

# MCC SMART COMPILER

## CA FOUNDATION

### PAPER 2 : BUSINESS LAWS

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## CHAPTER 1: INDIAN REGULATORY FRAMEWORK

### 1. INTRODUCTION

The purpose of a regulatory framework is to provide a set of uniform rules and regulations that will govern the conduct of people interacting with each other in personal as well as business relationships.

### 2. WHAT IS LAW?

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.

### 3. SOURCES OF LAW

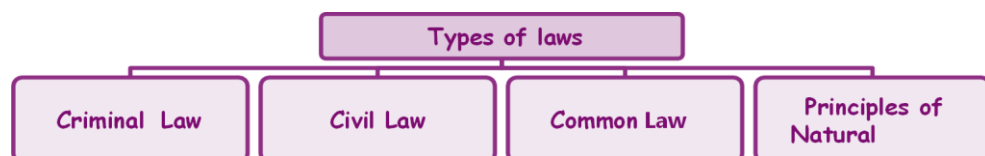
The main sources of law in India are the Constitution, the statutes or laws made by Parliament and State Assemblies, Precedents or the Judicial Decisions of various Courts and in some cases, established Customs and Usages.

**The Constitution of India, 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.

### 4. 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



#### Criminal Law

Criminal law is concerned with laws pertaining to violations of the rule of law or public wrongs and punishment of the same. **Criminal Law is governed under the Indian Penal Code, 1860, and the Code of Criminal Procedure, 1973 (Crpc).** The Indian Penal Code, 1860, defines the crime, its nature, and punishments whereas the Criminal Procedure Code, 1973, defines exhaustive procedure for executing the punishments of the crimes.

#### 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. 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.

#### 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** reinforces the obligation of courts to follow the same principle or judgement established by previous decisions while ruling a case where the facts are similar or "**on all four legs**" with the earlier decision.

### Principles of Natural Justice

Natural justice, often known as Jus Natural deals with certain fundamental principles of justice going beyond written law. **Nemo judex in causa sua** (Literally meaning "**No one should be made a judge in his own cause, and it's a Rule against Prejudice**"), **audi alteram partem** (Literally meaning "**hear the other party or give the other party a fair hearing**"), and reasoned decision are the rules of Natural Justice.

## 5. ENFORCING THE LAW

The Government of India exercises its executive authority through a number of Government Ministries or Departments of State. A Ministry is composed of employed officials, known as civil servants, and is politically accountable through a minister. 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.

### 1. The Ministry of Finance

The Ministry of Finance (**Vitta Mantralaya**) is a Ministry within the Government of India concerned with the economy of India, serving as the Treasury of India. In particular, it concerns itself with taxation, financial legislation, financial institutions, capital markets, centre and state finances, and the Union Budget.

#### Ministry of Finance

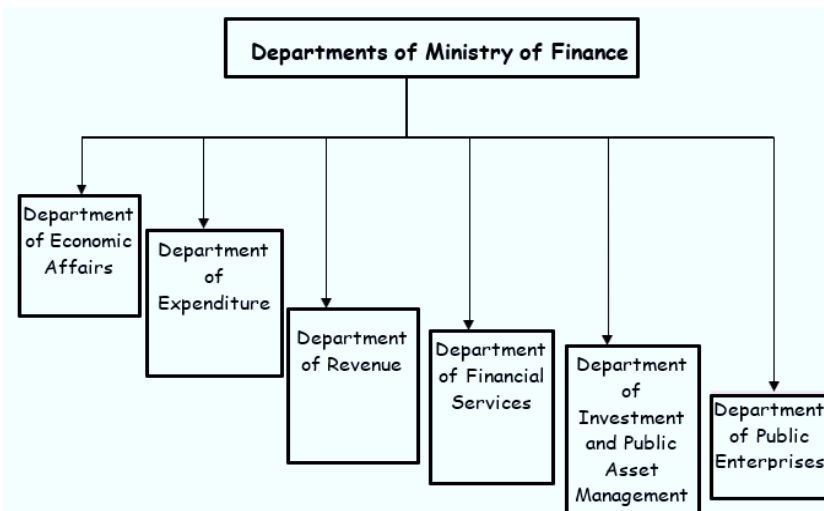
✚ is the **apex controlling authority**

✚ of four Central Civil Services, namely.

- ❖ **Indian Revenue Service**
- ❖ **Indian Audit and Accounts Service**
- ❖ **Indian Economic Service and**
- ❖ **Indian Civil Accounts Service.**

✚ Also the apex controlling authority of one of the central commerce services namely Indian Cost and Management Accounts Service.

#### Departments under the Ministry of Finance-

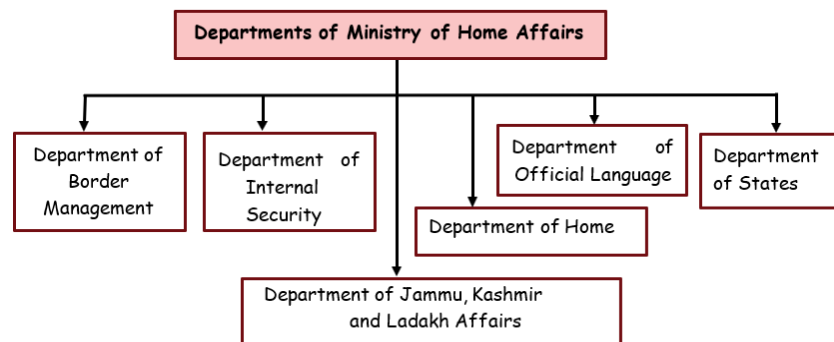


### (i) Ministry of Corporate Affairs (MCA)

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

### Ministry of Home Affairs (Gṛha Mantralaya)

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

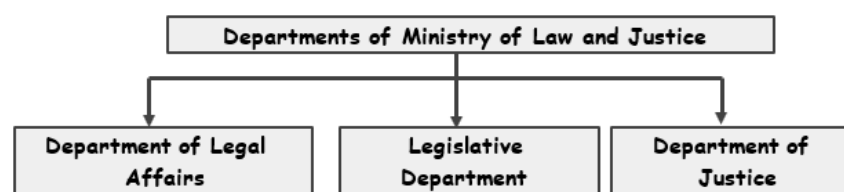


### Department of Official Language



### Ministry of Law and Justice

- ✚ in the Government of India is a Cabinet Ministry
- ✚ deals with the
  - ❖ **management of the legal affairs**, through the Department of Legal Affairs
  - ❖ **legislative activities** through the Legislative Department
  - ❖ **administration of justice in India** through the Department of Justice
- ✚ The Department of Legal Affairs is concerned with advising the various Ministries of the Central Government while the Legislative Department is concerned with drafting of principal legislation for the Central Government.



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

- ✚ is 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.

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

- ✚ is India's Central Bank and 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).

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

- ✚ is 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, which was passed by Lok Sabha 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 **attempts to simplify the process of insolvency and bankruptcy proceedings.**
- ✚ It handles the cases using two tribunals like NCLT (National company law tribunal) and Debt recovery tribunal.

## 6. STRUCTURE OF THE INDIAN JUDICIAL SYSTEM

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.**

In the hierarchy of courts, the Supreme Court is at the top, followed by the High Courts and District Courts. Decisions of a High Court are binding in the respective state but are only persuasive in other states.

### (i) Supreme Court

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

## (ii) High Court

The highest court of appeal in each state and union territory is the High Court. **Article 214 of the Indian Constitution states that there must be a High Court in each state.** The High Court has appellant, original jurisdiction, and Supervisory jurisdiction. However, Article 227 of the Indian Constitution limits a High Court's supervisory power.

### 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.

## (iii) District Court

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.

## (iv) 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.



## CHAPTER-2 THE INDIAN CONTRACT ACT, 1872

### UNIT 1: NATURE OF CONTRACTS

#### WHAT IS A CONTRACT ?

As per Sec 2 (h) "an agreement enforceable by law".

The contract consists of two essential elements:

(i) an agreement, and

(ii) its enforceability by law.

**Agreement** - "every promise and every set of promises, forming the consideration for each other".

**Section 2 (b) defines promise as-** "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".

**Agreement = Offer/Proposal + Acceptance + Consideration**

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

**Contract = Agreement + Enforceability by law**

#### ESSENTIALS OF A VALID CONTRACT

##### Essentials of a valid Contract

	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]	6	-

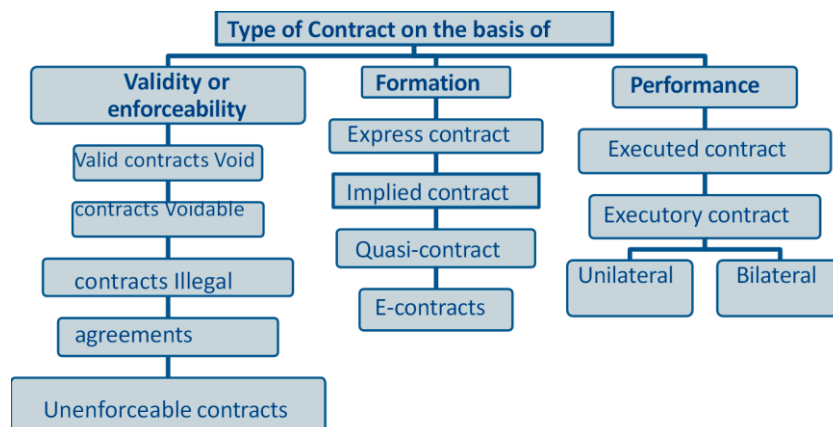
In terms of Section 10 of the Act, "all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void".

- 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.
- Parties must intend to create legal obligations:** There must be an intention on the part of the parties to create legal relationship between them. **Social or domestic type of agreements are not enforceable in court of law.**
- Other Formalities to be complied with in certain cases:** In case of certain contracts some other formalities have to be complied with to make an agreement legally enforceable.
- Certainty of meaning:** The agreement must be certain and not vague or indefinite.
- Possibility of performance of an agreement:** An agreement to do an act impossible in it self cannot be enforced.

**Now, 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:** when accepted, becomes a promise". An agreement is an outcome of offer and acceptance for consideration.
2. **Free Consent:** Two or more persons are said to consent when they agree upon the same thing in the same sense. Further such consent must be free.  
**Consent would be considered as free consent if it is not caused by coercion, undue influence, fraud, misrepresentation or mistake.**
3. **Capacity of the parties:** Capacity to contract means the legal ability of a person to enter into a valid contract. **Section 11** of the Indian Contract Act specifies that every person is competent to contract who
  - (i) Is of the **age of majority** according to the law to which he is subject and
  - (ii) Is of **sound mind** and
  - (iii) Is **not otherwise disqualified from contracting by any law**
4. **Consideration:** It is referred to as '*quid pro quo*' i.e. '**something in return**'.
5. **Lawful Consideration and Object:** The consideration and object of the agreement must be lawful.
6. **Not expressly declared to be void:** 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.

## TYPES OF CONTRACTS



### (I) On the basic 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.
2. **Void Contract:** **Section 2 (j) 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.
3. **Voidable Contract :** **Section 2(i)** defines 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".  
**Following are the situations where a contract is voidable:**
  - (i) When the **consent of party is not free is caused by coercion, undue influence, misrepresentation or fraud.**



(ii) When a person promises to do something for another person, but the other person prevents him from performing his promise, the contract becomes voidable at the option of first person.

(iii) When a party to a contract promise to perform a work within a specified time, could not perform within that time, the contract is voidable at the option of promisee.

4. **Illegal Contract:** It is a contract which the law forbids to be made. All illegal agreements are void but all void agreements are not necessarily illegal.

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.

## (II) On The Basic of the formation of contract

1. **Express Contracts:** A contract would be an express contract if the terms are expressed by **words or in writing**.

2. **Implied Contracts:** Implied contracts in contrast come into existence by implication.

**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]**.

3. **Quasi-Contract:** A quasi-contract is not an actual contract, but it resembles a contract. It is created by law under certain circumstances.

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

2. **Executory Contract:** 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.

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.

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

## PROPOSAL/OFFER [SECTION 2(a) OF THE INDIAN CONTRACT ACT, 1872]

**Definition of Offer/Proposal:** As per sec 2 (a)

**According to Section 2(a) of the Indian Contract Act, 1872,** "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal".

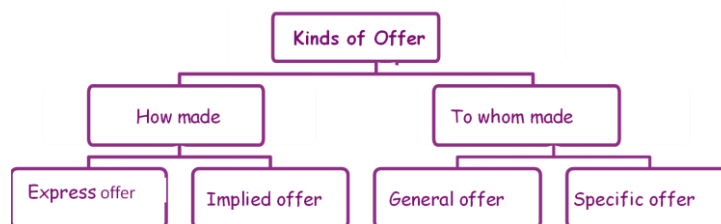
**Essentials of a proposal/ offer are -**

1. The person making the proposal or offer is called the **'promisor'**

2. For a valid offer, the party making it must express his willingness **'to do' or 'not to do' something:**

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

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.



### Classification of offer

An offer can be classified as general offer, special/specific offer, cross offer, counter offer, standing/ open/ continuing offer.



(a) **General offer:** It is an offer made to public at large and hence anyone can accept and do the desired act (*Carlill Vs. Carbolic Smoke Ball Co.*).

(b) **Special/specific offer:** When the offer is made to a specific or an ascertained person, it is known as a specific offer. [*Boulton Vs. Jones*]

(c) **Cross offer:** When two parties exchange identical offers in ignorance at the time of each other's offer, the offers are called cross offers.

(d) **Counter offer:** When the offeree offers to 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

(e) **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.

### Essential of a valid offer

1. **It must be capable of creating legal relations:** If the offer does not intend to give rise to legal consequences and creating legal relations, it is not considered as a valid offer in the eye of law.
2. **It must be certain, definite and not vague:**
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. (*Lalman Shukla v. Gauri Dutt*)
4. **It must be made with a view to obtaining the assent of the other party:**
5. **It may be conditional:**
6. **Offer should not contain a term the non-compliance of which would amount to acceptance:**
7. **The offer may be either specific or general:**
8. **The offer may be express or implied:**
9. **Offer is Different from a mere statement of intention, an invitation to offer, a mere communication of information, A prospectus and Advertisement.**

(a) A statement of intention and announcement.

(b) Offer must be distinguished from an answer to a question. (Case Law: Harvey vs. Facey [1893])

(c) A statement of price is not an offer: Quoting the price of a product does not constitute it as offer.

(d) An invitation to make an offer or do business. In case of "an invitation to make an 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.

When goods are sold through auction, the auctioneer does not contract with anyone who attends the sale.

## 10. A statement of price is not an offer

What is invitation to offer?

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

## ACCEPTANCE

Definition of Acceptance: As Per Sec 2 (C)

When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted.

Relationship between offer and acceptance: According to Sir William Anson "Acceptance is offer what a lighted match is to a train of gun powder". The effect of this observation is to that what acceptance triggers cannot be recalled or 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. This means as soon as the train of gun powder is lighted it would explode. Train of Gun powder [offer] in itself is inert, but it is the lighted match [the acceptance] which causes the gun powder to 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.

## Legal Rules regarding a valid acceptance

1. Acceptance can be given only by the person to whom offer is made: (Boulton vs. Jones (1857))

2. Acceptance must be absolute and unqualified:

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.

3. The acceptance must be communicated: To conclude a contract between the parties, the acceptance must be communicated in some perceptible form.

Any conditional acceptance or acceptance with varying or too deviant conditions is no acceptance. (Brogden vs. Metropolitan Railway Co. (1877))

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
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.**

## COMMUNICATION OF OFFER AND ACCEPTANCE

**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"**.

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

**Communication of acceptance:** There are two issues for discussion and understanding. They are: The modes of acceptance and when is acceptance complete?

the **modes of acceptance**. **Section 3** of the Act prescribes in general terms two modes of communication namely, **(a) by any act and (b) by omission**, intending thereby, to communicate to the other or which has the effect of communicating it to the other.

**Communication by act** would include any expression of words whether written or oral.

**Communication of acceptance by 'omission' to do something.**

However, silence would not be treated as communication by 'omission'.

**Communication of acceptance by conduct.**

when communication of acceptance is complete. In terms of **Section 4 of the Act**, it is complete.

**(i) As against the proposer**, when it is put in the course of transmission to him so as to be out of the power of the acceptor to withdraw the same;

**(ii) As against the acceptor**, when it comes to the knowledge of the proposer.

**Where a proposal is accepted by a letter sent by the post**, 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.

**Acceptance over telephone or telex or fax:** the acceptance is received

**Communication of special conditions:** Sometimes there are situations where there are contracts with special conditions. These special conditions are conveyed tacitly and the acceptance of these conditions are also conveyed by the offeree again tacitly or without him even realizing it. When someone travels from one place to another by air, it could be seen that special Conditions are printed at the back of the air ticket in small letters [in a non- computerized train ticket even these are not printed] Sometimes these conditions are found to have been displayed At the notice board of the Airlines office, which passengers may not have cared to read. The question here is whether these conditions can be considered to have been communicated to the passengers of the Airlines and can the passengers be treated as having accepted the conditions. The answer to the question is in the affirmative and was so held in **Mukul Datta vs. Indian Airlines [1962] AIR cal. 314** where the plaintiff had travelled from Delhi to Kolkata by air

and the ticket bore conditions in fine print. But such terms and condition should be reasonable.  
**(Lilly White vs. Mannuswamy)**

**Standard forms of contracts:** It is well established that a standard form of contract may be enforced on another who is subjectively unaware of the contents of the document, provided the party wanting to enforce the contract has given notice which, in the circumstances of a case, is sufficiently reasonable. But the acceptor will not incur any contractual obligation, if the document is so printed and delivered to him in such a state that it does not give reasonable notice on its face that it contains certain special conditions.

## COMMUNICATION OF PERFORMANCE

(i) From the viewpoint of proposer and

(ii) The other from the viewpoint of acceptor himself

From the viewpoint of proposer, when the acceptance is put into a course of transmission, when it would be out of the power of acceptor. From the viewpoint of acceptor, it would be complete when it comes to the knowledge of the proposer.

## REVOCATION OF OFFER AND ACCEPTANCE

Communication of revocation is complete.

(i) 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

(ii) as against the person to whom it is made, when it comes to his knowledge. 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.

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

**Contract through post-** As acceptance, in English law, cannot be revoked, so that once the letter of acceptance is properly posted the contract is concluded. In Indian law, the acceptor or 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.

**Revocation of proposal otherwise than by communication:** When a proposal is made, the proposer may not wait indefinitely for its acceptance. The offer can be revoked otherwise than by communication or sometimes by lapse.

### Modes of revocation of offer

(i) By notice of revocation:

(ii) By lapse of time: within the specified time and where no time is specified, then within a reasonable time. This is for the reason that proposer should not be made to wait indefinitely.

(iii) By non-fulfilment of condition precedent: gets revoked.

(iv) By death or insanity: knowledge of the acceptor.

(v) By counter offer

(vi) By the non-acceptance of the offer according to the prescribed or usual mode

(vii) By subsequent illegality.



## Difference between Agreement and Contract

Basis of differences	Agreement	Contract
<b>Meaning</b>	Every promise and every set of promises, forming the consideration for each other. (Promise + Consideration)	Agreement enforceable by law. (Agreement + Legal enforceability)
<b>Scope</b>	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.
<b>Legal obligation</b>	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.
<b>Nature</b>	All agreement are not contracts.	All contracts are agreements.

## On the basis of the Validity

S. No.	Basis	Void Contract	Voidable Contract
1	<b>Meaning</b>	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	<b>Enforceability</b>	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	<b>Cause</b>	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	<b>Performance of contract</b>	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	<b>Rights</b>	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.



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

#### Difference between offer and invitation to make an offer:

Basis	Offer	Invitation to offer
<b>Meaning</b>	Section 2(a) of the Act, an offer is the final expression of willingness by the offeror to be bound by the offer should the other 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 only invites the other party to make an offer on those terms.
<b>Intention of the parties</b>	If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer.	If a person has the intention of negotiating on terms it is called invitation to offer.
<b>Sequence</b>	An offer cannot be an act precedent to invitation to offer.	An invitation to offer is always an act precedent to offer.

## CHAPTER-2 UNIT 2: CONSIDERATION

### WHAT IS CONSIDERATION ?

**Section 2(d) defines consideration as follows:**

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

**Consideration is an act- doing something**

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

Form of consideration = Some benefit, right or profit to one party / some detriment, loss, or forbearance to the other

### LEGAL RULES REGARDING 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.  
 An act done at the desire of a third party is not a consideration (**Durga Prasad v. Baldeo**)
- 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 (**Chinnayya vs. Ramayya**)
- 3. Executed and executory consideration:** A consideration which consists in the performance of an act is said to be executed. When it consists in a promise, it is said to be executory.
- 4. Consideration may be past, present or future:**
- 5. Consideration need not be adequate:** 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.  
 But as an exception if it is shockingly less and the other party alleges that his consent was not free than this inadequate consideration can be taken as an evidence in support of this Allegation.
- 6. Performance of what one is legally bound to perform:** The performance of an act by a person who is legally bound to perform the same cannot be consideration for a contract.
- 7. Consideration must be real and not illusory:** It must be something to which the law attaches some value.
- 8. Consideration must not be unlawful, immoral, or opposed to public policy**  
 Anything which is immoral or opposed to public policy also cannot be valued as valid Consideration.

### SUIT BY A THIRD PARTY TO A CONTRACT

Only a person who is party to a contract can sue on it

The concept of stranger to consideration is a valid and is different from stranger to a contract.  
**stranger to a contract cannot sue is known as a "doctrine of privity of contract",**  
 is however, subject to certain exceptions.

- 1. In the case of trust,** a beneficiary can enforce his right under the trust
- 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, he may file the 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.
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.

### VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION

The general rule is that an agreement made without consideration is void (Section 25). However, the Indian Contract Act contains certain exceptions to this rule.

#### 1. **Natural Love and Affection:**

- 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

#### 2. **Compensation for past voluntary services :**

the following essential factors must exist :

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

#### 3. **Promise to pay time barred debt:**

#### 4. **Agency:**

5. **Completed gift**: "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:**

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**)

## CHAPTER-2 UNIT 3: OTHER ESSENTIAL ELEMENTS OF A CONTRACT

**Section 10 of the Indian Contract Act, 1872 provides that an agreement in order to be a contract, must satisfy the following conditions:**

- (i) the parties must be **competent** to contract;
- (ii) it must be made by the **free consent** of the parties;
- (iii) it must be made for a **lawful consideration** and with a **lawful object**;

### CAPACITY TO CONTRACT

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

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

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

- (A) **Age of Majority** : Every person domiciled in India shall attain the age of majority on the completion of 18 years Of and not before.

#### Law relating to Minor's agreement/Position of Minor

1. **A contract made with or by a minor is void ab-initio:** (*Mohori Bibi vs. Dharmo Das Ghose (1903)*)
2. **No ratification after attaining majority:**
3. **Minor can be a beneficiary or can take benefit out of a contract:**
4. **A minor can always plead minority:** A minor can **always plead minority** and is not stopped to Do so even where he has taken any loan or entered into any contract by falsely representing That He was major.
5. **Liability for necessities:** The case of necessities supplied to a minor or to any other person whom such minor is legally bound to support is governed by section 68 of the Indian Contract Act Necessaries mean those things that are essentially needed by a minor. **They cannot include luxuries or costly or unnecessary articles.**
6. **Contract by guardian - how far enforceable:** . Where the guardian makes a contract for the minor, which is within his competence and which is for the benefit of the minor, there will be valid contract which the minor can enforce.
7. **No specific performance:**
8. **No insolvency:**
9. **Partnership:** under **Section 30 of the Indian Partnership Act**, he can be admitted to the benefits of partnership.
10. **Minor can be an agent:** A minor can draw, deliver and endorse negotiable instruments without himself being liable.
11. **Minor cannot bind parent or guardian:** The parents will be held liable only when the child is acting as an agent for parents.
12. **Joint contract by minor and adult:** the adult will be liable on the contract and not the minor.
13. **Surety (Guarantor) for a minor:** when an adult stands surety for a minor then he is liable to third party as there is direct contract between the surety and the third party.

14. **Minor as Shareholder:** A minor, being incompetent to contract cannot be a shareholder of the company. But, a minor may, acting through his lawful guardian become a shareholder by transfer or transmission of fully paid shares to him.
15. **Liability for torts:** A minor is liable in tort unless the tort in reality is a breach of contract
- (B) **Person of sound mind:** "a person is said to be of sound mind for the purposes 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."  
*A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind.*
- (C) **Contract by disqualified persons:** The following persons fall in this category: Foreign Sovereigns and Ambassadors, Alien enemy, Corporations, Convicts, Insolvent etc.
- FREE CONSENT**
- Definition of Consent according to Section 13:**  
 "two or more persons are said to consent when they agree upon the same thing in the same sense."
- Definition of 'Free Consent' (Section 14)**  
 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**
- (I) **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**
- (i) Contract induced by coercion **is voidable** at the option of the party whose consent was so obtained.
- (ii) A person to whom **money has been paid or anything** delivered under coercion must repay **or return it. (Section 72)**
- Threat to commit suicide- Whether is it coercion?**  
**Section 15** declares that committing or threatening to commit any act forbidden by Indian Penal Code is coercion. **Hence, a threat to commit suicide will be regarded as coercion.**
- (II) **Undue influence (Section 16)**  
 "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**".
- The essential ingredients under this provision are:**
- Relation between the parties:**
  - Position to dominate the will:** A person is deemed to be in such position in the following circumstances:
    - Real and apparent authority:**
    - Fiduciary relationship:**
    - Mental distress:**
    - Unconscionable bargains**



3. **The object must be to take undue advantage:**

4. **Burden of proof:** When a party to contract decides to avoid the contract on the ground of undue influence, he has to prove that-

(a) The other party is in position to **dominate his will**,

(b) The other party **actually used his position to obtain his consent**,

(c) Transaction is **unfair or unconscionable**.

**Effect of undue influence - (Section 19A)**

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

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

### (III) **Fraud (Section 17)**

**Definition of Fraud under Section 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

(2) The **active concealment** of a 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 following are the essential elements of the fraud:**

1. There must be a representation or assertion and it must be false. However, silence may amount to fraud or an active concealment may amount to fraud.

**Whether Silence is fraud or not?**

silence is fraud in following situations:

(a) There is **duty to speak**.

(b) When **silence is equal to speech**.

2. The **representation** must be related to a **fact**.

3. The **representation** should be **made before the conclusion of the contract**

4. The **representation** should be made with a **knowledge of its falsity**

5. The **other party** must have been **induced to act** upon the representation

6. The **other party** must have **relied upon the representation**

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

**Effect of Fraud upon validity of a contract:** When the consent to an agreement is caused by the fraud, the contract is voidable at option of the party defrauded and he has the Following remedies:

(1) He can **rescind** the contract within a reasonable time.

(2) He can **sue for damages**.

(3) He can **insist on the performance** of the contract on the condition that he shall be put in the position in which he would have been had the representation made been true.

**Exception:** In the following cases, contract is not voidable:



- (i) If the party whose consent was caused by silence which amounting to fraud, had the means of discovering the truth with ordinary diligence.
- (ii) A fraud which did not cause the consent of the party to agreement.

#### (IV) **Misrepresentation (Section 18)**

According to Section 18, there is misrepresentation:

- (1) Statement of fact, which of false, would constitute misrepresentation if the maker **Believes to be true**
- (2) When there is a **breach of duty** by a person without any intention to deceive
- (3) When a party causes, even though done innocently, the other party to the agreement to **Make a mistake as to the subject matter.**

**Difference between Coercion and Undue influence:**

**Distinction between fraud and misrepresentation:**

**Mistake:** Mistake may be defined as innocent or erroneous belief which leads the party to misunderstand the others. Mistake may be either mistake of law or mistake of fact.

**Mistake of Law:**

**Mistake of Indian Law:** Mistake of law is further classified as mistake of Indian law or mistake of foreign law.

**Mistake of foreign law:** Such a mistake is treated as mistake of fact and the agreement in such a case is void.

**Mistake of fact:** Mistake of fact are of two types -

(i) **Bilateral Mistake**, (ii) **Unilateral Mistake**

(i) **Bilateral mistake:** Where both the parties to an agreement are under a Mistake as to a matter of fact essential to the agreement, there is a bilateral mistake.

**In such a case, the agreement is void (Section 20).**

(ii) **Unilateral Mistake:** According to **Section 22**, a contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact.

**When it is fraudulent:**

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 34:** 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.

**When consideration is immoral:**

**When consideration is opposed to public policy:**

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

- (i) **Trading with enemy:** Any trade with person owing allegiance to a Government at war with India without the licence of the Government of India is void
- (ii) **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.
- (iii) **Maintenance and Champerty:** Maintenance is an agreement in which a person promises to

**maintain suit in which he has no interest.**

**Champerty** is an agreement in which a person agrees to assist another in litigation in- **exchange** of a promise to hand over a portion of the proceeds of the action.

(a) It is unreasonable so as to be unjust to other party or

(b) It is made by a malicious motive like that of gambling in litigation

**(iv) 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.

**(v) Agreements tending to create monopolies:**

**(vi) Marriage brokerage agreements:** An agreement to negotiate marriage for reward, which is known as a marriage brokerage contract, is void.

**Note:** Marriage bureau only provides information and doesn't negotiate marriage for reward, therefore, it is not covered under this point.

**(vii) Interference with the course of justice:** An agreement whose object is to induce any judicial officer of the State to act partially or corruptly is void.

**(viii) Interest against obligation:** The object of such agreements is opposed to public policy.

**(ix) Consideration Unlawful in Part:** if any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void."

### **VOID AGREEMENTS :-**

1. Made by incompetent parties (Section 11)	6. Agreement in restraint of marriage (Section 26)
2. Agreements made under Bilateral mistake of fact (Section 20)	7. Agreements in restraint of trade (Section 27)
3. Agreements the consideration or object of which is unlawful (Section 23)	8. Agreement in restraint of legal proceedings (Section 28)
4. Agreement the consideration or object of which is unlawful in parts (Section 24)	9. Agreement the meaning of which is uncertain (Section 29)
5. Agreements made without consideration (Section 25)	10. Wagering Agreement (Section 30)
[Refer Unit 2]	11. Agreements to do impossible Acts (Section 56)

1. **Agreement in restraint of marriage (Section 26):** Every agreement in restraint of marriage of any person other than a minor, **is void.**

2. **Agreement in restraint of trade (Section 27):** **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 this rule is subject to the following exceptions, namely, where a person sells the goodwill of a Business and agrees with the buyer to refrain from carrying on a similar business, within specified local limits, Under Section 36 of the Indian Partnership Act, 1932 if an outgoing partner makes an agreement with the continuing partners that he will not carry on any business similar to that of the firm within a specified period. such an agreement, though in restraint of trade, will be valid under Section 11 of that Act an agreement between partners not to carry on competing business during the continuance of

partnership is valid.

3. **Agreement in restraint of legal proceedings (Section 28):** An agreement in restraint of legal proceeding is the one by which any party thereto is restricted absolutely from enforcing his rights under a contract through a Court or which abridges the usual period for **starting legal proceedings**. A contract of this nature is void.
4. **Agreement - the meaning of which is uncertain (Section 29):**
5. **Wagering agreement (Section 30):** 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.
  - (1) Essentials of a Wager There must be a promise to pay **money or money's worth**.
  - (2) Promise must be **conditional** on an event happening or not happening.
  - (3) There must be **uncertainty of event**.
  - (4) There must be **two parties**, each party must stand to win or lose.
  - (5) There must be **common intention to bet at** the timing of making such agreement.
  - (6) Parties should have **no interest in the event except for stake**.

#### **Transactions similar to Wager (Gambling)**

- (i) **Lottery transactions:** A lottery is a game of chance and **not of skill or knowledge**.  
 Where the prime motive of participant is **gambling**, the transaction amounts to a wager.
- (ii) **Crossword Puzzles and Competitions:** Crossword puzzles in which prizes depend upon the **correspondence of the competitor's solution with a previously prepared solution kept with the Editor of a newspaper is a lottery and therefore, a wagering transaction**.  
 Crossword puzzles, picture competitions and athletic competitions where prizes are awarded on the basis of skill and intelligence are the games of skill and hence such competitions are valid. According to the Prize Competition Act, 1955 prize competitions in games of skill are not wagers provided the prize money does not exceed Rs. 1,000.
- (iii) **Speculative transactions:** an agreement or a share market transaction where the parties intend to settle the difference between the contract price and the market price of certain Goods or shares on a specified day, is a gambling and hence void.
- (vi) **Horse Race Transactions:** A horse race competition where prize payable to the bet winner is less than ₹ 500, is a wager.

## Difference between Coercion and Undue influence:

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

### Distinction between fraud and misrepresentation:

Basis of difference	Fraud	Misrepresentation
<b>Intention</b>	To deceive the other party by hiding the truth.	There is no such intention to deceive the other party.
<b>Knowledge of truth</b>	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.
<b>Rescission of the contract and claim for damages</b>	The injured party can repudiate the contract and claim damages.	The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages.
<b>Means to discover the truth</b>	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.

### Distinction between Contract of Insurance and Wagering Agreement

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



## CHAPTER-2 UNIT 4 : PERFORMANCE OF CONTRACT

### PERFORMANCE OF CONTRACT CONTRACT

**Meaning:** "Performance of Contract" means **fulfilment of obligations** to the contract.

According to Section 37, 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.

**Types:** On the basis of Section 37, "Performance of Contract" may be actual or attempted.

**Actual Performance:** Where a party to a contract **has done what he had undertaken to do** or either of the parties has fulfilled their obligations under the contract within the time and in the manner prescribed.

**Offer to perform or attempted performance or tender of performance:** It may happen sometimes, when the performance becomes due, **the promisor offers to perform his obligation but the promisee refuses to accept the performance.**

### CONDITIONS TO BE SATISFIED FOR A VALID TENDER OR ATTEMPTED PERFORMANCE

It must be **unconditional**.

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

**Reasonable opportunity to examine goods.**

It must be for **whole obligation**.

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

1. **Promisor himself:** If there is something in the contract to show that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor.
2. **Agent**
3. **Legal Representatives**
4. **Third persons: Effect of accepting performance from third person- Section 41 :**  
 When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. That is, **performance by a stranger, if accepted by the promisee, this results in discharging the promisor.**
5. **Joint promisors (Section 42):**
  - When two or more persons have made a joint promise, **all such persons must jointly fulfil the promise.**
  - **If any of them dies, his legal representatives must, jointly with the surviving promisors fulfil the promise.**
  - If all of them die, the legal representatives of all of them must fulfil the promise jointly.
  -

### DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT

**In the case of succession :** When the benefits of a contract are succeeded to by process of law, then both burden and Benefits attaching to the contract, may sometimes devolve on the legal heir.

**In the matter of assignment,** however the benefit of a contract can only be assigned but not the liabilities thereunder. This is because when liability is assigned, a third party gets involved therein. Thus,



a debtor cannot relieve himself of his liability to creditor by assigning to someone else his obligation to repay the debt.

## LIABILITY OF JOINT PROMISOR & PROMISEE

### Devolution of joint liabilities (Section 42)

- When two or more persons have made a joint promise, **all such persons must jointly fulfil the promise.**
- **If any of them dies, his legal representatives must, jointly with the surviving promisors fulfil the promise.**
- If all of them die, the legal representatives of all of them must fulfil the promise jointly.

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

When two or more persons make a joint promise, **the promisee may, compel any one or more** of such joint promisors **to perform the whole of the promise.**

Sharing of loss by default in contribution - 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.

### Effect of release of one joint promisor- 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.

### Rights of Joint Promisees

"When a person has made a promise to two or more persons jointly, the right to claim performance rests, as between him and them, with them during their joint lives, and after the death of any of them, with the representative of such deceased person jointly with the survivor or survivors, and after the death of the last survivor, with the representatives of all jointly".

## TIME AND PLACE FOR PERFORMANCE OF THE PROMISE

The law on the subject is contained in Sections 46 to 50 explained below :

1. Time for performance of promise, where **no application** is to be made and **no time is specified** - Section 46
2. Time and place for performance of promise, where **time is specified** and **no application** to be made - Section 47
3. Application for performance on certain day to be at proper time and place - Section 48
4. Place for the performance of promise, where **no application** to be made and **no place fixed** for performance - Section 49
5. Performance in manner or at time **prescribed** or sanctioned **by promisee** - Section 50

## PERFORMANCE OF RECIPROCAL PROMISE

1. Promisor not bound to perform, unless reciprocal promisee ready and willing to perform - Section 51
2. Order of performance of reciprocal promises- Section 52

When the **order of performance** of the reciprocal promises is **expressly fixed** by the contract, **they shall be performed in that order**; and where the **order is not expressly fixed** by the contract, **they shall be performed** in that order which the **nature of the transaction requires**.

**3. Liability of party preventing event on which the contract is to take effect - Section 53**

When a contract contains reciprocal promises, and **one party to the contract prevents the other** from performing his promise, **the contract becomes voidable at the option of the party so prevented**; and he is entitled to compensation from the other party for any loss he may sustain in consequence of the non- performance of the contract.

**4. Effect of default as to that promise which should be first performed, in contract consisting of reciprocal promises (Section 54)**

If the promisor who has to perform his promise before the performance of the other's promise fails to perform it, he cannot claim performance of the other's promise, and is also liable for compensation for his non- performance.

**5. Effects of Failure to Perform at a Time Fixed in a Contract in which Time is Essential (Section 55)**

"When a party to a contract promises to do certain thing at or before the specified time, and fails to do any such thing at or before the specified time, **the contract**, or so much of it as has not been performed, becomes **voidable at the option of the promisee, if the intention of the parties was that time should be of essence of the contract**".

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

If it was not **the intention of the parties that time should be of essence of the contract**, **the contract does not become voidable** by the failure to do such thing at or before the specified time; but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.

**6. Agreement to do Impossible Act (Section 56)**

(a) initial impossibility, and (b) subsequent impossibility.

**a. Initial Impossibility (Impossibility existing at the time of contract):** When the parties agree upon doing of something which is obviously impossible in itself the agreement would be void.

**(i) If known to the parties:** It would be observed that an agreement constituted, **known to the parties**, may be impossible of being performed and hence **void**.

**(ii) If unknown to the parties:** Where **both the promisor and the promisee are ignorant** of the impossibility of performance, the contract is **void**

**(iii) If known to the promisor only:** Where at the time of entering into a contract, **the promisor alone knows about the impossibility of performance**, the promisee is entitled to **claim compensation** for any loss he suffered on account of non- performance.

**b. Subsequent or Supervening impossibility:** 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.* The **effect of such impossibility is that it makes the contract void**, and the parties are discharged from the further Performance.

**7. Reciprocal promise to do certain things that are legal, and also some other things that are illegal- Section 57**

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

**8. 'Alternative promise' one branch being illegal- Section 58**

The law on this point is contained in Section 58 which says that "In the case of the alternative promise, one branch of which is legal and the other illegal, **the legal branch alone can be enforced**".

### APPROPRIATION OF PAYMENTS

the payment is appropriated as per **Section 59 to 61** of the Indian Contract Act.

**1. Application of payment where debt to be discharged is indicated (Section 59):**

**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.**

**2. Application of payment where debt to be discharged is not indicated (Section 60):**

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. However, he cannot apply the payment to the disputed debt.

**3. Application of payment where neither party appropriates (Section 61):** **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.

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

The law is contained in Sections 62 to 67 of the Contract Act.

**1. Effect of novation, rescission, and alteration of contract (Section 62)**

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

#### Analysis of Section 62

- (a) **Effect of novation:** The parties to a contract may substitute a new contract for the old.
- (b) **Effect of rescission:** A contract is also discharged by rescission. When the parties to a contract agree to rescind it, the contract need not be performed.
- (c) **Effect of alteration of contract:** As in the case of novation and rescission, so also in a case where the parties to a contract agree to alter it, the original contract is rescinded, with the result that it need not be performed.

**2. Promisee may waive or remit performance of promise (Section 63):**

### 3. Restoration of Benefit under a Voidable Contract (Section 64)

#### 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.**

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

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

### 5. Communication of rescission (Section 66): rescission must be communicated to the other party in the same manner as a proposal is communicated under Section 4 of the Contract Act.

### 6. Effects of neglect of promisee to afford promisor reasonable facilities for performance (Section 67): If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, **the promisor is excused by such neglect or refusal** as to any non-performance caused thereby.

## DISCHARGE OF A CONTRACT

### 1. Discharge by performance: It takes place when the parties to the contract fulfil their obligations arising under the contract within the time and in the manner prescribed.

Discharge by performance may be

1. Actual performance; or
2. Attempted performance.

### 2. Discharge by mutual agreement: Section 62 of the Indian Contract Act provides if the parties to a contract agree to substitute a new contract for it, or to rescind or remit or alter it, the original contract need not be performed.

### 3. Discharge by impossibility of performance: The impossibility may exist from the very start. In that case, it would be impossibility ab initio. Supervening impossibility may take place owing to :

- an unforeseen change in law;
- the destruction of the subject-matter
- the non-existence or non-occurrence of particular state of things
- the declaration of a war (Section 56)

### 4. Discharge by lapse of time: A contract should be performed within a specified period as prescribed by the Limitation Act, 1963

### 5. Discharge by operation of law:

### 6. Discharge by breach of contract

### 7. Promisee may waive or remit performance of promise

### 8. Effects of neglect of promisee to afford promisor reasonable facilities for performance :

### 9. Merger of rights: Sometimes, the inferior rights and the superior rights coincide and meet in one and the same person. In such cases, the inferior rights merge into the superior rights. **On merger, the inferior rights vanish and are not required to be enforced.**

## CHAPTER-2 UNIT 5: BREACH OF CONTRACT AND ITS REMEDIES

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

### ANTICIPATORY BREACH OF CONTRACT

Anticipatory breach of a contract may take either of the following two ways

- (a) Expressly by words spoken or written, and
- (b) Impliedly by the conduct of one of the parties.

**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:

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**.

### ACTUAL BREACH OF CONTRACT

**Actual breach of contract may be committed-**

- (a) **At the time when the performance of the contract is due.**
- (b) **During the performance of the contract :**

**Remedies for Breach of Contract**

### SUIT FOR DAMAGES

- (i) **Ordinary damages:** 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 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.

- (ii) **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.

- (iii) **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.**

(iv) **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.

(v) **Damages for deterioration caused by delay**: In the case of deterioration caused to goods by delay, damages can be recovered from 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.**

(vi) **Pre - fixed damages**: Sometimes, **parties to a contract stipulate at the time of its formation** that on a breach of contract by any of them, **a certain amount will be payable as damage.** It may amount to either liquidated damages or a penalty

### **PENALTY AND LIQUIDATED DAMAGES (SECTION 74)**

**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.**

But where.

the **sum fixed** in the contract is **unreasonable and is used to force the other party** to perform the contract; **it is penalty.** Such a clause of 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.

**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.

### **Distinction between liquidated damages and penalty**

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.

5. The essence of liquidated damages is a **genuine pre-estimate of the damage**.

6. 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.

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

1. **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.
2. **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.

The claim for quantum meruit arises in the following cases

- (a) When an agreement is discovered to be void or when a contract becomes void.
- (b) When something is done without any intention to do so gratuitously.
- (c) Where there is an express or implied contract to render services but there is no agreement as to remuneration
- (d) When one party abandons or refuses to perform the contract
- (e) Where a contract is divisible and the party not in default has enjoyed the benefit of part performance.
- (f) When an indivisible contract for a lump sum is completely performed but badly the person who has performed the contract can claim the lump sum but the other party can make a deduction for bad work.

3. **Suit for specific performance**

4. **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.

## CHAPTER-2 UNIT-6 CONTINGENT AND QUASI CONTRACTS

### CONTINGENT CONTRACTS

#### 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".

**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".

#### Essentials of a contingent contract

- (a) The performance of a contingent contract would depend upon the **happening or non-happening** of some event or condition.
- (b) The event referred to as **collateral** to the contract.
- (c) The contingent event should **not be a mere 'will'** of the promisor.
- (d) The event must be **uncertain**.

### 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**.

#### (a) Enforcement of contracts contingent on an event happening:

"where a contingent contract is made to do or not to do anything if an uncertain future Event happens, it cannot be enforced by law unless and **until that event has happened**. **If the event becomes impossible, such contracts become void**".

#### (b) Enforcement of contracts contingent on an event not happening:

Section 33 says that "Where a contingent contract is made to do or not do anything if an uncertain future event does not happen, **it can be enforced only when the happening of that event becomes impossible and not before**".

#### (c) 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' of 'conduct' as Impossible of happening.

#### (d) 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.

#### (e) 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".

#### (f) 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.

## QUASI CONTRACTS

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.

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. These are known as quasi contracts as they create same obligations as in the case of regular contract.

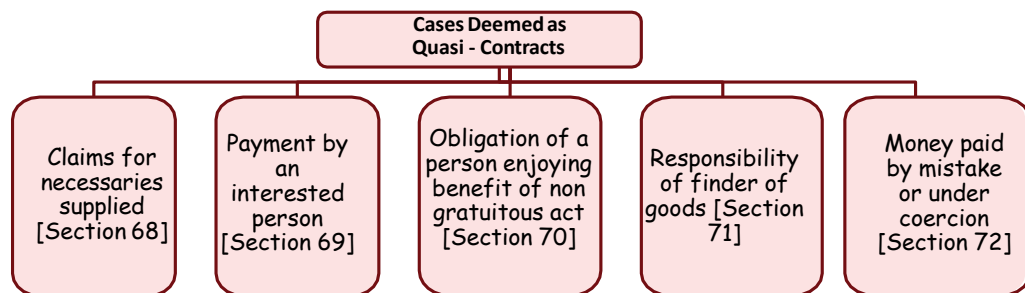
A quasi or constructive contract rest upon the maxims, "**No man must grow rich out of another person's loss**".

### Salient features of quasi contracts:

(a) In the first place, such a right is always a **right to money**

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

(c) Thirdly, it is a right which is available not against all the world, but against a **particular Person**.



### (a) Claim for necessities supplied to persons incapable of contracting (Section 68):

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

### (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):

"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 is **bound to pay compensation to the former** in respect of, or to restore, the thing so done or delivered".

**It thus follows that for a suit to succeed, the plaintiff must prove:**

✚ that he **had done the act or had delivered the thing lawfully**;

✚ that he **did not do so gratuitously**; and

✚ that the **other person enjoyed the benefit**.

### (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:**

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

(ii) **no right to appropriate** the goods and

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

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

### Difference between a contingent contract and a wagering contract

Basis of difference	Contingent contract	Wagering contract
<b>Meaning</b>	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.
<b>Reciprocal promises</b>	Contingent contract may not contain reciprocal promises.	A wagering agreement consists of reciprocal promises.
<b>Uncertain event</b>	In a contingent contract, the event is collateral.	In a wagering contract, the uncertain event is the core factor.
<b>Nature of contract</b>	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.
<b>Interest of contracting parties</b>	Contracting parties have interest in the subject matter in contingent contract.	The contracting parties have no interest in the subject matter.
<b>Doctrine of mutuality of lose and gain</b>	Contingent contract is not based on doctrine of mutuality of lose and gain.	A wagering contract is a game, losing and gaining alone matters.
<b>Effect of contract</b>	Contingent contract is valid.	A wagering agreement is void.

### Difference between quasi contracts and contracts

Basis of distinction	Quasi- Contract	Contract
<b>Essential for the valid contract</b>	The essentials for the formation of a valid contract are absent	The essentials for the formation of a valid contract are present
<b>Obligation</b>	Imposed by law	Created by the consent of the parties

## CHAPTER-2 UNIT 7: CONTRACT OF INDEMNITY AND GUARANTEE

### CONTRACT OF INDEMNITY

The term "Contract of Indemnity" is defined under Section 124 of the Indian Contract Act, 1872. It is "a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person."

Parties: -

- The party who promises to indemnify/ save the other party from loss- "indemnifier",
- The party who is promised to be saved against the loss- "indemnified" or "indemnity holder".

**Mode of contract of indemnity:** A contract of indemnity like any other contract may be express or implied

- A contract of indemnity is said to be express when a person expressly promises to compensate the other from loss.**
- A contract of indemnity is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case.**

A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance

### Rights of Indemnity-holder when sued

- all damages which he may be compelled to pay in any suit**
- all costs which he may have been compelled to pay** in bringing/ defending the suit and
- all sums which he may have paid** under the terms of any compromise of suit.

When does the liability of an indemnifier commence ?

the liability of an indemnifier commences as soon as the liability of the indemnity-holder becomes absolute and certain.

### CONTRACT OF GUARANTEE

**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.

**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

A contract of guarantee is a tripartite agreement between principal debtor, creditor and surety. There are, in effect three contracts

- A principal contract between the principal debtor and the creditor.**
- A secondary contract between the creditor and the surety.**
- An implied contract between the surety and the principal debtor** whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

### ESSENTIAL FEATURES OF A GUARANTEE

**The following are the requisites of a valid guarantee :-**

- Purpose:** The purpose of a guarantee being to secure the payment of a debt
- Consideration:** Like every other contract, a contract of guarantee should also be supported by some consideration. A guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor.



3. **Existence of a liability:** There must be an existing liability or a promise whose performance is guaranteed. Such liability or promise must be enforceable by law. The liability must be legally enforceable and not time barred.

4. **No misrepresentation or concealment** (section 142 and 143): Any guarantee which has been obtained by the means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid (section 142)

**Writing not necessary:** Section 126 expressly declares that a guarantee may be either oral or written.

### TYPES OF GUARANTEES

Guarantee may be classified under two categories:

1. **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.

2. **Continuing Guarantee [Section 129]** - A guarantee which extends to a series of transaction is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

### NATURE AND EXTENT OF SURETY'S LIABILITY

1. The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract

2. Liability of surety is of 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.

### 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 third person may have been aware of its existence. (Section 132)

### DISCHARGE OF A SURETY

By revocation of the Contract of Guarantee

(i) **Revocation of continuing guarantee by Notice.**

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.

(ii) **Revocation of continuing guarantee by surety's death** the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.

(iii) **By novation [Section 62]:** The surety under original contract is discharged if a fresh contract is entered into either between the same parties or between the other parties, the consideration being the mutual discharge of the old contract.

(iv) **By conduct of the creditor**

(v) **By variance in terms of contract :** it would discharge the surety in respect of all transactions taking place subsequent to such variance

(vi) **By release or discharge of principal debtor** The surety is discharged if the Creditor:

- i. enters into a fresh/ new contract with principal debtor; by which the principal debtor is released, or
- ii. does any act or omission, the legal consequence of which is the discharge of the principal Debtor.

**(vii) Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor**

- i. **Composition:** If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged.
- ii. **Promise to give time:** When the time for the payment of the guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt.
- iii. **Promise not to sue:** If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged.

**Cases where surety not discharged**

- i. Surety not discharged when agreement made with third person to give time to principal Debtor.
- ii. Creditor's forbearance to sue does not discharge surety.

**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.

**By the invalidation of the contract of guarantee**

- (a) **Guarantee obtained by misrepresentation :** Any guarantee which has been obtained by means of misrepresentation made by the creditor, or **with his knowledge and assent concerning a material part of the transaction, is invalid.**
- (b) **Guarantee obtained by concealment :** Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

**Guarantee on contract that creditor shall not act on it until co-surety joins**

**Section 144):** Where a person gives a guarantee upon a contract that the creditor shall not act upon it **until another person has joined in it as co-surety**, the guarantee is not valid if that other person does not join.

**RIGHTS OF A SURETY**

**Right against the principal debtor**

**Rights 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.**

**Implied promise to indemnify surety :** In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety.

**Right against the Creditor**

- (a) **Surety's right to benefit of creditor's securities [Section 141]:** 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.

(b) **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.

(c) **Right to share reduction:** The surety has right to **claim proportionate reduction in his** liability if the principal debtor becomes insolvent.

#### **Rights against co-sureties**

" Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties"

(d) **Co- sureties liable to contribute equally**

**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.**

## CHAPTER-2 UNIT 8: BAILMENT AND PLEDGE

### WHAT IS BAILMENT ?

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.

Parties to bailment :

- (a) **Bailor:** The person delivering the goods.
- (b) **Bailee :** The person to whom the goods are delivered.

#### Essential Elements:

The **essential elements** of a contract of bailment are -

- (a) **Contract:**
- (b) **Delivery of goods:**
  - 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.
- (c) **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.
- (d) **Return of goods:** Bailee is obliged to return the goods physically to the bailor.

### Types of bailment

1. On the basis of benefit, bailment can be classified into three types:
  - a. For the exclusive benefit of bailor
  - b. For the exclusive benefit of bailee:
  - c. For mutual benefit of bailor and bailee
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:** Non gratuitous bailment means where both the parties get some benefit i.e. bailment for the **benefit of both bailor & bailee**.

### DUTIES OF A BAILOR

**Duties of Bailor:** The duties of bailor are spelt out in a number of Sections [Section 150, 158, 159, 164]. These are categorized under the following headings:

- (i) **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.
  - 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.

(ii) **Duty to pay necessary expenses**

- 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.

(iii) **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.

(iv) **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 to make the bailment, or to receive back the goods or to give directions, respecting them (defective title in goods)
- b. It is the duty of the bailor **to receive back the goods** when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished.

### DUTIES OF A BAILEE

1. **Take reasonable care of the goods :** 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.
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.**
3. **Not to mix the goods:**
  1. 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
  2. If the bailee, without the consent of the bailor, **mixes the goods bailed with his own goods and the goods can be separated or divided**, the property in the goods remains in the parties respectively; but **the bailee is bound to bear the expense of separation or division and any damage arising from the mixture (Section 156).**
  3. 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 (Section 157)

4. **Return the goods (Section 160 & 161):** It is the duty of bailee to return, or deliver according to the bailor's directions, the goods bailed without demand, as soon as the time for which they were bailed, has expired, or the purpose for which they were bailed has been accomplished. [Section 160].
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
6. **Not to setup 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 :

- (i) **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
- (ii) **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
- (iii) **Right to file a suit against a wrong doer.**
- (iv) **Right to sue the bailee**
- (v) **Right to compensation:** If any damage is caused to the goods bailed because of the unauthorized use of the goods or unauthorized mixing of the goods, the bailor has a right to claim compensation for the same.

### RIGHTS OF A BAILEE

**Rights of bailee:** The following are the rights of the bailee:-

1. **Right to Deliver the Goods to any one of the joint bailors [Section 165]**
2. **Right to indemnity**
3. **Right to claim compensation in case of faulty goods (Section 150)**
4. **Right to claim necessary expenses**
5. **Right to Apply to Court to Decide the Title to the Goods**
6. **Right of particular lien for payment of services**
7. **Right of general lien (Sec. 171):**

### 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

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.
2. **On fulfillment of the purpose:** If the goods were delivered for a specific purpose, a bailment shall terminate on the fulfillment of that purpose.
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.
  - (b) A gratuitous bailment can be terminated by the bailor at any time by giving a notice to the bailee.
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 in the nature of goods which makes it impossible to be used for the purpose of bailment.

### FINDER OF LOST GOODS

**Right of finder of lost goods- may sue for specific reward offered :** A person 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.

**When finder of thing commonly on sale may sell it [Section 169]:** When a thing which is commonly the subject of sale is 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—

1. when the thing is in danger of perishing or of losing the greater part of its value or
2. when the lawful charges of the finder in respect of the thing found amount to two-thirds of its value

### 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:

- a. Particular Lien
- b. General Lien

**Particular Lien:** It is a right to retain only the particular goods in respect of which the claim is due.

**General Lien:** 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). Section 171 provides this right is available to Bankers, factors, wharfingers, policy brokers and attorneys of law.

## 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"**.

**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,

The subject matter of pledge is goods,

The subject matter of pledge is goods,

**RIGHTS OF A PAWNEE/ PLEDGEE:** Rights of Pawnee can be classified as under following headings:

- a. **Right to retain the pledged goods [Section 173]:** The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.
- b. **Right to retention of subsequent debts [Section 174]:** The Pawnee can retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged.
- c. **Pawnee's right to extraordinary expenses incurred [Section 175]:** The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.
- d. **Pawnee's right where pawnor makes default [Section 176]:** If the pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee has the following Rights :
  - a. the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or
  - b. he may sell the thing pledged on giving the pawnor reasonable notice of the sale.

### Rights of 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]:** 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:**

- Duty to take reasonable care of the pledged goods
- Duty not to make unauthorized use of pledged goods
- Duty to return the goods when the debt has been repaid or the promise has been performed
- Duty not to mix his own goods with goods pledged
- Duty not to do any act which is inconsistent with the terms of the pledge
- Duty to return accretion to the goods, if any.

### Duties of a Pawnor

**Pawnor has the following duties:**

- The pawnor is liable to pay the debt or perform the promise as the case may be
- It is the duty of the pawnor to compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned
- It is the duty of the pawnor to disclose all the faults which may put the pawnee under extraordinary risks.
- If loss occurs to the pawnee due to defect in pawnor's title to the goods, the pawnor must indemnify the pawnee.
- If the pawnee sells the good due to default by the pawnor, the pawnor must pay the Deficit.

### PLEDGE BY NON-OWNERS

Ordinarily, it is the owner of the goods, or any person authorized by him in that behalf, who can pledge the goods. But in order to facilitate mercantile transactions, the law has recognised certain exceptions. These exceptions are for bonafide pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left.

#### a. **Pledge by mercantile agent:**

A mercantile agent, who is in the possession of goods or document of title, with the consent of owner, can pledge them while acting in the ordinary course of business as a Mercantile Agent.

#### b. **Pledge by person in possession under voidable contract:**

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.
- 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.
- 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.

### Difference between Bailee's General and Particular Lien

General lien	Particular lien
Section 171 of the Indian Contract Act, 1872 confer on Bailee the right of General Lien.	Section 170 of the Indian Contract Act, 1872 confers on the Bailee, the right of particular lien.
General lien alludes to the right to keep possession of goods belonging to other against general balance of account.	Particular lien implies a right of the bailee to retain specific goods bailed for non-payment of amount.
A general lien is not automatic but is recognized through 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.



## DISTINCTION BETWEEN BAILMENT AND PLEDGE

Basis of Distinction	Bailment	Pledge
<b>Meaning</b>	Transfer of goods by one person to another for some specific purpose is known as bailment.	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.
<b>Parties</b>	The person delivering the goods under a contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee".	The person who delivers the good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "pawnee".
<b>Purpose</b>	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods).	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise.
<b>Consideration</b>	The bailment may be made for consideration or without consideration.	Pledge is always made for a consideration.
<b>Right to sell the goods</b>	The bailee has no right to sell the goods even if the charges of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed.	The pawnee has right to sell the goods if the pawnor fails to redeem the goods.
<b>Right to use of goods</b>	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledgee or Pawnee cannot use the goods pledged.

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.

**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.

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## CHAPTER-2 UNIT 9: AGENCY

### WHAT IS AGENCY ?

The Indian Contract Act, 1872 does not define the word 'Agency'. However, **section 182** of the Indian Contract Act, 1872 defines Agent and Principal as:

**Agent** means a person employed to do any act for another or to represent another in dealing with the third persons and

**The principal** means a person for whom such act is done or who is so represented.

#### Test of Agency

Whether the person has the capacity to bind the principal and make him answerable to the third party.

Whether he can establish privity of contract between the principal and third parties.

### APPOINTMENT AND AUTHORITY OF AGENTS

**Who may employ an agent:** According to **Section 183**, "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.

#### Who may be an agent:

According to Section 184 of the Act 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.

**Consideration not necessary:** According to **Section 185**, 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

"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.

#### Implied Agency includes:-

- (a) **Agency by Estoppel [Section 237]:** 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.

According to **section 237** of the Contract Act, an agency by estoppel may be created when following essentials are fulfilled:

- (i) The principal must have made a representation;
- (ii) The representation may be express or implied;
- (iii) The representation must state that the agent has an authority to do certain act although really he has no authority;
- (iv) The principal must have induced the third person by such representation; and
- (v) The third person must have believed the representation and made the contract on the belief of such representation.

- (b) **Agency by Necessity:** An agency of necessity arises due to some emergent circumstances. In emergency a person is authorised to do what he cannot do in ordinary circumstances.

(c) **Agency by Operation of Law:** When law treats one person as an agent of other. For **example**, a is the agent of the firm for the purposes of the business of the firm.

2. **Rights of person as to acts done for him without his authority, Effect of ratification**

**[Section 196]:** 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.

**Essentials of a valid Ratification**

(a) **Ratification may be expressed or Implied [Section 197]:** Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.

(b) **Knowledge requisite for valid ratification [Section 198]:** No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.

(c) **The whole transaction must be ratified [Section 199]:** There can be ratification of an act in entirely or its rejection in entirely. The principal cannot ratify a part of the transaction which is beneficial to him and reject the rest.

(d) **Ratification cannot injure third person [Section 200]:** When the interest of third parties is affected, the principle of ratification does not apply. Ratification cannot relate back to the date of contract if third party has in the intervening time acquired rights.

(e) **Ratification within reasonable time:**

(f) **Communication of Ratification:**

(g) **Act to be ratified must be valid:** Act to be ratified should not be void or illegal, for e.g. payment of dividend out of capital, forgery of signatures, any other criminal offence, or anything which is not permitted under law.

**EXTENT OF AGENT'S AUTHORITY**

(a) **Agent's authority in normal circumstances [Section 188]:** 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.

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

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

(i) Agent should not be in a position or have any opportunity to communicate with his principal within the time available.

(ii) There should have been actual and definite commercial necessity for the agent to act promptly.

(iii) The agent should have acted Bonafide and for the benefit of the principal.

(iv) The agent should have adopted the most reasonable and practicable course under the circumstances, and

(v) The agent must have been in possession of the goods belonging to his principal and which are the subject of contract.

**SUB-AGENTS**

**When agent cannot delegate [Section 190]:** 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.

**"Sub-agent" defined [Section 191]:** A "Sub-agent" is a person employed by, and acting under the control of, the original agent in the business of the agency.

**Exception where an agent can appoint Sub-agent:**

- (1) The appointment of a sub agent would be valid if the terms of appointment originally contemplated it.
- (2) Sometimes **customs of the trade** may provide for appointment of sub agents. *In both these cases the sub agent would be treated as the agent of the principal.*  
 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.

**Representation of principal by sub-agent properly appointed [Section 192]:** Where a sub-agent is properly appointed,

- (1) **Principal is liable to third parties for the acts of the sub-agent.**
- (2) **Agents responsibility for sub agents:** The agent is responsible to the principal for the acts of the sub-agent.
- (3) **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.

**Agent's responsibility for sub-agent appointed without authority [Section 193]:** Where an agent, without having authority to do so, has appointed a person to act as a sub-agent,

- (i) The agent is responsible for his acts both to the principal and to third persons;
- (ii) The principal is not responsible for the acts of the sub agent,
- (iii) The sub agent is not responsible to the principal at all. He is answerable only to the agent.

## **SUBSTITUTED AGENT**

Substituted Agent is a person appointed by the agent to act for the principal, in the business of agency, with the knowledge and consent of the principal. Substituted agents are not sub agents. They are agents of the principal.

**Relation between principal and person duly appointed by agent to act in business of agency [Section 194]:**

Where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him.

**Agent's duty in naming such person [Section 195]:** In selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

## **DUTIES AND OBLIGATIONS OF AN AGENT**

(i) **Duty to follow instructions or customs.**

(ii) **Duty of reasonable care and skill.**

(iii) **Duty to render proper accounts.**

(iv) **Agent's duty to communicate with principal.**

(v) **Duty not to deal on his own account :** Agent should not deal on his own account without first obtaining the consent of the principal, otherwise the principal may—  
 repudiate the transaction, **(Section 215)**

claim from the agent any benefit which may have resulted to him from the transaction. **(Section 216)**

(vi) **Duty not to make secret profits:** It is the duty of an agent not to make any secret profit in the business of agency. His relationship with the principal is of fiduciary nature and this requires absolute good faith in the conduct of agency.



## Duty not to delegate

### Agent's duty to pay sums received for principal [Section 218]:

Duty not to use any confidential information received in the course of agency against the principal.

## RIGHTS OF AN AGENT

**(i) Right of 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.

### (ii) Right to remuneration

**Agent's lien on principal's property [Section 221]:** In the absence of any contract to the contrary, an agent is entitled to retain the goods, papers and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursement and services in respect of the same has been paid or accounted for him.

### *The agent's right to lien is lost in the following cases:*

- (a) When the possession of the property is lost.
- (b) When the agent waives his right. Waiver may arise out of agreement express or implied.
- (c) The agent's lien is subject to a contract to the contrary.

### (iii) Right to indemnity:

#### (a) Right of indemnification for lawful acts

**(b) Right of indemnification against acts done in good faith [Section 223]:** Where the agent acts in good faith on the instruction of principal, agent is entitled for indemnification of any loss or damage from the principal.

**(c) Non-liability of employer of agent to do a criminal act:** According to section 224, where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that act.

**(d) Right to compensation for injury caused by principal's neglect [Section 225]:** Section 225 provides that the principal must compensate his agent in respect of injury caused to such agent due to principal's neglect or want of skill. Thus, every principal owes to his agent the duty of care, and not to expose him to unreasonable risks.

## PRINCIPAL'S LIABILITY TO THIRD PARTIES

An agent also cannot personally enforce contracts entered into by him on behalf of the principal.

**(i) Principal's liability for the Acts of the Agent [Section 226]:** Principal liable for the acts of agents which are within the scope of his authority.

**(ii) Principal's liability when agent exceeds authority [Section 227]:** 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.

**Principal not bound when excess of agent's authority is not separable [Section 228]:** Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction.

**Exception: Liability of principal inducing belief that agent's unauthorized acts were authorized**

**[Section 237]:** 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.

**(iii) Consequences of notice given to agent [Section 229]:** 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.

**(iv) Principal's liability for the agent's fraud, misrepresentation or torts [Section 238]:**

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.

### **PERSONAL LIABILITY OF AGENT TO THIRD PARTIES**

**Agent cannot personally enforce, nor be bound by, contracts on behalf of principal [Section 230]:**

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.

**(1) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad/foreign principal:**

**(2) Where the agent does not disclose the name of his principal or undisclosed principal;**

**(3) Non-existent or incompetent principal**

**(4) Pretended agent -**

**(5) When agent exceeds authority-** When the agent exceeds his authority, misleads the third person in believing that the agent he has the requisite authority in doing the act, then the agent can be made liable personally for the breach of warranty of authority.

### **RIGHTS OF THIRD PARTIES**

**(i) Rights of parties to a contract made by undisclosed agent :** If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal, the same right as he would have had as against the agent if the agent had been the principal.

**(ii) Performance of contract with agent supposed to be principal [Section 232]:** When agent does not disclosed 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.

**(iii) Option to Third Person- sue the Agent or the Principal:**

**(a) Right of person dealing with agent personally liable [Section 233]:** In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them, liable.

**(b) Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable [Section 234]:** 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**

### **Termination of agency [Section 201]**

**(a) Revocation:** 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

**Compensation for revocation by principal [Section 205]:** If there is premature revocation of agency without sufficient cause, the principal must compensate the agent, for such revocation.

**Notice of revocation [Section 206]:** When the principal, having justification to do so, revokes the authority, he must give reasonable notice of such revocation to the agent, otherwise, he can be liable to pay compensation for any damage caused to the agent (Section 206).

**Revocation and renunciation may be expressed or implied [Section 207]:**

Revocation of agency may be expressed or implied in the conduct of the principal.

**(b) Renunciation by agent :** An agent may renounce the business of agency in the same manner in which the principal has the right of revocation. In the first place, if the agency is for a fixed period, the agent would have to compensate the principal for any premature renunciation without sufficient cause.

**(c) Completion of business:** An agency is automatically and by operation of law terminated when its business is completed. Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed.

**(d) Death or insanity:** An agency is determined 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.

**(e) Principal's insolvency:** An agency ends on the principal being adjudicated insolvent.

**(f) 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 no. An agency comes to an automatic end on expiry of its term.

### **When the agency is irrevocable?**

"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."

**When termination of agent's authority takes effect as to agent, and as to third persons [Section 208]:**

The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

**Agent's duty on termination of agency by principal's death or insanity [Section 209]:** 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.

#### **Termination of sub-agent's authority [Section 210]:**

The termination of the authority of an agent causes the termination (subject to the rules herein contained

regarding the termination of an agent's authority) of the authority of all sub-agents appointed by him.

#### **Difference Between A Sub-Agent And A Substituted Agent**

S.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.

## CHAPTER-3 THE SALE OF GOODS ACT, 1930

### UNIT-1: FORMATION OF THE CONTRACT OF SALE

#### DEFINITIONS

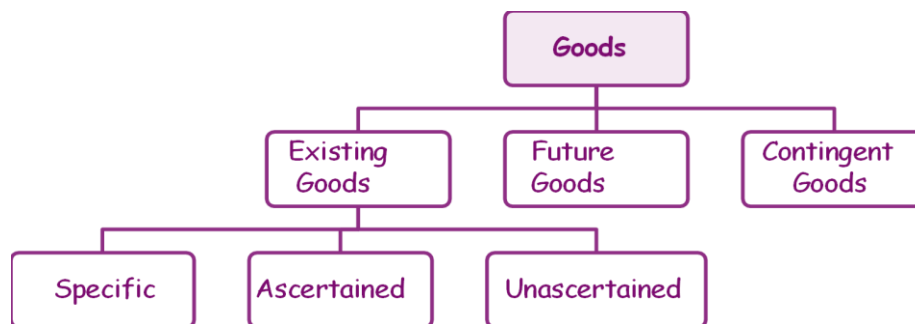
'Buyer' means a person who buys or agrees to buy goods [Section 2(1)].

'Seller' means a person who sells or agrees to sell goods [Section 2(13)].

"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' are claims, which can be enforced only by an action or suit,

"Goods" include both **tangible** goods and **intangible** goods like goodwill, copyrights, patents, trademarks etc.



#### (i) EXISTING GOODS:

which are in existence at the time of the of contract of sale, i.e., those owned or possessed or acquired by the seller at the time contract of sale [Section 6].

**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)].

(b) **Ascertained Goods** are those goods which are identified in accordance with the agreement **after the contract** of sale is made.

(c) **Unascertained goods** are the goods which are **not specifically identified** or ascertained at the time of making of the contract.

#### (ii) 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.**

#### (iii) CONTINGENT GOODS:

The acquisition of goods which depends upon an uncertain contingency (**uncertain event**) are called 'contingent goods' [Section 6(2)].



The property does not pass to the buyer at the time of making the contract.

### Delivery

Means **voluntary transfer of possession** from one person to another **[Section 2(2)]**.

It 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:**

<b>Actual delivery</b>	<b>Constructive delivery</b>	<b>Symbolic delivery</b>
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(i) **Actual delivery:** When the goods are physically delivered to the buyer.

(ii) **Constructive delivery:** When transfer of goods is effected without any change in or actual possession of the thing.

(iii) **Symbolic delivery:** When there is a delivery of a thing in token of a transfer of something else.

**For e.g. handing over documents of title to 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)]**.

"Document of title to goods" includes **bill of lading, dock-warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt, multimodal transport document, 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 there is a difference between a 'document showing title' and 'document of title'.

**Mercantile agent:** It means an agent who in the customary course of business has, 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.

**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. It means the general property (**right of ownership-in-goods**) and not merely a special property.

**Insolvent [Section 2(8)]:** 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.

**Price [Section 2(10)]:** Price means the money consideration for a sale of goods.

**Quality of goods** includes their state or condition. **[Section 2(12)]**

### SALE AND AGREEMENT TO SELL (SECTION 4)

**Section 4(1),** "A contract of sale of goods is a contract whereby the seller transfers or agrees

to transfer the property in goods to the buyer for a price".

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

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**.

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, it is called an **agreement** to sell. [Section 4(3)]

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. [Section 4(4)]

**When agreement to sell becomes sale:** when the time 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:

- (i) There must be at least **two parties**, the seller and the buyer and the two must be different persons.
- (ii) The subject matter of the contract must necessarily be **goods**
- (iii) A **price** in money (not in kind) should be paid or promised. But consideration can be from being partly in money and partly in kind.
- (iv) A **transfer of property** in goods from seller to the buyer must take place
- (v) A contract of sale may be **absolute or conditional**.
- (vi) All other essential elements of a **valid** contract must be present

### SALE DISTINGUISHED FROM OTHER SIMILAR CONTRACTS

**(i) Sale and Hire Purchase:** Contract of sale resembles with contracts of hire purchase very closely,

Term "hire- purchase agreement" means an agreement under which goods are let on hire and under which the hirer has an option to purchase them and includes an agreement under which-

- (a) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and
- (b) The property in the goods is to pass to such person on the payment of the last of such instalments, and
- (c) Such person has a right to terminate the agreement at any time before the property so passes;

**(ii) Sale and Bailment :** A '**bailment**' is the delivery of goods for some **specific purpose** under a contract on the condition that the same **goods are to be returned** when the purpose is accomplished

**(iii) Sale and contract for work and labour:** A contract of sale of goods is one in which some goods are sold or are to be sold for a **price**. 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.

## CONTRACT OF SALE HOW MADE (SECTION 5)

According to **Section 5(1)**, A contract of sale may be made in any of the following modes:

- (i) Contract of sale is made by an offer to buy or sell goods for a price and acceptance of such offer.
- (ii) There may be immediate delivery of the goods; or
- (iii) There may be immediate payment of price, but it may be agreed that the delivery is to be made at some future date; or
- (iv) There may be immediate delivery of the goods and an immediate payment of price; or
- (v) It may be agreed that the delivery or payment or both are to be made in instalments; or
- (vi) It may be agreed that the delivery or payment or both are to be made at some future date.

## SUBJECT MATTER OF CONTRACT OF SALE

### Existing or future goods (Section 6)

The goods may be either existing goods or future goods.

### Goods perishing before making of contract (Section 7):

Where there is a contract for the sale of specific goods, the **contract is void** if the goods perished or become so damaged that they no longer answer to their description in the contract.

### Goods perishing before sale but after agreement to sell (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 that they no longer answer to their description in the agreement, the agreement becomes **void**.

**Perishing of future goods:** If the future goods are specific, the destruction of such goods will amount to supervening impossibility and the contract shall become **void**.

## ASCERTAINMENT OF PRICE (SECTION 9 & 10)

### Ascertainment of price (Section 9) :

The **price** in the contract of sale may be-

- (i) **Fixed** by the contract, or
- (ii) **Agreed to be fixed** in a manner provided by the contract, e.g., by a valuer, or
- (iii) **Determined** by the course of dealings between the parties.

### Agreement to sell at valuation (Section 10):

The determination of price by a third party.

- (i) Where there is an agreement to sell goods on the terms that price has to be fixed by the **third party** and he either does not or **cannot make such valuation**, the agreement will be **void**.
- (ii) In case the third party is prevented by the default of either party from fixing the price, the **party at fault will be liable to the damages** to the other party who is not at fault.
- (iii) However, a buyer who has received and appropriated the goods must pay a reasonable price for them in any eventuality.

## CHAPTER-3 UNIT-2: CONDITIONS & WARRANTIES

### STIPULATION AS TO TIME (SECTION 11)

Price for goods may be fixed by the contract or may be agreed to be fixed later on in a specific manner. Stipulation as to time of delivery are usually the essence of the contract.

### INTRODUCTION- CONDITIONS AND WARRANTIES

A representation which forms a part of the contract of sale and affects the contract, is called a stipulation.

#### 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)]**

"A warranty is a stipulation **collateral** to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated". **[Sub-section (3)]**.

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. [Sub-section (4)]**

### WHEN CONDITION IS TO BE TREATED AS WARRANTY (SECTION 13)

**Section 13** specifies cases where a breach of condition be treated as a breach of warranty.

In the following cases, a contract is not avoided even on account of a breach of a condition:

- (i) Where the buyer altogether **waives** the performance of the condition.
- (ii) Where the buyer **elects** to treat the breach of the conditions, as one of a warranty.
- (iii) Where the contract is **non-severable** and the buyer has accepted either the whole goods or any part thereof.
- (iv) Where the fulfilment of any condition or warranty is **excused by law** by reason of impossibility or otherwise.

### 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 :

Which are presumed by law to be present in the contract.

(i) **Condition as to title [Section 14(a)]** : the condition implied is that the seller has the right to sell the goods (**means he should be the real owner**) at the time when the property is to pass.

(ii) **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.

**(iii) Sale by sample [Section 17]:** In a contract of sale by sample, there is an implied condition that

**(a)** The bulk shall correspond with the sample in quality;

**(b)** The buyer shall have a reasonable opportunity of comparing the bulk with the sample.

**(c)** The goods shall be free from any defect rendering them un-merchantable, which would not be apparent on reasonable examination of the sample.

**(iv) 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.

**(v) 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.

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.

**(vi) Condition as to Merchantability [Section 16 (2)]:** Where 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.

**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.

**"Merchantable quality"** means goods of such a quality and in such a condition a man of ordinary prudence would accept them as goods of that description.

**(vii) Condition as to wholesomeness :** there is another implied condition that the goods shall be shall be wholesome. , 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.

#### IMPLIED WARRANTIES:

**1. Warranty as to undisturbed possession [Section 14(b)]:** An implied warranty that the year shall have and enjoy quiet possession of the goods.

**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 favor of any third party not declared or known to the buyer before or at the time the contract



3. **Warranty as to quality or fitness by usage of trade [Section 16(3)]:** An implied by the warranty as to quality or fitness for a particular purpose may be annexed or attached 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.

### CAVEAT EMPTOR

The doctrine 'Caveat Emptor' means '**let the buyer beware**'. 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.

**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)**.

**Exceptions:**

1. **Fitness as to quality or use:** Where the buyer makes known to the seller the particular purpose and 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, **[Section 16 (1)]**.
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)]**. Here, the buyer is relying on the particular brand name.
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]**.
4. **Goods of Merchantable Quality:** Where the goods are bought by description from a seller who deals in goods of that description. **[Section 16(2)]**.
5. **Sale by sample:** Where the goods are bought by sample, if the bulk does not correspond with the sample **[Section 17]**.
6. **Goods by sample as well as description:**
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.
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.

## CHAPTER-3 UNIT-3: TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

### 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

### PASSING OF PROPERTY (SECTIONS 18 – 26)

Passing or transfer of property constitutes the **most important element** and factor to decide legal rights and liabilities of sellers and buyers.

Passing of property implies passing of ownership.

The rules regarding transfer of property in goods from the seller to the buyer depend on two basic factors:

**(a) Identification of Goods:** The buyer can get the ownership right on the goods only when the goods are specific and ascertained.

**(b) Intentions of parties:**

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) Property (Specific or ascertained goods) passes when intended to pass (Section 19):

Where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. **[sub-section (1)]**

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. **[sub-section (2)]**

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. **[sub-section (3)]**

### Stages of goods while passing of property

Specific goods in a deliverable state

Specific goods to be put into a deliverable state

Specific goods in a deliverable state when seller has to ascertain price.

1. **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**, it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed.

**2. 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.

**3. Specific goods in a deliverable state, when the seller has to do anything thereto in 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.

**(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 [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 assent may be given either before or after appropriation.

**2. Delivery of the goods to the carrier [Section 23(2)]:** Where the seller delivers the goods to the buyer or to a carrier or other bailee 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.

**3. Goods sent on approval or "on sale or return" (Section 24)**

The property therein passes to the buyer-

When he signifies his approval or acceptance to the seller or does any other act adopting the transaction;

if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection (till expiry of fixed time or reasonable time)

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

**Sale for cash only or Return**

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 in goods does not pass to the buyer until he has paid for the goods.

**Reservation of right of disposal (Section 25)**

The goods have already been delivered to the buyer property therein will not pass to the

buyer till the condition imposed, if any, by the seller has been fulfilled.

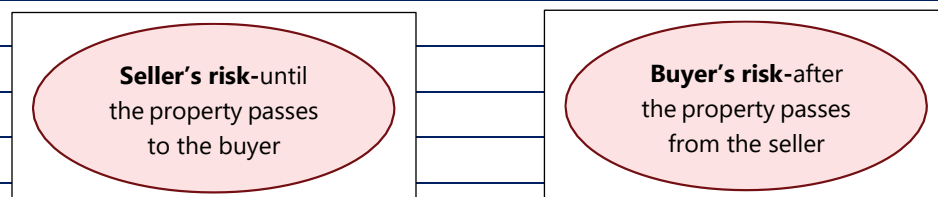
### **Circumstances under which the right to disposal may be reserved:**

If the goods are shipped or delivered to a railway administration for carriage and by the bill of lading or railway receipt 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.

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 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

### **RISK PRIMA FACIE PASSES WITH PROPERTY (SECTION 26)**



This rule is 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.
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

### **TRANSFER OF TITLE BY NON-OWNERS (SECTIONS 27 - 30)**

#### **Sale by person not the owner (Section 27):**

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 quod non habet*" which means that no one can give what he has not got.

#### **Exceptions:**

##### **(1) Sale by a Mercantile Agent:**

It would pass a good title to the buyer in the following circumstances;

- (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, **(Proviso to Section 27).**

##### **(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

in **good faith** and has 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 provided that the contract had not been rescinded until the time of the sale (**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**.
- (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, 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.
- (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.
- (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:**
- (i) Sale by an **Official Receiver or Liquidator** of the Company will give the purchaser a valid title.
  - (ii) Purchase of goods from a **finder of goods** will get a valid title under circumstances [**Section 169 of the Indian Contract Act, 1872**]
  - (iii) A sale by **pawnee** can convey a good title to the buyer [**Section 176 of the Indian Contract Act, 1872**]

## PERFORMANCE OF THE CONTRACT OF SALE

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

**Delivery of goods is of three types:**

(a) **Actual Delivery**

(b) **Symbolic delivery**

(c) **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,

**Payment and delivery are concurrent conditions (Section 32):** Unless otherwise agreed, **delivery** of the goods and payment of the price are concurrent conditions,

## RULES REGARDING DELIVERY OF GOODS

(i) **Delivery (Section 33):**

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 authorised to hold them on his behalf.

**(ii) Effect of part delivery: section 34** A delivery of part of goods, for the purpose of passing the property in such goods, will be treated as delivery of the whole;

But 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.

**(iii) Buyer to apply for delivery: [Section 35]** Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery.

**(iv) Place of delivery:**

Unless otherwise agreed

✚ goods sold are to be delivered at the place at which they are at the time of the sale, and

✚ goods agreed to be sold are to be delivered at the place at which they are at the time of the agreement to sell

✚ if goods are not then in existence, at the place at which they are manufactured or produced. **[Section 36(1)]**

**(v) Time of delivery:** Where under the contract of sale, the seller is bound to send the goods to the buyer, within a reasonable time. in time is not fixed. **[Section 36(2)]**

**(vi) Goods in possession of a third party:** Where the goods at the time of sale 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. Provided that nothing in this section shall affect the operation of the issue or transfer of any document of title to goods. **[Section 36(3)]**

**(vii) Time for tender of delivery:** Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. **[Section 36(4)].**

**(viii) Expenses for delivery:** It be borne by the seller in the absence of a contract to the contrary. **[Section 36(5)].**

**(ix) Delivery of wrong quantity [Section 37]:** Where the seller delivers to the buyer

**Less quantity** - The buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate.

**Quantity larger** - The buyer may accept the goods included in the contract and reject the rest, or he may reject the whole

If the buyer accepts the whole of the goods so delivered, he shall pay for them.

**Mixed quality** - the buyer may accept the goods which are in accordance with the contract and reject, or may reject the whole.

**(x) Instalment deliveries:** The buyer is not bound to accept delivery in instalments.

**(xi) Delivery to carrier:** The delivery of the goods to the carrier for transmission to the buyer, is *prima facie* deemed to be delivery to the buyer. **[Section 39(1)]**

**(xii) Deterioration during transit:** Where goods are delivered at a distant place, the liability for deterioration necessarily incidental to the course of transit will fall on the buyer,

**(xiii) Buyer's right to examine the goods:** Where goods are delivered to the buyer, who has not previously examined them, he is entitled to a reasonable opportunity of examining them.

## 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):**

The buyer 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):**

Seller is ready and willing to deliver the goods and the buyer does not take delivery of the goods, he is liable to the seller for any loss and also for a reasonable charge for the care and custody of the goods.

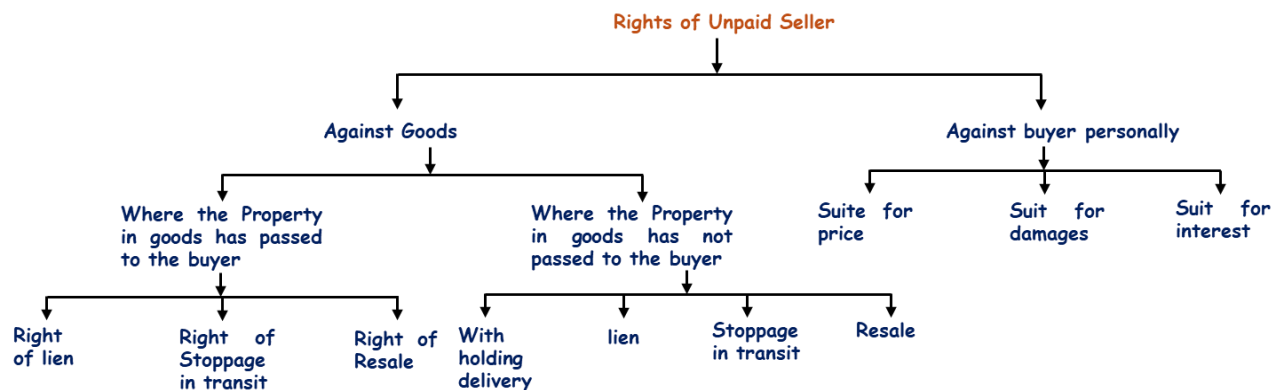
## CHAPTER-3 UNIT-4: UNPAID SELLER

In case buyer fails or refuses to pay, the seller, as an unpaid seller, shall have certain rights.

According to **Section 45(1) 1930**, the seller of goods is deemed to be an '**Unpaid Seller**' when-

- The **whole of the price has not been paid** or tendered
- When a bill of exchange or other negotiable instrument has been received as **conditional payment**, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

### RIGHTS OF AN UNPAID SELLER



### RIGHT OF UNPAID SELLER AGAINST THE GOODS

#### (1) SELLER'S LIEN (SECTION 47)

An unpaid seller has a right of lien on the goods for the price while he is in possession,

#### Exercise of right of lien:

This right can be exercised by him in the following cases only:

- where goods have been sold **without any stipulation of credit; (i.e., on cash sale)**
- where goods have been sold on credit but the **term of credit has expired**; or
- where the buyer becomes **insolvent**.

#### 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:

- 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.
- Where the buyer or his agent lawfully **obtains possession** of the goods.

(iii) Where seller has **waived** the right of lien.

(iv) By **Estoppel** i.e., where the seller so conducts himself that he leads third parties to believe that the lien does not exist.

### Exception:

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.)

## (2) RIGHT OF STOPPAGE IN TRANSIT (SECTION 50 TO 52)

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. 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]**

**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 until the buyer or his agent on that behalf takes delivery of them from such carrier.

### When does the transit come to an end?

The right of stoppage in transit is lost when transit comes to an end. Transit comes to an end in the following cases:

- ✚ When the buyer or other bailee **obtains delivery**.
- ✚ Buyer **obtains delivery before the arrival of goods** at destination.
- ✚ Where the carrier or other bailee **acknowledges to the buyer** or his agent
- ✚ Where goods are **delivered to the carrier hired by the buyer**,
- ✚ 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.
- ✚ Where the goods are **delivered to a ship chartered by the buyer**,

### How stoppage in transit is effected (Section 52):

#### Stoppage in transit

- By taking actual possession of goods by giving notice to the carrier not to deliver the goods.
- Goods redelivered to seller cost of re-delivery shall be borne by seller

**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.

**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.
- (b) When a **document of title to goods has been transferred to no 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**
- (i) In case of sale, right of lien or stoppage in transit is defeated, or
- (ii) In case of pledge, unpaid seller's right of lien or stoppage only be exercised, subject to the rights of the pledgee.

**Effect of stoppage:** The contract of sale is not rescinded 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.

The unpaid seller can exercise the right to re-sell the goods under the following conditions:

- (i) **Where the goods are of a perishable nature:**
- (ii) **Where he gives notice to the buyer of his intention to re-sell the goods:** If after the receipt of such notice the buyer fails within a reasonable time to pay or tender the price, The seller may resell the goods. 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.
- (iii) **Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods:** The subsequent buyer acquires the good title thereof as against the original buyer, even if notice of resale was not given to buyer.
- (iv) **A re-sale by the seller where a right of re-sale is expressly reserved in a contract of sale :** seller and he may resell the goods on buyer's default. the seller is not required to give notice of of resale. He is entitled to recover damages from the original buyer even if no notice of resale is given.
- (v) **Where the property in goods has not passed to the buyer:** The unpaid seller has in addition to his remedies a right of **withholding delivery** of the goods. (agreement to sale)  
 This right is similar to lien and is called "**quasi-lien**".

#### **RIGHTS OF UNPAID SELLER AGAINST THE BUYER (SECTIONS 55-61)**

An unpaid seller can enforce certain rights against the goods as well as against the buyer personally.

The right against the buyer are as follows:

##### **(1) Suit for price (Section 55)**

- (a) The property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay the seller may sue him for the price of the goods. **[Section 55(1)]**
- (b) 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  
**(This is the case of agreement to sell)**



(2) **Suit for damages for non-acceptance (Section 56):** the seller may sue him for damages for non-acceptance.

Section 73 of the Indian Contract Act, 1872 applies in this case to measure the damages.

(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)**.

**Suit for interest [Section 61]:** Where there is specific agreement 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, 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.

### REMEDIES OF BUYER AGAINST THE SELLER

1. **Damages for non-delivery (Section 57):**

Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.

2. **Suit for specific performance (Section 58):**

Where the seller commits breach of the contract of sale, the buyer can appeal to the court for specific performance.

**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) Damages would not be an adequate remedy.

(d) It will be granted as remedy if goods are of special nature or are unique

3. **Suit for breach of warranty (Section 59):** Where there is breach of warranty on the part of part of the seller, or where the **buyer elects to treat breach of condition as breach of warranty**, the buyer is not entitled to reject the goods only on the basis of such breach of warranty. **But he may -**

(i) set up against the seller the breach of warranty in **diminution or extinction of the price**; or

(ii) sue the seller for damages for **breach of warranty**.

4. **Repudiation of contract before due date (Section 60):** Where either party 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:**

(1) Nothing in this Act shall affect the right of the seller or the buyer to recover interest or special damages,

(2) 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.

## 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.

### Legal Rules of Auction sale: Section 64

Following rules to regulate the sale by auction:

(a) **Where goods are sold in lots:** Each lot is *prima facie* deemed to be subject of a separate contract of sale.

(b) **Completion of the contract of sale:** The sale is complete when the auctioneer announces its completion by the fall of hammer or in any other customary manner.

(c) **Right to bid may be reserved:** By or on behalf of the seller

(d) **Where the sale is not notified :** 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.

(e) **The sale may be notified to be subject to a reserve or upset price;**

(f) **If the seller makes use of pretended bidding to raise the price,** the sale is **voidable** at the option of the buyer.

## INCLUSION OF INCREASED OR DECREASED TAXES IN CONTRACT OF SALE (SECTION 64A)

Where after a contract has been made but before it has been performed, tax revision takes place.

The buyer would have to pay the increased price where tax increases and may derive the benefit of reduction if taxes are curtailed

**Following taxes are applied on the sale or purchase of goods:**

+ Any duty of customs or excise on goods,

+ Any tax on the sale or purchase of goods

## CHAPTER 4 THE INDIAN PARTNERSHIP ACT, 1932

### UNIT - 1 GENERAL NATURE OF PARTNERSHIP

#### 1.1 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

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

#### ELEMENTS OF PARTNERSHIP

Following five elements 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 recognized by law can enter into an agreement of partnership.

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.

According to Sec. 464 of companies Act 2013. Maximum number of partners - 50

2. **AGREEMENT:** Partnership is created by agreement not by nature (Sec. 5)

There must be an agreement entered into by all the persons concerned.

The relation of partnership arises from contract and not from status.

The nature of the partnership is voluntary and contractual.

Agreement may be express or implied . It may be oral or in writing

3. **BUSINESS:** There must exist a business. the term 'business' includes every trade, occupation and profession.

I partnership. There is intention to carry on the business and to share the profit thereof.

4. **AGREEMENT TO SHARE PROFITS:** 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 But an agreement to share losses is not an essential . However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio. sharing profits is only prime facie evidence. Not conclusive evidence.

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.

Existence of mutual agency which is the cardinal principle of partnership law.

There should be a binding contract of mutual agency between the partners. Each partner carrying on the business is the principal as well as the agent for all the other partners.

The true test of partnership is mutual agency rather than sharing of Profits.

**BUSINESS:** There must exist a business. the term 'business' includes every trade, occupation and profession. the motive of the business is the "acquisition of gains" partnership there is n intent to carry on the business and to share the profit thereof.

**AGREEMENT TO SHARE PROFITS:** 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. But an agreement to share losses is not an essential . However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio.

### 1.3 TRUE TEST OF PARTNERSHIP

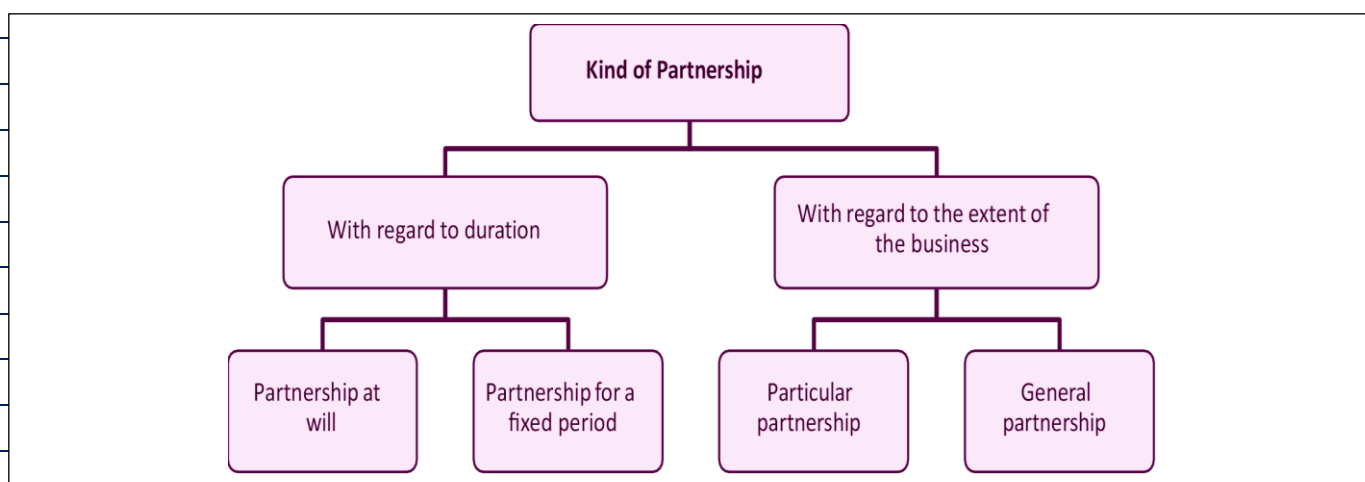
#### Mode of determining existence of partnership (Section 6):

For determining the existence of partnership, it must be proved.

1. There was an **agreement** between all the persons concerned;
2. The agreement was to **share the profits** of a business and
3. The business was **carried on by all or any of them** acting for all.

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.

### 1.5 KINDS OF PARTNERSHIPS



#### 1. **Section 7 partnership at will -**

**No fixed period** has been agreed upon for the duration of the partnership; and here is no provision made as to the determination of the partnership

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**

#### 2. **Partnership for a fixed period:** Where a provision is made by a contract for the **duration** of the partnership, the partnership is called 'partnership for a fixed period'

Such a partnership **comes to an end on the expiry of the fixed period**

#### 3. Where a person becomes a partner with another person in any **particular adventure or undertaking** the partnership is called 'particular partnership'

A partnership, dissolved by the completion of the adventure or undertaking

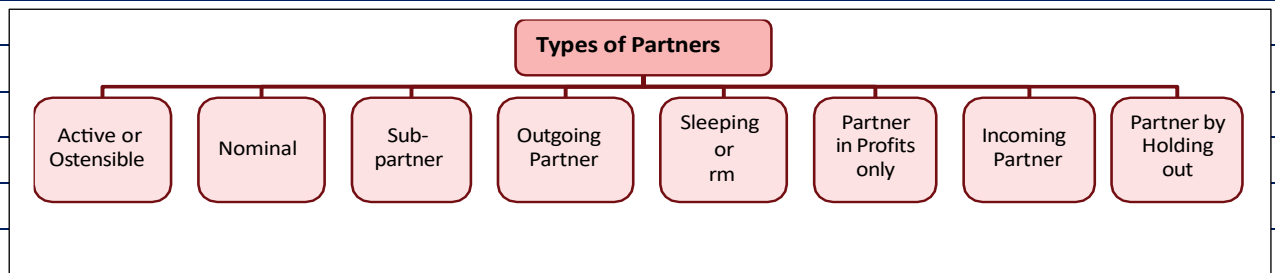
#### 4. **General partnership :** Where a partnership is constituted with respect to the **business in general**, it is called a general partnership. A general partnership is different from a particular Partnership, and limited liability partnership.

### Partnership Deed

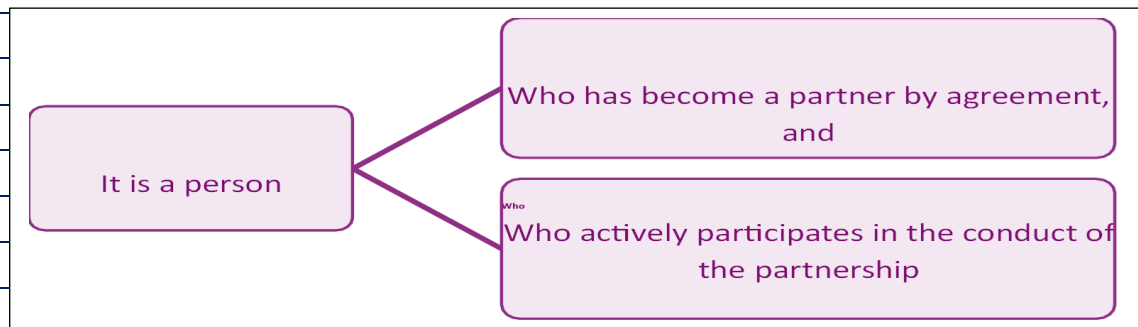
The **document in writing containing the various terms and conditions** as to the relationship of the partners to each other is called the 'partnership deed'.

It should be drafted and duly stamped. where the partnership comprises immovable property it must be in writing, stamped and registered under the Registration Act.

## 1.6 TYPES OF PARTNERS



### Active or Actual or Ostensible partner



In the event of his retirement, he must give **a public notice**

### Sleeping or Dormant Partner :

Share profits and losses and are **liable to the third parties** for all acts of the firm.

**Not required to give public notice** of their retirement from the firm.

### Nominal Partner:

Who **lends his name** to the firm, without having any real interest in it, **Not entitled to share the profits** of the firm.

Neither he invests in the firm nor takes part in the conduct of the business.

Liable to third parties for all acts of the firm

### Partner in Profits only :

Partner who is **entitled to share the profits only** without being liable for the losses.

**Liable to the third parties for all acts of the profits only.**

### Incoming partners:

Person who is **admitted as a partner into an already existing firm.**

Not liable for any act of the firm done before his admission as a partner.

### Outgoing partner:

**Who leaves a firm in which the rest of the partners continue to carry on business.**

Remains liable to third parties for all acts of the firm until public notice is given of his retirement.

### Partner by holding out (Section- 28) : Also known as **partnership by estoppel.**

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.

He is liable to the third party [who on faith of such representation has given credit to the firm]



## CHAPTER-4 UNIT-2 : RELATIONS OF PARTNERS

### RELATION OF PARTNERS TO ONE ANOTHER

#### 1. GENERAL DUTIES OF PARTNERS (SECTION 9):

The partners should carry business of the firm to the greatest **common advantages** and later, they should render to any partner or his legal representatives full information of all things affecting the firm. 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.

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.

### DETERMINATION OF RIGHTS AND DUTIES OF PARTNERS BY CONTRACT BETWEEN THE PARTNERS (SECTION 11):

- (1) 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.
- (2) **Agreements in restraint of trade-** Notwithstanding anything contained in section 27 of the Indian Contract Act, partner shall not carry on any business other than that of the firm while he is a partner.

#### 4. THE CONDUCT OF THE BUSINESS (SECTION 12):

Subject to contract between the partners

- Every partner has a right to **take part in the conduct of the business**;
  - Bound to **attend diligently to his duties** in the conduct of the business;
  - Any difference arising as to ordinary matters may be decided by majority of the partners, no change may be made in the **nature of the business** without the **consent of all partners**;
  - Every partner has a right to have **access, inspect and copy** any of the **books of the firm**.
  - The event of the death of a partner his heirs or legal representatives or their duly authorised agents have a right of access to and to inspect the copy of any of the books of the firm.
- (i) **Right to take part in the conduct of the Business [Section 12(a)]:** Every partner has the right to take part in the business of the firm.  
 If there is no contract to the contrary between the partners.
- (ii) **Right to be consulted [section 12(c)]:** 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.  
 The aforesaid **majority rule will not apply** where there is a **change in the nature of the firm** itself. In such a case, the **unanimous consent** of the partners is needed.

(iii) **Right of access to books [Section 12(d)]:**

Every partner 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, be exercised *bona fide*.

(iv) **Right of legal heirs/ representatives/ their duly authorised agents [Section 12(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.

5. **MUTUAL RIGHTS AND LIABILITIES (SECTION 13):**

Subject to contract between the partners

- a. partner is **not entitled** to receive **remuneration** for taking part in the conduct of the business;
- b. the partners are **entitled** to share equally in the **profits** earned, and shall contribute equally to the losses sustained by the firm;
- c. where a partner is entitled to interest on the capital subscribed by him such **interest** shall be **payable only out of profits**.
- d. a partner making any payment or advance beyond the amount of capital he has agreed to subscribe. Is entitled to **interest @ 6% per annum**.
- e. the firm shall **indemnify** a partner in respect of payments made and liabilities incurred by him-
  - (i) In the **ordinary and proper conduct** of the business, and in doing such act,
  - (ii) In an emergency, for the purposes of protecting the firm from loss, as would be done by a person of **ordinary prudence**, in his own case, under similar circumstances
- (f) a partner shall indemnify the firm for any loss caused to it by his wilful neglect in the conduct of business of the firm.

**PARTNERSHIP PROPERTY ( SECTION 14)**

The property which is deemed as belonging to the firm is comprised of the following item.

1. All property, rights and interests which partners may have brought into the common stock as their contribution to the common business;
2. 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
3. **Goodwill** of the business.

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.

**Goodwill** : Section 14 specifically lays down that the goodwill of a business to be regarded as 'property' of the 'firm'.

Goodwill may be defined as the **value of the reputation of a business** house in respect of profits expected in future over and above the normal level of profits earned by undertaking belonging to the same class of business

Goodwill can be sold separately or along with the other properties of the firm.

Any partner may make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits

## 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.

## PERSONAL PROFIT EARNED BY PARTNERS ( SECTION 16)

- (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 competing business he shall account for and pay to the firm all profits made by him in that business.

## RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM (SECTION 17)

1. Where a new partner or partners come in

2. Where some partner or partners go out, i.e., by death or retirement

3. Where the partnership concerned carries on business other than the business for which it was originally formed

4. Where the partnership business is carried out on after the expiry of the term fixed for the purpose.

- (a) **after a change in the firm:** Where a change occurs in the constitution of a firm, the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before the change.
- (b) **after the expiry of the term of the firm:** Where a firm constituted for a fixed term continues to carry on business after the expiry of that term, the mutual rights and duties of the partners remain the same.
- (c) **where additional undertakings are carried out:** where a firm constituted to carry out one or more adventures or undertakings carries out other adventures or undertakings.

## RELATION OF PARTNERS TO THIRD PARTIES

- 1. **PARTNER TO BE AN AGENT OF THE FIRM-** a partner is the agent of the firm for the purpose of the business of the firm.

The principal distinction between him and a mere agent is that he has a community of interest with other partners in the whole property and business and liabilities of partnership, whereas

an agent as such has no interest in either.

Applicable only to the act done by partners for the purpose of the business of the firm and not other transaction between partners.

## 2 **IMPLIED AUTHORITY OF PARTNER AS AGENT OF THE FIRM (SECTION 19):**

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.

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.

**MODE OF DOING ACT TO BIND FIRM (SECTION 22):** an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm

**Sections 19(1) and 22 deal with the implied authority of a partner.**

A partner has implied authority to bind the firm by all acts done by him in all matters connected with the partnership business and which are done in the usual way and are not in their nature beyond the scope of partnership. You must remember that an implied authority of a partner may differ in different kinds of business.

**If partnership be of a general commercial nature**

- (i) He may pledge or sell the partnership property
- (ii) He may buy goods on account of the partnership
- (iii) He may borrow money, contract debts and pay debts on account of the partnership
- (iv) 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.

## 3. **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. restrictions imposed effective against a third party when

- 1. The third party **knows** about the restrictions, and
- 2. The third party does not know that he is dealing with a partner in a firm

#### 4. 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)

Partners, as agents of each other can make binding admissions but only in relation to partnership transaction and in the ordinary course of business.

An admission or representation by a partner will not , bind the firm if his authority on the point is limited and the other party knows of the restriction.

#### EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24)

The notice to a partner, **working partner** not sleeping partner, operates as a notice to the firm except in the case of a fraud on the firm committed by or with the consent of that partner.

**The notice to one is equivalent to the notice to the rest of the partners** of the firm

Notice must be **actual and not constructive**.

#### LIABILITY TO THIRD PARTIES (SECTION 25 TO 27)

##### 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.

It is necessary that the act of the firm must have been done while he was a partner.

##### 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.

##### 3. LIABILITY OF FIRM FOR MISAPPLICATION BY PARTNERS (SECTION 27):

(a) 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.

(b) 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

#### RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29)

A **share in a partnership is transferable** 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.

### **Rights of such a transferee**

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 profit** i.e. he cannot challenge the account.

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 us from the date of dissolution**

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.

### **MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30)**

A minor cannot become a partner in a firm

He can be admitted to the benefits of partnership, with the consent of all the partners

#### **(1) Rights:**

- (i) A minor partner has a right to his agreed **share of the profits** and of the firm.
- (ii) He can have access to, inspect and copy the **accounts of the firm**.
- (iii) 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.
- (iv) On attaining majority, he may within 6 months **elect** to become a partner or not to become a partner.

#### **(2) Liabilities:**

##### **(i) 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) After attaining majority:**

Within 6 months of his attaining majority

The minor partner has to decide whether he shall remain a partner or leave the firm.

- (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 are as follows:

- (i) He becomes personally liable to third parties
- (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.

**LEGAL CONSEQUENCES OF PARTNER COMING IN AND GOING OUT ( SECTION 31- 35)**

Any change in the relation of partners will result in reconstitution of the partnership firm.

**1. INTRODUCTION OF A PARTNER (SECTION 31):**

Subject to a contract no new partners can be introduced into a firm without the consent of all the existing 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.

**2. RETIREMENT OF A PARTNER (SECTION 32):**

**(i) A partner may retire**

- (a) With the consent of all the other partners
- (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.

**(ii) 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. Such agreement may be implied.

**(iii) He and the 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.**

Retired partner is not liable to any third party who deals with the firm without knowing that he was a partner.

**(iv) Notices may be given by the retired partner or by any partner of the reconstituted firm**

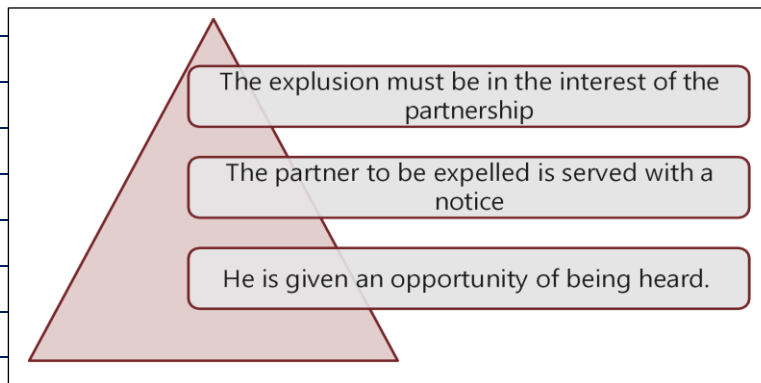
**3. EXPULSION OF A PARTNER (SECTION 33):**

**(i) The power of expulsion must have existed in a **contract** between the partners;**

**(ii) The power has been exercised by a **majority** of the partners; and**

**(iii) It has been exercised in **good faith**.**

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



Expulsion of partners does not necessarily result in dissolution of the firm.

#### 4. **INSOLVENCY OF A PARTNER (SECTION 34)**

- (i) Partner adjudicated as an insolvent he **ceases to be a partner** on the date on which the **order of adjudication** is made.
- (ii) Where under a contract between the partners the **firm is not dissolved**  
 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.

#### 5. **LIABILITY OF ESTATE OF DECEASED PARTNER (SECTION 35)**

Ordinarily, the effect of the death of a partner is the dissolution of the partnership, but dissolution by death of partner is **subject to a contract** partners are competent agree that the death of one will not have the effect of dissolving the partnership unless the firm consists of only two partners.

#### **RIGHTS OF OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS (SECTION 36)**

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.

#### **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-  
 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 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.

#### REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38)

a continuing guarantee given to a firm or to third party is **revoked** as to future transactions from the date of **any change** in the constitution of the firm.

## CHAPTER-4 UNIT-3 : REGISTRATION AND DISSOLUTION OF A FIRM

**APPLICATION FOR REGISTRATION (SECTION 58):** (1) The registration of a firm may be 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, (2) 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.

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 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. 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 of partnership is **delivered to the Registrar**.

**LATE REGISTRATION ON PAYMENT OF PENALTY (SECTION 59A-1):** If the statement in respect of any firm is not sent or delivered to the Registrar within the time specified, firm may be registered on payment, to the Registrar, of a penalty of one hundred rupees per year of delay or a part thereof.

### CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

Under the Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration. non-registration gives rise to a number of disabilities.

- (i) **No suit in a civil court by firm or other co-partners against third party:** 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.
- (ii) **No relief to partners for set-off of claim:** If an action is brought against the firm then neither the firm nor the partner can claim any set Off.
- (iii) **Aggrieved partner cannot bring legal action against other partner or the firm:** A partner is a person may sue for dissolution of the firm or for accounts and realization of his share in precluded from bringing legal action against the firm partner in the firm. But, such the firm's property where the firm is dissolved.
- (iv) **Third party can sue the firm :** an action can be brought against the firm by a third party.

**Exceptions :** Non-registration of a firm does not,



1. The right of **third parties** to **sue** the firm or any partner.
2. The right of partners to sue for the **dissolution** of the firm or for the **settlement of the accounts** of a dissolved firm, or for realization of the property of a dissolved firm.
3. The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.
4. The right to sue or claim a **set-off** if the value of suit does not exceed **₹100** in value.
5. 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.

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.

Where a new partner is introduced, the fact is to be notified to Registrar In case of default firm. cannot sue as new partner's name has not been entered in the register of firms.

### DISSOLUTION OF FIRM (SECTIONS 39 - 47)

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. the relationship between such a partner and other is dissolved, but the rest may decide to continue. i.e. no dissolution of the firm. It is called **dissolution of partnership**.

#### 1. DISSOLUTION WITHOUT THE ORDER OF THE COURT OR VOLUNTARY DISSOLUTION

##### (i) It consists of following four types:

Dissolution by Agreement (Section 40):

Right to the partners to dissolve the partnership by agreement with the consent of all the partners or in accordance with a contract.

##### (ii) Compulsory dissolution (Section 41):

A firm is compulsorily dissolved

Some event takes which make it lawful for the firm's business to be carried on 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.

##### (iii) Dissolution on the happening of certain contingencies (Section 42)

a firm can be dissolved

Where the firm is constituted for a fixed term, on the expiry of that term

Where the firm is constituted to carry out one or more adventures or undertaking, then by completion thereof

by the death of a partner, and

by the adjudication of a partner as an insolvent.

## 2. DISSOLUTION BY THE COURT (SECTION 44):

- (a) Insanity/unsound mind
- (b) Permanent incapacity
- (c) Misconduct
- (d) Persistent breach of agreement
- (e) Transfer of interest
- (f) Continuous/Perpetual losses
- (g) Just and equitable grounds

## CONSEQUENCES OF DISSOLUTION (SECTIONS 45 - 55)

### (a) Liability for acts of partners done after dissolution (Section 45):

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.

Notices under sub-section (1) may be given by any partner

#### Section 45 has two fold objection

- (1) It seeks to protect third parties dealing with the firm who had no notice of prior dissolution And
- (2) It also seeks to protect partners of a dissolved firm from liability towards third Parties.

Exceptions to the rule 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.

### (b) Right of partners to have business wound up after dissolution (Section 46):

On the dissolution of a firm every partner have the property of the firm applied in payment of the debts and liabilities of the firm surplus distributed among the partners.

### (c) Continuing authority of partners for purposes of winding up (Section 47):

After the dissolution of a firm the authority of each partner continue so far as may be necessary to wind up the affairs of the firm and to complete transactions Provided that firm is in no case bound by the acts of a partner who has adjudicated insolvent; this does not affect the liability of any person who represented as a partner of the insolvent. (Knowingly)

### (d) Mode of Settlement of partnership accounts (Section 48):

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;

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:

- (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**;
- (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.

**(e) 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:

- (i) The property of the firm shall be applied in the first instance in payment of the debts of the firm, and 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;
- (ii) 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.

## CHAPTER 5 THE LIMITED LIABILITY PARTNERSHIP ACT, 2008

### LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT

**Meaning:** A LLP is a **new form** of legal business entity with limited liability.

LLP as a **separate legal entity** and business organisation is an **alternative corporate** business form that gives the benefits of limited liability of a company and the flexibility a partnership.

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.

### Important Definitions

1. **Body Corporate [(Section 2(1)(d))]:** It means a company as defined in clause (20) of Section 2 of the Companies Act, 2013 and **includes**
  - (i) A limited liability partnership registered under this Act
  - (ii) A limited liability partnership incorporated outside India; and
  - (iii) A company incorporated outside India, but **does not include**
    - (i) A corporation sole;
    - (ii) A co-operative society registered under any law; and
    - (iii) Any other body corporate (not being a company as defined in clause (20) of section 2 of the Companies Act, 2013 or a limited liability partnership as defined in this Act), which the Central Government may, by notification in the Official Gazette, specify in this behalf.
2. **Business [Section 2(1)(e)]:** "Business" includes every trade, profession, service and occupation except any activity which the Central Government may, by notification exclude.
3. **Designated Partner [Section 2(1)(j)]:** "Designated partner" means any partner designated as such pursuant to section 7
4. **Entity [Section 2(1)(k)]:** "Entity" means any body corporate a firm setup under the Indian Partnership Act, 1932.
5. **Financial Year [Section 2(1)(l)]:** "Financial year", in relation to a LLP, means the period from the **1st day of April of a year to the 31st day of March** of the following year.
6. **Foreign LLP [section 2(1)(m)]:** It means a LLP formed, incorporated or registered **outside India** which establishes a place of business within India.
7. **Limited liability partnership [Section 2(1)(n)]:** Limited Liability Partnership means a partnership formed and registered under this Act.
8. **Limited Liability partnership agreement [Section 2(1)(o)]:** It means any **written agreement** between the partners of the LLP or 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.
9. **Partner [Section 2(1)(q)]:** Partner, in relation to a LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement.
10. **Small Limited Liability Partnership [Section 2(1)(ta)]:** It means a limited liability partnership—

- (i) The **contribution** of which, does not exceed **twenty-five lakh rupees** or such higher amount, not exceeding five crore rupees, as may be prescribed; and
- (ii) The **turnover** of which does not exceed **forty lakh rupees** or such higher amount, not exceeding fifty crore rupees, as may be prescribed; or
- (iii) Which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed.

#### **Non-applicability of the Indian Partnership Act, 1932 (Section 4):**

the provisions of the Indian Partnership Act, 1932 shall not apply to a LLP

**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 is of **unsound mind**
- (b) He is an **undischarged insolvent**; or
- (c) He has applied to be adjudicated as an insolvent and his **application is pending**.

#### **Minimum number of partners (Section 6):**

- (i) Every LLP shall have at least **two partners**.
- (ii) If at any time the number of partners of a LLP is **reduced below two** and the **LLP carries on business for more than six months** while the number is so reduced, the person, who is the only partner of the LLP- shall be **liable personally** for the obligations of the LLP incurred during that period.

#### **Designated partners (Section 7):**

- (i) Every LLP shall have at least **two designated partners** who are **individuals** and at least **one of them shall be a resident in India**.  
 If all the partners are bodies corporate, their nominees shall act as designated partners.



### **CHARACTERISTIC OF LLP**

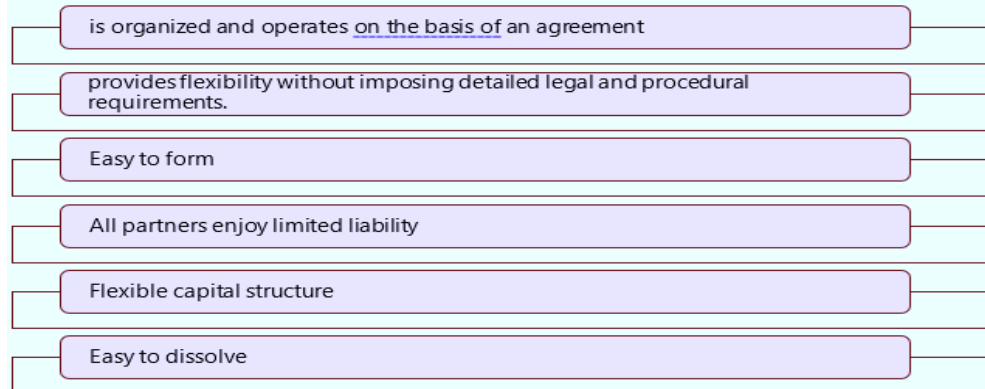
1. **LLP is a body corporate** : a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners and shall have perpetual succession.
2. **Perpetual Succession**: The LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name.
3. **Separate Legal Entity** : The LLP as 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. creditors of LLP shall be the creditors of LLP alone.
4. **Mutual Agency:-** No mutual agency.
5. **LLP Agreement**: Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners 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.
7. **Common Seal**: A LLP being an artificial person can act through its partners and designated



partners. LLP may have a common seal it is not mandatory for a LLP to have a common seal.

8. **Limited Liability:** Every partner of a LLP is, the agent of the LLP, but not of other partners. The liability of the partners will be limited to their agreed contribution in the LLP.
9. **Management of Business:** The partners in the LLP are entitled to manage the business of LLP. But only the designated partners are responsible for legal compliances.
10. **Minimum and Maximum number of Partners:** Every LLP shall have least two partners and 2 individuals as designated partners,  
There is no maximum limit on the partners in LLP.
11. **Business for Profit Only :** LLP must be carrying on a lawful business with a view to earn profit.
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 agreements including merger and amalgamation of LLPs shall be in accordance with the provisions of the LLP Act, 2008.
14. **Conversion into LLP:** An entity would be allowed to be converted into LLP .
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](http://www.mca.gov.in) and authenticated by a partner or designated partner of LLP by the use of electronic or digital signature.
16. **Foreign LLPs:** Section 2(1)(m) defines foreign limited liability partnership "as a limited liability partnership **formed, incorporated, or registered outside India** which established as **place of business within India**". Foreign LLP can become a partner in an Indian LLP.

#### Advantages of LLP form-



#### INCORPORATION OF LLP

##### Incorporation document (Section 11):

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
  - (c) **Statement to be filed:**

- along with the incorporation document, a statement 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.

- by any **one who subscribed** his name to the incorporation document shall be filed.

2. The incorporation document shall—

(a) Be in a **form** as may be **prescribed**.

(b) State the **name** of the LLP.

(c) The **proposed business** of the LLP.

(d) The **address** of the **registered office** of the LLP;.

(e) The **name and address** of each of the persons who are to be **partners** or **Designated Partners** of the LLP on incorporation.

(f) Contain such other information concerning the proposed LLP as may be prescribed.

3. If a person makes a statement as discussed above which he—

(a) **Knows to be false**; or

(b) **Does not believe to be true**, shall be punishable.

- with **imprisonment upto 2 years** and

- with **fine to of Rs. 10,000 - Rs. 5 Lakh**.

### Incorporation by registration (Section 12):

#### INCORPORATION BY REGISTRATION [SEC 12]

1. <b>Certificate</b>	On compliance of all the requirements as per Section 11 the Registrar shall register the incorporation document and give a certificate that the LLP is incorporated by the name specified therein <b>within 14 days</b> .
2. <b>Signature</b>	The certificate issued shall be <b>signed by the Registrar</b> .
3. <b>Official Seal</b>	The certificate issued shall authenticated by Official Seal of the Registrar.
4. <b>Conclusive Evidence</b>	The <b>certificate shall be conclusive evidence</b> that the LLP is incorporated by the name specified therein.

### 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.

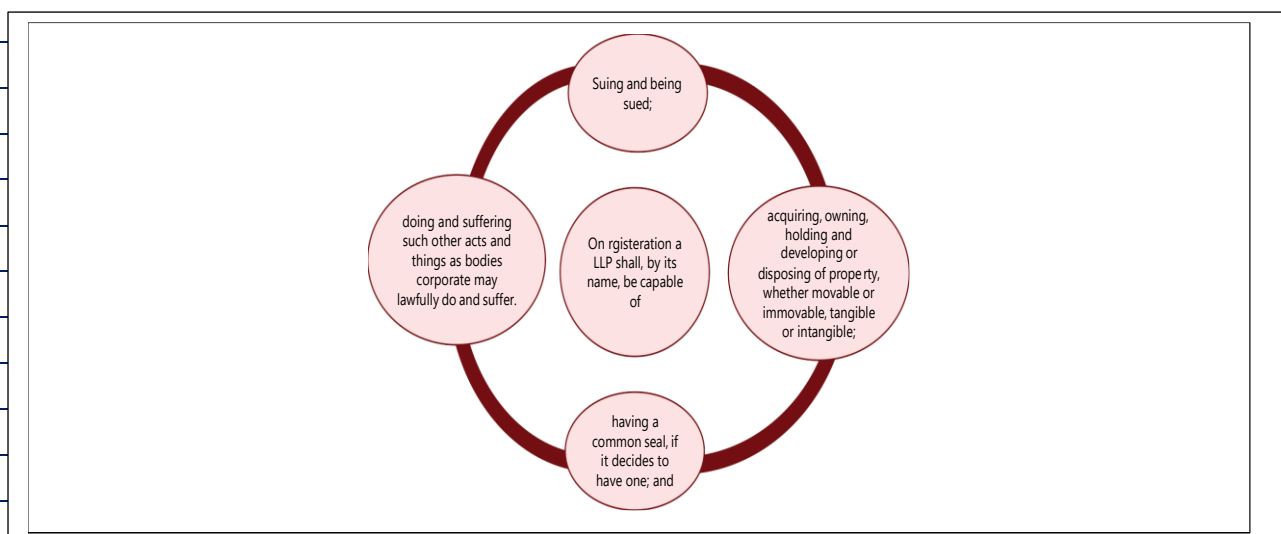
2. **A document may be served on a LLP** or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed **at the registered office** and any other address specifically declared by the LLP for the purpose 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- Rs. 5,00 per day, maximum - 50,000** for **LLP and its every partner.**

### Effect of registration (Section 14):



### Name (Section 15):

- (1) Every limited liability partnership shall have either the words **"limited liability partnership"** or the acronym **"LLP"** as the last words of its name.
- (2) No 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 **LLP** or a **company** or a **registered trade mark** of any other person.

### Reservation of name (Section 16):

1. 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.
2. Upon receipt of an application the **Registrar may 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. **LLP** registered name, is identical with or too nearly resembles to —
  - (a) That of any other LLP or a company; or
  - (b) A registered trade mark of a proprietor.

On application - **C.G. may direct** the LLP to **change its name with in 3 months from the order**
2. Where a LLP changes its name or obtains a new name 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.

3. If the LLP is in default in complying with any direction given under sub-section(1), **(for 3 month)** and the Registrar shall enter the new name in the register issue a fresh certificate of incorporation with new name.

## CHAPTER 6: THE COMPANIES ACT, 2013

### 1. COMPANY: MEANING AND ITS FEATURES

Section 2(20) of the Companies Act, 2013 defines the term 'company'. "Company means a company **incorporated under this Act or under any previous company law**".

**Features of a Company :** Following are the main features

1. **Separate Legal Entity** : when a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. **Its existence is distinct and separate from that of its members**. A company can own property, have bank account, raise loans, incur liabilities and enter into contracts.

(a) It's personality is **distinct** and **separate** from the personality of those who compose it.

(b) Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members.

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.**

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.

3. **Limited Liability**: The liability of a member depends upon the kind of company of which he is a Member.

(i) **company, Limited by shares** the liability extent of the nominal value of shares held by members.

(ii) **a company limited by guarantee**, the members are liable only to the extent of the amount guaranteed by them and that too only when the company goes into liquidation.

(iii) unlimited company, the liability of its members is unlimited as well.

4. **Artificial Legal Person :**

1. 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.

2. the company can own property, have banking account, raise loans, incur liabilities and enter into Contracts.

3. As the company is an **artificial person**, it can act only through some human agency, viz., directors. The directors can either on their own or through the common seal(of the company) can authenticate its formal acts.

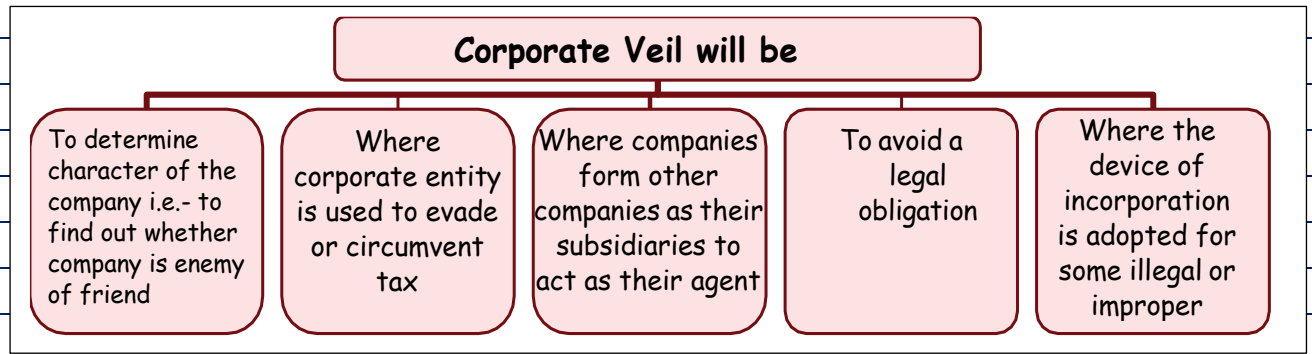
**In case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.**

### 2. CORPORATE VEIL THEORY

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.

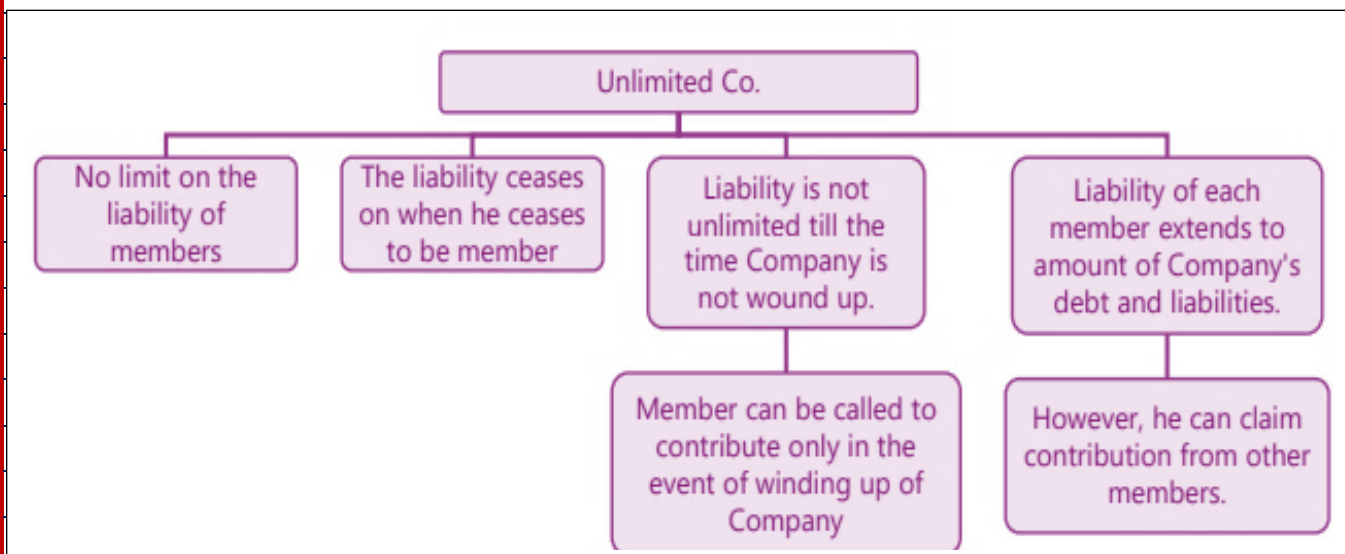




### 3. CLASSES OF COMPANIES UNDER THE ACT

#### 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.  
 a shareholder is a co-owner of the a company, he is not a co-owner of the company's assets. The extent of the rights and duties of a shareholder as co-owner is measured by his shareholdings.
- (b) **Company limited by guarantee:** Section 2(21) 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. the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions.
- (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.



#### 2. On the basis of members: Section 2(62) of the Companies Act, 2013 defines one person company

- (a) (OPC) as a company which has only one person as a member.

**OPC (One Person Company) - significant points**

- Only **one person** as member.
- **Minimum paid up capital** - no limit prescribed.
- The memorandum of OPC shall indicate the **name of the other person**, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
- The other person whose name is given in the memorandum shall give his prior **written consent**.
- Such other person may be given the right to **withdraw his consent**
- The member of OPC may at any time change the name of such other person by giving **notice** to the company and the Registrar.
- Any such change in the name of the person shall not be deemed to be an alteration of the memorandum
- Only a **natural person** who is an **Indian citizen whether resident in India or otherwise**.
  - ✓ shall be eligible to incorporate a OPC
  - ✓ shall be a nominee for the sole member of a OPC.
- **No person** shall be **eligible** to incorporate more **than one OPC** or become nominee in more than one such company.
- **No minor** shall become member or nominee of the OPC or can hold share with beneficial interest
- Such Company **cannot be** incorporated or **converted into a company under section 8 of the Act**
- Such Company **cannot carry out Non-Banking Financial Investment activities**.

**(b) Private Company [Section 2(68)]:**

- No minimum paid-up capital requirement.
- **Minimum** number of members - **2**
- **Maximum** number of members - **200**
- **Right to transfer shares restricted**.
- Prohibition on invitation to subscribe to securities of the company.
- Small company is a **private company**.
- OPC can be formed only as a private company.

**Small Company:** Small company given under the Section 2(85) a company, other than a public company-

- (i) **Paid-up share capital** of which does not exceed **fifty lakh rupees** or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
- (ii) **Turnover** of which as per profit and loss account for the immediately preceding financial year does not exceed **two crore rupees** or such higher amount as may be prescribed which shall not be more than one hundred crore rupees.

**Small Company -significant points**

**Should not be - Section 8 company**

**- Holding or a Subsidiary company.**

**(c) Public company [Section 2(71)]:**

- Is not a private company (Articles do not have the restricting clauses)
- Shares freely transferable

- No minimum paid up capital requirement
- Minimum number of members - 7
- Maximum numbers of members - No limit
- Subsidiary of a public company is deemed to be a public company.

### 3. On the basis of control:

#### (a) Holding and subsidiary companies :

holding company means a company of which such companies are subsidiary companies [Section 2(46)]

2(87) defines "subsidiary 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.

(b) **Associate company [Section 2(6)]**: 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.

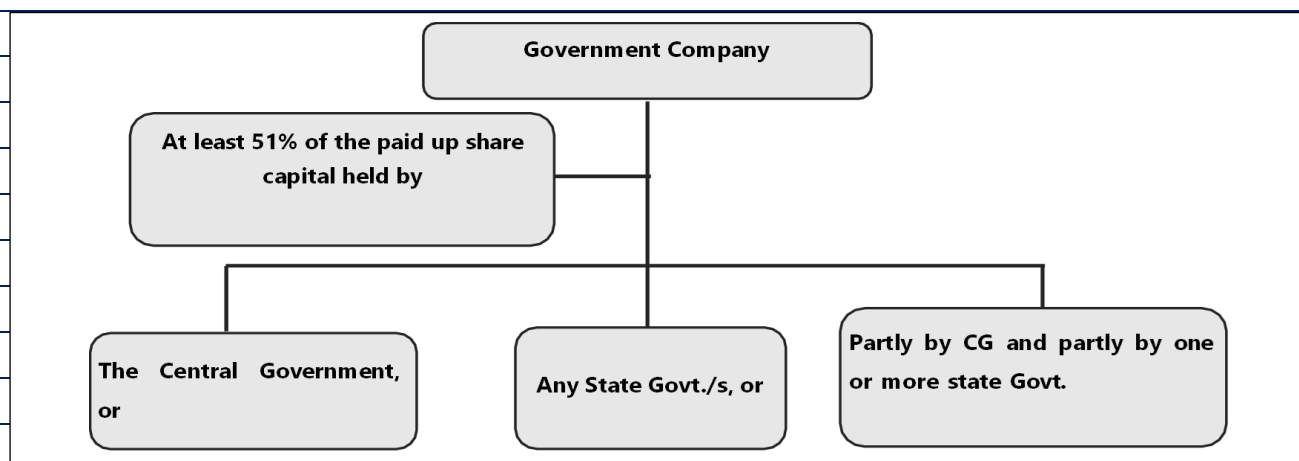
### 4. On the basis of access to capital :

(a) **Listed company**: section 2(52) a company which has any of its securities listed on any recognised stock exchange.

(b) **Unlisted company** means company other than listed company.

### 5. Other companies :

#### (a) Government company [Section 2(45)]



(b) **Foreign Company [Section 2(42)]**: It means any company or body corporate incorporated **outside India** which-

- (i) has a **place of business in India** whether by itself or through an agent, physically or through electronic mode; and
- (ii) **conducts any business activity in India** in any other manner.

(c) **Formation of companies with charitable objects etc. (Section 8 company) :**

Formation
• To promote Charitable objects
Application of profits
• To promote its objects
• No payment of dividends out of profits
Type of Co.
• Limited Liability
• Without the addition of words "Ltd" or "Pvt Ltd."
How status is granted
• The CG can grant such status
• However, CG has delegated the power to grant licence to ROC
Revocation of licence
• CG may revoke licence
• If conditions of section 8 are contravened, or
• affairs of the company are conducted fraudulently, or prejudicial to public interest
Effect of revocation of licence
• Co has to use words "Ltd." or "Pvt Ltd."

(d) **Dormant company (Section 455):** Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company.

**"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.

(e) **Meaning of Nidhi Companies [Section 406(1) of the Companies Act, 2013]:** In this section, "Nidhi" or "Mutual Benefit Society" means a company which the **Central Government** may, by notification in the Official Gazette, **declare** to be a Nidhi or Mutual Benefit Society.

(f) **Public Financial Institutions (PFI):** By virtue of Section 2(72) of the Companies Act, 2013, the following institutions are to be regarded as public financial institutions.

(i) the **Life Insurance Corporation of India**

(ii) the **Infrastructure Development Finance Company Limited**

(iii) **specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.**

(iv) **institutions notified by the Central Government** under section 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act.

(v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India

#### Conditions for an institution to be notified as PFI

Established or constituted by or under any Central or State Act

At least 51% of the paid-up share capital is held/controlled by the CG or by any State Govt./s or partly by the CG and partly by

#### 4. MODE OF REGISTRATION/INCORPORATION OF COMPANY

section 2(69) Promoter means a person -

- (a) who has been **named** as such in a **prospectus** or is identified by the company in the annual return referred to in section 92; or
- (b) who has **control over the affairs of the company**, directly or indirectly whether as a shareholder director or otherwise; or.
- (c) **in accordance with whose advice, directions**, or instructions the **Board of Directors of the company is accustomed to act**.

**FORMATION OF COMPANY:** Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company.

Public Co.	• 7 or more persons
Private Co.	• 2 or more persons
One Person Co.	• One person

**INCORPORATION OF COMPANY:** Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

1. **Filing of the documents and information with the registrar:** For the registration of the company following documents and information are required to be filed with the registrar.
  - The **memorandum and articles** of the company duly signed by all the subscribers to the Memorandum.
  - A **declaration by person who is engaged in the formation of the company** and by a person named in the articles 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
  - A **declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles** stating that-
    - He is **not convicted** of any offence in connection with the promotion, formation or management of any company, or
    - He has **not been found guilty of any fraud or misfeasance or of any breach of duty** to any company under the Act during the last five years.
    - And that all the **documents filed with the Registrar** for registration and information that is correct and complete and true to the best of his knowledge and belief.
  - the **address for correspondence** till its **registered office** is established
  - the **particulars of every subscriber** to the memorandum in the case of a body corporate, such particulars as may be prescribed.
  - the **particulars of the persons mentioned in the articles as the subscribers to the Memorandum**.
  - the **particulars of the interests of the persons mentioned in the articles** as the first directors of the company in other firms or bodies corporate along with their consent to



act as directors of the company.

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.
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.
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):** 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):** 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:** Where a company has been got incorporated by furnishing false or incorrect information. the Tribunal may, on an application made to it, on being satisfied that the situation so warrants,—
  - (a) pass such orders, as it may think fit, for regulation of the management of the company including changes in its memorandum and articles. or
  - (b) direct that **liability** of the members shall be **unlimited**; or
  - (c) **direct removal of the name of the company** from the register of companies; or
  - (d) pass an order for the **winding up of the company**; or
  - (e) pass such **other orders as it may deem fit**:

**Provided that before making any order -**

- the company shall be given a **reasonable opportunity of being heard** and
- the Tribunal shall take into consideration the transactions entered into by the company contracted or payment of any liability.

**Simplified Proforma for Incorporating Company Electronically (SPICe)**

**EFFECT OF REGISTRATION :** According to **Section 9**, from the date of incorporation 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.

**EFFECT OF MEMORANDUM AND ARTICLES:** As per Section 10 of the Companies Act, 2013, where the memorandum and articles when registered, shall **bind the company** and the members.

All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

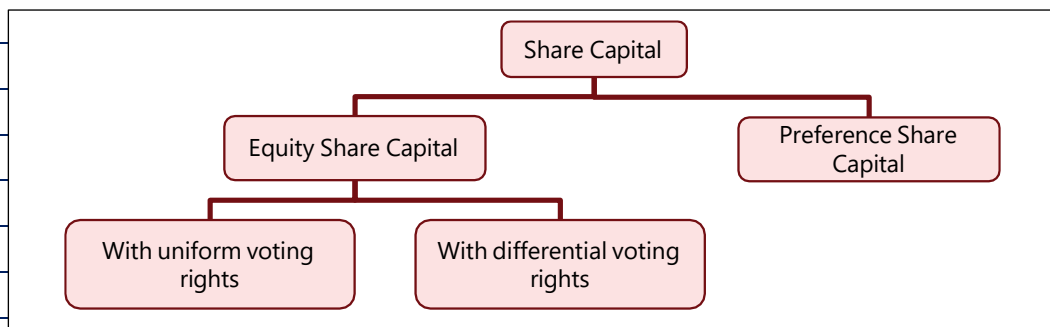
## 5. CLASSIFICATION OF CAPITAL

the contributions of persons to the common stock of the company form the capital of the company.

- (a) **Nominal or authorised or registered capital:** This form of capital has been defined in section 2(8) of the Companies Act, 2013. "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**.
- (b) **Issued capital:** Section 2(50) of the Companies Act, 2013 defines "issued capital" which means such capital as the **company issues from time to time** for subscription. Schedule III to the Companies Act, 2013, makes it obligatory for a company to disclose its issued capital in the balance sheet.
- (c) **Subscribed capital:** Section 2(86) of the Companies Act, 2013 defines "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:** Section 2(15) of the Companies Act, 2013 defines "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** is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

## 6. SHARES

1. **Nature of shares:** Section 2(84) of the Companies Act 2013 defines the term 'share' which means a share in the share capital of a company and includes stock.



**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.

2. **Kinds of share capital:-** Section 43 of the Companies Act, 2013 provides the kinds of share capital.
  - (i) **Equity share capital -**
    - (a) with **voting rights**; or
    - (b) with **differential rights as to dividend, voting** or otherwise in accordance with prescribed rules;
  - (ii) **Preference share capital**

**According to explanation to section 43 : -**

1. **"Equity share capital"**, with reference to any company limited by shares, means all share capital which is not preference share capital.
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.

## 7. MEMORANDUM OF ASSOCIATION

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.
- 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
- 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.

As per Section 4, Memorandum of a company shall be drawn up in such form as is given in Tables A, B, C, D and E in Schedule I of the Companies Act, 2013.

**Table A** company limited by shares.

**Table B** company limited by guarantee and not having a share capital.

**Table C** by guarantee and having a share capital.

**Table D** unlimited company.

**Table E** unlimited company and having share capital.

**Content of the memorandum:** The memorandum of a company shall state -

- (a) the name of the company (**Name Clause**) with the last word "Limited" or "Private Limited"
- (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, and also state.

- **in the case of a company limited by shares**, that the liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
- **in the case of a company limited by guarantee**, the amount up to which each

**member undertakes to contribute -**

- to the **assets of the company in the event of its being wound-up**
- to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

(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 detail of the subscribers to be formed into a company. The Memorandum shall conclude with the **association clause**.

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.

It is to be noted that a company being a legal person can through its agent, subscribe to the memorandum. However, a **minor cannot be a signatory to the memorandum** as he is not competent to contract. The guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.

The Memorandum of Association of a company cannot contain anything contrary to the provisions of the Companies Act.

## 8. DOCTRINE OF ULTRA VIRES

**Doctrine of ultra vires:** The meaning of the term ultra vires is simply "**beyond (their) powers**".

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.

**The whole position regarding the doctrine of ultra vires can be summed up as:**

- (i) When an act is performed, which though legal in itself, is not **authorized by the object** clause of the memorandum, or by the statute, it is said to be ultravires the company, and hence null and void.
- (ii) An act which is **ultravires, the company cannot be ratified** even by the unanimous consent of all the shareholders.
- (iii) An act which is **ultravires the directors, but intravires the company can be ratified** by the members of the company through a resolution passed at a general meeting.
- (iv) If an act is **ultravires the Articles**, it **can be ratified by** altering the Articles by a Special Resolution at a general meeting.

## 9. ARTICLES OF ASSOCIATION

The articles of association of a company are its rules and regulations, which are framed to

manage its internal affairs.

the articles are the **internal regulations** of the company.

The articles of association are in fact 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.

**Section 5 of the Companies Act, 2013 seeks to provide the contents and model of articles of association. The section lays the following law-**

1. **Contains regulations:** The articles of a company shall contain the regulations for management of the company.
2. **Inclusion of matters** a company may also include such additional matters in its articles as may be considered necessary for its management.
3. **Contain provisions for entrenchment:** The articles may contain provisions for entrenchment (to protect something).
4. **Manner of inclusion of the entrenchment provision:** The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members in the case of a private company and by a special resolution in the case of a public company.
5. **Notice to the registrar of the entrenchment provision:** Where the articles contain provisions for entrenchment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.
6. **Forms of articles:** The articles of a company shall be in respective forms specified in Tables F, G, H, I and J in Schedule I as may be applicable to such company.
7. **Model articles:** A company may adopt all or any of the regulations contained in the model articles applicable to such company.
8. **Company registered after the commencement of this Act:** In case of any company, articles which is registered after the commencement of this Act, in so far as the registered of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

**The following are the key differences between the Memorandum of Association vs. Articles of Association:**

1. **Objectives:** Memorandum of Association defines and **delimits the objectives** of the company whereas the Articles of association lays down the **rules and regulations for the internal management** of the company. Articles determine how the objectives of the company are to be achieved.
2. **Relationship:** Memorandum defines the **relationship of the company with the outside world** and Articles define the **relationship between the company and its members**.
3. **Alteration:** Memorandum of association can be **altered** only under certain circumstances and in the manner provided for in the Act. In most cases permission of the Regional



Director, or the Tribunal is required. The articles can be altered simply by passing a special Resolution.

4. **Ultra Vires:** Acts done by the company beyond the scope of the memorandum are ultra-vires and void. These cannot be ratified even by the unanimous consent of all the shareholders. The acts ultra-vires the articles can be ratified by a special resolution of the shareholders, provided they are not beyond the provisions of the memorandum.

## 10. DOCTRINE OF INDOOR MANAGEMENT

**Doctrine of Constructive Notice:** Section 399 of the Companies Act, 2013 provides that any person can inspect by electronic means any document kept by the Registrar, or make record of the same, or get a copy or extracts of any document, including certificate of incorporation of any company, on payment of prescribed fees.

It is therefore, the duty of every person dealing with a company to inspect its documents

**By constructive notice is meant :**

- (i) a person not only presumed to have read the documents but also **understood** them in their true perspective.
- (ii) 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.

**Doctrine of Indoor Management:** *The Doctrine of Indoor Management is the exception to the doctrine of constructive notice.* The aforesaid doctrine of constructive notice *does in no sense mean that outsiders are deemed to have notice of the internal affairs of the company.*

**Exceptions to the doctrine of Indoor Management:** Thus, you will notice that the aforementioned rule 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.

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.
- (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.

## CHAPTER 7: THE NEGOTIABLE INSTRUMENTS ACT, 1881

### (1) MEANING OF NEGOTIABLE INSTRUMENTS

**Negotiable Instruments** is an instrument (the word instrument means a document) which is **freely transferable** (by customs of trade) from one person to another by mere delivery or by indorsement and delivery. The property in such an instrument pass to a *bona fide* 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

#### 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.

#### 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 (indorsement means signing of the instrument) on the instrument is an indorsement in **blank** i.e., the person who possesses it can demand payment.

**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.

Characterstics							
written	signed	transferable	title free from defects	can be transferred number of times	Unconditional promise/order to pay	certainty of sum payable, time of payment and the payee	delivered

### (2) PROMISSORY NOTE

#### Meaning

"A '**promissory note**' is an instrument in **writing** (not being a bank-note or a currency-note) containing an **unconditional undertaking signed by the maker**, to pay a **certain sum** of money only to, or to the order of, a certain person, or to the bearer of the instrument."

#### Parties to promissory note

(1) **Maker:** The person who makes the promise to pay is called the Maker.

(2) **Payee:** Payee is the person to whom the amount on the note is payable

#### Essential Characteristics of a Promissory Note

(a) In **writing-**

(b) There must be an **express promise to pay**.

(c) The promise to pay should be **definite and unconditional**.

(d) A promissory note must be **signed by the maker** otherwise it is incomplete and ineffective.

(e) Promise **to pay money only**.

(f) Promise to pay a **certain sum**.

(g) The **maker and payee must be certain, definite and different persons**.

(h) **Stamping**: A promissory note must be duly stamped

### (3) **BILLS OF EXCHANGE**

A "**bill of exchange**" is an instrument in **writing** containing an **unconditional order**, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a **certain person** or to the bearer of the instrument.

#### **Parties to the bill of exchange**

(a) **Drawer**: The maker of a bill of exchange.

(b) **Drawee**: The person directed by the drawer to pay is called the 'drawee'.

(c) **Payee**: The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid.

#### **Essential characteristics of bill of exchange**

(a) It must be in **writing**.

(b) Must contain an **express order to pay**.

(c) The order to pay must be **definite and unconditional**.

(d) The **drawer must sign** the instrument.

(e) Drawer, drawee, and payee must be **certain**.

However, a bill of exchange payable on demand, in which name of the payee is mentioned, is valid.

(f) The **sum must be certain**.

(g) The order must be to **pay money only**.

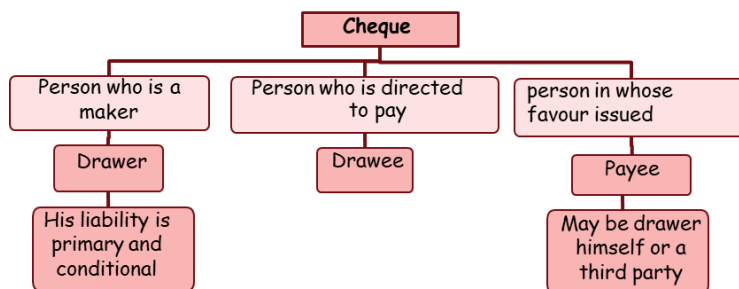
(h) It must be **stamped**.

### (4) **CHEQUE [SECTION 6]**

A "**cheque**" is a **bill of exchange drawn** on a specified banker and not expressed to be payable otherwise than on demand and it **includes** the **electronic image of a truncated cheque** and a **cheque in the electronic form**.

**It is Payable on demand**

#### **Parties to Cheque:**



#### **Essential Characteristics of a cheque**

(a) all the **essential characteristics of a bill of exchange**

(b) Must be drawn on a **specified banker**

(c) It must be **payable on demand**.

**Note**: These two additional features distinguish a cheque from bill. Thus, all cheques are bills while all bills are not cheques.

## (5) CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

### "Bearer instrument" and "order instrument" [Section 13]

**Bearer Instrument:** It is an instrument where the **name of the payee is blank** or name of payee is specified with the words **"or bearer"** or **last indorsement is blank**. Such instrument can be **negotiated 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**, such instrument can be negotiated by indorsement and delivery.

### "Inland instrument" and "Foreign instrument" [Sections 11 & 12]

**"Inland instrument":** A promissory note, bill of exchange or cheque **drawn or made in India** and made **payable in, or drawn upon any person resident in India** shall be deemed to be an inland instrument.

**"Foreign instrument":** A foreign instrument is one which is not an inland instrument.

### Liability of maker/ drawer of foreign bill

In the absence of a contract to the contrary, 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).

### Inchoate and Ambiguous Instruments

**Inchoate Instrument:** It means an instrument that is incomplete in certain respects. this gives a power to its holder to make it complete by writing any amount either within limits specified therein or limits specified by the stamp's affixed on it. **The principle of this rule of an inchoate instrument is based on the principle of estoppel.**

**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.

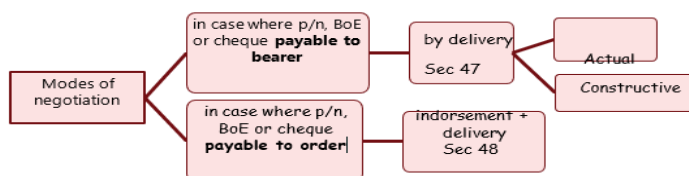
**Ambiguous Instrument: Section 17** - "Where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thenceforward treated accordingly."

**After exercising his option, the holder cannot change** that it is the other kind of instrument.

## (6) NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

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 or by indorsement and delivery**.

### Modes of Negotiation



## Importance of Delivery in Negotiation [Section 46]

Delivery of an instrument is essential.

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.

The delivery can be, actual or constructive.

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 rights in the instrument are not transferred to the indorsee unless after the indorsement the same has been delivered.

According to section 57, the legal representative of a deceased person cannot negotiate by an instrument by mere delivery.

### Delivery when effective between the parties

Negotiation of instruments between the parties	How delivery is to be made
As between parties standing in immediate relation	Delivery to be effectual must be made by the party making, accepting, or endorsing the instrument, or by a person authorized by him in that behalf.
As between such parties and any holder of the instrument other than a holder in due course	It may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

## DISHONOR OF CHEQUE FOR INSUFFICIENCY, ETC., OF FUNDS IN THE ACCOUNTS [SECTION 138]

Where any cheque drawn by a person on an account maintained by him with a banker—

✚ for payment of any amount of money

✚ to another person from that account

✚ for the discharge, in whole or in part, of any debt or other liability,

✚ is returned by the bank unpaid,

either because of the—

amount of money standing to the credit of that account is insufficient to honor the cheque, or

that it exceeds the amount arranged to be paid from that account by an agreement made with that bank.

such person shall be deemed to have committed an offence and 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.

When section 138 shall be not apply: unless the below given conditions are complied with—

(a) Cheque presented within validity period:

(b) Demand for the payment through the notice:

compliant can be filed after 45 days of dishonor of the cheque i.e., 30 days of notice period +15 days of the receipt of the said notice.



## **PRESUMPTION IN FAVOR OF HOLDER [SECTION 139]**

When a cheque is dishonored, 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.

## **DEFENCE WHICH MAY NOT BE ALLOWED IN ANY PROSECUTION UNDER [SECTION 138]**

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 38**

## **(7) PRESENTMENT OF INSTRUMENTS**

### **Presentment for acceptance [Section 61]**

A bill of exchange **payable after sight** must be presented to the drawee thereof for acceptance by a person entitled to **demand acceptance, within a reasonable time** after it is drawn, and in business hours on a business day. (if no time or places is specified)

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.**

### **Presentment of promissory note for sight [Section 62]**

A promissory note, payable at a certain period after sight, must be presented to the maker **for sight** (if he can after reasonable search be found) by a person entitled to demand payment, within a reasonable time after it is made and in business hours on a business day.

### **Drawee's time for deliberation [Section 63]**

The holder must, allow the drawee **48 hours** (exclusive of public holidays) to consider **whether** he will accept it.

### **Presentment for payment [Section 64]**

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

In **default of such presentment**, the other parties thereto are **not liable**

### **Hours for presentment (Section 65)**

Must be made during the **usual hours of business**, and, if at a banker's within banking hours.

### **Presentment for payment of instrument payable after date or sight (Section 66)**

Must be presented for payment at **maturity.**

### **Presentment for payment of promissory note payable by instalments (Section 67)**

Must be presented for payment on the **third day after the date fixed for payment of each instalment**; and non-payment on such presentment has the same effect as non-payment of a note at maturity.

### **Presentment for payment of instrument payable at specified place and not elsewhere (Section 68)**

Must be presented for payment at that place.

### **Instrument payable at specified place (Section 69)**

Must be presented for payment at that place.

### Presentment where no exclusive place specified (Section 70)

Must be presented for payment at the **place of business (if any)** or at the **usual residence**, of the maker, drawee or acceptor as the case may be.

### Presentment when maker, etc., has no known place of business or residence (Section 71)

Such presentment may be made to him in person **wherever he can be found**.

### Presentment of cheque to charge drawer (Section 72)

Subject to the provisions of section 84, a cheque must, be presented at the bank upon which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer **Section 72**.

### Presentment of cheque to charge any other person (Section 73)

A cheque must, be presented within a **reasonable time** after delivery thereof by such person

### Presentment of instrument payable on demand (Section 74)

Subject to the provisions of **section 31**, a negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.

### Presentment by or to agent, representative of deceased, or assignee of insolvent (Section 75)

Presentment for acceptance or payment may be made to the duly authorised agent of the drawee, maker or acceptor, as the case may be, or, where the drawee, maker or acceptor has died, to his legal representative, or, where he has been declared an insolvent, to his assignee

### Excuse for delay in presentment for acceptance or payment (Section 75A)

Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When the **cause of the delay ceases** to operate, **presentment must be made within a reasonable time**

### When presentment unnecessary (Section 76)

- (a) (i) If the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or
- (i) if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or
- (ii) if the instrument being payable at some other specified place, neither he nor any person authorised to pay it attends at such place during the usual business hours, or
- (iii) if the instrument not being payable at any specified place, he cannot after due search be found;
- (i) if the instrument being payable at his place of business, he closes such place on a business day
- (b) as against any party sought to be charged therewith, if he has engaged to pay not with standing non-presentment;
- (c) as against any party if, after maturity, with knowledge that the instrument has not been presented—
- he makes a part payment on account of the amount due on the instrument, or promises to pay the amount due thereon in whole or in part, or otherwise waives his right to take advantage of any default in presentment for payment; 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 (Section 77).*

**(8) RULES OF COMPENSATION**

***Rules as to compensation (Section 117)***

The compensation payable in case of dishonor of instrument 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;
- (d) when the person charged and such endorser reside at different places, the endorser is entitled to receive such sum at the current rate of exchange between the two places;
- (e) the party entitled to compensation may draw a bill upon the party liable to compensate him, Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill.