buyer).

Example 6: A sold certain goods to B of Mumbai and the goods are handed over to railways for transmission to B. In the mean time, B sold these goods to C for consideration. B becomes insolvent. A can still exercise his right of stoppage in transit. Here we assume that seller did not give his assent for sub sale, therefore he can still exercise his right of stoppage in transit.

The right of stoppage is defeated if the buyer has transferred the document of title or pledges the goods to a sub-buyer in **good faith** and for consideration.

Exceptions where unpaid seller's right of lien and stoppage in transit are defeated:

A. When the seller has assented to the sale, mortgage or other disposition of the goods made by the buyer. (ख़ुद ही Seller ने permission दिया है की बेचो)

Mount D. F. Ltd. vs Jay & Jay (Provisions) Co. Ltd)

Example 7: A entered into a contract to sell cartons in possession of a wharfinger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now B sold goods to C and C duly paid to B. But anyhow B failed to make the payment to A. A wanted to exercise his right of lien and ordered the wharfinger not to make delivery to C. Held that the seller had assented to the resale of the goods by the buyer to the sub-buyers. As a result, A's right to lien is defeated.

B. When a document of title to goods has been transferred to the buyer

- And the buyer transfers the documents to a person who has bought goods in good faith and for value i.e. for price, then, the proviso of sub-section (1) stipulates as follows:

(i) If the last-mentioned transfer is **by way of sale** - right of lien or stoppage in transit is **defeated**, or

(ii) If the last mentioned transfer is **by way of pledge** - unpaid seller's right of lien or stoppage **only be exercised, subject to the rights of the pledgee**.

However, the pledgee may be required by the unpaid seller to use in the first instance, other goods or securities of the pledger available to him to satisfy his claims. [Sub- section (2)].

Effect of stoppage

- The contract of sale is not rescinded when the seller exercises his right of stoppage in transit.
- The contract still remains in force and the buyer can ask for delivery of goods on payment of price.

Right of re-sale [Section 54]

The right of resale is a very **valuable** right given to an unpaid seller. In the absence of this right, the unpaid seller's other rights against the goods that is **lien and the stoppage in transit** would

until paid by the buyer. The unpaid seller can **exercise the right to re-sell** the goods under the following conditions:

Where the goods are of a perishable nature: In such a case, the buyer need not be informed of the intention of resale.

Conditions for Resale

- **Perishable Goods:** Seller can resell without informing the buyer.
- **Notice to Buyer:** If the buyer fails to pay after being notified, the seller can resell. The seller can:
  - Recover losses if the resale price is lower than the original contract price.
  - Keep profits if the resale price is higher, but only if notice was given.

Resale Without Notice

If no notice is given, the seller cannot claim losses or keep profits.

Good Title to Subsequent Buyer

If the seller resells after exercising lien or stoppage in transit, the new buyer gets good title, **even without notice to the original buyer**.

Express Right in Contract

If the contract explicitly allows resale on default, the seller can resell without notice and recover damages.

Quasi-Lien

- If the property in goods **hasn't passed** to the buyer, the seller can **withhold delivery**, **similar** to a **lien**.
- This is the additional right used in case of agreement to sell.

RIGHTS OF UNPAID SELLER AGAINST THE BUYER (SECTIONS 55-61)

Rights of unpaid seller against the buyer personally: An unpaid seller can enforce certain rights against the goods as well as against the buyer personally. Rights of unpaid seller against the buyer:

- Known as seller's remedies for breach of contract of sale.
- Called rights in personam and are in addition to his rights against the goods.
- The right against the buyer are as follows:

1. **Suit for price (Section 55):**
   - **Section 55(1):** *This is the case of 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(2):** *This is the case of agreement to sell*
     - When 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 **although** the **property** in the **goods has not passed** and the goods have **not been appropriated** to the contract.
2. **Suit for damages for non-acceptance (Section 56):**
   - Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance.
   - Measure of damages, Section 73 of the Indian Contract Act, 1872

- Where the buyer repudiates the contract **before the date of delivery**, the seller may treat the contract as **rescinded** and sue damages for the breach.
- This is known as the **'rule of anticipatory breach of contract'**.

4. **Suit for interest [Section 61]:**
   - Where there is specific agreement between the seller and the buyer as to interest on the price of the goods from the date on which payment becomes due, the seller may recover interest from the buyer.
   - If, however, there is no specific agreement to this effect, the seller may charge interest on the price when it becomes due from such day as he may notify to the buyer.

In the absence of a contract to the contrary, the Court may award interest to the seller in a suit by him at such rate as it thinks fit on the amount of the price from the date of the tender of the goods or from the date on which the price was payable.

REMEDIES OF BUYER AGAINST THE SELLER

Breach of Contract (अनुबंध का उल्लंघन)

By seller:

Breach of contract by seller, where he-
❑ Fails to deliver the goods at the time or in manner prescribed
❑ Repudiates the contract
❑ Deliver non-conforming goods and buyer rejects and revokes acceptance

If the seller commits a breach of contract,

The buyer gets the following rights against the seller:

Maggi Table (Revise in just 2 minutes)	
REMEDIES OF BUYER AGAINST THE SELLER	
Section	**Crux / Key Words**
Section 57	Damages for non-delivery by seller.
Section 58	Suit for specific performance; applies to specific goods.
Section 59	Breach of warranty; buyer's remedies.
Section 60	Repudiation of contract before due date; damages.
Suit for Interest	Right to recover interest or special damages.

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.

   Example 8: A' a shoe manufacturer, agreed to sell 100 pairs of shoes to 'B' at the rate of ₹10,500 per pair. 'A' knew that 'B' wanted the shoes for the purpose of further reselling them to 'C' at the rate of ₹11,000/- per pair. On the due date of delivery, 'A' failed to deliver the shoes to 'B'. In consequence, 'B' could not perform his contract with 'C' for the supply of 100 pairs of shoes. In this case, 'B' can recover damages from 'A' at the rate of ₹500/- per pair (the difference between the contract price and resale price).

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**. This remedy is allowed by the court subject to these conditions:

(a) The contract must be for the sale of **specific and ascertained** goods.

(b) The power of the court to order specific performance is subject to **provisions of Specific Relief Act of 1963**.

(c) It empowers the court to order specific performance where **damages would not be an adequate remedy**.

(d) It will be granted as remedy **if goods are of special nature or are unique**.

> *Example 9: 'A' agreed to sell a rare painting of Mughal period to 'B'. But on the due date of delivery, 'A' refused to sell the same. In this case, 'B' may file a suit against 'A' for obtaining an order from the Court to compel 'A' to perform the contract (i.e. to deliver the painting to 'B' at the agreed price).*

3. **Suit for breach of warranty (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–
   - set up against the seller the breach of warranty in **diminution** or **extinction** of the price; or
   - 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 filed 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**.

> *Example 10: In case of a sale of cigarettes which turned out to be mildewed and unfit for consumption, damages were awarded on the basis of the difference between the contract price and the price released.*
>
> *Example 11: In case of absence of transfer of title or registration, the purchaser cannot claim damages for breach of conditions and warranties relating to sale.*

AUCTION SALE (SECTION 64)

- An 'Auction Sale' is a mode of selling property by **inviting bids publicly** and the property is **sold** to the **highest bidder**.
- An **auctioneer** is an **agent** governed by the Law of Agency.
- When he sells, he is only the agent of the seller.
- He may, however, sell his own property as the principal and need not disclose the fact that he is so selling.

1. **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.
2. **Completion of the contract of sale:** The sale is complete when the auctioneer announces its completion by the
   Fall of hammer or in any other customary manner.
   Until such announcement is made, any bidder may retract from his bid.
3. **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.
4. **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.
5. **Reserved price:** The sale may be notified to be subject to a reserve or upset price.
6. **Pretended bidding:** If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

Example 12: P sold a car by auction. It was knocked down to Q who was only allowed to take it away on giving a cheque for the price and signing an agreement that ownership should not pass until the cheque was cleared. In the meanwhile till the cheque was cleared, Q sold the car to R. It was held that the property was passed on the fall of the hammer and therefore R had a good title to the car. Both sale and sub sale are valid in favour of Q and R respectively.

INCLUSION OF INCREASED OR DECREASED TAXES IN CONTRACT OF SALE (SECTION 64A)

When a contract is made and taxes change (revision) before it's fulfilled or performed, the price can be adjusted based on the new tax rates:

- **Types of Taxes:** Customs duties, excise duties, and sales taxes.
- **Price Adjustment:**
  - If taxes increase, the buyer pays the higher price.
  - If taxes decrease, the buyer benefits from the lower price.
- **Agreement Exception:** Parties can agree not to adjust the price based on tax changes.

This means the seller can add the increased taxes to the price, but the effect can be excluded by mutual agreement.

"PROBLEM KYA HAI? - UNIT 4"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - SOGA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

1. Mr. D sold some goods to Mr. E for $ 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. **(Module)**

Ans. **Position of Mr. D:** Mr. D sold some goods to Mr. E for $ 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 and already delivered to E, 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:

1. **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.
2. **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.
3. **Suit for interest [Section 61]:** If there is no specific agreement between 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.

2. 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. Can Ram exercise right of stopping the goods in transit? **(Module)**

Ans. 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.

1. The seller must be unpaid
2. He must have parted with the possession of goods
3. The goods must be in transit
4. The buyer must have become insolvent
5. The right is subject to the provisions of the Act.

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. He may recover the price of other 100 bales sent by lorry by using his rights against the buyer.

3. Suraj sold his car to Sohan for $ 75,000. After inspection and satisfaction, Sohan paid $ 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. **(Module)**

Ans. 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

buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for the price of the goods [Section 55(1)].

2. 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.

4. A, who is an agent of a buyer, had obtained the goods from the Railway Authorities and loaded the goods on his truck. In the meantime, the Railway Authorities received a notice from B, the seller for stopping the goods in transit as the buyer has become insolvent.

Referring to the provisions of Sale of Goods Act, 1930, decide whether the Railway Authorities can stop the goods in transit as instructed by the seller? **(Module)**

Ans. The right of stoppage of goods in transit means the right of stopping the goods after the seller has parted with the goods. Thereafter the seller regains the possession of the goods.

This right can be exercised by an unpaid seller when he has lost his right of lien over the goods because the goods are delivered to a carrier for the purpose of taking the goods to the buyer. This right is available to the unpaid seller only when the buyer has become insolvent.

The conditions necessary for exercising this right are:

1. The buyer has not paid the total price to the seller
2. The seller has delivered the goods to a carrier thereby losing his right of lien
3. The buyer has become insolvent
4. The goods have not reached the buyer, they are in the course of transit. (Section 50, 51 and 52).

In the given case A, who is an agent of the buyer, had obtained the goods from the railway authorities and loaded the goods on his truck. After this the railway authorities received a notice from the seller B to stop the goods as the buyer had become insolvent.

According to the Sale of Goods Act, 1930, the railway authorities cannot stop the goods because the goods are not in transit. A who has loaded the goods on his truck is the agent of the buyer. That means railway authorities have given the possession of the goods to the buyer. The transit comes to an end when the buyer or his agent takes the possession of the goods.

5. J sold a machine to K. K gave a cheque for the payment. The cheque was dishonoured. But J 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? **(Module)**

Ans. 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:

B. 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, I 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.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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 May'23) (SM)**

Ans. 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.

2. Ravi sold 500 bags of wheat to Tushar. Each bag contains 50 Kilograms of wheat. Ravi sent 450 bags by road transport and Tushar himself took remaining 50 bags. Before Tushar receives delivery of 450 bags sent by road transport, he becomes bankrupt. Ravi being still unpaid, stops the bags in transit.

The official receiver, on Tushar's insolvency claims the bags. Decide the case with reference to the provisions of the Sale of Goods Act, 1930. **(RTP Nov'23) (PYQ Dec'21 3 Marks)**

Ans. **Right of stoppage in transit (Section 50 of the Sale of Goods Act, 1930):**

Subject to the provisions of this Act, when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit and may retain them until paid or tendered price of the goods.

When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right of asking the carrier to return the goods back, or not to deliver the goods to the buyer.

the seller, can stop the goods in transit by giving a notice of it to Tushar. The official receiver, on Tushar's insolvency cannot claim the bags.

3. 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 ofcontract, 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:

1. State, whether Mr. Shankar was right in his decision?
2. What would be your answer if Mr. Ganesh became insolvent within five days of contract?

(RTP Jun'24)

Ans. 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.

1. 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.
2. In case Mr. Ganesh became insolvent before the delivery of wheat, Mr. Shankar had the right to apply the lien and he could withholdthe delivery

4. When can an unpaid seller of goods exercise his right of lien over the goods under the Sale of Goods Act, 1930? 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 Jun'22 6 Marks) (RTP Nov'22) (SM) (MTP 6 Marks, Nov 21)

Ans. A lien is a right to retain possession of goods until the payment of the price. it is available to the unpaid seller of the goods who is in possession of them where:

1. the goods have been sold without any stipulation as to credit;
2. the goods have been sold on credit, but the term of credit has expired;
3. the buyer becomes insolvent.

the buyer. He can exercise his right even if he is in possession of the goods as agent or bailee for the buyer.

Termination of lien: An unpaid seller looses his right of lien thereon-

- 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;
- When the buyer or his agent lawfully obtains possession of the goods;
- Yes, he can exercise his right of lien even after he has obtained a decree for the price of goods from the court.

5. Discuss the rights of an unpaid seller against the buyer under the Sales of Goods Act, 1930.
(MTP Nov'22 6 Marks) (MTP Mar'22 6 Marks) (PYQ 6 Marks, Jul'21)

Ans. The right against the buyer are as follows:

1. **Suit for price (Section 55 of the Sale of Goods Act, 1930)**
   (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)]
   (b) 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 although the property in the goods has not passed and the goods have not been appropriated to the contract. [Section 55(2)].
2. **Suit for damages for non-acceptance (Section 56):** Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance.
3. **Repudiation of contract before due date (Section 60):** Where the buyer repudiates the contract before the date of delivery, the seller may treat the contract as rescinded and sue damages for the breach. This is known as the 'rule of anticipatory breach of contract.
4. **Suit for interest [Section 61]:** Where there is specific agreement between the seller and the buyer as to interest on the price of the goods from the date on which payment becomes due, the seller may recover interest from the buyer. If, however, there is no specific agreement to this effect, the seller may charge interest on the price when it becomes due from such day as he may notify to the buyer.

In the absence of a contract to the contrary, the Court may award interest to the seller in a suit by him at such rate as it thinks fit on the amount of the price from the date of the tender of the goods or from the date on which the price was payable.

6. Mr. Shekharan sells 100 bags of cement to Mr. Raghwan for cash and consigns goods to him through railways. He also sends the railway receipt to Mr. Raghwan. When the goods were in transit, Mr. Raghwan becomes insolvent and Mr. Raghwan sells the said goods to Mr. Ravi by assigning the railway receipt to Mr. Ravi who has no idea about the insolvency of Mr. Raghwan. Mr. Shekharan who is being unpaid seller wants to exercise his right to stoppage in transit.

A. State with reason, can Mr. Shekharan do so under the Sale of Goods Act, 1930?
B. Whether your answer would be same if Mr. Ravi have knowledge of Mr. Raghwan's insolvency at the time of buying the goods? **(MTP May/23 6 Marks)**

becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit and he may resume possession of the goods as long as they are in the course of transit and may retain them until payment or tender of the price. However right of stoppage in transit is available only in the following conditions:

1. The seller must be an unpaid seller.
2. When the buyer becomes insolvent; and
3. When the goods are in transit.

This right of stoppage in transit is lost if buyer makes sub - sale of such goods during in transit and that buyer purchased in good faith.

(a) On the basis of above provisions and facts, it can be said that even Mr. Shekharan is an unpaid seller, he cannot apply his right of stoppage in transit as goods has been taken by Mr. Ravi in good faith.

(b) Further, if Mr. Ravi has knowledge of Mr. Raghwan's insolvency at the time of buying the goods, Mr. Ravi has not bought the goods in good faith. Hence, Mr. Shekharan can exercise his right of stoppage in transit.

7. What are the rights of unpaid seller in context to re-sale of the goods under Sale of Goods Act, 1930? **(MTP 6 Marks, Nov'23) (PYQ 6 Marks, Nov 22)**

Ans. Right of re-sale [Section 54 of the Sale of Goods Act, 1930):

The unpaid seller can exercise the right to re-sell the goods under the following conditions:

1. **Where the goods are of a perishable nature:** In such a case, the buyer need not be informed of the intention of resale.
2. **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)].
3. **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.
4. **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.

entitled to recover damages from the original buyer even if no notice of resale is given.

5. **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".

8. Describe in brief the rights of the buyer against the seller in case of breach of contract of Sale under Sale of Goods Act, 1930. **(MTP Dec'23 6 Marks) (PYQ Jun'23 6 Marks)**

Ans. If the seller commits a breach of contract, the buyer gets the following rights against the seller:

1. **Damages for non-delivery [Section 57 of the Sale of Goods Act, 1930]:** 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 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 or is forced to treat breach of condition as breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods on the basis of such breach of warranty; but the buyer may - set up against the seller the breach of warranty in diminution or extinction of the price; or) 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:**
   (a) The buyer is entitled to recover interest or special damages, or to recover the money paid where the consideration for the payment of it has failed.
   (b) 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.

9. 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. **(PYQ Jun'23 2 Marks)**

Ans. 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.

10. 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? **(PYQ Dec' 23 6 Marks)**

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.

According to sub-section (2), the seller may exercise his right of lien notwithstanding that he in possession of the goods as agent or bailee for the buyer.

As per the provisions of Section 48, where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien.

Termination of lien (Section 49): According to sub-section (1), the unpaid seller of goods loses his lien thereon-

(a) 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;

(b) when the buyer or his agent lawfully obtains possession of the goods;

(c) by waiver thereof.

The unpaid seller of goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree for the price of the goods. [Sub-section (2)]

11. 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)**

Ans. By virtue of provisions of 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.

12. What are the rules which regulate the Sale by Auction under the Sale of Goods Act, 1930? **(PYQ 4 Marks, Jan'21)**

Ans. Rules of Auction sale: Section 64 of the Sale of Goods Act, 1930 provides following rules to regulate the sale by auction:

1. **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.
2. **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.
3. **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.

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.

5. **Reserved price:** The reserved price is the lowest price at which a seller is willing to sell an item. The auction sale may be notified to be subject to a reserve or upset price; and
6. **Pretended bidding:** If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

13. What do you understand by the term "unpaid seller" under the Sale of Goods Act, 1930? When can an unpaid seller exercise the right of stoppage of goods in transit?

(MTP 6 Marks, Apr'21)

Ans. **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) bill of exchange or other negotiable instrument has been received as conditional payment, and it has been dishonored.

Right of stoppage of goods in transit: 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.

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.

04

CHAPTER

The Indian Partnership Act, 1932

TABLE OF CONTENT FOR THE CHAPTER

UNIT-1 - GENERAL NATURE OF PARTNERSHIP

- PRE-REQUISITE 4.3
- DEFINITION OF 'PARTNERSHIP', 'PARTNER', 'FIRM' AND 'FIRM NAME' (SECTION 4) 4.3
- ELEMENTS OF PARTNERSHIP 4.3
- TRUE TEST OF PARTNERSHIP 4.6
- PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANISATION 4.8
- KINDS OF PARTNERSHIPS 4.12
- TYPES OF PARTNERS 4.13
- ***"PROBLEM KYA HAI? - UNIT 1"*** 4.16

UNIT-2 - RELATIONS OF PARTNERS

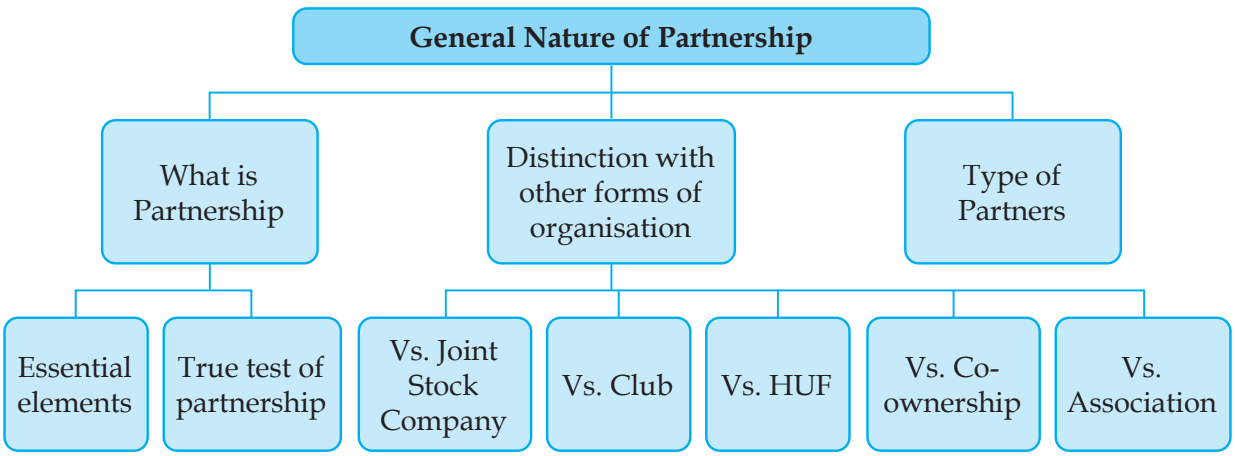
- RELATION OF PARTNERS TO ONE ANOTHER 4.25
- PARTNERSHIP PROPERTY (SECTION 14) 4.29
- PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16) 4.30
- RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM (SECTION 17) 4.31
- RELATION OF PARTNERS TO THIRD PARTIES 4.32
- EFFECT OF ADMISSIONS BY A PARTNER (SECTION 23) 4.33
- EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24) 4.34
- LIABILITY TO THIRD PARTIES (SECTION 25 TO 27) 4.35
- RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29) 4.37
- MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30) 4.37
- LEGAL CONSEQUENCES OF PARTNER COMING IN & GOING OUT (SECTION 31-35) 4.39
- RIGHTS OF OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS (SECTION 36) 4.44
- RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS (SECTION 37) 4.44
- REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38) 4.44
- ***"PROBLEM KYA HAI? - UNIT 2"*** 4.45

UNIT 3 : REGISTRATION AND DISSOLUTION OF A FIRM

- REGISTRATION OF FIRMS 4.61
- CONSEQUENCES OF NON-REGISTRATION (SECTION 69) 4.63
- DISSOLUTION OF FIRM (SECTIONS 39-47) 4.64
- MODES OF DISSOLUTION OF A FIRM (SECTIONS 40-44) 4.65
- CONSEQUENCES OF DISSOLUTION (SECTIONS 45-55) 4.68
- *"PROBLEM KYA HAI? - UNIT 3"* 4.72

UNIT 01

General Nature of Partnership



PRE-REQUISITE

- Applicable to the whole of India
- Act became applicable from 1st October 1932
- This act at this level cover sections - 1 to 74

DEFINITION OF 'PARTNERSHIP', 'PARTNER', 'FIRM' AND 'FIRM NAME' (SECTION 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.
- **Partners -** Persons who have entered into partnership with one another individually and
- **Firm -** Collectively and
- **Firm Name -** The name under which their business is carried on.

ELEMENTS OF PARTNERSHIP

- The definition of the partnership contains the following five elements which must co-exist before a partnership can come into existence.

Asso. of 2 or more (एक से भले दो)	Agreement (साँझा)	Business (धंधे से बड़ा कुछ नहीं)	Share profit (रोकड़ा)	By all or any one acting for all (हमेशा "हम" - मैं नहीं)

1. 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. (**NATURAL OR LEGAL PERSON**)
  - **A firm - since it is not a person** recognized in the eyes of law cannot be a partner.
  - **A minor cannot be a partner** in a firm, but with the consent of all the partners, may be admitted to the benefits of partnership.

NATURAL PERSON AND MAJOR	YES
NATURAL PERSON AND MINOR	NO
FIRM	NO
LLP	YES
COMPANY	YES

- MAXIMUM NO. OF PARTNERS:
  - The partnership Act is Silent
  - Section 464 of the Companies Act, 2013 - 50 partners

2. Agreement

- There must be an agreement entered into by all the persons concerned.
- This element relates to **voluntary contractual** nature of partnership. Thus, the nature of the partnership is **voluntary and contractual**.
- An agreement from which relationship of Partnership arises may be express.
- It may also be implied:
  - from the **act** done by partners and
  - from a **consistent course** of **conduct** being followed,

- It may be **oral** or in **writing**.

3. Business

- First, there **must exist a business**. **'Business'** includes **every trade, occupation and profession**. The existence of business is **essential**.
- Secondly, the **motive** of the business is the **"acquisition of gains"** which leads to the formation of partnership.
- Therefore, there can be **no partnership** where there is **no intention** to carry on the **business and** to **share the profit** thereof.

4. Agreement To Share Profits (Not Losses)

- The sharing of profits is an essential feature of partnership (**NOT TRUE TEST OF PARTNERSHIP** - Will be covered ahead)
- 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 element**.
- It is open to one or more partners to agree to share all the losses. **(Choice and not compulsion)**
- However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio.

> ***Example 1:*** *Co-owners who share amongst themselves the rent derived from a piece of land are not partners, because there does not exist any business.*
>
> ***Example 2:*** *No charitable institution or club may be floated in partnership [A joint stock company may, however, be floated for non-economic purposes].*
>
> ***Example 3:*** *X and Y buy certain bales of cotton which they agree to sell on their joint account and to share the profits equally. In these circumstances, X and Y are partners in respect of such cotton business.*

5. Business Carried on by all or any of them Acting for All

Mutual Agency

- 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.

An act of one partner in the course of the business of the firm is in fact an act of all partners.

Each partner = Principal as well as the agent for all the other partners.

- He is an agent in so far as he can bind the other partners by his acts and he is a principal to the extent that he is bound by the act of other partners.

> The true test of partnership is ***mutual agency*** rather than sharing of profits. If mutual agency is absent, then there will be no partnership.

Example 4: A, B and C are partners in ABC Associates, a partnership firm. If A made certain purchases for the purpose of business from Mr. K, then Mr. K can recover the money from A, B or C as all partners are liable for any act done on behalf of firm.

In KD Kamath & Co.

The Supreme Court has held that the two essential conditions to be satisfied are that:

1. *There should be an agreement to share the profits as well as the losses of business; and*
2. *The business must be carried on by all or any of them acting for all, within the meaning of the definition of 'partnership' under section 4.*

The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied.

Partnership Deed

The 'Partnership Agreement' is also known as 'Partnership Deed'.

- Which can be written as well as verbal but desired is written to avoid future disputes.
- Express or implied
- It should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899.
- If it is for immovable property then written + stamped and registered.
- No particular formalities are required for an agreement of partnership.
- Partnership deed may contain the following information:-

1. Name of the partnership firm.
2. Names of all the partners.
3. Nature and place of the business of the firm.
4. Date of commencement of partnership.
5. Duration of the partnership firm.
6. Capital contribution of each partner.
7. Profit Sharing ratio of the partners.
8. Admission and Retirement of a partner.
9. Rates of interest on Capital, Drawings and loans.
10. Provisions for settlement of accounts in the case of dissolution of the firm.
11. Provisions for Salaries or commissions, payable to the partners, if any.
12. 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.

TRUE TEST OF PARTNERSHIP

Mode of Determining Existence of Partnership (Section 6)

Why do we require this?

- To check if a group of persons is or is not a firm, or whether a person is or not a partner in a firm,

For determining the existence of partnership, it must be proved.

1. There was an **agreement** between all the persons concerned;

3. The **business** was carried on by all or any of them acting for all **(Mutual Agency)**

1. **Agreement:**

Section 5 - Partnership is created by agreement and not by status. The relation of partnership arises from contract and not from status.

- The members of a Hindu Undivided family carrying on a family business - NOT PARTNERS
- Burmese Buddhist husband and wife carrying on business - NOT PARTNERS

2. **Sharing of Profit:**

Profit-linked payments does not automatically make someone a partner in a business.

- The receipt by a person of a share of the profits of a business, or
- of a payment contingent upon the earning of profits or
- varying with the profits earned by a business,

does not of itself make him a partner with the persons carrying on the business. Cases:

(a) **by a lender of money to persons engaged or about to engage in any business,**

Example: Imagine A lends ₹10 lakhs to B's business and they agree that A will receive 10% of the profits as interest. Even though A receives a share of the profits, A is not considered a partner. A is merely a lender, not involved in the day-to-day running of the business.

(b) **by a servant or agent as remuneration,**

Example: C is an employee at D's firm, and they agree that C will receive a bonus equal to 5% of the business profits. Despite C receiving profit-based remuneration, C is not a partner; C remains an employee.

(c) **by a widow or child of a deceased partner, as annuity, or**

Example: E was a partner in a firm, but after E's death, the firm agrees to pay E's widow F an annuity of ₹50,000 per year, sourced from the business's profits. F is not a partner in the firm; she's just receiving a benefit as a dependent of the deceased partner.

(d) **by a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner with the persons carrying on the business.**

Example: G sells his share of the business to H but agrees to receive payments based on the business's future profits as consideration. G is not a partner after selling his share; G is just receiving deferred payment for the sale.

Sharing of profit is an essential element to constitute a partnership. But, it is only a *prima facie* evidence and not conclusive evidence

- CO-OWNERS: The sharing of profits or of gross returns accruing from property by persons holding joint or common interest in the property would not by itself make such persons partners.
- Although the right to participate in profits is a strong test of partnership BUT NOT THE ONLY TEST OF PARTNERSHIP. It depends upon the whole contract between the parties.
- REFER SECTION 6 WHEN: But the task becomes difficult when either there is no specific agreement or the agreement is such as does not specifically speak of partnership. In such a case for testing the existence or otherwise of partnership relation, Section 6 has to be referred.

between the parties as shown by all relevant facts taken together. The rule is easily stated and is clear but its application is difficult.

- CUMULATIVE EFFECT OF ALL RELEVANT FACTS: Such as written or verbal agreement, real intention and conduct of the parties, other surrounding circumstances etc., are to be considered while deciding the relationship between the parties and ascertaining the existence of partnership.

3. **Agency** - Covered above in detailed

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.

Santiranjan Das Gupta Vs. Dasyran Murzamull (Supreme Court)

In this case following factors weighed upon the Supreme Court to reach the conclusion that there is NO partnership between the parties:

1. *Parties have not retained any record of terms and conditions of partnership.*
2. *Partnership business has maintained no accounts of its own, which would be open to inspection by both parties.*
3. *No account of the partnership was opened with any bank.*
4. *No written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership.*

PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANISATION

Partnership Vs. Joint Stock Company (Company)

I	Incorporated Association
T	Transferability of Shares
O	Ownership - separate from its members
P	Perpetual Succession
C	Common Seal
L	Limited Liability
A	Artificial Legal Person
S	Separate Legal Entity
S	Separate Property and Sue

Basis	Partnership	Joint Stock Company
Legal status	A firm is not legal entity i.e. it has no legal personality distinct from the personalities of its constituent members.	A company is a separate legal entity distinct from its members (*Salomon v. Salomon*).
Agency	In a firm, every partner is an agent of the other partners as well as of the firm.	In a company, a member is not an agent of the other members or of the company, his actions do not bind either.

Distribution of profits	The profits of the firm must be distributed among the partners according to the terms of the partnership deed.	There is no such compulsion to distribute its profits among its members. Some portion of the profits, but generally not the entire profit, become distributable among the shareholders only when dividends are declared.
Extent of liability	In a partnership, the liability of the partners is unlimited. This means that each partner is liable for debts of a firm incurred in the course of the business of the firm and these debts can be recovered from his private property, if the joint estate is insufficient to meet them wholly.	In a company limited by shares, the liability of a shareholder is limited to the amount, if any, unpaid on his shares, but in the case of a guarantee company, the liability is limited to the amount for which he has agreed to be liable. However, there may be companies where the liability of members is unlimited.
Property	The firm's property is that which is the "joint estate" of all the partners as distinguished from the separate' estate of any of them and it does not belong to a body distinct in law from its members.	In a company, its property is separate from that of its members who can receive it back only in the form of dividends or refund of capital.
Transfer of shares	A share in a partnership cannot be transferred without the consent of all the partners.	In a company a shareholder may transfer his shares, subject to the provisions contained in its Articles. In the case of public limited companies whose shares are quoted on the stock exchange, the transfer is usually unrestricted.
Management	In the absence of an express agreement to the contrary, all the partners are entitled to participate in the management.	Members of a company are not entitled to take part in the management unless they are appointed as directors, in which case they may participate. Members, however, enjoy the right of attending general meeting and voting where they can decide certain questions such as election of directors, appointment of auditors, etc.
Registration	Registration is not compulsory in the case of partnership.	A company cannot come into existence unless it is registered under the Companies Act, 2013.
Winding up	A partnership firm can be dissolved at any time if all the partners agree.	A company, being a legal person is either wind up by the National Company Law Tribunal or its name is struck of by the Registrar of Companies.

Number of membership	According to section 464 of the Companies Act, 2013, the number of partners in any association shall not exceed 100. However, the Rule given under the Companies (*Miscellaneous*) *Rules, 2014* restrict the present limit to 50.	A private company may have as many as 200 members but not less than two and a public company may have any number of members but not less than seven. A private Company can also be formed by one person known as one person Company.
Duration of existence	Unless there is a contract to the contrary, death, retirement or insolvency of a partner results in the dissolution of the firm.	A company enjoys a perpetual succession.

Partnership Vs. Club

Basis of Difference	Partnership	Club
Definition	It is an association of persons formed for earning profits from a business carried on by all or any one of them acting for all.	A club is an association of persons formed with the object not of earning profit, but of promoting some beneficial purposes such as improvement of health or providing recreation for the members, etc.
Relationship	Persons forming a partnership are called partners and a partner is an agent for other partners.	Persons forming a club are called members. A member of a club is not the agent of other members.
Interest in the property	Partner has interest in the property of the firm.	A member of a club has no interest in the property of the club.
Dissolution	A change in the partners of the firm affect its existence.	A change in the membership of a club does not affect its existence.

Partnership vs. Hindu Undivided Family

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	partner is unlimited.	the liability of the Karta is unlimited, and the other coparcener are liable only to the extent of their share in the profits of the family business.
Calling for accounts on closure	A partner can bring a suit against the firm for accounts, provided he also seeks the dissolution of the firm.	On the separation of the joint family, a member is not entitled to ask for account of the family business.
Governing Law	A partnership is governed by the Indian Partnership Act, 1932.	A Joint Hindu Family business is governed by the Hindu Law.
Minor's capacity	In a partnership, a minor cannot become a partner, though he can be admitted to the benefits of partnership, only with the consent of all the partners.	In Hindu undivided family business, a minor becomes a member of the ancestral business by the incidence of birth. He does not have to wait for attaining majority.
Continuity	A firm subject to a contract between the partners gets dissolved by death or insolvency of a partner.	A Joint Hindu family has the continuity till it is divided. The status of Joint Hindu family is not thereby affected by the death of a member.
Number of Members	In case of Partnership number of members should not exceed 50.	Members of HUF who carry on a business may be unlimited in number.
Share in the business	In a partnership, each partner has a defined share by virtue of an agreement between the partners.	In a HUF, no coparceners has a definite share. His interest is a fluctuating one. It is capable of being enlarged by deaths in the family diminished by births in the family.

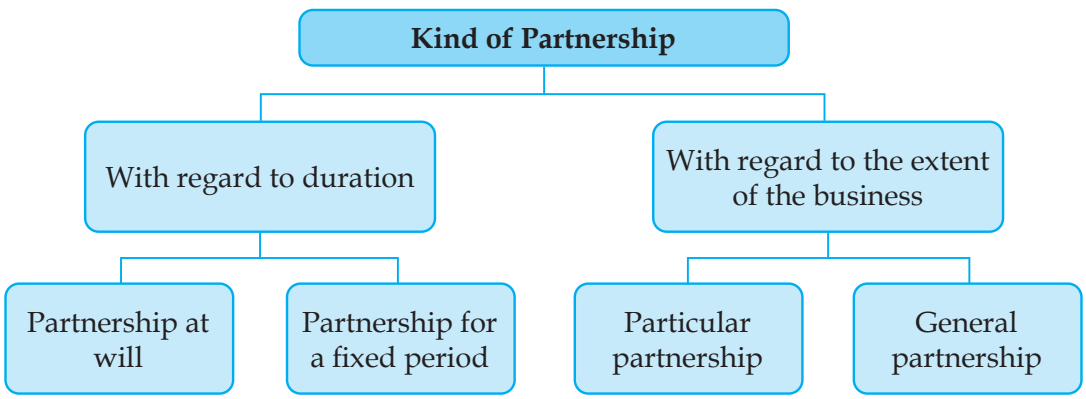
Partnership Vs. Co-Ownership or joint ownership i.e. the relation which subsists between persons who own property jointly or in common.

Basis of Difference	Partnership	Co-ownership
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.
Implied agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.
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.
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.

Basis of Difference	Partnership	Association
Meaning	Partnership means and involves setting up relation of agency between two or more persons who have entered into a business for gains, with the intention to share the profits of such a business.	Association evolves out of social cause and there is no necessarily motive to earn and share profits. The intention is not to enter in a business for gains.
Examples	Partnership to run a business and earn profit thereon.	Members of charitable society or religious association or an improvement scheme or building corporation or a mutual insurance society or a trade protection association.

KINDS OF PARTNERSHIPS

The following chart illustrates the various kinds of partnership:



The various kinds of partnership are discussed below:

1. **Partnership at WILL (Section 7):**

   (a) **No fixed period has been agreed** upon for the duration of the partnership;

   And

   (b) There is **no provision** made as to the **determination of the partnership**.

   - These **two conditions must** be **satisfied** before a partnership can be regarded as a 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.

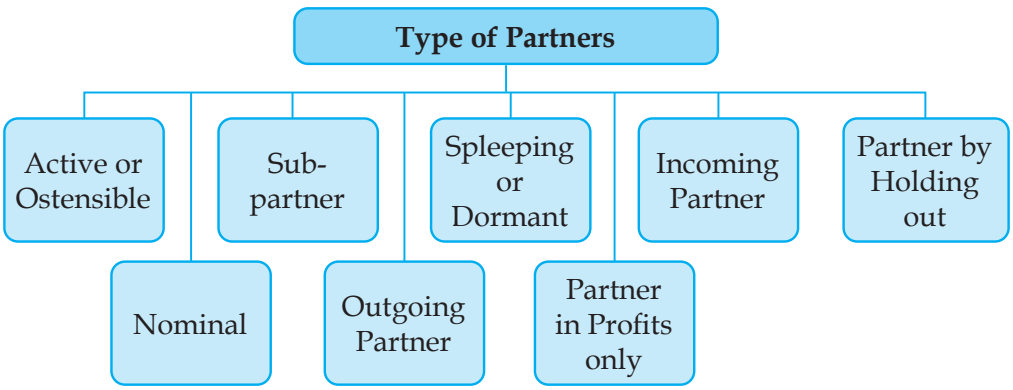
2. **Partnership for a fixed period:**
   - Where a provision is made by a contract - for the duration of the partnership, the partnership
   - It is a partnership **created for a particular period of time**.
   - Such a partnership **comes** to an **end** on the **expiry** of the fixed period.

- A partnership may be organized for the prosecution of a single adventure as well as for the conduct of a continuous business.
- A partnership, constituted for a single adventure or undertaking is, subject to any agreement, **dissolved by the completion of the adventure or undertaking**.

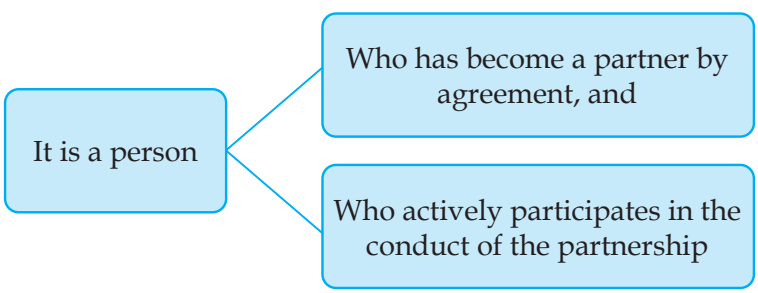
4. **General partnership:**
   - Where a partnership is constituted with respect to the **business** in general, it is called a **general** partnership.
   - A **general partnership** is **different** from a **particular partnership**.
   - In the case of a particular partnership, the liability of the partners extends only to that particular adventure or undertaking, but it is not so in the case of general partnership.
   - General partnership is different from limited liability partnership.

TYPES OF PARTNERS

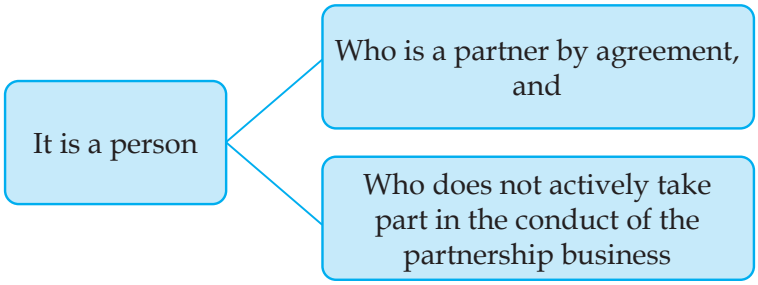
Based on the extent of liability, the different classes of partners are:



1. **Active or Actual or Ostensible partner:**



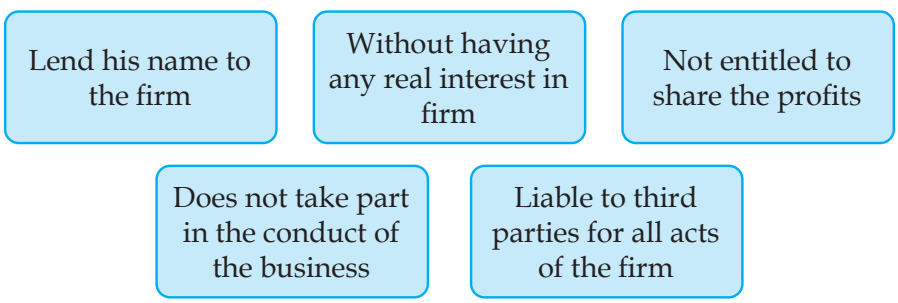
- Who actively aprticipates in the conduct of partnership/business.
- He acts as an agent of other partners for all acts done in the ordinary course of business.
- In the event of his retirement, he must give a public notice in order to absolve himself of liabilities for acts of other partners done after his retirement.



- Who does not actively aprticipates in the conduct of partnership/business.
- They share profits and losses and are liable to the third parties for all acts of the firm.
- They are, however NOT required to give public notice of their retirement from the firm.

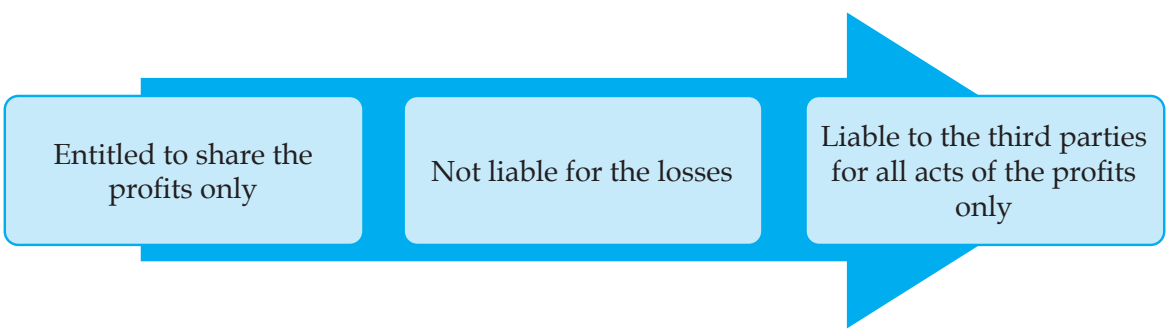
3. Nominal Partner:

- A person who lends his name to the firm, without having any real interest in it, is called a nominal partner.
- He is not entitled to share the profits of the firm.
- Neither he invests in the firm nor takes part in the conduct of the business.
- He is, however liable to third parties for all acts of the firm.



4. Partner in profits only:

- A partner who is entitled to share the profits only without being liable for the losses is known as the partner for profits only and Also liable to the third parties for all acts of the profits only.



5. Incoming partners:

- A person who is admitted as a partner into an already existing firm with the consent of all the existing partners is called as "incoming partner".
- Such a partner is NOT liable for any act of the firm done BEFORE his admission as a partner.

- A partner who leaves a firm in which the rest of the partners continue to carry on business is called a retiring or outgoing partner.
- Such a partner remains liable to third parties for all acts of the firm UNITL public notice is given of his retirement.

> ***Example 5:*** *Mr. A joined as a partner on 10th September, 2021 in a firm MNQ Associates which was existing from 10th July, 2017. Mr. A will not be liable for any acts of the firm done before his date of joining i.e. 10th September, 2021*

7. 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.
- 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 6:*** *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'.
- 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.
- 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.

> ***Example 7:*** *A partnership firm consisting of P, Q, R and S. S retires from the firm without giving public notice and his name continues to be used on letterheads. Here, S is liable as a partner by holding out to creditors who have lent on the faith of his being a partner.*

CLIPS

Aspect	Active/Actual/ Ostensible Partner	Sleeping/ Dormant Partner	Nominal Partner	Partner in Profits Only
Conduct in Business (C)	✓	×	×	×
Acts as an Agent for Other Partners	✓	×	×	×

Liable to Third Parties **(L)**	✓	✓	✓	✓
Entitled to Share Profits **(S)**	✓	✓	×	✓
Entitled to Share Losses	✓	✓	×	×
Invests Capital in Firm **(I)**	✓	✓	×	×/✓
Right to Participate in Management	✓	×	×	×
Real Interest in Business	✓	✓	×	✓
Public Notice on Retirement Required **(P)**	✓	×	✓	✓

"PROBLEM KYA HAI? - UNIT 1"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - IPA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTION

1. Mr. XU and Mr. YU are partners in a partnership firm. Mr. XU introduced MU (an employee) as his partner to ZU. MU remained silent. ZU, a trader believing MU as partner supplied 50 Laptops to the firm on credit.

After expiry of credit period, ZU did not get amount of Laptop sold to the partnership firm. ZU filed a suit against XU and MU for the recovery of price. Does MU is liable for such purpose?

Ans. As per Section 28 of Indian Partnership Act, 1932, 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.

In the given case, MU (the Manager) is also liable for the price because he becomes a partner by holding out as per Section 28 of Indian Partnership Act, 1932.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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

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)

Ans. 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. 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. 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"he suit against firm, answer would remain same.

2. Mr. Ram and Mr. Raheem are working as teachers 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 $ 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 $2800 and $200 asa penalty to resume the electricity connection. Mr. John claimed * 3000 from Mr. Ram but Mr. Ram replied that he is liable only for $ 1500. Mr. John said that Mr. Ram and Mr. Raheem are partners therefore he can claim the full amount from any of the partners. Explain, whether under the provision of the Indian Partnership Act, 1932, Mr. Ram is liable to pay whole amount of 73000 to Mr. John? **(RTP Jun'24, May'23)**

Ans. 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 provisions 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. ₹1500. Mr. John has to claim the rest of ₹1500 from Mr. Raheem.

(MTP Jun'22 6 Marks) (MTP 6 Marks, Oct'21)

Ans.

Basis	Partnership	Joint Stock Company
Legal status	A firm is not legal entity i.e. it has no legal personality distinct from the personalities of its constituent members.	A company is a separate legal entity distinct from its members *(Salomon v. Salomon)*.
Agency	In a firm, every partner is an agent of the other partners as well as of the firm.	In a company, a member is not an agent of the other members or of the company, his actions do not bind either.
Distribution of profits	The profits of the firm must be distributed among the partners according to the terms of the partnership deed.	There is no such compulsion to distribute its profits among its members. Some portion of the profits, but generally not the entire profit, become distributable among the shareholders only when dividends are declared.
Extent of liability	In a partnership, the liability of the partners is unlimited. This means that each partner is liable for debts of a firm incurred in the course of the business of the firm and these debts can be recovered from his private property, if the joint estate is insufficient to meet them wholly.	In a company limited by shares, the liability of a shareholder is limited to the amount, if any, unpaid on his shares, but in the case of a guarantee company, the liability is limited to the amount for which he has agreed to be liable. However, there may be companies where the liability of members is unlimited.
Property	The firm's property is that which is the "joint estate" of all the partners as distinguished from the 'separate' estate of any of them and it does not belong to a body distinct in law from its members.	In a company, its property is separate from that of its members who can receive it back only in the form of dividends or refund of capital.
Transfer of shares	A share in a partnership cannot be transferred without the consent of all the partners.	In a company a shareholder may transfer his shares, subject to the provisions contained in its Articles. In the case of public limited companies whose shares are quoted on the stock exchange, the transfer is usually unrestricted.

Management	agreement to the contrary, all the partners are entitled to participate in the management.	to take part in the management unless they are appointed as directors, in which case they may participate. Members, however, enjoy the right of attending general meeting and voting where they can decide certain questions such as election of directors, appointment of auditors, etc.
Registration	Registration is not compulsory in the case of partnership.	A company cannot come into existence unless it is registered under the Companies Act, 2013.
Winding up	A partnership firm can be dissolved at any time if all the partners agree.	A company, being a legal person is either wind up by the National Company Law Tribunal or its name is struck of by the Registrar of Companies.
Number of membership	According to section 464 of the Companies Act, 2013, the number of partners in any association shall not exceed 100. However, the Rule given under the Companies *(Miscellaneous) Rules, 2014* restrict the present limit to 50.	A private company may have as many as 200 members but not less than two and a public company may have any number of members but not less than seven. A private Company can also be formed by one person known as one person Company.
Duration of existence	Unless there is a contract to the contrary, death, retirement or insolvency of a partner results in the dissolution of the firm.	A company enjoys a perpetual succession.

4. What is Particular Partnership as per Indian Partnership Act, 1932?

(MTP Nov'22 2 Marks) (PYQ 2 Marks, Jan'21)

Ans. 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.

5. Ms. Lucy while drafting partnership deed taken care of few important points. What are those points?

She wants to know the list of information which must be part of partnership deed drafted by her. Also, give list of information to be included in partnership deed?

(MTP Nov'22 4 Marks) (SM) (MTP 6 Marks, Nov'21)

Ans. Ms. Lucy while drafting partnership deg must take care of following important points:

- No particular formalities are required for an agreement of partnership.

containing the various terms and conditions as to the relationship of the partners to each other is called the 'partnership deed'.

- Partnership deed should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899.
- If partnership comprises immovable property, the instrument of partnership must be in writing, stamped and registered under the Registration Act.

List of information included in Partnership Deed while drafting Partnership Deed by Ms. Lucy:

1. Name of the partnership firm.
2. Names of all the partners.
3. Nature and place of the business of the firm.
4. Date of commencement of partnership.
5. Duration of the partnership firm.
6. Capital contribution of each partner.
7. Profit Sharing ratio of the partners.
8. Admission and Retirement of a partner.
9. Rates of interest on Capital, Drawings and loans.
10. Provisions for settlement of accounts in the case of dissolution of the firm.
11. Provisions for Salaries or commissions, payable to the partners, if any.
12. Provisions for expulsion of a partner in case of gross breach of duty or fraud.

Note: Ms. Lucy may add or delete any provision according to the needs of the partnership firm.

6. 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.

(MTP May'23 6 Marks) (MTP Nov'22 6 Marks) (MTP Mar'22 6 Marks) (MTP Nov'22 6 Marks) (MTP Mar'22 6 Marks)

Ans. **Definition of Partnership:** '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. (Section 4 of the Indian Partnership Act, 1932)

The definition of the partnership contains the following five elements which must co-exist before a partnership can come into existence:

1. Association of two or more persons
2. Agreement
3. Business
4. Agreement to share Profits
5. Business carried on by all or any of them acting for all

Elements of Partnership: The definition of the partnership contains the following five elements which must co-exist before a partnership can come into existence:

1. **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 partners, may be admitted to the benefits of partnership.

the Companies Act, 2013 read with the relevant Rules has now put a limit of 50 partners in any association/partnership firm.

2. **Agreement:** It may be observed that partnership must be the result of an agreement between two or more persons. There must be an agreement entered into by all the persons concerned. This element relates to voluntary contractual nature of partnership. Thus, the nature of the partnership is voluntary and contractual. An agreement from which relationship of Partnership arises may be express. It may also be implied from the act done by partners and from a consistent course of conduct being followed, showing mutual understanding between them. It may be oral or in writing.
3. **Business:** In this context, we will consider two propositions. First, there must exist a business. For the purpose, the term 'business' includes every trade, occupation and profession. The existence of business is essential. Secondly, the motive of the business is the "acquisition of gains" which leads to the formation of partnership. Therefore, there can be no partnership where there is no intention to carry on the business and to share the profit thereof.
4. **Agreement to share profits:** 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 element. It is open to one or more partners to agree to share all the losses. However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio.
5. **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. An act of one partner in the course of the business of the firm is in fact an act of all partners. Each partner carrying on the business is the principal as well as the agent for all the other partners.

He is an agent in so far as he can bind the other partners by his acts and he is a principal to the extent that he is bound by the act of other partners. 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.

7. "Sharing in the profits is not conclusive evidence in the creation of partnership". Comment.

(MTP Nov'23 4 Marks) (PYQ Dec'21 4 Marks)

Ans. "Sharing in the profits is not conclusive evidence in the creation of partnership"

Sharing of profit is an essential element to constitute a partnership. But it is only a prima facie evidence and not conclusive evidence, in that regard. The sharing of profits or of gross returns accruing from property by persons holding joint or common interest in the property would not by itself make such persons partners. Although the right to participate in profits is a strong test of partnership, and there may be cases where, upon a simple participation in profits, there is a partnership, yet whether the relation does or does not exist must depend upon the whole contract between the parties.

Where there is an express agreement between partners to share the profit of a business and the business is being carried on by all or any of them acting for all, there will be no difficulty in the light of provisions of Section 4 of the Indian Partnership Act, 1932, in determining the existence or otherwise of partnership.

is such as does not specifically speak of partnership. In such a case for testing the existence or otherwise of partnership relation, Section 6 has to be referred.

According to Section 6, regard must be had to the real relation between the parties as shown by all relevant facts taken together. The rule is easily stated and is clear, but its application is difficult.

Cumulative effect of all relevant facts such as written or verbal agreement, real intention and conduct of the parties, other surrounding circumstances etc., are to be considered while deciding the relationship between the parties and ascertaining the existence of partnership.

Hence, the statement is true/correct that mere sharing in the profits is not conclusive evidence.

8. What do you mean by 'Partnership for a fixed period' as per the Indian Partnership Act, 1932? **(MTP Dec'23 2 Marks) (RTP Nov'23) (PYQ May'22 2 Marks)**

Ans. Partnership for a fixed period (Indian Partnership Act, 1932): 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.

9. What is the difference between partnership and co-ownership as per the Indian Partnership Act, 1932? **(MTP Dec'23 4 Marks) (PYQ Nov'22 4 Marks)**

Ans. 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
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.
Implied agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.
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.
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.

10. State whether the following are partnerships:

1. A and B jointly own a car which they used personally on Sundays and holidays and let it on hire as 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 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. **(PYQ Dec 21 6 Marks)**

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. Yes, this is a case of partnership because there is an agreement between two firms to combine into one firm.
3. Yes, this is a case of partnership because A & B, co-owners, have agreed to conduct a business in common for profit.
4. No, this is not a case of partnership as no charitable association can be floated in partnership.
5. No, this is not a case of partnership as they are co-owners and not the partners. Further, there exist no business.
6. Yes, this is a case of partnership as there exist the element of doing business and sharing of profits equally.

11. Sate giving reasons whether the following are partnerships as per the provisions under the Indian Partnership Act, 1932.

1. 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?
2. X, a publisher, agrees to publish a book at his own expense written by Y and to pay Y, half of the net profit. Does this create a relationship of partnership between X and Y? Is liable to a paper dealer for paper supplied to X to print Y's book?
3. 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? **(PYQ Dec'23 6 Marks)**

Ans.

1. As per 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.

   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.
2. No, it is not a case of partnership

   Reason: Sharing of profit, which is a 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.

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.

12. What do you mean by "Particular Partnership" under the Indian Partnership Act, 1932?

(PYQ 2 Marks, Jan'21)

Ans. **Nominal Partner:** A person who lends his name to the firm, without having any real interest in it, is called a nominal partner.

Liabilities: He is not entitled to share the profits of the firm. Neither he invests in the firm nor takes part in the conduct of the business. He is, however liable to third parties for all acts of the firm.

13. "Business carried on by all or any of them acting for all". Discuss the statement under the Indian Partnership Act, 1932. **(PYQ 4 Marks, Jan'21)**

Ans. 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. In other words, there should be a binding contract of mutual agency between the partners.

An act of one partner in the course of the business of the firm is in fact an act of all partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He is an agent in so far as he can bind the other partners by his acts and he is a principal to the extent that he is bound by the act of other partners.

It may be noted that the true test of partnership is mutual agency. If the element of mutual agency is absent, then there will be no partnership.

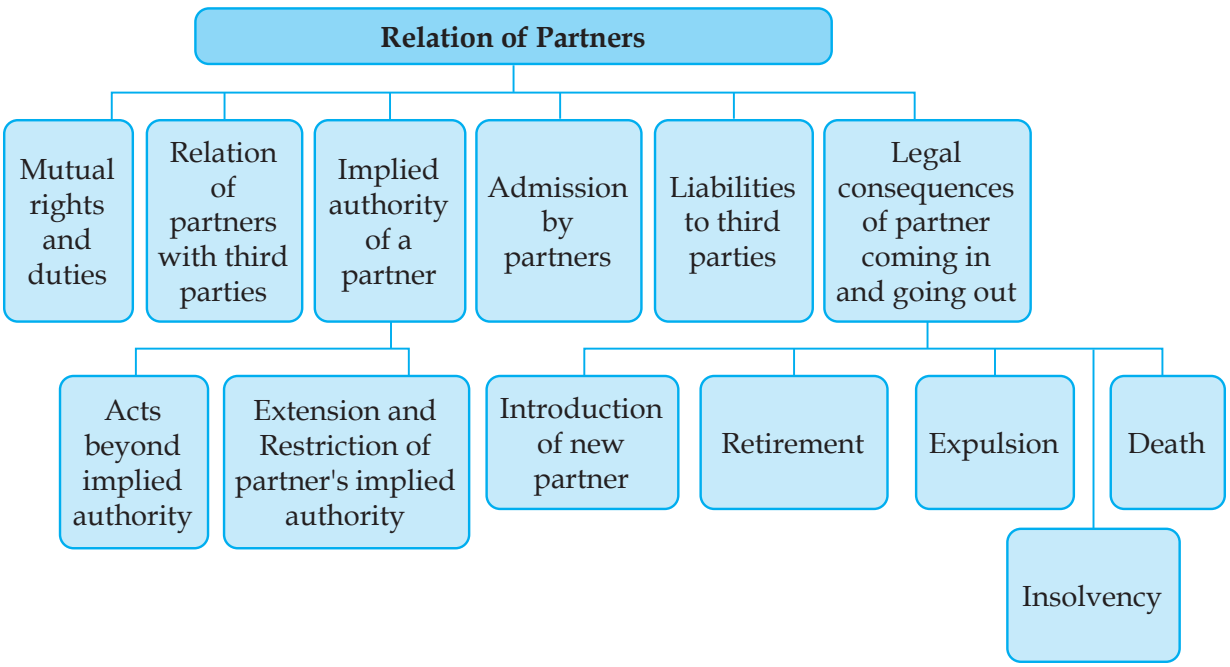
In KD Kamath & Co., the Supreme Court has held that the two essential conditions to be satisfied are that:

1. there should be an agreement to share the profits as well as the losses of business; and
2. the business must be carried on by all or any of them acting for all, within the meaning of the definition of 'partnership' under section 4.

The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied.

UNIT 02

Relations of Partners



RELATION OF PARTNERS TO ONE ANOTHER

The Partnership Act contains various provisions regulating the relationship between partners.

9	**General Duties Of Partners (Generally 9** बजे की Duty होती है **)**
10	**Duty To Indemnify For Loss Caused By Fraud (**late हो गया 10 बजे पहुँचा loss हो गया, इनको लग रहा है मैंने fraud किया**)**
11	**Determination Of Rights And Duties Of Partners By Contract Between The Partners (**Meeting बुलाया rights & Duties बताया**)**
12	**The Conduct Of The Business (**कैसे काम करना है - Conduct**)**
13	**Mutual Rights And Liabilities (**तेरा मेरा**)**

1. **GENERAL DUTIES OF PARTNERS (SECTION 9):** They are Absolute duties of partners means can't be changed with the contract:
   - Greatest Commom Advantange: The partners should **carry** business of the firm to the **greatest common advantages** and

representatives **full information** of all things affecting the firm.

- Maintain Good faith: A partner must observe the **utmost good faith** in his dealings with the other partners.
- Render TRUE Accounts: All the partners are bound to render accounts to each other but where some of the accounts are kept by one of them, prima facie he would be the proper person to explain and give full information about them.

> ***Example 1:*** *In a transaction between partners for the sale and purchase of a share in the business, if one of them is better acquainted with the accounts than the other, it is his duty to disclose all material facts.*

2. DUTY TO INDEMNIFY FOR LOSS CAUSED BY FRAUD (SECTION 10):

- The partner, committing **fraud** in the **conduct** of the **business** of the firm, must make **good the loss** sustained by the firm by his **misconduct** and the **amount** so **brought** in the **partnership** should be **divided** between the partners.
- An act of a partner imputable (Unwanted or false credit) to the **firm** or the principles of agency, which is a **fraud on** his **co-partners**, **entitles** the **co-partners** as between themselves, to throw the whole of the **consequences upon him** (सबकुछ fraud करने वाले partner के माथे) Means in case of an act done by partner which is a fraud and made the firm liable because of his act - Gives firm the right to recover the amount from him later)

3. DETERMINATION OF RIGHTS AND DUTIES OF PARTNERS BY CONTRACT BETWEEN THE PARTNERS - (SECTION 11):

(a) Subject to the provisions of this Act,

- the mutual rights and duties of the partners of a firm may be **determined by contract between the partners**, and such contract may be **express or may be implied** by a course of dealing.
- Such contract may be **varied by consent of all the partners**, and such **consent** may be express or may be implied by a course of dealing.

(b) Agreements in restraint of trade: Notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such contracts may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

"Partnership relies heavily on mutual consent, both for its creation and for setting the terms of the agreement. Partners can agree to form or change the partnership at any time, and this agreement doesn't need to follow a specific format".

4. THE CONDUCT (बरताव) OF THE BUSINESS (SECTION 12): (एक तरीक़े से - Right and Duties है Business Related)

चाहे रात 12 (Section) की भी बजे -

सब business में participate करेंगे (a) , diligently duties निभायेंगे (b), decision majority के साथ पास करेंगे (c) and Books (पढ़ाई) bhi dekhenge (d) (e)

Section 12	Aspect	Details
a	Participation in Business	Every' partner has the right to take part in the conduct of the business.

b	Duties and Diligence	Every partner must diligently attend to their duties in the business.
c	Decision Making	❑ Differences on ordinary matters decided by majority. ❑ All partners have the right to express opinions before decisions. ❑ No change in the nature of the business without consent of all partners.
d	Access to Books	Every partner has the right to access, inspect, and copy any of the firm's books.
e	Rights of Heirs (Upon Death)	Heirs or legal representatives have the right to access and inspect copies of the firm's books.

(a) Section 12(a) - Right to take part in the conduct of the Business: Every partner has the right to take part in the business of the firm. This is because partnership business is a business of the partners and their management powers are generally co-extensive (साथ साथ चलती है दोनों चीज़ें और दोनों का मक़सद एक ही है)

"These legal rules apply only if the partners haven't agreed otherwise.

- When Management powers are assigned to certain partners as per the contract - In such cases, courts usually won't interfere unless there's clear evidence of illegal actions or a breach of trust".

> ***Example 2:*** *Now suppose this management power of the particular partner is interfered with and he has been wrongfully precluded from participating therein. Can the Court interfere in these circumstances? The answer is in the affirmative. The Court can, and will, by injunction, restrain other partners from doing so. It may be noted in this connection that a partner who has been wrongfully deprived of the right of participation in the management has also other remedies, e.g., a suit for dissolution, a suit for accounts without seeking dissolution, etc.*

(b) Section 12(b) - Every partner is bound to attend diligently to his duties in the conduct of the business.

(c) Section 12(c) - Right to be consulted:

- Where any **difference arises** between the partners with regard to the **business** of the firm, it shall be determined by the views of the **majority** of them, and every partner shall have the **right** to **express** his **opinion** before the matter is decided.
- But no change in the nature of the business of the firm can be made **without the consent of all the partners**.
- This means that in **routine matters**, the **opinion** of the **majority** of the partners will **prevail**.
- Of course, the **majority** must act in **good faith** and **every partner** must be **consulted** as far as practicable.

  The unanimous (100%) consent of the partners is needed - The aforesaid majority rule will not apply where there is a change in the nature of the firm itself.

- Every partner whether active or sleeping is entitled to have access to any of the books of the firm and to inspect and take out of copy thereof.
- The right must, however, be exercised *bona fide*.

(e) Section 12(e) - Right of legal heirs/ representatives/ their duly authorised agents:

- 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.

5. MUTUAL RIGHTS AND LIABILITIES (SECTION 13):

Section 13	Aspect	Details
a	No Remuneration	A partner is not entitled to receive remuneration for participating in the conduct of the business.
b	Profit and Loss Sharing	Partners are entitled to share equally in profits and must contribute equally to losses.
c	Interest on Capital	Interest on capital is payable only out of profits if a partner is entitled to it.
d	Interest on Advances	A partner who makes a payment or advance beyond their agreed capital is entitled to 6% interest per annum.
e	Indemnification by Firm	The firm shall indemnify a partner for payments and liabilities incurred: ❑ In ordinary and proper conduct of business. ❑ In an emergency, to protect the firm from loss, as a prudent person would do.
f	Indemnification by Partner	A partner must indemnify the firm for any loss caused by their willful neglect in conducting business.

A. Section 13(a) - Right to Remuneration

- No partner is entitled to receive any remuneration in addition to his share in the profits of the firm for taking part in the business of the firm.
- 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.

B. Section 13(b) - Right to Share Profits

- Partners are entitled to share equally in the profits earned and so contribute equally to the losses sustained by the firm.
- The amount of a partner's share must be ascertained by enquiring whether there is any agreement in that behalf between the partners.

proving that the shares are unequal, will lie on the party alleging the same.

- There is **no connection between** the proportion in which the partners shall **share the profits** and the proportion in which they have **contributed towards the capital** of the firm.

C. Section 13(c) - Interest on Capital

Generally NO but the following elements must be there before a partner can be entitled to interest on moneys brought by him in the partnership business:

- an **express agreement** to that effect, or practice of the particular partnership OR
- **any trade custom** to that effect OR
- a **statutory provision** which entitles him to such interest.

D. Section 13(d) - Interest on Advances

- Suppose a partner makes an **advance** to the firm in **addition** to the amount of **capital** to be **contributed** by him, in such a case, the partner is entitled to claim interest thereon @ **6% per annum**.
- While interest on capital account ceases to run on dissolution, the interest on advances keep running even after dissolution and up to the date of payment.

E. Section 13(e) - Right to be Indemnified

- Every partner has the **right to be indemnified by the firm** in respect of **payments** made and **liabilities** incurred by him in the ordinary and **proper conduct of the business** of the firm as well as in the **performance of an act in an emergency** for protecting the firm from any loss, if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstances.

F. Right to Indemnify the Firm [Section 13(f)]

- **A partner must indemnify** the firm for any loss caused to it by **wilful neglect** in the conduct of the business of the firm.

PARTNERSHIP PROPERTY (SECTION 14)

1. THE PROPERTY OF THE FIRM (SECTION 14)

Property of the firm' - 'partnership property' - 'partnership assets' - 'joint stock' - 'common stock' - 'joint estate',

All property, rights and interests to which the firm, that is, all partners collectively, may be entitled.

- This is comprised of the following items:
  - (a) all property, rights and interests which partners may have brought into the common stock **as their contribution** to the common business;
  - (b) all the property, rights and interest **acquired or purchased by or for the firm**, or for the purposes and in the course of the business of the firm; and
  - (c) **Goodwill** of the business.
- The determination of the question whether a particular property is or is not 'property' of the firm **ultimately depends on the real intention or agreement of the partners**.
- Thus, the **mere fact that the property of a partner is being used for the purposes** of the firm **shall not** by itself make it partnership property, **unless it is intended to be treated as such**.

- by an agreement at any time,
- convert the property of any partner or partners or the separate property of any partner into a partnership property.
- if made in good faith, would be effectual between the partners and against the creditors of the firm

Goodwill

Aspect	Details
Goodwill as Property	Goodwill is considered **property** of the firm, subject to a contract between the partners.
Definition of Goodwill	Goodwill represents the **value of the reputation** of a business, leading to **profits above the normal level** expected.
Rights Upon Dissolution	Upon dissolution, each partner has the right to have the **goodwill sold** for the benefit of all partners, unless agreed otherwise.
Sale of Goodwill	Goodwill can be sold **separately** or along with other properties of the firm.
Restrictions on Competition	A partner may agree with the buyer of goodwill **not to compete** in a similar business within a specified time or area.
Validity of Restriction	Such an agreement is **valid** if the restrictions are **reasonable**, despite Section 27 of the Indian Contract Act, 1872.

Property of a Partner

Where the property is exclusively belonging to a person, it does not become a property of the partnership merely because it is used for the business of the partnership, **such property will become property of the partnership if there is an agreement**.

2. APPLICATION OF THE PROPERTY OF THE FIRM (SECTION 15)

- Section 15 provides that the property of the firm shall be held and used exclusively for the purpose of the firm.
- In partnership, there is a community of interest which all the partners take in the property of the firm.
- But that does not mean than during the subsistence of the partnership, a particular partner has any proprietary interest in the assets of the firm.
- Every partner of the firm has a right to get his share of profits till the firm subsists and he has also a right to see that all the assets of the partnership are applied to and used for the purpose of partnership business.

PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16)

1. If a partner derives any profit for himself -
   (i) from any transaction of the firm, or
   (ii) from the use of the property or
   (iii) business connection of the firm or the firm name,
   (iv) he shall account for that profit and pay it to the firm;

firm, he shall account for and pay to the firm all profits made by him in that business.

Example 3: A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. It was held that A was bound to account to the firm for the profit so made by him. This rule, however, is subject to a contract between partners.

Example 4: A, B, C and D started a business in partnership for importing salt from foreign ports and selling it at Chittagong. A struck certain transactions in salt on his own account, which were found to be of the same nature as the business carried on by the partnership. It was held that A was liable to account to the firm for profits of the business so made by him. This rule is also subject to a contract between the partners.

RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM (SECTION 17)

How a change may take place in the constitution of the firm. It may occur in one of the four ways:

- Where a new partner or partners come in
- Where some partner or partners go out, i.e., by death or retirement
- Where the partnership concerned carries on business other than the business for which it was originally formed
- Where the partnership business is carried out on after the expiry of the term fixed for the purpose

1. **After a change in the firm:** If the firm's constitution changes, the partners' rights and duties stay the same as before, **as much as possible.**
2. **After the expiry of the term of the firm:** If a firm with a fixed term continues after the term ends, the partners' rights and duties remain the same, consistent with a partnership at will
3. **Where additional undertakings are carried out:** If a firm takes on new ventures, the rights and duties for these are the same as for the original ventures.

Sections	Heading
Section 18	Partner to be an Agent of the Firm
Section 19	Implied Authority of Partner as Agent of the Firm
Section 20	Extension and Restriction of Partners' Implied Authority
Section 21	Partner's Authority in an Emergency
Section 22	Mode of Doing Act to Bind Firm

1. PARTNER TO BE AN AGENT OF THE FIRM (SECTION 18)

MUTUAL AGENCY - A partner is the agent of the firm for the purpose of the business of the firm.

Not applicable to all transactions and dealings between the partners themselves. ONLY to the act done by partners for the purpose of the business of the firm.

- The partners are both a principal and an agent.
- AGENT VS PARTNER

Being a partner - he has a community of interest with other partners in the whole property and business and liabilities of partnership but

Being a mere agent whereas an agent as such has no interest in either.

2. IMPLIED AUTHORITY OF PARTNER AS AGENT OF THE FIRM (SECTION 19)

The authority of a partner to bind the firm (or all the partners) by carrying on an act done in the usual business way.

- In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to (Means ये सब implied authority में cover नहीं होता है)

Action	Description
Submit Dispute to Arbitration	Resolve business disputes through arbitration.
Open Bank Account	Open a bank account in the partner's own name for the firm.
Compromise or Relinquish Claim	Settle or give up any claim or part of a claim for the firm.
Withdraw Suit or Proceedings	Withdraw legal cases or proceedings initiated by the firm.
Admit Liability	Acknowledge liability in a lawsuit or legal proceeding against the firm.
Acquire or Transfer immovable property	Purchase real estate for the firm and Sell or transfer real estate owned by the firm
Enter into partnership	Form a partnership with others on behalf of the firm.

3. MODE OF DOING ACT TO BIND FIRM (SECTION 22)

- A partner's actions can bind the firm **if done in the firm's name** or in a way that shows **an intention to bind the firm**.
- Combined reading of - Sections 19 and 22: A partner's actions that are typical for the business type will bind the firm if done in the firm's name or in a way that shows intent to bind the firm.
- **Restrictions on Implied Authority:**
  - **Usual Business:** The act must relate to the usual business of the firm. (The usual way of carrying on the business will depend on the nature and circumstances of each particular case)

normal business operations.

- **Firm's Name:** The act must be done in the firm's name or in a manner that expresses or implies an intention to bind the firm.

You must remember that an implied authority of a partner may differ in different kinds of business.

> *Example 5: X, a partner in a firm of solicitors, borrows money and executes a promissory note in the name of firm without authority. The other partners are not liable on the note, as it is not part of the ordinary business of a solicitor to draw, accept, or endorse negotiable instruments; however, it may be usual for one partner of firm of bankers to draw, accept or endorse a bill of exchange on behalf of the firm.*

- **If partnership be of a general commercial nature,**
  1. he may pledge or sell the partnership property;
  2. he may buy goods on account of the partnership;
  3. he may borrow money, contract debts and pay debts on account of the partnership;
  4. he may draw, make, sign, endorse, transfer, negotiate and procure to be discounted, Promissory notes, bills of exchange, cheques and other negotiable papers in the name and on account of the partnership.

4. EXTENSION AND RESTRICTION OF PARTNERS' IMPLIED AUTHORITY (SECTION 20)

- The implied authority of a partner may be extended or restricted by contract between the partners.
- Under the following conditions, the restrictions imposed on the implied authority of a partner by agreement shall be effective against a third party:
  (a) The third party knows about the restrictions, and
  (b) The third party does not know that he is dealing with a partner in a firm.

> *Example 6: A, a partner, borrows from B 1,000 in the name of the firm but in excess of his authority, and utilizes the same in paying off the debts of the firm. Here, the fact that the firm has contracted debts suggests that it is a trading firm, and as such it is within the implied authority of A to borrow money for the business of the firm. This implied authority, as you have noticed, may be restricted by an agreement between him and other partners. Now if B, the lender, is unaware of this restriction imposed on A, the firm will be liable to repay the money to B. On the contrary, B's awareness as to this restriction will absolve the firm of its liability to repay the amount to B.*

To restrict or extend the implied authority
Extension or restriction is only possible with the consent of all the partners.
NOT any one partner or even a majority of the partners

5. PARTNER'S AUTHORITY IN AN EMERGENCY (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.

EFFECT OF ADMISSIONS BY A PARTNER (SECTION 23)

- Admissions as Evidence:
  - Admissions made by a partner

- are considered binding on the firm.
- If a partner admits to a certain fact or liability, it can be used as **evidence** against the firm in legal proceedings.

- Binding admissions can only be made in relation to -
  - partnership transaction and
  - in the ordinary course of business.
  - An admission or representation by a partner will not however bind the firm if his authority on the point is limited and the other party knows of the restriction.
  - **Fraud or Misrepresentation:** Admissions made fraudulently or under duress might not be binding.
- **With Third Parties:** Admissions by a partner are effective and binding, meaning third parties can use these admissions as evidence in claims or disputes involving the firm.
- **Internal Disputes:** The same admissions may not have the same binding effect in disputes between partners, where the context of the admission and the partnership agreement may play a larger role in resolving the issue.

Examples:

If a partner admits to owing money to a supplier, the supplier can use this admission to claim the debt from the firm.

Similarly, if a partner acknowledges a contract with a customer, the firm is bound by that admission in its dealings with the customer.

Impact in Internal Disputes: ★

Disputes Between Partners:

In disputes between the partners themselves, the effect of such admissions may be limited. The internal resolution of disputes might involve considering the partnership agreement, the partner's authority, and the context of the admission.

Examples: ★

If two partners are disputing a matter internally, one partner's admission might not automatically resolve the issue unless it is clear that the admission was made in the course of partnership business and is binding according to the partnership agreement.

Example 7: X and Y are partners in a firm dealing in spare parts of different brands of motorcycle bikes. Z purchases a spare part for his Yamaha motorcycle after being told by X that the spare part is suitable for his motorcycle. Y is ignorant about this transaction. The spare part proves to be unsuitable for the motorcycle and it is damaged. X and Y both are responsible to Z for his loss.

EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24)

1. **Notice to Active Partner:** A notice given to a partner who is actively involved in the firm's business is considered as notice to the entire firm (Just as a notice to an agent is notice to his principal)
2. **Exception for Fraud:** This rule does not apply if the notice relates to fraud committed by or with the consent of that partner.

- **Actual Notice:** The notice must be actually received by the partner.
- **Active Partner:** It must be received by a working partner, not a passive or sleeping partner.
- **Firm's Business:** The notice must pertain to the firm's business activities.

A notice given to a partner actively involved in the firm is effectively a notice to the whole firm, except in cases involving fraud. The notice must be actual, received by an active partner, and relevant to the firm's business.

Example 8: P, Q, and R are partners in a business for purchase and sale of second hand goods. R purchases a second hand car on behalf of the firm from S. In the course of dealings with S, he comes to know that the car is a stolen one and it actually belongs to X. P and Q are ignorant about it. All the partners are liable to X, the real owner. The only exception would lie in the case of fraud, whether active or tacit.

Example 9: A, a partner who actively participates in the management of the business of the firm, bought for his firm, certain goods, while he knew of a particular defect in the goods. His knowledge as regards the defect, ordinarily, would be construed as the knowledge of the firm, though the other partners in fact were not aware of the defect. But because A had, in league with his seller, conspired to conceal the defect from the other partners, the rule would be inoperative and the other partners would be entitled to reject the goods, upon detection by them of the defect.

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:

Sections	Heading
Section 25	Liability Of A Partner For Acts Of The Firm
Section 26	Liability Of The Firm For Wrongful Acts Of A Partner
Section 27	Liability Of Firm For Misapplication By Partners

Aspect	Section 25: Liability of a Partner for Acts of the Firm	Section 26: Liability of the Firm for Wrongful Acts of a Partner	Section 27: Liability of Firm for Misapplication by Partners
Scope of Liability	Partners are liable for acts within the firm's business.	The firm is liable for wrongful acts by partners.	The firm is liable for misuse of its property by partners.
Nature of Acts	Acts done in the firm's business and authority.	Wrongful acts like fraud or negligence by partners.	Misuse or misapplication of firm's property by partners.
Extent of Liability	Partners are personally liable.	Firm is jointly and severally liable.	Firm is liable for losses from misapplication.
Responsibility of Firm	Firm is not directly liable.	Firm bears responsibility for wrongful acts.	Firm is responsible for misapplication losses.
Impact on Third Parties	Partners can be sued for business-related acts.	Firm can be sued for partners' wrongful acts.	Firm can be sued for misapplied funds.

Legal Recourse	Partners can be individually sued.	Legal action can be taken against the firm.	Legal action can be taken against the firm.

1. LIABILITY OF A PARTNER FOR ACTS OF THE FIRM (SECTION 25)

- The partners are jointly and severally responsible to third parties for all acts which come under the scope of their express or implied authority.
- This is because that all the acts done within the scope of authority are the acts done towards the business of the firm.
- The expression 'act of firm' connotes any act or omission by all the partners or by any partner or agent of the firm, which gives rise to a right enforceable by or against the firm.
- Again in order to bring a case under Section 25, it is necessary that the act of the firm, in respect of which liability is brought to be enforced against a party, must have been done while he was a partner.

> ***Example 10:*** *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)

- The firm is liable to the same extent as the partner for any loss or injury caused to a third party by the wrongful acts of a partner, if they are done by the partner while acting:
  (a) in the ordinary course of the business of the firm
  (b) with the authority of the partners.
- If the act in question can be regarded as authorized and as falling within either of the categories mentioned in Section 26,

  The fact that the **method employed** by the **partner** in doing it was **unauthorized** or wrongful **would not affect** the **question**.
- Furthermore, all the partners in a firm are liable to a third party for loss or injury caused to him by the **negligent** act of a **partner acting** in the **ordinary course** of the **business**.

> ***Example 11:*** *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)

Two clauses of Section 27 - Two categories of cases of misapplication of money by partners.

A. 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.

- 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.

- If receipt of money by one partner is not within the scope of his apparent authority,
- his receipt cannot be regarded as a receipt by the firm and
- the other partners will not be liable,
- unless the money received comes into their possession or under their control.

Example 12: A, B, and C are partners of a place for car parking. P stands his car in the parking place but A sold out the car to a stranger. For this liability, the firm is liable for the acts of A.

RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29)

Transfer of Interest:

- A partner's share in a partnership can be transferred like any other property.
- A partner's interest in the partnership can be regarded as an existing interest and tangible property which can be assigned.
- However, since partnerships rely on mutual trust, the transferee (buyer) doesn't get the same rights as the original partner.

During the Partnership:

- The transferee cannot:
  - Interfere in the business.
  - Demand accounts.
  - Inspect the firm's books.
- The transferee can only:
  - Receive the transferring partner's share of the profits.
  - Must accept profits as agreed by the original partners without questioning the accounts.

After Dissolution or Partner's Retirement:

- The transferee is entitled to:
  - Receive the transferring partner's share of the firm's assets.
  - Request an account of the assets from the date of dissolution to determine their share.

Consent of All the Partners is Required:

- A partner cannot by transferring his own interest, make anybody else a partner in his place, unless the other partners agree to accept that person as a partner.
- At the same time, a partner is not debarred from transferring his interest.

MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30)

Aspect	Details
Minor's Contract	A minor cannot be bound by a contract because a minor's contract is void and not merely voidable.
Partnership and Minors	A minor cannot become a partner in a firm because partnership is founded on a contract.

Admission to Benefits of Partnership	A minor can be admitted to the benefits of partnership under Section 30 of the Act. He can be a beneficiary in the firm. We need 2 MAJOR Partners atleast.
Rights and Liabilities	When admitted to benefits with the consent of all partners, the rights and liabilities of the minor will be governed under Section 30.

1. Rights of a Minor

"PASTES":

1. **Profits Share:** A minor partner has a right to his agreed share of the profits and property of the firm.
2. **Accounts Access:** He can have access to, inspect and copy the accounts of the firm.
3. **Suing (when severing connection):** He can sue the partners for accounts or for payment of his share but only when severing his connection with the firm, and not otherwise.
4. **Time to Elect (6 months after majority):** On attaining majority, he may within 6 months elect to become a partner or not to become a partner.
5. **Entitlement (to share if becomes partner):** If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor.
6. **Share (not liable for acts after public notice if opts out):** If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

2. Liabilities

- **Before Attaining Majority**
  - **Extent of Liability**
    - Limited to share in profits and property of the firm.
  - **Personal Liability**
    - No personal liability for debts incurred during minority.
  - **Insolvency**
    - Cannot be declared insolvent. Share vests in Official Receiver/Assignee if firm is insolvent.

- **After Attaining Majority**
  - **Decision to Become Partner or Not**
    - Must decide within 6 months of majority or upon knowledge of admitting him for the benefit of the firm.
    - Failure to decide results in automatic (Deemed) partnership.
  - **Elects Not to Become Partner**
    - Public Notice
      - Rights and liabilities remain as a minor until notice given.
      - Share not liable for acts of firm after notice date.
      - Entitled to sue for share of property and profits.
  - **Becomes a Partner**

└── Personally liable to third parties for acts done since benefits admitted (जब पहली बार beneficiary बना)

└── **Rights**

└── Share in property and profits remains as entitled as a minor.

A. Before attaining majority:

(a) The liability of the minor is confined only to the extent of his share in the profits and the property of the firm.

(b) Minor has no personal liability for the debts of the firm incurred during his minority.

(c) Minor cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the Official Receiver/Assignee (which means minor can recover his share in the firm on proportionate basis from official receiver/assignee).

B. After attaining majority:

- Within 6 months of his attaining majority or on his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor partner has to decide whether he shall remain a partner or leave the firm.
- Where he has elected not to become partner, he may give public notice that he has elected not to become partner and such notice shall determine his position with regard to the firm If he fails to give such notice he shall become a partner in the firm on the expiry of the said six months.

(a) When he becomes partner: If the minor becomes a partner on his own willingness or by his failure to give the public notice within specified time, his rights and liabilities as given in Section 30(7) are as follows:

I. He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

II. His share in the property and the profits of the firm remains the same to which he was entitled as a minor.

(b) When he elects not to become a partner:

I. His rights and liabilities continue to be those of a minor up to the date of giving public notice.

II. His share shall not be liable for any acts of the firm done after the date of the notice.

III. He shall be entitled to sue the partners for his share of the property and profits. It may be noted that such minor shall give notice to the Registrar that he has or has not become a partner.

LEGAL CONSEQUENCES OF PARTNER COMING IN & GOING OUT (SECTION 31-35)

Any change in the relation of partners will result in **reconstitution** of the partnership firm. Thus, **I.R.A.D.E.**

1. **Admission** of a new partner (Section 31) **(A)**
2. **Retirement** of a partner (Section 32) **(R)**
3. **Insolvency** of a partner (Section 34) **(I)**
4. **Expulsion** of the partner (Section 33) **(E)**

a firm will be reconstituted

1. INTRODUCTION OF A PARTNER (SECTION 31)

GROUND RULE (Method) -

1. No new partners can be introduced into a firm without the consent of all the existing partners.
2. Subject to the contract between the partners:

Rights and liabilities of new partner:

- The liabilities of the new partner ordinarily commence from the date when he is admitted as a partner, unless he agrees to be liable for obligations incurred by the firm prior to the date.

  What about the case where the new partner could be liable for the existing or old acts as well ? Is it possible ? YES
- It's possible through - **Novation** is the technical term which is not a mere agreement amongst partners. It involves consent of -
  (a) **Old Partners**
  (b) **New Partners**
  (c) **Crditors**
- The new firm, including the new partner who joins it, may agree to assume liability for the existing debts of the old firm, and creditors may agree to accept the new firm as their debtor and discharge the old partners. The creditor's consent is necessary in every case to make the transaction operative.
- Thus, an agreement between the partners and the incoming partner that he shall be liable for existing debts will not ipso facto give creditors of the firm any right against him.

  In case of partnership of two partners: ★

  This section does not apply to a partnership of two partners which is automatically dissolved by the death of one of them.

Aspect	Details
Liability for Existing Debts	An incoming partner is **not liable** for debts and liabilities incurred before their admission.
Liability for Future Liabilities	An incoming partner is liable for debts and obligations incurred **after** their admission.
Partnership Deed	The partnership deed may specify different terms regarding the new partner's liability.
Indemnity	Any indemnity arrangement for past liabilities should be clearly documented in the partnership deed.

2. RETIREMENT OF A PARTNER (SECTION 32)

GROUND RULE (Method) -

1. A partner may retire -
   (a) With the **consent of all** the other partners OR
   (b) in accordance with an **express agreement** by the partners OR
   (c) where the partnership is at will, **by giving notice in writing to all** the other partners of his intention to retire.

Date of Public Notice is IMPORTANT. Retiring partner is not liable for the acts and contracts made after this date but liable for the ones before this.
If Retiring partner wants to be discharged for the acts and contracts made before the date of public notice then a new agreement (Novation) is required.

2. A **retiring partner** may be **discharged** from any liability
   - **to any third party** for acts of the firm
   - **done before his retirement**
   - **by an agreement** made by him with such third party and the partners of the reconstituted firm, and
   - such **agreement** may be **implied** by a **course** of **dealing** between the **third party** and the **reconstituted** firm
   - after they had knowledge of the retirement.
3. The retired partner and the existing partners
   - continue to be liable as partners to third parties
   - for any act done by any of them
   - which would have been an act of the firm if done before the retirement,
   - until public notice is given of the retirement
4. This public notice can be given by existing as well as retiring partner

Provided that a retired partner is not liable to any third party who deals with the firm without knowing that he was a partner.

In Vishnu Chandra Vs. Chandrika Prasad [Supreme Court]
The Supreme Court in *Vishnu Chandra Vs. Chandrika Prasad*, held that the expression 'if any partner wants to dissociate from the partnership business', in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from the partnership. The expression clearly indicated that in the event of retirement, the partnership business will not come to an end.

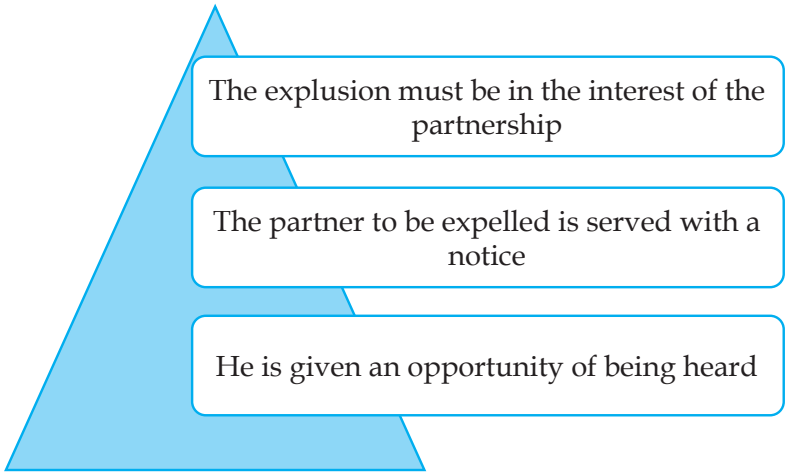
Example 13: *Mere retirement of a partner, who was the tenant of the premises in which the partnership business was carried out, would not result in assignment of the tenancy rights in favour of the remaining partners even though the retiring partner ceases to have any right, title or interest in the business as such.*

3. EXPULSION OF A PARTNER (SECTION 33)

❑ **GROUND RULE (Method) -**

(a) the power of expulsion **must have existed in a contract** between the partners;
(b) the power has been exercised by a **majority of the partners**; and
(c) it has been exercised in **good faith.**

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



If a partner is otherwise expelled, the expulsion is null and void.

- It may be noted that under the Act, the expulsion of partners does not necessarily result in dissolution of the firm.
- The invalid expulsion of a partner does not put an end to the partnership even if the partnership is at will and it will be deemed to continue as before.

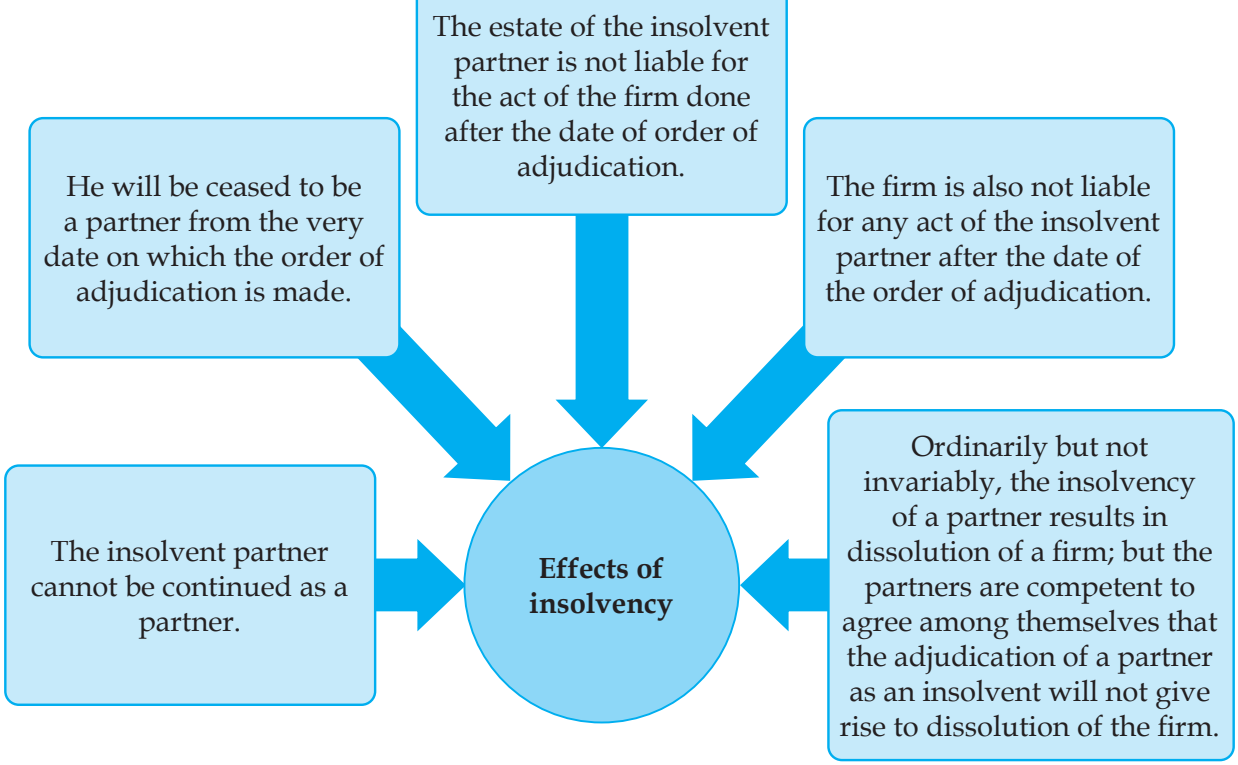
Example 14: A, B and C are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly. A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C. Considering the provisions of Indian Partnership Act, 1932 state whether they can expel a partner from the firm?

Answer: Thus, according to the test of good faith as required under Section 33(1), expulsion of Partner B is not valid.

- In this context, you should also remember that provisions of Sections 32 (2), (3) and (4) which we have just discussed, will be equally applicable to an expelled partner as if he was a retired partner.

4. INSOLVENCY OF A PARTNER (SECTION 34)

1. Where a partner in a firm is adjudicated as an insolvent:
   - he ceases to be a partner on the date
   - on which the order of adjudication is made,
   - whether or not the firm is hereby dissolved.
2. Where under a contract between the partners:
   - the firm is not dissolved by the adjudication of a partner as an insolvent,
   - the estate of a partner so adjudicated is not liable for any act of the firm and
   - the firm is not liable for any act of the insolvent,
   - done after the date on which the order of adjudication is made.



5. LIABILITY OF ESTATE OF DECEASED PARTNER (SECTION 35)

Aspect	Details
Effect of Death on Partnership	Ordinarily, the death of a partner leads to the dissolution of the partnership.
Contractual Agreement	Partners can agree that the death of one partner will not dissolve the partnership concerning the surviving partners, unless the firm consists of only two partners.
Dissolution Exception	If the partnership consists of only two partners, the death of one will dissolve the partnership.
Liability of Deceased Partner's Estate	The estate of the deceased partner is absolved from liability for future obligations of the firm.
Public Notice Requirement	No notice is required to be given to the public or persons dealing with the firm to absolve the deceased partner's estate from future liabilities.

Example 15: *X was a partner in a firm. The firm ordered goods in X's lifetime; but the delivery of the goods was made after X's death. In such a case, X's estate would not be liable for the debt; a creditor can have only a personal decree against the surviving partners and a decree against the partnership assets in the hands of those partners. A suit for goods sold and delivered would not lie against the representatives of the deceased partner. This is because there was no debt due in respect of the goods in X's lifetime.*

- An outgoing partner may carry on business competing with that of the firm and he may advertise such business, but subject to contract to the contrary, he **may not**,
  (a) **use** the **firm name**,
  (b) **represent himself** as carrying on the business of the firm or
  (c) **solicit** the custom of persons who were dealing with the firm before he ceased to be a partner.
- Agreement in restraint of trade:
  - A partner may make an agreement with his partners
  - that on ceasing to be a partner
  - he will not carry on any business similar to that of the firm
  - within a specified period or within specified local limits and,
  - not with standing anything contained in section 27 of the Indian Contract Act, 1872, such agreement **shall be valid if the restrictions imposed are reasonable**.

RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS (SECTION 37)

- Where **any member of a firm has died** or otherwise ceased to be partner, and the surviving or **continuing partners carry on the business of the firm** with the property of the firm **without any final settlement of accounts** as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, **the outgoing partner or his estate is entitled** at the option of himself or his representatives **to such share of the profits** made since he ceased to be a partner as may be attributable to the **use of his share of the property** of the firm or to interest at the rate of **6% per annum** on the amount of **his share in the property of the firm**:

  Provided that whereby contract between the partners, an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.

Example 16: A, B and C are partners in a manufacture of machinery. A is entitled to three- eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. A's estate is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

Example 17: A, B and C are partners. C retires after selling his share in the partnership firm. A and B fail to pay the value of the share to C as agreed to. The value of the share of C on the date of his retirement from the firm would be pure debt from the date on which he ceased to be a partner as per the agreement entered between the parties. C is entitled to recover the same with interest.

REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38)

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

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - IPA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTION

1. A, B and Care 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?

Ans. 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.

1. 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
2. Interest at the rate of 6% 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's Legal representatives shall be entitled, at their option to:

(a) the 20% shares of profits (as per the partnership deed); or

(b) interest at the rate of 6 per cent per annum on the amount of A's share in the property.

MTPs, RTPs AND PYQPs QUESTIONS

1. A, B and C are partners in M/s ABC & Company. The firm has decided to purchase a machine from M/s LMN & Company. Before A & B purchase the machine, C died. The machine was purchased but thereafter A and B became insolvent and the firm was unable to pay for machine. Explain, would the estate of C liable for the dues of M/s LMN & Company? **(RTP Nov'22)**

Ans. Liability of Partner in case of death

According to Section 35 of Indian Partnership Act, 1932, the estate of a deceased partner is not liable for any act of the firm done after his death. The estate of the deceased partner may be absolved from liability for the future obligations of the firm, it is not necessary to give any notice either to the public or the persons having dealings with the firm.

In the instant case, M/s ABC & Company was having three partners A, B and C. The firm was going to purchase a machine from M/s LMN & Company. Before A & B purchase the machine, C died. Machine was purchased but after that A and B became insolvent and the firm was unable to pay for machine. On the basis of above provisions and facts of the problem given, the machine was purchased after the death of C. Hence, the estate of C would not be liable for the dues of M/s LMN & Company.

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 May' 23)**

Ans. 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.

3. When the continuing guarantee can be revoked under the Indian Partnership Act, 1932? **(RTP Nov'23)**

Ans. 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.

4. What do you mean by Goodwill as per the provisions of Indian Partnership Act, 1932? **(RTP Nov'23)**

Ans. 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 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.

5. M/s ABC Associates has been 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. Vikas, a Chartered Accountant. Mr. B and Mr. C were not interested that Mr. Vikas joining them as partner in M/s ABC Associates. After some time, Mr. Vikas 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,

Mr. Vikas be introduced as a partner if his father wants to retire? As an advisor, help them resolve the issues applying the necessary provisions from the indian Partnership Act, 1932.

(RTP Nov'23) (PYQ May'22 6 Marks)

Ans.

1. **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. Vikas can be introduced as a partner with the consent of Mr. B and Mr. C, the existing partners.

2. **Rights of Transferee of a Partner's interest (Section 29):** 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. Vikas, the transferee in M/S ABC Associates, cannot inspect the books of the firm and the contention of the other partners is right that Mr. Vikas cannot challenge the books of accounts.

6. With reference to the provisions of Indian Partnership Act, 1932 explain the various effects of insolvency of a partner. **(RTP Nov' 23)**

Ans. Effects of insolvency of a partner (Section 34 of the Indian Partnership Act, 1932):

1. The insolvent partner cannot be continued as a partner.
2. He will be ceased to be a partner from the very date on which the order of adjudication is made.
3. The estate of the insolvent partner is not liable for the acts of the firm done after the date of order of adjudication.
4. The firm is also not liable for any act of the insolvent partner after the date of the order of adjudication.
5. Ordinarily, the insolvency of a partner results in dissolution of a firm; but the partners are competent to agree among themselves that the adjudication of a partner as an insolvent will not give rise to dissolution of the firm.

7. 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:

1. To what extent X will be liable if he failed to give public notice after attaining majority?
2. Can Mr. L recover his debt from X? **(RTP Nov'23) (SM)**

Ans. As per the provisions of Section 30(5) of the Indian Partnership Act, 1932, at any time within six months of his 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.

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.

1. 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.
2. 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.

8. 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 continued 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 Jun'24) (RTP May'22)**

Ans. 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.

9. A, B & 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 INR 350 per Kilogram. B already had 1000 kg of iron bars in stock which he had purchased before price hike in the market for INR 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 INR 350? Assume there is no contract between the partners regarding the above.

(RTP Jun'24) (RTP Nov'21)

partners:

A. if a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;

B. if a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

In the given scenario, B had sold iron bar to the firm at the current prevailing market rate of 350 per Kg though he had stock with him which he bought for INR 200 per Kg. Hence, he made an extra profit ofINR 150 per Kg. This arises purely out of transactions with the firm. Hence, Bis accountable to the firm for the extra profit earned thereby.

10. 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?

(RTP Jun 24) (RTP May'23) (SM)

Ans. Section 29 of the Indian Partnership Act, 1932 provides that a share in a partnership is transferable like any other property, but as the partnership relationship is based on mutual confidence, the assignee of a partner's interest by sale, mortgage or otherwise cannot enjoy the same rights and privileges as the original partner.

The rights of such a transferee are as follows:

1. During the continuance of partnership, such transferee is not entitled
   (a) to interfere with the conduct of the business,
   (b) to require accounts, or
   (c) to inspect 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 the dissolution of the firm or on the retirement of the transferring partner, the transferee will be entitled, against the remaining partners:
   (a) to receive the share of the 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 as from the date of the dissolution.

By virtue of Section 31, no person can be introduced as a partner in a firm without the consent of all the partners. A partner cannot by transferring his own interest, make anybody else a partner in his place, unless the other partners agree to accept that person as a partner. At the same time, a partner is not debarred from transferring his interest. A partner's interest in the partnership can be regarded as an existing interest and tangible property which can be assigned.

11. 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

insolvent and failed to pay the price of furniture to M/s AB and Co. Now M/s AB and Co. has filed a casé 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 Jun'22 6 Marks) (RTP May 22) (MTP 6 Marks, Oct'21)

Ans. According to Section 35 of the Indian Partnership Act, 1932, where under a contract between the partners, the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death.

Further, in order that the estate of the deceased partner may be absolved from liability for the future obligations of the firm, it is not necessary to give any notice either to the public or the persons having dealings with the firm.

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. 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. So, the estate of the deceased partner may be absolved from liability for the future obligations of the firm.

12. 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 therefore. Discuss in brief the points for which Mr. B is not entitled during continuance of partnership?

(MTP Nov'22 4 Marks) (SM) (RTP May 21)

Ans. As per Section 29 of Indian Partnership Act, 1932, 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 le 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.

In the given case during the continuance of partnership, such transferee Mr. B is not entitled:

- to interfere with the conduct of the business.
- to require accounts.
- to inspect books of the firm.

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.

13. M/s ABC & Associates, a partnership firm with A, B and C as senior partners engaged in the business of curtain manufacturing and exporting to foreign countries. On 25th August, 2020, they inducted Mr. P, an expert in the field of curtain manufacturing as their partner. On 10th January 2022, Mr. P was blamed for unauthorized activities and thus expelled from the partnership by approval of all of the remaining partners.

A. Examine whether action by the partners was justified or not?

B. 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?

(MTP Apr'23 6 Marks) (SM)

A partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by contract between the partners.

The test of good faith as required under Section 33(1) includes three things:

- The expulsion must be in the interest of the partnership.
- The partner to be expelled is served with a notice.
- He is given an opportunity of being heard.

If a partner is otherwise expelled, the expulsion is null and void.

A. Action by the partners of M/s ABC & Associates, a partnership firm to expel Mr. P from the partnership was justified as he was expelled by approval of the other partners exercised in good faith to protect the interest of the partnership against the unauthorized activities charged against Mr. P. A proper notice and opportunity of being heard has to be given to Mr. P.

B. The following are the factors to be kept in mind prior expelling a partner from the firm by other partners:

- the power of expulsion must have existed in a contract between the partners;
- the power has been exercised by a majority of the partners; and
- it has been exercised in good faith.

14. Mr. Naresh is one of the four partners in M/s XY Enterprises. He owes a sum of Rs. 6 crore to his friend Mr. Akash which he is unable to pay on due time. So, he wants to sell his share in the firm to Mr. Akash for settling the amount.

In the light of the provisions of the Indian Partnership Act, 1932, discuss each of the following:

(i) Can Mr. Naresh validly transfer his interest in the firm by way of sale?

(ii) What would be the rights of the transferee (Mr. Akash) in case Mr. Naresh wants to retire from the firm after a period of 6 months from the date of transfer?

(MTP May'23 6 Marks) (MTP Nov'22 6 Marks) (MTP Mar'22 6 Marks) (PYQ 6 Marks, Jul 21)

Ans. According to Section 29 of the Indian Partnership Act, 1932,

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.
2. If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled as against the remaining partners to receive the share of the assets of the firm to which the transferring partner is entitled, and, for the purpose of ascertaining that share, to an account as from the date of the dissolution.

   In the light of facts of the question and provision of law:

   (i) Yes, Mr. Naresh can validly transfer his interest in the firm by way of sale.

   (ii) On the retirement of the transferring partner (Mr. Naresh), the transferee (Mr. Akash) will be entitled, against the remaining partners:

was entitled, and

B. for the purpose of ascertaining the share, he is entitled to an account as from the date of the dissolution.

So, in this case on Mr. Naresh's retirement, Mr. Akash would be entitled to receive the value of Mr. Naresh's share to the extent of ₹6 crore in the firm's assets.

15. A and B are partners in M/s Aee Bee & Company. Firm is doing business of trading of plastic bottles. A is authorised to sell the stock of plastic bottles. It was decided between them that A should sell the plastic bottles at the minimum price which they have decided and if A sell at a price less than minimum price, he should first take the permission of B. Due to sudden change in government policy, the price of plastic bottles was continuously declining. To save the loss of firm, A sold the stock at lower price.

Meanwhile, A tried to contact B but couldn't do so as B was on foreign trip. Afterwards when B came, he filed the suit to recover the difference of sale price and minimum price to the firm. Whether B can do so under the provisions of Indian Partnership Act, 1932?

(MTP Nov'23 6 Marks)

Ans. According to Section 13(e) of Indian Partnership Act 1932, every partner has the right to be indemnified by the firm in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business of the firm as well as in the performance of an act in an emergency for protecting the firm from any loss, if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstances.

In the instant case, due to some emergency, A sold the stock at lower price to save the firm from loss. A couldn't contact B as he was on foreign trip.

Hence, on the basis of above provisions and facts of the problem given, selling by A at a lower price was to save the firm from loss. As the act of A was in favour of firm, he was not liable to bear the loss.

16. Can a minor become a partner in a partnership firm? Justify your answer and also explain the rights of a minor in a partnership firm. **(MTP Dec'23 4 Marks) (PYQ May'22 4 Marks)**

Ans. Minor as a partner: A minor is not competent to contract. Hence, a person who is a minor according to the law to which he is subject may not be a partner in a firm, but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

Rights of a minor in a partnership firm:

1. A minor partner has a right to his agreed share of the profits and of the firm.
2. He can have access to, inspect and copy the accounts of the firm.
3. He can sue the partners for accounts or for payment of his share but only when severing his connection with the firm, and not otherwise.
4. On attaining majority, he may within 6 months elect to become a partner or not to become a partner. If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor. If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

17. 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

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. **(MTP Dec' 23 6 Marks)**

Ans. 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. Sunder 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.

18. Can a partner be expelled? If so, how? Which factors should be kept in mind prior to expelling a partner from the firm by the other partners according to the provision of Indian Partnership Act, 1932? **(PYQ Nov'22 6 Marks)**

Ans. Expulsion of partner and factors to be kept in mind:

As per Section 33 of the Indian Partnership Act, 1932, a partner may not be expelled from a firm except

1. the power of expulsion must have existed in a contract between the partners;
2. the power has been exercised by a majority of the partners; and
3. it has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bona fide interest of the business of the firm and shall be null and void.

The test of good faith as required under Section 33(1) includes three things:

1. The expulsion must be in the interest of the partnership.
2. The partner to be expelled is served with a notice.
3. He is given an opportunity of being heard.

Yes, a partner may be expelled by other partners strictly in compliance with the provisions of section 33.

19. 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. **(PYQ Jun' 23 6 Marks)**

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.

20. What are the rights of partners with respect to conduct of the business of a firm as prescribed under the Indian Partnership Act, 1932? **(PYQ Jun'23 4 Marks)**

Ans. 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.

21. Discuss the rule regarding a partner's implied authority to bind the firm for his acts. Also, explain the situations when the partner has no implied authority to bind the firm. **(PYQ Dec'23 6 Marks)**

Ans. As per the provisions of Sections 19(1) read with the provisions of Section 22 of the Indian Partnership Act, 1932, which deal with the implied authority of a partner, provide that 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, provided that the act is done in the firm name, or any manner expressing or implying an intention to bind the firm.

Such an authority of a partner to bind the firm is called his implied authority.

As per the provisions of Section 20 of the 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.

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.

As per the provisions of sub-section (2) of Section 19 the Indian Partnership Act, 1932, in the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to-

(a) submit a dispute relating to the business of the firm to arbitration;
(b) open a banking account on behalf of the firm in his own name;
(c) compromise or relinquish any claim or portion of a claim by the firm;
(d) withdraw a suit or proceedings filed on behalf of the firm;
(e) admit any liability in a suit or proceedings against the firm;
(f) acquire immovable property on behalf of the firm;
(g) transfer immovable property belonging to the firm; and
(h) enter into partnership on behalf of the firm.

22. Explain in detail the circumstances which lead to liability of firm for misapplication by partners as per provisions of the Indian Partnership Act, 1932. **(RTP May 21)**

Ans. Liability of Firm for Misapplication by Partners (Section 27 of Indian Partnership Act, 1932): 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.

Analysis of section 27:

It may be observed that the workings of the two clauses of Section 27 are 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 a partner, he receives money or property belonging to a third party and misapplies that money or property. For this provision to be 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.

23. 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)**

Ans. As per Section 29 of the Indian Partnership Act, 1932, during the continuance of the business, a transferee is not entitled

II. To require the accounts

III. To inspect the books of the firm He is only entitled to his share of profit.

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).

24. 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? **(PYQ 6 Marks, Jan'21) (RTP May'21)**

Ans. According to Section 35 of the Indian Partnership Act, 1932, where under a contract between the partners the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death.

Further, in order that the estate of the deceased partner may be absolved from liability for the future obligations of the firm, it is not necessary to give any notice either to the public or the persons having dealings with the firm.

In the given question, JR Limited has supplied furniture to the partnership firm, after P's death. The firm did not give notice about P's death to public or people dealing with the firm. Afterwards, the firm became insolvent and could not pay JR Limited.

In the light of the facts of the case and provisions of law:

(i) Since the delivery of furniture was made after P's death, his estate would not be liable for the debt of the firm. 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 P's lifetime.

(ii) It will not make any difference even if JR Limited supplied furniture to the firm believing that all the three partners are alive, as it is not necessary to give any notice either to the public or the persons having dealings with the firm, so the estate of the deceased partner may be absolved from liability for the future obligations of the firm.

25. 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. **(PYQ 4 Marks, Jan'21)**

Ans. Liability of a partner for acts of the firm (Section 25 of the Indian Partnership Act, 1932): 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.

The partners are jointly and severally responsible to third parties for all acts which come under the scope of their express or implied authority. This is because that all the acts done within the scope of authority are the acts done towards the business of the firm.

The expression 'act of firm' connotes any act or omission by all the partners or by any partner or agent of the firm, which gives rise to a right enforceable by or against the firm. Again in

which liability is brought to be enforced against a party, must have been done while he was a partner.

Liability of the firm for wrongful acts of a partner and for misapplication by partners (Sections 26 & 27 of the Indian Partnership Act, 1932): Where, 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.

A partner acting within his apparent authority receives money or property from a third party and misapplies it, or 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.

26. Define Implied Authority. In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to do certain acts. State the acts which are beyond the implied authority of a partner under the provisions of the Indian Partnership Act, 1932? **(PYQ 6 Marks, Jul'21)**

Ans. According to Section 19 of the Indian Partnership Act, 1932, 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.

The authority of a partner to bind the firm conferred by this section is called his "implied authority" In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to-

(a) submit a dispute relating to the business of the firm to arbitration;
(b) open a banking account on behalf of the firm in his own name;
(c) compromise or relinquish any claim or portion of a claim by the firm;
(d) withdraw a suit or proceedings filed on behalf of the firm;
(e) admit any liability in a suit or proceedings against the firm;
(f) acquire immovable property on behalf of the firm;
(g) transfer immovable property belonging to the firm; and
(h) enter into partnership on behalf of the firm.

27. "Though a minor cannot be a partner in a firm, he can nonetheless be admitted to the benefits of partnership".

A. Referring to the provisions of the Indian Partnership Act, 1932, state the rights which can be enjoyed by a minor partner.
B. State the liabilities of a minor partner both:
   (i) Before attaining majority and
   (ii) After attaining majority. **(MTP 6 Marks, Mar'21)**

Ans.

A. Rights which can be enjoyed by a minor partner:

1. A minor partner has a right to his agreed share of the profits and of the firm.
2. He can have access to, inspect and copy the accounts of the firm.
3. He can sue the partners for accounts or for payment of his share but only when severing his connection with the firm, and not otherwise.

become a partner. If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor. If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

B. (i) Liabilities of a minor partner before attaining majority:

(a) The liability of the minor is confined only to the extent of his share in the profits and the property of the firm.

(b) Minor has no personal liability for the debts of the firm incurred during his minority.

(c) Minor cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the Official Receiver/Assignee.

(ii) Liabilities of a minor partner after attaining majority:

Within 6 months of his attaining majority or on his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor partner has to decide whether he shall remain a partner or leave the firm.

Where he has elected not to become partner he may give public notice that he has elected not to become partner and such notice shall determine his position as regards the firm. If he fails to give such notice he shall become a partner in the firm on the expiry of the said six months.

28. 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? **(MTP 6 Marks, Mar'21)**

Ans. A partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by contract between the partners. It is, thus, essential that:

1. the power of expulsion must have existed in a contract between the partners;
2. the power has been exercised by a majority of the partners; and
3. it has been exercised in good faith.

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

The test of good faith as required under Section 33(1) includes three things:

- The expulsion must be in the interest of the partnership.
- The partner to be expelled is served with a notice.
- He is given an opportunity of being heard.

If a partner is otherwise expelled, the expulsion is null and void.

Thus, according to the test of good faith as required under Section 33(1), expulsion of Partner Y is not valid.

29. Whether a minor may be admitted in the business of a partnership firm? Explain the rights of a minor in the partnership firm. **(MTP 6 Marks, Apr'21) (RTP Nov'21)(SM)**

Ans. A minor cannot be bound by a contract because a minor's contract is void and not merely voidable.

contract.

Though a minor cannot be a partner in a firm, he can nonetheless be admitted to the benefits of partnership under Section 30 of the Indian Partnership Act, 1932. In other words, he can be validly given a share in the partnership profits. When this has been done and it can be done with the consent of all the partners then the rights and liabilities of such a partner will be governed under Section 30 as follows:

Rights:

1. A minor partner has a right to his agreed share of the profits and of the firm.
2. He can have access to, inspect and copy the accounts of the firm.
3. He can sue the partners for accounts or for payment of his share but only when severing his connection with the firm, and not otherwise.
4. On attaining majority he may within 6 months elect to become a partner or not to become a partner.

If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor.

If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

30. 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 6 Marks, Apr'21)

Ans. According to Section 20 of the Indian Partnership Act, 1932, the partners in a firm may, by contract between the partners, extend or restrict implied authority of any partners.

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.

The implied authority of a partner may be extended or restricted by contract between the partners. Under the following conditions, the restrictions imposed on the implied authority of a partner by agreement shall be effective against a third party:

1. The third party knows above the restrictions, and
2. The third party does not know that he is dealing with a partner in a firm.

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.

recover money from the firm.

31. 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 6 Marks, Nov'21)

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

1. the power of expulsion must have existed in a contract between the partners;
2. the power has been exercised by a majority of the partners; and
3. it has been exercised in good faith.

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

The test of good faith as required under Section 33(1) includes three things:

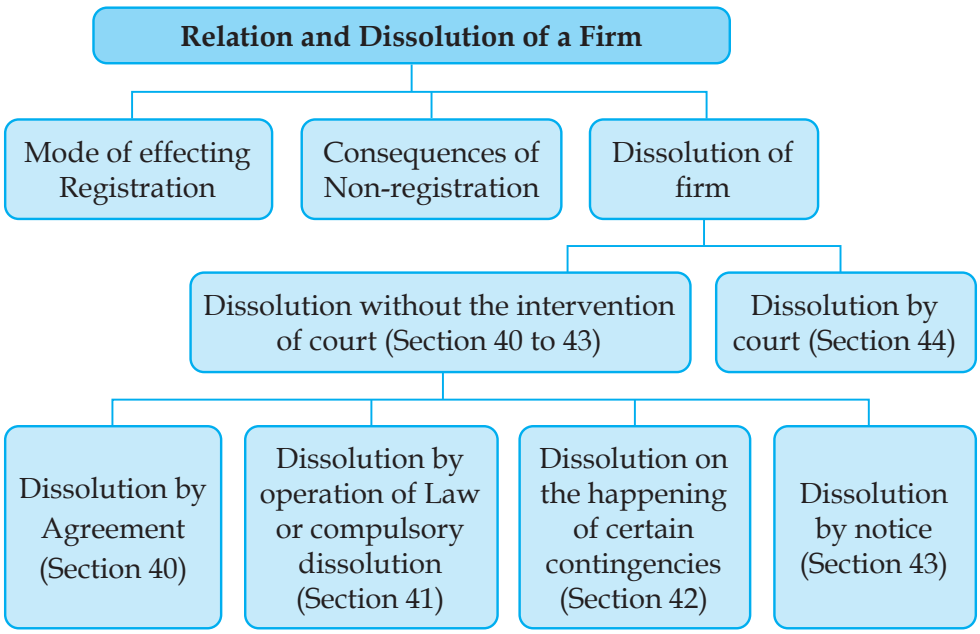
- The expulsion must be in the interest of the partnership.
- The partner to be expelled is served with a notice.
- He is given an opportunity of being heard.

If a partner is otherwise expelled, the expulsion is null and void.

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.

UNIT 03

Registration and Dissolution of a Firm



REGISTRATION OF FIRMS

- Is it compulsory in India to get your firm registered? - NO, ITS OPTIONAL.
- 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 does not make the registration of firms compulsory nor does it impose any penalty for non-registration.

APPLICATION FOR REGISTRATION (SECTION 58)

- Apply to ROF of your POB area
- Prescribed Form and Fees
- Content - NAME PANDDu
- Statement shall be signed by all the partners or their agents

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- **(NAME - PANDDu)**

a. The firm's name

c. **A -** Additional place - The names of any other places where the firm carries on business,

d. **N -** New partner the date when each partner joined the firm,

e. **D** - Details of Partners - the names in full and permanent addresses of the partners, and

f. **DU -** the duration of the firm.

- The statement shall be signed by all the partners, or by their agents specially authorised in this behalf. Each person signing the statement shall also verify it in the manner prescribed.

A firm name shall not contain any of the following words, namely:

Note: '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.

GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS
Central Registration Centre

Certificate of Incorporation

[Pursuant to sub-section (2) of section 7 and sub-section (1) of section 8 of the Companies Act, 2013 (18 of 2013) and rule 18 of the Companies (Incorporation) Rules, 2014]

I hereby certify that [redacted] PRIVATE LIMITED is incorporated on this Thirteenth day of January Two thousand twenty under the Companies Act, 2013 (18 of 2013) and that the company is limited by shares.

The Corporate Identity Number of the company is XXXX09DL202XXXX36XXXX

The Permanent Account Number (PAN) of the company is [redacted]

The Tax Deduction and Collection Account Number (TAN) of the company is [redacted]

Given under my hand at Manesar this Thirteenth day of January Two thousand twenty .

Digital Signature Certificate
VILAS SAMBHAJI HAJARE
DEPUTY REGISTRAR OF COMPANIES
For and on behalf of the Jurisdictional Registrar of Companies
Registrar of Companies
Central Registration Centre

REGISTRATION (SECTION 59)

- When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the statement in a Register called the Register of Firms and shall file the statement.
- Then he shall issue a certificate of Registration.
- However, registration is deemed to be completed as soon as:
  - an application in the prescribed form
  - with the prescribed fee and
  - necessary details concerning the particulars of partnership is delivered to the Registrar.

  Take the delivery date as effective date and not the date when ROF makes an entry in the register.
- The recording of an entry in the register of firms is a routine duty of Registrar.

If the statement in respect of any firm is not sent or delivered to the Registrar within the time specified in sub- section (1A) of section 58, then the firm may be registered on payment, to the Registrar, of a penalty of **one hundred rupees per year** of delay or a part thereof. Ex - Consider 2.1 or 2.5 years as 3 years.

CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

Disadvantages (Disabilities) of not registering the partnership firm:

- Section 69 - non-registration of partnership firm gives rise to a number of disabilities which we shall presently discuss. These are as follows:

Suit - UNRG Firm to 3rd Party NO	Suit - 3rd Party to UNRG Firm YES	Set off Claim - N.A. (Allowed only upto ₹100)	Suit - Partner of UNRG Firm to Other Partner or UNRG Firm NO

1. **No suit in a civil court by firm or other co-partners against third party:**
   - An Unregistered 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,

   In other words,
   - To sue a third party you have to be registered and
   - the persons suing have been in the register of firms as partners in the firm.
2. **Third party can sue the firm:** In case of an unregistered firm, an action can be brought against the firm by a third party.
3. **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
   - the firm can't pursue other proceedings to enforce the rights arising from any contract.
4. **Aggrieved partner cannot bring legal action against other partner or the firm:**
   - A partner of an unregistered firm (or any other person on his behalf)
   - is precluded from bringing legal action against the firm or
   - any person alleged to be or to have been a partner in the firm.
     - But, such a person may sue for dissolution of the firm or
     - for accounts and realization of his share in the firm's property where the firm is dissolved.

Exceptions: Non-registration of a firm does not, however effect the following rights:

मतलब Firm RG. हो UNRG. या ना हो ये हक़ हमेशा रहेंगे -

Already Covered -

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 right to sue or claim a set-off if the value of suit does not exceed ₹100 in value.
4. Power of an Official Assignees, Receiver of Court: To release the property of the insolvent partner and to bring an action.

- of the deceased partner of a firm for accounts of the firm
- to realise the property of the firm.

> ***Example 1:*** *A & Co. is registered as a partnership firm in 2017 with A, B and C partners. In 2018, A dies. In 2019, B and C sue X in the name and on behalf of A & Co. without fresh registration. Now the first question for our consideration is whether the suit is maintainable?*
>
> ***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,*
>
> *1. the suit must be instituted by or on behalf of the firm which had been registered;*
>
> *2. the person suing had been shown as partner in the register of firms. In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.*

Now, in the above example, what difference would it make, if in 2019 B and C had taken a new partner, D, and then filed a suit against X without fresh registration?

- Where a new partner is introduced, the fact is to be notified to Registrar who shall make a record of the notice in the entry relating to the firm in the Register of firms.
- Therefore, the firm cannot sue as D's (new partner's) name has not been entered in the register of firms.
- It was pointed out that in the second requirement, the phrase "person suing" means persons in the sense of individuals whose names appear in the register as partners and who must be all partners in the firm at the date of the suit.

Summary: Cases where NO Fresh registration taken:

1. **When a partner dies and firm continues - Old partners can sue even if not notified the ROF**
2. **When taken a new partner (Incoming partner) - Old partners cannot sue. You have to notify the ROF.**

DISSOLUTION OF FIRM (SECTIONS 39-47)

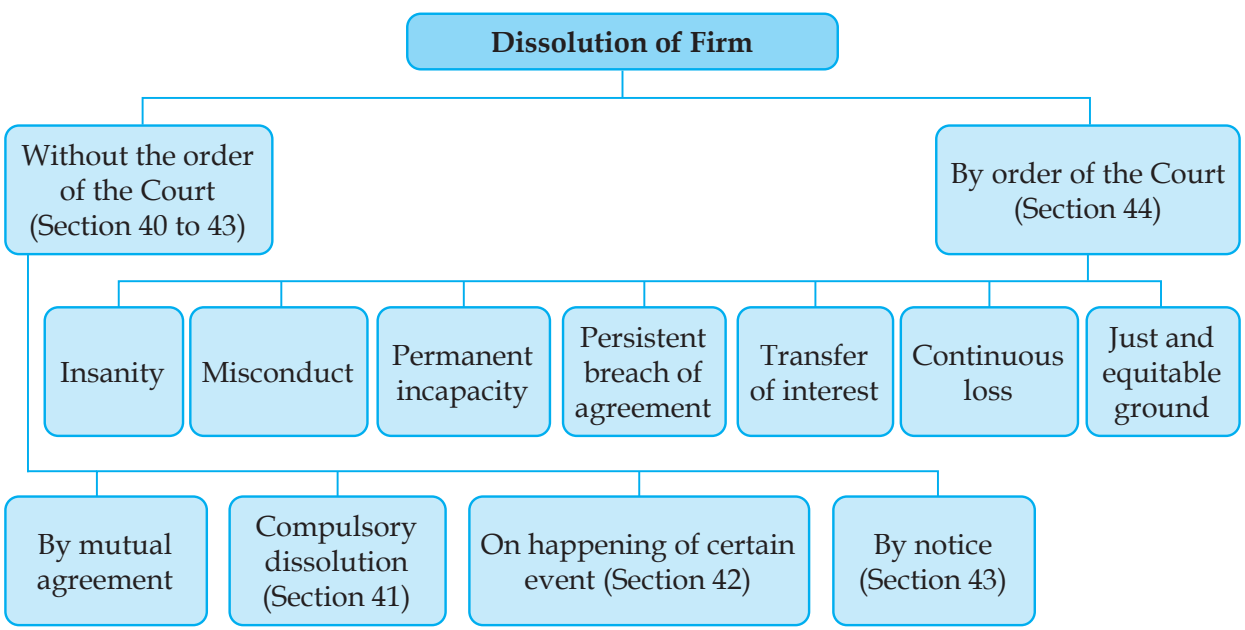
- Section 39 of the Indian Partnership Act, 1932: The dissolution of partnership between ALL partners of a firm is called the 'dissolution of the firm'.
- Thus, the dissolution of firm means the discontinuation of the legal relation existing between ALL the partners of the firm.
- But when only one or more partners retires or becomes incapacitated 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, it is called dissolution of partnership.

partnership terminates as between each and every partner of the firm.

Dissolution of Firm Vs. Dissolution of Partnership

Aspect	Dissolution of Firm	Dissolution of Partnership
Definition	Complete termination of the firm, including all partnerships within the firm.	Termination of the existing partnership, but the firm may continue with new partners.
Closure of Business	✓ The entire business is closed.	× The business may continue with new or remaining partners.
Legal Entity	✓ The firm ceases to exist as a legal entity.	× The firm continues with a reconstituted partnership.
Impact on Partners	✓ All partners' relationships are terminated.	× Only the existing partnership is terminated; partners may reform with new terms.
Winding Up of Affairs	✓ Assets arc liquidated, debts are paid off, and any surplus is distributed among partners.	× The existing partnership's affairs are settled, but the firm's operations continue.
New Agreement Needed	× No new agreement as the firm is dissolved completely.	✓ A new partnership agreement is needed if the firm continues with remaining or new partners.
Third-Party Relationships	✓ All third-party contracts and relationships are terminated.	× Third-party contracts may continue under the reconstituted firm.
Distribution of Assets and Liabilities	✓ Assets and liabilities arc distributed among partners.	× Assets and liabilities remain with the continuing firm.

MODES OF DISSOLUTION OF A FIRM (SECTIONS 40-44)



It consists of following four types:

Agreement 40	Compulsory 41	On happening of an event 42	By notice 43

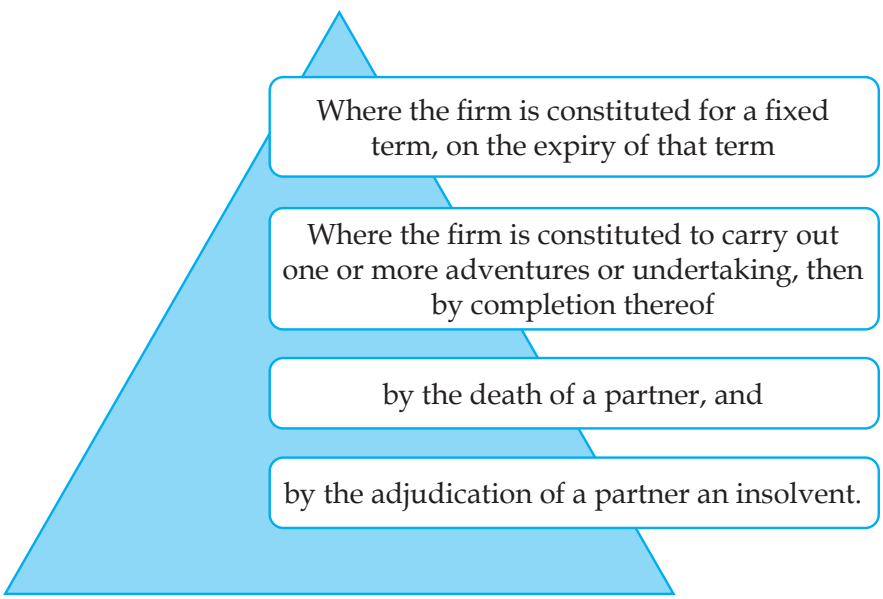
A. Dissolution by Agreement (Section 40): Section 40 gives right to the partners to dissolve the partnership - by agreement with the consent of all the partners or in accordance with a contract between the partners. 'Contract between the partners' means a contract already made.

B. Compulsory dissolution (Section 41): A firm is compulsorily dissolved - by the adjudication of ALL the partners or of all the partners but one as insolvent (Except one); or by the happening of any event which makes it unlawful for the business of the firm or for the partners to carry it on in partnership.

However, when 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.

Example 2: A firm is carrying on the business of trading a particular chemical and a law is passed which bans on the trading of such a particular chemical. The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.

C. Dissolution on the happening of certain contingencies (Section 42): Subject to contract between the partners, a firm can be dissolved on the happening of any of the following contingencies:



D. Dissolution by notice of partnership at will (Section 43): Where the partnership is at will - the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. In case date is mentioned in the Notice:

(a) The firm is dissolved as from the date mentioned in the notice as the date of dissolution, or

(b) in case no date is so mentioned, as from the date of the communication of the notice.

Court may, at the suit of the partner, dissolve a firm on any of the following ground:

IMPROVE -
I: Insanity/Unsound Mind
M: Misconduct
P: Persistent Breach of Agreement
R: Repeated Losses (Continuous/Perpetual Losses)
O: Obsolete Capacity (Permanent Incapacity)
V: Voluntary Transfer of Interest
E: Equitable Grounds (Just and Equitable Grounds)

A. **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. Temporary sickness is no ground for dissolution of firm

Example 3: A, B and C are partners in a firm. A has severe infection and got typhoid. Due to this, he was not able to conduct business for few weeks. This kind of illness cannot be treated as the ground for dissolution.

B. **Permanent incapacity (Obselete capacity):** 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.

C. **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. It is not necessary that misconduct must relate to the conduct of the business. The important point is the adverse effect of misconduct on the business. In each case nature of business will decide whether an act is misconduct or not.

D. **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.

Example 4: If one of the partners keeps erroneous accounts and omits to enter receipts or if there is continued quarrels between the partners or there is such a state of things that destroys the mutual confidence of partners, the court may order for dissolution of the firm.

E. **Transfer of interest (Voluntary):** 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 due by the partner, the court may dissolve the firm at the instance of any other partner.

F. **Repeated/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.

equitable for the dissolution of the firm, it may dissolve a firm. The following are the cases for the just and equitable grounds:

(a) **Deadlock** in the management.
(b) Where the **partners** are not in **talking terms** between them.
(c) Loss of **substratum**.
(d) **Gambling** by a partner on a **stock exchange**.

CONSEQUENCES OF DISSOLUTION (SECTIONS 45-55)

Consequent to the dissolution of a partnership firm, the partners have certain rights and liabilities, as are discussed:

45	PROTECT - NOTICE OF Dissolution - ❍ 3rd parties (when unaware of dissolution) ↔ Firm ❍ Partners ↔ Liabilities towards 3rd parties
46	After DISS. Property of the firm → Debt & Liabilities → Surplus among partners
47	Continuing authority of Partners after WP - R / O / Authority to bind the firm → For the purpose of WP only
48	Mode of Settlement - Losses and Assets
49	Firm's property → For Firm's debt first then separate debt of partners and Partners' separate property → For separate debt first then firm's debt

1. **Liability for acts of partners done after dissolution (Section 45):** Section 45 has two fold objectives-
   (a) It seeks to protect third parties dealing with the firm who had no notice of prior dissolution and
   (b) It also seeks to protect partners of a dissolved firm from liability towards third parties.

   Example 5: X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution. In such a case, Y also would be liable for the amount because no public notice was given.

   However, there are exceptions to the rule stated in above example i.e. even where notice of dissolution has not been given, there will be no liability for subsequent acts in the case of:
   (a) the estate of a deceased partner,
   (b) an insolvent partner, or
   (c) a dormant partner, i.e., a partner who was not known as a partner to the person dealing with the firm.
2. **Right of partners to have business wound up after dissolution (Section 46):** On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representative, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights.
3. **Continuing authority of partners for purposes of winding up (Section 47):**

   जो Authority, winding up के लिए ज़रूरी है वो rights and obligations रहेगी partners के पास

- the **authority** of **each partner** to **bind** the firm, and
- the **other mutual rights** and **obligations** of the partners,
- **continue** notwithstanding the dissolution, so far as may be necessary
- to **wind** up the **affairs** of the firm and
- to **complete transactions begun** but **unfinished** at the time of the dissolution, but not otherwise.

Provided that the firm is **in no case bound** by the acts of a partner who has been **adjudicated insolvent**; but this proviso does not affect the liability of any person who has after the adjudication represented **himself** or **knowingly** permitted himself to be **represented** as a **partner** of the **insolvent**.

4. **Mode of 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:-

Settle LOSSES out of → Flow -		
PROFITS	CAPITAL	PARTNERS IN PSR

(a) **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;

EXAMPLE -

ABC Partners with three partners: Amit, Bharat, and Chetan. They have decided to dissolve the partnership and need to settle the firm's accounts.

DATA -

Profits: ₹30,000

Capital: ₹50,000 (Amit: ₹20,000, Bharat: ₹15,000, Chetan: ₹15,000)

Losses/Deficit: ₹90,000

Step 1: Settle Losses Out of Profits

The first step is to use the profits to cover the losses.

Losses: ₹90,000

Profits Available: ₹30,000

So, the firm will use ₹30,000 from the profits to reduce the loss:

Remaining Loss: ₹90,000 - ₹30,000 = ₹60,000

Step 2: Settle Remaining Losses Out of Capital

Remaining loss of ₹60,000 using the partners' capital contributions.

Capital Available: ₹50,000 (Amit: ₹20,000, Bharat: ₹15,000, Chetan: ₹15,000)

Remaining Loss after Capital Adjustment: ₹60,000 – ₹50,000 = ₹10,000

Now, the firm has no capital left, and there is still a ₹10,000 loss to cover.

Step 3: Settle Any Further Losses by Partners Individually

The final step - The partners cover the remaining loss of ₹10,000 personally. (Assuming they share profits and losses equally (1 : 1 : 1):

Each partner must contribute: ₹10,000 ÷ 3 = ₹3,333.33

contributed by the partners to make up deficiencies of capital, must be applied in the following manner and order:

Utilize ASSETS in the following flow -			
DEBT	ADVANCE (Partner's)	CAPITAL	Residual - To Partners in PSR

I. in paying the **debts** of the firm to third parties;
II. in paying to **each partner** rateably what is **due** to him from **capital**; (To be read as Advances from Partner)
III. in paying to each partner rateably what is due to him on **account of capital**; and
IV. the residue, if any, shall be **divided among** the **partners** in the **proportions** in which they were entitled to share profits

Example:

Imagine a small partnership firm called XYZ Associates with three partners: Xavier, Yash, and Zara. They have decided to dissolve the partnership.

DATA:

Assets Available: ₹1,50,000
Debts to Third Parties: ₹50,000
Advances from Partners: Xavier: ₹10,000, Yash: ₹5,000, Zara: ₹5,000
Total Advances: ₹20,000
Capital Contributed by Partners: Xavier: ₹30,000, Yash: ₹20,000, Zara: ₹10,000
Total Capital: ₹60,000, Profit-Sharing Ratio: Equal (1 : 1 : 1)

Step 1: Pay Debts to Third Parties

The first priority is to pay off the debts to third parties.
Debts to third parties: ₹50,000
Remaining assets after paying debts: ₹1,50,000 – ₹50,000 = ₹1,00,000

Step 2: Pay Advances from Partners

Next, the firm pays back the advances made by the partners.
Total Advances: ₹20,000 (Xavier: ₹10,000, Yash: ₹5,000, Zara: ₹5,000)
Remaining assets after paying advances: ₹1,00,000 – ₹20,000 = ₹80,000

Step 3: Pay Capital Contributed by Partners

Now, the firm returns the capital that each partner originally contributed.
Total Capital: ₹60,000 (Xavier: ₹30,000, Yash: ₹20,000, Zara: ₹10,000)
Since ₹80,000 is available, it can fully cover the total capital of ₹60,000.
Remaining assets after paying capital: ₹80,000 – ₹60,000 = ₹20,000

Step 4: Divide Any Residual Assets Among Partners

Any remaining assets are divided among the partners based on their PSR
Remaining assets to be divided: ₹20,000 Profit-sharing ratio: Equal (1 : 1 : 1)
Each partner receives:
Xavier: ₹20,000 ÷ 3 = ₹6,666.67, Yash: ₹6,666.67, Zara: ₹6,666.67

Example 6:

Case 1: *Without any specific agreement, the deficiency is shared equally between X's estate and Y, so both bear ₹2,50,000 of the loss.*

X and Y were partners sharing profits and losses equally and X died. On taking partnership accounts, it transpired that he contributed ₹6,60,000 to the capital of the firm and Y only ₹40,000. The assets amounted to ₹2,00,000. In such situation, the deficiency (6,60,000 + 40,000 – 2,00,000 i.e. 5,00,000) would have to be shared equally by Y and X's estate.

Case 2:

With an agreement to distribute assets based on capital contribution, X's estate bears a larger portion of the deficiency (₹4,71,450), while Y bears a smaller portion (₹28,550).

Capital Proportion:

X: *₹6,60,000 / ₹7,00,000 = 94.29%*

Y: *₹40,000 / ₹7,00,000 = 5.71%*

Deficiency Covered by Each Partner: *The deficiency of ₹5,00,000 would be shared in these proportions:*

X's Estate: *94.29% of ₹5,00,000 = ₹4,71,450*

Y: *5.71% of ₹5,00,000 = ₹28,550*

- If in the above example, the agreement provided that on dissolution the surplus assets would be divided between the partners according to their respective interests in the capital and on the dissolution of the firm a deficiency of capital was found, then the assets would be divided between the partners in proportion to their capital with the result that X's estate would be the main loser.

GARNER & MURRAY RULE

Deficiency Allocation: When a partner is insolvent during the dissolution of a partnership, the deficiency (shortfall) caused by their inability to pay is distributed among the solvent partners based on their last agreed capital contributions, not their profit-sharing ratios.

Partner	Capitol Contribution (₹)	Deficiency Allocation (₹)	Final Capitol after Deficiency (₹)
A	3000O	6000	24000
B	2000O	4000	16000
C	10000	C is Insolvent	0

5. **Payment of firm debts and of separate debts (Section 49):** Where there are **joint debts due from the firm and also separate debts due from any partner:**

(a) the property of the firm shall be applied in -

(i) the first instance in payment of the debts of the firm, and

(ii) if there is any surplus, then the share of each partner shall be applied to the payment of his separate debts or paid to him;

(b) the separate property of any partner shall be applied first in the payment of his separate debts and surplus, if any, in the payment of debts of the firm

Imagine a partnership firm called ABC Traders with two partners, Arun and Bala. The firm owes money to third parties, and both Arun and Bala also have personal

Financial Situation			
Firm's Debts (Joint Debts): ₹1,50,000			
Firm's Assets: ₹1,00,000			
Arun's Separate Debts: ₹50,000			
Arun's Separate Assets: ₹30,000			
Bala's Separate Debts: ₹40,000			
Bala's Separate Assets: ₹50,000			

Category	Arun	Bala	Firm
Firm's Debts (Joint Debts)			₹1,50,000
Firm's Assets			₹1,00,000
Remaining Firm's Debts			₹5,50,000
Arun's Separate Debts	₹5,50,000		
Arun's Separate Assets	₹30,000		
Remaining Arun's Separate Debts	₹20,000		
Bala's Separate Debts		₹40,000	
Bala's Separate Assets		₹50,000	
Remaining Bala's Separate Debts		₹0	
Bala's Surplus Assets		₹10,000	
Remaining Firm's Debts after Bala's Surplus			₹40,000

"PROBLEM KYA HAI? - UNIT 3"

QUESTION BANK FOR THE UNIT

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - IPA

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTION

1. What is the procedure of registration of a partnership firm under the Indian Partnership Act, 1932? **(Module)**

Ans. **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,

(e) the names in full and permanent addresses of the partners, and

(f) the duration of the firm.

The statement shall be signed by all the partners, or by their agents specially authorised in this behalf.

2. Each person signing the statement shall also verify it in the manner prescribed.
3. 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.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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? **(RTP May' 22)**

Ans. 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.

2. 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)**

Ans. **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.

1. Two firms each having 12 partners combined by an agreement into one firm.
2. A and B, co-owners, agree to conduct the business in common for profit.
3. Some individuals form an association to which each individual contributes ₹500 annually. The objective of the association is to produce clothes and distribute the clothes free to the war widows.
4. A and B, co-owners share between themselves the rent derived from a piece of land.
5. A and B buy commodity X and agree to sell the commodity with sharing the profits equally.

(RTP Nov'23)

Ans.

1. Yes, this is a case of partnership because there is an agreement between two firms to combine into one firm.
2. Yes, this is a case of partnership because A & B, co-owners, have agreed to conduct a business in common for profit.
3. No, this is not a case of partnership as no charitable association can be floated in partnership.
4. No, this is not a case of partnership as they are co-owners and not the partners. Further, there exist no business.
5. Yes, this is a case of partnership as there exist the element of doing business and sharing of profits equally.

4. 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 Jun' & May' 23)**

Ans. 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.

5. 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 Mar 22 4 Marks)**

Ans. Mode of Settlement of partnership accounts: As per Section 48 of the Indian Partnership Act, 1932, in settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:

capital, and, lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits;

2. 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.

6. 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)**

Ans. Consequences of Non-registration of partnership firm (Section 69 of the Indian Partnership Act, 1932): Non-registration of partnership gives rise to a number of disabilities. Though registration of firm is not compulsory, vet the consequences or disabilities of non-registration have a persuasive pressure for their registration. Following are the consequences:

A. 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.

B. 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.

C. Aggrieved partner cannot bring legal action against other partner or the firm: A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm.

D. Third-party can sue the firm: In case of an unregistered firm, an action can be brought against the firm by a third party.

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.

7. When does dissolution of a partnership firm take place under the provisions of the Indian Partnership Act, 1932? Explain. **(MTP Apr'23 4 Marks) (MTP Jun'22 4 Marks)(SM) (MTP 4 Marks, Apr'21) (MTP 4 Marks, Oct'21)**

existing between all the partners of the Firm. But when only one of the partners retires or becomes incapacitated 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 breach of agreement by a partner; (v) transfer or sale of the whole interest of a partner; (vi) business being carried on at a loss; (vii) the court being satisfied on other equitable grounds that the firm should be dissolved.

8. 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 May'23 4 Marks) (MTP Nov'22 4 Marks) (MAJP Mar'22 4 Marks) (PYQ 4 Marks, Jul'21)**

Ans. Mode of Settlement of partnership accounts: As per Section 48 of the Indian Partnership Act, 1932, in settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:

1. 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;
2. 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.

9. Indian Partnership Act does not make the registration of firm's compulsory nor does it impose any penalty for non-registration". In light of the given statement, discuss the consequences

to non-registration of firms. **(MTP Nov'23 6 Marks)**

Ans. The Indian Partnership Act, 1932 does not make the registration of firm's compulsory nor does it impose any penalty for non-registration. However, under Section 69 of the Indian Partnership Act, 1932, non-registration of partnership gives rise to a number of disabilities. These disabilities briefly are as follows:

1. **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.
2. **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.
3. **Aggrieved partner cannot bring legal action against other partner or the firm:** A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. But such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.
4. **Third party can sue the firm:** In case of an unregistered firm, an action can be brought against the firm by a third party.

   Following are the Rights unaffected due to non-registration of firms: Non-registration of a firm does not, however effect the following rights:

   (a) The right of third parties to sue the firm or any partner
   (b) 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.
   (c) The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.
   (d) The right to sue or claim a set-off if the value of suit does not exceed ₹100 in value.
   (e) The right to suit and proceeding instituted by legal representatives or heirs of the deceased partner of a firm for accounts of the firm or to realise the property of the firm.

10. Explain the grounds on which court may dissolve a partnership firm in case of any partner files a suit for the same. **(PYQ May' 22 4 Marks)**

Ans. According to Section 44 of the Indian Partnership Act, 1932, Court may, at the suit of the partner, dissolve a firm on any of the following grounds:

A. 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. Temporary sickness is no ground for dissolution of firm.

B. 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.

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.

D. Persistent breach of agreement: Following comes into category of breach of contract:

- Embezzlement,
- Keeping erroneous accounts
- Holding more cash than allowed
- Refusal to show accounts despite repeated request etc.

E. 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 due by the partner, the court may dissolve the firm at the instance of any other partner.

F. 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.

G. 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:

(a) Deadlock in the management.
(b) Where the partners are not in talking terms between them.
(c) Loss of substratum.
(d) Gambling by a partner on a stock exchange.

11. "Indian Partnership Act does not make the registration of firm's compulsory nor does it impose any penalty for non-registration". In light of the given statement, discuss the consequences of non-registration of the partnership firms in India. Also, explain the rights unaffected due to non-registration of firms. **(PYQ Nov'22 6 Marks) (SM)**

Ans. It is true to say that Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration.

Following are the consequences of Non-registration of Partnership Firms in India: The Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration. However, under Section 69 of the Indian Partnership Act, 1932, non-registration of partnership gives rise to a number of disabilities. These disabilities briefly are as follows:

1. **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.
2. **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 Rs. 100 or pursue other proceedings to enforce the rights arising from any contract.
3. **Aggrieved partner cannot bring legal action against other partner or the firm:** A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing

the firm. But, such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.

4. **Third party can sue the firm:** In case of an unregistered firm, an action can be brought against the firm by a third party.

Following are the Rights unaffected due to non-registration of firms: Non- registration of a firm does not, however effect the following rights:

(a) The right of third parties to sue the firm or any partner

(b) 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.

(c) The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.

(d) The right to sue or claim a set-off if the value of suit does not exceed ₹100 in value.

(e) The right to suit and proceeding instituted by legal representatives or heirs of the deceased partner of a firm for accounts of the firm or to realise the property of the firm.

12. Explain about the registration procedure of a partnership firm as prescribed under the Indian Partnership Act, 1932. **(PYQ Jun'23 6 Marks)**

Ans. Application for Registration (Section 58 of the Indian Partnership Act, 1932): 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.

The statement shall be signed by all the partners, or by their agents specially authorised in this behalf.

1. Each person signing the statement shall also verify it in the manner prescribed.
2. 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.

Registration (Section 59): When the Registrar in satisfied that the provisions of section 58 (above mentioned provisions) have been duly complied With, he shall record an entry of the statement in a register called the Register of Firms and shall file the statement. The Firm when registered shall use the brackets and word (Registered) immediately after its name.

13. State the rules that should be observed by the partners in settling the accounts of the firm after dissolution under the Indian Partnership Act, 1932? **(PYQ Dec'23 4 Marks)**

Act, 1932, in settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:

1. 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;
2. 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.

14. 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)**

Ans. 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.

15. "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? **(MTP 4 Marks, Mar'21)**

Ans. 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:

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.

2. **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.
3. **Aggrieved partner cannot bring legal action against other partner or the firm:** A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm.
4. **Third party can sue the firm:** in case of an unregistered firm, an action can be brought against the firm by a third party.

16. "Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration". In light of the given statement, discuss the consequences of non-registration of the partnership firms In India? **(MTP 4 Marks, Nov'21) (RTP May'21)**

Ans. It is true to say that Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration.

Following are consequences of Non-registration of Partnership Firms in India:

The Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration. However, under Section 69, non-registration of partnership gives rise to a number of disabilities which we shall presently discuss. Although registration of firms is not compulsory, yet the consequences or disabilities of non-registration have a persuasive pressure for their registration.

These disabilities briefly are as follows:

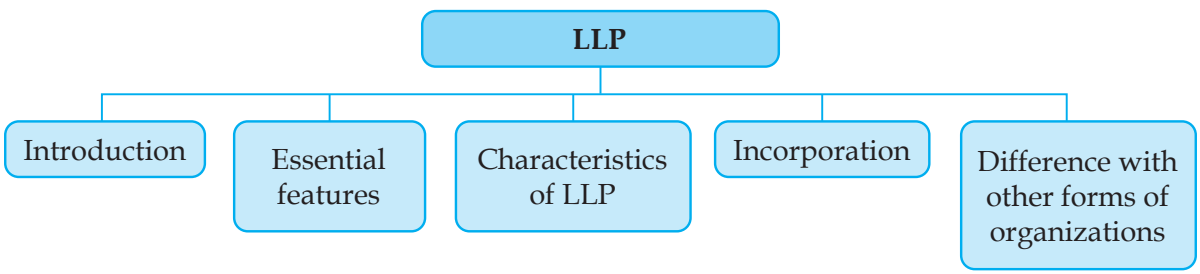
1. **No suit in a civil court by firm or other co-partners against third party:** The firm or any other person on its behalf cannot bring an action against the third party for breach of contract entered into by the firm, unless the firm is registered and the persons suing are or have been shown in the register of firms as partners in the firm. In other words, a registered firm can only file a suit against a third party and the persons suing have been in the register of firms as partners in the firm.
2. **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.
3. **Aggrieved partner cannot bring legal action against other partner or the firm:** A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. But, such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.
4. **Third party can sue the firm:** In case of an unregistered firm, an action can be brought against the firm by a third party.

05
CHAPTER

The Limited Liability Partnership Act, 2008

TABLE OF CONTENT FOR THE CHAPTER

INTRODUCTION	5.1
NEED OF NEW FORM OF LIMITED LIABILITY PARTNERSHIP	5.2
MEANING AND CONCEPT	5.2
ADVANTAGES OF LLP FORM	5.3
IMPORTANT DEFINITIONS	5.3
CHARACTERISTIC OF LLP	5.6
INCORPORATION OF LLP	5.7
DIFFERENCES WITH OTHER FORMS OF ORGANISATION	5.11
" PROBLEM KYA HAI?"	5.13



INTRODUCTION

The Ministry of Law and Justice on 9th January 2009 (misprinted in the module as 2007) notified. The Limited Liability Partnership Act, 2008

- **2008 -** Bill was passed by the Parliament on 12th December, 2008 and
- **2009 -** The President of India has assented to the Bill on 7th January, 2009
- **2021 -** Amended- The LLP (Amendment) Act, 2021 (31st August, 2021)
- This Act is for formation and regulation of LLPs and matters connected therewith or incidental thereto.
- The LLP Act, 2008 has **81 sections and 4 schedules.**
  - The First Schedule =
    - Mutual rights and duties of partners and
    - Between limited liability partnership and its partners where there is absence of formal agreement with respect to them.
  - The Second Schedule - Conversion of a Firm into LLP.

- The Fourth Schedule - Conversion of Unlisted public company into LLP.

- Administration of the Act - **The Ministry of Corporate Affairs (MCA) + the Registrar of Companies (ROC)**

The Companies Act, 2013 → **Registrar of Companies**
The Indian Partnership Act, 1932 → **Registrar of Firms**
The Limited Liability Partnership Act, 2008 → **Registrar of Companies**

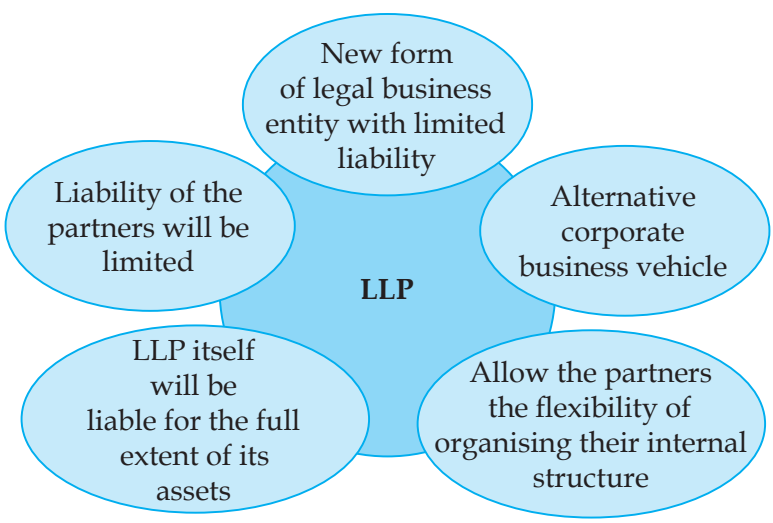
- Framing of the rules, amendments in OG with regards to the Act - **CG**
- It is also to be noted that 'The Indian Partnership Act, 1932 is not applicable to LLPs.
- Non-applicability of the Indian Partnership Act, 1932 (Section 4): The provisions of the Indian Partnership Act, 1932 shall not apply to a LLP.

NEED OF NEW FORM OF LIMITED LIABILITY PARTNERSHIP

- A need has been felt for a new corporate form that would provide:
  - an alternative to the traditional partnership with unlimited personal liability on the one hand and
  - the statute-based governance structure of the limited liability company on the other hand.
- Owing to flexibility in its structure and operation: The LLP is a suitable vehicle for small enterprises and for investment by venture capital.

MEANING AND CONCEPT

- 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.
- **It gives benefits of limited liability of a company and the flexibility of a partnership.**
- 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.



New form → Alternative Corporate business vehicle → LLP is a HYBRID system

Benefits of Company	Benefits of Partnership Firm
❑ Body Corporate	❑ Flexibility
❑ Limited Liability	❑ Agreement
❑ Perpetual Succession	❑ Easy to create
❑ Separate Legal Entity	❑ Easy to dissolve
❑ Artificial Legal person	❑ Compliances are less
LLP has taken advantages of both the form of organisation	

ADVANTAGES OF LLP FORM

LLP form is a form of business model which:

- Is organized and operates on the basis of an agreement
- Provides flexibility without imposing detailed legal and procedural requirements
- Easy to form
- All partners enjoy limited liability
- Flexible capital structure
- Easy to dissolve

IMPORTANT DEFINITIONS

1. **Body Corporate Section 2(1)(d):★** A BODY CORPORATE CAN BECOME A PARTNER IN LLP. SO WE NEEED TO UNDERSTAND WHAT IS A BODY CORPORATE?

   It means a company as defined in section 3 of the Act and includes -

   (a) a LLP **registered under this** Act;

   (b) a LLP **incorporated outside India**; and

   (c) a company incorporated outside India,

   but does **not include**

   (a) a **corporation sole**;

(c) any other body corporate (not being a company as defined in section 3 of x the Companies Act, 1956 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**.

2. **Business [Section 2(1)(e)]:** Business includes every trade, profession, service and occupation. LLP can't be formed for **CHARITABLE PURPOSE. ONLY PROFIT.**
3. **Designated Partner [Section 2(j)]:** Designated partner means any **partner designated as such pursuant to Sec. 7.**
4. **Financial Year [Section 2(1)(l)]:** The period from -

   REGULAR Case - the 1st April to 31st March of the following year**.**

   SPECIAL Case - LLP incorporated **after the 30th September** of a year - the financial year may end on **31st March of the year next following that year**.★

   Example 1: If a LLP has been incorporated on 15th October, 2019, then its financial year may be from 15th October, 2019 to 31st March, 2021.

5. **Foreign LLP [section 2(1)(m)]:**★★
   (a) It means a LLP formed, incorporated or registered outside India
   (b) which establishes a place of business within India.

Formed/Incor./Reg.	POB	Foreign LLP?
In India	Within India	**NO (Normal LLP)**
Outside India	Within India	**YES**
Outside India	Outside India	**NO**
In India	Outside India	**NO (Normal LLP)**

6. **Limited Liability partnership agreement Section 2(1)(o):**
   (a) It means any **written agreement between the partners of the LLP** or
   (b) **Between the LLP and its partners**

   which determines the mutual rights and duties of the partners and their rights and duties in relation to that LLP.
7. **Partner [Section 2(q)]:** Partner, in relation to a LLP, means any person who **becomes a partner in the LLP in accordance with the LLP agreement.**
8. **Small LLP [Section 2(1)(ta)]:**★★ It means a limited liability partnership (Satisfy both the conditions)
   (a) **Contribution** of which **does not exceed 25 lacs** rupees or Max. **not exceeding 5 crores (CG has power to increase it till this figure)** as may be described

   AND

   (b) **Turnover** of which -
      (i) as per the statement of Accounts and Solvency for the
      (ii) **immediately preceding financial year**
      (iii) **does not exceed 40 Lacs rupees or max. 50 crores (CG has power to increase it till this figure)** as may be described

   OR

conditions as may be prescribed.

9. **Partners (Section 5):** 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**.
10. **Minimum number of partners (Section 6):**
   1. Every LLP shall have **at least two partners**.
   2. If at any time the number of **partners of a LLP is reduced below two and**
      (a) **the LLP carries on business for more than six months** while the number is so reduced★
      (b) the person, who is the only partner of the LLP during the time that it so carries on business after those six months and
      (c) has the knowledge of the fact that it is carrying on business with him alone,
      (d) shall be liable personally for the obligations of the LLP incurred during that period.
11. **Designated partners (Section 7):**
   1. Every LLP shall have **at least two designated partners**:
      (a) who are individuals and
      (b) at least **one of them shall be a resident in India (ROI)**. ★

   ★2. If in LLP - ALL THE PARTNERS ARE BODY CORPORATE or in which one or more partners are individuals and bodies corporate (COMBINATION) - **at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners**.

Resident in India: A person who has **stayed in India** for a period of **not less than 120 days during the financial year**.

Example 2: A There is an LLP by the name Indian Helicopters LLP having 5 partners namely -
Mr. A (Non resident),
Mr. B (Non Resident)
Ms. C (resident),
Ms. D (resident) and
Ms .E (resident).
In this case, at least 2 should be named as Designated Partner out of which 1 should be resident. Hence, if Mr. A and Mr. B are designated then it will not serve the purpose. One of the designated partners should be there out of Ms. C, Ms. D and Ms. E.

★

BASIS	Partners	Designated Partners
MIN	2	2
MAX	No limit	No limit
WHO ?	Individual & Body Corporate	Only Individual
WHAT ?	Business	Compliances

Body Corporate	Perpetual Succession	Separate legal entity	Mutual Agency
LLP Agreement	Artificial Legal person	Common Seal	Limited liability
Management of business	Minimum and maximum number of partners	Business for profit only	Investigation
Compromise or Arrangement	Conversion into LLP	E-filing of documents	Foreign LLPs

1. **LLP is a body corporate:** Section 3 of LLP Act provides that a LLP is a body corporate formed and incorporated under this Act and is **a legal entity separate from that of its partners**.
2. **Perpetual Succession:**
   - The LLP can continue its existence irrespective of changes in partners.
   - **Death, insanity, retirement or insolvency of partners has no impact on the existence of LLP.**
   - It is capable of entering into contracts and holding property in its own name.
3. **Separate Legal Entity: The LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP.** In other words, creditors of LLP shall be the creditors of LLP alone.
4. **Mutual Agency:★**
   - **No partner is liable on account of the independent or unauthorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.**
   - In other words, all partners will be the agents of the LLP alone. No one partner can bind the other partner by his acts.
5. **LLP Agreement:**
   - **Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners.**
   - The LLP Act, 2008 provides flexibility to partner to devise the agreement as per their choice.
   - In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act, 2008.
6. **Artificial Legal Person:**
   - A LLP is an artificial legal person because it is created by a legal process and is clothed with all rights of an individual.
   - It can do everything which any natural person can do, except of course that, it cannot be sent to jail, cannot take an oath, cannot marry or get divorce nor can it practise a learned profession like CA or Medicine.

because it really exists.

7. **Common Seal:**
   - A LLP being an artificial person can act through its partners and designated partners.
   - **LLP may have a common seal, if it decides to have one [Section 14(c)].**
   - Thus, it is not mandatory for a LLP to have a common seal.
   - It shall remain under the custody of some responsible official and it shall be affixed in the **presence of at least 2 Designated Partners (DP) of the LLP**.
8. **Limited Liability: Every partner of a LLP is, for the purpose of the business of LLP, the agent of the LLP, but not of other partners (Section. 26).** ★

   The liability of the partners will be limited to their agreed contribution in the LLP. Such contribution may be of tangible or intangible nature or both.

   Example 3: The professionals like Engineering consultants, Legal Advisors and Accounting Professional are afraid of entering into business due to unlimited liability.

   Hence the LLP partnership Act provides an avenue for these professionals to Limited Liability Partnership firms which restricts their liability to the agreed amount. This has encouraged Professionals to form LLP.
9. **Management of Business:** The partners in the LLP are entitled to manage the business of LLP. But only **the designated partners are responsible for legal compliances**.
10. **Minimum and Maximum number of Partners:** ★
    - Every LLP shall have **at least two partners and** shall also have at **least 2 individuals as designated partners**, of whom **at least one shall be resident in India**.
    - There is **no maximum limit** on the **partners in LLP**.
11. **Business for Profit Only:** ★★
    - The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit.
    - Thus **LLP cannot be formed for charitable or non-economic purpose**.
12. **Investigation:** The Central Government shall have powers to investigate the affairs of an LLP **by appointment of competence authority for the purpose**.
13. **Compromise or Arrangement:** Any compromise or arrangement including merger and amalgamation of LLPs shall be in accordance with the provisions of the LLP Act, 2008.
14. **Conversion into LLP:** A firm, private company or an unlisted public company **would be allowed** to be converted into LLP in accordance with the provisions of LLP Act, 2008.
15. **E-Filing of Documents:** Every form or application of document required to be filed or delivered under the act and rules made thereunder, shall be filed in computer readable electronic form on its **website www.mca.gov.in** and authenticated by a partner or designated partner of LLP by the use of electronic or digital signature.

INCORPORATION OF LLP

Section	Description
11	Incorporation document
12	Incorporation by registration
13	Registered office of LLP and change therein

15	Name
16	Reservation of name
17	Change of name of LLP

Incorporation Document (Section 11)

The most important document need for registration is the incorporation document.

LLP's Partners → Registrar
Incorporation Document
Statement
Prescribed fees

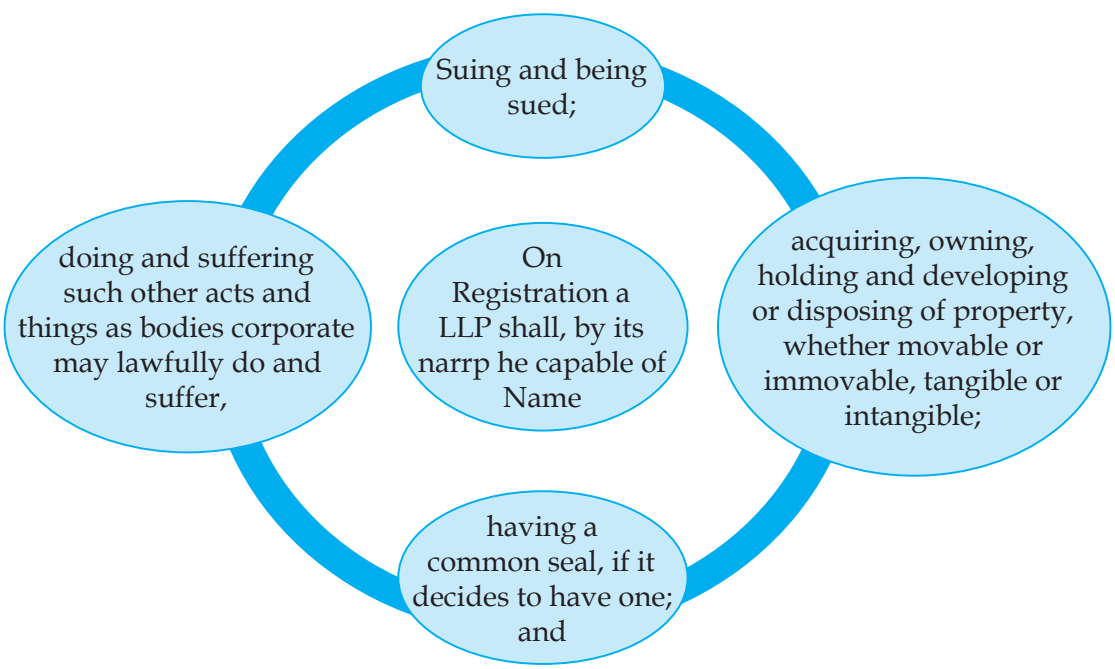
1. **For a LLP to be incorporated:**
   (a) **two or more persons associated for carrying on a lawful business** with a view to profit shall subscribe their names to an incorporation document;
   (b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the Registrar of the State in which the **registered office of the LLP is to be situated**; and
   (c) Statement to be filed:
      (i) there shall be filed along with the incorporation document, a statement in the prescribed form,
      (ii) **made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant**, who is engaged in the formation of the LLP and
      (iii) by **ANY ONE** who **subscribed his name to the incorporation document**, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.
2. **The incorporation document shall:**
   (a) be **in a form** as may be prescribed;
   (b) state the **name of the LLP**;
   (c) state the **proposed business** of the LLP;
   (d) state the **address of the registered office** of the LLP;
   (e) state the **name and address of each of the persons who are to be partners of the LLP on incorporation**;
   (f) state the **name and address of the persons who are to be designated partners** of the LLP on incorporation;
   (g) contain such other information concerning the proposed LLP as may be prescribed.
3. **If a person makes a statement as discussed above which he:**
   (a) **knows to be false**; or
   (b) does not believe to be true, shall be punishable
      (i) with **imprisonment for a term which may extend to 2 years** and
      (ii) with **fine which shall not be less than ₹10,000 but which may extend to ₹5 Lakhs**.

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 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 there-in.

Registered Office of LLP and Change Therein (Section 13)

1. Every LLP 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 LLP 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 LLP for the purpose in such form and manner as may be prescribed.
3. A LLP **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 the LLP contravenes any provisions of this section, the LLP and its every partner shall be **punishable with fine which shall not be less than ₹2,000 but which may extend to ₹25,000**.

Effect of Registration (Section 14)

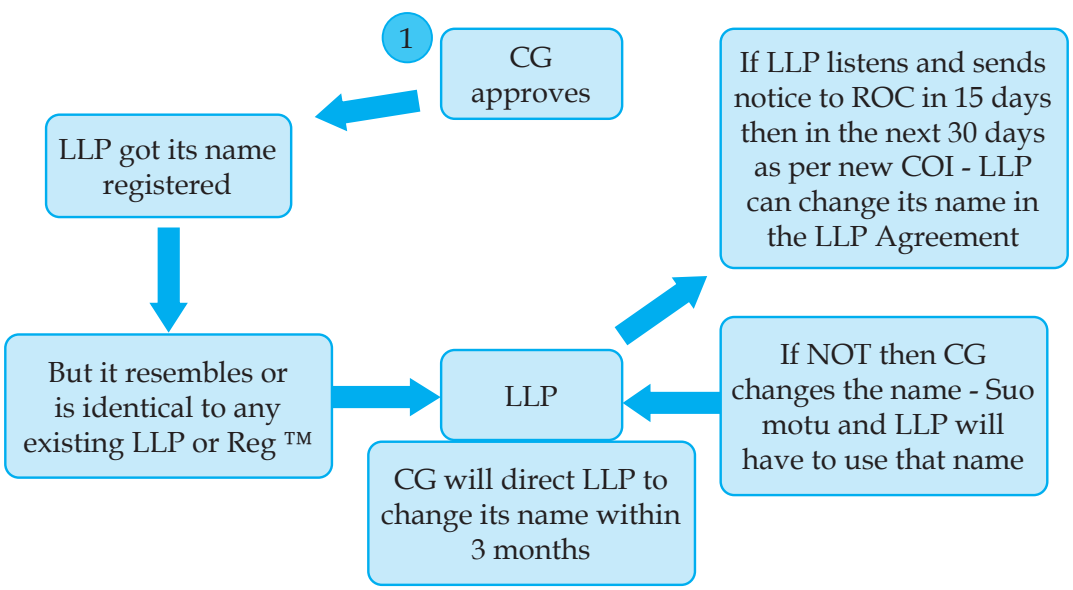


1. Every limited liability partnership shall have either the words **"limited liability partnership" or the acronym "LLP" as the last words of its name**.
2. No LLP shall be registered by a name which, in the opinion of the Central Government is:
   (a) **undesirable**; or
   (b) **identical or too nearly resembles** to that of any other partnership firm or LLP or body corporate or a registered trade mark, or a trade mark which is the subject matter of an application for registration of any other person under the **Trade Marks Act, 1999**.

Reservation of Name (Section 16)

- A person may apply in such form and manner and accompanied by such fee as may be prescribed to the Registrar for the reservation of a name set out in the application as:
  (a) **the name of a proposed LLP**; or
  (b) **the name to which a LLP proposes to change its name**.
- Upon receipt of an application under sub-section (1) and on payment of:
  (i) the prescribed fee,
  (ii) the Registrar may, if he is satisfied,
  (iii) subject to the rules prescribed by the Central Government in the matter,
  (iv) that the name to be reserved is not one which may be rejected on
  (v) any ground referred to in sub-section (2) of section 15,
  (vi) **reserve the name for a period of 3 months from the date of intimation by the Registrar**.

Change of Name of LLP (Section 17)



1. Notwithstanding anything contained in sections 15 and 16,
   - **if through inadvertence or otherwise (galti se)**,
   - a LLP, on **its first registration or**
   - **on its registration by a new body corporate**,
   - its registered name, is registered by

(a) that of **any other LLP 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 LLP or proprietor ★ referred to in clauses (a) and (b) respectively or a company,
- the **Central Government may direct that such LLP to change its name or new name**
- **within a period of 3 months from the date of issue of such direction**.

It is further provided that - ★

- **an application of the proprietor of the registered trademarks shall be maintainable**
- **within a period of 3 years from**
- **the date of incorporation or registration or change of name** of the LLP under this Act.

2. Where a **LLP changes its name or obtains a new name** under sub-section (1):
   - it shall **within a period of 15 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 30 days of such change in the certificate of incorporation**,
   - such LLP shall change its name in the LLP agreement.
3. If the **LLP is in default** in complying with any direction given under sub-section (1):
   - the **Central Government shall allot a new name to the LLP** in such manner as may be prescribed and
   - the **Registrar shall enter the new name in the register of LLP in place of the old name and**
   - **issue a fresh certificate of incorporation with new name**,
   - which the LLP shall use thereafter.

   Nothing contained in this subsection shall prevent a LLP from subsequently changing its name in accordance with the provisions of section 16.

DIFFERENCES WITH OTHER FORMS OF ORGANISATION

Distinction between LLP and Partnership Firm:

Sr. No.	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.

	succession	insolvency of the partner(s) does not affect its existence of LLP. Partners may join or leave but its existence continues forever.	or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7.	Name	Name of the LLP to contain the word limited liability partnership (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8.	Liability	Liability of each partner is limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.
9.	Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10.	Designated partners	At least two designated partners and atleast one of them shall be resident in India.	There is no provision for such partners under the Partnership Act, 1932.
11.	Common seal	It may have its common seal as its official signatures.	There is no such concept in partnership.
12.	Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13.	Annual filing of documents	LLP is required to file: (i) Annual statement of accounts (ii) Statement of solvency (iii) Annual return with the registration of LLP every year.	Partnership firm is not required to file any annual document with the registrar of firms.
14.	Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
15.	Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

Distinction between LLP and LLC:

Sr. No.	Basis	LLP	Limited Liability Company
1.	Regulating Act	The LLP Act 2008.	The Companies Act, 2013.
2.	Members/Partners	The persons who contribute to LLP are known as partners of the LLP.	The persons who invest the money in the shares are known as members of the company.
3.	Internal governance structure	The internal governance structure of a LLP is qoverned by contract agreement between the partners.	The internal governance structure of a company is regulated by statute (i.e.. Companies Act, 2013).

4.	Name	Name of the LLP to contain the word "Limited Liability partnership" or "LLP" as suffix.	Name of the public company to contain the word "limited" and Pvt. Co. to contain the word "Private limited" as suffix.
5.	No. of members/ partners	Minimum - 2 partners Maximum - No such limit on the partners in the Act The partners of the LLP can be individuals/or body corporate through the nominees.	**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 aqreed contribution except in case of willful fraud.	Liability of a member is limited to the amount unpaid on the shares held by them.
7.	Management	The business of the company is managed by the partners including the designated partners authorized in the agreement.	The affairs of the company are managed by board of directors elected by the shareholders.
8.	Minimum number of directors/ designated partners	Minimum 2 designated partners.	Pvt. Co. - 2 directors Public co. - 3 directors

"PROBLEM KYA HAI?"

QUESTION BANK FOR THE CHAPTER

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - The LLP, 2008

- ICAI Study material
- Previous year Question Papers (PYQPs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. Examine the concept of LLP.

Ans. **Meaning:** A LLP is a new form of legal business entity with limited liability. It is an alternative corporate business vehicle that gives the benefits of limited liability 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.

Concept of "limited liability partnership"

- The LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name.

partners is limited to their agreed contribution in the LLP.

- Further, no partner is liable on account of the independent or unauthorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.
- Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity.
- LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership.

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.

2. Enumerate the various characteristics of the LLP.

Ans. LLP registered with the Registrar under the LLP Act, 2008 has the following characteristics:

- Body Corporate
- Perpetual Succession
- Separate legal entity
- Mutual Agency
- LLP Agreement
- Artificial Legal person
- Common Seal
- Limited liability
- Management of business
- Minimum and maximum number of partners
- Business for profit only
- Investigation
- Compromise or Arrangement
- Conversion into LLP
- E-filing of documents
- Foreign

3. What are the effects of registration of LLP?

Ans. **Effect of registration (Section 14):**

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.

Act, 2008.

Ans. 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:

1. To complete and submit incorporation document in the form prescribed with the Registrar electronically;
2. To have at least two partners for incorporation of LLP [Individual or body corporate];
3. To have registered office in India to which all communications will be made and received;
4. 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.
5. 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.
6. 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.
7. LLP Name.

MTPs, RTPs AND PYQPs QUESTIONS

1. What is the procedure for maintenance of books of account, other records and audit of Limited Liability Partnership under LLP Act, 2008? **(RTP Nov'22)**

Ans. Maintenance of books of account, other records and audit, etc. (Section 34 of LLP Act, 2008):

The LLP shall maintain such proper books of account as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.

Every LLP shall, within a period of six months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement shall be signed by the designated partners of the LLP.

Every LLP shall file within the prescribed time, the Statement of Account and Solvency prepared with the Registrar every year in such form and manner and accompanied by such fees as may be prescribed.

The accounts of LLP shall be audited in accordance with such rules as may be prescribed.

2. Explain the Small Limited Liability Partnership under the LLP Act, 2008. **(RTP May'23)**

Ans. **Small Limited Liability Partnership [Section 2(ta) of the LLP Act, 2008]:**

It means a limited liability partnership

1. 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 (i)
2. 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

conditions as may be prescribed.

3. Discuss the conditions under which LLP will be liable and not liable for the acts of the partner under Limited Liability Partnership Act, 2008. **(RTP Nov 23)**

Ans. **Conditions under which LLP will be liable [Section 27(2) of the LLP Act, 2008]:**

The LLP is liable if a partner of a LLP is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the LLP or with its authority.

Conditions under which LLP will not be liable [Section 27(1) of the LLP Act, 2008]:

A LLP is not bound by anything done by a partner in dealing with a person if -

(a) the partner in fact has no authority to act for the LLP in doing a particular act; and

(b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.

4. A & B were friends. Now they have plans of setting up a supermarket in their locality. They are confused as to whether to register as a traditional partnership or as a Limited Liability Partnership. As an advisor, enumerate the differences between the two forms of business highlighting the compliances & other legal formalities. **(RTP Jun' 24) (RTP Nov'21)**

Ans. Comparison between a Limited Liability Partnership (LLP) and partnership can be analysed on the below tabulated parameters.

Sr. No.	Basis	LLP	Partnership Firm
1.	Regulating Act	The Limited Liability Partnership Act 2008	The Indian Partnership Act 1932
2.	Body corporate	It is a body corporate.	It is not a body corporate.
3.	Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4.	Creation	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.
5.	Registration	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary. Only the registered partnership firm can sue the third parties.
6.	Perpetual succession	The death, insanity, retirement or insolvency of the partner(s) does not affect its existence of LLP. Partners may join or leave but its existence continues forever.	The death, insanity, retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7.	Name	Name of the LLP to contain the word limited liability partnership (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
8.	Liability	Liability of each partner is limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended up to the personal assets of the partners.

	agency	by his own acts but not the other partners.	as well as other partners by his own acts.
10.	Designated partners	At least two designated partners and at least one of them shall be resident in India.	There is no provision for such partners under the Partnership Act, 1932.
11.	Common seal	It may have its common seal as its official signatures.	There is no such concept in partnership.
12.	Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13.	Annual filing of documents	LLP is required to file: (a) Annual statement of accounts (b) Statement of solvency (c) Annual return with the registration of LLP every year.	Partnership firm is not required to file any annual document with the registrar of firms.
14.	Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
15.	Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

5. What do you mean by Designated Partner? Whether it is mandatory to appoint Designated partner in a LLP? **(MTP Jun'22 5 Marks)(SM) MTP 5 Marks, Nov' 21)**

Ans. Designated Partner [Section 2(j)]: "Designated partner" means any partner designated as such pursuant to section 7.

According to section 7 of the LLP Act, 2008:

1. Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.
2. If in LLP, 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 LLP or nominees of such bodies corporate shall act as designated partners.

6. What is Small Limited Liability Partnership as per Limited Liability Partnership (Amendment) Act, 2021? **(MTP Nov'22 5 Marks)**

Ans. "Small Limited Liability Partnership [Section 2(ta) of the Limited Liability Partnership Act, 2008]: It means a Limited Liability Partnership -

1. 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
2. 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

conditions as may be prescribed.

7. Limited Liability Partnership (LLP) gives the benefits of limited liability of a company on one hand and the flexibility of a partnership on the other. Discuss.

(MTP Nov'22 5 Marks) (MTP Mar'22 5 Marks) (PYP 5 Marks, Jul'21)

Ans. LLP gives the benefits of limited liability of a company and the flexibility of a partnership

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 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.

8. "LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership". Explain.

(MTP Apr'23 5 Marks) (RTP May'22) (SM) (MTP 5 Marks, Oct 21)

Ans. 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 a 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 LLf"ls a suitable vehicle for small enterprises and for investment by venture capital.

9. Enumerate the circumstances in which Limited Liability Partnership (LLP) may be wound up by Tribunal under the LLP Act, 2008. **(MTP May'23 5 Marks) (MTP 5 Marks, Mar 21)**

Ans. Circumstances in which LLP may be wound up by Tribunal (Section 64 of the LLP Act, 2008):

A LLP may be wound up by the Tribunal:

(a) if the LLP decides that LLP be wound up by the Tribunal;

(b) if, for a period of more than six months, the number of partners of the LLP is reduced below two;

(c) if the LLP is unable to pay its debts;

(d) if the LLP has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;

Solvency or annual return for any five consecutive financial years; or

(f) if the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

10. "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. **(MTP Nov'23 5 Marks) (PYP Nov'22 5 Marks)**

Ans.

Sr. No.	Basis	LLP	Limited Liability Company
1.	Regulating Act	The LLP Act, 2008.	The Companies Act, 2013.
2.	Members/ Partners	The persons who contribute to LLP are known as partners of the LLP.	The persons who invest the money in the shares are known as members of the company.
3.	Internal governance structure	The internal governance structure of a LLP is governed by contract agreement between the partners.	The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).
4.	Name	Name of the LLP to contain the word "Limited Liability partnership" or "LLP" as suffix.	Name of the public company to contain the word "limited" and Pvt. Co. to contain the word "Private limited" as suffix.
5.	No. of members/ partners	Minimum – 2 partners Maximum – No such limit on the partners in the Act. The partners of the LLP can be individuals/or body corporate through the nominees.	**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 except in case of willful fraud.	Liability of a member is limited to the amount unpaid on the shares held by them.
7.	Management	The business of the company is managed by the partners including the designated partners authorized in the agreement.	The affairs of the company are managed by board of directors elected by the shareholders.
8.	Minimum number of directors/ designated partners	Minimum 2 designated partners.	Pvt. Co. – 2 directors Public co. – 3 directors

as per the provisions of the Limited Liability Partnership Act, 2008.

(MTP Dec'23 5 Marks) (PYP Jun 23 5 Marks)

Ans. Unlimited liability in case of fraud (Section 30 of the Limited Liability Partnership Act, 2008):

1. **In case of fraud:**
   - In the event of an act carried out by a LLP, or any of its partners,
   - with intent to defraud creditors of the LLP or any other person, or for any fraudulent purpose,
   - the liability of the LLP and partners who acted with intent to defraud creditors or for any fraudulent purpose,
   - shall be unlimited for all or any of the debts or other liabilities of the LLP.

   However, in case any such act is carried out by a partner, the LLP is liable to the same extent as the partner, unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.
2. **Punishment:** Where any business is carried on with such intent or for such purpose as mentioned in sub-section (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with
   - imprisonment for a term up to 5 years and
   - with fine which shall not be less than $ 50,000, but which may extend to ₹5 Lakhs.
3. **Compensations on commission of fraud:** Where a LLP or any partner or designated partner or employee of such LLP has conducted the affairs of the LLP in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the LLP and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.

However, such LLP shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the LLP.

12. State the rules regarding registered office of a Limited Liability Partnership (LLP) and change therein as per provisions of the Limited Liability Partnership Act, 2008. **(PYP Dec 21 5 Marks)**

Ans. Registered office of LLP and Change therein (Section 13 of the Limited Liability Partnership Act, 2008)

1. Every LLP 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 LLP 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 LLP for the purpose in such form and manner as may be prescribed.
3. A LLP 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 onry upon such filing.
4. If the LLP contravenes any provisions of this section, the LLP and its every partner shall be punishable with fine which shall not be less than ₹2000, but which may extend to ₹25000.

elements under the LLP Act, 2008. **(PYP May 22 5 Marks)**

Ans. 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:

(a) To complete and submit incorporation document in the form prescribed with the Registrar electronically;
(b) To have at least two partners for incorporation of LLP [Individual or body corporate);
(c) To have registered office in India to which all communications will be made and received;
(d) To appoint minimum two individuals as designated partners who will be responsible for number of duties including doing of all acts, matters and things as are required to be done by the LLP. At least one of them should be resident in India.
(e) 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.
(f) 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.
(g) LLP Name.

14. Explain the provisions relating to the registration of changes in partners under the Limited Liability Partnership Act, 2008. **(PYP Dec'23 5 Marks)**

Ans. Registration of changes in partners (Section 25 of the Limited Liability Partnership Act, 2008):

1. Every partner shall inform the LLP of any change in his name or address within a period of 15 days of such change.
2. A LLP shall—
   (a) where a person becomes or ceases to be a partner, file a notice with the Registrar within 30 days from the date he becomes or ceases to be a partner; and
   (b) where there is any change in the name or address of a partner, file a notice with the Registrar within 30 days of such change.
3. A notice filed with the Registrar under sub-section (2) -
   (a) shall be in such form and accompanied by such fees as may be prescribed;

as may be prescribed; and

(c) if it relates to an incoming partner, shall contain a statement by such partner that he consents to becoming a partner, signed by him and authenticated in the manner as may be prescribed.

4. If the LLP contravenes the provisions of sub-section (2) as regards intimation to the Registrar, the LLP and its every designated partner shall be liable to a penalty of ₹10,000.
5. If the contravention referred to in sub-section (1) is made by any partner of the LLP, such partner shall be liable to a penalty of ₹10,000.
6. Any person who ceases to be a partner of a LLP may himself file with the Registrar the notice referred to in sub-section (3) if he has reasonable cause to believe that the LLP may not file the notice with the Registrar and in case of any such notice filed by a partner, the Registrar shall obtain a confirmation to this effect from the LLP unless the LLP has also filed such notice.

However, where no confirmation is given by the LLP within 15 days, the registrar shall register the notice made by a person ceasing to be a partner under this section.

15. What do you mean by Designated Partner? Whether it is mandatory to appoint Designated partner in a LLP? **(RTP May 21)**

Ans. Designated Partner [Section 2(j) of the LLP Act, 2008]: "Designated partner" means any partner designated as such pursuant to section 7. According to section 7 of the LLP Act, 2008:

1. Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.
2. If in LLP, 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 LLP or nominees of such bodies corporate shall act as designated partners.
3. Resident in India: For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less than 182 days during the immediately preceding one year.

16. State the circumstances under which a LLP and its partners may face unlimited liability under the Limited Liability Partnership Act, 2008. **(PYP 5 Marks, Jan'21)**

Ans. As per Section 30 of the Limited Liability Partnership Act, 2008, LLP and its Partners may face unlimited liability in case of fraud. According to this section, the liability arises, in the event of an act carried out by an LLP or any of its partners -

- with intent to defraud creditors of the LLP,
- or any other person, or
- for any fraudulent purpose.

The liability of the LLP and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP. However, in case any such act is carried out by a partner, the LLP is liable to the same extent as the partner unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.

Where LLP, Partner or employee of LLP has conducted the affairs of the LLP in fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the LLP and any such partner or employee shall be liable to pay compensation to any such person who has suffered any loss by reason of such conduct.

06 CHAPTER

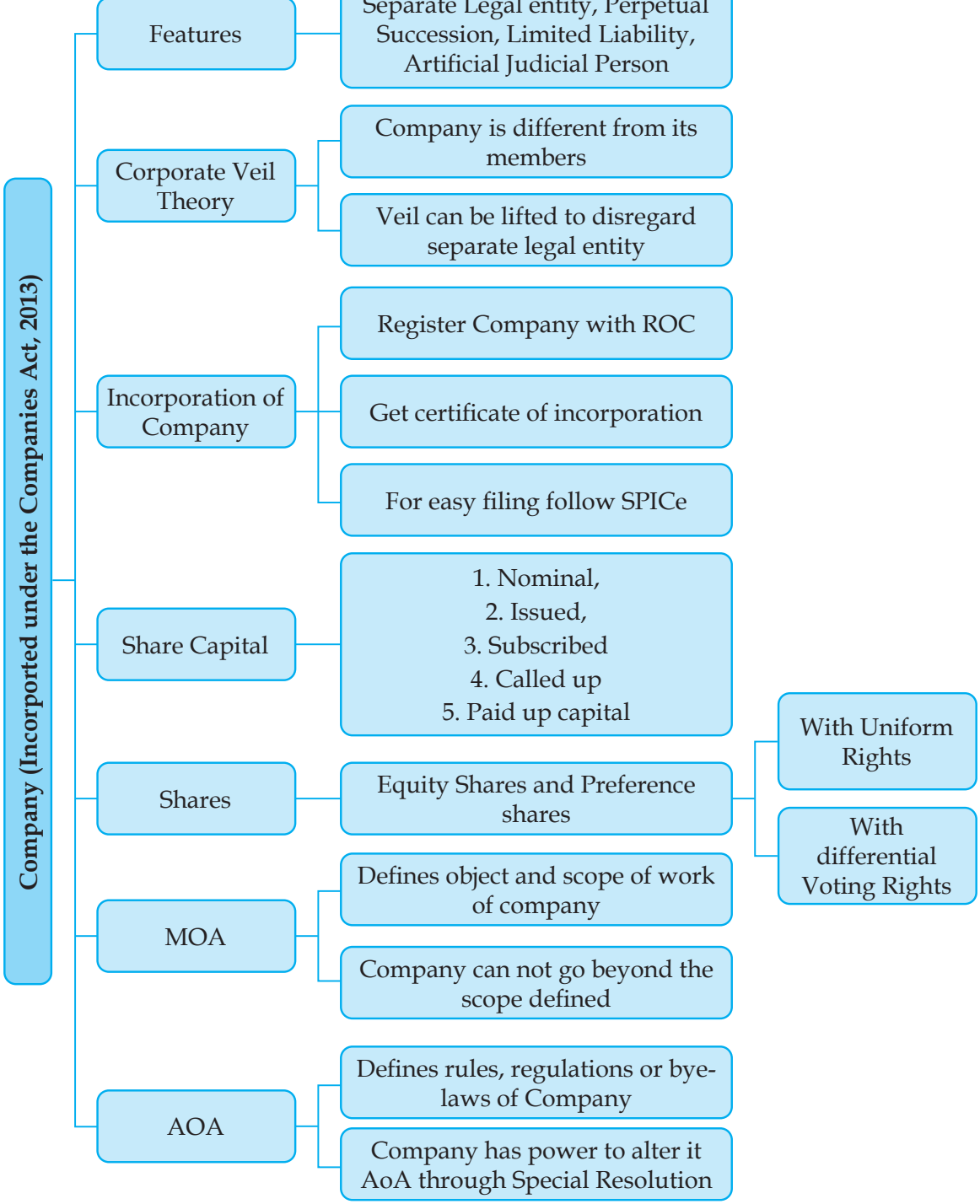
The Companies Act, 2013

TABLE OF CONTENT FOR THE CHAPTER

- INTRODUCTION 6.1
- APPLICABILITY OF THE COMPANIES ACT, 2013 6.3
- COMPANY: MEANING AND ITS FEATURES 6.3
- CLASSES OF COMPANIES UNDER THE ACT 6.9
- MODE OF REGISTRATION/INCORPORATION OF COMPANY 6.19
- CLASSIFICATION OF CAPITAL 6.24
- MEMORANDUM OF ASSOCIATION 6.26
- DOCTRINE OF ULTRA VIRES 6.29
- ARTICLES OF ASSOCIATION 6.32
- DOCTRINE OF INDOOR MANAGEMENT 6.33
- EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT 6.35
- *"PROBLEM KYA HAI?"* 6.36

INTRODUCTION

- The Companies Act, 2013 was enacted to -
  - Consolidate and Amend the law relating to the companies.
- Extent to the whole of India
- The Companies Act, 2013
  - The Companies Act, 1956 → 1942 → 1913
- The Act contains:
  - 470 sections and
  - 7 schedules
  - 29 chapters
  - A substantial part of this Act is in the form of Companies Rules.
- The Companies Act, 2013 aims to improve:
  - corporate governance,
  - simplify regulations,
  - strengthen the interests of minority investors and
  - for the first time legislates the role of whistle-blowers and provisions relating to class action suit.


Company (Incorporated under the Companies Act, 2013)
Features
Separate Legal entity, Perpetual Succession, Limited Liability, Artificial Judicial Person
Corporate Veil Theory
Company is different from its members
Veil can be lifted to disregard separate legal entity
Incorporation of Company
Register Company with ROC
Get certificate of incorporation
For easy filing follow SPICe
Share Capital
1. Nominal,
2. Issued,
3. Subscribed
4. Called up
5. Paid up capital
Shares
Equity Shares and Preference shares
With Uniform Rights
With differential Voting Rights
MOA
Defines object and scope of work of company
Company can not go beyond the scope defined
AOA
Defines rules, regulations or bye-laws of Company
Company has power to alter it AoA through Special Resolution

The provisions of the Act shall apply to:

Companies incorporated under this Act or under any previous company law.	**Insurance companies** except those provisions inconsistent with **The Insurance Act, 1938 or the IRDA Act, 1999**	**Banking companies** except those provisions inconsistent with **The Banking Regulation Act, 1949**	**Electricity Companies** (generation or supply) except those provisions inconsistent with **The Electricity Act, 2003**	Companies governed by any special Act.

COMPANY: MEANING AND ITS FEATURES

Meaning

Chief Justice Marshall:

1. A corporation is an artificial being, invisible, intangible, existing only in contemplation of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as accidental to its very existence.
2. **Professor Haney:** A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.
3. **Section 2(20) of the Companies Act, 2013:** "Company means a company incorporated under this Act or under any previous company law".

Features of a Company

I	Incorporated Association	Registered group of members. Public 7 and Private 2
T	Transferability of Shares	As per the Articles as shares are movable property. In Pvt restricted but not prohibited & in Public freely transferable
O	Ownership - Separate from its Members	Members do not participate in day to day affairs. The company is managed by BOD elected by members. So ultimate control of members
P	Perpetual Succession	Members may come and go but company goes on forever.
C	Common Seal	Sign of a company as it's an artificial person. Now optional as per Co Act
L	Limited Liability	Limited by shares - Unpaid value
A	Artificial Legal Person	Yes, not a fictitious person. Exist only in the eyes of law.
S	Seperate Legal Entity	Distinct from its members having its own rights & obligations
S	Seperate Property and Sue	Can enjoy property in its own name. Members are neither owners or co-owners nor they have any insurable interest. Also company can sue and can be sued

Following features are described in detailed:

1. **Separate Legal Entity:** This is the most distinctive and **striking feature** in the company form of organisation vis- à-vis the other forms of business organisations:

- 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 which is different from the subscribers to the memorandum of association**.

(b) **Even members can contract with company, acquire right against it or incur liability to it**.

(c) For the debts of the company, only its creditors can sue it and not its members.

(d) A company is **capable of owning, enjoying and disposing of property in its own name**.

(e) Although the capital and assets are contributed by the shareholders, the **company becomes the owner of its capital and assets**.

(f) The **shareholders are not the private or joint owners** of the company's property.

A member does not even have an insurable interest in the property of the company. The leading case on this point is of:

Macaura Vs. Northern Assurance Co. Limited (1925)

Timber Company

M

'M is the owner of a timber company and holds all shares except for one.

He is also a major creditor of the company.

M insured the company's timber in his own name.

Unfortunately, the timber caught fire, leading to significant losses.

M decided to claim insurance compensation for the damages incurred

Judgement

Held - the insurance company was not liable to him - As no shareholder has any right to any item of property owned by the company, He has no legal or equitable interest in them.

Hence in this case, since the timber was insured in the company's name, M could not claim the compensation from insurance company.

2. **Perpetual Succession:**
   - Members may **die or change**, but the **company goes on till it is wound up on the grounds specified by the Act**.

existence of the company.

- Since a company is an artificial person created by law, law alone can bring an end to its life.
- **Its existence is not affected by the death or insolvency of its members.**

> ***Example 1:*** *Many companies in India are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence. There was a company which has 7 members and all of them died in an aircraft. Despite this the company still exists unlike partnership form of business.*

3. **Limited Liability:** The **liability of a member depends upon the kind of company of which he is a member**.
   - In the case of a *limited liability company,*
     - the debts of the company in totality do not become the debts of the shareholders.
     - The **liability of the members of the company is limited** to the **extent of the nominal value of shares held by them**.
     - In no case can the shareholders be asked to pay anything more than the unpaid value of their shares.
   - In the case of a *company limited by guarantee,*
     - the **members are liable only to the extent of the amount guaranteed by them** and
     - that too only when the company goes into liquidation.
   - However, if it is an **unlimited company, the liability of its members is unlimited as well**.
4. **Artificial Legal Person:**
   I. A company is an **artificial person** as it is created by a **process other than natural birth**.
   II. 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.**
   III. The **company being a separate legal entity**:
      A. **can own property, have banking account, raise loans, incur liabilities and enter into contracts.**
      B. Even **members can contract with company**, acquire right against it or incur liability to it.
      C. It **can sue and be sued in its own name**.
      D. It can do **everything** which any natural person can do **except be sent to jail, take an oath, marry or practice a learned profession**.
      E. Hence, it is a legal person in its own sense.
   IV. As the company is an *artificial person*, it can **act only through** some human agency, viz., **directors**.
   V. The **directors can** act as its agency, but they are not the "agents" of the members of the company. The directors can **either on their own or through the common seal (of the company) can authenticate its formal acts**.
5. **Common Seal:**
   - A company being an artificial person it needs to work through the agency of human beings.
   - **Common seal is the official signature of a company**, which is affixed by the officers and employees of the company on its every document.

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.

- 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.

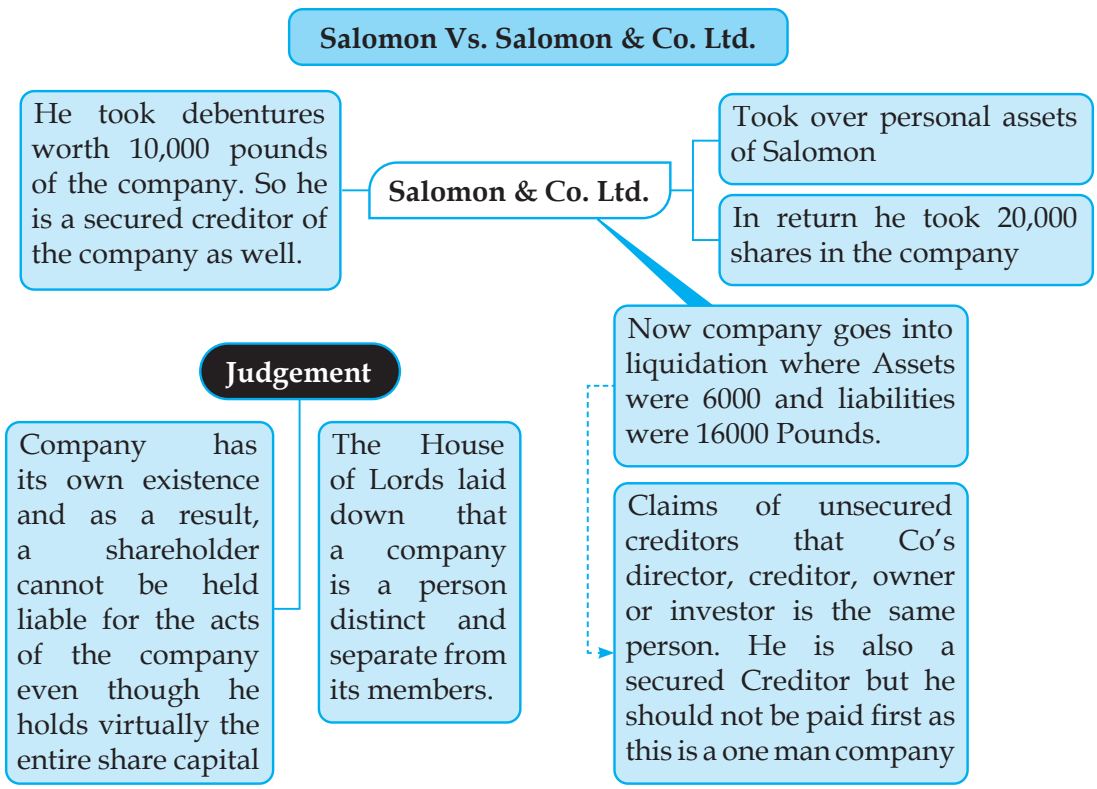
Corporate Veil Theory

1. **Corporate Veil:** 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 Company is at law a different person altogether from the subscribers to the memorandum, and*
- *though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers, and the same hands receive the profits,*

- *Nor are the subscribers, as members, liable, in any shape or form, except to the extent and in the manner provided by the Act.*

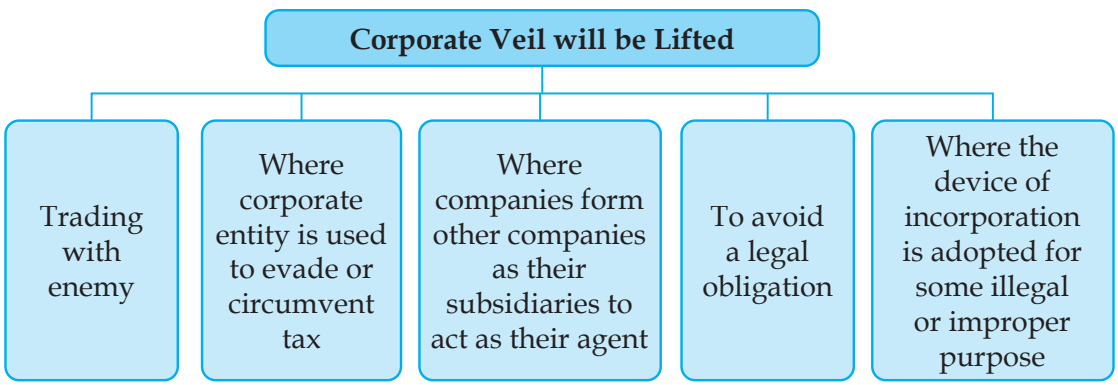
2. Lifting of Corporate Veil (पर्दा): पीछे तो देखो पर्दे के पीछे क्या है?

- It means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade.

> Where the Courts ignore the company and see 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. ★

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**:



I. To determine the character of the company i.e. to find out whether co-enemy or friend:

> ***Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.***
> **If the public interest is not likely to be in jeopardy, the Court may not be willing to crack the corporate shell. (अगर Public Interest की बात है तो court पर्दे को उठा देगी) to check whether a company is an enemy company.**

Company = Unnatural person - No mind or conscience so cannot be a friend or enemy.

So a company = An enemy company,

If its affairs are under the control of people of an enemy country.

II. To protect revenue/tax:

When matters are =

Evasion of Taxes, duties and stamps means where corporate entity is used to evade or circumvent tax - the Court can disregard the corporate entity

Jugalkishore vs. Commissioner of Income Tax

Dinshaw Maneckjee Petit

Dinshaw incorporate: 4 Companies (doing no business & all the capital invested by Dinshaw)

4 Companies -- Investment

Dividend & Interest

Loan to Dinshaw (which was never repaid)

It was held that the company was not a genuine company at all but merely the assessee himself disguised under 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.

III. **To avoid a legal obligation:** Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen,

Workmen of Associated Rubber Industry Ltd., v. Associated Rubber Industry Ltd.

Associated Rubber Industry bought shares of INARCO ltd

Sometime in 1968 - Shares are transferred to its won subsidiary - This company has NO -

- *Assets of its own except those transferred to it by the principal company,*
- *Business or income of its own except receiving dividends from shares transferred to it by the principal company and*
- *Purpose except to reduce the gross profit of the principal company so as to reduce the amount paid as bonus to workmen.*

All the dividend income also went to the subsidiary

Issue -

The workmen of Associated Rubber Industries Ltd contended that the new subsidiary company was formed in order to pay lower bonuses to workmen as a result of transferring the dividend amount to the subsidiary company.

Here a company created a subsidiary and transferred to it, its investment holdings in a bid to reduce its liability to pay bonus to its workers.

Judgement -

Thus, the Supreme Court brushed aside the separate existence of the subsidiary company.

IV. **Formation of subsidiaries to act as agents:** A company may sometimes be regarded as -

- An agent or trustee of its members, or of another company, and may therefore be deemed to have lost its individuality in favour of its principal.
- Here the principal will be held liable for the acts of that company.

Merchandise Transport Limited vs. British Transport Commission (1962) -

Transport company wanted to obtain licences for its vehicles but could not do so if applied in its own name.

It, therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary.

The vehicles were to be transferred to the subsidiary company.

Held, the parent and the subsidiary were one commercial unit and the application for licences was rejected.

V. Company formed for fraud/improper conduct or to defeat law:

- Where the device of incorporation is adopted for some illegal or improper purpose,
- To defeat or circumvent law, to defraud creditors or to avoid legal obligations.

[Gilford Motor Co. vs. Horne] -

Mr. Horne - MD of a company - Under Non compete clause

Left the company and formed another company with the intent of creating competition and to conduct solicitation

He established a rival business to Gilford Motor, in which the sole shareholders were Mr. Horne's wife and one of his business associates.

Only Horne himself was subject to any legal restrictions imposed by Gilford; the new company itself was not.

Held, the Court saw through the corporate veil and held that Mr. Horne was the person behind it and that the non-compete clause in the employment contract should be interpreted as binding not only on Mr. Horne personally but also on the new company.

CLASSES OF COMPANIES UNDER THE ACT

Companies may be classified into various classes on the following basis:

Liability	Size (Members)	Control	Listing	Others
Unlimited	Public Co.	Holding Co.	Listed	Foreign Company
Limited	Private Co.	Subsidiary Co.	Unlisted	Gov. Company
1. By Guarantee	Opc	Associate Co.		Section 8 - Npo
2. By Shares	Small Co.			Dormant Co.
Both				Nidhi Co

1. On the basis of liability:

(a) Company limited by shares:

- Section 2(22) - when the liability of the members of a company is limited by its memorandum of association to the amount (if any) unpaid on the shares held by them, it is known as a company limited by shares.
- It is implied that for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings.
- His separate property cannot be encompassed to meet the company's debt.
- Though a shareholder is a co-owner of the company, he is not a co-owner of the company's assets.

person.

(b) Company limited by guarantee:

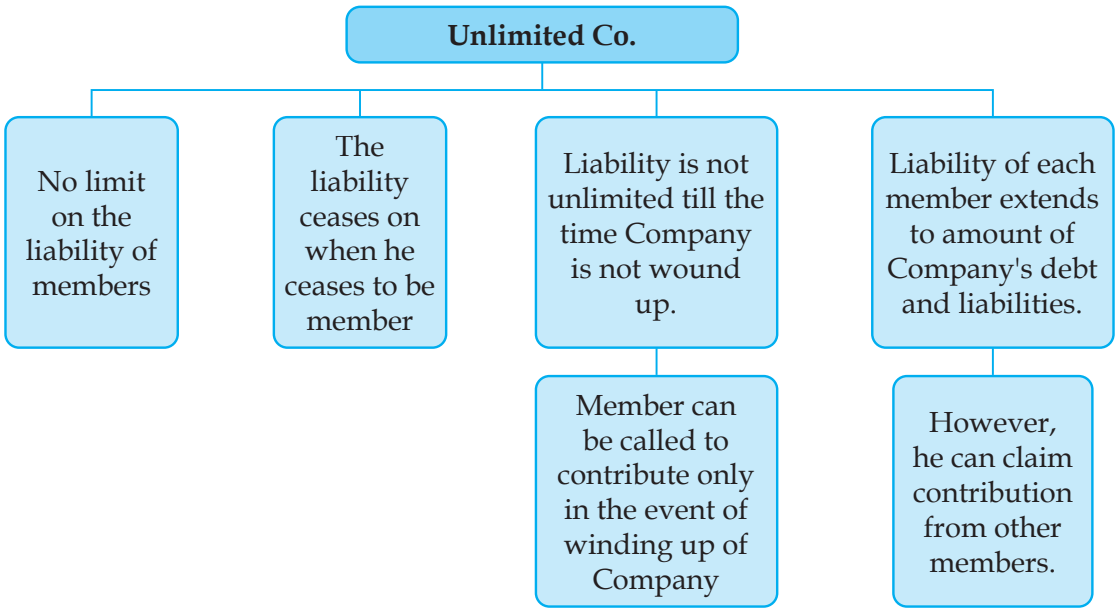
- Section 2(21) - As the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company **in the event of its being wound up**.
- Thus, the liability of the member of a guarantee company is limited upto a stipulated sum mentioned in the memorandum.
- Members cannot be called upon to contribute beyond that stipulated sum.
- The **common features** are:
  - legal personality and
  - limited liability.
  - To be stated in their memorandum that the members' liability is limited.
- The **point of distinction** between these two types of companies:

Basis	Guarantee Company	Share Capital Company
Meaning	When MOA says that liability of members shall be restricted to the amount they have guaranteed.	When memo says that liability of members shall be restricted to the unpaid amount on the shares held by them.
SC	May or may not have SC	Must have SC
Quantum of Liability	In case of Winding up liability of every member: - Guaranteed amount and If SC - Unpaid amount of shares	Liability of every member : Unpaid amount on the shares held by them.
When does liability arise?	Only in the case of Winding up	When valid call is made by co.
Suitability	Where huge Initial capital is not required & funds can be arranged by way of borrowings, fees charged etc.	Where huge Initial capital is required & financial resources cant be arranged by way of borrowings

(c) Unlimited company:

- Section 2(92) - Unlimited company as a company not having any limit on the liability of its members.
- In such a company, the liability of a member ceases when he ceases to be a member.
- **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 as 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.

and debts of the company, which can be unlimited.



2. On the basis of members:

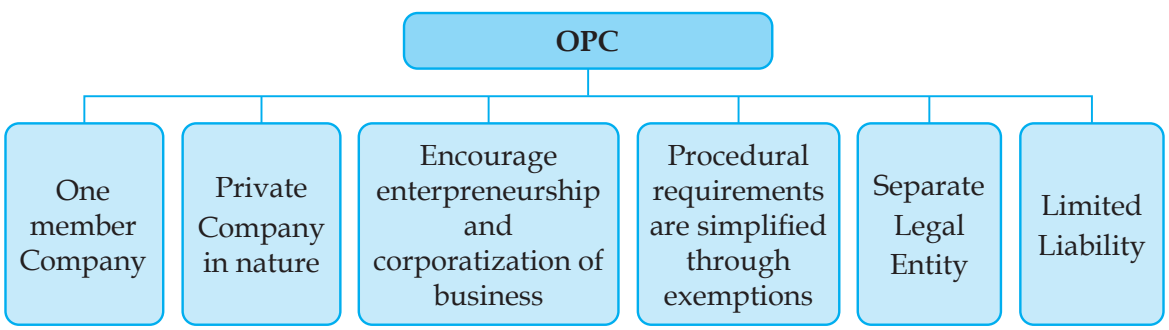
(a) One person company:

- Section 2(62) - A new class of companies which can be incorporated by a **single person**.
- One person company (OPC) as a company which has **only one person as a member**.
- One person company has been introduced to encourage entrepreneurship and corporatization of business.
- OPC - A type of Company so it is a separate legal entity with a limited liability of the member.
- Sole proprietary concern the liability of owner is not restricted and it extends to the owner's entire assets constituting of official and personal.
- Section 3(1)(c) - **OPC is a private limited company**
- **All OPCs are private but all private are not OPCs** with the minimum paid up share capital as may be prescribed and having one member.
- **OPC (One Person Company) - significant points**
  - Only one person as member.
  - Minimum paid up capital – no limit prescribed.

  Provisions related to Member and Nominee
- The memorandum of OPC **shall have- the name** of the other person, who in the event of -
  - the subscriber's death or
  - his incapacity to contract,

  become the member of the company.
- His **prior written consent** is required in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation of the company along with its e-memorandum and e-articles.

- **Change in the name** of such other person **can be done** by giving **notice** to -
  - the company and
  - the company shall intimate the same to the Registrar.
- Such change in the name of the person shall not be deemed to be an alteration of the memorandum. **Who can be a Member and Nominee?**
- **Only a natural person**
- who is an Indian citizen
- whether 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 eligible to incorporate a OPC; and shall be a nominee for the sole member of a OPC.
- **What are the DONT'S ?**
- Involvement in TWO OPCs - NO means More than ONE not allowed - Neither for Member nor for Nominee.
- Minor ≠ Member or nominee.
- OPC ≠ cannot be incorporated or converted into a Section 8. **NO**
- OPC = May be converted to private or public companies. **YES**
- OPC ≠ cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporate.
- Here the member can be the sole member and director as well.



(b) Private Company [Section 2(68)]:

PP - Prohibits any invitation to the **public** to subscribe for any securities of the company

R - Restricts the right to transfer its shares

- Articles Restricts but do not Prohibit ★
- Uniform rights to all the members. No discrimination

Lim - Limits the number of its members to 200 (Except OPC) ★

- Joint members - Counted as ONE
- For counting 200 members - Do not include -

A. Existing employees cum members and

B. Former employees who were members of the company while in that employment and have continued to be members after the employment ceased. (employees cum members)

Small Company:

- Small company is a private company.
- Section 2(85) which means a company –

Paid up capital – not more than ₹4 Crores

Or

Turnover – not more than ₹40 Crores

Exceptions: This clause shall not apply to:

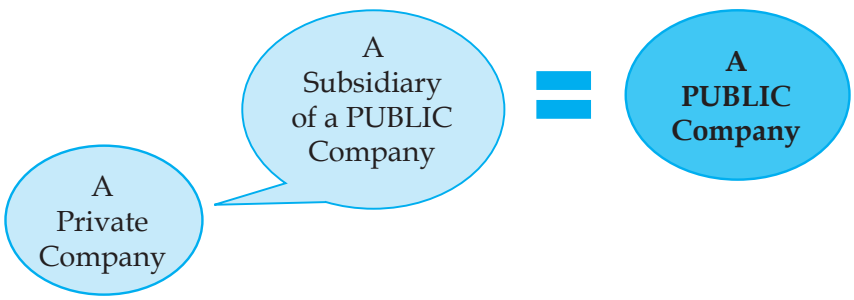
(i) a holding company or a subsidiary company;

(ii) a company registered under section 8; or

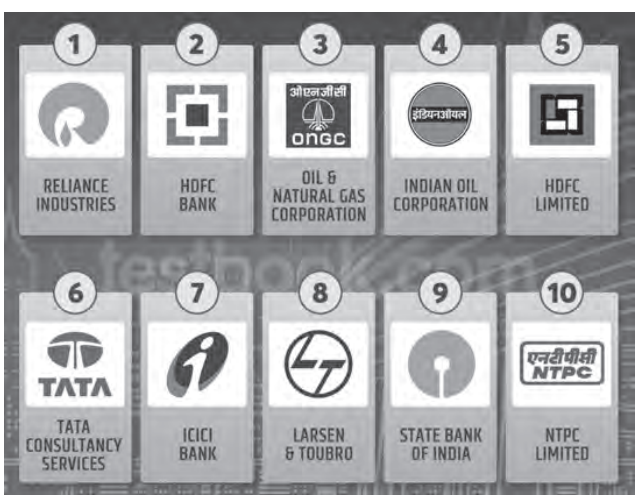
(iii) a company or body corporate governed by any special Act.

(c) Public company [Section 2(71)]: "Public company" means a company which –

- Is not a private company (Articles do not have the restricting clauses).
- Shares are freely transferable.
- No minimum paid up capital requirement.
- Minimum number of members – 7.
- Maximum numbers of members – No limit.
- **Status of private company, which is subsidiary to public company:**



In view of Section 2(71) of the Companies Act, 2013 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.



(a) Holding and subsidiary companies: Definitions are in relation to each other.

- Holding means Who - **(either a or b)**.
  - (i) controls the composition of the Board of Directors
    What do you mean by controlling BOD?
    HC at its discretion can appoint or remove all or a majority of the directors;
    OR
  - (ii) exercises or controls more than one-half of the total voting power or 50% or more of total Share Capital either at its own or together with one or more of its subsidiary companies.
- Company includes any body corporate **(Means includes foreign companies as well)**.
- Total Share Capital = Equity SC + Convertible Preference SC
- Explanation –

A (Main HC) → B (SC) → C (Step down SC of A) → D

Example 2: A will be subsidiary of B, if B controls the composition of the Board of Directors of A, i.e., if B can, without the consent or approval of any other person, appoint or remove a majority of directors of A.

Example 3: A will be subsidiary of B, if B holds more than 50% of the share capital of A.

Example 4: B is a subsidiary of A and C is a subsidiary of B. In such a case, C will be the subsidiary of A. In the like manner, if D is a subsidiary of C, D will be subsidiary of B as well as of A and so on.

Associate company [Section 2(6)]: A company where holding company has a **significant influence, but which is not a subsidiary company** of the company and includes a joint venture company.

Atleast 20% but Max 50% of Total Voting Powers

Explanation. – For the purpose of this clause –

(a) **Significant influence = Control of at least 20% of total voting power**, or control of or participation in business decisions under an agreement;

(b) **Joint venture = A joint arrangement** whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

4. On the basis of access to capital:

(a) Listed company: It is a company which has any of its securities listed on any recognised stock exchange.

(b) Unlisted company: Means company other than listed company.

Example 5: Scan Steel Rods Limited is a Public Limited Company whose shares are listed in the Stock Exchange, Kolkata. Hence Scan Steel Rods Limited is a Listed Company. The reason for calling it "Listed" is because the company and the Stock Exchange have signed a Listing Agreement for trading of shares in the capital market.

5. **Other companies:**

(a) Government company [Section 2(45)]:

- Government Company means any company in which -

Not less than 51% of the paid-up share capital (with Voting rights) is held by-

- Central Government, or
- State Government or Governments, or
- Partly by the CG and partly by one or more SG, and
- Includes a company which is a subsidiary company of such a Government company.

  Explanation: The "paid up share capital" shall be construed as "total voting power", where shares with differential voting rights (DVRs) have been issued.

(b) Foreign Company [Section 2(42)]: It means any company or body corporate **incorporated outside India** which has a **place of business in India** whether **by itself or through an agent, physically or through electronic mode; and conducts any business** activity in India in any other manner.

- Section 8 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, Reliance Research Institute, Reliance Foundation, TATA Foundation, and Infosys Foundation etc.

Power of Central government to issue the license: Central Government registers:

(i) such person or association of persons
(ii) as a company with limited liability
(iii) without the addition of words 'Limited' or 'Private limited' to its name,
(iv) by issuing licence on such conditions as it deems fit.
(v) On registration the company shall enjoy same privileges and obligations as of a limited company.

Revocation of license:

- Yes, 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 or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register.
- But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

Order of the Central Government:

- After a licence is revoked - Central Government may in the public interest order that the company to be amalgamated with another company registered under this section having similar objects, to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order, or the company be wound up.

Penalty/punishment in contravention:

- If a company makes any default in complying with this section be punishable with -

Fine on the company - 10 lakh to 1 crore rupees

and

Fine on the directors and every officer of the company
₹25,000 to 25 lakh rupees.

- If proved that the affairs of the company were conducted fraudulently then Section 447 on every officer in default.

Significant points to sum up:

- Requirement of minimum share capital does not apply.
- Uses its profits for the promotion of the objective for which it is formed.
- Does not declare dividend to members.
- Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.

- On revocation, Central Government may direct it to
  (a) Converts its status and change its name
  (b) Wind – up
  (c) Amalgamate with another company having similar object.
- Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- Requirement of minimum number of directors, independent directors etc. does not apply.
- Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- A partnership firm can be a member of Section 8 company.

Formation

- To promote Charitable objects

Application of profits

- To promote its objects
- No payment of dividends out of profits

Type of Co.

- Limited Liability
- Without the addition of words "Ltd." or "Pvt. Ltd."

How status is granted

- The CG can grant such status
- However, CG has delegated with power to grant licence to ROC

Revocation of licence

- CG may revoke licence
- It conditions of section 8 are contravened, or
- affairs of the company are conducted fraudulently, or projudicial to public interest

Effect of revocation of licence

- Co has to use words "Ltd." or "Pvt. Ltd."

(d) Dormant company (Section 455): Where a company is formed for a **future project or to hold an asset or intellectual property** and has **no significant accounting transaction** or

of a dormant company.

Inactive company = 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 -

Any transaction other than— (ये Significant accounting transaction नहीं है)

- payment of fees by a company to the Registrar;
- payments made by it to fulfil the requirements of this Act or any other law;
- allotment of shares to fulfil the requirements of this Act; and
- payments for maintenance of its office and records.

(e) Meaning of Nidhi Companies - Section 406(1): Nidhi" or "Mutual Benefit Society" - A company which the CG may by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society.

Nidhi Companies are created mainly for cultivating the habit of thrift and savings amongst its members.

(f) Public Financial Institutions (PFI) - Section 2(72): The following institutions are to be regarded as PFI:

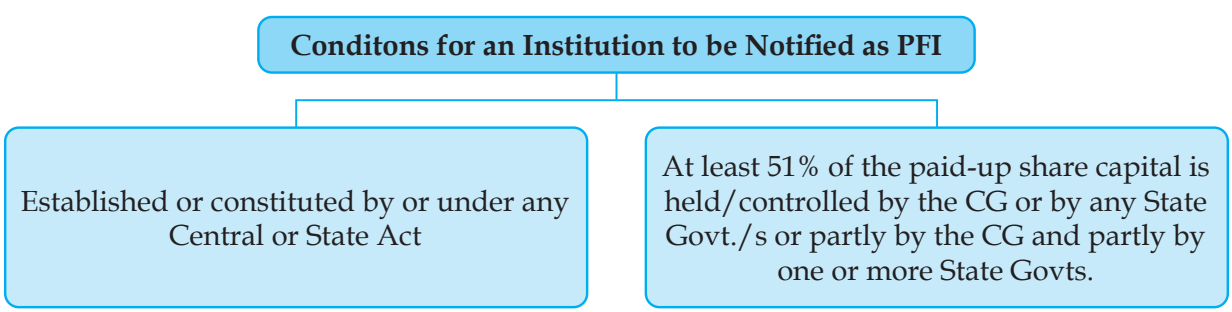
(i) The Life Insurance Corporation of India **(LIC)**,
(ii) The Infrastructure Development Finance Company Limited, **(IDFC Ltd.)**
(iii) Company in Unit Trust of India **(UTI)**
(iv) Institutions under **Section 4A(2)** of the Companies Act, 1956
(v) Such other institution as may be notified by the CG in consultation with the RBI

Conditions:

(i) Established or constituted by or under any Central or State Act other than this Act or the previous Companies Law;

or

(ii) Not less than 51% per cent of the paid-up share capital is held or controlled by the CG or by any SG or partly by the CG and partly by one or more SGs.



PROMOTERS under Section 2(69)

- Who has been **named** as such in a **prospectus or in the annual return** referred to in section 92; or who has **control over the affairs of the company**, directly or indirectly whether as a shareholder, director or otherwise; or in accordance with **whose advice, directions, or instructions the Board of Directors** of the company is accustomed to **act**.
- Persons who **form the company** are known as promoters.
- It is they who **conceive the idea** of forming the company.
- They take **all necessary steps** for its registration.

Idea दे रहा हूँ	Form the company दोस्तों का साथ सही कार्लो	सारे Affair Control करलो	Prospectus (रिश्ते) annual return हर साल - वापस ए जाते है	मेरी यही - advice, कहलों या directions, or या हुक्म instructions

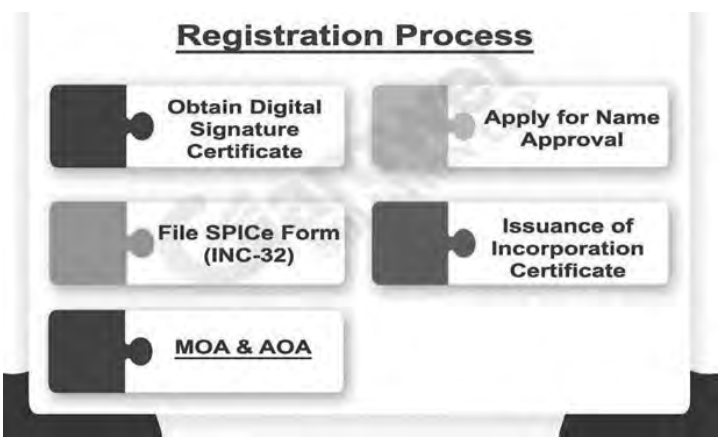
- It should, however, be noted that persons acting only in a professional capacity e.g., the solicitor, banker, accountant etc. are not regarded as promoters.
- **Duty of a promoter:**
  - Not to make secret profit, He can make a profit but not a secret one and should make full and fair dislcosure
  - Full and fair disclosure of his interest in every transaction or contract with company in which he is interested

Formation of Company

Section 3 of the Companies Act, 2013 -

- In the case of a **public company - Any 7** or more persons
- In case of a **private company - 2 or more** persons
- In case of one **person company - 1 person** can form
  - for any lawful purpose
  - by subscribing their names to memorandum and
  - complying with the requirements of this Act in respect of registration.

INCORPORATION OF COMPANY - Section 7



2. DIN	6. ROC scrutiny
3. Name availability for proposed company	7. COI by ROC
4. MOA & AOA	

1. **Filing of the documents and information with the registrar: Document LIST:**

e-MOA and e-AOA INC 33-34	2 types of Declarations	Proposed RO Address	Know Your Subscribers and Directors

To the registrar within whose jurisdiction the registered office (RO) of the company is proposed to be situated:

(a) **MOA and AOA** - Duly signed by all the subscribers to the memorandum

(b) **A declaration** -

- By person who is engaged in the formation of the company (an advocate, a CA, cost accountant or CS in practice), **and**
- by a person named in the articles (director, manager or secretary of the company),

That all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.

(c) **A declaration - From first director(s) and each subscriber -**

Stating that-

(i) Not convicted of any offence in connection with the promotion, formation or management of any company, or

(ii) Not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last five years,

(iii) and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

(d) **The address** for correspondence till its registered office is established;

(e) **The particulars** of every subscriber to the memorandum -

- Names, including surnames or family names, residential address, nationality along with proof of identity, and
- DIN in case of Directors in the case of a subscriber being a body corporate, such particulars as may be prescribed and

(f) **Interest in other entities** and consent to act as a director from the first directors of the company

(g) Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company *[The Companies (Incorporation) Rules, 2014].*

2. **Issue of certificate of incorporation on registration:** The Registrar on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS
Central Registration Centre

Certificate of Incorporation

[Pursuant to sub-section (2) of section 7 and sub-section (1) of section 8 of the Companies Act, 2013 (18 of 2013) and rule 18 of the Companies (Incorporation) Rules, 2014]

I hereby certify that [redacted] LIMITED is incorporated on this Tenth day of October Two thousand twenty under the Companies Act, 2013 (18 of 2013) and that the company is limited by shares.

The Corporate Identity Number of the company is XXXX99DL202XXXX37XXXX

The Permanent Account Number (PAN) of the company is [redacted]

The Tax Deduction and Collection Account Number (TAN) of the company is [redacted]

Given under my hand at Manesar this Thirteenth day of October Two thousand twenty .

[redacted]

Digital Signature Certificate
SHIVARAJ C RANJERI
ASST. REGISTRAR OF COMPANIES
For and on behalf of the Jurisdictional Registrar of Companies
Registrar of Companies
Central Registration Centre

3. **Allotment of Corporate Identity Number (CIN):** On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company **a corporate identity number, (CIN)** which shall be a **distinct identity** for the company and which shall **also be included in the certificate**.
4. **Maintenance of copies of all documents and information:** The company shall **maintain and preserve** at its **registered office copies** of all documents and information as originally filed, **till its dissolution under this Act**.
5. **Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. at the time of Incorporation):** If any person furnishes any false or incorrect particulars of any information or suppresses **any material information**, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, **he shall be liable for action for fraud under section 447**.
6. **Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation):** Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing **any material fact or information** in any documents or declaration filed or made for incorporating such company, or by any fraudulent action, then
   - the promoters,
   - the persons named as the first directors of the company and
   - the persons making declaration under this section
   - **shall each be liable for action for fraud under section 447**.
7. **Order of the Tribunal (Power):** In the case above - The Tribunal may on an application made to it, on being satisfied that the situation so warrants — Pass orders for -
   (a) Regulation of the management of the company

(i) In public interest or

(ii) In the interest of the company and its members and creditors; or

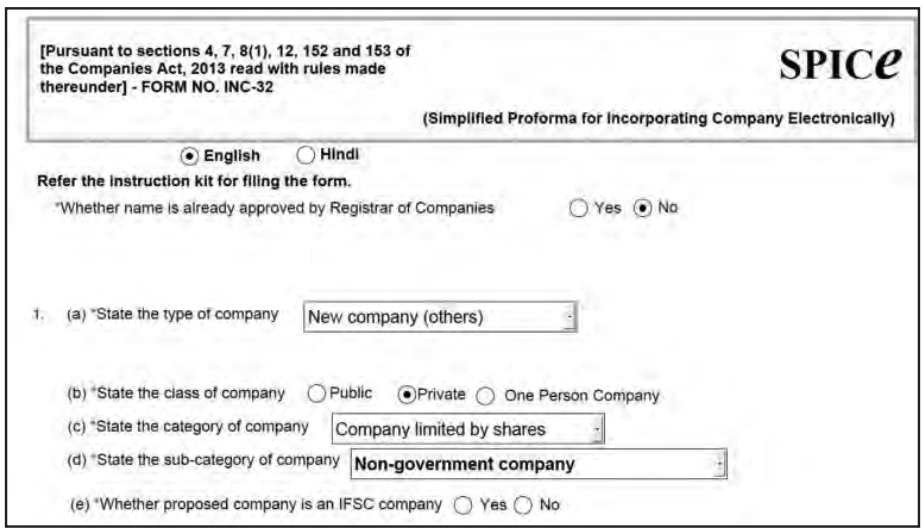
(c) Make **members liability unlimited**; or

(d) **Removal of the name** of the company from the ROC or

(e) **Winding up** of the company; or

(f) pass such other orders as it may deem fit

Provided that before making any order the company shall be given **a reasonable opportunity of being heard** in the matter.


[Pursuant to sections 4, 7, 8(1), 12, 152 and 153 of the Companies Act, 2013 read with rules made thereunder] - FORM NO. INC-32

SPICe

(Simplified Proforma for Incorporating Company Electronically)

English Hindi

Refer the instruction kit for filing the form.

*Whether name is already approved by Registrar of Companies Yes No

1. (a) *State the type of company New company (others)

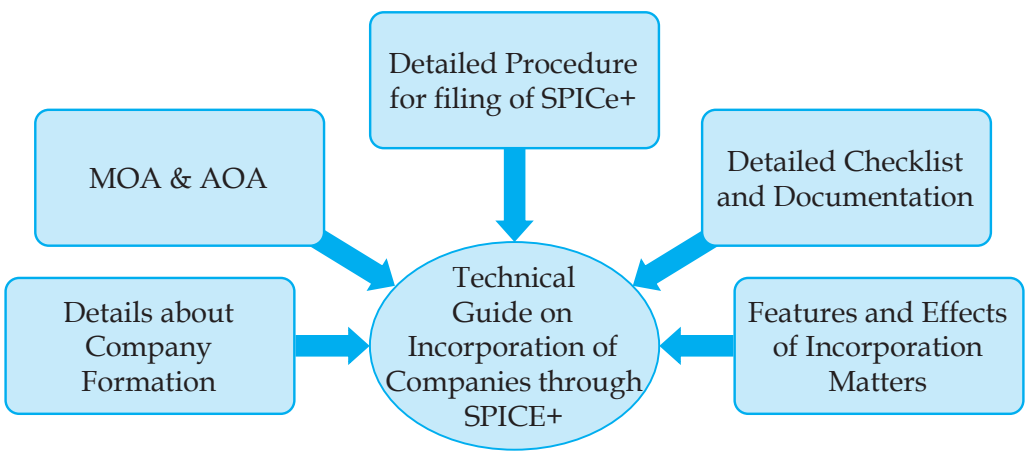
(b) *State the class of company Public Private One Person Company

(c) *State the category of company Company limited by shares

(d) *State the sub-category of company Non-government company

(e) *Whether proposed company is an IFSC company Yes No

Simplified Proforma for Incorporating Company Electronically (SPICe): MCA has simplified the process of filing of forms for incorporation of a company through Simplified Proforma for incorporating company electronically.



Section 9 - EFFECT OF REGISTRATION

From the **date of incorporation** (mentioned in the certificate of incorporation),

- SUBSCRIBERS → MEMBER OF THE COMPANY
  COMPANY → BODY CORPORATE

members of the company, shall be a body corporate by the name contained in the memorandum.

- Such a registered company shall be capable of exercising all the functions of an incorporated company under this Act and
  - having **perpetual succession** with
  - power to **acquire, hold** and dispose of **property**, both movable and immovable, tangible and intangible,
  - to **contract** and
  - to **sue** and be sued, by the said name
- Some important case laws -

Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala
State Trading Corporation of India vs. Commercial Tax Officer

- *The company becomes a legal person separate from the incorporators.*
- *A binding contract between the company and its members as evidenced by the Memorandum and Articles of Association*
- *It has perpetual existence until it is dissolved by liquidation or struck out of the register.*
- *A shareholder who buys shares, does not buy any interest in the property of the company.*

Spencer & Co. Ltd. Madras vs. CWT Madras

- *A company may purchase shares of another company and thus become a controlling company.*
- *However, merely because a company purchases ALL shares of another company it will not serve as a - means of putting an end to the corporate character of another company and Each company is a separate juristic entity.*

Heavy Electrical Union vs. State of Bihar

- *The mere fact that the entire share capital has been contributed by the Central Government and all its shares are held by the President of India and other officers of the Central Government*
- *Does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government*

Section 10 - BINDING FORCE OF MOA & AOA

MOA/AOA shall bind the company and the members as if they respectively had been signed by the company.

COMPANY IS BOUND TO MEMBERS

1. Company cannot deprive any member of its rights
2. If company is about to commit a breach then members may obtain an injunction from court and
3. If co has already committed a breach then members can sue the company/director/ responsible persons

MEMBERS ARE BOUND TO COMPANY

1. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.
2. To observe all the provisions of the memorandum and of the articles.

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 fixed amount**.

The contributions of persons to the common stock of the company form the capital of the company.

SHARE - (to be discussed in detail later)

The proportion of the capital to which each member is entitled, is his share.

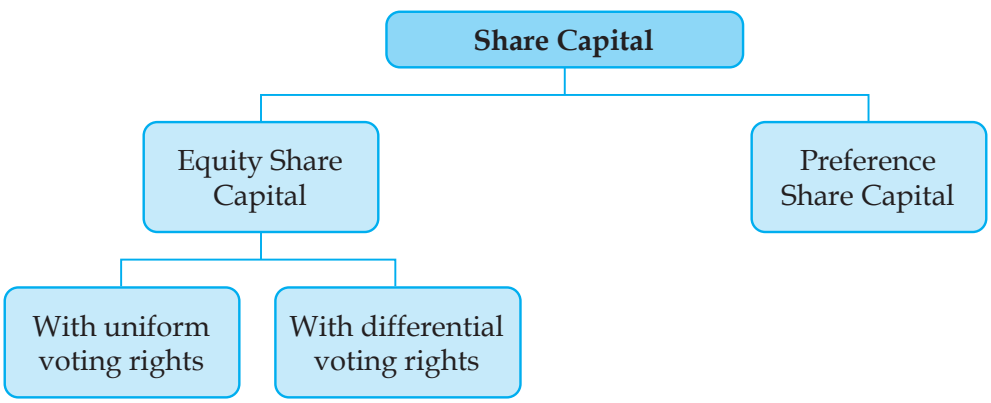
> ***Borland Trustees vs. Steel Bors. & Co. Ltd.***
> *A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.*

TYPES

1. **Nominal or authorised or registered capital:**
   - "Authorised capital" or "Nominal capital" means such capital as is authorised by the **memorandum** of a company to be the maximum amount of share capital of the company.
   - Thus the **MAXIMUM** sum the company is **authorised** to raise by issuing shares, and upon which it pays the **stamp duty**.
   - It is usually **fixed** at the amount - the **company** will **need** including the **working capital** and **reserve capital**, if any.
2. **Issued capital:**
   - Such capital as the company issues from time to time for subscription.
   - It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.
   - Schedule III to the Companies Act, 2013, makes it obligatory for a company to disclose its issued capital in the balance sheet.
3. **Subscribed capital:**
   - Such part of the Issued 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.
   - **Paid-up capital must be stated in equally conspicuous characters** as the authorised capital, the subscribed capital on -
   - Any notice, advertisement or other official communication or any business letter, bill head or letter paper of a company
   - A **default** in this regard will make the **company** and every **officer** who is in default liable to pay penalty extending ₹10,000 and ₹5,000 respectively. [Section 60].
4. **Called-up capital:**
   - Such part of the Issued capital, which has been called for payment.
   - It is the total amount called up on the shares issued.
5. **Paid-up capital:**
   - The total amount paid or credited as paid up on shares issued.
   - **It is equal to called up capital less calls in arrears.**

1. **Nature of shares:**
   - Share which means a share in the share capital of a company and includes stock.
   - A share thus represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company.
   - Shareholders are not in the eyes of law part owners of the undertaking.
   - Shareholder has not only contractual rights against the company but also certain other rights as per the provisions of the Companies Act.
2. **Shares are a movable property:** According to section 44 of the Companies Act, 2013, - the shares or debentures or other interests of any member in a company shall be **movable** property **transferable** in the manner provided by the articles of the company.
3. **Shares shall be numbered:**
   - Section 45 provides, every share in a company having a share capital, shall be **distinguished** by its **distinctive number**.
   - This implies that **every share** shall be **numbered**.
   - However, this shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.
4. **Kinds of share capital:** Section 43 -

   The share capital of a company limited by shares shall be of two kinds -



A. Equity share capital: Equity share capital means all share capital which is not preference share capital but can be divided into two types -

(a) with voting rights; or

(b) with differential rights as to dividend, voting or otherwise in accordance with prescribed rules (DVRs)

> ***Example 6:*** *It is to be noted that, Tata Motors in 2008 introduced equity shares with differential voting rights called 'A' equity shares in its rights issue.*
>
> *In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares.*
>
> *Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting.*
>
> *Other companies which have issued equity shares with differential voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others.*

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 winding up) or Repayment of Capital of that - 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;

★ **Exception:** In case of private company - Section 43 shall not apply where memorandum or articles of association of the private company so provides.

MEMORANDUM OF ASSOCIATION

Statutory definition - As originally framed or altered from + + + under the act or any previous law/Act.

- 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: **(Question expected)**
  1. **POWERS & SCOPE OF THE COMPANY:** It contains the object for which the company is formed-
     (a) It identifies the possible scope of its operations
     (b) beyond which its actions cannot go
  2. **KNOWLEDGE FOR SHAREHOLDER & OTHER PARTIES:** It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities company can engage in. **(Outsider point of view)**
  3. **SHAREHOLDER should know where their money is utilised for?** 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. **(Investor point of view)**
  4. **MOA IS A PUBLIC DOCUMENT:** 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.★
- **WHAT COMPANY CAN'T DO BASED ON MOA?**
  - 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.

Tables A, B, C, D and E in Schedule I of the Act - **Form for MOA of a company-**

1. **Table A -** Company limited by shares.
2. **Table B** - Company limited by guarantee and not having a share capital.
3. **Table C** - Company limited by guarantee and having a share capital.
4. **Table D** - Unlimited company.
5. **Table E** - Unlimited company and having share capital.

Forms for Memorandum
- Table A – L – S
- Table B – L – G – SC
- Table C – L – G + SC
- Table D – UL – SC
- Table E – UL + SC

Content of the Memorandum

★ The clauses listed below are compulsory clauses, or "Conditions".

In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

★ The MOA of a company cannot contain anything contrary to the provisions of the Companies Act. (बाप से पंगा नहीं)

If it does, the same shall be devoid of any legal effect.

Similarly, all other documents of the company must comply with the provisions of the Memorandum.

S.No.	Clause	Description
1.	Name Clause	❑ "Limited" = Public limited company, ❑ "Private Limited" = Private limited. ❑ Not applicable to Section 8 of the Act. ❑ 'Electoral Trust' may be allowed for Registration of companies to be formed under section 8 of the Act ❑ Section 8 of the Act shall include the words - foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust and the like etc. ❑ A Government company's = Must end with the word "Limited". ❑ In the case of OPC, the words "One Person Company", should be included below its name.
2.	Registered Office or Situation clause	The State in which the registered office of the company is to be situated
3.	Object Clause	❑ The objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. ❑ If any company has changed its activities which are not reflected in its name, ❍ it shall change its name in line with its activities within a period of six months ❍ from the change of activities ❍ after complying with all the provisions as applicable to change of name.

4.	Liability clause	❑ The liability of members of the company, whether limited or unlimited, and also state,— ❑ Limited by shares - Liability of its members is limited to the amount unpaid, if any, on the shares held by them ❑ Limited by guarantee - The amount up to which each member undertakes to contribute - ❍ To the assets of the company in the event of its being wound-up while he is a member or ❍ Within one year after he ceases to be a member for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and ❍ To the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves
5.	Capital Clause	❑ Amount of authorized capital divided into share of fixed amounts and ❑ The number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. ❑ A company not having share capital need not have this clause.
6.	Subscription or Association Clause	❑ The detail of the subscribers to be formed into a company. ❑ The Memorandum shall conclude with the association clause. ❑ Every subscriber to the Memorandum shall take atleast one share, and shall write against his name, the number of shares taken by him.
7.	Nomination clause (OPC)	❑ In the case of OPC, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

Some Rules related to MOA

1. It must be printed, divided into paragraphs, numbered consecutively, and
2. Signed by at least -
   (a) 7 persons in case of a public company
   (b) 2 in the case of a private company
   (c) 1 in the case of One Person Company
3. in the presence of at least one witness, who will attest the signatures.
4. The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation etc., must also be entered.
5. It is to be noted that a company being a legal person can through its agent, subscribe to the memorandum.

guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.

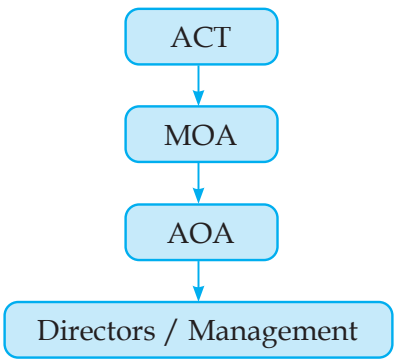
DOCTRINE OF ULTRA VIRES

Doctrine of ultra vires:

- Doctrine = Theory
- Ultra = Beyond
- Vires = Power

Meaning: Any act(s) done BEYOND THE POWERS or in excess of the legal powers of the company.

WHY Something like this needs to be discussed ? Because - The powers in their nature are limited



The objects of a company in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further.

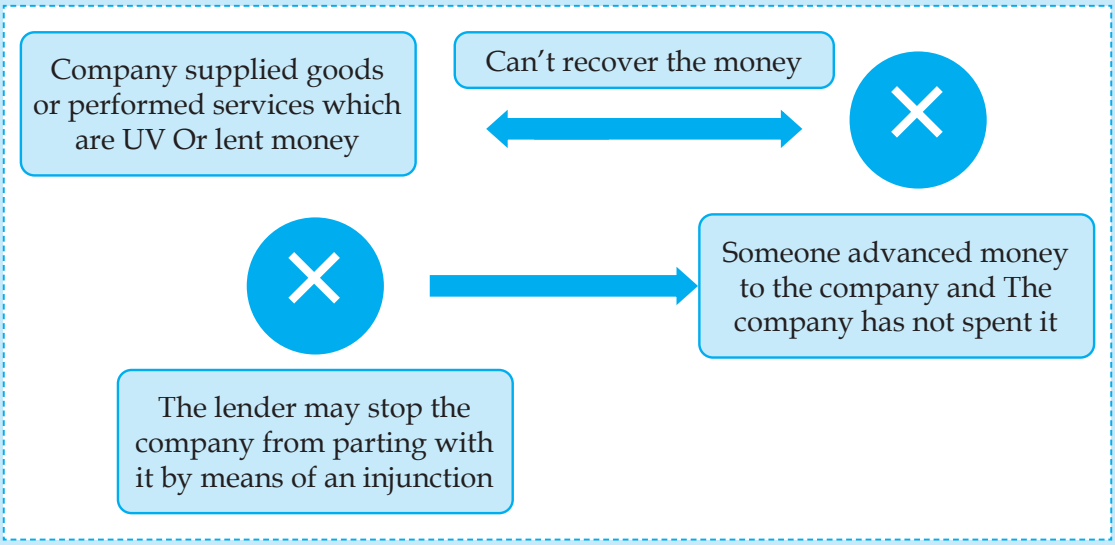
Consequences or Impact of Ultra vires acts: Acts or contracts → Beyond the powers of not only of the directors but → company also

- **Void-ab-initio** and **Inoperative** in law and
- **Not binding** on the company.
- Can't **MISAPPLY** the **funds** for purposes **other than** those **sanctioned** by the MOA. If done then directors are personally liable.
- Can't carry on a **trade different** from the one it is **authorised** to carry on.
- 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, when someone deals with a company - it is deemed (presumed) to know about the powers of the company.
If in spite of this you enter into a transaction which is ultra vires the company, **you cannot enforce it against the company.**

Example 1:

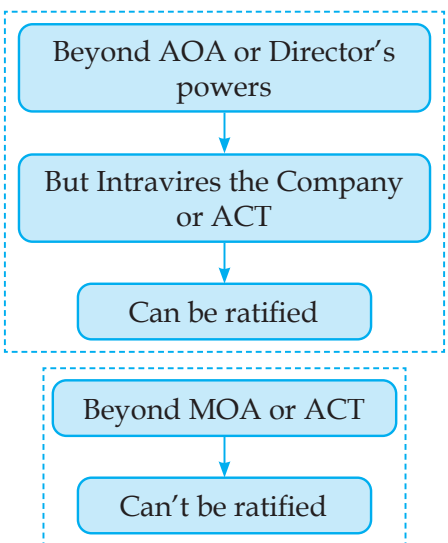
This is because the company does not become the owner of the money, which is ultra vires the company.



As the lender remains the owner, he can take back the property in specie.

If the ultra vires loan has been utilised in meeting lawful debt of the company, then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

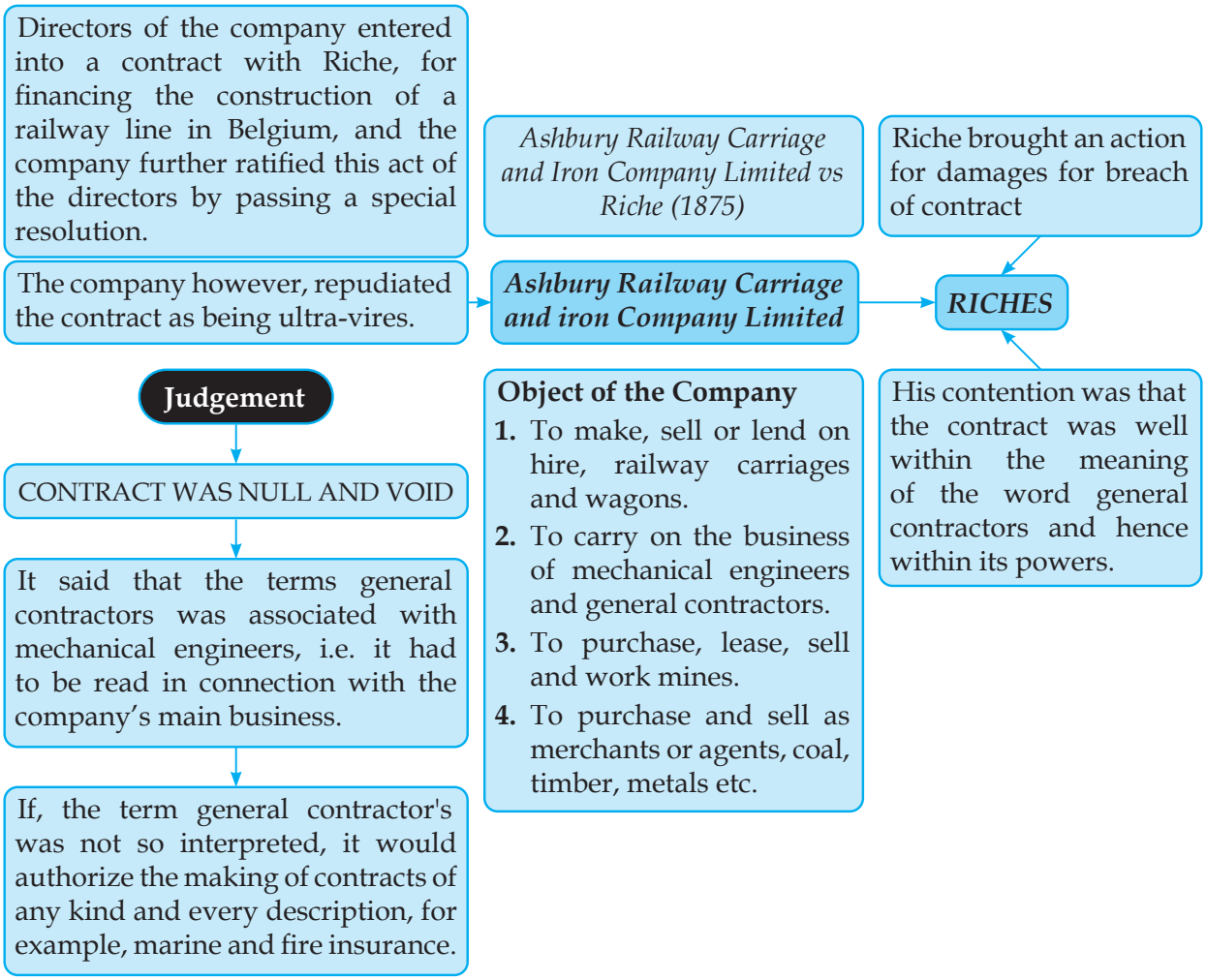
WHEN CAN BE RATIFIED ? - (Approval through voting)



An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company.

Sometimes - YES, When ?

- If the act is UV the power of the directors → YES, the shareholders can ratify it;
- If it is ultra vires the articles of the company → The company can alter the articles
- If the act is within the power of the company but is done irregularly → shareholder can validate it.



Acts and their impact:

Legal ACT but Not authorized by the object clause of the memorandum, or by the statute,	Ultravires the company and hence Null and void.
Ultravires the company means object clause or MOA	Cannot be ratified even by the unanimous consent of all the shareholders.
Ultravires the directors but Intravires the company	Can be ratified by the members of the company through a resolution passed at a general meeting.
Ultravires the Articles	Can be ratified by altering the Articles by a Special Resolution at a general meeting.

An ultra vires contract can never be made binding on the company. It cannot become "Intravires" by reasons of estoppel, acquiescence, Iapse of time, delay or ratification.

- **Benefit of the Doctrine:**
  - restraining the activities of the directors,
  - It prevents the company from changing its activities in a direction which is not agreed by all.

As now the **object clause** can be easily **altered**, by **passing just a special resolution** of the shareholders.

ARTICLES OF ASSOCIATION

Statutory definition - As originally framed or altered from + + + under the act or any previous law/Act

Section 5 of the Act - WHY AOA ?

- **Rules and regulations** which are framed to manage its internal affairs.
- The **bye-laws** of the company according to which -
  - director and other officers are required to perform their functions as regards the management of the company, its accounts and audit.
- A company may adopt all or any of the regulations contained in the model articles applicable to such company.

> ***Guiness vs. Land Corporation of Ireland***
> *The articles are the internal regulations of the company.*

> ***Ashbury Carriage Co. vs. Riches***
> *The articles play a part subsidiary to memorandum of association.*
> *They accept the memorandum as the charter of incorporation*
> *The articles proceed to define the duties, the rights and powers of the governing body as between themselves and the company and*
> *How the business of the company is to be carried on, and*
> *How changes in the internal regulation of the company may from time to time be made.*

> ***S.S. Rajkumar vs. Perfect Castings (P) Ltd***
> *The document containing the articles of association of a company (the Magna Carta) is a business document; hence it has to be construed strictly.*
> *It regulates domestic management of a company and*
> *creates certain rights and obligations between the members and the company*

The contents and model of articles of association:

Sr. No.	Clause	Description
1.	Contains regulations	The Rules and regulations for internal management of the company.
2.	Inclusion of matters	A company may also include such additional matters in its articles as may be considered necessary for its management.
3.	Entrenchment provision (सख़्ती)	To protect something or to have extra additional safeguards - Certain specified provisions can be altered to make them more restrictive and tough to override. Entrenchment may be made: ❑ At the time of formation ❑ By amendment – Through consent of all in Private and SR in case of Public company. Shall give notice to ROC for such provision.

Schedule I as may be applicable to such company.

Forms for Articles

- Table F – L by S
- Table G – L by G + SC
- Table H – L by G
- Table I – UL + SC
- Table J – UL – SC

Key differences between the MOA vs. AOA:

Basis	MOA	AOA
Objectives	Defines and delimits the **objectives** of the company.	Lays down the **rules** and **regulations** for the **internal management** of the company. Articles determine how the objectives of the company are to be achieved.
Relationship	Company → outside world	Company → its members.
Alteration	Can be altered only under certain circumstances and in the manner provided for in the Act. In most cases permission of the **Regional Director, or the Tribunal** is required.	The articles can be altered simply by passing a **special resolution**
Ultra Vires	Acts done by the company **beyond** the **scope** of the MOA are **ultra-vires** and void. These **cannot be ratified** even by the unanimous consent of all the shareholders.	The acts ultra-vires the articles can be **ratified** by a **special resolution** of the shareholders, **provided** they are **not beyond** the **provisions** of the **memorandum**.

DOCTRINE OF INDOOR MANAGEMENT

For us to understand Doctrine of Indoor we need to understand -

Doctrine of Constructive Notice:

In the favour of company
Creates a presumption in the favour of the company

Section 399 - Since MOA and AOA is a "public document", it is open to public inspection - For electronic check, copy, extract including COI of the company on payment of prescribed fees

It is therefore, the duty of every person dealing with a company to inspect its documents and make sure that his contract is in conformity with their provisions but whether a person reads them or not, **it will be presumed that he knows** the contents of the documents.

This kind of presumed/implied notice is called constructive notice.

- This is presumed that the person has **read** the documents and also **understood** them in their true perspective.
- Every person dealing with the company not only has the constructive notice of the memorandum and articles, but **also** of **all** the other **related documents**, such as **Special Resolutions** etc., which are required to be registered with the Registrar.

Final Verdict as per this Doctrine

If a person enters into a contract which is **beyond** the **powers** of the **company** as defined in the memorandum, or **outside** the **authority** of **directors** as per memorandum or articles, he **cannot acquire** any **rights** under the **contract against** the **company**.

Kotla Venakataswamy Vs Rammurthi (1934)
AOA required every document to be signed by 3 persons : MD, working director and secretary
A mortgage deed was not signed by MD
It was held that plaintiff cannot enforce the contract as the deed was invalid.

Doctrine of Indoor Management (Turquand Rule):

In the favour of outsiders
Creates a presumption in the favour of the company

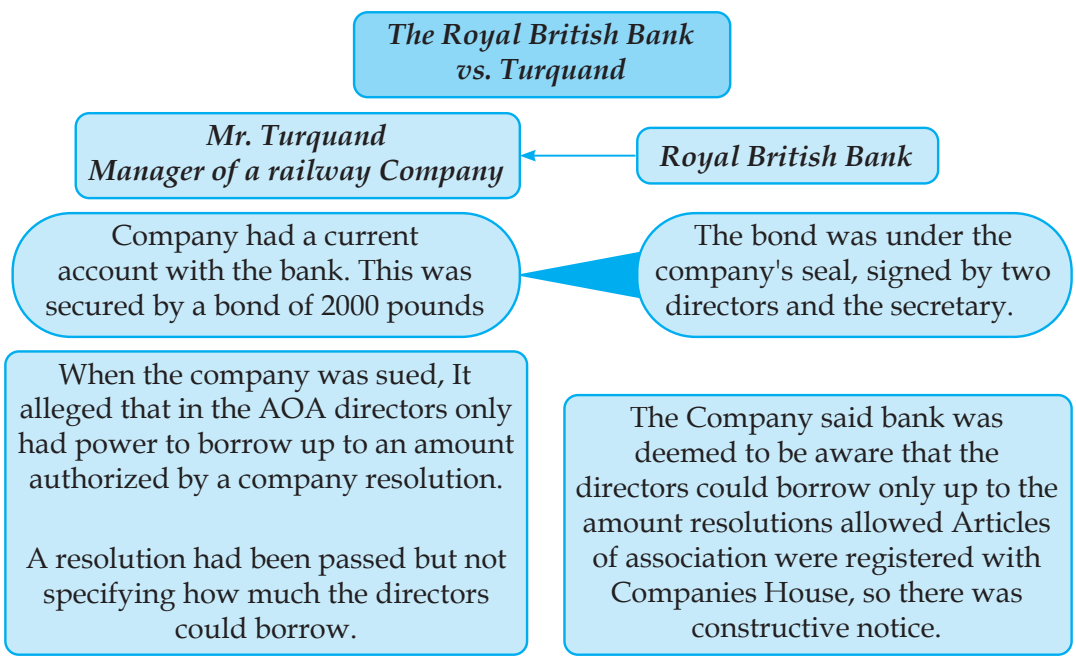
The Doctrine of Indoor Management is the exception to the doctrine of constructive notice.

An outsiders are NOT deemed to have notice of the internal affairs of the company.

An outsider is entitled to assume and presume that all the detailed internal formalities for doing any act have been observed and taken care of.

Thus doctrine protects innocent outsiders from any irregularities in company

FACTS of the Royal British Bank vs. Turquand



Judgement

Held, it was decided that the bond was valid, so the Royal British Bank could enforce the terms

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

Doctrine of Indoor Management is Important:

- To persons dealing with a company through its directors or other persons.
- They are entitled to assume that the acts of the directors or other officers of the company are validly performed - if they are within the scope of their apparent authority.

The above-mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

1. **Actual or constructive knowledge of irregularity:** The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.
   (आपको कमी या गलती का पहले से पता था तो आप इस Doctrine को खुदके प्रोटेक्शन के लिए use नहीं कर सकते)

   Howard vs. Patent Ivory Manufacturing Co.
   - *The directors could not defend themselves where they lent money and*
   - *got issued debentures to themselves without the resolution because*
   - *they should have known that the extent to which they were lending money to the company*
   - *required the assent of the general meeting which they had not obtained.*

   Morris v Kansseen
   - *A director could not defend himself where*
   - *an allotment of shares to him*
   - *as he participated in the meeting, which made the allotment.*
   - *His appointment as a director also fell through because none of the directors appointed him was validly in office.*

2. **Suspicion of Irregularity:** The doctrine in no way, rewards those who behave negligently.
   (बेवक़ूफ़ो के लिए कोई जगह नहीं है)
   - Where the person dealing with the company is put upon an inquiry,
   - for example, where the transaction is unusual or
   - not in the ordinary course of business,
   - it is the duty of the outsider to make the necessary enquiry.
   - the circumstances surrounding the contract are suspicious and therefore invite inquiry.
   - Suspicion should arise from the fact that an officer who is acting in the matter which is apparently outside the scope of his authority.

Ananda Bihari Lal vs. Dinshaw & Co.

- *A person accepted a transfer of a company's property from its accountant, the transfer was held void.*
- *The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to transfer of the company's property.*

Haughton & Co. v. Nothard, Lowe & Wills Ltd

- *where a person holding directorship in two companies*
- *agreed to apply the money of one company in payment of the debt to other,*
- *the court said that it was something so unusual*
- *that the plaintiff were put upon inquiry*
- *to ascertain whether the persons making the contract*
- *had any authority in fact to make it*

3. **Forgery** - (चोरी और ऊपर से सीना जौरी) - धौके के लिए use नहीं कर सकते
   - The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.
   - Forgery may in circumstances exclude the 'Turquand Rule'.

Ruben v Great Fingall Consolidated.

- *In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company.*
- *The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.*
- *The plaintiff contended that whether the signature were genuine or forged was a part of the internal management, and therefore, the company should be estopped from denying genuineness of the document.*
- *But it was held, that the rule has never been extended to cover such a complete forgery.*

"PROBLEM KYA HAI?"

QUESTION BANK FOR THE CHAPTER

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - TCA, 2013

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

1. What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital. **(MODULE)**

Ans. **Company limited by guarantee:** Section 2(21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets

a guarantee company is limited upto a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital:

The common features between a 'guarantee company' and 'share company' are legal personality and limited liability. In the latter case, the member's liability is limited by the amount remaining unpaid on the share, which each member holds. Both of them have to state in their memorandum that the members' liability is limited.

However, the point of distinction between these two types of companies is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the latter case, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

2. Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? **(MODULE)**

Ans. Doctrine of ultra vires: The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

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, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company.

Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if

within the power of the company but is done irregularly, shareholder can validate it.

3. 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". **(MODULE)**

Ans. **Doctrine of Indoor Management (the Companies Act, 2013):** According to the "doctrine of indoor management" the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more.

They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of "constructive notice" and popularly known as the rule laid down in the celebrated case of Royal British Bank v. Turquand. Thus, the doctrine of indoor management aims to protect outsiders against the company.

The above mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

(a) Actual or constructive knowledge of irregularity: The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

In Howard vs. Patent Ivory Manufacturing Co. where the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

Likewise, in Morris v Kansseen, a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

(b) Suspicion of Irregularity: The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

The protection of the "Turquand Rule" is also not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. Suspicion should arise, for example, from the fact that an officer is purporting to act in matter, which is apparently outside the scope of his authority.

Where, for example, as in the case of Anand Bihari Lal vs. Dinshaw & Co. the plaintiff accepted a transfer of a company's property from its accountant, the transfer was held void. The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property.

Similarly, in the case of Haughton & Co. v. Nothard, Lowe & Wills Ltd. where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said that it was something so unusual "that the

had any authority in fact to make it." Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf."

(c) Forgery: The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

Forgery may in circumstances exclude the 'Turquand Rule'. The only clear illustration is found in the Ruben v Great Fingall Consolidated. In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.

The plaintiff contended that whether the signatures were genuine or forged was a part of the internal management, and therefore, the company should be stopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

4. 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? **(MODULE)**

Ans. 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.

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 façade and hold the persons in control of the management of its affairs liable for the acts of the company. 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.

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.

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.

Hence, A cannot be regarded as separate from the private limited companies he formed.

5. 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

a loan of ' 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? **(MODULE)**

Ans. **Doctrine of Indoor Management:** According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

Thus,

1. What happens internal to a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but do not know the information he/she is not privy to.
2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

In the given question, 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.

6. 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? **(MODULE)**

Ans. (Answer has been changed as per latest amendment and information. This is the latest answer. Follow this)

(a) No, it is not mandatory for Navita to withdraw her nomination in the said OPC even if she is leaving India permanently as only a natural person who is an Indian citizen can be a member and nominee in the OPC whether or nor resident in India.

(b) Yes, Navita can continue her nomination in the said OPC, irrespective of the fact that she maintaines the status of Resident of India after her marriage.

(a) A company being an artificial person cannot own property and cannot sue or be sued.

(b) A private limited company must have a minimum of two members, while a public limited company must have at least seven members. **(MODULE)**

Ans.

(a) A company being an artificial person cannot own property and cannot sue or be sued 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.

(b) A private limited company must have a minimum of two members, while a public limited company must have at least seven members.

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.

MTPs, RTPs AND PYQPs QUESTIONS

1. 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 on 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:

(a) Whether Jagannath Oils Limited is required to reduce the number of members.

(b) 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?

(RTP May' 22) (MTP 4 Marks, Nov'21)

Ans. 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,

(i) 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

A. 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.

B. 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.

2. 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 1 st 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? **(RTP May' 22) (MTP 3 Marks, Mar 21)**

Ans. 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:

1. 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 register. But before 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.
2. 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.
3. 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 commary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company

and with such liabilities, duties and obligations as may be specified in the order.

3. 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)

Ans. **Corporate Veil:** 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.

However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons exercising control over the affairs of the company are held personally liable for the act and debts of the company.

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

1. To determine the character of the company i.e. to find out whether co-enemy or friend.
2. To protect revenue/tax
3. To avoid a legal obligation
4. Formation of subsidiaries to act as agents
5. Company formed for fraud/ improper conduct or to defeat law

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 POR 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.

4. 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)**

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 licence was rejected.

Hence, in this case the parent and the subsidiary company shall not be treated as separate commercial units.

5. ABC Pvt Ltd, has been overstating expenditures in their Profit & Loss account for the past few years.

On Inquiry, it was found that the mere purpose was to avoid tax. However, there was no fraudulent intentions. Should the corporate veil of the company be lifted? Kindly justify. **(RTP Nov'22)**

Ans. Corporate veil refers to the concept that members of a company are shielded from liability connected to the company's action. It is the legal concept whereby the company is identified separately from the members of the company. However, under the below circumstances, the company law disregards the principle of corporate personality.

- To determine the character of the company
- To protect revenue/tax
- To avoid a legal obligation
- Formation of subsidiaries to act as agents
- Company formed for fraud/improper conduct.

In the given scenario, though the intention of the company was not fraudulent to defeat law, it had the intention of avoiding taxes and protecting revenue.

Hence, corporate veil should be lifted and the principles of corporate personality will be disregarded.

6. 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)**

Ans. 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.

7. No limit Private Company is incorporated as unlimited company having share capital of $10,00,000.

One of its creditors, Mr. Samuel filed a suit against a shareholder Mr. Innocent for recovery of his debt against No limit Private Company. Mr. Innocent has given his plea in the court

in recovering his dues from Mr. Innocent? **(RTP Nov'22)**

Ans. 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

8. In the Flower Fans Private Limited, there are only 5 members. All of them go in a boat on a pleasure trip into an open sea. The boat capsizes and all of them died being drowned. Explain with reference to the provisions of Companies Act, 2013:

(i) Is Flower Fans Private Limited no longer in existence?

(ii) Further is it correct to say that a company being an artificial person cannot own property and cannot sue or be sued? **(RTP May'23) (MTP Jun'22 3 Marks) (MTP 3 Marks, Oct'21)**

Ans.

1. **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.

   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.

2. **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 prop"rty, 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.

9. 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.

(RTP May 23) (MTP Mar'22 6 Marks) (MTP May' 23 6 Marks)

Ans. **Doctrine of ultra vires:** The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited. It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

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 imspection.

Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.

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.

10. Articles of Association of XYZ Private Limited provides that Board of Directors (BOD) can take the loan upto $ 5,00,000 for Company by passing the board resolution. In that case, the loan amount is in excess of the limit, special resolution is required to be passed in general meeting. Due to urgent needs of funds, BOD applied for loan in a reputed bank for $ 10,00,000 without passing the resolution in the general meeting. BOD 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 act was ultra vires to company. Kindly, advise. **(RTP May'23) (MTP Nov'22 4 Marks)**

Ans. According to doctrine of Indoor Management, persons dealing with the Company are presumed to have read the registered documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more; they need not enquire into the regularity of internal proceedings as required by Memorandum and Articles. This was also decided in case of Royal British Bank Vs. Turquand.

In the instant case, XYZ Private Limited have taken loan from reputed bank for * 10,00,000 by passing Board Resolution while Special Resolution was necessary for such amount. BOD 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 demanding the repayment of loan, company denied the payment as act was ultra vires to company.

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.

2013. **(RTP May 23)**

Ans. In line with the Companies Act, 2013, following are the classification of the Companies on the basis of control:

A. Holding and subsidiary companies: 'Holding and subsidiary' companies are relative terms.

A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies. [Section 2(46)]

For the purposes of this clause, the expression "company" includes any body corporate.

Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

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

(i) 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;

(ii) the expression "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.

The term "Total Share Capital", means the aggregate of the -

1. Paid-up equity share capital; and
2. Convertible preference share capital.

12. 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 R 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? **(RTP Nov'23)**

Ans. Section 2(87) of the Companies Act, 2013 defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company:

1. controls the composition of the Board of Directors; or
2. 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:

For the purposes of this section -

1. a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
2. "layer" in relation to a holding company means its subsidiary or subsidiaries.

is holding 1,60,000 shares (90,000 + 70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.

In the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hefle, KL Private Limited is holding company of PQ Private Company and BC Private Limited is a holding company of KL Private Limited.

Hence, by virtue of Chain relationship, BC Private Limited becomes the holding company of PQ Private Limited.

13. Narendra Motors Limited is a Government Company. Shah Auto Private Limited have share capital of *10 crore in the form of 10,00,000 shares of $ 100 each. Narendra Motors Limited is holding 5,05,000 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' 23) (RTP Nov'21)

Ans. According to the provisions of Section 2(45) of Companies Act, 2013, Government Company means any company in which not less than 51% of the paid-up share capital is held by:

1. the Central Government, or
2. by any State Government or Governments, or
3. 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.

According to Section 2(87), "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding 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.

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.

14. Mr. Dhruv was appointed as an employee of Sunmoon Timber Private Limited on the condition that if he were 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 filed a suit against Seven Stars Timbers Private Limited for violation of contract. Seven Stars Timbers Private Limited argued that the contract was entered into between Mr. Dhruv and Sunmoon Timber Private Limited and as company has separate legal entity, Seven Stars

whether separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited will be disregarded? **(RTP Jun'24)**

Ans. It was decided by the court in the case of Gilford Motor Co. Vs. Horne, 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 the separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited should be disregarded.

15. AK Private Limited has borrowed 7 36 crore from BK Finance Limited.However, as per memorandum of AK Private Limited, the maximum borrowing power of the company is $30 crore. Examine whether AK Private Limited is liable to pay this debt? State the remedy, if any available to BK Finance Limited. **(RTP Jun'24)**

Ans. This case is governed by the 'Doctrine of Ultra Vires'. According to this doctrine, any act done, or a contract made by the company which travels beyond the powers of the company conferred upon it by its Memorandum of Association is wholly void and inoperative in law and is therefore not binding on the company. This is because the Memorandum of Association of the company is, in fact, its charter; it defines its constitution and the scope of the powers of the company.Hence, a company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. Hence, any agreement ultra vires the company shall be null and void.

1. **Whether AK Private Limited is liable to pay the debt?**

   As per the facts given, AK Private Limited borrowed * 36 crore from BK Finance Limited which is beyond its borrowing power of 30 crore.

   Hence, contract for borrowing of 36 crore, being ultra vires the Memorandum of Association and thereby is void. AK Private Limited is not, therefore, liable to pay the debt.

2. **Remedy available to BK Finance Limited:**

   In light of the legal position explained above, BK Finance Limited cannot enforce the said transaction and thus has no remedy against the company for recovery of the money lent. BK Finance limited may take action against the directors of AK Private Limited as it is the personal liability of its directors to restore the borrowed funds. Besides, BK Finance Limited may take recourse to the remedy by means of 'Injunction', if feasible.

16. Mike LLC incorporated in Singapore having an office in Pune, India. Analyze whether Mike LLC would be called a foreign company as per the provisions of the Companies Act, 2013? Also explain the meaning of foreign company.

(RTP Jun'24) (MTP Nov'23 3 Marks) (PYP Nov'22 3 Marks)

Ans. Foreign Company [Section 2(42) of the Companies Act, 2013]: It means any company or body corporate incorporated outside India which:

1. has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
2. conducts any business activity in India in any other manner.

is a foreign Company.

17. 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 Mar'22 4 Marks)

Ans. 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.

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.

18. The paid-up capital of Ram Private Limited is * 10 Crores in the form of 7,00,000 Equity Shares of R 100 each and 3,00,000 Preference Shares of $ 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 Jun'22 4 Marks) (MTP 4 Marks, Oct'21)

Ans. According to Section 2(87) of Companies Act, 2013 "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company:

1. controls the composition of the Board of Directors; or
2. 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:

For the purposes of this section

1. the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
2. the expression "company" includes anybody corporate;

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, Ram Private Limited is having paid-up capital of R10 Crores in the form of 7,00,000 Equity Shares of *100 each and 3,00,000 Preference Shares of R100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited.

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

Lakhan Private Limited.

19. "The Memorandum of Association is a charter of a company". Discuss. Also explain in brief the contents of Memorandum of Association. **(MTP Jun'22 6 Marks) (MTP 6 Marks, Oct'21)**

Ans. 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 presum] 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.

Content 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 a public limited company, or the last words "Private Limited" in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act.

(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.

20. Can a non-profit organization be registered as a company under the Campanies Act, 2013? If so, what procedure does it have to adopt? **(MTP Nov'22 6 Marks)(SM)**

Ans. Yes, a non-profit organization can be registered as a company under the Companies Act, 2013 by following the provisions of section 8 of the Companies Act, 2013. 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,

promoting its objects and prohibiting the payment of any dividend to its members.

The Central Government has the power to issue license for registering a section 8 company.

1. 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.
2. The registrar shall on application register such person or association of persons as a company under this section.
3. On registration, the company shall enjoy same privileges and obligations as of a limited company.

21. 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 tain 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)**

Ans. 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.

22. 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. **(MTP Nov'22 4 Marks) (PYP May'22 3 Marks)**

Ans. 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.

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, is a foreign citizen and not an indian citizen. Hence, S's name cannot be given as nominee in the memorandum.

Law. **(MTP Nov'22 6 Marks) (PYP Dec 21 6 Marks)**

Ans.

1. **Meaning of capital:** The term capital has variety of meanings. But in relation to a company limited by shares, the term 'capital' means 'share capital'. Share capital means capital of the company expressed in terms of rupees divided into shares of fixed amount.
2. **Classification of capital:** In the domain of Company Law, the term capital can be classified as follows:
   - **(a) Nominal or authorized or registered capital:** This expression means such capital as is authorised by memorandum of a company to be the maximum amount of share capital of the company.
   - **(b) Issued capital:** It means such capital as the company issues from time to time for subscription.
   - **(c) Subscribed capital:** As such part of the capital which is for the time being subscribed by the members of a company.
   - **(d) Called up capital:** As such part of the capital which has been called for payment. It is the total amount called up on the shares issued.
   - **(e) Paid-up capital:** It is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

24. 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 7 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? **(MTP Nov'22 3 Marks)**

Ans. Section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company:

(a) controls the composition of the Board of Directors; or

(b) 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:

For the purposes of this section -

1. a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (i) is of another subsidiary company of the holding company;
2. "layer" in relation to a holding company means its subsidiary or subsidiaries.

   In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000 + 70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.
3. in the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of Q Private Company and BC Private Limited is a holding company of KL Private Limited.

of PQ Private Limited.

25. Mr. Mohan had purchased some goods from Sunflower Limited on credit. A credit period of one month was allowed to Mr. Mohan. Before the due date, Mr. Mohan went to the company and wanted to repay the amount due from him. He found only Mr. Ramesh there, who was the factory supervisor of the company. Mr. Ramesh told Mr. Mohan that the Accountant and the cashier are on leave, he is in-charge of receiving money and he may pay the amount to him. Mr. Ramesh issued a money receipt under his signature. After two months, Sunflower limited issued a notice to Mr. Mohan for nonpayment of the dues within the stipulated period. Mr. Mohan informed the company that he had already cleared the dues and he is no more responsible for the same. He also contended that Mr. Ramesh is an employee of the company whom he had made the payment and being an outsider, he trusted the words of Mr. Ramesh as duty distribution is a job of the internal management of the company. Analyse the situation and decide whether Mr. Mohan is free from his liability.

(MTP Apr'23 4 Marks) (MTP 4 Marks, Apr'21)

Ans. **Doctrine of Indoor Management:** The Doctrine of Indoor Management is the exception to the Doctrine of Constructive Notice. The Doctrine of Constructive Notice does not mean that outsiders are deemed to have notice of the internal affairs of the company. For instance, if an act is authorised by the Articles or Memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed.

The doctrine of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required.

In the given question, Mr. Mohan has made payment to Mr. Ramesh and he (Mr. Ramesh) gave to receipt of the same to Mr. Mohan. Thus, it will be rightful on part of Mr. Mohan to assume that Mr. Ramesh was also authorised to receive money on behalf of the company. Hence, Mr. Mohan will be free from liability for payment of goods purchased from Sunflower Limited, as he has paid amount due to an employee of the company.

26. Mr. Rajeev, 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 Mr. Rajeev as a pretended loan. This way, Mr. Rajeev 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. **(MTP Apr'23 6 Marks)**

(MTP 4 Marks, Mar'21) (MTP 6 Marks, Apr'21)

Ans. 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. 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 facade and hold the persons in control of the management of its affairs liable for

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 assessee.

1. The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the facade of the assessee himself. Therefore, the whole idea of Mr. Rajeev was simply to split his income into three parts with a view to evade tax. No other business was done by the company.
2. The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried on no other business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to hand them over to the assessee as pretended loans. The same was upheld in Re Sir Dinshaw Maneckjee Petit and Juggilal vs. Commissioner of Income Tax.

27. Aqua Limited was registered as a public company. There are 230 members in the company as noted below:

1. Directors and their relatives - 190
2. Employees - 15
3. Ex-Employees (Shares were allotted when they were employees - 10
4. 5 couples holding shares jointly in the name of husband and wife (5 × 2) - 10
5. Others - 5

The Board of Directors of the company proposes to convert it into a private company. Also advise whether reduction in the number of members is necessary

(MTP Apr'23 3 Marks) (MTP 3 Marks, Apr'21)

Ans. According to section 2(68) of the Companies Act, 2013, "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles, except in case of One Person Company, limits the number of its members to two hundred.

However, 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.

It is further provided 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.

In the instant case, Aqua Limited may be converted into a private company only if the total members of the company are limited to 200.

Total Number of members

Directors and their relatives	190
5 couples holding shares jointly in the name of husband and wife (5 × 1)	5
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.

the financial year ended on 31st March, 2023 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.

(MTP May'23 4 Marks)

Ans. 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.

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.

29. Mr. Raj formed a company with a capital of ₹5,00,000. He sold his business to another company for ₹4,00,000. For the payment of sale, he accepted shares worth ₹3,00,000 (30,000 shares of ₹10 each).

The balance 1,00,000 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 ₹60,000. The debts due to unsecured creditors were ₹80,000.

Mr. Raj retained the entire sum of ₹60,000 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 ₹60,000 should be paid to them.

Examine the rights of Mr. Raj and other creditors. Who will succeed?

(MTP May 23 3 Marks) (MTP Mar 22 3 Marks)

Ans. **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.

Thus, the shareholders are protected from the acts of the company. The leading case law of Saloman Vs Saloman and Co. 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.

30. Parasnath Infra Height Limited is a public company having 215 members. Out of 215 members, 20 members were employee in the company during the period 1st June, 2021 to 30th June, 2023. They were allotted shares in Parasnath Infra Height Limited on 1st April, 2017 which are held by them till today i.e. 31st October, 2023. Now, company wants to convert itself into a private company.

of members under the provisions of Companies Act, 2013? **(MTP Nov'23 4 Marks)**

Ans. 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, —

1. restricts the right to transfer its shares;
2. 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
3. prohibits any invitation to the public to subscribe for any securities of the company;

In the given problem, 20 members were employees of the company but they were not employee at the time of getting membership i.e. 1st April, 2017 and nor on existing date i.e. 31st October, 2023.

Hence, they will be considered as members for the purpose of the limit of 200 members.

Hence, taking into account the provisions of Section 2(68) of the Act, the company is required to reduce the number of members to 200 before converting it into a private company.

31. The Articles of Association (AOA) of Avenue International Private Limited contained a clause that in case of insolvency of any member, his shares in the company should be sold to other person and at the price fixed by directors of the company. Mr. Neeraj, a shareholder was adjudicated insolvent. His official assignee in insolvency claimed that he was not bound by the provisions of AOA and is free to sell the shares at their true value. Referring the provisions of the Companies Act 2013, whether official assignee is bound by AOA? **(MTP Nov'23 6 Marks)**

Ans. The Articles of Association (AOA) of a company are its rules and regulations, which are framed to manage its internal affairs. Just as the Memorandum contains the fundamental conditions upon which the company is allowed to be incorporated, so also the articles are the internal regulations of the company (Guiness vs. Land Corporation of Ireland). Further according to the decision taken in case of S.S. Rajkumar vs. Perfect Castings (P) Ltd., the document containing the AOA of a company (the Magna Carta) is a business document; hence it has to be construed strictly. It regulates the domestic management of a company and creates certain rights and obligations between the members and the company. On the basis of above, it can be said that Official assignee of Mr. Neeraj is bound by the AOA.

32. ABC Private Limited is a registered company under the Companies Act, 2013 with paid up capital of ₹35 lakhs and turnover of ₹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. **(MTP Dec'23 4 Marks) (PYP Jun'23 3 Marks)**

Ans. Small Company: Small Company as defined under Section 2(85) of the Companies Act, 2013 means a company, other than a public company

(i) paid-up share capital of which does not exceed Rs. 4 crore or such higher amount as may be prescribed which shall not be more than Rs. 10 crore; and

year does not exceed ₹40 Crore or such higher amount as may be prescribed which shall not be more than ₹100 crore.

Exceptions: This clause shall not 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.

In the instant case, since the paid-up capital of ABC Private Limited is ₹35 Lakhs and turnover is ₹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.

33. Explain the concept of 'Corporate Veil'. Briefly state the circumstances when the corporate veil can be lifted as per the provisions of the Companies Act, 2013.

(MTP Dec'23 6 Marks) (PYP Jun'23 6 Marks)

Ans. **Corporate Veil:** Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company. Due to this, members of a company are shielded from liability connected to the company's actions.

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:

1. **To determine the character of the company i.e. to find out whether co-enemy or friend:** It is true that, unlike a natural person, a company does not have mind or conscience; therefore, it cannot be a friend or foe. It may, however, be characterised as an enemy company, if its affairs are under the control of people of an enemy country. For this purpose, the Court may examine the character of the persons who are really at the helm of affairs of the company.
2. **To protect revenue/tax:** In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue. Where corporate entity is used to evade or circumvent tax, the Court can disregard the corporate identity.
3. **To avoid a legal obligation:** Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction.
4. **Formation of subsidiaries to act as agents:** A company may sometimes be regarded as an agent or trustee of its members, or of another company, and may therefore be deemed to have lost its individuality in favour of its principal. Here the principal will be held liable pr the acts of that company.
5. **Company formed for fraud/improper conduct or to defeat law:** 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.

34. Mr. R, a manufacturer of toys approached MNO Private Limited for supply of raw material worth f 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 $ 1,50,000/-.

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?

(MTP Dec'23 3 Marks) (PYP Nov'22 4 Marks)

Ans.

1. **Fate of the suit and the liability of Mr. R towards the company:** Doctrine of the Indoor Management According to the Doctrine of the Indoor Management, the outsiders are not deemed to have notice of the internal affairs of the company. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority.

   So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required. This is the indoor management rule, that the company's indoor affairs are the company's problem. This rule has been laid down in the landmark case-the Royal British Bank vs. Turquand. (Known as "Turquand Rule") 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.

2. **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.

   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.

35. AK Private Limited has borrowed 7 36 crores from BK Finance Limited. However, as per 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. **(PYQ Dec'21 4 Marks)**

Ans. This case is governed by the 'Doctrine of Ultra Vires'. According to this doctrine, any act done or a contract made by the company which travels beyond the powers of the company conferred upon it by its Memorandum of Association is wholly void and inoperative in law and is therefore not binding on the company. This is because, the Memorandum of Association of the company is, in fact, its charter; it defines its constitution and the scope of the powers of the company. Hence, a company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. Hence, any agreement ultra vires the company shall be null and void.

1. **Whether AK Private Limited is liable to pay the debt?**

   As per the facts given, AK Private Limited borrowed $ 36 crores from BK Finance Limited which is beyond its borrowing power of R 30 crores.

association and thereby ultra vires the company, is void. AK Private Limited is not, therefore, liable to pay the debt.

2. **Remedy available to BK Finance Limited:**

In light of the legal position explained above, BK Finance Limited cannot enforce the said transaction and thus has no remedy against the company for recovery of the money lent. BK Finance limited may take action against the directors or AK Private Limited as it is the personal ability or Its directors to restore the borrowed funds. Besides, BK Finance Limited may take recourse to the remedy by means of 'Injunction', if feasible.

36. 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. **(PYQ Dec'21 3 Marks)**

Ans. Section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company

1. controls the composition of the Board of Directors; or
2. 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:

For the purposes of this section -

A. a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (i) is of another subsidiary company of the holding company;

B. "layer" in relation to a holding company means its subsidiary or subsidiaries.

In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000+70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.

In the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of PQ Private Company and BC Private Limited is a holding company of KL Private Limited.

Hence, by virtue of Chain relationship, BC Private Limited becomes the holding company of PQ Private Limited.

37. The Articles of Association of Aarna Limited empowers its managing agents to borrow loans on behalf of the company. Ms. Anika, the director of the company, borrowed " 18 Lakhs in name of the company from Quick Finance Limited, a non-banking finance company. Later on, Aarna Limited refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and therefore the company is not liable to pay such loan.

Decide whether the contention of Aarna Limited is correct in accordance with the provisions of the Companies Act, 2013? **(PYQ May'22 4 Marks)**

According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect the external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

Thus,

1. What happens internal to a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but do not know the information he/she is not privy to.
2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

In the given question, Quick Finance Limited being external to the company, need not enquire whether the necessary resolution was passed properly. Even if Aarna Limited claims that no resolution authorizing the loan was passed, Aarna Limited is bound to repay the loan to Quick Finance Limited.

38. Explain the Doctrine of ultra vires under the Companies Act, 2013. What are the consequences of 'ultra vires acts of the company? **(PYQ May' 22 6 Marks)**

Ans. **Doctrine of ultra vires:**

The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid. It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by tie company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum.

Likewise, it can be restrained from carrying on a trade different from the one it is authorized to carry on.

Consequences of ultra vires' acts of the company:

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, when one deals with a company one is deemed to know about the powers of the company. If in spite of this one enters into a transaction which is ultra vires the company, he/she cannot enforce it against the company.

An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company.

instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholders can validate such acts.

39. 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 $ 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? **(PYQ Nov 22 4 Marks)**

Ans. 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.

40. Explain listed company and unlisted company as per the provisions of the Companies Act, 2013. **(PYQ Nov 22 2 Marks)**

Ans. **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.

41. ABC Limited has allotted equity shares with voting rights to XYZ Limited worth * 15 crores and convertible preference shares worth & 10 crores during the financial year 2022-23. After that the total share capital of the company is R 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.

(PYQ Jun' 23 4 Marks)

Ans. 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.

worth ₹15 crore and convertible preference shares worth ₹710 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 (₹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.

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.

42. 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 $ 9.5 crore (95 lakh shares of $ 10 each). Y Limited directly holds 2,50,600 shares of 2 Private Limited which is having share capital of 7 5 crore in the form of 5 lakh shares of 7 100 each.

Z Private Limited claimed the status of a subsidiary company of $ 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?

(PYQ Dec' 23 4 Marks)

Ans. According to Section 2(45) of the Companies Act, 2013, Government Company means any company in which not less than 51% of the paid-up share capital is held by:

(a) the Central Government, or

(b) by any State Government or Governments, or

(c) 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.

As per Section 2(87) of the Companies Act, 2013, "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company

(a) controls the composition of the Board of Directors;

(b) or 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.

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.

43. Explain the kinds of share capital as per the Companies Act, 2013. Also explain when the capital shall be deemed to be preference capital. **(PYQ Dec'23 6 Marks)**

Ans. Kinds of share capital: Section 43 of the Companies Act, 2013 provides the kinds of share capital.

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

   (a) with voting rights; or

   (b) 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.

44. 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 7 th 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. **(PYQ Dec'23 3 Marks)**

Ans. "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. [Explanation (i) to Section 455 of the Companies Act, 2013]

"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.

[Explanation (ii) to Section 455 of the Companies Act, 2013]

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

of more than 2 years have already elapsed, it will be treated as Inactive Company.

45. SK Infrastructure Limited has a paid up share capital divided into 6,00,000 equity shares of $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. **(RTP May' 21)**

Ans. Government Company [Section 2(45) of the Companies Act, 2013]: Government Company means any company in which not less than 51% of the paid-up share capital is held by-

1. the Central Government, or
2. by any State Government or Governments, or
3. 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.

In the instant case, paid up share capital of SK Infrastructure Limited is 6,00,000 equity shares of ₹100 each. 200,000 equity shares are held by Central government and 1,20,000 equity shares are held by Government of Maharashtra. The holding of equity shares by both government is 3,20,000 which is more than 51% of total paid up equity shares.

Hence, SK Infrastructure Limited is a Government company.

46. Mr. Anil formed a One Person Company (OPC) on 16th April, 2018 for manufacturing electric cars. The turnover of the OPC for the financial year ended 31st March, 2019 was about & 2.25 Crores. His friend Sunil wanted to invest in his OPC, so they decided to convert it voluntarily into a private limited company. Can Anil do so? **(RTP May' 21)**

Ans. As per the provisions of Sub-Rule (7) of Rule 3 of the Companies (Incorporation) Rules, 2014, an OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of its incorporation, except threshold limit (paid up share capital is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees. In the instant case, Mr. Anil formed an OPC on 16th April, 2018 and its turnover for the financial year ended 31st March, 2019 was ₹2.25 Crores. Even though two years have not expired from the date of its incorporation, since its average annual turnover during the period starting from 16th April, 2018 to 31st March, 2019 has exceeded ₹2 Crores, Mr. Anil can convert the OPC into a private limited company along with Sunil.

47. 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

and Seven Stars Timbers Private Limited will be disregarded? **(RTP Nov'21)**

Ans. 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.

48. 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. 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.

(RTP Nov'21)

Ans. (Answer has been changed as per latest amendment and information. This is the latest answer. Follow this)

As per the provisions of the Companies Act, 2013, only a natural person who is an Indian citizen and whether or not a 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.

1. 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. (Which is immaterial)

Hence Mr. A is 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 In 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.

49. 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 - 20

(Including 10 joint holders holding shares jointly in the name of father and son)

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.

(PYQ 4 Marks, Jan 21)

Directors of said company proposes to convert it into private company. In lines with Section 2 (68) of the Companies Act, 2013, a private company by its Articles, limits the number of its members to 200.

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.

It is further provided that, following persons shall not be included in the number of members-

1. Persons who are in the employment of the company: and
2. 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.

As per the facts, ABC Limited has members constituting of Directors & their relatives, employees, Ex-employees and others including 10 joint holders. In line with the requirement for being a private company, following shall be restricted to be as members i.e., Directors & their relatives & joint holders holding shares jointly constituting 200 members (190 + 10).

Accordingly, ABC Limited when converted to private company shall not be required to reduce the number of members as the number of members as per requirement of a private company, is fulfilled that is of maximum 200 members.

50. Explain Doctrine of 'Indoor Management' under the Companies Act, 2013. Also state the circumstances where the outsider cannot claim relief on the ground of 'Indoor Management'.

(PYQ 6 Marks, Jan'21)

Ans. **Doctrine of Indoor Management (The Companies Act, 2013):** According to the "doctrine of indoor management" the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more. They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of "constructive notice" and popularly known as the rule laid down in the celebrated case of Royal British Bank v. Turquand. Thus, the doctrine of indoor management aims to protect outsiders against the company.

The above mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

(a) Actual or constructive knowledge of irregularity: The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

(b) Suspicion of Irregularity: The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

(c) Forgery: The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

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. **(PYQ 3 Marks, Jan 21)**

Ans. Government Company [Section 2(45) of the Companies Act, 2013]: Government Company means any company in which not less than 51% of the paid-up share capital is held by-

1. The Central Government, or
2. By any State Government or Governments, or
3. 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.

In the instant case, paid up share capital of SK Infrastructure Limited is 6,00,000 equity shares of $ 100 each. 200,000 equity shares are held by Central government and 1,20,000 equity shares are held by Government of Maharashtra. The holding of equity shares by both government is 3,20,000 which is more than 51% of total paid up equity shares.

Hence, SK Infrastructure Limited is a Government company.

52. Y incorporated a "One Person Company (OPC)" making his sister Z as nominee. Z is leaving India permanently due to her marriage abroad. Due to this fact, she is withdrawing her consent of nomination in the said OPC. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below:

(i) Is it mandatory for Z to withdraw her nomination in the said OPC, if she is leaving India permanently?

(ii) Can Z continue her nomination in the said OPC, if she maintained the status of Resident of India after her marriage? **(PYQ 4 Marks, Jul'21)**

Ans. (Answer has been changed as per latest amendment and information. This is the latest answer. Follow this)

(a) No, it is not mandatory for Z to withdraw her nomination in the said OPC even if she is leaving India permanently as only a natural person who is an Indian citizen can be a member and nominee in the OPC whether or nor resident in India.

(b) Yes, Z can continue her nomination in the said OPC, irrespective of the fact that she maintaines the status of Resident of India after her marriage.

53. Explain the classification of the companies on the basis of control as per the Companies Act, 2013. **(PYQ 6 Marks, Jul'21)**

Ans. **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

1. 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;
2. the expression "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.

The term "Total Share Capital", means the aggregate of the:

(a) Paid-up equity share capital; and

(b) Convertible preference share capital.

Capital? **(PYQ 3 Marks, Jul'21)**

Ans. Difference between Guarantee Company [Section 2(21) of the Companies Act, 2013] and a Company having share capital [Section 2(22)].

In case of guarantee company, the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; whereas in the case of company having share capital, members may be called upon to discharge their liability at any time, either during the company's life -time or during its winding up.

It is clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be held from other sources like endowment, fees, charges, donations, etc.

In Narendra Kumar Agarwal vs. Saroj Maloo, the Supreme Court has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

55. The persons (not being members) dealing with the company are always protected by the doctrine of indoor management. Explain. Also, explain when doctrine of Constructive Notice will apply. **(MTP 6 Marks, Mar 21)**

Ans. **Doctrine of Indoor Management:**

According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management is opposite to the doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a safeguard against the possibility of abusing the doctrine of constructive notice.

Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

(a) Knowledge of irregularity: In case an 'outsider has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.

(b) Negligence: If, with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.

to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

56. Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? **(MTP 6 Marks, Nov'21)**

Ans. **Doctrine of ultra vires:** The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

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, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company.

Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

57. Manicar Limited has allotted equity shares with voting rights to Nanicar Limited worth & 10 Crores and issued Non-Convertible Debentures worth ₹30 Crores during the Financial Year 2017-18. After that total Paid-up Equity Share Capital of the company is ₹100 Crores and Non-Convertible Debentures stands at ₹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 3 Marks, Nov'21) (RTP May'21)**

Ans. As per Section 2(6) of the Companies Act, 2013, an Associate Company in relation to another company, means a company in which that other company has a significant influence, but

joint venture company. The term "significant influence" means control of at least 20% of total share capital, or control of business decisions under an agreement.

The term "Total Share Capital", means the aggregate of the:

(a) Paid-up equity share capital; and

(b) Convertible preference share capital.

In the given case, as Manifer Ltd. has allotted equity shares with voting rights to Nanicar Limited of ₹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.

07

CHAPTER

The Negotiable Instruments Act, 1881

TABLE OF CONTENT FOR THE CHAPTER

- INTRODUCTION 7.1
- MEANING OF NEGOTIABLE INSTRUMENTS 7.2
- PROMISSORY NOTE 7.3
- BILLS OF EXCHANGE 7.5
- CHEQUE [SECTION 6] 7.7
- NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS 7.12
- DISHONOUR OF CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS [SECTION 138 TO 142] 7.14
- PRESENTMENT OF INSTRUMENTS 7.16
- RULES OF COMPENSATION 7.17
- *"PROBLEM KYA HAI?"* 7.17

Chapter covers following headings

Notes, Bills & Cheques-Types, Classification and its characterstics	Modes of Negotiation	Presentment of Instruments	Rules of Compensation

INTRODUCTION

1. The main objective of the Act is to:
   - legalise the system by which instruments could pass from hand to hand by negotiation
   - like any other goods.
2. The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881.
3. This is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques.
4. The Act applies to the whole of India, but nothing herein contained affects the Reserve Bank of India Act, 1934, (section 21 which provides the Bank to have the right to transact Government business in India), or affects any local usage relating to any instrument in an oriental language.

contrary.

6. Other native instruments like Treasury Bills, Bearer Debentures, Railway Receipts, Delivery Orders, Bill of Lading etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

The significant amendments made in the Negotiable Instruments Act, 1881 (N.I. Act):

- The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002;
- The Negotiable Instruments (Amendment) Act, 2015; and
- The Negotiable Instruments (Amendment) Act, 2018.

MEANING OF NEGOTIABLE INSTRUMENTS

- Negotiable Instruments is an instrument (Instrument = document)
  which is freely transferable (by customs of trade)
  from one person to another
  by -
  - mere delivery or
  - by indorsement and delivery.
- Property in such an instrument → pass 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.

Order

1. **A negotiable instrument is payable to order when:**
   (a) It is expressed to be so payable
   (b) When it is expressed to be payable to a specified person and does not contain words prohibiting its transfer. (i.e. it is transferrable by indorsement and delivery)

Bearer

2. **A negotiable instrument is payable to bearer when:**
   (a) When it is expressed to be so payable e.g. pay bearer.
   (b) When the only or last indorsement on the instrument is an indorsement in blank i.e., the person who possesses it can demand payment.

   Indorsement = signing of the instrument

   For example,. A cheque made payable to specified person and that cheque is endorsed by signing on the back of the cheque by that specified person

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.

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.

Writing	Signed	Freely TRF	Till Satisfaction	Promise or Order to Pay	रोकड़ा ONLY	Certain व्यक्ति रोकड़ा समय	Delivery

PROMISSORY NOTE

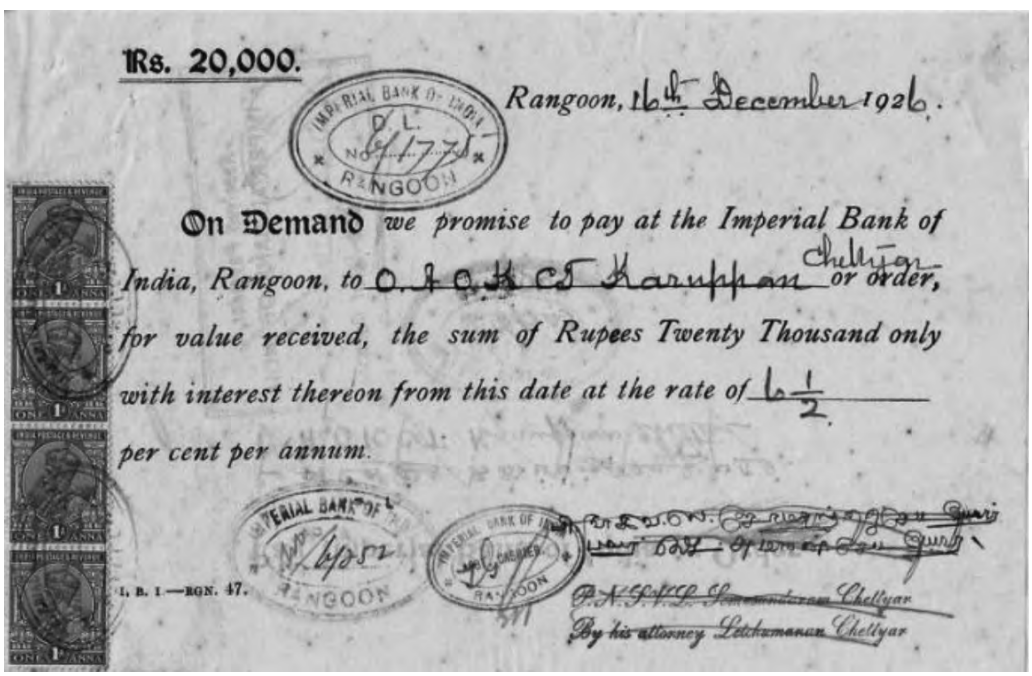
Meaning

- Section 4 of the NI Act, 1881,
- A 'promissory note' is an instrument in writing

Bank-note or a currency-note ≠ PN

- 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.

Specimen of Promissory Note


Rs. 20,000.

Rangoon, 16th December 1926.

On Demand we promise to pay at the Imperial Bank of India, Rangoon, to O. A. O. K. CT. Karuppan Chettyar or order, for value received, the sum of Rupees Twenty Thousand only with interest thereon from this date at the rate of 6 1/2 per cent per annum.

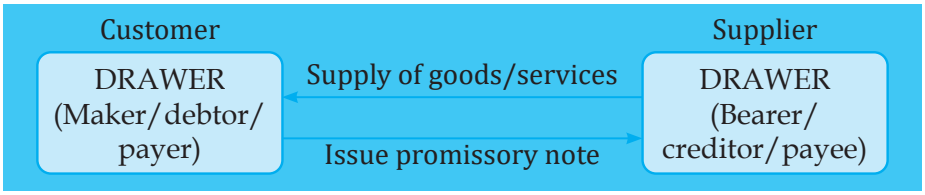
I. B. I.—RGN. 47.

1. **Maker:** The person who makes the promise to pay is called the Maker. He is the debtor and must sign the instrument.
2. **Payee:** Payee is the person to whom the amount on the note is payable.

Maker (Drawer) → Drawee

Payer → Payee

Debtor → Creditor



Essential Characteristics of a Promissory Note

1. In writing- An oral promise to pay is not sufficient.
2. There must be an express promise to pay.

   Mere acknowledgment of debt is insufficient ★

   I.O.U - ₹10,000 - ✗ PN ✗

   As NO promise only Acknowledgement

   Example 1: I acknowledge myself to be indebted to B in ₹1,000, to be paid on demand, for value received. (Valid promissory note as the promise to pay is definite)
3. **No ifs and Buts:** The promise to pay should be definite and unconditional.
   - Therefore, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event, are not promissory notes.
   - However, the promise to pay may be subject to a condition, which according to the ordinary experience of mankind, is bound to happen. ★

   Example 2: I promise to pay B ₹500 seven days after my marriage with C. (the promissory note is invalid as marriage with C may or may not happen.)

   Example 3: I promise to pay B500 on D's death- as the death of D is certain, promise is unconditional. Thus, the promissory note is valid.

   Example 4: I promise to pay B ₹500 on D's death, provided D leaves me enough to pay that sum. Invalid promissory note as promise is dependent on D's leaving behind money which is not certain.
4. A promissory note must be signed by the maker otherwise it is incomplete and ineffective.
5. Promise to pay money only. ★

   गाड़ी ✗ रोकड़ा ✓

   घोड़ा ✗ रोकड़ा ✓

   बंगला ✗ रोकड़ा ✓
6. Promise to pay a certain sum. कुछ दूँगा ✗ बताओ कितना ✓

   Example 5: "I promise to pay B ₹500 and all other sums which shall be due to him". - Promissory note invalid as the amount payable is not certain.

easily ascertained. In such cases, the promissory note will be valid. ★

Example 6: "I promise to pay B ₹500 alongwith simple interest at the rate of 12% per annum.

7. The maker and payee must be certain, definite and different persons

   दो जिस्म एक जान ×.

   ★ A promissory note cannot be made payable to the bearer [Section 31 of the Bank of India Act, 1934 (RBI Act)].

   Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.

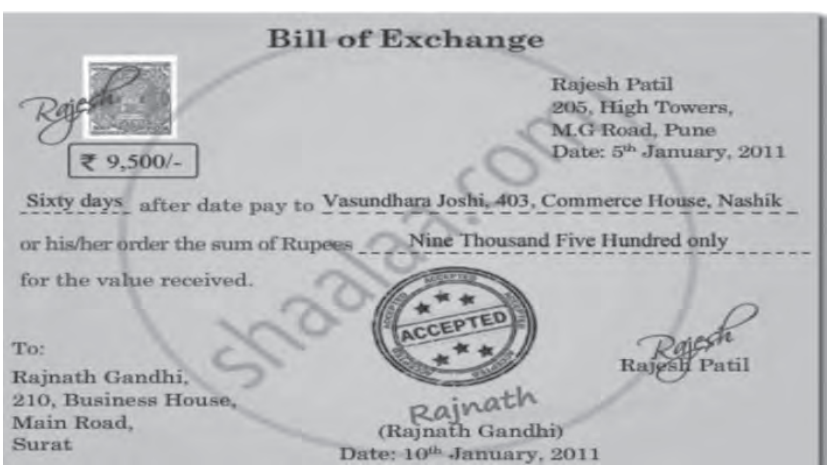
8. **Stamping:** A promissory note must be properly stamped in accordance with the provisions of the Indian Stamp Act and such stamp must be duly cancelled by maker's signatures or initials on such stamp or otherwise

BILLS OF EXCHANGE

A "Bill of Exchange" is an Instrument in Writing

1. containing an unconditional order,
2. signed by the maker,
3. directing a certain person हुक्म
4. to pay a certain sum of money
5. only to, or to the order of, a certain person or to the bearer of the instrument.

Specimen of Bill of Exchange



1. **Drawer:** The maker of a bill of exchange.
2. **Drawee:** The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill, he is called an acceptor and is liable for the payment of the bill. His liability is primary and unconditional.
3. **Payee:** The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid.

Essential Characteristics of Bill of Exchange

1. It must be in writing.
2. Must contain an express order to pay.
3. The order to pay must be definite and unconditional.
4. The drawer must sign the instrument.
5. Drawer, drawee, and payee must be certain.
   - All these three parties may not necessarily be three different persons.
   - One can play the role of two.
   - But there must be two distinct persons in any case.
   - As per Section 31 of RBI Act, 1934, a bill of exchange cannot be made payable to bearer on demand.

     Example 7: *"On demand pay to the bearer the sum of rupees five hundred, for value received". It is invalid BOE.*

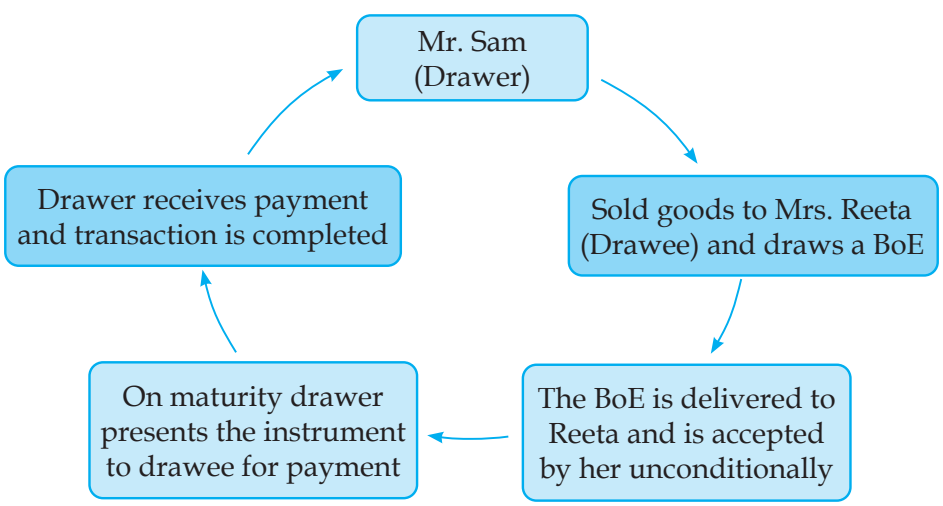
   - However, a bill of exchange payable on demand, in which name of the payee is mentioned, is valid.

   On Demand ✓ if payee name is mentioned

   To Bearer + On Demand × No - Not possible

   Example 8: *"On demand pay to A or order the sum of rupees five hundred for value received". It is valid BOE.*
6. The sum must be certain.
7. The order must be to pay money only.
8. It must be stamped.

Process of Bill of Exchange



- firstly the seller sold goods to the buyer/customer and then draws a bill of exchange on him.
- The Bill of exchange is delivered by the buyer who accepts it without any condition.
- On maturity of bill of exchange, the buyer will pay the amount due to the payee. (The payee may be the drawer himself or a third party.)

Difference between Promissory Note and Bill of Exchange

Definitely जो	Nature है तुम्हारा	Party करने का	वो Accept कर लो	वरना bear नहीं कर पाओगे

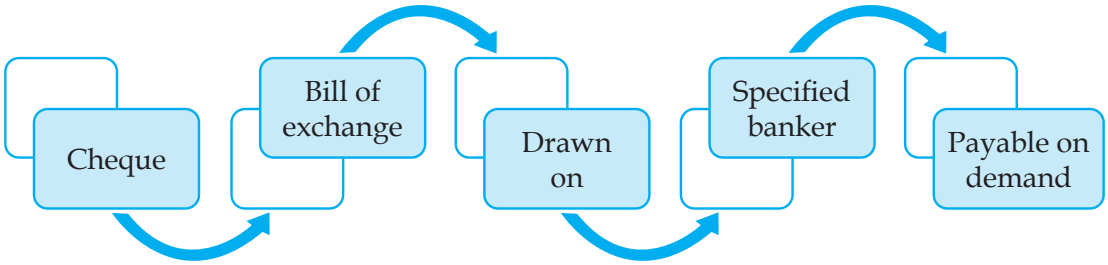
Sr. No.	Basis	Promissory Note	Bill of Exchange
1.	**Definition**	"A Promissory Note" is an instrument in writing (not beinq a banknote or a currency-note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.	"A bill of exchanqe" is an instrument in writing containing an unconditional order, siqned by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.
2.	**Nature of Instrument**	In a promissory note, there is a promise to pay money.	In a bill of exchanqe, there is an order for making payment.
3.	**Parties**	In a promissory note, there are only 2 parties namely: i. the maker and ii. the payee	In a bill of exchange, there are 3 parties which are as under i. the drawer ii. the drawee iii. the payee
4.	**Acceptance**	A promissory note does not require any acceptance, as it is siqned by the person who is liable to pay.	A bills of exchanqe needs acceptance from the drawee.
5.	**Payable to bearer**	A promissory note cannot be made payable to bearer.	On the other hand, a bill of exchange can be drawn payable to bearer. However, it cannot be payable to bearer on demand.

CHEQUE [SECTION 6]

- Cheque = BOE
- drawn on a specified banker and
  (Drawee = Fixed = Banker) ★
- not expressed to be payable otherwise than on demand and
  (Payable = Fixed = Demand)

- the electronic image of a truncated cheque and
- a cheque in the electronic form.

- ★ Payable on demand means:



- It should be payable whenever the holder chooses to present it to the drawee (the banker).
- **Explanation I:** For the purposes of this section, the expressions:
  - **(a)** Cheque in the electronic form-means a cheque drawn in electronic form by using any computer resource, and signed in a secure system with a digital signature (with/without biometric signature) and asymmetric crypto system or electronic signature, as the case may be;
  - **(b)** "a truncated cheque" means a cheque which is truncated during a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

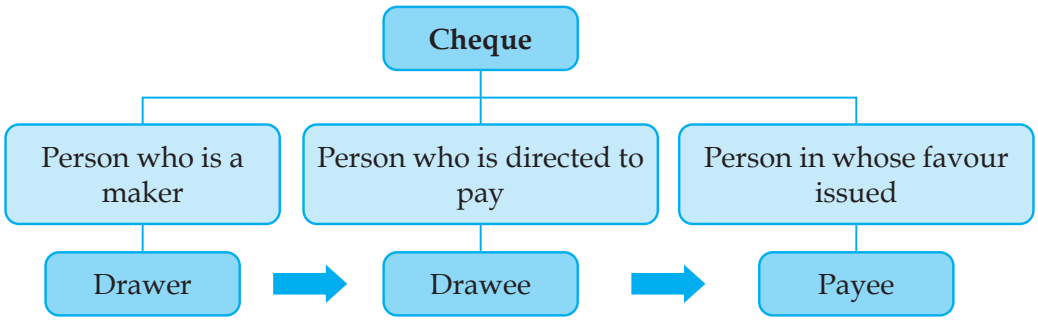
Physically बना था	B1 Image	Clearing house	B2 Image

- **Explanation II:** For the purposes of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India. A combined reading of sections 5 and 6 tells us that a bill of exchange is a negotiable instrument in writing containing an instruction to a third party to pay a stated sum of money at a designated future date or on demand. Whereas a cheque is also a bill of exchange but is drawn on a banker and payable on demand.

Specimen of Cheque

1. **Drawer:** The person who draws a cheque i.e., makes the cheque (Debtor). His liability is primary and conditional.
2. **Drawee:** The specific bank on whom cheque is drawn. He makes the payment of the cheque. In case of cheque, drawee is always banker. "drawee in case of need" — When in the bill or in any indorsement thereon, the name of any person is given in addition to the drawee to be resorted to in case of need such person is called a "drawee in case of need".
3. **Payee:** The person named in the instrument (i.e., the person in whose favour cheque is issued), to whom or to whose order the money is to be paid, is called the payee.

★ 2 cases - Payee = Drawer and III Party.



Essential Characteristics of a Cheque

According to the definition of cheque under section 6, a cheque is a species of bill of exchange. Thus, it should fulfil:

1. all the essential characteristics of a bill of exchange
2. Must be drawn on a specified banker.
3. It must be payable on demand.

Note: These two additional features distinguish a cheque from bill. Thus, all cheques are bills while all bills are not cheques.

"Bearer Instrument" and "Order Instrument" [Section 13]

Bearer Instrument:

- It is an instrument where the name of the payee
  - Is **blank** or
  - Is specified with the words **"or bearer"** or
  - where the **last indorsement is blank**.

Bearer = By mere Delivery

Order Instrument:

- It is an instrument which is payable to a person or
- Payable to a person or his order or
- Payable to order of a person or
- where **the last indorsement is in full**

Order = By Indorsement + Delivery

"Inland Instrument" and "Foreign Instrument" [Sections 11 & 12]★

"Inland instrument":

- A promissory note, bill of exchange or cheque

And

Made payable in or drawn upon any person resident in India

Satisfy both the conditions

Example 9:

I. *A promissory note made in Kolkata and payable in Mumbai.*

II. *A bill drawn in Varanasi on a person resident in Jodhpur (although it is stated to be payable in Singapore).*

III. *A, a resident of Agra, drew (i.e., made) a bill of exchange in Agra on B, a merchant in New York. And B accepted the bill of exchange as payable in Delhi. It is an inland bill of exchange. In this case, the bill of exchange was drawn in India and also payable in India.*

IV. *A, resident of Mumbai, drew a bill of exchange in Mumbai on B, a merchant in Mathura. And B accepted the bill of exchange as payable in London. It is also an inland bill of exchange. In this case, the bill of exchange was drawn in India on a person resident in India. It is immaterial that the amount is payable in London. An inland instrument remains inland even if it has been endorsed in a foreign country.*

V. *If the bills of exchange mentioned in above two examples, are endorsed in France, they will remain inland bills.*

"Foreign instrument":

जो Inland नहीं है

First check to satisfy both the conditions of the Inland. If not then come here.

A foreign instrument is one which is not an inland instrument. In other words, can be understood as follows:

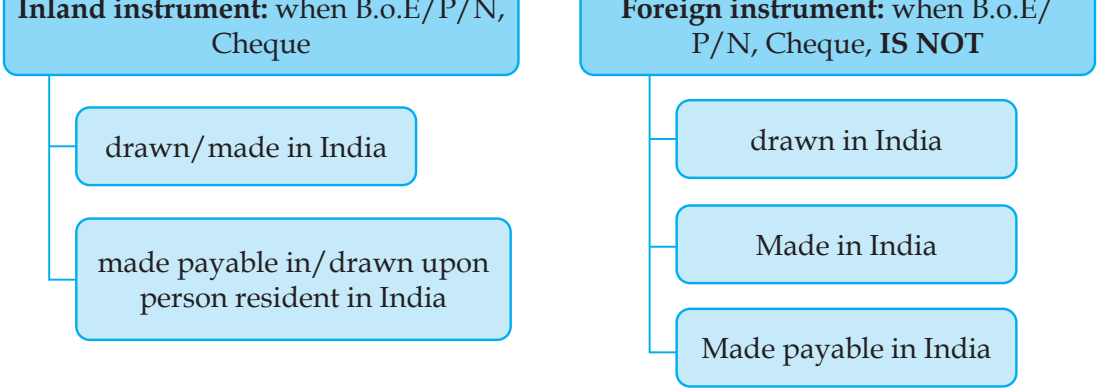
Place where bill is drawn	Residence of Person on whom drawn and place where made payable	Nature of Instrument
P/N, BOE, C drawn/made outside India	on a person resident in or outside India + made payable in India	are foreiqn bills.
	on a person residinq outside India + payable outside India	
	on a person residing in India + payable outside India	

Liability of Maker/Drawer of Foreign Bill

In the absence of a contract to the country, the liability of the maker or drawer of a foreign promissory note or bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the respective liabilities of the acceptor and indorser by the law of the place where the instrument is made payable (Section 134)

Liability of Maker or Drawer	जहां बना वहाँ का law ऑफ़ the land	Liability of Acceptor or Indorser	जहां payable है वहाँ का law ऑफ़ the land

Example 10: A bill of exchange is drawn by A in Berkley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%. The bill is indorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 15%.



Before we understand the next concept, let's understand Holder and Holder in Due Course - ★

- **Holder - Legally entitled to:**
  - Have possession of NI
  - Receive and recover the amount stated in the NI
- **Holder in due course (HDC):**
  - Holder
  - Consideration
  - Before Maturity
  - In Good faith

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 a 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.

अधूरा Incomplete/Signed but left incomplete/Power with holder/Max Stamp

- The principle of this rule of an inchoate instrument is based on the principle of estoppel means The principle of estoppel is based on the idea that if someone (A) causes another person (B) to act on the basis of a particular state of affairs, then A cannot go back on their words or actions that led B to act in that way. (जो वादा किया वो निभाना पड़ेगा)

Liability on drawing inchoate instrument:

The person signing and delivering the inchoate instrument is liable both to a holder and holder in due course. However, there is a difference in their respective rights:

- The holder of such an instrument cannot recover the amount in excess of the amount intended to be paid by the signor.
- The holder in due course can, however, recover any amount on such instrument provided it is covered by the stamp affixed on the instrument.

Holder	Only till intended amount	HDC	Till Stamp Value

wholly blank or having written "incomplete", he thereby gives prima facie authority to the holder thereof to make or complete, for any amount specified therein and not exceeding the amount covered by the stamp.

- **The person so signing shall be liable upon such instrument, in the capacity in which he signed the same,** to any HDC for such amount.
- Provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder".

Signed and Delivered	Stamped	Wholly blank or Incomplete	Authority to holder to complete

Example 11: **NO delivery = No liability (refer delivery topic for the same)**

A person signed a blank acceptance on a bill of exchange and kept it in his drawer.

The bill was stolen by X and he filled it up for ₹20,000 and negotiated it to an innocent person for value.

It was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument.

Further, as a condition of liability, the signer as a maker, drawer, indorser or acceptor must deliver the instrument to another. In the absence of delivery, the signer is not liable.

Furthermore, the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.

Ambiguous Instrument:

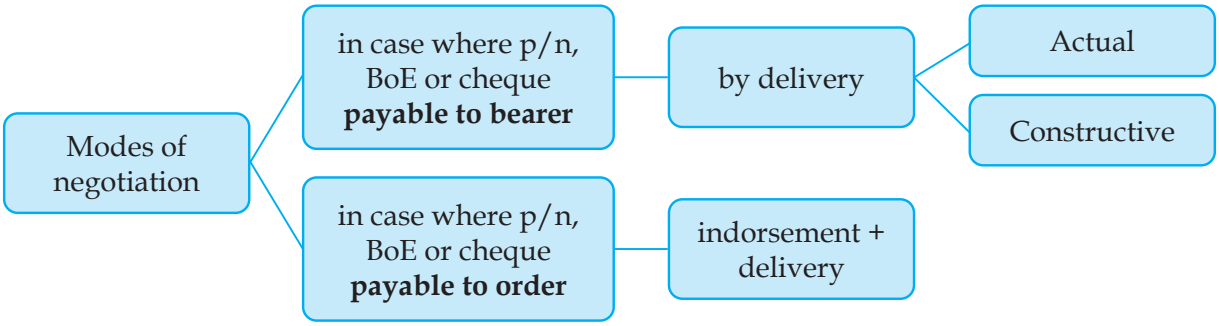
अस्पष्ट - Vague/Not clear

Why? because NI has the properties of both - PN & BOE

- Section 17:
  - 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 promissory note, or as a bill of exchange.
- After exercising his option, the holder cannot change that it is the other kind of instrument.

NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

- One of the essential characteristics of a negotiable instrument is that it is **freely transferable** from one person to another.
- The rights in a negotiable instrument can be transferred from one person to another by negotiation.
- According to Section 14 of the N.I. Act, when a negotiable instrument is transferred to any person with a view to **constitute the person holder** thereof, the instrument is deemed to have been negotiated. Thus, there is a transfer of ownership of the instrument.
- Negotiable instruments may be negotiated either by delivery when these are payable to bearer or by indorsement and delivery when these are payable to order.



I. A promissory note, bill of exchange or cheque payable to bearer is negotiable by the delivery thereof.

II. A promissory note, bill of exchange or cheque payable to order is negotiable by the holder by indorsement and delivery thereof.

Example 12: X drew a cheque for ₹50,000 payable to Y and delivered it to him. Y indorsed the cheque in favour of Z but kept it in his table drawer. Subsequently, Y died, and cheque was found by Z in Y's table drawer. In this case, Z does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him.

Negotiation by Delivery [Section 47] - Payable to Bearer

Subject to the provisions of section 58 [Instrument obtained by unlawful means or for unlawful consideration], a promissory note, bill of exchange or cheque **payable to bearer** is negotiable by **delivery thereof**.

Exception: Condition based NI:

- A promissory note, bill of exchange or cheque delivered on condition that it will take effect if a certain event take place.
- It is not negotiable unless such event happens.
- Except in the hands of a holder for value without notice of the condition = HDC

Example 13: **Actual and Constructive delivery**

1. A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.
2. A, the holder of a negotiable instrument payable to bearer, which is in the hands of A's banker, who is at the time the banker of B, directs the banker to transfer the instrument to B's credit in the banker's account with B. The banker does so, and accordingly now possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

Negotiation by Indorsement [Section 48] - Payable to Order

Subject to the provisions of section 58, a promissory note, bill of exchange or cheque **payable to order**, is negotiable by the holder by **indorsement and delivery** thereof.

Importance of Delivery in Negotiation [Section 46]

- Delivery of an instrument is essential whether the instrument is payable to bearer or order for effecting the negotiation.
- The delivery must be **voluntary**, and the **object** of delivery should be **to pass the property** in the instrument to the person to whom it is delivered.

- Actual delivery =

  Takes place when the instrument changes hand physically.
- ★Constructive delivery =

  Takes place when the instrument is delivered to the agent, clerk or servant of the indorsee on his behalf or when the indorser, after indorsement, holds the instrument as an agent of the indorsee.

Section 46 also lays down that when an instrument is conditionally or for a special purpose only, the property in it does not pass to the transferee, even though it is indorsed to him, unless the instrument is negotiated to a holder in due course.

The contract on a negotiable instrument until delivery remains incomplete and revocable.

★The delivery is essential not only -

- At the time of **negotiation** but also
- At the time of **making or drawing** of negotiable instrument.

★The rights in the instrument are not transferred to the indorsee unless **after the indorsement the same has been delivered**.

If a person makes the indorsement of instrument but before the same could be delivered to the indorsee the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof. (Section 57)

Explanation: According to section 57,

- 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.
- A legal representative is not an agent of the deceased.
- 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.

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

DISHONOR OR BOUNCING OF CHEQUE - SECTION 138

Where any cheque drawn by a person on an account maintained by him with a banker:

- for payment of any amount of money
- to another person from that account
- for the discharge, in whole or in part, of any debt or other liability,

  A cheque given as - ★

GIFT	DONATION	SECURITY	MORAL OBLIGATION	ILLEGAL

  would be outside the purview of this section
- is returned by the bank unpaid,
- either because of the—

  (a) amount of money standing to the credit of that account is insufficient to honor the cheque, or

  (b) that it exceeds the amount arranged to be paid from that account by an agreement made with that bank,

with - **Penalty** -

Imprisonment for a term = May extend to Two years, or
With fine = May extend to twice the amount of the cheque, or
Both.

When section 138 shall be not apply:

Unless the below given conditions are complied with—

1. Cheque presented within validity period - 3 months from the date on which it is drawn or within the period of its validity, whichever is earlier.
2. Demand Notice -
   (i) For the payment by the payee or the holder in due course of the cheque for,
   (ii) the said amount of money by giving a notice, in writing,
   (iii) to the drawer of the cheque,
   (iv) **within 30 days** of the receipt of information by him,
   (v) from the bank regarding the return of the cheque as unpaid, and
3. Failure of drawer to make payment:
   (i) The drawer of such cheque fails to make the payment to the payee or the holder in due course of the cheque,
   (ii) **Within fifteen days** of the receipt of the said notice.

To conclude - Compliant can be filed -

After 45 days of dishonor of the cheque =

30 days of notice period + 15 days of the receipt of the said notice.

Example 14: X issued a post-dated cheque to Y on the account of discharge of its liability.
Further, X instructed to the bank to stop the payment due to unavailability of the adequate amount in the account.
Here, in this instance section 138 of the Act is attracted as when a cheque is dishonoured on account of stop payment instructions sent by the drawer to his banker in respect of a post-dated cheque irrespective of insufficiency of funds in the account.
A post-dated cheque is deemed to have been drawn on the date it bears and the three months period for the purposes of section 138 is to be counted from that date.
So, X will be liable for dishonour of cheque. Once a cheque is issued by the drawer, a presumption under section 139 must follow.

Presumption in Favor of Holder [Section 139]

When a cheque is dishonoured, it shall be presumed, unless the contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, or any debt or other liability.

Presumption prescribed here is a

"rebuttable presumption" CAN BE CHALLENGED IN THE COURT

as the provisions clearly provides that the person issuing the cheque is at liberty to prove to the contrary. The effect of this presumption is to place the evidential burden on the accused.

It shall not be a defence in a prosecution of 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

PRESENTMENT OF INSTRUMENTS

Presentment for Acceptance

Some basics:

- *Acceptance required only for BOE not for PN and Cheque.* **[Section 61] BOE**
- *In default of such presentment, no party thereto is liable thereon to the person making such default.*
- *If the drawee cannot, after reasonable search, be found, the bill is dishonoured.*
- *If not mentioned anything about time and place its always REASONABLE time at Business hours on a business day & Place of Business*
- *The holder must allow the drawee 48 hours (exclusive of public holidays) to consider whether he will accept it.* **[Section 63]**
- If the bill is directed to the drawee at a particular place = It must be presented at that place
- A presentment through the post office by means of a registered letter is sufficient.
- Must be presented to the MAKER. **[Section 62] PN**

Presentment for Payment [Section 64]

Promissory notes → Maker

bill of exchange → Acceptor

cheques → Drawee

- If TIME instrument = At Maturity **(Section 66)**
- If DEMAND instrument = Reasonable
- Hours = Usual hours of business & Banker's within banking hours. **(Section 65)**
- A PN payable by instalments = Must be on the 3rd day after the date fixed for payment of each instalment **(Section 67)**
- **Exception:** 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.
- Payable at a specified place then be presented for payment at that place. **(Section 68 & 69)**
- If no exclusive place then at the place of business (if any) or at the usual residence **(Section 70)**
- When maker, etc., has no known place of business or residence then such presentment may be made to him in person wherever he can be found **(Section 71)**
- For acceptance or payment present to - **(Section 75)**
  - Agent
  - In case of death - Legal Representative
  - In case of insolvent - Assignee
- **Excuse:** Okay if delay is caused by circumstances beyond the control of the holder, and not because of his default, misconduct or negligence. **(Section 75A)**

No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:

A. If the maker, drawee or acceptor **intentionally prevents** the presentment of the instrument, or
   - Place of business = Closes such place on a business day during the usual business hours, or
   - Some other specified place, neither he nor any person authorised to pay it attends at such place during the usual business hours, or
   - He cannot after due search be found.

B. He has engaged some other party to pay.

C. He himself makes a part payment or or promises to pay the amount due thereon in whole or in part.

D. Waives his right to take advantage of any default in presentment for payment.

E. As against the drawer, if the drawer could not suffer damage from the want of such presentment.

Liability of Banker for Negligently Dealing with Bill Presented for Payment (Section 77)

When a bill of exchange, accepted payable at a specified bank, has been duly presented there for payment and dishonoured, if the banker so negligently or improperly keeps, deals with or delivers back such bill as to cause loss to the holder, he must compensate the holder for such loss.

RULES OF COMPENSATION

Rules as to Compensation (Section 117)

The compensation 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:

1. Expenses properly incurred in **presenting, noting and protesting it**.
2. If resides at a place different then entitled to receive such sum at the **current rate of exchange** between the two places.
3. With interest at **18% per annum** from the date of payment until payment.

"PROBLEM KYA HAI?"

QUESTION BANK FOR THE CHAPTER

Compiled by - CA Chaitanya Jain

This section is complied with questions and suggested answers for the chapter - The NIA, 1881

- ICAI Study Material
- Previous year Question Papers (PYQs)
- Mock Test Papers (MTPs)
- Revision Test Papers (RTPs)

MODULE QUESTIONS

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

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

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

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

So, the claim of N to have the other half of the P/N sent to him is not maintainable.

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

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

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

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

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

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

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

4. Rama executes a promissory note in the following form, 'I promise to pay a sum of 7,10,000 after three months'. Decide whether the promissory note is a valid promissory note.

Ans. 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.

Negotiable Instruments Act, 1881:

(i) X who obtains a cheque drawn by Y by way of gift.

(ii) A, the payee of the cheque, who is prohibited by a court order from receivingthe amount of the cheque.

(iii) M, who finds a cheque payable to bearer, on the road and retains it.

(iv) B, the agent of C, is entrusted with an instrument without indorsement by C, who is the payee.

(v) B, who steals a blank cheque of A and forges A's signature.

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

To the ace provision in the given cases—

(i) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.

(ii) No, he is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.

(iii) No, M is not a holder of the Instrument though he is in possession of the cheque, so is not entitled to the possession of it in his own name.

(iv) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.

(v) No, B is not a holder because he is in wrongful possession of the instrument.

6. State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2020.

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

When a bill is made payable at stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance. When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens (Section 23).

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

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23). In calculating the date a bill made payable a certain number of days after date rafter sight or after a certain event is at maturity,

for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

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

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 4th May, 2020. The period of 100 days ends on 12th August, 2020 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2020 which happens to be a public holiday. As such it will fall due on 14th August, 2020 i.e. the next preceding business day.

7. Mr. Muralidharan drew a cheque payable to Mr. Vyas or order. Mr. Vyas lost the cheque and was not aware of the loss of the cheque. The person who found the cheque forged the signature of Mr. Vyas and indorsed it to Mr. Parshwanath as the consideration for goods bought by him from Mr. Parshwanath.

Mr. Parshwanath encashed the cheque, on the very same day from the drawee bank. Mr. Vyas intimated the drawee bank about the theft of the cheque after three days. Examine the liability of the drawee bank.

Ans. **Cheque payable to order [Section 85 of the Negotiable Instruments Act, 1881]**

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

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

Even though the signature of Mr. Vyas is forged, the banker is protected and is discharged. The true owner, Mr. Vyas, cannot recover the money from the drawee bank in this situation.

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

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

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

(a) When a bill is duly presented for acceptance, and the drawee, or one ofseveral drawees not being partners, refuse acceptance within forty eight hours from the time of presentment, the bill is dishonoured. In other words, when the drawee makes default in acceptance upon being duly required to accept the bill.

(b) Where presentment is excused and the bill is not accepted.

(c) Where the drawee is incompetent to contract, the bill may be treated as dishonoured.

(e) Where the drawee could not be found even after reasonable search

(f) When a drawee gives a qualified acceptance, the holder may treat the instrument dishonoured.

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

MTPs, RTPs AND PYQPs QUESTIONS

1. Sachin bought 1000 Kg rice from Saurabh for ₹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 Jun'24)**

Ans. 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.

2. 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 Jun'24)**

Ans. 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

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.

3. On a Bill of Exchange for ₹1 lakh, X's acceptance to the Bill is forged. A takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether 'A' can be considered as a 'Holder in due course' and whether he (A) can receive the amount of the Bill from 'X. **(MTP Mar 19, 4 Marks, 3 Marks Oct 20, & March '23)**

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

But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue on tort the person who had received. This principle is universal in character, by reason where of even a holder in due course is not exempt from it. A holder in due course is protected when there is defect in the title. But he derives no title when there is entire absence of title as in the case of forgery. Hence 'A' cannot receive the amount on the bill.

4. Manoj owes money to Umesh. Therefore, he makes a promissory note for the amount in favour of Umesh, for safety of transmission he cuts the note in half and posts one half to Umesh. He then changes his mind and calls upon Umesh to return the half of the note which he had sent. Umesh requires Manoj to send the other half of the promissory note. Decide how rights of the parties are to be adjusted. Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881. **(MTP Mar'21 4 Marks, May'20, March'19,3 Marks)**

Ans. The question arising in this problem is whether the making of promissory note is complete when one half of the note was delivered to Umesh. Under Section 46 of the Negotiable Instruments Act, 1881, the making of a promissory note is completed by delivery, actual or constructive. Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole. So, the claim of Umesh to have the other half of the promissory note sent to him is not maintainable. Manoj is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the promissory note.

5. Mr. Manoj Malik, a major and Preet, a minor executed a promissory note in favour of Rimpy. Examine with reference to the provisions of the Negotiable Instruments Act, 1881, the validity of the promissory note and whether it is binding on Mr. Manoj Malik and Preet.
(MTP 3 Marks March 21)

Ans. According to Section 26 of the Negotiable Instruments Act, 1881, every person competent to contract (according to the law to which he is subject to) has capacity to bind himself and be bound by making, drawing, accepting, endorsing delivering and negotiating an instrument. A party having such capacity may himself put his signature or authorize some other person to do so.

except himself. A minor may be a drawer where the instrument is drawn or endorsed by him. In that case he does not incur any liability himself although other parties to the instrument can be made liable and the holder can receive payment from any other party thereto.

Therefore, in the instant case, the promissory note is valid and it is binding on Mr. Manoj Malik but not on Preet, a minor.

6. What is the meaning of Not negotiable crossing as per the Negotiable Instruments Act, 1881?

(MTP 3 Marks March 21)

Ans. **Not negotiable Crossing**

This requires writing of words "not negotiable" in addition to the two parallel lines. These words may be written inside or outside these lines. According to Section 130, a person taking a cheque crossed generally or specially, bearing in either case the word "not negotiable" shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it. It is a statutory crossing. A cheque with such crossing is not negotiable, but continues to be transferable as before. Ordinarily, in a negotiable instrument, if the title of the transferor is defective, the transferee, if he is a Holder in Due Course, will have a good title. When the words "not negotiable" are written, even a Holder in Due Course will get the same title as that of transferor. Thus, if the title of the transferor is defective, the title of transferee will also be so.

Hence, the addition of the words not negotiable does not restrict the further transferability of the cheque, but it entirely takes away the main feature of negotiability, which is that a holder with a defective title can give a good title to the subsequent holder in due course.

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

(i) Whether D can sue the prior parties of the bill, and

(ii) Whether the prior parties other than D have any right of action inter se?

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

(MTP 3 Marks April 21)

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

(i) In the problem, as asked in the question, A has drawn a bill on B and B accepted the bill without consideration and transferred it to C without consideration. Later on, in the next transfer by C to D is for value. According to provisions of the aforesaid section 43, the bill ultimately has been transferred to D with consideration. Therefore, D can sue any of the parties i.e. A, B or C, as D arrived a good title on it being taken with consideration.

(ii) As regards to the second part of the problem, the prior parties before D i.e., A, B and C have no right of action inter se because first part of Section 43 clearly lays down that a negotiable instrument, made, drawn, accepted, indorsed or transferred without

between the parties to the transaction prior to the parties who receive it on consideration.

8. As per the Negotiable Instruments Act, 1881, what are the parties who may cross a cheque? **(MTP 3 Marks Apr'21)**

Ans. A cheque may be crossed by the following parties:

- **By Drawer:** A drawer may cross it generally or specially.
- **By Holder:** A holder may cross an uncrossed cheque generally or specially. If the cheque is crossed generally, the holder may cross specially. If cheque crossed generally or specially, he may add words "not negotiable".
- **By Banker:** A banker may cross an uncrossed cheque, or if a cheque is crossed generally he may cross it specially to himself. Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker, his agent; for collection.

9. Give the answer of the following:

(i) A promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. Does this amount to material alteration?

(ii) Amit draws a cheque for ₹1000 and hands it over to Beena by way of gift. Is Beena a holder in due course? **(MTP 4 Marks April 21)**

Ans.

(i) An alteration is material which in any way alters the operation of the instrument and affects the liability of parties thereto. Any alteration is material which alters the business effect of the instrument if used for any business purpose. In the given case, a promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. As per the provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence, adding the words "on demand" does not alter the business effect of the instrument.

(ii) The "holder" of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof, and to receive or recover the amount due thereon from the parties thereto. "Holder in due course" means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque (if payable to bearer), or the payee or indorsee thereof, (if payable to order), before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In the given question, Beena is a holder but not a holder in due course as she does not get the cheque for value and consideration. Her title is good and bonafide. As a holder she is entitled to receive ₹1000 from the bank on whom the cheque is drawn.

10. Rama executes a promissory note in the following form, 'I promise to pay a sum of 7,10,000 after three months'. Decide whether the promissory note is a valid promissory note. **(MTP 3 Marks Oct 21) (SM)**

Ans. 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

Bank of India Act, 1934 and cannot be legally enforced.

11. What are the essential characteristics of Negotiable Instruments. **(MTP 3 Marks Oct 21, Mar 22)**

Ans. 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.

12. Discuss with reasons, in the following given conditions, whether 'M' can be called as a "holder" under the Negotiable Instruments Act, 1881:

1. 'M' the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.
2. 'M' the agent of 'Q' is entrusted with an instrument without endorsement by 'Q' who is the payee. **(MTP 4 Marks Oct'21)**

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

On applying the above provision in the given cases:

1. 'M' is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.
2. No, 'M' is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.

13. What are the parties to a bill of exchange. **(MTP 3 Marks Nov 21)**

Ans. The parties to a bill of exchange are:

1. **Drawer:** The maker of a bill of exchange.
2. **Drawee:** The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill, he is called an acceptor and is liable for the payment of the bill. His liability is primary and unconditional.
3. **Payee:** The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid.

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

(a) Megha, who finds a cheque payable to bearer, on the road and retains it.

(b) Bob, who steals a blank cheque of Alpa and forges Alpa's signature.

(MTP 4 Marks Nov 21)

'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases:

(a) No, Megha is not a holder of the Instrument though she is in possession of the cheque, so is not entitled to the possession of it in his own name.

(b) No, Bob is not a holder because he is in wrongful possession of the instrument.

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

1. Madan was going to office through metro rail. He found a cheque payable to bearer, on the floor of coach number 6 and retains it.
2. Preeti, the agent of Mr. Rajesh, is entrusted with an instrument without indorsement by Mr. Rajesh, who is the payee. **(MTP 3 Marks March'22)**

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

On applying the above provision in the given cases:

1. In the given question, though Madan is in possession of the cheque but is not entitled to the possession of it in his own name (he got the cheque on the floor of metro coach). Hence, Madan is not a holder of the Instrument.
2. In the given question though the agent (i.e. Preeti) may receive payment of the amount mentioned in the cheque, yet she cannot be called the holder thereof because she has no right to sue on the instrument in her own name. Hence, Preeti is not a holder.

16. A bill of exchange is drawn by 'A' in Berkley where the rate of interest is 15% and accepted by 'B' payable in Washington where the rate of interest is 6%. The bill is indorsed in India and is dishonoured. An action on the bill is brought against 'B' in India. Advise as per the provisions of the Negotiable Instruments Act, 1881, what rate of interest 'B' is liable to pay?
(MTP 4 Marks March 22)

Ans. According to section 134 of the Negotiable Instruments Act, 1881, in the absence of a contract to the country, the liability of the maker or drawer of a foreign promissory note or bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the respective liabilities of the acceptor and indorser by the law of the place where the instrument is made payable.

In the given case, since action on the bill is brought against B in India, he is liable to pay interest at the rate of 6% only.

17. Mr. Mudit is the employee in Senior Research Analyst Private Limited. He went to a Super Mall, a departmental store, where he purchased some goods for his personal use on credit. Mr. Mudit gave a cheque drawn on the Senior Research Analyst Private Limited's account to Super Mall towards the full payment of the dues. The cheque was dishonoured by the company's bank. Mr. Mudit was neither a director nor a person in-charge of the company. Explain under the provisions of the Negotiable Instruments Act, 1881, whether Mr. Mudit has committed an offence under section 138. **(MTP 4 Marks April 22)**

by a person on an account maintained by him with a banker for payment of any amount of money to another person from/out of that account for discharging any debt or liability, and if it is dishonoured by banker on sufficient grounds, such person shall be deemed to have committed an offence and shall be liable.

According to section 141, if the person committing an offence under section 138 is a company, every person who, at the time the offence was committed was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

However, in this case, Mudit is neither a director nor a person-in-charge of the company and is not connected with the day-to-day affairs of the company and had neither opened nor is operating the bank account of the company. Further, the cheque, which was dishonoured, was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Therefore, Mudit has not committed an offence under section 138.

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

1. Babita finds a cheque payable to bearer, on the road and retains it.
2. Biswas, the agent of Chandan, is entrusted with an instrument without indorsement by Chandan, who is the payee. **(MTP 3 Marks April 22 & Sep'22)**

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

1. Babita is not a holder of the Instrument though she is in possession of the cheque. She is not entitled to the possession of it in her own name.
2. No, Biswas is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.

19. What is the meaning of 'Acceptor for honour' and 'payment for honour'? Give your answer in terms of the Negotiable Instruments Act, 1881. **(MTP 3 Marks Sep'22)**

Ans. When a bill of exchange has been dishonoured by non-acceptance and any person accepts it for honour of the drawer or of any indorsers, such person is called 'an Acceptor for honour'. The payment which he makes is known as 'payment for honour.

20. Mr. Krishna draws a cheque of ₹20,000 and gives to Mr. Balram by way of gift. State with reason whether

1. Mr. Balram is a holder in due course as per the Negotiable Instrument Act, 1881?
2. Mr. Balram is entitled to receive the amount of ₹20,000 from the bank?

(MTP 4 Marks Sep'22)(SM) (MTP 3 Marks Nov 21)

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

- any person
- who for consideration becomes the possessor of a promissory note, bill of exchange or cheque (if payable to bearer), or the payee or indorsee thereof, (if payable to order),

- without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In the instant case, Mr. Krishna draws a cheque of ₹20,000 and gives to Mr. Balram by way of gift. Hence,

1. Mr. Balram is holder but not a holder in due course since he did not get the cheque for value and consideration.
2. Mr. Balram's title is good and bonafide. As a holder he is entitled to receive ₹20,000 from the bank on whom the cheque is drawn.

21. Mr. Sridhar has issued a promissory note of 71,000 to Mr. Mohan on 17th May 2022 payable 3 months after date. After that, a sudden holiday was declared on 20th August 2022 due to Moharram. As per the provisions of the General Clauses Act 1897, what should be the date of presentment of promissory note for payment? Whether it should be 19th August 2022 or 21st August 2022? **(MTP 4 Marks, Sep'22)**

Ans. Section10 of the General Clauses Act, 1897 provides where by any legislation or regulation, any act or proceeding is directed or allowed to be done or taken in any court or office on a certain day or within a prescribed period then, if the Court or office is closed on that day or last day of the prescribed period, the act or proceeding shall be considered as done or taken in due time if it is done or taken on the next day afterwards on which the Court or office is open.

A promissory note of ₹1000 was issued by Mr. Sridhar to Mr. Mohan on 17th May 2022 which was payable 3 months after date. After that, a sudden holiday was declared on 20th August 2022 due to Moharram.

In the given case, the period of 3 months ends on 17th August 2022. Three days of grace are to be added. It falls due on 20th August 2022 which declared to be a public holiday after the issue of Promissory Note. In the light of provisions of section 10 of the General Clauses Act 1897, the due date will be on next day when office is open i.e. 21st August 2022.

22. Shama' made a promissory note for ₹4,500 payable to 'Vihari', and delivered the same to 'Vihari' on the condition that he ('Vihari') will demand payment only on the death of 'Kayah'. Before the death of 'Kayah', 'Vihari' indorsed and delivered the promissory note to 'Deepak', who receive the promissory note in good faith. On the date of maturity, 'Deepak' presented the promissory note for payment but 'Shama' denied for payment by stating that he issued this promissory note on the condition that it can be paid only on the death of 'Kayah'. Can 'Deepak' recover the amount due on the promissory note from 'Shama' under the provisions of the Negotiable Instrument Act 1881? **(MTP Oct'22) (RTP Nov '21)**

Ans. By virtue of provisions of section 9 of the Negotiable Instrument Act 1881, any person who for consideration became the possessor of a negotiable instrument in good faith and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. Exception to section 47 provides if a negotiable instrument is delivered to a person, upon condition, i.e. it will be effective on the happening of a certain event, such negotiable instrument cannot be further negotiated unless such event happens. However, if it is transferred to a holder in due course, his rights will not be affected by such condition.

'Shama' issued a promissory note to 'Vihari' on the condition that he ('Vihari' will demand payment only on the death of 'Kayah'. Before the death of 'Kayah', 'Vihari' indorsed and delivered the promissory note to 'Deepak', who receive the promissory note in good faith. On due date, 'Deepak' presented the promissory note for payment but 'Shama' denied for payment.

promissory note in good faith, he is a holder in due course and his rights will not be affected by any condition attached to the instrument by any prior party. Therefore, 'Deepak' can recover the amount due on the promissory note from 'Shama'.

23. A signs his name on a blank cheque with 'not negotiable crossing' which he gives to B with an authority to fill up a sum of 73,000 only. But B fills it for ₹5,000. B then endorsed it to C for a consideration of 75,000 who takes it in good faith. Examine whether C is entitled to recover the full amount of the instrument from B or A as per the provisions of the Negotiable Instruments Act, 1881. **(MTP 3 Marks Oct'22, PYQ July'21, 3 Marks)**

Ans. As per section 130 of the Negotiable Instruments Act, 1881, a cheque marked "not negotiable" is a transferable instrument. The inclusion of the words 'not negotiable' however makes a significant difference in the transferability of the cheques i.e., they cannot be negotiated. The holder of such a cheque cannot acquire title better than that of the transferor.

In the given question, A gave to B the blank cheque with 'not negotiable crossing'. B had an authority to fill only a sum of ₹3,000 but he filled it up ₹5,000. This makes B's title defective. B then endorsed it to C for consideration of ₹5,000.

24. Examine the following cases with respect to their validity. State your answer with reasons.

1. A bill of exchange is drawn, mentioning expressly as 'payable on demand'. The bill will be at maturity for payment on 04-01-2022, if presented on 01-01-2022.
2. A holder gives notice of dishonor of a bill to all the parties except the acceptor. The drawer claims that he is discharged from his liability as the holder fails to give notice of dishonour of the bill to all the parties thereto. **(MTP 4 Marks Oct'22)**

Ans.

1. The bill of exchange is drawn, mentioning expressly as 'payable on demand'. The bill will be at maturity for payment on 04-1-2022, if presented on 01-01-2022:

   This statement is not valid as no days of grace are allowed in the case of bill payable on demand.
2. As per section 93 of the Negotiable Instruments Act, 1881, notice of dishonor must be given by the holder to all parties other than the maker or the acceptor or the drawee whom the holder seeks to make liable. Accordingly, notice of dishonour to the acceptor of a bill is not necessary. Therefore, claim of drawer that he is discharged from his liability on account of holder's failure to give notice to all the parties thereto, is invalid.

25. What are the parties to promissory note and a bill of exchange. **(MTP 3 Marks March '23)**

Ans.

1. In a promissory note, there are only 2 parties namely: the maker and ii. the payee.
2. In a bill of exchange, there are 3 parties which are as under: the drawer, the drawee and the payee.

26. Give three example when the alterations to an instrument do not effect the liabilities of parties thereto. **(MTP 3 Marks April'23)**

Ans. The following alterations do not affect the liability of parties thereto:

1. If the alteration is unintentional and due to pure accident (e.g. accidental disfigurement of document).

negligence on his part.

3. An alteration made to correct a clerical error or a mistake, thus, if instead of 1823, the date entered was 1832, the agent of drawer held entitled to correct mistake [Brutt v pikard (1824) Ry & M 37]. Such correction is deemed to be giving effect to the original intention of the parties.
4. Alteration made to carry out common intention of original parties is permitted by Section 87. For example, where the words "or order" after the name of payee, inserted subsequently [Byrom v Thomson (1839) 11 A&E 31].
5. Alteration with the consent of the parties liable thereto.
6. An alteration made before the completion or the issue of negotiable Instrument.
7. A material alteration doesn't affect the liability of those parties who become liable after the alteration is made. Section 88 provides that the acceptor or indorser is bound by his acceptance.
8. An alteration which is not material e.g. when a bill payable to bearer is converted to bill payable to order/or an incomplete name of a person converted into the complete name of same person.

27. 'A' draws a cheque for ₹5,000 in favour of 'B'. 'A' had sufficient funds in his bank account to meet it, when the cheque ought to be presented in the bank. The bank fails before the cheque is presented. 'B' wants to claim it from 'A'. Decide, whether 'A' is liable as per the Negotiable Instruments Act, 1881. **(4 Marks April 23) (PYQ 4 Marks May'22)**

Ans. According to section 84 of the Negotiable Instruments Act, 1881, if a holder does not present a cheque within reasonable time after its issue, and the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him.

In the given situation, when the cheque ought to be presented, 'A' had sufficient funds at the bank to meet it. The bank failed before the cheque was presented. Thus, the drawer ('A') is discharged, but the holder (B) can prove against the bank for the amount of the cheque.

28. The Negotiable Instruments Act, 1881

1. Calculate the date of maturity of bill of exchange drawn on 1.6.2019, payable 120 days after considering the relevant provisions of the Negotiable Instruments Act, 1881.
2. Chandra issues a cheque for ₹50,000/- in favour of Daye. Chandra has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank, in the meantime, became bankrupt. Decide under the provisions of the Negotiable Instruments Act, 1881, whether Daye can recover the money from Chandra? **(RTP May 21, MTP 3 Marks Apr'23)**

Ans.

1. Date of maturity of the bill of exchange: In this case the day of presentment for sight is to be excluded i.e. 1st June, 2019. The period of 120 days ends on 29th September, 2019 (June 29 days + July 31 days + August 31 Days + September 29 days = 120 days). Three days of grace are to be added. It falls due on 2nd October, 2019, which happens to be a public holiday. As such it will fall due on 1st October, 2019 i.e., the next preceding Business Day.
2. Section 84(1) of the Negotiable Instruments Act, 1881 provides that cheque should be presented to Bank within reasonable time. If cheque is not presented within reasonable time, meanwhile the drawer suffers actual damage, the drawer is discharged to the

it was presented within reasonable time. As per section 84(2), in determining what is a reasonable time, regard shall be had to (a) the nature of the instrument (b) the usage of trade and of bankers, and (c) facts of the particular case. The drawer will get discharge, but the holder of the cheque will be treated as creditor of the bank, in place of drawer.

He will be entitled to recover the amount from Bank [section 84(3)].

In the above case drawer i.e. Chandra has suffered damage as cheque was not presented by Daye within reasonable time. Hence, Chandra will be discharged but Daye will be the creditor of bank for the amount of cheque and can recover the amount from the bank.

29. 'Anjum' drew a cheque for ₹20,000 payable to 'Babloo' and delivered it to him. 'Babloo' endorsed the cheque in favour of 'Rehansh' but kept it in his table drawer. Subsequently, 'Babloo' died, and cheque was found by 'Rehansh' in 'Babloo's table drawer. 'Rehansh' filed the suit for the recovery of cheque. Whether 'Rehansh' can recover cheque under the provisions of the Negotiable Instrument Act 1881? **(RTP May '22)**

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

The contract on a negotiable instrument until delivery remains incomplete and revocable. The delivery is essential not only at the time of negotiation but also at the time of making or drawing of negotiable instrument. The rights in the instrument are not transferred to the indorsee unless after the indorsement the same has been delivered. If a person makes the indorsement of instrument but before the same could be delivered to the indorsee the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof. [Section 57]

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

30. Mr. Zahid accepted a bill of exchange and gave it to Mr. Kamil for the purpose of getting it discounted and handing over the proceeds to Mr. Zahid. Mr. Kamil couldn't get the bill discounted and returned the bill to Mr. Zahid. Mr. Zahid cut the bill in two pieces for the purpose to cancel it and he threw the pieces on the street. Mr. Kamil picked up the pieces and joined those pieces in such manner that the bill seemed to have been folded for safe custody, rather than cancelled. Mr. Kamil put it into circulation and it finally reached to Mr. Salim, who took it in good faith and for value. Explain in the light of the provisions of the Negotiable Instruments Act, 1881, whether Mr. Zahid is liable to pay the bill to Mr. Salim? **(RTP Nov'22)**

Ans. According to the section 9 of the Negotiable Instrument Act 1881, "Holder in due course" means any person who for consideration became the possessor of a negotiable instrument in good faith and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. Further, section 120 says that no maker of a promissory note and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn. Thus, a holder in due course gets a good title to the bill.

In the given question, since Mr. Salim acquired the bill in good faith and for value, he becomes the holder in due course. Mr. Zahid cannot deny the original validity of the bill towards Mr. Salim

Mr. Zahid.

31. A bill of exchange is drawn payable to 'Amir' or order. 'Amir' endorses it to 'Rani', 'Rani' to 'Kajol', 'Kajol' to 'Sharukh', 'Sharukh' to 'Madhuri' and 'Madhuri' to 'Amir'. State with reasons under the provisions of the Negotiable Instrument Act, 1881 whether 'Amir' can recover the amount of the bill from 'Rani', 'Kajol', 'Sharukh' and 'Madhuri', if he has originally endorsed the bill to 'Rani' by adding the words 'Sans Recourse'. **(RTP May 23)**

Ans. In the course of negotiation, if a negotiable instrument is circulated/negotiated back by an indorser to any of the prior party on the negotiable instruments, it is termed as negotiation back. The person who becomes the holder in due course under this negotiation back cannot make any of the intermediate indorsers liable on the instruments. But where an indorser had excluded his liability, by the use of the words 'sans recourse' or 'without recourse to me' and after that becomes the holder of the instrument in his own right under the 'negotiation back' all intermediate indorsers are liable to him and in case of dishonour, he can recover the amount from all or any one of them.

In the given question, on the basis of above facts it is clear that 'Amir', the endorser becomes the holder after it is negotiated to several parties. In normal situation none of the intermediate parties would be liable to 'Amir'. But in the given problem 'Amir's original endorsement is 'sans recourse' and therefore, he is not liable to 'Rani', 'Kajol', 'Sharukh' and 'Madhuri'. But if the bill is negotiated back to 'Amir', all of them are liable to him and he can recover the amount from all or any of them.

32. Mr. Vibhav made endorsement of a bill of exchange amounting ₹35,000 to Mr. Rishab. But, before the same could be delivered to Mr. Rishab, Mr. Vibhav passed away. Mr. Somesh, son of Mr. Vibhav, who was the only legal representative of Mr. Vibhav approached Mr. Rishab and informed him about his father's death. Now, Mr. Somesh 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. Somesh can complete the instrument in the above scenario? **(RTP Nov'23, PYQ 3 Marks Nov'22)**

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

The rights in the instrument are not transferred to the indorsee unless after the indorsement, the same has been delivered. If a person makes the indorsement of instrument but before the same could be delivered to the indorsee, the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof.

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

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

33. Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following: A Bill of Exchange originally drawn by R for a sum of ₹10,000 but accepted by S only for ₹7,000. **(PYQ 3 Marks Jan' 21)**

of a bill of exchange acquiesces in a qualified acceptance, or one limited to part of the sum mentioned in the bill, or which substitutes a different place or time for payment, or which, where the drawees are not partners, is not signed by all the drawees, all previous parties whose consent is not obtained to such acceptance are discharged as against the holder and those claiming under him, unless on notice given by the holder they assent to such acceptance.

Explanation to the above section states that an acceptance is qualified where it undertakes the payment of part only of the sum ordered to be paid.

In view of the above provisions, the bill, which has been drawn by R for ₹10,000/-, has been accepted by S only for ₹7,000/-. It is a clear case of qualified acceptance, which may either be rejected by R or he may give assent to the acceptance of ₹7,000/- only.

34. A promissory note specifies that three months after, A will pay ₹10,000 to B or his order for value received. It is to be noted that no rate of interest has been stipulated in the promissory note. The promissory note falls due for payment on 01.09.2019 and paid on 31.10.2019 without any interest.

Explaining the relevant provisions under the Negotiable Instruments Act, 1881, state whether B shall be entitled to claim interest on the overdue amount? **(PYQ 3 Marks Jan 21)**

Ans. **When no rate of interest is specified in the instrument:** As per the provisions of Section 80 of the Negotiable Instruments Act, 1881, when no rate of interest is specified in the instrument, interest on the amount due thereon shall, notwithstanding any agreement relating to interest between any parties to the instrument, be calculated at the rate of eighteen per cent per annum, from the date at which the same ought to have been paid by the party charged, until tender or realization of the amount due thereon, or until such date after the institution of a suit to recover such amount as the Court directs.

In the given question, the promissory note falls due for payment on 1.9.2019 and was paid on 31.10.2019. The note does not mention any rate of interest, hence interest will be charged @ 18% p.a. Thus, B shall be entitled to claim interest on the overdue amount for the period from 01.09.2019 to 31.10.2019, @ 18% p.a.

35. Gireesh, a legal successor of Ripun, the deceased person, signs a Bill of Exchange in his own name inherit the occate from the deceased payable to Mukund after 3 months from 1st January, 2019. On maturity, when Mukund presents the bill to Gireesh, he (Gireesh) refuses to pay for the bill on the ground that since the original liability was that of Ripun, the deceased, therefore, he is not liable to pay for the bill. Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether Mukund can succeed in recovering 50,000 from Gireesh. Would your answer be still the same in case Gireesh specified the limit of his liability in the bill and the value of his inheritance is more than the liability? **(PYQ 4 Marks Jan 21)**

Ans. **Liability of a legal representative (Section 29 of the Negotiable Instruments Act, 1881):** A legal representative of a deceased person, who signs his name on a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him.

Thus, in the absence of an express contract to the contrary, the liability of a legal representative is unlimited. However, a legal representative may, by an express agreement, limit his liability to the extent of the assets received by him.

as he has admitted liability of ₹50,000 i.e. to the extent of the assets received by him from the Ripun, the deceased.

Yes, the limit of liability specified in the bill by Gireesh, will remain same even if value of his inheritance is more than the liability, in case he specified the liability by an express agreement.

36. Mr. Harsha donated ₹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. **(PYQ 3 Marks July '21)**

Ans. In the given instance, Mr. Harsha donated ₹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.

37. Examine the following cases with respect to their validity. State your answer with reasons.

1. A bill of exchange is drawn, mentioning expressly as 'payable on demand'. The bill will be at maturity for payment on 04-01-2021, if presented on 01-01-2021.
2. A holder gives notice of dishonor of a bill to all the parties except the acceptor. The drawer claims that he is discharged from his liability as the holder fails to give notice of dishonour of the bill to all the parties thereto. **(PYQ 3 Marks Jul'21)**

Ans.

1. The bill of exchange is drawn, mentioning expressly as 'payable on demand'. The bill will be at maturity for payment on 04-1-2021, if presented on 01-01-2021: This statement is not valid as no days of grace are allowed in the case of bill payable on demand.
2. A holder gives notice of dishonor of a bill to all the parties except the acceptor. The drawer claims that he is discharged form his liability as the holder fails to give notice of dishonour of the bill to all the parties thereto:

As per section 93 of the Negotiable Instruments Act, 1881, notice of dishonor must be given by the holder to all parties other than the maker or the acceptor or the drawee whom the holder seeks to make liable. Accordingly, notice of dishonour to the acceptor of a bill is not necessary. Therefore, claim of drawer that he is discharged from his liability on account of holder's failure to give notice to all the parties thereto, is invalid.

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

First endorsement 'N'

Second endorsement 'O'

'M' strikes out, without Q's consent, the endorsements by 'O' and 'P'. Decide, with reasons, whether 'M' is entitled to recover anything from 'Q' under the provisions of the Negotiable Instruments Act, 1881. **(PYQ 3 Marks Dec'21)**

Ans. According to section 40 of the Negotiable Instruments Act, 1881, Where the holder of a negotiable instrument:

- without the consent of the indorser,
- destroys or impairs the indorser's remedy against a prior party,

the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

In the given question, 'M' strikes out, without Q's consent, the endorsements by 'O' and 'P'. In the light of the above provision of law and facts of the question, 'M' is not entitled to recover anything from 'Q' make liable. Accordingly, notice of dishonour to the acceptor of a bill is not necessary. Therefore, claim of drawer that he is discharged from his liability on account of holder's failure to give notice to all the parties thereto, is invalid.

39. A is a payee and holder of a bill of exchange. He endorses it in blank and delivers it to B. B endorses it in full to C or order. C without endorsement transfers the bill to D. State giving reasons whether D, as bearer of the bill of exchange, is entitled to recover the payment from A or B or C. **(PYQ 3 Marks Dec'21)**

Ans. According to section 49 of the Negotiable Instruments Act, 1881, the holder of a negotiable instrument indorsed in blank may-without signing his own name, by writing above the endorser's signature a direction to pay to any other person as endorsee, convert the indorsement in blank into an indorsement in full; and the holder does not thereby incur the responsibility of an endorser.

According to section 55, if a negotiable instrument, after having been indorsed in blank, is indorsed in full, the amount of it cannot be claimed from the endorser in full, except by the person to whom it has been indorsed in full, or by one who derives title through such person.

As per the facts of the question and above mentioned provisions of the Negotiable Instruments Act, 1881, Das the bearer of the Bill of Exchange, is entitled to receive payment or to sue drawer, acceptor, or A who indorsed the bill in blank, but he cannot sue B or C.

40. Referring the provisions of the Negotiable Instruments Act, 1881 give the answer of the following.

1. A promissory note was made without mentioning any time for payment. The holder added the words 'on demand' on the face of the instrument. Whether this may be treated as material alteration in the instrument?
2. Ankit draws a cheque for ₹2,000 and hands it over to Shreya by way of gift. Whether Shreya is a holder in due course? **(PYQ 4 Marks Dec'21 ,March '23)**

Ans.

1. **Material alteration:** An alteration is material which in any way alters the operation of the instrument and affects the liability of parties thereto.

   Any alteration is material

   - which alters the business effect of the instrument if used for any business purpose;
   - which causes it to speak a different language in legal effect form that which it originally spoke or which changes the legal identity or character of the instrument.

date, (ii) the sum payable, (iii) the time of payment, (iv) the place of payment, or the addition of a place of payment.

A promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. As per the above provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence, adding the words "on demand" does not alter the business effect of the instrument.

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

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

In the given case, Ankit draws a cheque for ₹2,000 and hands it over to Shreya by way of gift. Hence, Shreya can be termed as a holder because she has a right to possession and to receive the amount due in her own name. But she cannot be termed as a holder in due course.

41. Examine the validity of the following statements with reference to the Negotiable Instruments Act, 1881.

1. When payment on an instrument is made in due course, both the instrument and the parties to it are discharged.
2. Alteration of rate of interest specified in the Promissory Note is not a material alteration.
3. Conversion of the blank indorsement into an indorsement in full is not a material alteration and it does not require authentication. **(PYQ 3 Marks, May '22)**

Ans.

1. When payment on an instrument is made in due course, both the instrument and the parties to it are discharged: Valid Reasoning: As per section 78 of the Negotiable Instrument Act, 1881, When payment on an instrument is made in due course, both the instrument and the parties to it are discharged subject to the provision of section 82(c). The payment on an instrument may be made by any party to the instrument. It may even be made by a stranger provided it is made on account of the party liable to pay.
2. Alteration of rate of interest specified in the Promissory Note is not a material alteration: Not valid Reasoning: An alteration is material which in any way alters the operation of the instrument and affects the liability of parties thereto. Hence, Alteration of rate of interest is material alteration.
3. Conversion of the blank indorsement into an indorsement in full is not a material alteration and it does not require authentication: Valid Reasoning: Conversion of a blank indorsement into an indorsement in full [under Section 49 of the Negotiable Instruments Act, 1881] is not a material alteration. It has been authorised by the Act and do not require any authentication.

Act, 1872.

1. Creditor should proceed legal action first against the Principal Debtor and later against the surety.
2. A guarantee which extends to a single debt/specific transaction is called continuing Guarantee.
3. Variation which is not material and beneficial to the surety will not discharge him of his liability.
4. If the bailee does not use the goods according to the terms and conditions of bailment, the contract of bailment becomes void. **(PYQ 4 Marks, May '22)**

Ans.

1. Creditor should proceed legal action first against the Principal Debtor and later against the surety: Invalid Reasoning: As per Section 128 of the Indian Contract Act, 1872, the surety's liability is co-extensive with that of Principal debtor. It's not mandatory that creditor should proceed legal action in case of default, first against the Principal debtor and later against the surety. It is on creditor to start action first either against the Principal debtor or the surety.
2. A guarantee which extends to a single debt/specific transaction is called continuing Guarantee: Invalid Reasoning: Continuing Guarantee [Section 129 of the Indian Contract Act, 1872] - A guarantee which extends to a series of transaction is called a continuing guarantee. It applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.
3. Variation which is not material and beneficial to the surety will not discharge him of his liability: Valid Reasoning: Based on the principle held in the M.S Anirudhan v Thomco's Bank Ltd. AIR 1963 SC 746 that the surety's liability will not be discharged where the alteration is for beneficial to him and is not substantial in nature.
4. If the bailee does not use the goods according to the terms and conditions of bailment, the contract of bailment becomes void: Invalid Reasoning: As per Section 153, a contract of bailment is voidable at the option of the bailor, if the bailee does not use the goods according to the terms and conditions of bailment.

43. Healthcare Services Limited (the Bidder), bids the tender floated by Super Care Hospital (the Tenderer), attaching a cheque dated 01.04.2021 for ₹5,00,000 towards earnest money deposit. Since the tender process was extended, the Tenderer returned the cheque expiring on 30.06.2021 to the Bidder for its resubmission after having revalidated by changing the date of the cheque to 01.07.2021. Accordingly, the revalidated cheque was resubmitted by the Bidder to the Tenderer. The cheque was presented by the Tenderer to the banker. It was dishonoured by the bank. Examine, whether the cheque altered with a new date shall be deemed to be a valid cheque binding the Bidder for payment as per the Negotiable Instruments Act, 1881?

(PYQ 3 Marks, May '22)

Ans. An alteration is material which in any way alters the operation of the instrument and affects the liability of parties thereto.

By material alteration the identity of original instrument is destroyed and those parties who had agreed to be liable on the original instrument cannot be made liable on the new

vs Prasanna Kumar 33 Cal 812). It makes no difference whether the alteration is made by a party who is in possession of the same, or by a stranger while the instrument was in the custody of a party, because the party in custody of instrument is bound to preserve it in its integrity. The rule is defended on the ground that no man shall be permitted to take the chance of committing a fraud without running any risk of loss by the event when it is detected.

The party who consents to the alteration as well as the party who makes the alteration are disentitled to complain against such alteration.

In the given Question, the tenderer (Super Care Hospital returned the cheque to the bidder (i.e. the drawer of cheque-Healthcare Services Limited) for its resubmission after having revalidated by changing the date of the cheque. The drawer himself altered the date of the cheque for re-validating the same instrument, he cannot take advantage of it by saying that the cheque becomes void as there was a material alteration thereto. It is always open to a drawer to voluntarily re-validate a negotiable instrument including a cheque [Veera Exports v T. Kalavathy (2002) 1 SCC97].

In the light of the above discussion, the cheque altered with a new date shall be deemed to be a valid cheque and thus, binding the Bidder for payment.

44. Venkat executed a promissory note in favour of Raman for ₹45 Lakhs. The amount was payable hundred days after sight. Raman presented the promissory note for sight on 4 th May 2021. Ascertain the date of maturity of the promissory note with reference to the relevant provisions of the Negotiable Instruments Act, 1881. **(PYQ 3 Marks Nov '22)**

Ans. **Maturity of Negotiable Instrument**

Where a bill or note is payable at a fixed period after sight, the maturity of a note or bill is the date on which it falls due. It's a time instrument and is at maturity on the third day after the day on which it is expressed to be payable. Thus, a time instrument payable after sight is allowed three days grace period. [Section 22 of the Negotiable Instrument Act, 1881 (the Act)].

Calculation of Maturity (Section 23 of the Act)

In calculating the date at which a promissory note or bill of exchange, made payable at stated number of months after date or after sight or after a certain event, is at maturity, the period stated shall be held to terminate on the day of the month, which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight, the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight.

Section 24 of the Act states that where a bill or note is payable after date or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

In the present case, the day of presentment for sight is to be excluded i. e. 4th May, 2021. The period of 100 days will start from 5th May, 2021 i.e. May -27 days, June - 30 days July - 31 days and August 12 days (Total 100 days) and ends on 12th August. After 3 days of grace period added to it, it falls due on 15th August which is a public holiday. When the day on which a promissory note or bill of exchange is at maturity is a Public holiday, the instrument shall be deemed to be due on the next preceding business day.

on 14th August, 2021 (i.e. the next preceding business day.)

Note: The concept of after sight is not usually applied to Promissory notes. Therefore, a Promissory note payable 100 days after sight would have to be presented only after 100 days for payment. As per the question, it appears that promissory note is presented for payment (after 100 days) on 4th May 2021. Now the maker i.e. promisor would be required to pay it within the usual 3 grace days calculated from the 4th May 2021. This would be on 7th May 2021. Therefore, in the given case, the date of Maturity shall be 7th May 2021 (4th May 2021 + 3 days)".

45. A bill of exchange was drawn by Mr. G on Mr. H for #50,000 towards the value of goods purchased by Mr. H from Mr. G. Mr. H accepted the bill and returned it back to Mr. G. After that Mr. G handed over the bill to his supplier Mr. K to settle the amount of a transaction. On the due date, Mr. K presented the bill before Mr. H for payment. Mr. H denied to make payment and the bill was dishonoured. After five days of the date of dishonour of the bill, Mr. K gave a written notice of dishonour by post with acknowledgement to Mr. G without knowing the fact that Mr. G had passed away one day back. After one month, thereafter, Mr. K claimed the amount from Mr. L, the only son of Mr. G, who was the only legal representative of Mr. G; Mr. L contended that the notice of dishonour was neither served to him nor he had received the notice of dishonour which was sent by Mr. K addressing to his father and therefore, he is not liable for the amount of the bill. Referring to the relevant provisions of the Negotiable Instruments Act, 1881, advise Mr. K., whether the contention of Mr. L is tenable. Would your answer differ in case Mr. L contended that even though he received the notice of dishonour addressed to his father, since it was not addressed to him, he is not liable for the amount of the bill? **(PYQ 4 Marks Nov'22)**

Ans. **Dishonour by Non-Payment:**

According to the Negotiable Instruments Act, 1881, a promissory note, bill of exchange and cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same (Section 92).

As per the requirement of the Negotiable Instruments Act, 1881, in line with the given facts, notice of dishonour must be given to all parties other than the acceptor of the bill, whom the holder seeks to make liable.

Notice of dishonour to the acceptor of a bill is not necessary as per Section 93 of the Act. Here the acceptor is primarily liable upon the instrument, on the due date and at the proper place. It is they who dishonour the instrument by no-acceptance or non-payment and notice to them will merely be notice of fact already known to them.

When negotiable instrument is dishonoured by non-payment, the holder must give a notice of dishonour to the drawer or his previous holder in order to make them liable on the instrument.

In order to make the drawer liable on dishonour by drawee/acceptor, it is necessary that a notice of dishonour must have been given to him.

When the party to whom notice of dishonour is dispatched is dead, but the party dispatching the notice is ignorant of his death, the notice is sufficient (Section 97).

acknowledgement to Mr. G (the drawer), Mr. K (the holder of the bill) was not aware of the death of Mr. G. So, the notice served addressed to him, was sufficient as per Section 97 of the Negotiable Instruments Act, 1881. Hence, the contention of Mr. L (the legal representative of Mr. G) is not tenable and he is liable on the bill.

2nd Part: Where Mr. L, received the notice of dishonour addressed to his father though not addressed to Mr. L

In a case, where Mr. L, received the notice of dishonour addressed to his father though not addressed to Mr. L, then also he will remain liable for the amount of bill. Hence, the answer will not differ.

46. 'A drew a cheque for ₹20,000 payable to 'B and delivered it to him. 'B' endorsed the cheque in favour of 'R' but kept it in his table drawer. Subsequently, 'B' died, and cheque was found by 'R' in 'B's table drawer. 'R' filed the suit for the recovery of cheque. Whether 'R' can recover cheque under the provisions of the Negotiable Instruments Act, 1881? **(PYQ 3 Marks, May '23)**

Ans. Negotiation by indorsement [Section 48 of the Negotiable Instruments Act, 1881]: Subject to the provisions of section 58, a promissory note, bill of exchange or cheque payable to order, is negotiable by the holder by indorsement and delivery thereof.

As per the given provision, as R does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. So, R cannot recover cheque, though endorsed in his favour.

47. Mr. X draws a cheque in favour of Mr. R for payment of his outstanding dues of ₹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 ₹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. constitute an offence?

(PYQ 3 Marks, May '23)

Ans. As per the facts stated in the question, Mr. X (drawer) issued the cheque to Mr. R for outstanding dues of ₹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 ₹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.

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.

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

(a) X receives a promissory note drawn by his father by way of gift.

(b) A received a cheque for full and final settlement of his dues from his client but, he is prohibited by a court order from receiving the amount of the cheque.

(c) B, the agent of C, is entrusted with an instrument without endorsement by C, who is the payee

(d) P works in a bank. He steals a blank cheque of A and forges A's signature.

(PYQ 4 Marks, May'23)

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

On applying the above provision in the given cases:

(a) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.

(b) No, A is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.

(c) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.

(d) No, P is not a holder because he is in wrongful possession of the instrument.

49. Calculate the date of maturity of the following bill of exchange explaining the relevant rules relating to determination of the date of maturity, as provided in the Negotiable Instruments Act, 1881.

(i) The bill of exchange drawn on 21/06/2023. Date of maturity of a bill payable 100 days after date.

(ii) A bill of exchange drawn on 20/04/2023 is payable twenty days after sight and the bill is presented for acceptance on 30/04/2023. **(PYQ 4 Marks Nov 23)**

Ans. According to section 22 of the Negotiable Instruments Act, 1881, the maturity of a promissory note or bill of exchange is the date at which it falls due. Every promissory note or bill of exchange (which is not expressed to be payable on demand, at sight or on presentment) is at maturity on the third day after the day on which it is expressed to be payable.

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

made payable at certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or of presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, shall be excluded. A bill which is payable after sight is in the nature of time instrument.

Hence, in this case, the period of 100 days will start from 22nd June, 2023.

Month and No. of days in month to make 100 days

June → 9

July → 31

August → 31

September → 29

Thus, 100 days will end on 29th September, 2023. After 3 days of grace period are added to the bill of exchange, it falls due on 2nd October, 2023 which is a public holiday. Accordingly, the date of maturity of the bill of exchange will fall due on 1st October, 2023 (i.e. the next preceding business day.)

II. In this case, the day on which the bill of exchange is presented for acceptance is to be taken into consideration i.e. 30th April, 2023. The period of 20 days will start from 1st May, 2023 and will end on 20th May, 2023. Being a time instrument payable after sight is allowed three days grace period as per section 22. Accordingly said bill will become mature, after 3 days of grace period to the due date, therefore, bill will be said to be matured on 23rd May, 2023.

50. Mr. Rama bought an electric watch of ₹50,000 from SN Watch Co. For the purpose of making payment, he drew a cheque payable to Mr. SN Dhawan, owner of the watch company or ordered. Mr. SN Dhawan put the cheque in office drawer. One of the employee Mr. Joseph stole the cheque from office drawer, forged the signature of Mr. Dhawan and indorsed it to Mr. Parashar for goods he bought from him of ₹50,000. Mr. Parashar encashed the cheque, on the very same day from Mr. Rama's account. After 3 days Mr. Dhawan came to know about the theft. He intimated Mr. Rama about the theft of the cheque. Examine the liability of the Mr. Rama in this case.

(PYQ 4 Marks Nov'23)

Ans. According to section 85(1) of the Negotiable Instruments Act, 1881, where a cheque payable to order purports to be indorsed by or on behalf of the payee, the banker is discharged by payment in due course.

The banker, in other words, can debit his customers account even though the indorsement by the payee might turn out to be forgery or the indorsement might have been placed by the payee's agent without his authority.

According to section 14 of the Negotiable Instruments Act, 1881, when a negotiable instrument is transferred to any person with a view to constitute the person holder thereof, the instrument is deemed to have been negotiated. Thus, there is a transfer of ownership of the instrument.

In the given case, the cheque is transferred to Mr. SN Dhawan by Mr. Rama whereby Mr. SN Dhawan becomes the holder in due course and the ownership of the cheque is transferred to him. The banker can debit Mr. Rama's account even though the indorsement by the payee is forged. Since, the account of Mr. Rama has already been debited, and ownership of the

SN Dhawan he (Mr. Rama) does not have any further liability in this case.

51. RNL Ltd. issued a post-dated cheque of ₹5.50 Lakh to Mr. YR Gupta on account of full and final settlement of its liability for shares purchased of a renowned company. Company draws the cheque on 21.8.2023 and mentioned the cheque to be paid on 26.9.2023.

Further, Company instructed the bank, on which cheque was drawn to stop the payment of cheque, if at the time of presentment, Bank account has insufficient funds to make payment. Mr. YR Gupta presented the cheque to bank for payment on 30.11.2023. On 30.11.2023 bank account maintained by company was having only 74.90 lakh. Bank denied for payment.

The cheque was dishonored for non-payment. In the above case, who will be responsible for dishonor of cheque and payment of 75.50 lakh due to Mr. YR Gupta? **(PYQ 4 Marks Nov'23)**

Ans. 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 returned/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.

According to section 139 of the Act, when a cheque is dishonoured, it shall be presumed, unless the contrary prove, that a holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, of any debt or other liability.

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 presentation for the reasons stated in that section. As per the facts stated in the question, RNL Limited (drawer) after having issued the cheque to Mr. YR.

Gupta (drawee), instructed the bank to stop payment of cheque, if at the time of presentment, Bank account of company has insufficient funds to make payment. In the given case, on presentment of cheque by Mr. YR Gupta, Bank denied payment and the cheque was dishonored.

In view of the facts of the question and the provisions of law, RNL Limited has committed an offence under section 138. Also, section 140 specifies absolute liability of the drawer of the cheque for commission of an offence under the section 138 of the Act. Accordingly, RNL Limited will be responsible for dishonor of cheque and payment of < 5.50 lakh due to Mr. YR Gupta.