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CMA – Inter Paper 6 – LAW & ETHICS

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1. The Indian Contracts Act, 1872

1.1 Essential elements of a contract, Offer and Acceptance

1.1.1 The Law of contract: Introduction



As a result of increasing complexities of business environment, innumerable contracts are entered into by the parties in the usual course of carrying on their business. 'Contract' is the most usual method of defining the rights and duties in a business transaction. This branch of law is different from other branches of law in a very important respect. It does not prescribe so many rights and duties, which the law will protect or enforce; it contains a number of limiting principles subject to which the parties may create rights and duties for themselves. The Indian Contract Act, 1872 codifies the legal principles that govern 'contracts'. The Act basically identifies the ingredients of a legally enforceable valid contract in addition to dealing with certain special type of contractual relationships like indemnity, guarantee, bailment, pledge, quasi contracts, contingent contracts etc.

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

This unit refers to the essentials of a legally enforceable agreement or contract. It sets out rules for the offer and acceptance and revocation thereof. It states the circumstances when an agreement is voidable or enforceable by one party only, and when the agreements are void, i.e. not enforceable at all.

1.1.2 WHAT IS A CONTRACT?

The term contract is defined under section 2(h) of the Indian Contract Act, 1872 as- **"an agreement enforceable by law".**

The contract consists of two essential elements:

(i) an agreement, and

(ii) its enforceability by law.

(I) Agreement - The term 'agreement' **given in Section 2(e)** of the Act is defined as- "every promise and every set of promises, forming the consideration for each other".

To have an insight into the definition of agreement, we need to understand promise.

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(II) 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".

The following points emerge from the above definition:

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

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

Agreement = Offer/Proposal + Acceptance

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

(IV) Contract = Accepted proposal/Agreement + Enforceability by law

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

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

So Law of Contract deals with only such legal obligations which has resulted from agreements. Such obligation must be contractual in nature. However some obligations are outside the purview of the law of contract.

Example: An obligation to maintain wife and children, an order of the court of law etc. These are status obligations and so out of the scope of the Contract Act.

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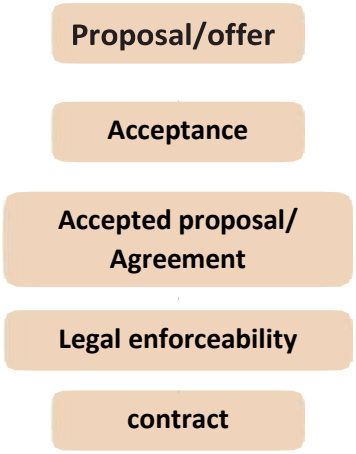

Difference between Agreement and Contract

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

1.1.3 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	Fulfillment of legal formalities
4	Lawful consideration	4	Certainty of meaning
5	Legal object	5	Possibility of performance
6	Not expressly declared to be void	6	-

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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".

Since section 10 is not complete and exhaustive, so there are certain others sections which also contains requirements for an agreement to be enforceable. Thus, in order to create a valid contract, the following elements should be present:

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

Example: To constitute a contract of sale, there must be two parties- seller and buyer. The seller and buyer must be two different persons, because a person cannot buy his own goods. In State of ***Gujarat vs. Ramanlal S & Co***. when on dissolution of a partnership, the assets of the firm were divided among the partners, the sales tax officer wanted to tax this transaction. It was held that it was not a sale. The partners being joint owner of those assets cannot be both buyer and seller.

2. **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 and hence they do not result into contracts.

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

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

4. **Certainty of meaning:** The agreement must be certain and not vague or indefinite.

Example: A agrees to sell to Be a hundred tons of oil. There is nothing certain in order to show what kind of oil was intended for.

1. **Possibility of performance of an agreement:** The terms of agreement should be capable of performance. An agreement to do an act impossible in itself cannot be enforced.

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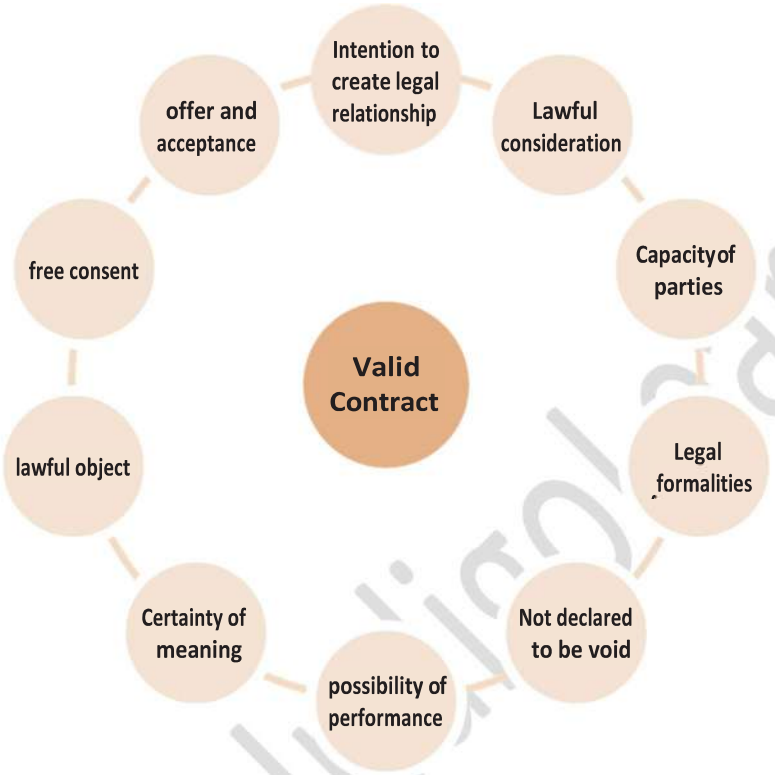
Example: A agrees with B to discover treasure by magic. The agreement cannot be enforced as it is not possible to be performed.

Essential elements of a valid contract



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

1) **Offer and Acceptance or an agreement:** An agreement is the first essential element of a valid contract. According to Section 2(e) of the Indian Contract Act, 1872, "Every promise and every set of promises, forming consideration for each other, is an agreement" and according to Section 2(b) "A proposal when accepted, becomes a promise". An agreement is an outcome of offer and acceptance.

2) **Free Consent:** Two or more persons are said to consent when they agree upon the same thing in the same sense. This can also be understood as identity of minds in understanding the terms viz consensus ad idem. Further such a consent must be free. Consent would be considered as free consent if it is not caused by coercion, undue influence, fraud or, misrepresentation or mistake. When consent to an agreement is caused by coercion, undue influence, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

   When consent is vitiated by mistake, the contract becomes void.

Example: A threatened to shoot B if he (B) does not lend him Rs. 2000 and B agreed to it. Here the agreement is entered into under coercion and hence voidable at the option of B.
(Students may note that the terms coercion, undue influence, fraud, misrepresentation, mistake are explained in the coming units)

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
   (a) is of the age of majority according to the law to which he is subject and
   (b) is of sound mind and
   (c) is not otherwise disqualified from contracting by any law to which he is subject.

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

   Qualification (a) refers to the age of the contracting person i.e. the person entering into contract must be of 18 years of age. Persons below 18 years of age are considered minor, therefore, incompetent to contract.

   Qualification (b) requires a person to be of sound mind i.e. he should be in his senses so that he understands the implications of the contract at the time of entering into a contract. A lunatic, an idiot, a drunken person or under the influence of some intoxicant is not supposed to be a person of sound mind.

   Qualification (c) requires that a person entering into a contract should not be disqualified by his status, in entering into such contracts. Such persons are: an alien enemy, foreign sovereigns, convicts etc. They are disqualified unless they fulfil certain formalities required by law.

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

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

   Example:- A agrees to sell his books to B for Rs. 100, B's promise to pay Rs. 100 is the consideration for A's promise to sell his books and A's promise to sell the books is the consideration for B's promise to pay Rs. 100.

5) **Lawful Consideration and Object:** The consideration and object of the agreement must be lawful.

   Section 23 states that consideration or object is not lawful if it is prohibited by law, or it is such as would defeat the provisions of law, if it is fraudulent or involves injury to the person or property of another or court regards it as immoral or opposed to public policy.

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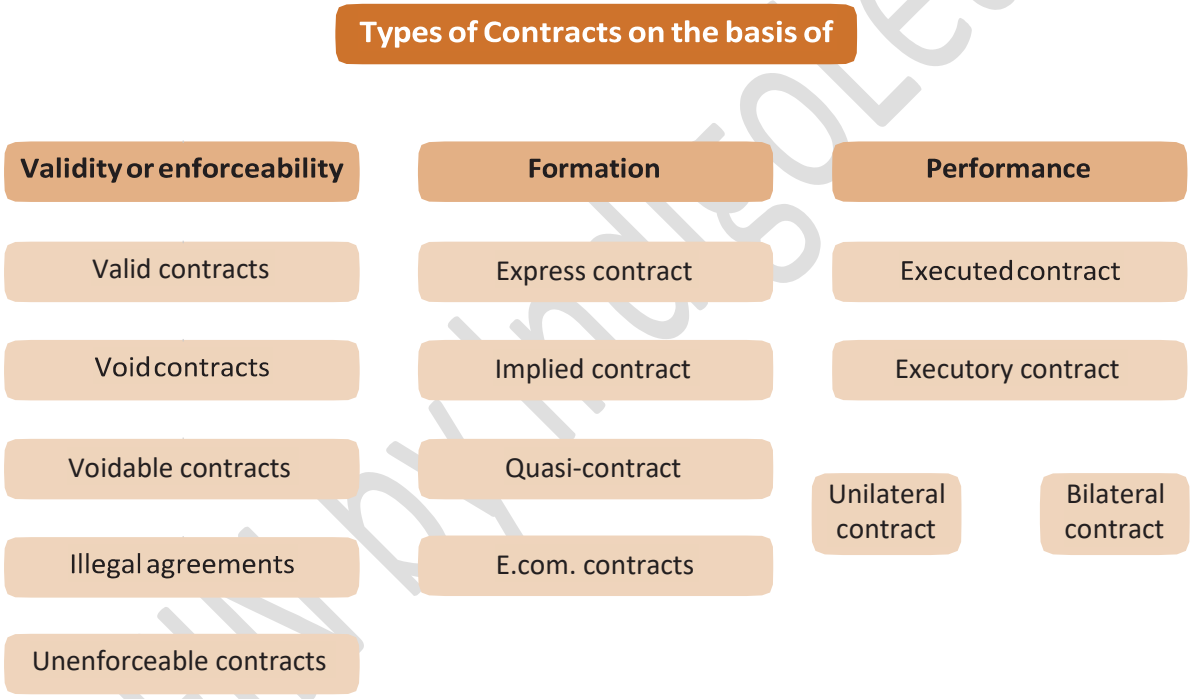
Example : 'A' promises to drop prosecution instituted against 'B' for robbery and 'B' promises to restore the value of the things taken. The agreement is void, as its object is unlawful.

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.

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

1.1.4 TYPES OF CONTRACT



I. On the basis of the validity

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

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.

Example: Mr. X agrees to write a book with a publisher. After few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract.

Example: A contracts with B (owner of the factory) for the supply of 10 tons

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of sugar, but before the supply is affected, the fire caught in the factory and everything was destroyed. Here the contract becomes void.

It may be added by way of clarification here that when a contract is void, it is not a contract at all but for the purpose of identifying it, it has to be called a [void] contract.

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

This in fact means where one of the parties to the agreement is in a position or is legally entitled or authorized to avoid performing his part, then the agreement is treated and becomes voidable.
Such a right might arise from the fact that the contract may have been brought about by one of the parties by coercion, undue influence, fraud or misrepresentation and hence the other party has a right to treat it as a voidable contract.

At this juncture it would be desirable to know **the distinction between a Void Contract and a Voidable Contract**. The distinction lies in three aspects namely definition, nature, and rights. These are elaborated hereunder:

(a) **Definition:** A void contract cannot be enforced at all. A voidable contract is an agreement which is enforceable only at the option of one of the parties but not at the option of the other. Therefore 'enforceability' or otherwise, divides the two types of contracts.

(b) **Nature:** By nature, a void contract is valid at the time when it is made but becomes unenforceable and thus void on account of subsequent developments or events like supervening impossibility, subsequent illegality etc., Repudiation of a voidable contract also renders the contract void. Similarly, a contingent contract might become void when the occurrence of the event on which it is contingent becomes impossible.

On the other-hand voidable contract would remain valid until it is rescinded by the person who has the option to treat it as voidable. The right to treat it as voidable does not invalidate the contract until such right is exercised. All contracts caused by coercion, undue influence, fraud, misrepresentation are voidable. Generally, a contract caused by mistake is void.

(c) **Rights:** As regards rights of the parties, in the case of a void contract there is no legal remedy for the parties as the contract cannot be performed in any way. In the case of voidable contract, the aggrieved party has a right to rescind it within a reasonable time. If it is so rescinded, it becomes void. If it is not rescinded, it is a valid contract.

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Difference can be summarized as under

S. No.	Basis	Void Contract	Voidable Contract
1	Meaning	A Contract ceases to be enforceable by law becomes void when it ceases to be enforceable.	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.
2	Cause	A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties.	A contract becomes a voidable contract if the consent of a party was not free.
3	Performance of contract	A void contract cannot be performed.	If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming the performance of the contract.
4	Rights	A void contract does not grant any right to any party.	The party whose consent was not free has the right to rescind the contract.

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

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

According to Section 2(g) of the Indian Contract Act, "an agreement not enforceable by law is void". The Act has specified various factors due to which an agreement may be considered as void agreement. One of these factors is unlawfulness of object and consideration of the contract i.e. illegality of the contract which makes it void. The illegal and void agreement diuer from each other in the following respects:

(a) **Scope:** All illegal agreements are void. However, all void agreements are not illegal. Despite this, there is similarity between illegal and void

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agreements that in both the cases it is void ab- initio and cannot be enforced by law.

(b) **Nature and character:** Illegal agreements are void since the very beginning they are invariably described as void ab initio. As already emphasized under the scope, a contract by nature, which is valid, can subsequently change its character and can become void.

(c) **Effect on collateral transactions:** In the case of illegal contract, even the collateral transactions namely transactions which are to be complied with before or after or concurrently along with main contract also become not enforceable. In contrast in the case of voidable contracts the collateral transactions can be enforced despite the fact that the main contract may have become voidable, to the extent the collateral transactions are capable of being performed independently.

(d) **Penalty or punishment:** All illegal agreements are punishable under different laws say like Indian Penal Code etc. Whereas parties to void agreements do not face such penalties or punishments.

Differences can be summarized as:

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

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

II. **On the basis 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. Section 9 of the Act provides that if a proposal or acceptance of any promise is made in words the promise is said to be express.

Example: A tells B on telephone that he offers to sell his house for Rs. 2 lacs

and B in reply informs A that he accepts the offer, this is an express contract.

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

   Example: Where a coolie in uniform picks up the luggage of A to be carried out of the railway station without being asked by A and A allows him to do so, it is an implied contract and A must pay for the services of the coolie detailed by him.

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

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

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

III. On the basis of the performance of the contract

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

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

2) **Executory Contract:** 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.

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

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

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

Example: M advertises payment of are ward of Rs. 5000 to anyone who finds his missing boy and brings him. As soon as B traces the boy, there comes into existence an executed contract because B has performed his share of obligation and it remains for M to pay the amount of reward to B. This type of Executory contract is also called unilateral contract.

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

Example: A promises to sell his plot to B for Rs. 1 lac cash down, but B pays only Rs. 25,000 as earnest money and promises to pay the balance on next Sunday. On the other-hand A gives the possession of plot to B and promises to execute a sale deed on the receipt of the whole amount. The contract between the A and B is executory because there remains something to be done on both sides. Executory contracts are also known as Bilateral contracts.

1.1.5 PROPOSAL/OFFER[SECTION2(a)OFTHEINDIANCONTRACT ACT, 1872]

Definition of Offer/Proposal:

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".

Analysis of the above definition Essentials of a proposal/offer are-

1. **The person making the proposal or offer is called the 'promisor' or 'offeror':** The person to whom the offer is made is called the 'offeree' and the person accepting the offer is called the 'promisee' or 'acceptor'.

2. **For a valid offer, the party making it must express his willingness 'to do' or 'not to do' something:**
Mere expression of willingness does not constitute an offer.

Example: Where 'A' tells 'B' that he desires to marry by the end of 2017, it does not constitute an offer of marriage by 'A' to 'B'. Therefore, to constitute

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a valid offer expression of willingness must be made to obtain the assent (acceptance) of the other. Thus, if in the above **example,** 'A' further adds, 'Will you marry me', it will constitute an offer.

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

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

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

Classification of offer

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

Now let us examine each one of them.

(a) **General offer:** It is an offer made to public at large and hence anyone can accept and do the desired act ***(Carlill v. Carbolic Smoke Ball Co.)***. In terms of Section 8 of the Act, anyone performing the conditions of the offer can be considered to have accepted the offer. Until the general offer is retracted or withdrawn, it can be accepted by anyone at any time as it is a continuing offer.

Case Law: Carlill Vs. Carbolic Smoke Ball Co. (1893)

Facts: In this famous case Carbolic smoke Ball Co. advertised in several newspapers that a reward of
£100 would be given to any person who contracted influenza after using the smoke balls produced by the Carbolic Smoke Company according to printed directions. One lady, Mrs. Carlill, used the smoke balls as per the directions of company and even then, suffered from influenza. Held, she could recover the amount as by using the smoke balls she had accepted the offer.

Case Law: Lalman Shukla v. Gauri Dutt

Facts: G (Gauridutt) sent his servant L (Lalman) to trace his missing nephew. He then announced that anybody who traced his nephew would be entitled to a certain reward. L, traced the boy in ignorance of this announcement. Subsequently when he came to know of the reward, he claimed it. Held, he was not entitled to the reward, as he did not know the offer.

(b) **Special/specific offer:** When the offer is made to a specific or an ascertained person, it is known as a specific offer. Specific offer can be

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accepted only by that specified person to whom the offer has been made. ***[Boulton v. Jones]***

Example: 'A' offers to sell his car to 'B' at a certain cost. This is a specific offer.

Cross offer: When two parties exchange identical offers in ignorance at the time of each other's offer, the offers are called cross offers. There is no binding contract in such a case because offer made by a person cannot be construed as acceptance of the another's offer.

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

(c) **Counteroffer:** 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. It is also called as Conditional Acceptance.

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

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

1.1.6 Essential of a valid offer

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

2. ***It must be certain, definite, and not vague:*** If the terms of an offer are vague or indefinite, its acceptance cannot create any contractual relationship. Thus, where A offers to sell B 100 quintals of oil, there is nothing whatever to show what kind of oil was intended. The offer is not capable of being accepted for want of certainty.

3. ***It must be communicated to the offeree:*** An offer, to be complete, must be communicated to the person to whom it is made, otherwise there can be no

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acceptance of it. Unless an offer is communicated, there can be no acceptance by it. An acceptance of an offer, in ignorance of the offer, is not acceptance and does not confer any right on the acceptor.

This can be illustrated by the landmark case of ***Lalman Shukla v. GauriDutt***

Facts: G (Gauridutt) sent his servant L (Lalman) to trace his missing nephew. He then announced that anybody who traced his nephew would be entitled to a certain reward. L traced the boy in ignorance of this announcement. Subsequently when he came to know of the reward, he claimed it. **Held,** he was not entitled to the reward, as he did not know the offer.

4. ***It must be made with a view to obtaining the assent of the other party:*** Offer must be made with a view to obtaining the assent of the other party addressed and not merely with a view to disclosing the intention of making an offer.

5. ***It may be conditional:*** An offer can be made subject to any terms and conditions by the offeror.

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

Offer should not contain a term the noncompliance of which would amount to acceptance: Thus, one cannot say that if acceptance is not communicated by a certain time the offer would be considered as accepted.

Example: A proposes B to purchase his android mobile for Rs. 5000 and if no reply by him in a week, it would be assumed that B had accepted the proposal. This would not result into contract.

6. ***The offer may be either specific or general:*** Any offer can be made to either public at large or to the any specific person. (Already explained in the heading types of the offer)

7. **Offer is Different from a mere statement of intention, an invitation to offer, a mere communication of information, Casual Equity, A prospectus and Advertisement.**

(i) **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.

Example: An advertisement for sale of goods by auction is an invitation to the

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offer. It merely invites offers/bids made at the auction. Similarly, Red Herring Prospectus issued by a company, is only an invitation to the public to make an offer to subscribe to the securities of the company.

(ii) A statement of intention and announcement.

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

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

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

(i) Will you sell us Bumper Hall Pen? and

(ii) Telegraph lowest cash price.

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

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

However the Privy Council did not agree with the plantiffs on the ground that while plantiffs had asked two questions, the defendant replied only to the second question by quoting the price but did not answer the first question but reserved their answer with regard to their willingness to sell. Thus, they made no offer at all. Their Lordships held that the mere statement of the lowest price at which the vendor would sell contained no implied contract to sell to the person who had enquired about the price.

The above decision was followed in Mac Pherson vs Appanna [1951] A.S.C. 184 where the owner of the property had said that he would not accept less than £ 6000/- for it. This statement did not indicate any offer but indicated only an invitation to offer.

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

The offer may be express or implied*: An offer may be made either by words or by conduct*

Example: A boy starts cleaning the car as it stops on the traffic signal without being asked to do so, in such circumstances any reasonable man

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could guess that he expects to be paid for this, here boy makes an implied offer.

1.1.7 ACCEPTANCE

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

"When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted. The proposal, when accepted, becomes a promise".

Analysis of the above definition

1. When the person to whom proposal is made - for example if A offers to sell his car to B for Rs.200000. Here, proposal is made to B.
2. The person to whom proposal is made i.e. B in the above example and if B signifies his assent on that proposal. In other words, if B grants his consent on A's proposal, then we can say that B has signified his consent on the proposal made by A.
3. When B has signified his consent on that proposal, we can say that the proposal has been accepted.
4. Accepted proposal becomes promise.

Relationship between offer and acceptance: ***According to Sir William Anson "Acceptance is to offer what a lighted match is to a train of gun powder"***. The effect of this observation is that what acceptance triggers cannot be recalled or undone. But there is a choice to the person who had the train to remove it before the match is applied. It in effect means that the offer can be withdrawn just before it is accepted. Acceptance converts the offer into a promise and then it is too late to revoke it. This means as soon as the train of 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. Once an offer is accepted it becomes a promise and cannot be withdrawn or revoked. An offer remains an offer so long as it is not accepted but becomes a contract as soon as it is accepted.

Legal Rules regarding a valid acceptance

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

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Case Law: Boulton vs. Jones (1857)

Facts: Boulton bought a business from Brocklehurst. Jones, who was Broklehurst's creditor, placed an order with Brocklehurst for the supply of certain goods. Boulton supplied the goods even though the order was not in his name. Jones refused to pay Boultan for the goods because by entering into the contract with Blocklehurst, he intended to set out his debt against Brocklehurst. **Held,** as the offer was not made to Boulton, therefore, there was no contract between Boulton and Jones.

In case of a general offer, it can be accepted by any person who has the knowledge of the offer. ***[Carlill vs. Carbolic Smoke Ball Co. (1893)]***

(2) Acceptance must be absolute and unqualified: As per section 7 of the Act, acceptance is valid only when it is absolute and unqualified and is also expressed in some usual and reasonable manner unless the proposal prescribes the manner in which it must be accepted. If the proposal prescribes the manner in which it must be accepted, then it must be accepted accordingly.

Example: 'A' enquires from 'B', "Will you purchase my car for Rs. 2 lakhs?" If 'B' replies "I shall purchase your car for Rs. 2 lakhs, if you buy my motorcycle for Rs. 50000/-, here 'B' cannot be considered to have accepted the proposal. If on the other hand 'B' agrees to purchase the car from 'A' as per his proposal subject to availability of valid Registration Certificate / book for the car, then the acceptance is in place though the offer contained no mention of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore, the acceptance in this case is unconditional.

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

(a) **Brogden vs. Metropolitan Railway Co. (1877)**

Facts: B a supplier, sent a draft agreement relating to the supply of coal to the manager of railway Co. viz, Metropolitian railway for his acceptance. The manager wrote the word "Approved" on the same and put the draft agreement in the drawer of the table intending to send it to the company's solicitors for a formal contract to be drawn up. By an over sight the draft agreement

remained in drawer. Held, that there was no contract as the manager had not communicated his acceptance to the supplier, B.

(b) M offered to sell his land to N for £280. N replied purporting to accept the offer but enclosed a cheque for £ 80 only. He promised to pay the balance of £ 200 by monthly instalments of £ 50 each. It was held that N could not enforce his acceptance because it was not an unqualified one. ***[Neale vs. Merret [1930] W. N. 189].***

(c) An offer to sell his house to B for Rs. 1,00,000/-. B replied that, "I can pay Rs. 80,000 for it. The offer of 'A' is rejected by 'B' as the acceptance is not unqualified. B however changes his mind and is prepared to pay Rs. 1,00,000/-. This is also treated as counteroffer and it is up to A whether to accept it or not. ***[Union of India v. Bahulal AIR 1968 Bombay 294].***

Where an offer made by the intended offeree without the knowledge that an offer has been made to him cannot be deemed as an acceptance thereto. ***(Bhagwandas v. Girdharilal)***

A mere variation in the language not involving any difference in substance would not make the acceptance ineffective. ***[Heyworth vs. Knight [1864] 144 ER 120].***

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

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

(5) Time: Acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given within the reasonable time and before the offer lapses. What is reasonable time is nowhere defined in the law and thus would depend on facts and circumstances of the particular case.

(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.

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Case Law: Felthouse vs. Bindley (1862)

Facts: F (Uncle) offered to buy his nephew's horse for £30 saying "If I hear no more about it I shall consider the horse mine at £30." The nephew did not reply to F at all. He told his auctioneer, B to keep the particular horse out of sale of his farm stock as he intended to reserve it for his uncle. By mistake the auctioneer sold the horse. F sued him for conversion of his property. **Held,** F could not succeed as his nephew had not communicated the acceptance to him.

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

(7) Acceptance by conduct/Implied Acceptance: Section 8 of the Act lays down that "the performance of the conditions of a proposal, or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, constitutes an acceptance of the proposal. This section provides the acceptance of the proposal by conduct as against other modes of acceptance i.e. verbal or written communication.

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

For example, when a tradesman receives an order from a customer and executes the order by sending the goods, the customer's order for goods constitutes the offer, which has been accepted by the trades man subsequently by sending the goods. It is a case of acceptance by conduct.

1.1.8 COMMUNICATION OF OFFER AND ACCEPTANCE

The importance of 'offer' and 'acceptance' in giving effect to a valid contract was explained in the previous paragraphs. One important common requirement for both 'offer' and 'acceptance' is their effective communication. Effective and proper communication prevents avoidable revocation and misunderstanding between parties.

When the contracting parties are face-to-face, there is no problem of communication because there is instantaneous communication of offer and acceptance. In such a case the question of revocation does not arise since the offer and its acceptance are made instantly.

The difficulty arises when the contracting parties are at a distance from one another and they utilise the services of the post office or telephone or email (internet). In such cases, it is very much relevant for us to know the exact time when the offer or acceptance is made or complete.

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The Indian Contract Act,1872 gives a lot of importance to "time" element in deciding when the offer and acceptance is complete

1) **Communication of offer:** In terms of Section 4 of the Act, "the communication of offer is complete when it comes to the knowledge of the person to whom it is made". This can be explained by **an example**. Where 'A' makes a proposal to 'B' by post to sell his house for Rs. 5 lakhs and if the letter containing the offer is posted on 10th March and if that letter reaches 'B' on 12th March the offer is said to have been communicated on 12th March when B received the letter.

   Thus, it can be summed up that when a proposal is made by post, its communication will be complete when the letter containing the proposal reaches the person to whom it is made.

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

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

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

   Let us, first consider 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.

3) **Communication by act** would include any expression of words whether written or oral. Written words will include letters, telegrams, faxes, emails and even advertisements. Oral words will include telephone messages. Again communication would include any conduct intended to communicate like positive acts or signs so that the other person understands what the person 'acting ' or 'making signs' means to say or convey.

4) **Communication of acceptance by 'omission' to do something.** Such omission is conveyed by a conduct or by forbearance on the part of one person to convey his willingness or assent. However, silence would not be treated as communication by 'omission'.

5) **Communication of acceptance by conduct.** For instance, delivery of goods at a price by a seller to a willing buyer will be understood as a communication by conduct to convey acceptance. Similarly one need not explain why one boards a public bus or drop a coin in a weighing machine. The first act is a conduct of acceptance and its communication to the offer by the public transport authority to carry any passenger. The second act is

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again a conduct conveying acceptance to use the weighing machine kept by the vending company as an offer to render that service for a consideration.

The other issue in communication of acceptance is about the effect of act or omission or conduct. These indirect efforts must result in effectively communicating its acceptance or non-acceptance. If it has no such effect, there is no communication regardless of which the acceptor thinks about the offer within himself. Thus, a mere mental unilateral assent in one's own mind would not amount to communication. Where a resolution passed by a bank to sell land to 'A' remained uncommunicated to 'A', it was held that there was no communication and hence no contract. ***[Central Bank Yeotmal vs Vyankatesh (1949) A. Nag. 286]***.

Let us now come to the issue of 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.

For instance, in the above *example*, if 'B' accepts, A's proposal and sends his acceptance by post on 14th, the communication of acceptance as against 'A' is complete on 14th, when the letter is posted. As against 'B' acceptance will be complete, when the letter reaches 'A'. Here 'A' the proposer will be bound by B's acceptance, even if the letter of acceptance is delayed in post or lost in transit. The golden rule is proposer becomes bound by the contract the moment acceptor has posted the letter of acceptance. But it is necessary that the letter is correctly addressed, adequately stamped and duly posted. In such an event the loss of letter in transit, wrong delivery, non-delivery etc., will not affect the validity of the contract. However, from the viewpoint of acceptor, he will be bound by his acceptance only when the letter of acceptance has reached the proposer. So, it is crucial in this case that the letter reaches the proposer. If there is no delivery of the letter, the acceptance could be treated as having been completed from the viewpoint of proposer but not from the viewpoint of acceptor. Of course, this will give rise to an awkward situation of only one party to the contract, being treated as bound by the contract though no one would be sure as to where the letter of acceptance had gone.

(iii) **Acceptance over telephone or telex or fax:** When an offer is made of instantaneous communication like telex, telephone, fax or through e-mail, the contract is only complete when the acceptance is received by the

offeree, and the contract is made at the place where the acceptance is received ***(Entores Ltd. v. Miles Far East Corporation)***. However, in case of a call drops and disturbances in the line, there may not be a valid contract.

(iv) **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.

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

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 Air-lines 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.

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

CASE LAW: Lilly White vs. Mannuswamy (1970)
Facts: P delivered some clothes to drycleaner for which she received a laundry receipt containing a condition that in case of loss, customer would be entitled to claim 15% of the market price of value of the article, P lost her new saree. Held, the terms were unreasonable, and P was entitled to recover full value of the saree from the drycleaner.

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

(v) **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

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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. In this connection, let us consider a converse situation. A transport carrier accepted the goods for transport without any conditions. Subsequently, he issued a circular to the owners of goods limiting his liability for the goods. In such a case, since the special conditions were not communicated prior to the date of contract for transport, these were not binding on the owners of goods ***[Raipur transport Co. vs. Ghanshyam [1956] A. Nag.145]***.

1.1.9 COMMUNICATION OF PERFORMANCE

We have already discussed that in terms of Section 4 of the Act, communication of a proposal is complete when it comes to the knowledge of the person to whom it is meant. As regards acceptance of the proposal, the same would be viewed from two angles. These are:

(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 in to 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.

At times the offeree may be required to communicate the performance (or act) by way of acceptance. In this case it is not enough if the offeree merely performs the act but he should also communicate his performance unless the offer includes a term that a mere performance will constitute acceptance. The position was clearly explained in the famous case of ***Carlill Vs Carbolic &Smokeball Co***. In this case the defendant a sole proprietary concern manufacturing a medicine which was a carbolic ball whose smoke could be inhaled through the nose to cure influenza, cold and other connected ailments issued an advertisement for sale of this medicine. The advertisement also included a reward of $100 to any person who contracted influenza, after using the medicine (which was described as 'carbolic smoke ball'). Mrs. Carlill bought these smoke balls and used them as directed but contracted influenza. It was held that Mrs. Carlill was entitled to a reward of
$100 as she had performed the condition for acceptance. Further as the advertisement did not require any communication of compliance of the condition, it was not necessary to communicate the same. The court thus in the process laid down the following three important principles:

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(i) an offer, to be capable of acceptance, must contain a definite promise by the offeror that he would be bound provided the terms specified by him are accepted.

(ii) an offer may be made either to a particular person or to the public at large, and if an offer is made in the form of a promise in return for an act, the performance of that act, even without any communication thereof, is to be treated as an acceptance of the offer.

1.1.10 REVOCATION OF OFFER AND ACCEPTANCE

If there are specific requirements governing the making of an offer and the acceptance of that offer, we also have specific law governing their revocation.

In term of **Section 4,** communication of revocation (of the proposal or its acceptance) 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.

The above law can be *illustrated* as follows: If you revoke your proposal made to me by a telegram, the revocation will be complete, as far as you are concerned when you have dispatched the telegram. But as far as I am concerned, it will be complete only when I receive the telegram.

As regards revocation of acceptance, if you go by the above example, I can revoke my acceptance (of your offer) by a telegram. This revocation of acceptance by me will be complete when I dispatch the telegram and against you, it will be complete when it reaches you.

But the important question for consideration is when a proposal can be revoked? And when can an acceptance be revoked? These questions are more important than the question when the revocation (of proposal and acceptance) is complete.

Ordinarily, the offeror can revoke his offer before it is accepted. If he does so, the offeree cannot create a contract by accepting the revoked offer.

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

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

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

this case it was held that the offer was already revoked.

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

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

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

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

In English law, the moment a person expresses his acceptance of an offer, that moment the contract is concluded, and such an acceptance becomes irrevocable, whether it is made orally or through the post. In Indian law, the position is different as regards contract through post.

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.

Contract over Telephone- A contract can be made over telephone. The rules regarding offer and acceptance as well as their communication by telephone or telex are the same as for the contract made by the mutual meeting of the parties. The contract is formed as soon as the offer is accepted but the offeree must make it sure that his acceptance is received by the offeror, otherwise there will be no contract, as communication of acceptance is not complete. If telephone unexpectedly goes dead during conversation, the acceptor must confirm again that the words of acceptance were duly heard by the offeror.

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.

1.1.11 Modes of revocation of offer

(i) By notice of revocation

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(ii) **By lapse of time:** The time for acceptance can lapse if the acceptance is not given within the specified time and where no time is specified, then within a reasonable time. This is for the reason that proposer should not be made to wait indefinitely. It was held in ***Ramsgate Victoria Hotel Co. Vs Montefiore (1866 L.R.Z. Ex 109)***, that a person who applied for shares in June was not bound by an allotment made in November. This decision was also followed in ***India Cooperative Navigation and Trading Co. Ltd. Vs Padamsey PremJi.*** However, these decisions now will have no relevance in the context of allotment of shares since the Companies Act, 2013 has several provisions specifically covering these issues.

(iii) **By non-fulfilment of condition precedent:** Where the acceptor fails to fulfill a condition precedent to acceptance the proposal gets revoked. This principle is laid down in Section 6 of the Act. The offeror for instance may impose certain conditions such as executing a certain document or depositing certain amount as earnest money. Failure to satisfy any condition will result in lapse of the proposal. As stated earlier 'condition precedent' to acceptance prevents an obligation from coming into existence until the condition is satisfied. Suppose where 'A' proposes to sell his house to be 'B' for Rs. 5 lakhs provided 'B' leases his land to 'A'. If 'B' refuses to lease the land, the offer of 'A' is revoked automatically.

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

(v) By counteroffer

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

(vii) By subsequent illegality

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1.2 Void and Voidable agreements

1.2.1 VOID AGREEMENTS

Expressly declared Void Agreements

	Made by incompetent parties (Section 11)		Agreement in restraint of marriage (Section 26)
	Agreements made under Bilateral mistake of fact (Section 20)		Agreements in restraint of trade (Section 27)
	Agreements the consideration or object of which is unlawful (Section 23)		Agreement in restraint of legal proceedings (Section 28)
	Agreement the consideration or object of which is unlawful in parts (Section 24)		Agreement the meaning of which is uncertain (Section 29)
	Agreements made without consideration (Section 25)		Wagering Agreement (Section 30)
	[Refer Unit 2]		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. So, if a person, being a major, agrees for good consideration not to marry, the promise is not binding and considered as void agreement.

(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, so long as the buyer or his successor in interest carries on a like business therein, such an agreement is valid (goodwill is the advantage enjoyed by a business on account of public patronage and encouragement from habitual customers). The local limits within which the seller of the goodwill agrees not to carry on similar business must be reasonable. 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 or within specified local limits, such an agreement, thought in restraint of trade, will be valid, if the restrictions imposed are reasonable. Similarly, under Section 11 of that Act an agreement between partners not to carry on competing business during the continuance of partnership is

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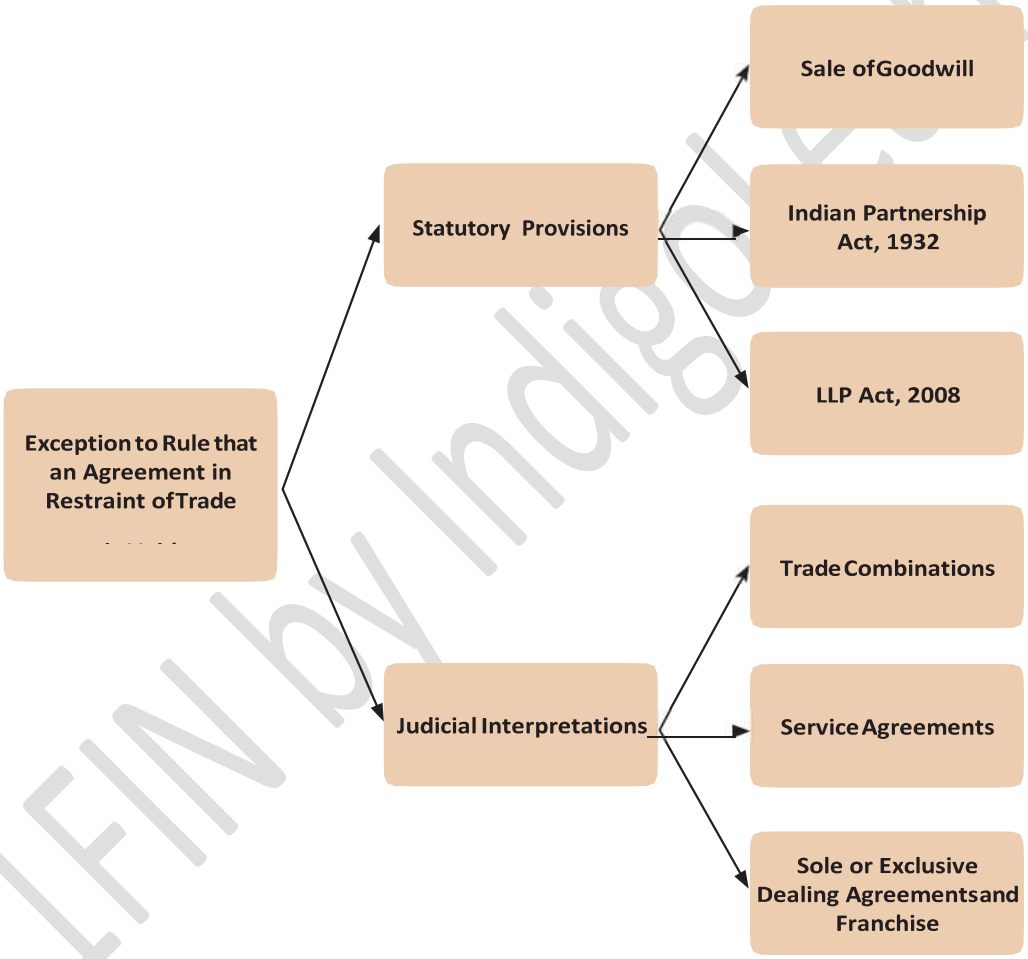
valid.

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

Example 1: B, a physician and surgeon, employs A as an assistant for a term of three years and A agrees not to practice as a surgeon and physician during these three years. The agreement is valid and A can be restrained by an injunction if he starts independent practice during this period.

Example 2: An agreement by a manufacturer to sell during a certain period his entire production to a wholesale merchant is not in restraint of trade.



(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.

However, there are certain exceptions to the above rule:

(i) A contract by which the parties agree that any dispute between them in respect of any subject shall be referred to arbitration and that only the

amount awarded in such arbitration shall be recoverable is a valid contract.

(ii) Similarly, a contract by which the parties agree to refer to arbitration any question between them which has already arisen, or which may arise in future, is valid; but such a contract must be in writing.

4. **Agreement - the meaning of which is uncertain (Section 29):** An agreement, the meaning of which is not certain, is void, but where the meaning thereof is capable of being made certain, the agreement is valid.
Example: A agrees to sell B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. But the agreement would be valid if A were dealer only in coconut oil; because in such a case its meaning would be capable of being made certain.

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. The essence of a wager is that each side should stand to win or lose, depending on the way an uncertain event takes place in reference to which the chance is taken and in the occurrence of which neither of the parties has legitimate interest.

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

1.2.2 Essentials of a Wager

1. 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. Even if the lottery is sanctioned by the Government of India it is a wagering transaction. The only effect of such sanction is that the person responsible for running the lottery will not be punished under the Indian Penal Code. Lotteries are illegal and even collateral transactions to it are tainted with illegality (Section 294A of Indian Penal Code).

(ii) Crossword Puzzles and Competitions: Crossword puzzles in which prizes depend upon the correspondence of the competitor's solution with a

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previously prepared solution kept with the editor of a newspaper is a lottery and therefore, a wagering transaction.

Case Law: ***State of Bombay vs. R.M.D. Chamarbangwala AIR (1957)***

Facts: A crossword puzzle was given in magazine. Abovementioned clause was stated in the magazine. A solved his crossword puzzle and his solution corresponded with previously prepared solution kept with the editor. Held, this was a game of chance and therefore a lottery (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.

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.

Example: A and B enter into an agreement in which A promises to pay Rs. 2,00,000 provided'Chetak' wins the horse race competition. This is a wagering transaction.

However, Secion 30 is not applicable in an agreement to contribute toward plate, prize or sum of money of the value of Rs. 5,00,000 or above to be awarded to the winner of a horse race.

Transactions resembling with wagering transaction but are not void

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

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

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

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

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Distinction between Contract of Insurance and Wagering Agreement

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

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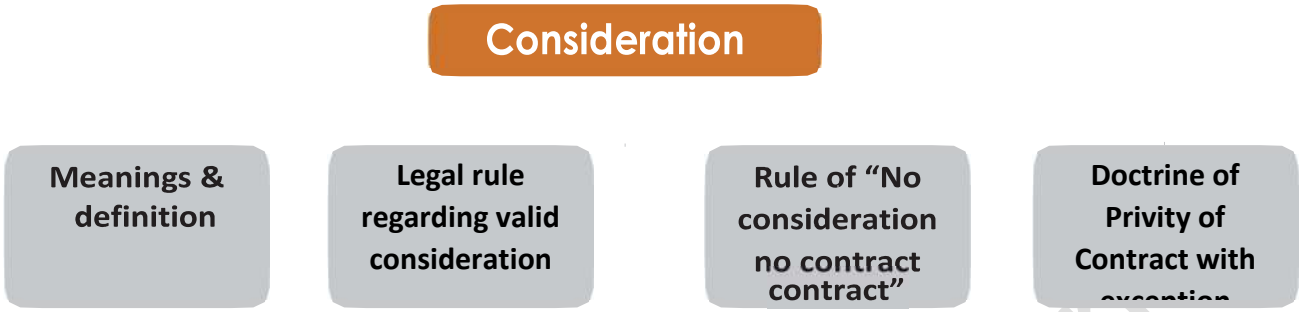
1.3 Consideration



Consideration is an essential element of a valid contract without which no single promise will be enforceable. It is a term used in the sense of *quid pro quo*, i.e., 'something in return'. Having a double aspect of a benefit to the promisor and a detriment to the promisee, it has to be really understood in the sense of some detriment as envisaged by English Law. In this Unit, we shall try to understand the concept of consideration and also the legal requirements regarding consideration.

1.3.1 WHAT IS CONSIDERATION?

Consideration is the price agreed to be paid by the promisee for the obligation of the promisor. The word consideration was described in a very popular English case of ***Misa v. Currie*** as:

"A valuable consideration in the sense of law may consist either in some right, interest, profit or benefit accruing to one party (i.e. promisor) or forbearance, detriment, loss or responsibility given, suuered or undertaken by the other (i.e., the promisee)."

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".

Analysis of Definition of Consideration

(1) Consideration is an act- doing something.

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

(2) Consideration is abstinence- abstain from doing something.

Example- Abhishek promises Bharti not to file a suit against him if he (Bharti) would pay him (Abhishek) Rs. 1,00,000. Here abstinence on the part of Abhishek

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would constitute consideration against Bharti's payment of Rs. 1,00,000 in favor of Abhishek.

(3) **Consideration must be at the desire of the promisor.**

(4) **Consideration may move from promisee or any other person.**

(5) **Consideration may be past, present, or future.**

Thus, from above it can be concluded that:

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.

1.3.2 LEGAL RULES REGARDINGCONSIDERATION

(i) **Consideration must move at the desire of the promisor:** Consideration must be offered by the promisee or the third party at the desire or request of the promisor. This implies "return" element of consideration. Contract of marriage in consideration of promise of settlement is enforceable.

An act done at the desire of a third party is not a consideration.

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

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

(ii) **Consideration may move from promisee or any other person:** In India, consideration may proceed from the promisee or any other person who is not a party to the contract. The definition of consideration as given in Section 2(d) makes that proposition clear. According to the definition, when at the desire of the promisor, the promisee or any other person does something such an act is consideration. In other words, there can be a stranger to a consideration but not stranger to a contract.

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

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(iii) **Executed and executory consideration:** A consideration which consists in the performance of an act is said to be executed. When it consists in a promise, it is said to be executory. The promise by one party may be the consideration for an act by some other party, and vice versa.

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

(iv) **Consideration may be past, present, or future:** The words "has done or abstained from doing" [as contained in Section 2(d)] are a recognition of the doctrine of past consideration. In order to support a promise, a past consideration must move by a previous request. It is a general principle that consideration is given and accepted in exchange for the promise. The consideration, if passed, may be the motive but cannot be the real consideration of a subsequent promise. But in the event of the services being rendered in the past at the request or the desire of the promisor, the subsequent promise is regarded as an admission that the past consideration was not gratuitous.

Example: 'A' performed some services to 'B' at his desire. After a week, 'B' promises to compensate 'A' for the work done by him. It is said to be past consideration and A can sue B for recovering the promised money.

(v) **Consideration need not be adequate:** Consideration need not to be of any particular value. It need not be approximately of equal value with the promise for which it is exchanged but it must be something which the law would regard as having some value. Something in return need not be equal to something given. It can be considered a bad bargain of the party.

It may be noted in this context that Explanation 2 to Section 25 states that an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate. But as an exception if it is shockingly less and the other party alleges that his consent was not free than this inadequate consideration can be taken as an evidence in support of this allegation

Example: X promises to sell a house worth Rs. 6 lacs for Rs. 1 lac only, the adequacy of the price in itself shall not render the transaction void, unless the party pleads that transaction takes place under coercion, undue influence, or fraud.

(vi) **Performance of what one is legally bound to perform:** (consideration must not be performance of existing duty) The performance of an act by a person who is legally bound to perform the same cannot be consideration for a contract. Hence, a promise to pay

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money to a witness is void, for it is without consideration. Hence such a contract is void for want of consideration. Similarly, an agreement by a client to pay to his counsel after the latter has been engaged, a certain sum over and above the fee, in the event of success of the case would be void, since it is without consideration.

But where a person promises to do more that he is legally bound to do, such a promise provided it is not opposed to public policy, is a good consideration. It should not be vague or uncertain.

(vii) **Consideration must be real and not illusory:** Consideration must be real and must not be illusory. It must be something to which the law attaches some value. If it is legally or physically impossible it is not considered valid consideration.

Examples: A man promises to discover treasure by magic. This transaction can be said to be void as it is illusory.

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

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

1.3.3 SUIT BY A THIRD PARTY TO A CONTRACT

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

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

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

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

(1) **In the case of trust,** a beneficiary can enforce his right under the trust, though he was not a party to the contract between the settler and the trustee.

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(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. For example, if L gives to M Rs. 20,000 to be given to N, and M informs N that he is holding the money for him, but afterwards M refuses to pay the money. N will be entitled to recover the same from the former i.e. M.

(6) **In the case of 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.

1.3.4 VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION

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

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

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

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

(iii) It must be in writing.

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

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

Example: A husband, by a registered agreement promised to pay his

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earnings to his wife. Held the agreement though without consideration, was valid.

2. **Compensation for past voluntary services:** A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable under Section 25(2). In order that a promise to pay for the past voluntary services be binding, the following essential factors must exist:

(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.

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

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

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

4. **Agency:** According to Section 185 of the Indian Contract Act, 1872, no consideration is necessary to create an agency.

5. **Completed gift:** In case of completed gifts, the rule no consideration no contract does not apply.

Explanation (1) to Section 25 states "nothing in this section shall affect the validity as between the donor and donee, of any gift actually made." Thus, gifts do not require any consideration.

6. **Bailment:** No consideration is required to affect the contract of bailment (Section 148).

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)***

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1.4 Legality of Object

Which considerations and objects are lawful, and those which are not (Section 23):

The consideration or object of an agreement is lawful, **unless-**

2. It is forbidden by law; or
3. Is of such a nature that, if permitted, it would defeat the provisions of any law; or
4. Is fraudulent; or
5. Involves injury to the person or property of another; or
6. The court regards it as immoral; or
7. Opposed to public policy.

In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.

In the following examples, the agreement is void because the object is unlawful:

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

(2) A promise to B to abandon a prosecution which he had instituted against B for robbery and B promises in lieu thereof to restore the value of the property robbed. The agreement is void as its object, namely, the stifling of prosecution, is unlawful.

Section 10 of the Indian Contract Act provides for the legality of consideration and objects thereto. Section 23 of the Act also states that every agreement of which the object or consideration is unlawful is void.

The following is an ***example*** of the agreement which is void because of unlawful consideration.

A promise to obtain for B an employment in the public service and B promises, in return, to pay Rs. 1,00,000. to A. The agreement is void, as the consideration thereof is unlawful. Here A's promise to procure for B an employment in the public services is the consideration for B's promise to pay Rs. 1,00,000. The consideration, being opposed to public policy, is unlawful.

Under Section 23 of the Indian Contract Act, in each of the following cases the consideration or object of an agreement is said to be unlawful:

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

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Example: A license to cut grass is given to X by the Forest Department under the Forest Act. One of the terms of license is that the licensee should not assign his interest under the license without the permission of the Forest Officer, and a fine is prescribed for a breach of this condition. But the observance of the conditions of the license is not obligatory under the Forest Act. If A in breach of the condition, agrees to assign his interest under the license to B, that agreement will be valid. Here, the assignment is not prohibited by law, the condition against assignment has been imposed only for administrative purpose or solely for the protection of revenue.

(ii) **When consideration or object defeats the provision of law:** The words **'defeat the provisions of any law'** must be taken as limited to defeating the intention which the law has expressed. The court looks at the real intention of the parties to an agreement. If the intention of the parties is to defeat the provisions of law, the court will not enforce it.

Legislative enactment would be defeated by an agreement by a debtor not to plead limitation, as the object is to defeat the provisions of the Limitation Act. The Hindu Law is defeated by an agreement to give son in adoption in consideration of annual allowance to the natural parents.

(iii) **When it is fraudulent:** Agreements which are entered into to promote fraud are void. For example, an agreement for the sale of goods for the purpose of smuggling them out of the country is void and the price of the goods so sold, cannot be recovered.

(iv) **When consideration defeats any rule for the time being in force in India.**

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

(1) 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.

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

(vi) **When consideration is immoral:** The following are the examples of

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agreements where the object or consideration is unlawful, being immoral. A landlord cannot recover the rent of a house knowingly let to prostitute who carries on her vocation there. Here, the object being immoral, the agreement to pay rent is void.

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

(vii) **When consideration is opposed to public policy:** The expression 'public policy' can be interpreted either in a wide or in a narrow sense. The freedom to contract may become illusory unless the scope of 'public policy' is restricted. In the name of public policy, freedom of contract is restricted by law only for the good for the community. In law, public policy covers certain specified topics, e.g., trading with an enemy, stifling of prosecutions, champerty, maintenance, interference with the course of justice, marriage brokerage, sales of public offices, etc. Agreements tending to create interest against duty, agreements tending to create monopolies and agreements not to bid at an auction are also opposed to public policy. An attempt to enlarge the scope of the doctrine is bound to result in the curtailment of individual freedom of contract.

(viii) **Agreements opposed to public policy**

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

(1) **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, as the object is opposed to public policy. Here, the agreement to trade offends against the public policy by tending to prejudice the interest of the State in times of war.

(2) **Stifling Prosecution:** An agreement to stifle prosecution i.e. "an agreement to present proceedings already instituted from running their normal course using force" tends to be a perversion or an abuse of justice; therefore, such an agreement is void. The principle is that one should not make a trade of felony. The compromise of any public offences is generally illegal. Under the Indian Criminal Procedure Code, there is, however, a statutory list of compoundable offences and an agreement to drop proceeding relating to such offences with or without the permission of the Court, as the case may be, in consideration the accused promising to do something for the complainant, is not opposed to public policy. Thus, where A agrees to sell certain land to B in consideration of B abstaining from

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taking criminal proceeding against A with respect to an offence which is compoundable, the agreement is not opposed to public policy. But it is otherwise if the offences are uncompoundable.

(3) 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.

The agreement for supplying funds by way of Maintenance or Champerty is valid unless

(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 or oppressing other party by encouraging unrighteous suits and not with the bona-fide object of assisting a claim believed to be just.

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

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

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

(5) Agreements tending to create monopolies: Agreements having for their object the establishment of monopolies are opposed to public policy and therefore void.

(6) Marriage brokerage agreements: An agreement to negotiate marriage for reward, which is known as a marriage brokerage contract, is void, as it is opposed to public policy. For instance, an agreement to pay money to a person hired to procure a wife is opposed to public policy and therefore void.

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

(7) 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,

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as it is opposed to public policy; so also is an agreement by A to reward B, who is an intended witness in a suit against A in consideration of B's absenting himself from the trial. For the same reasons, an agreement which contemplates the use of under-hand means to influence legislation is void. Similarly, as agreement to induce any executive officer of the State to act partially or corruptly is void.

(8) Interest against obligation: The following are examples of agreement that are void as they tend to create an interest against obligation. The object of such agreements is opposed to public policy.

(1) An agreement by an agent to receive without his principal's consent compensation from another for the performance of his agency is invalid.

(2) A, who is the manager of a firm, agrees to pass a contract to X if X pays to A Rs. 200,000 privately; the agreement is void.

(9) Consideration Unlawful in Part: By virtue of Section 24, 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."

This section is an obvious consequence of the general principle of Section 23. There is no promise for a lawful consideration if there is anything illegal in a consideration which must be taken as a whole. The general rule is that where the legal part of a contract can be severed from the illegal part, the bad part may be rejected, and the good one can be retained. But where the illegal part cannot be severed, the contract is altogether void.
Example: A promises to superintend, on behalf of B, a legal manufacturer of indigo and an illegal traffic in other articles. B promises to pay A salary of Rs. 20,000 per month. The agreement is void, the object of A's promise and the consideration for B's promise being in part unlawful.

1.5 E-Contracts

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. In electronic commerce, different parties/persons create networks which are linked to other networks through ED1 - Electronic Data Inter change. This helps in doing business transactions using electronic mode. These are known as EDI contracts or Cyber contracts or mouse click contracts.

1.6 Constraints to enforce contractual obligations

1.6.1 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 is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject".

Analysis of Section 11

This section deals with personal capacity of three types of individuals only. Every person is competent to contract who-

(A) has attained the age of majority,

(B) is of sound mind and

(C) is not disqualified from contracting by any law to which he is subject.

(A) Age of Majority: In India, the age of majority is regulated by the Indian Majority Act, 1875.

Every person domiciled in India shall attain the age of majority on the completion of 18 years of age and not before. The age of majority being 18 years, a person less than that age even by a day would be minor for the purpose of contracting.

Law relating to Minor's agreement/Position of Minor

1. **A contract made with or by a minor is void ab-initio:** A minor is not competent to contract and any agreement with or by a minor is void from the very beginning.

In the leading case of ***Mohori Bibi vs. Dharmo Das Ghose (1903)***, "A, a minor borrowed Rs. 20,000 from B and as a security for the same executed a mortgage in his favour. He became a major a few months later and filed a suit for the declaration that the mortgage executed by him during his minority was void and should be cancelled. It was held that a mortgage by a minor was void and B was not entitled to repayment of money.

It is especially provided in Section 10 that a person who is incompetent to contract cannot make a contract within the meaning of the Act.

2. **No ratification after attaining majority:** A minor cannot ratify the agreement on attaining majority as the original agreement is void ab initio and a void agreement can never be ratified.

Example: X, a minor makes a promissory note in the name of Y. On attaining majority, he cannot ratify it and if he makes a new promissory note in place of

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old one, here the new promissory note which he executed after attaining majority is also void being without consideration.

3. **Minor can be a beneficiary or can take benefit out of a contract:** Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor. Thus, a promissory note duly executed in favour of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.

A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership (Section 30 of the Indian Partnership Act, 1932).

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

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. Rule of estoppel cannot be applied against a minor. It means he can be allowed to plea his minority in defence.

5. **Liability for necessaries:** The case of necessaries supplied to a minor or to any other person whom such minor is legally bound to support is governed by section 68 of the Indian Contract Act. A claim for necessaries supplied to a minor is enforceable by law. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries. There is no personal liability of the minor, but only his property is liable.

   (i) To render minor's estate liable for necessaries two conditions must be satisfied.

   (ii) The contract must be for the goods reasonably necessary for his support in the station in life.

   (iii) The minor must not have already a sufficient supply of these necessaries.

   (iv) Necessaries mean those things that are essentially needed by a minor. They cannot include luxuries or costly or unnecessary articles. Necessaries extend to all such things as reasonable persons would supply to an infant in that class of society to which the infant belongs. Expenses on minor's education, on funeral ceremonies come within the scope of the word 'necessaries.

The whole question turns upon the minor's status in life. Utility rather than ornament is the criterion.

Contract by guardian - how far enforceable: Though a minor's agreement is void, his guardian can, under certain circumstances enter into a valid contract on minor's behalf. Where the guardian makes a contract for the minor, which is

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within his competence and which is for the benefit of the minor, there will be valid contract which the minor can enforce. But all contracts made by guardian on behalf of a minor are not valid. For instance, the guardian of a minor has no power to bind the minor by a contact for the purchase of immovable Property. But a contract entered into by a certified guardian (appointed by the Court) of a minor, with the sanction of the court for the sale of the minor's property, may be enforced by either party to the contract.

No specific performance: A minor's agreement being absolutely void, there can be no question of the specific performance of such an agreement.

6. **No insolvency:** A minor cannot be declared insolvent as he is incapable of contracting debts and dues are payable from the personal properties of minor and he is not personally liable.
7. **Partnership:** A minor being incompetent to contract cannot be a partner in a partnership firm, but under Section 30 of the Indian Partnership Act, he can be admitted to the benefits of partnership.
8. **Minor can be an agent:** A minor can act as an agent. But he will not be liable to his principal for his acts. A minor can draw, deliver, and endorse negotiable instruments without himself being liable.
9. **Minor cannot bind parent or guardian:** In the absence of authority, express or implied, an infant is not capable of binding his parent or guardian, even for necessaries. The parents will be held liable only when the child is acting as an agent for parents.
10. **Joint contract by minor and adult:** In such a case, the adult will be liable on the contract and not the minor. ***In Sain Das vs. Ram Chand***, where there was a joint purchase by two purchasers, one of them was a minor, it was held that the vendor could enforce the contract against the major purchaser and not the minor.
11. **Surety for a minor:** In a contract of guarantee when an adult stands surety for a minor then he (adult) is liable to third party as there is direct contract between the surety and the third party.
12. **Minor as Shareholder:** A minor, being incompetent to contract cannot be a shareholder of the company. If by mistake he becomes a member, the company can rescind the transaction and remove his name from register. But, a minor may, acting though his lawful guardian become a shareholder by transfer or transmission of fully paid shares to him.
13. **Liability for torts:** A tort is a civil wrong. A minor is liable in tort unless the tort in reality is a breach of contract. Thus, where a minor borrowed a horse for riding only, he was held liable when he lent the horse to one of his friends who jumped and killed the horse. Similarly, a minor was held liable for his failure to return certain instruments which he had hired and then passed on

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to a friend.

(B) **Person of sound mind:** According to section 12 of Indian Contract Act, "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.

A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

Example 1: A patient in a lunatic asylum, who is at intervals, of sound mind, may contract during those intervals.

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

Person who is usually of Unsound Mind but occasionally of Sound Mind

may make a Contract when he is of Sound Mind.

Person who is usually of Sound Mind but occasionally of Unsound Mind

may not make a Contract when he is of Unsound Mind

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

1.6.2 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."

Parties are said to have consented when they not only agreed upon the same thing but also agreed upon that thing in the same sense. 'Same thing' must be understood as the whole content of the agreement. Consequently, when parties to a contract make some fundamental error as to the nature of the transaction, or as to the person dealt with or as to the subject-matter of the agreement, it cannot be said that they have agreed upon the same thing in the same sense. And if they do not agree in the same sense, there cannot be consent. A contract cannot arise in the absence of consent.

If two persons enter into an apparent contract concerning a particular person or ship, and it turns out that each of them, misled by similarity of name, had a different person or ship in his mind, no contract would exist between them as they were not ad idem, i.e., of the same mind. Again, ambiguity in the terms of an agreement, or an error as to the nature of any transaction or as to the subject-matter of any agreement may prevent the formation of any contract on the ground of absence of consent. In the case of fundamental error, there is really no consent whereas, in the case of mistake, there is no real consent.

As has been said already, one of the essential elements of a contract is consent and there cannot be a contract without consent. Consent may be free or not free. Only free consent is necessary for the validity of a contract.

Definition of 'Free Consent' (Section 14)

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

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

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

1.6.3 ELEMENTS VITIATING FREE CONSENT

We shall now explain these elements one by one.

(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."

Analysis of Section 15

The section does not require that coercion must proceed from a party to the contract; nor is it necessary that subject of the coercion must be the other contracting party, it may be directed against any third person whatever. Following are the essential ingredients of coercion:

(i) Committing or threatening to commit any act forbidden by the India Penal Code; or

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(ii) the unlawful detaining or threatening to detain any property to the prejudice of any person whatever,

(iii) With the intention of causing any person to enter into an agreement.

(iv) It is to be noted that is immaterial whether the India Penal Code is or is not in force at the place where the coercion is employed.

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

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

(ii) As to the consequences of the rescission of voidable contract, the party rescinding a void contract should, if he has received any benefit, thereunder from the other party to the contract, restore such benefit so far as may be applicable, to the person from whom it was received.

(iii) A person to whom money has been paid or anything delivered under coercion must repay or return it. (Section 71)

Example: Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code. The threat of suicide amounts to coercion within Section 15.

II Undue influence (Section 16)

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

A person is deemed to be in position to dominate the will of another:

(a) Where he holds a real or apparent authority over the other; or

(b) Where he stands in a fiduciary relationship to the other; or

(c) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress for example, an old illiterate person.

Example 1:

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

Example 2:

A, a man enfeebled by disease or age, is induced by B's influence over him as his

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medical attendant, to agree to pay B an unreasonable sum for his professional services. B employs undue influence.

Example 3:

A, being in debt to B, the money lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence.

Example 4:

A applies to a banker for a loan at a time when there is a stringency in money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence.

Analysis of Section 16

The essential ingredients under this provision are:

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

(1) ***Position to dominate the will:*** Relation between the parties exist in such a manner that one of them is in a position to dominate the will of the other. A person is deemed to be in such position in the following circumstances:

(a) **Real and apparent authority:** Where a person holds a real authority over the other as in the case of master and servant, doctor, and patient and etc.

Example: A father, by reason of his authority over the son can dominate the will of the son.

(b) **Fiduciary relationship:** Where relation of trust and confidence exists between the parties to a contract. Such type of relationship exists between father and son, solicitor and client, husband and wife, creditor, and debtor, etc.

Example: By reason of fiduciary relationship, a solicitor can dominate the will of his client and a trustee can dominate the will of the beneficiary.

(c) **Mental distress:** An undue influence can be used against a person to get his consent on a contract where the mental capacity of the person is temporarily or permanently affected by the reason of mental or bodily distress, illness or of old age.

Example: A doctor is deemed to be in a position to dominate the will of his patient enfeebled by protracted illness.

(d) **Unconscionable bargains:** Where one of the parties to a contract is in a position to dominate the will of the other and the contract is apparently unconscionable i.e., unfair, it is presumed by law that consent must have

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been obtained by undue influence. Unconscionable bargains are witnessed mostly in money-lending transactions and in gifts.

Example: A youth of 18 years of age, spend thrift and a drunkard, borrowed Rs. 90,000 on a bond bearing compound interest at 2% per mensem (p.m.). It was held by the court that the transaction is unconscionable, the rate of interest charged being so exorbitant ***[Kirpa Ram vs. Sami-Ud-din Ad. Khan (1903)]***

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

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

(4) ***Power to set aside contract induced by undue influence- (Section 19A)***

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

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

Example 1:

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

Case study: A student was induced by his teacher to sell his brand new car to the latter at less than the purchase price to secure more marks in the examination. Accordingly the car was sold. However, the father of the student persuaded him to sue his teacher. State on what ground the student can sue the teacher?

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

(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:

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(1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true.

(2) the active concealment of a fact by one having knowledge or belief of the fact.

(3) a promise made without any intention of performing it.

(4) any other act fitted to deceive.

(5) any such act or omission as the law specially declares to be fraudulent.

Explanation to Section 17

Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silence is, in itself, equivalent to speech.

Example 1:

A sells, by auction, to B, a horse which A knows to be unsound, A says nothing to B about the unsoundness of the horse. This is not fraud by A.

Example 2:

B is A's daughter and has just come of age. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.

Example 3:

B says to A –"If you do not deny it, I shall assume that the horse is sound". A says nothing. Here A's silence is equivalent to speech.

Analysis of Section 17

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.

(2) The representation must be related to a fact.

(3) The representation should be made before the conclusion of the contract with the intention to induce the other party to act upon it.

(4) The representation or statement should be made with a knowledge of its falsity or without belief in its truth or recklessly not caring whether it is true or false.

(5) The other party must have been induced to act upon the representation or assertion.

(6) The other party must have relied upon the representation and must have been deceived.

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(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 in 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.

Mere silence is not fraud

A party to the contract is under no obligation to disclose the whole truth to the other party. 'Caveat Emptor'

i.e. let the purchaser beware is the rule applicable to contracts. There is no duty to speak in such cases and silence does not amount to fraud. Similarly there is no duty to disclose facts which are within the knowledge of both the parties.

Example: H sold to W some pigs which were to his knowledge suffering from fever. The pigs were sold 'with all faults' and H did not disclose the fact of fever to W. Held there was no fraud. ***[Word vs. Hobbs. (1878)]***.

Silence is fraud:

1. **Duty of person to speak:** Where the circumstances of the case are such that it is the duty of the person observing silence to speak. For example, in contracts of *uberrimae fidei* (contracts of utmost good faith).

   Following contracts come within this category:

   (a) Fiduciary Relationship: Here, the person in whom confidence is reposed is under a duty to act with utmost good faith and make full disclosure of all material facts concerning the agreement, known to him.

   Example: A broker was asked to buy shares for client. He sold his own shares without disclosing this fact. The client was entitled to avoid the contract or affirm it with a right to claim secret profit made by broker on the transaction since the relationship between the broker and the client was relationship of utmost good faith. ***(Regier V. Campbell Staurt)***

   (b) Contracts of Insurance: In contracts of marine, fire and life insurance, there is an implied condition that full disclosure of material facts shall be made, otherwise the insurer is entitled to avoid the contract.

   (c) Contracts of marriage: Every material fact must be disclosed by the parties to a contract of marriage ***(Hazi Ahmed v. Abdul Gassi)***.

   (d) Contracts of family settlement: These contracts also require full disclosure of material facts within the knowledge of the parties.

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(e) **Share Allotment contracts:** Persons issuing 'Prospectus' at the time of public issue of shares/ debentures by a joint stock company have to disclose all material facts within their knowledge.

2. **Where the silence itself is equivalent to speech:** For example, A says to B "If you do not deny it, I shall assume that the horse is sound." A says nothing. His silence amounts to speech.

   In case of fraudulent silence, contracts is not voidable if the party whose consent was so obtained had the means of discovering the truth with ordinary diligence (Exception to section 19)

(IV) Misrepresentation(Section-18) Misrepresentation means and includes-

(1) the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true.

(2) any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or anyone claiming under him; by misleading another to his prejudice or to the prejudice of anyone claiming under him.

(3) causing, however, innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

Analysis of Section 18

According to Section 18, there is misrepresentation:

(1) statement of fact, which of false, would constitute misrepresentation if the maker believes it to be true but which is not justified by the information, he possesses.

(2) When there is a breach of duty by a person without any intention to deceive which brings an advantage to him.

(3) When a party causes, even though done innocently, the other party to the agreement to make a mistake as to the subject matter.

Example 1:

A makes a positive statement to B that C will be made the director of a company. A makes the statement on information derived, not directly from C but from M. B applies for shares on the faith of the statement which turns out to be false. The statement amounts to misrepresentation, because the information received second-hand did not warrant A to make the positive statement to B.

Difference between Coercion and Undue influence:

Basis of difference	Coercion	Undue Influence
Nature of action	It involves the physical force or threat. The aggrieved party is	It involves moral or mental pressure.

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	compelled to make the contract against its will.	
Involvement of criminal action	It involves committing or threatening to commit and act forbidden by Indian Penal Code or detaining or threatening to detain property unlawfully.	No such illegal act is committed or a threat is given.
Relationship between parties	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.
Exercised by whom	Coercion need not proceed from the promisor nor need it be the 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.
Enforceability	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.
Position of benefits received	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
Intention	To deceive the other party by hiding the truth.	There is no such intention to deceive the other party.
Knowledge of truth	The person making the suggestion believes that the statement as untrue.	The person making the statement believes it to be true, although it is not true.

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Recission of the contract and claim for damages	The injured party can repudiate the contract and claim damages.	The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages.
Means to discover the truth	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.

Legal effects of agreements without free consent - (Section 19)

When consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

A party to contract, whose consent was so caused by fraud or misrepresentation may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representation made had been true.

Exception - If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 17, the contract is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

Explanation to Section 19 - A fraud or misrepresentation which did not cause the consent to a contract of the party on whom such fraud was practiced, or to whom such misrepresentation was made, does not render a contract voidable.

Example: A, intending to deceive B, falsely represents that 500 maunds of indigo are made annually at A's factory, and thereby induces B to buy the factory. The contract is voidable at the option of B. This is because when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

Analysis of Section 19

It has already been considered that when consent to an agreement is caused by coercion, undue influence, fraud or misrepresentation, though the agreement amounts to a contract, such a contract is voidable at the option of the party those consent was so obtained. The party, however, may insist that the contract should be performed and that he should be put in the same position in which he would have been, if the representation made had been true.

But a person who had the means of discovering the truth with ordinary diligence cannot avoid a contract on the ground that his consent was caused by

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misrepresentation or silence amounting to fraud.

Example: A by a misrepresentation leads B to believe erroneously that 750 tons of sugar is produced per annum at the factory of A. B examines the accounts of the factory, which should have disclosed, if ordinary diligence had been exercised by B, that only 500 tons had been produced. Thereafter B purchases the factory. In the circumstance, B cannot repudiate the contract on the ground of A's misrepresentation.

Where a party to a contract commits fraud or misrepresentation, but the other party is not, in fact, misled by such fraud or misrepresentation, the contract cannot be avoided by the later. **(Explanation to Section 19).** Thus, when a seller of specific goods deliberately conceals a fault in order that the buyer may not discover it even if he inspects the goods but the buyer does not in fact, make any inspection, the buyer cannot avoid the contract, as he is not in fact deceived by the conduct of the seller.

Mistake: Mistake may be defined as innocent or erroneous belief which leads the party to misunderstand the others. Mistake may be either Bilateral or Unilateral. Bilateral mistake is when both the parties to a contract are under a mistake. Unilateral mistake is when only one party to the contract is under a mistake.

Effect of mistake on validity of a contract:

Mistake is some unintentional act, omission, or error, arising from unconsciousness, ignorance or forgetfulness, imposition, or misplaced confidence. It may be of two kind-

It is essential for the creation of a contract that both the parties should agree to the same thing in the same sense. Thus, if two persons enter into a contract, each of them thinking about a different subject matter, no contract will arise. As a result, a mistake may lead a contract towards void-ness. Its effect can be broadly studied as under:

(i) **Mistake of Law:** A mistake of law does not render a contract void as one cannot take excuse of ignorance of the law of his own country. But if the mistake of law is caused through the inducement of another, the contract may be avoided. Mistake of foreign law is excusable and is treated like a mistake of fact. Contract may be avoided on such mistake.

(ii) **Mistake of fact:** Where the contracting parties misunderstood each other and are at cross purposes, there is a bilateral or mutual mistake. Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.

Example: A offers to sell his Ambassador Car to B, who believes that A has only Fiat Car, agrees to buy the car. Here, the two parties are thinking about different subject matter so that there is no real consent and the agreement is void.

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1.7 Quasi, Contingent and Termination of contracts

1.7.1 QUASI CONTRACTS

A valid contract must contain certain essential elements, such as ouer and acceptance, capacity to contract, consideration and free consent. But sometimes the law implies a promise imposing obligations on one party and conferring right in favour of the other even when there is no ouer, no acceptance, no genuine consent, lawful consideration, etc. and in fact neither agreement nor promise. Such cases are not contracts in the strict sense, but the Court recognises them as **relations resembling those of contracts** and enforces them as if they were contracts. Hence the term **Quasi -contracts (i.e. resembling a contract).** Even in the absence of a contract, certain social relationships give rise to certain specific obligations to be performed by certain persons. These are known as quasi contracts as they create same obligations as in the case of regular contract.

Quasi contracts are based on principles of equity, justice and good conscience.

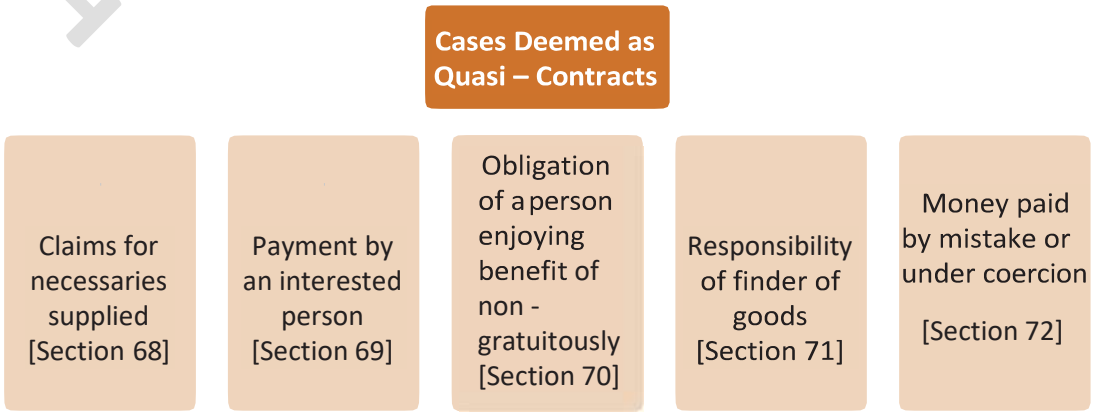
A quasi or constructive contract rests upon the maxims, "No man must grow rich out of another persons loss".

Example 1: T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.
Example 2: A pays some money to B by mistake. It is really due to C. B must refund the money to A.

These relations are called as quasi-contractual obligations. In India it is also called as 'certain relation resembling those created by contracts.

Salient features of quasi contracts:

(a) In the first place, such a right is always a right to money and generally, though not always, to a liquidated sum of money.
(b) Secondly, it does not arise from any agreement of the parties concerned, but is imposed by the law; and



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

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

To establish his claim, the supplier must prove not only that the goods were supplied to the person who was minor or a lunatic but also that they were suitable to his actual requirements at the time of the sale and delivery.

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

Example: B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of the sale will be the annulment of B's lease. B, to prevent the sale and the consequent annulment of his own lease, pays to the government the sum due from A. A is bound to make good to B the amount so paid.

(c) **Obligation of person enjoying benefits of non-gratuitous act (Section 70):** In term of section 70 of the Act "where a person lawfully does anything for another person, or delivers anything to him not intending to do so gratuitously and such other person enjoys the benefit thereof, the latter is bound to pay compensation to the former in respect of, or to restore, the thing so done or delivered".

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

(i) that he had done the act or had delivered the thing lawfully.

(ii) that he did not do so gratuitously; and

(iii) that the other person enjoyed the benefit.

The above can be illustrated by a case law where 'K' a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in mean-time government went on appeal. The appeal was decided in favour of the government and 'K' was directed to return the salary paid to him during the period of reinstatement. ***[ShyamLal vs. State of U.P. A.I.R (1968) 130]***

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

(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.

In ***Hollins vs. Howler L. R. & H. L.,*** 'H' picked up a diamond on the floor of 'F's shop and handed over the same to 'F' to keep till the owner was found. In spite of the best euorts, the true owner could not be traced. After the lapse of some weeks, 'H' tendered to 'F' the lawful expenses incurred by him and requested to return the diamond to him. 'F' refused to do so. ***Held,*** 'F' must return the diamond to 'H' as he was entitled to retain the goods found against everybody except the true owner.

Example: 'P' a customer in 'D's shop puts down a brooch worn on her coat and forgets to pick it up and one of 'D's assistants finds it and puts it in a drawer over the weekend. On Monday, it was discovered to be missing. 'D' was held to be liable in the absence of ordinary care which a prudent man would have taken.

(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".

Every kind of payment of money or delivery of goods for every type of 'mistake' is recoverable.
[Shivprasadvs Sirish Chandra A.I.R. 1949 P.C. 297]

Example: A payment of municipal tax made under mistaken belief or because of misunderstanding of the terms of lease can be recovered from municipal authorities. The above law was affirmed by Supreme Court in cases of ***Sales tax officer vs. Kanhaiyalal A. I. R. 1959 S. C. 835***

Similarlyany money paid by coercion is also recoverable. The word coercion is not necessarily governed by section 15 of the Act. The word is interpreted to mean and include oppression, extortion, or such other means ***[Seth Khanjelekvs National Bank of India]***.

In a case where 'T' was traveling without ticket in a tram car and on checking he was asked to pay `5/- as penalty to compound transaction. T filed a suit

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against the corporation for recovery on the ground that it was extorted from him. The suit was decreed in his favour. ***[Trikamdas vs. Bombay Municipal Corporation A. I. R.1954]***

In all the above cases the contractual liability arose without any agreement between the parties.

Difference between quasi contracts and contracts

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

1.7.2 CONTINGENT CONTRACTS

In this unit we shall briefly examine what is called a'contingent contract', its essentials and the rules regarding enforcement of this type of contracts. The Contract Act recognises certain cases in which an obligation is created without a contract. Such obligations arise out of certain relations which cannot be called as contracts in the strict sense. There is no ouer, no acceptance, no *consensus ad idem* and in fact neither agreement nor promise and yet the law imposes an obligation on one party and confers a right in favour of the other. We shall have a look on these cases of 'Quasi-contracts'.

A contract may be absolute or a contingent. An Absolute contract is one where the promisor undertakes to perform the contract in any event without any condition.

Definition of 'Contingent Contract' (Section 31)

"A contract to do or not to do something, if some event, collateral to such contract, does or does not happen".

Meaning of collateral Event: ***Pollock and Mulla*** defined collateral event as "an event which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise".

Example: A contracts to pay B `100,000 if B's house is burnt. This is a contingent contract. Here the burning of the B's house is neither a performance promised as part of the contract nor it is the consideration obtained from B. The liability of A arises only on the happening of the collateral event.

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Essentials of a contingent contract

(a) **The performance of a contingent contract would depend upon the happening or non-happening of some event or condition.** The condition may be precedent or subsequent.

Example: 'A' promises to pay `50,000 to 'B' if it rains on first of the next month.

(b) **The event referred to as collateral to the contract.** The event is not part of the contract. The event should be neither performance promised nor a consideration for a promise.

Thus (i) where A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards, the contract is a conditional contract and not contingent; because the event on which B's obligation is made to depend is part of the promise itself and not a collateral event. (ii) Similarly, where A promises to pay B `1,00,000 if he marries C, it is not a contingent contract. (iii) 'A' agreed to construct a swimming pool for 'B' for `200,000. And 'B' agreed to make the payment only on the completion of the swimming pool. It is not a contingent contract as the event (i.e. construction of the swimming pool) is directly connected with the contract.

(c) **The contingent event should not be a mere 'will' of the promisor.** The event should be contingent in addition to be the will of the promisor.

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

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

(d) **The event must be uncertain.** Where the event is certain or bound to happen, the contract is due to be performed, then it is a not contingent contract.

Example: 'A' agreed to sell his agricultural land to 'B' after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfilment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.

1.7.3 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.**

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Enforcement of contracts contingent on an event happening: Where a contract identifies happening of a future contingent event, the contract cannot be enforced until and unless the event 'happens'. If the happening of the event becomes impossible, then the contingent contract is void.

Section 32 says that "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".

Example: A contracts to pay B a sum of money when B marries C. C dies without being married to B. The Contract becomes void.

(a) **Enforcement of contracts contingent on an event not happening:** Where a contingent contract is made contingent on a non-happening of an event, it can be enforced only when it is happening becomes impossible. 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".

Example: Where 'P' agrees to pay 'Q' a sum of money if a particular ship does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.

Where A agrees to pay sum of money to B if certain ship does not return however the ship returns back. Here the contract becomes void.

(b) **A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does something to make the 'event' or 'conduct' as impossible of happening.**

Section 34 says that "if a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to have become impossible when such person does anything which renders it impossible that he should so act within any definite time or otherwise than under further contingencies".

Example: Where 'A' agrees to pay 'B' a sum of money if 'B' marries 'C'. 'C' marries 'D'. This act of 'C' has rendered the event of 'B' marrying 'C' as impossible; it is though possible if there is divorce between 'C' and 'D'.

In *Frost V. Knight*, the defendant promised to marry the plaintiff on the death of his father. While the father was still alive, he married another woman. It was held that it had become impossible that he should marry the plaintiff and she was entitled to sue him for the breach of the contract.

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(c) **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.

Example: A promises to pay B a sum of money if certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

(d) **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".

Example: A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

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

Difference between a contingent contract and a wagering contract

Basis of difference	Contingent contract	Wagering contract
Meaning	A contingent contract is a contract to do or not to do something with reference to a collateral event happening or not happening.	A wagering agreement is a promise to give money or money's worth with reference to an uncertain event happening or not happening.
Reciprocal promises	Contingent contract may not contain reciprocal promises.	A wagering agreement consists of reciprocal promises.
Uncertain event	In a contingent contract, the event is collateral.	In a wagering contract, the uncertain event is the core factor.
Nature of contract	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.

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Interest of contracting parties	Contracting parties have interest in the subject matter in contingent contract.	The contracting parties have no interest in the subject matter.
Doctrine of mutuality of lose and gain	Contingent contract is not based on doctrine of mutuality of lose and gain.	A wagering contract is a game, losing and gaining alone matters.
Effect of contract	Contingent contract is valid.	A wagering agreement is void.

1.7.4 DISCHARGE OF A CONTRACT

A contract is discharged when the obligations created by it come to an end. A contract may be discharged in any one of the following ways:

(i) **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.

Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement. When the promisor ouers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance or tender.

Example: A contracts to sell his car to B on the agreed price. As soon as the car is delivered to B and B pays the agreed price for it, the contract comes to an end by performance.

(ii) **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. The principles of Novation, Rescission, Alteration, and Remission are already discussed.

Example: A owes B ` 1,00,000. A enters into an agreement with B and mortgage his (A's), estates for `50,000 in place of the debt of `1,00,000. This is a new contract and extinguishes the old.

Example: A owes B ` 5,00,000. A pays to B ` 3,00,000 who accepts it in full satisfaction of the debt. The whole is discharged.

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

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(a) an unforeseen change in law.

(b) the destruction of the subject-matter essential to that performance.

(c) the non-existence or non-occurrence of particular state of things, which was naturally contemplated for performing the contract, as a result of some personal incapacity like dangerous malady.

(d) the declaration of a war (Section 56).

Example 1: A agrees with B to discover a treasure by magic. The agreement is void due to initial impossibility.

(iii) Discharge by lapse of time: A contract should be performed within a specified period as prescribed by the Limitation Act, 1963. If it is not performed and if no action is taken by the promisee within the specified period of limitation, he is deprived of remedy at law.

Example: If a creditor does not file a suit against the buyer for recovery of the price within three years, the debt becomes time-barred and hence irrecoverable.

(iv) Discharge by operation of law: A contract may be discharged by operation of law which includes by death of the promisor, by insolvency etc.

(v) Discharge by breach of contract: Breach of contract may be actual breach of contract or anticipatory breach of contract. If one party defaults in performing his part of the contract on the due date, he is said to have committed breach thereof. When on the other hand, a person repudiates a contract before the stipulated time for its performance has arrived, he is deemed to have committed anticipatory breach. If one of the parties to a contract breaks the promise the party injured thereby, has not only a right of action for damages but he is also discharged from performing his part of the contract.

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

Example: A owes B `5,00,000. C pays to B `1,00,000 and B accepts them, in satisfaction of his claim on
A. This payment is a discharge of the whole claim.

(vii) Effects of neglect of promisee to afford promisor reasonable facilities for performance: 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

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caused thereby. (Section 67)

(viii) **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.

Example: A took a land on lease from B. Subsequently, A purchases that very land. Now, A becomes the owner of the land and the ownership rights being superior to rights of a lessee, the earlier contract of lease stands terminated.

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

Under this heading, we shall discuss the principles of Novation, Rescission and Alteration. The law is contained in Sections 62 to 67 of the Contract Act.

(i) **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. If they do so, it will be a case of novation. On novation, the old contract is discharged and consequently it need not be performed. Thus, it is a case where there being a contract in existence some new contract is substituted for it either between the same parties or between different parties the consideration mutually being the discharge of old contract. Novation can take place only by mutual agreement between the parties.

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

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

(c) **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. In other words, a contract is also discharged by

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

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

Novation means substitution of an existing contract with a new one. Novation may be made by changing in the terms of the contract or there may be a change in the contracting parties. But in case of alteration the terms of the contract may be altered by mutual agreement by the contracting parties but the parties to the contract will remain the same.

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

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

Example: A owes B `5,00,000. A pays to B, and B accepts, in satisfaction of the whole debt, `2,00,000 paid at the time and place at which the `5,00,000 were payable. The whole debt is discharged.

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

(iv) **Obligations of Person who has Received Advantage under Void Agreement or contract that becomes void (Section 65)**
"When an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it."

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Analysis of Section 65

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

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

In a case, the plantiff hired a godown from the defendant for twelve months and paid the whole of the rent in advance. After about seven months the godown was destroyed by fire, without any fault or negligence on the part of the plantiff and the plantiff claimed a refund of a proportionate amount of the rent. Held, the plantiff was entitled to recover the rent for the unexpired term, of the contract.

The Act requires that a party must give back whatever he has received under the contract. The benefit to be restored under this section must be benefit received under the contract (and not any other amount). A agrees to sell land to B for `400,000. B pays to A `40,000 as a deposit at the time of the contract, the amount to be forfeited by A if B does not complete the sale within a specified period. B fails to complete the sale within the specified period, nor is he ready and willing to complete the sale within a reasonable time after the expiry of that period. A is entitled to rescind the contract and to retain the deposit. The deposit is not a benefit received under the contract, it is a security that the purchaser would fulfill his contract and is ancillary to the contract for the sale of the land.

(v) **Communication of rescission (Section 66):** You have noticed that a contract voidable at the option of one of the parties can be rescinded; but rescission must be communicated to the other party in the same manner as a proposal is communicated under Section 4 of the Contract Act. Similarly, a rescission may be revoked in the same manner as a proposal is revoked.

(vi) **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.

Example: If an apprentice refuses to learn, the teacher cannot be held liable for not teaching.

Example: A contracts with B to repair B's house. B neglects or refuses to appoint out to A the places in which his house requires repair. A is excused for the non-performance of the contract if it is caused by such neglect or refusal.

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1.8 **Special Contracts**: Indemnity and Guarantee; Bailment and Pledge; Law of Agency

1. Contract of Indemnity and Guarantee

1.8.1 Contract of Indemnity

Definition u/s 124: "a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person."

Basic Conditions:

- "existence of loss" is essential to the promise
- Such loss is caused by:
- conduct of the promisor himself or
- conduct of any other person.

Loss occasioned by the conduct accident or an act of God is **not covered.**

- It could be either
  - *Express Contract*: a person expressly promises to compensate the other from loss→ written/oral
  - *Implied Contract*: it is to be inferred from the conduct of the parties or from the circumstances of the case
- Must fulfil all the *essentials of a valid contract* which includes:
  - Offer and acceptance
  - Intention to create legal obligation
  - Consideration
  - Competency to contract
  - Free consent
  - Lawful object
  - The agreement must not be expressly declared to be void- eg: an agreement in restraint of trade/ marriage etc.
  - The terms of the agreement must not be vague or uncertain
  - The agreement must be capable of performance- An agreement to do an impossible act is void.
  - Legal formalities complied

  Example: A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined Rs. 1000, B cannot claim this amount from A because the object of the agreement is unlawful.
- Insurance Contracts
  - **Fire Insurance or Marine Insurance**
  - Contract of indemnity
  - **Life Insurance**
  - NOT a contract of indemnity

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- *When does the liability of an indemnifier commence?* → (as per court rulings Act is silent)→ as soon as the liability of the indemnity-holder becomes:
- Absolute: 100% surety of the liability
  and
- Certain: Amount is fixed/can be calculated definitely.

Example: A promises to compensate X for *any loss* that he may suffer by filling a suit against Y. The court orders X to pay Y damages of Rs 10000 . As the loss has become certain, X may claim the amount of loss from A and pass it to Y

Example: Mr. X contracts with the Government to return to India after completing his studies at University of Cambridge and serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

Example: X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighbouring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.

Example: X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Here, there is contract of indemnity between X and the company.

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

a. A contract of indemnity is said to be express when a person expressly promises to compensate the other from loss
b. 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 indemnity is like any other contract and must fulfil all the **essentials of a valid contract** which includes:

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

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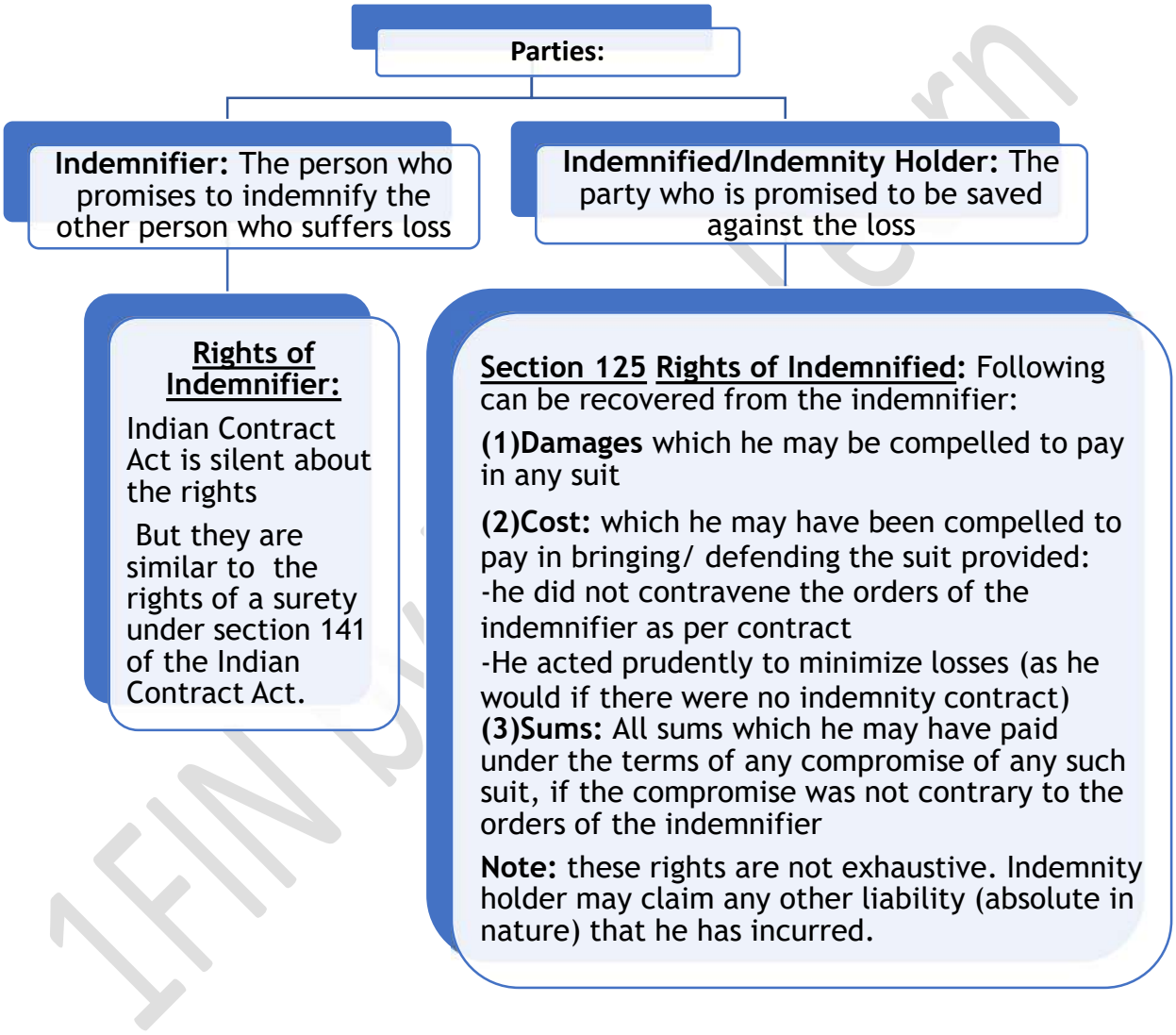
j. Legal formalities

1.8.2 Rights of Indemnity—holder when sued (Section 125) :

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor/indemnifier—



Example: A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined Rs. 1000, B cannot claim this amount from A because the object of the agreement is unlawful.

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.

1.8.3 Section 126 – "Contract of guarantee", "surety", "principal debtor" and "creditor"

A Contract of Guarantee:

- to perform the promise, or
- to discharge the liability

of a third person in case of his default is called a contract of guarantee. Guarantee is a **promise to pay a debt owed by a third person** in case the latter does not pay. It is **a tripartite agreement between principal debtor, creditor, and surety,** in effect three contracts

(i) A **principal contract** between the principal debtor and the creditor
(ii) A **secondary contract** between the creditor ad the surety.
(iii) 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.

- Guarantee: An Express contract→ **oral** or **written.**

Parties in Guarantee contract:

1) **Surety (Guarantor):** The person who gives the guarantee is called the surety.
2) **Creditor**: The person to whom the guarantee is given is called creditor.
3) **Principal Debtor:** The person in respect of who is default the guarantee is given is called Principal Debtor.

Example 1 : When A requests B to lend Rs. 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C failing to do so, he (A) will himself pay to B, there is a contract of guarantee. Here, B is the creditor, C the principal debtor and A the surety.

Example 2 : Where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of guarantee.

Analysis

From the definition, it can be analysed that, Guarantee is a **promise to pay a debt owed by a third person** in case the latter does not pay.

Any guarantee given may be **oral** or **written.**

From the above definition, it is clear that in a contract of guarantee is **a tripartite agreement between principal debtor, creditor, and surety**. There are, in effect three contracts

(i) A **principal contract** between the principal debtor and the creditor

(ii) A **secondary contract** between the creditor ad the surety.

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(iii) 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.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.

ESSENTIAL FEATURES OF A GUARANTEE

The following are the requisites of a valid guarantee:

1) **Principal Debt**: The purpose of a guarantee being to **secure** the **payment of a debt**, the existence of recoverable debt is necessary. It is of the essence of a guarantee that there should be someone liable as a principal debtor and the surety undertakes to be liable on his default. If there is no principal debt, there can be no valid guarantee.
2) **Consideration:** Like every other contract, a contract of guarantee should also be supported by some consideration. A guarantee without consideration is void, but there need be no direct consideration between the surety and the creditor. As per Section 127 consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee, but past consideration is no consideration for the contract of guarantee. Even if the principal debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void.
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)
Any guarantee which the creditor has obtained by means of **keeping silence** as to material circumstances, is invalid (section 143)
Example 1: A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C, with his

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previous conduct. B afterwards make default. The guarantee is invalid.

5) **Writing not necessary**: **Section 126** expressly declares that a guarantee may be either oral or written.
6) **Joining of the other co-sureties (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. That implies, the guarantee by a surety is not valid if a condition is imposed by a surety that some other person must also join as a co-surety, but such other person does not join as a co-surety.

Key points relating to A Guarantee

- ✓ existence of **recoverable debt**
- ✓ **Consideration**: there need be no direct consideration between the surety and the creditor. As per Section 127 consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee.
- ✓ surety must be **competent to contract**
- ✓ Even if the principal debtor is incompetent to contract, the guarantee is valid.
- ✓ There must be an **existing liability or a promise** whose performance is guaranteed. Liability must be legally enforceable and not time barred.
- ✓ **No misrepresentation or concealment** by the creditor in obtaining guarantee. (Guarantor must be made aware of all material facts wrt liability/promise so he can make the right decision)
- ✓ It is an express contract→ oral or writing
- ✓ **Joining of the other co-sureties (Section 144):** Where a person gives a guarantee upon the condition that another surety must join along with him, and no such person joins as surety then such guarantee is not valid.

1.8.4 Nature and Extent of Surety's Liability (section 128):

- At the time of making of contract of guarantee, the surety is at liberty to state the limit of his liability

He is liable only to the extent of his **stated limit** on the default of the principal debtor.

- Liability of surety is of secondary nature as he is liable only on default of principal debtor
- Where a debtor **cannot be held liable** on account of any defect in the document, the **liability** of the **surety also ceases**.

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- In the absence of any such contract, the liability of the surety is **co-extensive with that of the principal** debtor. It means that the surety is liable for what the principal debtor is liable. However, the liability of the surety may be made less than that of the principal debtor
- Surety's liability continues even if the principal debtor has not been sued or is omitted from being sued. In other words, a **creditor may choose to proceed against a surety first**, **unless there is an agreement to the contrary**.
- Whatever the case may be, the liability of the surety is **secondary and conditional** that is it arises on the default of the principal debtor.

Example : A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

1.8.5 Kinds of Guarantee:

1) **Specific Guarantee:** A guarantee given for a **single debt/ particular transaction**. 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.** Here, A surety's liability continues until the revocation of the guarantee.

1.8.6 Difference between Indemnity and Guarantee:

	Indemnity	Guarantee
1) **Number of Parties**	two parties i.e. indemnifier and indemnified.	Three parties i.e. surety, creditor and principal debtor.
2) **Number of Contracts**	In indemnity there is only one contract between indemnifier and indemnified.	In guarantee, there are three contracts i.e. between surety and creditor between surety and principal debtor an implied contract of indemnity between the principal debtor and surety.
3) **Type of contract**	expressed or Implied.	Always an express contract.
4) ***Nature of Undertaking***	A contract of indemnity is of contingent nature	A contract of guarantee is a collateral contract

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5) **Nature of Liability**	The liability of indemnifier is Primary, Absolute, Total	Here the primary liability is that of principal debtor. The liability of surety is secondary and conditional.
6) **Commencement of Liability**	The liability of indemnifier commences when the indemnified suffer loss	The liability of surety commences when the principal debtor makes default
7) **Objective**	To save the indemnified from a loss which may occur to him in the future	To provide security to the creditor in respect of existing debs and liabilities
8) **Right to sue third party**	Indemnifier cannot sue the third person in his own name, but he may initiate the proceedings on behalf of indemnified	On the default of principal debtor, the surety (after discharging his liability) may sue him in his own name because he gets all the right of a creditor after discharging the debts.
9) Competency to contract	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

1.8.7 Continuing Guarantee (Section 129):

A guarantee which extends to a series of transactions is called a "**continuing guarantee**".

Liability of surety is revoked by:

1) **By Notice:** A continuing guarantee may be revoked at any time by the surety by giving notice to the creditor but only for future transaction.
2) **By Death (of surety):** In the absence of any special contract, a continuing guarantee is revoked by the death of surety but only for future transaction.

1.8.8 Section 132 – Liability of Two Persons, Primarily Liable, Not Affected by Arrangement Between Them That One Shall be Surety on Other's Default

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other (Guarantee), the creditor cannot sue the guarantor, even if he is aware of such second contract because he is not party to such contract. The two debtors shall hold the same liability as per primary contract.

Example: A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is

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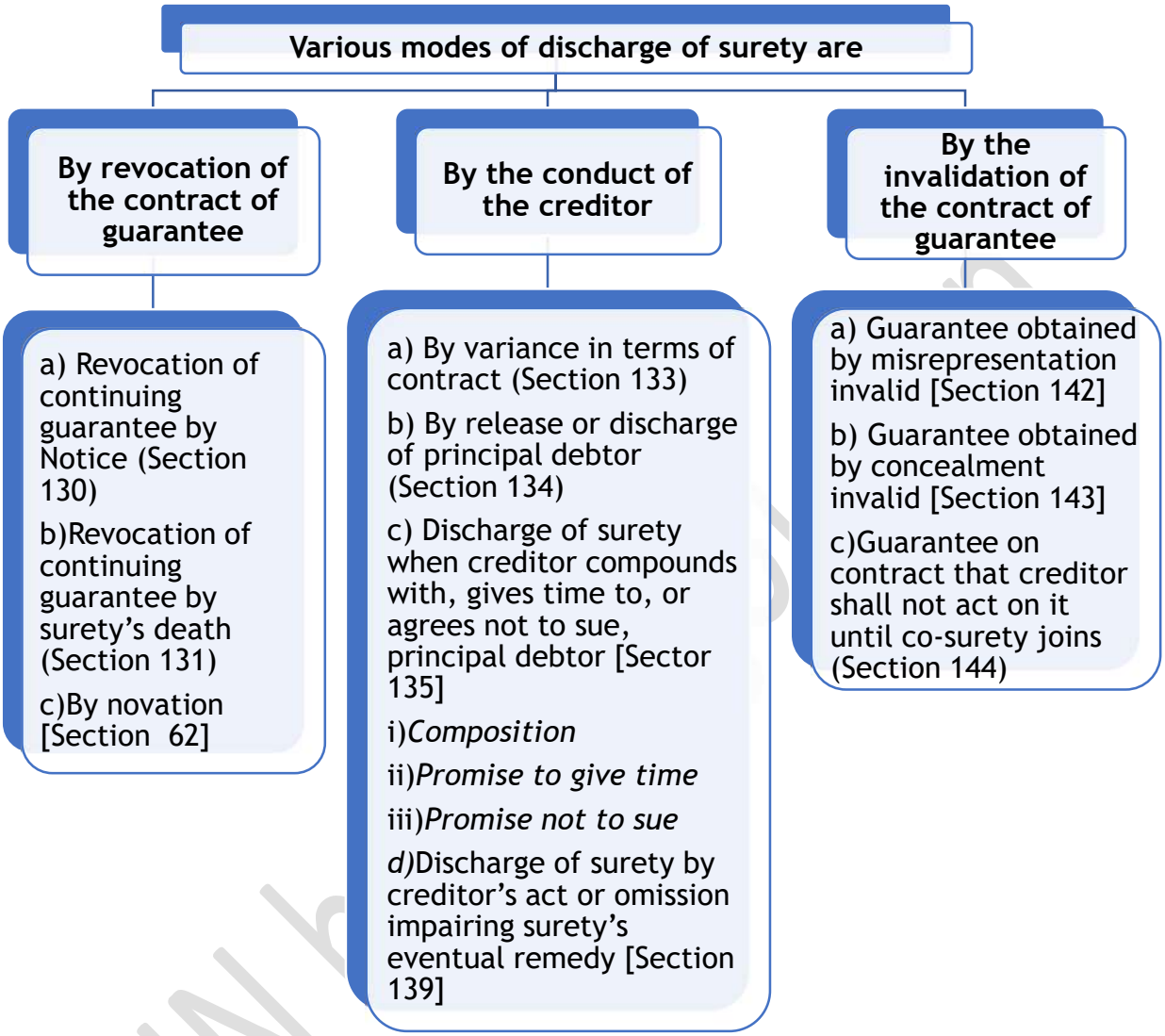
made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

1.8.9 Discharge of A Surety



1) By revocation of the Contract of Guarantee: -

*a) **Revocation of continuing guarantee by Notice (Section 130):***

Revoked by Notice by surety → to creditor → wrt future transactions

Revocation of specific guarantee: Revoked by Notice by surety → to creditor →only if liability to principal debtor has not accrued

Example 2: A guarantees to B, to the extent of 100,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C Rs. 20000. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee to pay Rs. 20000.

b) ***Revocation of continuing guarantee by surety's death (Section 131*)**: death of surety operates as a revocation of a continuing guarantee as to the <u>future transactions taking place after the death of surety</u>. Exception → if there is

contract contrary to that.

c) ***By novation [Section 62*]: if 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.

2) By conduct of the creditor: -

a) ***By variance in terms of contract (Section 133):*** variance in the terms of contract between the principal debtor and creditor **without surety's consent** would discharge the surety in respect of all transactions taking place subsequent to such variance.

Note: *Variation which is not substantial or material or which is beneficial to the surety will not discharge him of his liability.*

Example 1: A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent and is not liable to make good this loss.

Example 2: surety guaranteed the repayment of loan provided by the bank to the principal debtor of only up to Rs. 25,000. Subsequently, since the bank was willing to provide loan only up to Rs. 20,000, the principal debtor reduced the amount to Rs. 20,000 in the guarantee form and without intimation to the surety. Since the change in condition is to the benefit of surety, he shall not be relieved of the liability. (*exception)*

b) ***By release or discharge of principal debtor (Section 134*): if the creditor**

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

Example: A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

c) ***Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135]:***

- *Composition:* variation of the original contract without consulting the surety→ surety is discharged
- *Promise to give time:* when more time is allowed to principal debtor to repay debt on due date→ surety is discharged.

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Exception:- **section 136**→ Where a contract to give time to the principal debtor is made by the creditor with a *third person*, and not with the principal debtor, the surety is not discharged.--> **Example:** C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

- *Promise not to sue:* If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged.

  Exception:- **section 137**→Mere forbearance/delay on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not discharge the surety (unless provision in the guarantee contract to the contrary)→ **Example:** B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

- *Exception to all above*: if the surety assents to above variations→ then he shall continue to remain liable

d) ***Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139]:*** If the creditor does any act/omits to do an act, which is inconsistent with the rights of the surety→ the surety is discharged.
SC Case→ "A bank granted a loan on the security of the stock in the godown. The loan was also guaranteed by the surety. The goods were lost from the godown on account of the negligence of the bank officials. The surety was discharged to the extent of the value of the stock so lost."

Example 2: A puts M as apprentice to B and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

3) By the invalidation of the contract of guarantee: -

a) ***Guarantee obtained by misrepresentation invalid [Section 142]:*** misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction→ invalid

b) ***Guarantee obtained by concealment invalid [Section 143*]:** keeping silence as to material circumstances→ invalid

Example 1: A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

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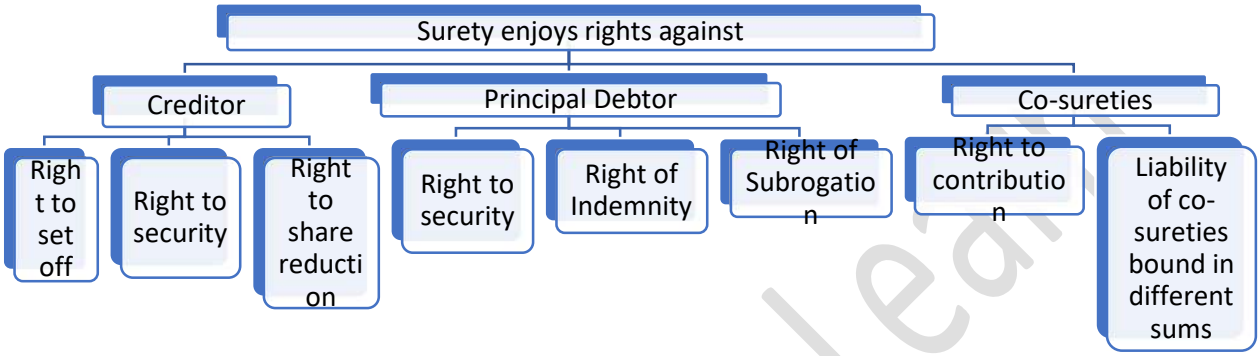
c) ***Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144):*** Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co- surety, the guarantee is not valid if that other person does not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

1.8.10 Rights of Surety:



Against Creditor:

1) **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 of making a contract of guarantee. This is immaterial whether the surety is or is not aware of the existence of such security. 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.
2) **Right of Set-off:** The surety is entitled (in a suit filed by the creditor against the surety) to the benefit of any set-off for counter claim which the principal debtor might possess against the creditor.
3) **Right to share reduction:** The surety has right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

Against Principal Debtor:

1) **Right of Subrogation [Section 140]:** The terms subrogation may be defined as the substitution of one person with another with same right and liabilities.
   After discharging his liability on the default of principal debtor, the surety is vested with all the rights which the creditor has against the principal debtor, for e.g.
   a) Right to recover money paid from debtor
   b) Right to securities (if any) held by creditor.
   c) Right to initiate proceedings against the principal debtor in his own name.

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2) **Right to security:** On repayment, surety steps into the shoes of the creditor. He has all the rights of the creditor including the right to sell the security and recover the debt from debtor.

3) **Right to Indemnity [Section 145]:** The surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, *but not sums which he paid wrongfully.*

Example 3: A guarantees to C, to the extent of 2,00,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,00,000 rupees, but obtains from A payment of the sum of 2,00,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied. (*Mistake of surety. Not the fault of principal debtor)*

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

1) **Co-sureties liable to contribute equally (Section 146):** when two or more persons **are co-sureties** for
   - the **same debt**, or duty,
   - **either jointly, or severally** and
   - **whether under the same or different contracts** and
   - **whether with or without the knowledge of each other**,
   - are **liable to pay each an equal share of the whole/part debt.**
   - **Any excess paid by one of them can be recovered from other co sureties.**
   - **Exceptions** → the co-sureties have a contract to share debt in different ratios

   Example 1: A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.

2) **Liability of co-sureties bound in different sums (Section 147):** 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 but up to the specified limit.

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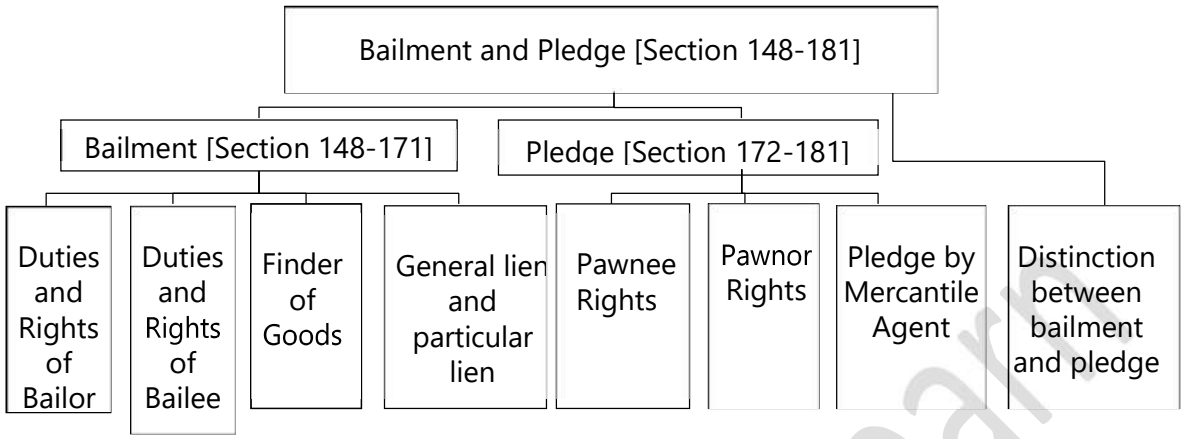
2. Bailment and Pledge

Unit Overview:-



1.8.1 WHAT IS BAILMENT?

The word "Bailment" has been derived from the French word "ballier" which means "to deliver". Bailment etymologically means 'handing over' or 'change of possession'. As per Section 148 of the Act, 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. The person delivering the goods is called the "bailor". The person to whom they are delivered is called the "bailee".

Example: Where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

Example: X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is contract for bailment.

Analysis:

The essential elements of a contract of bailment are—

a. **Contract**: Bailment is based upon a contract. The contract may be express or implied. No consideration is necessary to create a valid contract of bailment.
b. **Delivery of goods** It involves the delivery of goods from one person to another for some purposes. Bailment is only for moveable goods and never for immovable goods or money. The delivery of the possession of goods is of the following kinds:

i. **Actual Delivery**: When goods are physically handed over to the bailee by the bailor. Eg: delivery of a car for repair to workshop

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ii. **Constructive Delivery**: Where delivery is made by doing anything that has the effect of putting goods in the possession of the bailee or of any person authorized to hold them on his behalf. Eg: Delivery of the key of a car to a workshop dealer for repair of the car.
Purpose: The goods are delivered for some purpose. The purpose may be express or implied.
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. The change of possession does not lead to change of ownership. In bailment, bailor continues to be the owner of goods as there is no change of ownership. Where a person is in custody without possession, he does not become a bailee.

For example, servants of a master who are in custody of goods of the master do not become bailees.
Similarly, depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in possession of the owner though kept in a locker at the bank.

iii. **Return of goods**: Bailee is obliged to return the goods physically to the bailor. The goods should be returned in the same form as given or may be altered as per bailor's direction. It should be noted that exchange of goods should not be allowed. The bailee cannot deliver some other goods, even not those of higher value. Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Different forms of Bailment: Following are the popular forms of bailment

1) Delivery of goods by one person to another to be held for the bailor's use.
2) Goods given to a friend for his own use without any charge.
3) Hiring of goods.
4) Delivering goods to a creditor to serve as security for a loan.
5) Delivering goods for repair with or without remuneration.
6) Delivering goods for carriage.

Note: 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

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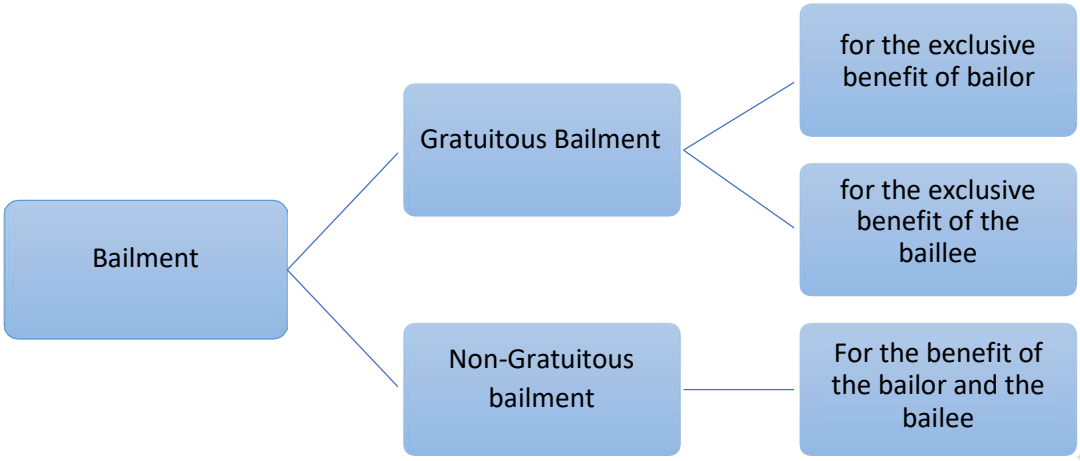
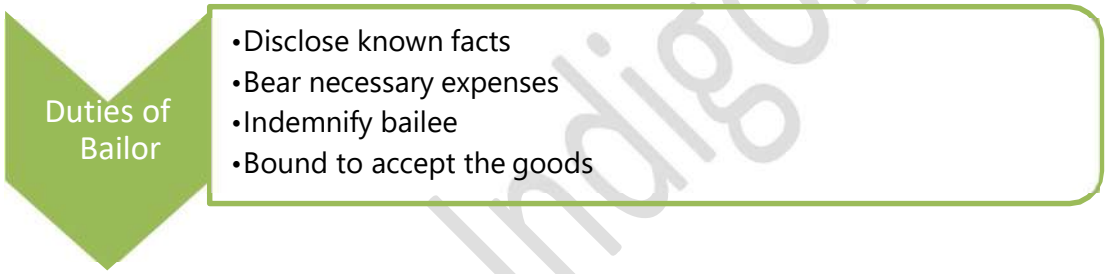


1.8.2 DUTIES OF A BAILOR

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:



These are enumerated hereunder:

i. **Bailor's duty to disclose faults in goods bailed [Section 150]**: The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Example 1: A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

Example 2: A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

ii. The condition for the liability of the bailor are:

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The bailor should have the knowledge of the defect and the bailee should not be aware

The defect in the goods must be such as exposes the bailee to extraordinary risks or materially interferes with the use of goods.

In Hyman & Wife v. Nye & Sons (1881), A hired from B a carriage along with a pair of horses and a driver for a specific journey. During the journey, a bolt in the under-part of the carriage broke away. As a result of this, the carriage became upset and A was injured. It was held that B was liable to pay damages to A for the injury sustained by him. The court observed that it was the bailor's duty to supply a carriage fit for the purpose for which it was hired.

Sometimes, the goods bailed are of dangerous nature (e.g., explosives). In such cases it is the duty of the bailor to disclose the nature of goods. [Great Northern Ry'.case (1932)]

iii. **Duty to pay necessary expenses [Section 158]**: 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. However, in case of non-gratuitous bailment the bailor is liable to pay the extraordinary expenses.

Example: A hired a taxi from B for the purpose of going to Gurgaon from Noida, during the journey, a major defect occurred in the engine. A had to pay Rs. 5000 as repair charges. These are the extraordinary expenses and it is the bailor's duty to bear such expenses. However, the usual and ordinary expenses for petrol, toll tax etc are to be borne by the bailee itself.

iv. **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.

v. **Bailor's responsibility to bailee [Section 164]**: The bailor is responsible to the bailee for the following:

1) 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).

2) 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. If the bailor refuses to take delivery of goods when it is offered at the proper time the bailee can claim compensation for all necessary expenses incurred for the safe custody. Example: X delivered his car to S for five days for safe keeping. However, X did not take back the car

for one month. In this case, S can claim the necessary expenses incurred by him for the custody of the car.

1.8.3 DUTIES OF A BAILEE

1) **Take reasonable Care of the goods (Section 151 & 152)**: In all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

   Example 1: If X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss [caused on account of riot].

   Example 2: A deposited his goods in B's godown. On account of unprecedented floods, a part of the goods was damaged. It was held that, B is not liable for the loss (Shanti Lal V. Takechand).

   Exception: Bailee when not liable for loss, etc., of thing bailed [Section 152]: The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in section 151.

2) **Not to make inconsistent use of goods (section 153 & 154)**: As per Section 154, if the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

   Example 1: A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

   Example 2: 'A' hires a horse in Kolkata from B expressly to march to Varanasi. 'A' ride with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'A' is liable to make compensation to B for the injury to the horse.

   As per Section 153, a contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

   Example: A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. This is, at the option of A, a termination of the bailment.

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3) **Not to mix the goods (Section 155, 156 and 157)**: Bailee is not entitled to mix up the goods bailed with his own goods except with the consent of the bailor. If he, with the consent of the bailor, mixes the goods bailed with his own goods, both the parties shall have an interest in proportion to their respective shares in the mixture thus produced (Sec. 155).

   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 bailee is bound to bear the expenses of separation and division and any damage arising from the mixture (Sec. 156).

   Example: A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark; A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

   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 compensation by the bailee for loss of the goods (Sec. 157).

   Example: A bails a barrel of Cape flour worth Rs. 4500 to B. B, without A's consent, mixes the flour with country flour of his own, worth only Rs. 2500 a barrel. B must compensate A for the loss of his flour.

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 purpo.se for which they were bailed has been accomplished. [Section 160]

   If, by the default of the bailee, the goods are not returned, delivered, or tendered at the proper time, he is responsible to the bailor for any loss, destruction, or deterioration of the goods from that time. [Section 161]

   Example – X delivered books to Y to be bound. Y promised to return the books within a reasonable time. X pressed for the return of the book. But Y, failed to deliver them back even after the expiry of reasonable time. Subsequently the books were burnt in an accidental fire at the premises of Y. In this case Y was held liable for the loss.

5) **Return an accretion from the Goods [Section 163]**: In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

   Example: A leaves a cow in the custody of B. The cow gives birth a calf. B is bound to deliver the calf as well as the cow to A.

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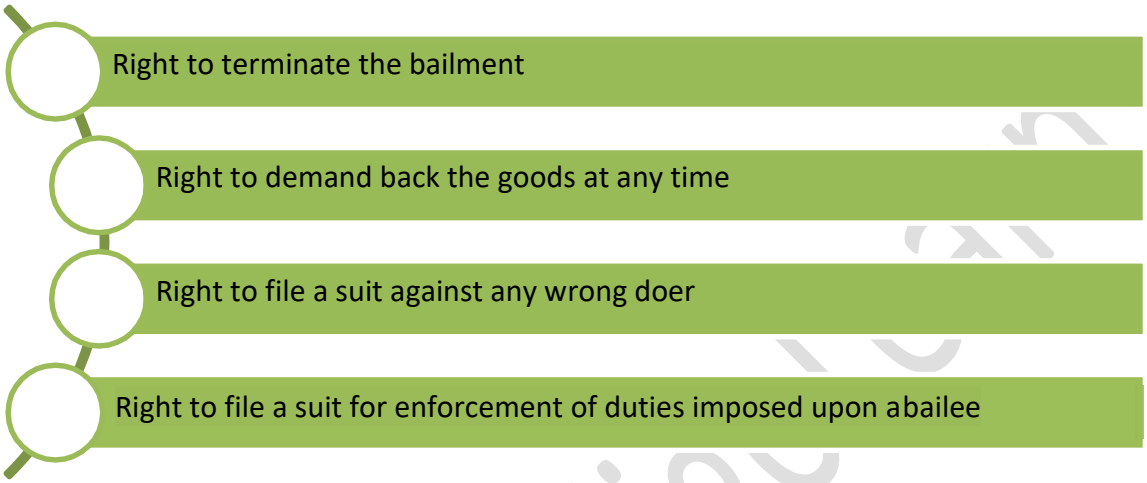
6) **Not to setup Adverse Title**: Bailee must not set up a title adverse to that of the bailor. He must hold the goods on behalf of and for the bailor. He cannot deny the title of the bailor.

1.8.4 RIGHTS OF A BAILOR

Rights of Bailor: Broadly rights of bailor are also the duty of the bailee can be categorized as under:



The following are the rights of bailor:

1) **Right to terminate the bailment [Section 153]**: A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.
   Example: A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. This is, at the option of A, a termination of the bailment.
   Termination of bailment may take place in the following circumstances:
2) **Premature Termination (Section 159)**: When the goods are lent gratuitously, the bailor can demand back the goods at any time even before the expiry of the time fixed or the achievement of the object.

   Example: A, while going out of station delivered his ornaments to B for safe custody for one month. But A returned to station after one week. He may demand the return of his ornaments even though the time of one month has not expired.

   However, due to the premature return of the goods, if the bailee suffers any loss, which is more than the benefit actually obtained by him from the use of the goods bailed, the bailor has to compensate the bailee.

3) **Right to file a suit against a wrong doer [Section 180 and section 181]** (discussed in detail on next page)
4) **Right to sue the bailee**: The bailor has a right to sue the bailee for enforcing all the liabilities and duties of him. It includes:

i. Right to claim compensation for loss caused to the goods by the negligence of the bailee.
ii. Right to claim compensation for unauthorized mixing of goods
iii. Right to claim damages for unauthorized use of the goods
iv. Right to demand back goods.
v. Right to any accretion to the goods bailed.

1.8.5 RIGHTS OF A BAILEE

Rights of bailee: As a matter of fact, all the duties of the bailor are the rights of the bailee. In addition to that, the bailee has the following other rights also.

1) **Right to Deliver the Goods to any one of the Joint Bailors [Section 165]:** If several joint owners bailed the goods, the bailee has a right to deliver them to any one of the joint owners unless there was a contract to the contrary.

   Example: A, B and C are the joint owners of a harvesting combine. They delivered it on hire to D for one month. After the expiry of one month, D may return the "combine" to any one of the joint owners namely, A, B or C.

2) **Right to indemnity (Sec. 166):** Bailee is entitled to be indemnified by the bailor for any loss arising to him by reasons that the bailor was not entitled to make the bailment or to receive back the goods or to give directions in respect to them. If the bailor has no title to the goods, and the bailee in good faith, delivers them back to, or according to the directions of the bailor, the bailee shall not be responsible to the owner in respect of such delivery. Bailee can also claim all the necessary expenses incurred by him for the purpose of gratuitous bailment.
3) **Right to claim compensation in case of faulty goods (Sec. 150)**: A bailee is entitled to receive compensation from the bailor or any loss caused to him due to the failure of the bailor to disclose any faults in the goods known to him. If the bailment is for hire, the bailor will be liable to compensate even though he was not aware of the existence of such faults.
4) **Right to claim extraordinary expenses (Sec. 158)**: A bailee is expected to take reasonable care of the gods bailed. In case he is required to incur any extraordinary expenses, he can hold the bailor liable for such expenses.
5) **Right to Apply to Court to Decide the Title to the Goods [Section 167]**: If the goods bailed are claimed by the person other than the bailor, the bailee may apply to the court to stop its delivery and to decide the title to the goods. **Example**: A, a dealer in T.V. delivered a T.V. to B for using in summer vacation. Subsequently, C claimed that the T.V. belonged to him as it was delivered only for repairs, to A and thus, B should deliver it to him. In this case, B may apply to the Court to decide the question of ownership of the T.V. so that he may deliver it to the right owner.
6) **Right of particular lien for payment of services [Section 170]**: Where the bailee has (a) in accordance with the purpose of bailment, (b) rendered any

service involving the exercise of labour of skill, (c) in respect of the goods, he shall have (d) in the absence of a contract to the contrary, right to retain such goods, until he receives due remuneration for the services he has rendered in respect of them. Bailee has, however, only a right to retain the article and not to sell it. The service must have entirely been formed within the time agreed or a reasonable time and the remuneration must have become due.

This right of particular lien shall be available only against the property in respect of which skill and labour has been used.

7) **Right of general lien (Sec. 171)**: Bankers, factors, wharfingers, attorneys of a High Court and policy brokers will be entitled to retain, as a security for a general balance of amount, any goods bailed to them in the absence of a contract to the contrary. By agreement other types of bailees excepting the above given five (Bankers, factors, wharfingers, attorneys of a High Court and policy brokers) may also be given this right of general lien.

1.8.6 RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY)

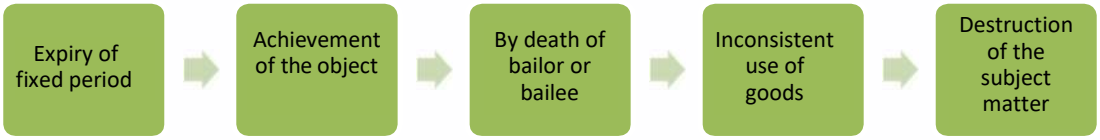
1) **Suit by bailor & bailee against wrong doers [Section 180]:** If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.
2) **Apportionment of relief or compensation obtained by such suits [Section181]:** 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

1.8.7 TERMINATION OF BAILMENT

A contract of bailment shall terminate in the following circumstances:

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 fulfilment of the purpose**: If the goods were delivered for a specific purpose, a bailment shall terminate on the fulfilment 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. However, the termination should not cause loss to the bailee in excess of the benefit derived by him. In case the loss exceeds the benefit derived by the bailee, the bailor must compensate the bailee for such a loss (Sec. 159)

4) **By death**: A gratuitous bailment terminates upon the death of either the bailor or the bailee.
5) **Destruction of the subject matter**: If the original condition of the bailed goods does not exist or is destroyed, the contract of bailment is automatically terminated, because the purpose will not be fulfilled, or the performance of the contract is impossible



1.8.8 FINDER OF LOST GOODS

1) **Right of finder of lost goods; may sue for specific reward offered [Section 168]:** The finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner; but he may retain the goods against the owner until he receives such compensation; and, where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

Analysis: The 'finder of lost goods can ask for reimbursement for expenditure incurred for preserving the goods but also for searching the true owner. If the real owner refuses to pay compensation, the 'finder' cannot sue but retain the goods so found.

Further where the real owner has announced any reward, the finder is entitled to receive the reward. The right to collect the reward is a primary and a superior right even more than the right to seek reimbursement of expenditure.

2) **When finder of thing commonly on sale may sell it [Section 169]:** When a thing which is commonly the subject of sale if lost, if the owner cannot with reasonable diligence be found, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it—
   a. when the thing is in danger of perishing or of losing the greater part of its value, or
   b. when the lawful charges of the finder in respect of the thing found amount to two-thirds of its value.

Analysis: The finder though has no right to sell the goods found in the normal course, he may sell the goods if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:

   a) when the article is in danger of perishing and losing the greater part of the value or

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b) when the lawful charges of the finder amount to two-third or more of the value of the article found.

1.8.9 GENERAL LIEN AND PARTICULAR LIEN

1) **Bailee's particular lien [Section 170]**: Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.

   Example 1: A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

   Example 2: A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months' credit for the price. B is not entitled to retain the coat until he is paid.

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

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

2) **General lien of bankers, factors, wharfingers, attorneys and policy brokers [Section 171]**: Bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to the effect.

   Analysis: Bankers, factors, wharfingers, policy brokers and attorneys of law have a general lien in respect of goods which come into their possession during the course of their profession.

   For instance, a banker enjoys the right of a general lien on cash, cheques, bills of exchange and securities deposited with him for any amounts due to him. For instance, 'A' borrows Rs. 500/- from the bank without security and subsequently again borrows another Rs. 1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned Rs. 1000/- being the

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second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

Under the right of general lien, the goods cannot be sold but can only be retained for dues. The right of lien can be waived through a contract.

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 labour or skill.	It comes into play only when some **labour 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**, eg, 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

1.8.10 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".

Analysis: Pledge is a variety or specie of bailment. It is bailment of goods as security for payment of debt or performance of a promise. The person who pledges [or bails] is known as pledgor or also as pawnor, the bailee is known as pledgee or also as pawnee. In pledge, there is no change in ownership of the property. Under exceptional circumstances, the pledgee has a right to sell the property pledged. Section 172 to 182 of the Indian Contract Act,1872 deal specifically with the bailment of pledge.

Example: A lends money to B against the security of jewellery deposited by B with him i.e. A. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor and A is a pawnee.

ESSENTIALS 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:

a. There shall be a bailment for security against payment or performance of the promise,
b. The subject matter of pledge is goods,
c. Goods pledged for shall be in existence,
d. There shall be the delivery of goods from pledger to pledgee,

Essentials of contract of pledge:

- There must be bailment for security for payment of debt/ performance of a promise.
- Goods must be the subject matter of the contract of pledge.
- The goods pledged must be in existence.
- There must be a delivery of goods from pawnor to pawnee

Pawnee's rights:

Rights of Pawnee can be classified as under the following headings:

1) **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.
   Example: Where 'M' pledges stock of goods for certain loan from a bank, the bank has a right to retain the stock not only for adjustment of the loan but also for payment of interest.
2) **Right to retention of subsequent debts [Section 174]**: The Pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the Pawnee.
3) **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. For such expenses, however, he does not have the right to retain the goods.
4) **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 may bring a suit against the pawnor upon the debt or promise, and retain the goods

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pledged as a collateral security; or he may sell the thing pledged on giving the pawnor reasonable notice of the sale.

If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

Rights of a pawnor

As the bailor of goods pawnor has all the rights of the bailor. Along with that he also has the right of redemption to the pledged goods which is enumerated under Section 177 of the Act.

Right to redeem [Section 177]: 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:

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

Duties of a Pawnor

Pawnor has the following duties:

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

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1.8.11 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 Bonafede pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left.

1) **Pledge by mercantile agent [Section 178]:** Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the Pawnor has no authority to pledge.

Explanation: In this section, the expressions 'mercantile agent and documents of title' shall have the meanings assigned to them in the Sale of Goods Act, 1930.

Analysis: Though generally only an owner of goods can pledge, the Act recognizes the right of certain mercantile agents to pledge provided it is done with the consent of the owner of the goods. Such a pledge done in the ordinary course of business is valid. Pledge in this case can be affected through pledge of documents like a bill of lading or a railway receipt etc.

The necessary conditions of validity under the section 178 are as follows:

i. The person pledging the goods must be a mercantile agent,
ii. Mercantile agent must be in possession either of the goods or the documents of title to goods,
iii. Such possession must be with the consent of the owner. If possession has been obtained dishonestly or by a trick, a valid pledge cannot be affected,
iv. Pledge must have been made by the mercantile agent, when acting in the ordinary course of business of a mercantile agent,
v. The pledgee must act in good faith.
vi. The pledgee should have no notice of the pledger's defect of title. If the pledgee knows that the pledger has a defective title, the pledge will not be valid.

2) **Pledge by person in possession under voidable contract [Section 178A]:** When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, 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.

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3) **Pledge where pawnor has only a limited interest [Section 179]**: Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

4) **Pledge by a co-owner in possession**: Where the goods are owned by many people 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.

5) **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.

For example, A buys a cycle from B. But leaves the cycle with the seller. B then pledges the cycle with C, who does not know of sale to B, and acted in good faith. This is valid pledge.

DISTINCTION BETWEEN BAILMENT AND PLEDGE

S.no	Basis of Distinction	Bailment	Pledge
1	*Meaning*	Transfer of goods by one person to another for some specific purpose is known as bailment	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.
2	*Terms Applicable*	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"
3	*Purpose*	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods)	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise.
4	*Consideration*	The bailment may be made for consideration or without consideration	Pledge is always made for a consideration.
5	*Right to sell the goods*	The bailee has no right to sell the goods even if the charges of bailment are not paid to	The pawnee has right to sell the goods if the pawnor fails to redeem

		him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed	the goods.
6.	*Right to use of goods*	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledgee or Pawnee cannot use the goods pledged.

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3. Agency

1.8.1 Introduction

An agency relationship is established when one party (agent) is authorized by another party (principal) to act on his/ her behalf.

An agent has the potential to form contracts on behalf of the principal and in doing so, will bind the principal.

It is a relation of trust and confidence.

What is Agency?

The Indian Contract Act,1872 does not define the word 'Agency'.

But it does define the term **'agent'** as "a person employed to do any act for another or to represent another in dealings with third persons".

The person for whom the act is done or who is so represented is called **"Principal"**. [Section 182].

Test of Agency

(i) Whether the person has the capacity to bind the principal and make him answerable to the third party → **bind him in legal relationship**

(ii) Whether he can establish Privity of Contract between the principal and third parties→ **i.e, there is right to sue between principal and 3rd party**
Relevant Maxim →The Rule of Agency is based on the maxim ***"Qui facit per alium, facit per se"*** i.e., he who acts through an agent is himself acting.

1.8.2 Appointment and Authority of Agents

Who may employ an agent [Section 183]: age of majority + sound mind	**Who may be an agent [Section 184]:** age of majority + sound mind
Consideration not necessary [Section 185]: no consideration is necessary to create an agency acceptance of the office of an agent is sufficient consideration	

Example:

P appoints Q, a minor, to sell his car for not less than Rs. 2,50,000. Q sells it for Rs. 2,00,000. P will be held bound by the transaction and further shall have no right against Q for claiming the compensation for having not obeyed the instructions, since Q is a minor and a contract with a minor is 'void-ab-initio'.

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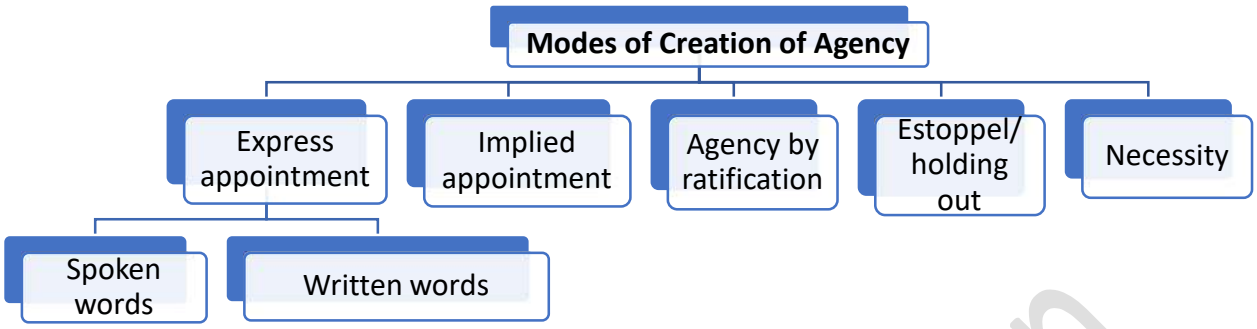
1.8.3 Creation of Agency



I. **Express appointment (S: 187)**

Given by words, spoken, or written. Eg: by deeds or orally

II. **Implied Authority (S: 187):**

Inferred from

- the circumstances of the case.
- things spoken or written,
- or in the ordinary course of dealing

Example 1: If a person realizes rent and gives it to the landlord, he impliedly acts for the landlord as an agent.

III. **Agency by Estoppel [Section 237]:**

when one person by representation, act or omission has intentionally caused or permitted another person to believe that he is the agent of the principal, without the authority of principal→ then he shall not be allowed to deny his previous statement

Essential features of Agency by Estoppel:

- ✓ the principal must have made a representation.
- ✓ representation → express or implied.
- ✓ representation must state that the agent has an authority to do certain act although really, he has no authority.
- ✓ principal must have induced the third person by such representation
- ✓ third person must have believed the representation and made the contract

IV. **Agency by Necessity:** Thus, where an agent is authorised to do certain act, and while doing such an act, an emergency arises, he acquires an extra-ordinary or special authority to prevent his principal from loss.

Example: Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire

V. **Ratification: Rights of person as to acts done for him without his authority, Effect of ratification [Section 196]:** "Ratification" means approving a previous

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act or transaction. Where acts are done by one person on behalf of another, but without his knowledge or authority he may elect to ratify it. This will make the agency valid. Ratification may be express or implied by the conduct

Example: X who is Y's agent has on 10th January 2019 purchases goods from Z on credit without Y's permission. After the purchase, on 20th January 2019, Y tells X that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit.

Essentials of a valid Ratification

- ✓ may be expressed or Implied [Section 197]

Example (implied ratification): A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A.

Example : A, without B's authority, lends B's money to C. Afterwards B accepts interests on the money from C. B's conduct implies a ratification of the loan.

- ✓ Person ratifying must have knowledge of material facts [Section 198]

Example: A has an authority from P to buy certain goods at the market rate. He buys at a higher rate, but P accepts the purchase. Afterwards P comes to know that the goods purchased by A for P belonged to A himself. The ratification is not binding on P.

- ✓ The principal cannot ratify a part of the transaction which is beneficial to him and reject the rest. Any part of transaction which is ratified→ is deemed ratification of the whole transaction [Section 199]
- ✓ Ratification of unauthorized act cannot injure third person [Section 200]: when the interest of third parties is detrimentally affected, the principle of ratification does not apply. → **Third party cannot be put through trouble without prior authority of the principal. If done so, such acts cannot be ratified by principal.**

Example : A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

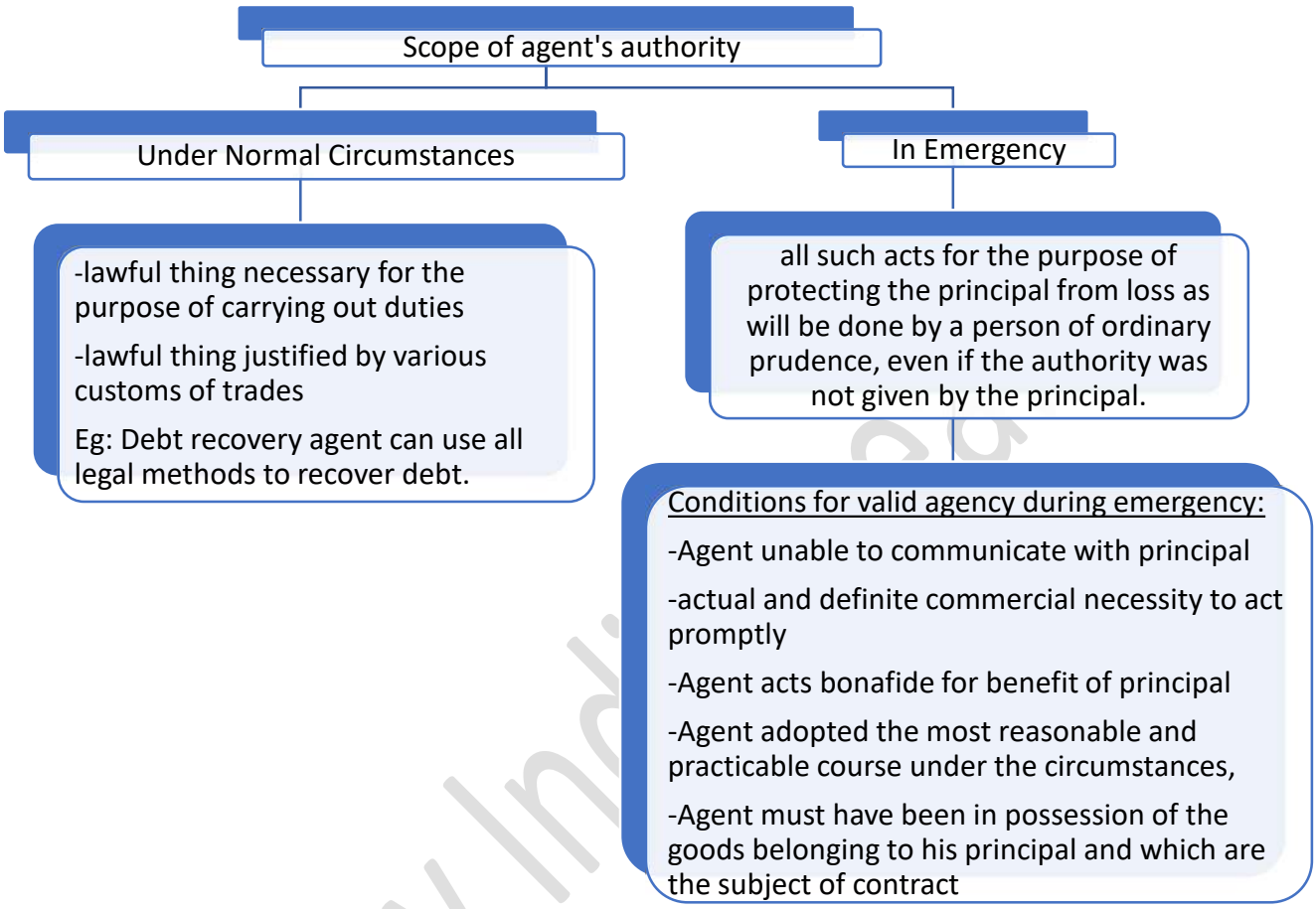
Example : A holds a lease from B, terminable on three months' notice. C, an unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

- ✓ Ratification within reasonable time
- ✓ Ratification must be communicated to the other party.
- ✓ Act to be ratified should not be void or illegal

1.8.4 Extent of Agent's Authority

The authority of an agent means his capacity to bind the principal to third parties.

The agent can bind the principal only if he acts within the scope of his authority.



Sub Agents

Meaning → Agent of an agent, ie, person employed by, and acting under the control of, the original agent

When agent cannot delegate [Section 190]? → For those acts which he has expressly or impliedly undertaken to perform personally. As a general rule→ agent cannot delegate his duties to other agents.--> "delegates non protest delegate".

1.8.5 Exception where an agent can appoint Sub-agent:

(i) Original appointment authorises such sub agent appointment
(ii) Customs of trade may allow sub agency
(iii) Unforeseen emergency arises

Representation of principal by sub-agent properly appointed [Section 192]:

- ✓ Principal is bound by the acts of sub-agent
- ✓ agent is responsible to the principal for the acts of the sub-agent
- ✓ sub-agent is responsible for his acts to the agent, but not to the principal, except in case of fraud or wilful wrong.

Agent's responsibility for sub-agent appointed without authority [Section 193]:

- ✓ agent is responsible for the acts of sub-agent to both principal and 3rd parties
- ✓ Principal is not bound by/responsible for the acts of sub- agent

Substitute Agent

- He is selected/appointed by the agent for a particular task. His name and details are confirmed and consented by the principal.
- He is not sub-agent.
- [Reason: such substitute agent may have better qualification/accessibility to perform part of the business]

1.8.6 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 substitute agent for the business entrusted. Principal is bound by his actions.

Example : A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub-agent but is A's agent for the conduct of the sale.

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. Principal shall not be responsible in case of negligence of the agent.

Example 1: A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

1.8.7 Difference between sub-agent and substitute 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

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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.

1.8.8 Duties and obligations of an Agent

(i) Duty to execute mandate: Agent should perform the work which he has been appointed to do. Otherwise he shall be liable to compensate the principal.

(ii) Duty to follow instructions or customs [section 211]: Agent must conduct business as per the instructions of the principal. In absence of instruction, he must follow general customs of business. Otherwise, loss sustained/undue profits made must be compensated back by agent to principal.

Example: B, a broker, in whose business it is not the custom to sell on credit, sells goods of an on credit to C, whose credit at the time was very high. C, before payment, becomes insolvent. B must make good the loss to A.

(iii) Duty of Reasonable care and skill [section 212] to be used in exercising all his duties. Moreover, he is liable to compensate the principal for his negligence/misconduct

Example 2: A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. A must make compensation to his principal in respect of any loss thereby sustained.

(iv) Agent' duty to communicate with principal [Section 214] and seeking his instructions in case of any difficulty in execution of his duties.

(v)Duty to Avoid Conflict of interest (Duty not to deal on his own account):

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a. **Right of principal when agent deals, on his own account, in business of agency without principals consent [Section 215]:** If an agent deals on his own account – without first obtaining the consent of his principal and acquainting him with all material circumstances →the principal may cancel the transaction, if

i. material fact has been dishonestly concealed from him or

ii. Dealings have been disadvantageous to him.

Example 1: A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

b. **Principal's right to benefit gained by agent dealing on his account in business of agency [section 216]:** If an agent deal on behalf of the principal without his knowledge, the principal is entitled to claim any benefit resulting from the transaction from the agent.

(vi) Duty not to make secret profits. Secret profit→ any advantage obtained by the agent over and above his agreed remuneration and which he would not have been able to make without his position as an agent.

(vii) Duty to render proper accounts [Section 213]→ Accounts supported with vouchers must be submitted whenever demanded by principal

(viii) Duty not to Delegate [section 190] acts which he is personally responsible to fulfil unless its required in ordinary course of trade

(ix) Agent's duty to pay sums received for principal [Section 218]→ subject to deduction of sums due to be paid to him

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

1.8.9 Rights of Agent

(i) **Right of retain out of sums received on principal's account [Section 217]:** Agent has right to retain out of any sums received on account of the principal in business, following sums:

a. all moneys due to himself

b. expenses properly incurred by him in conducting such business

c. remuneration

(ii) **Right to remuneration [Section 219]:** Such Remuneration may be as per contract or as per usual customary in business.

However, an agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the [Section 220].

Example: An employs B to recover Rs. 1, 00,000 from C. Through B's misconduct the money is not recovered. B is entitled to no remuneration for his services and

must make good the loss.

(iii) **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.

Conditions:

- ✓ agent should be lawfully entitled to receive remuneration/commission from the principal
- ✓ Property belongs to the principal
- ✓ Property have been received by the agent in his capacity and during the course of his ordinary duties as agent.
- ✓ Agent has only a particular/specific lien (means lien can be exercised only against a particular property and in the given transaction. Not in general for any other transactions).

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

- ✖ Possession of the property is lost.
- ✖ Agent waives his right expressly or impliedly.
- ✖ Contract does not allow lien.

(iv) **Right to indemnity:** 'Indemnity' means security or protection against a loss or other financial burden. Principal is bound to indemnity the agent against all costs incurred in the following situations:-

a. **Right of indemnification for lawful acts [Section 222]:** Loss caused even after lawfully execution of authority (due to cancellation of contract by third party/other unforeseen event/litigation expenses)→ shall be indemnified by principal.

   Example: 'A' of Delhi appoints 'B' of Mumbai as agent to sell his merchandise. As a result, 'B' contracts to deliver the merchandise to various parties. But A fails to send the merchandise to B and B faces litigations for non- performance. Here, A is bound to protect B against the litigations and all costs

b. **Right of indemnification against acts done in good faith [Section 223]:** losses/damages caused even though agent acted in good faith→ shall be indemnified by principal. Reimbursement cannot be claimed where the agent has contravened any laws and penalty is levied.

   Example: Where P appoints A as his agent and directs him to sell certain goods which in fact do not belong to P. if third parties sue A for this act, A is entitled for reimbursement

c. **Non-liability of employer of agent to do a criminal act [section 224]:** where one person employs another to do an act which is criminal, the employer is

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not liable to the agent.

(v) **Right to compensation for injury caused by principal's neglect [Section 225]:** principal must make compensation to his agent any loss/damage caused to him due to principal's neglect or want of skill.

Example: A employs B as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskilfully put up, and B is in consequence hurt. A must make compensation to B.

1.8.10 Agent's liability to third parties

Generally, no personal liability of Agent incurred.

The liability remains that of the principal unless there is a contract to the contrary.

I. **Principal is liable/bound by for the Acts of the Agent as per authority given in contract. Legal consequences and obligations born by principal as if he entered into contract himself.[Section 226]**

II. **Principal not bound, when agent exceeds authority [Section 227]:** In such situation part of the contract which is as per authority, shall be binding on the principal.

Example: A, being owner of a ship and cargo, authorizes B to procure an insurance for 4, 00,000 on the ship. B procures 2 policies for 400000 each. Principal is liable only for premium payable on one such policy.

III. **Principal is not bound when excess of agent's authority is not separable from the authorized part of the transaction [Section 228]. Example:** A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of Rs. 6, 00,000. A may repudiate the whole transaction.

IV. **Consequences of notice given to agent [Section 229]:** Any notice given to agent during course of business would be deemed notice to principal. **Example:** A is employed by B to buy from C goods of which C is the apparent owner. In the course of sale, Agent realized that C was not owner. It is deemed notice to Principal. Hence, principal *cannot* set off payment due from C against such goods.

V. **Agent cannot personally enforce, nor be bound by, contracts on behalf of principal [Section 230]:** Agent can neither sue nor be sued on contracts made by him on his principal's behalf. Exception→

a. If the contract states otherwise.

b. sale or purchase of goods for a **merchant resident abroad/foreign principal** by agent

c. agent **does not disclose the name of his principal**

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d. Principal is minor/incompetent to contract/non-existent

VI. Rights of parties to a contract made by agent not disclosed [Section 231]:

If an agent makes a contract with a person who does not knows/suspect that he is an agent, 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.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract, if he can show that, if he had known who the principal in the contract was, he would not have entered into the contract.

VII. Performance of contract with agent supposed to be principal [Section 232]:

Where one man makes a contract with another, neither knowing nor having reasonable ground to suspect that the other is an agent, the principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example: A, who owes 50,000 rupees to B, sells 1, 00,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice worth 1L without allowing him to set off A's debt 50K.

VIII. Right of person dealing with agent personally liable [Section 233]:

In cases where the agent holds himself personally liable, but is acting for the principal, a person dealing with him may hold either him or his principal, or both of them, liable.

Example: A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

IX. 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.

X. Liability of pretended agent [Section 235]: A pretended agent is a person who represents himself to be an agent of another, when in fact he has no authority from him, whatsoever.

- If the principal ratifies his acts as agent, he has no liability.
- But if the principal refuses to ratify his acts, he becomes personally liable to third party for any loss or damage caused to him.

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XI. **Person falsely contracting agent not entitled to performance [Section 236]:** A person with whom a contract has been entered into in the character of agent, is not entitled to require the performance of it if he was in reality acting, not as agent, but on his own account. In simple words, where the person acts as an agent although he is actually the principal, he shall be denied from enforcing the performance later in the capacity of the principal

XII. **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.

Example 1: A consigns goods to B for sale and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

XIII. **Effect, on agreement, of misrepresentation or fraud by agent [Section 238]:** Misrepresentation by agents acting in the course of their business for their principals, have the same effect as if such misrepresentations or frauds had been made, or committed, by the principals. Misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

Example 1: A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

1.8.11 Modes of Termination of Agency:

i. **Revocation:** Principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal [Section 203].

Principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations as arise for acts already done in the agency. [Section 204].

Compensation for revocation by principal, or renunciation by agent [Section 205]: Where there is an express or implied contract that the agency should be continued for any period of time, the principal must make compensation to the agent for any previous revocation or renunciation of the agency without sufficient cause.

Notice of revocation or renunciation [Section 206]: Reasonable notice must be

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given of such revocation or renunciation; otherwise the damage must be made good to the one by the other

Revocation and renunciation may be expressed or implied [Section 207]: Example: A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

ii. **Renunciation by agent [Section 206]:** An agent may renounce the business of agency.

Agency is for a fixed period; the agent would have to compensate the principal for any premature renunciation without sufficient cause. [S. 205]

Reasonable notice of renunciation is necessary. If the agent renounces without proper notice, he shall have to make good any damage thereby resulting to the principal. [S. 206]

iii. **Completion of business between agent and principal →** agency ends

iv. **Death or insanity of agent or principal→** agency ends

v. **Principal's insolvency→** agency ends

vi. **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 purpose fulfilled or not.

1.8.12 When the agency is irrevocable?

Section 202 states that where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

Example: A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

1.8.13 Effects of Termination [Section 208]

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.

Example 1: A directs B to sell goods for him and agrees to give B five per cent commission on the price fetched by the goods. An afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it sells the goods for Rs. 1,00,000. The sale is binding on A, and B is entitled to Rs. 5,000 as his commission.

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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.

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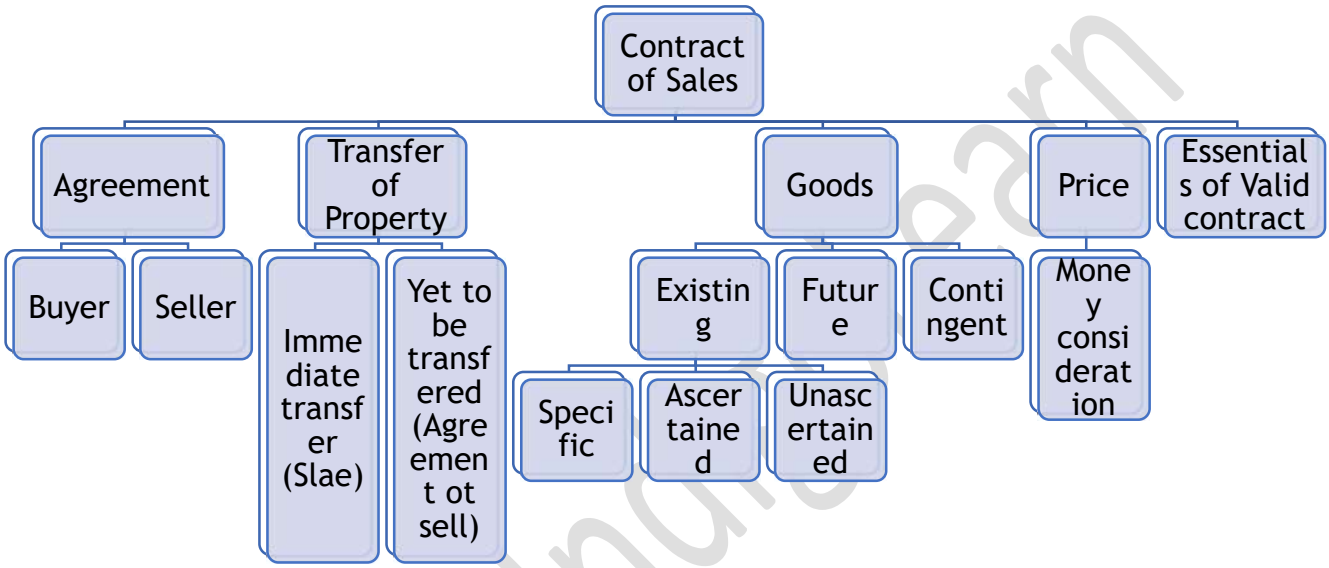
2. The Sale of Goods Act, 1930

2.1 Definition

2.1.1 Introduction

Sale of Goods Act, 1930 is the Act to define and amend the law relating to the sale of goods. It extends to the whole of India except the State of Jammu and Kashmir. It came into force on 1st July 1930.



The Sale of Goods Act, 1930 defines the terms which have been frequently used in the Act, which are as follows –



(A) **Buyer and Seller:** ***'Buyer'*** means a person who buys or agr [Section 2(1)]. ***'Seller'*** means a person who sells or agre [Section 2(13)]. The two terms, 'buyer' and 'seller' are cor represent the two parties to a contract of sale of goods. Bot however, used in a sense wider than their common meani person who buys but also the one who agrees to buy is a bu 'seller' means not only a person who sells but also a person who agrees to sell.

(B) **Goods and other related terms:**

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

This is a wider definition than contained in the English law, which does not consider 'stock' and 'shares' as goods, though it includes a ship.

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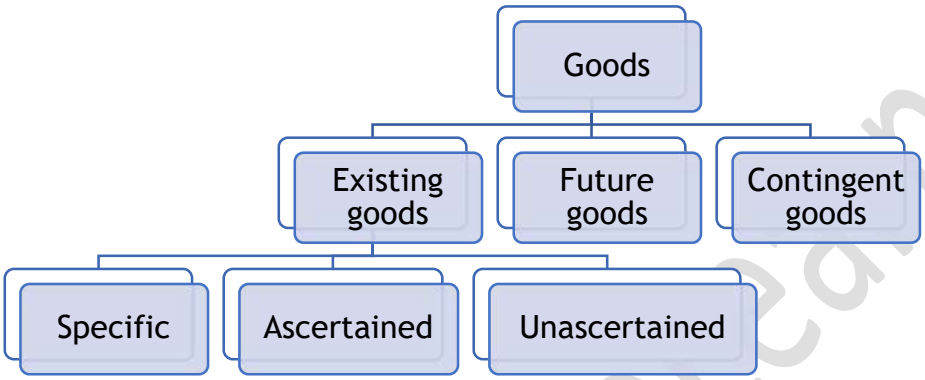
'Actionable claims' are claims, which can be enforced only by an action or suit, e.g., debt. A debt is not a movable property or goods. Even the Fixed Deposit Receipts (FDR) are considered as goods under Section 176 of the Indian Contract Act read with Section 2(7) of the Sales of Goods Act.

2.1.2 Classification of Goods



(i) **EXISTING GOODS** are such goods as are in existence at the time of the contract of sale, i.e., those owned or possessed by the seller at the time of 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)].**

Example 1: Any specified and finally decided goods like a Samsung Galaxy S7 Edge, Whirlpool washing machine of 7 kg etc.

Example 2: 'A' had five cars of differentmodels. He agreed to sell his 'fiat' car to 'B' and 'B' agreed to purchase the same car. In this case, the sale is for specific goods as the car has been identified and agreed at the time of the contract of sale.

(b) **Ascertained Goods** are those goods which are identified in accordance with the agreement after the contract of sale is made. This term is not defined in the Act but has been judicially interpreted. In actual practice the term 'ascertained goods' is used in the same sense as 'specific goods.' When from a lot or out of large quantity of unascertained goods, the number or quantity contracted for is identified, such identified goods are called ascertained goods.

Example: A wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside. On selection the goods becomes ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract. It may be noted that before the

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ascertainment of the goods, the contract was for the sale of unascertained goods.

(c) **Unascertained goods** are the goods which are not specifically identified or ascertained at the time of making of the contract. They are indicated or defined only by description or sample.

Example: If A agrees to sell to B one packet of salt out of the lot of one hundred packets lying in his shop, it is a sale of unascertained goods because it is not known which packet is to be delivered. As soon as a particular packet is separated from the lot, it becomes ascertained or specific goods.

(ii) **FUTURE GOODS mean, goods to be manufactured or produced or acquired by the seller after making the contract of sale [Section 2 (6)].**

A contract for the sale of future goods is always an agreement to sell. It is never actual sale because a man cannot transfer what is not in existence.

Example 1: 1,000 quintals of potatoes to be grown on A's field, is not illegal, though the actual sale of future goods is not possible. This is an example of agreement to sell.

Example 2: P agrees to sell to Q all the milk that his cow may yield during the coming year. This is a contract for the sale of future goods.

Example 3: T agrees to sell to S all the oranges which will be produced in his garden this year. It is contract of sale of future goods, amounting to 'an agreement to sell.'

(iii) **CONTINGENT GOODS:** The acquisition of which by the seller depends upon an uncertain contingency (uncertain event) are called 'contingent goods' [Section 6(2)].

Contingent goods also operate as 'an agreement to sell' and not a 'sale' so far as the question of passing of property to the buyer is concerned. In other words, like the future goods, in the case of contingent goods also, the property does not pass to the buyer at the time of making the contract.

Example: A agrees to sell to B a Picasso painting provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

(A) **Delivery - its forms and derivatives:** Delivery means voluntary transfer of possession from one person to another [Section 2(2)]. As a general rule, delivery of goods may be made by doing anything, which has the effect of putting the goods in the possession of the buyer, or any person authorized to hold them on his behalf.

Forms of delivery: Following are the kinds of delivery for transfer of possession:

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Delivery of goods

Voluntary transfer of possession by one person to another		
Actual delivery	Constructive delivery	Symbolic delivery

a. **Actual delivery:** When the goods are physically delivered to the buyer.

b. **Constructive delivery:** When it is effected without any change in the custody or actual possession of the thing as in the case of delivery by attornment (acknowledgement) e.g., where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request.

c. **Symbolic delivery:** When there is a delivery of a thing in token of a transfer of something else, i.e., delivery of goods in the course of transit may be made by handing over documents of title to goods, like bill of lading or railway receipt or delivery orders or the key of a warehouse containing the goods is handed over to buyer.

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)]. For example, when A contracts to sell timber and make bundles thereof, the goods will be in a deliverable state after A has put the goods in such a condition.

(B) "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 or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented. [Section 2(4)]

Examples: Bill of lading, dock warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, warrant, an order of delivery of goods. The list is only illustrative and not exhaustive. Any other document which has the above characteristics also will fall under the same category. Though a bill of lading is a document of title, a mate's receipt is not; it is regarded at law as merely an acknowledgement for the receipt of goods. A document amounts to a document of title only where it shows an unconditional undertaking to deliver the goods to the holder of the document.

However, there is a **difference between a 'document showing title' and 'document of title'. A share** certificate is a 'document' showing title but not a document of title. It merely shows that the person named in the share certificate is entitled to the share represented by it, but it does not allow

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that person to transfer the share mentioned therein by mere endorsement on the back of the certificate and the delivery of the certificate.

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

Examples of such kind of agents are auctioneers, factors, brokers, etc.

(D) **Property [Section 2(11)]:** 'Property' here means 'ownership' or general property. In every contract of sale, the ownership of goods must be transferred by the seller to the buyer, or there should be an agreement by the seller to transfer the ownership to the buyer. It means the general property (right of owner-ship-in-goods) and not merely a special property.

The property in the goods means the general property i.e., all ownership right of the goods. Note that the 'general property' in goods is to be distinguished from a 'special property'. It is quite possible that the general property in a thing may be in one person and a special property in the same thing may be in another e.g., when an article is pledged. The general property in a thing may be transferred, subject to the special property continuing to remain with another person i.e., the pledgee who has a right to retain the goods pledged till payment of the stipulated dues.

Example: If A who owns certain goods pledges them to B, A has general property in the goods, whereas B has special property or interest in the goods to the extent of the amount of advance he has made.

(E) **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.

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

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

2.1.3 Sale and Agreement to sale (Section 4)

According to 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". There may be a contract of sale between one part- owner and another.

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, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

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[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)]**

Analysis

A contract for the sale of goods may be either sale or agreement to sell.

Sale: In Sale, the property in goods is transferred from seller to the buyer immediately. The term sale is defined in the Section 4(3) of the Sale of Goods Act, 1930 as – "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."

Agreement to Sell: In an agreement to sell, the ownership of the goods is not transferred immediately. It is intending to transfer at a future date upon the completion of certain conditions thereon. The term is defined in Section 4(3) of the Sale of Goods Act, 1930, as – "where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell."

Thus, whether a contract of sale of goods is an absolute sale or an agreement to sell, depends on the fact whether it contemplates immediate transfer from the seller to the buyer or the transfer is to take place at a future date.

When agreement to sell becomes sale: 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.

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.
The subject matter of the contract must necessarily be goods covering only movable property. It may be either existing goods, owned or possessed by the seller or future goods.

(i) A price in money (not in kind) should be paid or promised. But there is nothing to prevent the consideration from being partly in money and partly in kind.

(ii) A transfer of property in goods from seller to the buyer must take place.
The contract of sale is made by an offer to buy or sell goods for a price by one party and the acceptance of such offer by other.

(iii) A contract of sale may be absolute or conditional.
All other essential elements of a valid contract must be present in the contract of sale, e.g. competency of parties, legality of object and consideration etc.

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2.1.4 DISTINCTION BETWEEN SALE AND AN AGREEMENT TO SELL

Sale and Hire Purchase: Contract of sale resembles with contracts of hire purchase very closely, and indeed the real object of a contract of hire purchase is the sale of the goods ultimately.

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

(a) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and

(b) The property in the goods is to pass to such person on the payment of the last of such instalments, and Such person has a right to terminate the agreement at any time before the property so passes; None the less a sale has to be distinguished from hire purchase as their legal are quite different

Basis of difference	Sale	Hire- Purchase
Time of passing property	Property in the goods is transferred to the buyer immediately at the time of contract.	The property in goods passes to the hirer upon payment of the last installment.
Position of the party	The position of the buyer is that of the owner of the goods.	The position of the hirer is that of a bailee till he pays the last installment.
Termination of contract	The buyer cannot terminate the contract and is bound to pay the price of the goods.	The hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining installments.
Burden of Risk of insolvency of the buyer	The seller takes the risk of any loss resulting from the insolvency of the buyer.	The owner takes no such risk, for if the hirer fails to pay an installment, the owner has right to take back the goods.
Transfer of title	The buyer can pass a good title to a bona *fide purchaser* from him.	The hirer cannot pass any title even to a bona fide purchaser.
Resale	The buyer in sale can resell the goods	The hire purchaser cannot resell unless he has paid all the installments.

distinction between the 'sale' and 'hire-purchase' are as follows:

(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 to the bailor or are to be disposed of according to the directions of the bailor. Provisions related to bailment are regulated by the Indian Contract Act, 1872.

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The difference between bailment and sale may be clearly understood by studying the following:

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

(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.

Example: Where gold is supplied to a goldsmith for preparing an ornament or when an artist is asked to paint a picture.

2.2 Transfer of Ownership

2.2.1 INTRODUCTION

Sale of goods involves transfer of ownership of property from seller to buyer. It is essential to determine the time at which the ownership passes from the seller to the buyer.

Importance of the time of transfer:

The general rule is that risk prima facie passes with the property. In case where goods are lost or damaged, the burden of loss will be borne by the person who is the owner at the time when the goods are lost or damaged. Where the goods are damaged by the act of the third party , it is the owner who can take action. Suit for price by the seller lies only when the property has passed to the buyer.

2.2.2 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

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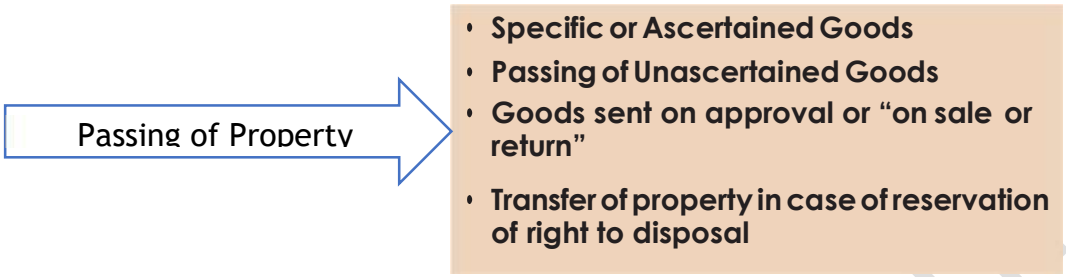
implies passing of ownership. If the property has passed to the buyer, the risk in the goods sold is that of buyer and not of seller, though the goods may still be in the seller's possession.

The primary rules determining the passing of property from seller to buyer are as follows:



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 differentintention 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:

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

   Example: X goes into a shop and buys a television and asks the shopkeeper for its home delivery. The shopkeeper agrees to do it. The television immediately becomes the property of X.

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

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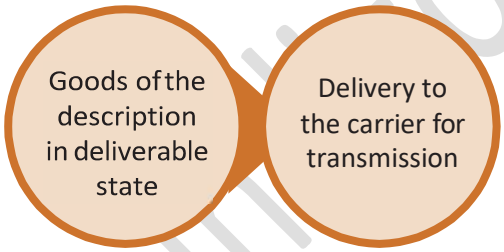
to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

Example: A sold carpets to the Company which were required to be laid. The carpet was delivered to the company's premises but was stolen before it could be laid. It was held that the carpet was not in deliverable state as it was not laid, which was part of the contract and hence, the property had not passed to the buyer company.

B. Goods must be ascertained

Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained. **[Section 18]**

The rules in respect of passing of property of unascertained goods are as follows:



1. **Sale of unascertained goods by description [Section 23(1)]:** Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be express or implied and may be given either before or after the appropriation is made.
2. **Delivery to the carrier [Section 23(2)]:** Where, in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.

   Example: A bill of lading of railway parcel is made out in the name of the buyer and is sent to him, the ownership in the goods passes from the seller to the buyer. In case the goods are subjected to accidental

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loss or by theft, the seller will not be liable.

Analysis of section 23:

Sale of unascertained goods and Appropriation: Appropriation of goods involves selection of goods with the intention of using them in performance of the contract and with the mutual consent of the seller and the buyer.

The essentials are:

a) There is a contract for the sale of unascertained or future goods
b) The goods should conform to the description and quality stated in the contract.
c) The goods must be in a deliverable state.
d) The goods must be unconditionally (as distinguished from an intention to appropriate) appropriated to the contract either by delivery to the buyer or his agent or the carrier.
e) The appropriation must be made by:
    (i) the seller with the assent of the buyer; or
    (ii) the buyer with the assent of the seller.
f) The assent may be express or implied.
g) The assent may be given either before or after appropriation.

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

When goods are delivered to the buyer on approval or "on sale or return" or other similar terms, the property therein passes to the buyer-

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

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

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

Example 1: P brought a musical instrument from a musical shop on a condition that he will purchase it, if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument. The ownership is transferred when he has decided to purchase the instrument as his own.

A buyer under a contract on the basis of 'sale or return' is deemed to have exercised his option when he does any act exercising domination over the goods showing an unequivocal intention to buy, example, if he pledges the

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goods with a third party. Failure or inability to return the goods to the seller does not necessarily imply selection to buy.

Example 2: 'A' delivered some jewelry to 'B' on sale or return basis. 'B' pledged the jewelry with 'C'. It was held that the ownership of the jewelry had been transferred to 'B' as he had adopted the transaction by pledging the jewelry with 'C'. In this case, 'A' has no right against 'C'. He can only recover the price of the jewelry from 'B'.

Example 3: A sends to Be a water motor on approval or return in March,2016. B to return it after trial in August,2016. The water motor has not been returned within a reasonable time, and therefore, A is not bound to accept it and B must pay the price.

D. Sale for cash only or Return

It may be noted that where the goods have been delivered by a person on "sale or return" on the terms that the goods were to remain the property of the seller till they are paid for, the property therein does not pass to the buyer until the terms are complied with, i.e., cash is paid for.

Example:'A' delivered his jewellery to'B' on sale for cash only or return basis. It was expressly provided in the contract that the jewellery shall remain 'A's property until the price is paid. Before the payment of the price, 'B' pledged the jewellery with 'C'. It was held that at the time of pledge, the ownership was not transferred to 'B'. Thus, the pledge was not valid and 'A' could recover the jewellery from 'C'.

E. Reservation of right of disposal (Section 25)

Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such case, notwithstanding the delivery of the goods to a buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled. **[Sub-section (1)]**

Where goods are shipped, or delivered to a railway administration for carriage by railway and by the bill of lading or railway receipts, as the case may be, the goods are deliverable to the order of the seller or his agent, the seller is *prima facie* deemed to reserve the right of disposal. **[Sub-section (2)]**

Where the seller of goods draws on the buyer for the price and transmits to the buyer the bill of exchange together with the bill of lading or, as the case may be, the railway receipt, to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading or the railway receipt if he does not honour the bill of exchange; and, if he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him. **[Sub-**

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section (3)]

Analysis:

This section preserves the right of disposal of goods to secure that the price is paid before the property in goods passes to the buyer.

Where there is contract of sale of specific goods or where the goods have been subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, as the case may be, reserve the right to dispose of the goods, until certain conditions have been fulfilled. In such a case in spite of the fact that the goods have already been delivered to the buyer or to a carrier or other bailee for the purpose of transmitting the same to the buyer, the property therein will not pass to the buyer till the condition imposed, if any, by the seller has been fulfilled.

Example: X sends furniture to a company by a truck and instructs the driver not to deliver the furniture to the company until the payment is made by company to him.

The property passes only when the payment is made.

Circumstances under which the right to disposal may be reserved: In the following circumstances, seller is presumed to have reserved the right of disposal:

(1) If the goods are shipped or delivered to a railway administration for carriage and by the bill of lading or railway receipt, as the case may be, the goods are deliverable to the order of the seller or his agent, then the **seller will be prima facie deemed to have reserved to the right of disposal.**

(2) Where the seller draws a bill on the buyer for the price and sends to him the bill of exchange together with the bill of lading or (as the case may be) the railway receipt to secure acceptance or payment thereof, the buyer must return the bill of lading, if he does not accept or pay the bill.

And if he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not passes to him.

It should be noted that Section 25 deals with "conditional appropriation" as distinguished from 'unconditional appropriation' dealt with under Section 23 (2).

2.2.3 RISK *PRIMA FACIE* PASSES WITH PROPERTY (SECTIONS 26)

According to section 26, unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not:

Provided that, where delivery has been delayed through the fault of either buyer

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or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as bailee of the goods of the other party.

According to section 26, unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not:

Provided that, where delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as bailee of the goods of the other party.

2.2.4 TRANSFER OF TITLE (SECTIONS 27 – 30)

Sale by person not the owner (Section 27): Subject to the provisions of this Act and of any other law for the time being in force, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell.

Provided that, where a mercantile agent is, with the consent of the owner, in possession of the goods or of a document of title to the goods, any sale made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the buyer acts in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell.

Analysis:

In general the seller sells only such goods of which he is the absolute owner. But sometimes a person may sell goods of which he is not the owner, then the question arises as to what is the position of the buyer who has bought the goods by paying price. The general rule regarding the transfer of title is that the seller cannot transfer to the buyer of goods a better title than he himself has. 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.

Example 1: If A sells some stolen goods to B, who buys them in good faith, B will get no title to that and the true owner has a right to get back his goods from B.

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Example 2: P, the hirer of vehicle under a hire purchase agreement, sells them to Q. Q, though a bona fide purchaser, does not acquire the ownership in the vehicle. At the most he acquires the same right as that of the hirer.

If this rule is enforced rigidly then the innocent buyers may be put to loss in many cases. Therefore, to protect the interests of innocent buyers, a number of exceptions have been provided to this rule.

Exceptions: In the following cases, a non-owner can convey better title to the bona fide purchaser of goods for value.

(1) **Sale by a Mercantile Agent:** A sale made by a mercantile agent of the goods for document of title to goods would pass a good title to the buyer in the following circumstances: namely.

(a) If he was in possession of the goods or documents with the consent of the owner.

(b) If the sale was made by him when acting in the ordinary course of business as a mercantile agent; and

(c) If the buyer had acted in good faith and has at the time of the contract of sale, no notice of the fact that the seller had no authority to sell **(Proviso to Section 27).**

(2) **Sale by one of the joint owners (Section 28):** If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them of such joint owner in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell.

Example: A, B, and C are three brothers and joint owners of a T.V and VCR and with the consent of B and C, the VCR was kept in possession of A. A sells the T.V and VCR to P who buys it in good faith and without notice that A had no authority to sell. P gets a good title to VCR and TV.

(3) **Sale by a person in possession under voidable contract:** A buyer would acquire a good title to the goods sold to him by a seller who had obtained possession of the goods under a contract voidable on the ground of coercion, fraud, misrepresentation or undue influence provided that the contract had not been rescinded until the time of the sale **(Section 29).**

Example: X fraudulently obtains a diamond ring from Y. This contract is voidable at the option of Y. But before the contract could be terminated, X sells the ring to Z, an innocent purchaser. Z gets the good title and Y cannot recover the ring from Z even if the contract is subsequently set aside.

(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

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them or of the documents of title to them, he may sell them to a third person, and if such person obtains the delivery thereof in good faith and without notice of the previous sale, he would have good title to them, although the property in the goods had passed to the first buyer earlier. A pledge or other disposition of the goods or documents of title by the seller in possession are equally valid **[Section 30(1)].**

Example: During ICL matches, P buys a TV set from R. R agrees to deliver the same to P after some days. In meanwhile R sells the same to S, at a higher price, who buys in good faith and without knowledge about the previous sale. S gets a good title.

(5) **Sale by buyer obtaining possession before the property in the goods has vested in him:** Where a buyer with the consent of the seller obtains possession of the goods before the property in them has passed to him, he may sell, pledge or otherwise dispose of the goods to a third person, and if such person obtains delivery of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods, he would get a good title to them **[Section 30(2)].**

However, a person in possession of goods under a 'hire-purchase' agreement which gives him only an option to buy is not covered within the section unless it amounts to a sale.

Example: A took a car from B on this condition that A would pay a monthly installment of Rs. 5,000 as hire charges with an option to purchase it by payment of Rs. 1,00,000 in 24 installments.

After the payment of few installments, A sold the car to C. B can recover the car from C since A had neither bought the car, nor had agreed to buy the car. He had only an option to buy the car.

(6) **Effect of Estoppel:** Where the owner is estopped by the conduct from denying the seller's authority to sell, the transferee will get a good title as against the true owner. But before a good title by estoppel can be made, it must be shown that the true owner had actively suffered or held out the other person in question as the true owner or as a person authorized to sell the goods.

Example: 'A' said to 'B', a buyer, in the presence of 'C' that he (A) is the owner of the horse. But 'C' remained silent though the horse belonged to him. 'B' bought the horse from 'A'. Here the buyer (B) will get a valid title to the horse even though the seller (A) had not title to the horse. In this case, 'C', by his own conduct, is prevented from denying 'A's authority to sell the horse.

(7) **Sale by an unpaid seller:** Where an unpaid seller who had exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a

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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.

(i) Purchase of goods from a finder of goods will get a valid title under circumstances [Section 169 of the Indian Contract Act, 1872]

(ii) A sale by pawnee can convey a good title to the buyer [Section 176 of the Indian Contract Act, 1872]

2.2.5 PERFORMANCE OF THE CONTRACT OF SALE (SECTIONS 31 - 44)

(a) **Definition of Delivery [section 2(2)]:** Delivery means voluntary transfer of possession from one person to another.

Thus, if the possession is taken through unfair means, there is no delivery of the goods. Delivery of goods sold may be made by doing anything which the parties agree, shall be treated as delivery or putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.

Duties of seller and buyer (Section 31): It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale.

Payment and delivery are concurrent conditions (Section 32): Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.

Rules Regarding Delivery of goods (Section 33-41)

The Sale of good Act, 1930 prescribes the following rules of 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: A delivery of part of goods, in progress of the delivery of the whole has the same effect, for the purpose of passing the property in such goods, as a delivery of the whole; 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. **(Section 34)**

Example: Certain goods lying at wharf were sold in a lot. The seller

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instructed the wharfinger to deliver them to the buyer who had paid for them and the buyer, thereafter, accepted them and took away part. Held, there was delivery of the whole.

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

(iv) **Place of delivery:** Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each case on the contract, express or implied, between the parties. Apart from any such contract, 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 or if 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, but no time for sending them is fixed, the seller is bound to send them within a reasonable time. **[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. What is reasonable hour is a question of fact. **[Section 36(4)].**

(viii) **Expenses for delivery:** The expenses of and incidental to putting the goods into a deliverable state must 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 a quality of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate. **[Sub-section (1)]**

Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, 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 at the contract rate. **[Sub- section (2)]**

Where the seller delivers to the buyer the goods he contracted to sell

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mixed with goods of a differentdescription not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject, or may reject the whole. **[Sub-section (3)]**

The provisions of this section are subject to any usage of trade, special agreement or course of dealing between the parties. **[Sub-section (4)]**

Example: A agrees to sell 100 quintals of wheat to B at Rs. 1,000 per quintal. A delivers 1,100 quintals. B may reject the whole lot or accept only 1,000 quintals and reject the rest or accept the whole lot and pay for them at the contract of sale.

(x) **Instalment deliveries:** Unless otherwise agreed, the buyer is not bound to accept delivery in instalments. The rights and liabilities in cases of delivery by instalments and payments thereon may be determined by the parties of contract. **(Section 38)**

(xi) **Delivery to carrier:** Subject to the terms of contract, 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, though the seller agrees to deliver at his own risk. **(Section 40)**

Example: P sold to Q a certain quantity of iron rods which was to be sent by proper vessel. It was rusted before it reached the buyer. The rust of the rod was so minimal and was not effecting the merchantable quality and the deterioration was not necessarily incidental to its transmission. It was held that Q was bound to accept the goods.

(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 in order to ascertain whether they are in conformity with the contract. Unless otherwise agreed, the seller is bound, on request, to afford the buyer a reasonable opportunity of examining the goods. **(Section 41)**

2.2.6 Rule related to Acceptance of Delivery of Goods (Section 42):

The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller, or when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

Analysis:

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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.

2.2.7 Buyer not bound to return rejected goods (Section 43):

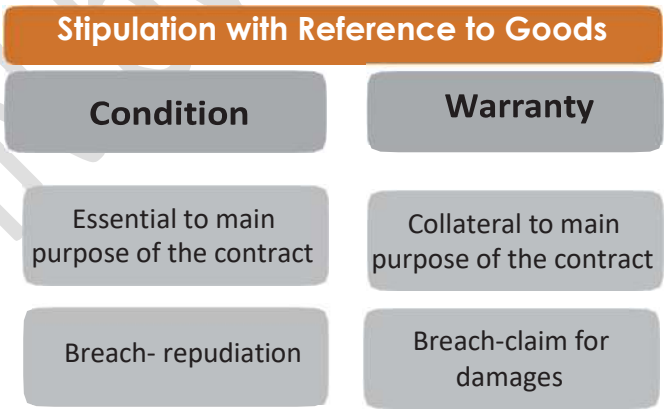
Unless otherwise agreed, where goods are delivered to the buyer and he refuses to accept them, having the right so to do, he is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them.

2.2.8 Liability of buyer for neglecting or refusing delivery of goods (Section 44):

When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not within a reasonable time after such request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery and also for a reasonable charge for the care and custody of the goods.

Provided further that nothing in this section shall affect the rights of the seller where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.

2.3 Conditions and Warranties



2.3.1 STIPULATION AS TO TIME (SECTION 11)

Stipulations as to time: Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be of the essence of a contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

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Analysis:

As regard time for the payment of price, unless a different intention appears from the terms of contract, stipulation as regard this, is not deemed to be of the essence of a contract of sale. But delivery of goods must be made without delay. Whether or not such a stipulation is of the essence of a contract depends on the terms agreed upon.

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

2.3.2 INTRODUCTION

At the time of selling the goods, a seller usually makes certain statements or representations with a view to induce the intending buyer to purchase the goods. Such representations are generally about the nature and quality of goods, and about their fitness for buyer's purpose.

When these statements or representations do not form a part of the contract of sale, they are not relevant and have no legal effects on the contract. But when these form part of the contract of sale and the buyer relies upon them, they are relevant and have legal effects on the contract.

A representation which forms a part of the contract of sale and affects the contract, is called a stipulation. However, every stipulation is not of equal importance.

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)]

Example: Ram consults Shyam, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Shyam suggests 'Maruti' and Ram accordingly buys it from Shyam. The car turns out to be unfit for touring purposes. Here the term that the 'car should be suitable for touring

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purposes' is a condition of the contract. It is so vital that its non-fulfilment defeats the very purpose for which Ram purchases the car. Ram is therefore entitled to reject the car and have refund of the price.

Let us assume Ram buys a new Maruti car from the show room and the car is guaranteed against any manufacturing defect under normal usage for a period of one year from the date of original purchase and in the event of any manufacturing defect there is a warranty for replacement of defective part if it cannot be properly repaired. After six months Ram finds that the horn of the car is not working, here in this case he cannot terminate the contract. The manufacturer can either get it repaired or replaced it with a new horn. Ram gets a right to claim for damages, if any, suffered by him but not the right of repudiation.

Difference between conditions and warranties:

The following are important differences between conditions and warranties.

Point of differences	Condition	Warranty
Meaning	A condition is essential to the main purpose of the contract.	It is only collateral to the main purpose of the contract.
Right in case of breach	The aggrieved party can repudiate the contract or claim damages or both in the case of breach of condition.	The aggrieved party can claim only damages in case of breach of warranty.
Conversion of stipulations	A breach of condition may be treated as a breach of warranty.	A breach of warranty cannot be treated as a breach of condition.

2.3.3 WHEN CONDITION TO BE TREATED AS WARRANTY (SECTION 13)

Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated. [Sub-section (1)]

Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect. [Sub-section (2)]

Nothing in this section shall affect the case of any condition or warranty

fulfilment of which is excused by law by reason of impossibility or otherwise. [Sub-section (3)]

Analysis:

Section 13 specifies cases where a breach of condition be treated as a breach of warranty. As a result of which the buyer loses his right to rescind the contract and can claim for damages only.

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. A party may for his own benefit, waive a stipulation.

(ii) Where the buyer elects to treat the breach of the conditions, as one of a warranty. That is to say, he may claim only damages instead of repudiating the contract.

Example: A agrees to supply B 10 bags of first quality sugar @ Rs. 625 per bag but supplies only second quality sugar, the price of which is Rs. 600 per bag. There is a breach of condition and the buyer can reject the goods. But if the buyer so elects, he may treat it as a breach of warranty, accept the second quality sugar and claim damages @ Rs. 25 per bag.

(iii) Where the contract is non-severable, and the buyer has accepted either the whole goods or any part thereof. Acceptance means acceptance as envisaged in Section 72 of the Indian Contract Act, 1872.

(iv) Where the fulfilment of any condition or warranty is excused by law by reason of impossibility or otherwise.

2.3.4 EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES (SECTION 14-17)

'Conditions' and 'Warranties' may be either **express or implied**. They are "express" when the terms of the contract expressly state them. They are implied when, not being expressly provided for.

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

The **implied conditions**, on the other hand, are those, which are presumed by law to be present in the contract. It should be noted that an implied condition may be negated or waived by an express agreement.

b) **Implied Conditions:** Following conditions are implied in a contract of sale of goods unless the circumstances of the contract show a different intention.

(i) **Condition as to title [Section 14(a)].** In every contract of sale, unless there is an agreement to the contrary, the first implied condition on the part of the seller is that

(a) in case of a sale, he has a right to sell the goods, and

(b) in the case of an agreement to sell, he will have right to sell the goods at the time when the property is to pass.

In simple words, the condition implied is that the seller has the right to sell the goods at the time when the property is to pass. If the seller's title turns out to be defective, the buyer must return the goods to the true owner and recover the price from the seller.

Example 1: A purchased a tractor from B who had no title to it. After 2 months, the true owner spotted the tractor and demanded it from A. Held that A was bound to hand over the tractor to its true owner and that A could sue B, the seller without title, for the recovery of the purchase price.

Example 2: If A sells to B tins of condensed milk labelled 'C.D.F. brand', and this is proved to be an infringement of N Company's trade mark, it will be a breach of implied condition that A had the right to sell. B in such a case will be entitled to reject the goods or take ou the labels, and claim damages for the reduced value. If the seller has no title and the buyer has to make over the goods to the true owner, he will be entitled to refund of the price.

(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. This rule is based on the principle that "if you contract to sell peas, you cannot compel the buyer to take beans." The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods.

Thus, it has to be determined whether the buyer has undertaken to purchase the goods by their description, i.e., whether the description was essential for identifying the goods where the buyer had agreed to purchase. If that is required and the goods tendered do not correspond with the description, it would be breach of condition entitling the buyer to reject the goods.

It is a condition which goes to the root of the contract and the breach of it entitles the buyer to reject the goods whether the buyer is able to inspect them or not.

Example 1: A at Kolkata sells to B twelve bags of "waste silk" on its way from Murshidabad to Kolkatta. There is an implied condition that the silk shall be such as is known in the market as "Waste Silk". If it not, B is entitled to reject the goods.

Example 2: A ship was contracted to be sold as "copper-fastened vessel" but actually it was only partly copper-fastened. Held that goods did not correspond to description and hence could be returned or if buyer took the

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goods, he could claim damages for breach.

The Act, however, does not define 'description'. A sale has been deemed to be by the description

(i) where the class or kind to which the goods belong has been specified, e.g., 'Egyptian cotton', "java sugar", "Shfleld crockery", etc., and

(ii) where the goods have been described by certain characteristics essential to their identification, e.g., jute bales of specified shipment, steel of specific dimension, etc.

It may be noted that the description in these cases assumes that form of a statement or representation as regards the identity of particular goods by reference to the place of origin or mode of packing, etc. Whether or not such a statement or representation is essential to the identity of the goods is a question of fact depending, in each case, on the construction of the contract.

(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,

Example: In a case of sale by sample of two parcels of wheat, the seller allowed the buyer an inspection of the smaller parcel but not of the larger parcel. In this case it was held that the buyer was entitled to refuse to take any latent of the parcels of wheat.

(a) the goods shall be free from any defect rendering them un-merchantable, which would not be apparent on reasonable examination of the sample. This condition is applicable only with regard to defects, which could not be discovered by an ordinary examination of the goods. But if the defects are latent, then the buyer can avoid the contract.

Example: A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of the price plus damages.

(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. In case the goods correspond with the sample but do not tally with description or vice versa or both, the buyer can repudiate the contract.

Example: A agreed with B to sell certain oil described as refined sunflower

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oil, warranted only equal to sample. The goods tendered were equal to sample but contained a mixture of hemp oil. B can reject the goods.

(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.

However, the condition as to the reasonable fitness of goods for a particular purpose may be implied if the buyer had made known to the seller the purpose of his purchase and relied upon the skill and judgment of the seller to select the best goods and the seller has ordinarily been dealing in those goods. Even this implied condition will not apply if the goods have been sold under a trademark or a patent name.

Example 1: 'A' bought a set of false teeth from 'B', a dentist. But the set was not fit for 'A's mouth. 'A' rejected the set of teeth and claimed the refund of price. It was held that 'A' was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled.

Example 2: 'A' went to 'B's shop and asked for a 'Merrit' sewing machine. 'B' gave 'A' the same and 'A' paid the price. 'A' relied on the trade name of the machine rather than on the skill and judgement of the seller 'B'. In this case, there is no implied condition as to fitness of the machine for buyer's particular purpose.

As a general rule, it is the duty of the buyer to examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable for his purpose for which he is buying them. This is known as rule of caveat emptor which means "Let the buyer beware".

(vi) **Condition as to Merchantability [Section 16(2)]:** Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality.

Provided that, if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed.

The expression "merchantable quality", though not defined, nevertheless connotes goods of such a quality and in such a condition a man of ordinary prudence would accept them as goods of that description. It does not imply any legal right or legal title to sell.

Example 1: If a person orders motor horns from a manufacturer of horns, and the horns supplied are scratched and damaged owing to bad packing, he is entitled to reject them as unmerchantable.

(vii) **Condition as to wholesomeness:** In the case of eatables and

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provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.

Example: A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

2.3.5 Implied Warranties:



It is a warranty which the law implies into the contract of sale. In other words, it is the stipulation which has not been included in the contract of sale in express words. But the law presumes that the parties have incorporated it into their contract. It will be interesting to know that implied warranties are read into every contract of sale unless they are expressly excluded by the express agreement of the parties.
These may also be excluded by the course of dealings between the parties or by usage of trade (Section 62).

The examination of Sections 14 and 16 of the Sale of Goods Act, 1930 discloses the following implied warranties:

1. **Warranty as to undisturbed possession [Section 14(b)]:** An implied warranty that the buyer shall have and enjoy quiet possession of the goods. That is to say, if the buyer having got possession of the goods, is later on disturbed in his possession, he is entitled to sue the seller for the breach of the warranty.

2. **Warranty as to non-existence of encumbrances [Section 14(c)]:** An implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time the contract is entered into.

Example: A pledges his car with C for a loan of Rs. 15,000 and promises him to give its possession the next day. A, then sells the car immediately to B, who purchased it on good faith, without knowing the fact. B, may either ask A to clear the loan or himself may pay the money and then, file a suit against A for recovery of the money with interest.

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

   Regarding implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied, the rule is 'let the buyer beware' i.e., the seller is under no duty to reveal unflattering truths about the goods sold, but this rule has certain exceptions.

4. **Disclosure of dangerous nature of goods:** Where the goods are dangerous

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in nature and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of warranty, the seller may be liable in damages.

2.3.6 CAVEAT EMPTOR

In case of sale of goods, the doctrine 'Caveat Emptor' means 'let the buyer beware'. When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. If the goods turn out to be defective he cannot hold the seller liable. The seller is in no way responsible for the bad selection of the buyer. The seller is not bound to disclose the defects in the goods which he is selling.

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.

The rule of Caveat Emptor is laid down in the Section 16, which states that, "subject to the provisions of this Act or of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale".

Following are the conditions to be satisfied:

- if the buyer had made known to the seller the purpose of his purchase, and
- the buyer relied on the seller's skill and judgement, and
- seller's business to supply goods of that description (Section 16).

Example 1: A sold pigs to B. These pigs being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy. The rule of the law being "Caveat Emptor".

Exceptions: The doctrine of Caveat Emptor is, however, subject to the following exceptions.

1. **Fitness as to quality or use:** Where the buyer makes known to the seller the particular purpose for which the goods are required, so as to show that he relies on the seller's skill or judgment and the goods are of a description which is in the course of seller's business to supply, it is the duty of the seller to supply such goods as are reasonably fit for that purpose [Section 16 (1)].

   Example: An order was placed for some trucks to be used for heavy traffic in a hilly country. The trucks supplied by the seller were unfit for this purpose and broke down. There is a breach of condition as to fitness.

   In ***Priest vs. Last***,

   P, a draper, purchased a hot water bottle from a retail chemist, P asked the chemist if it would stand boiling water. The Chemist told him that the bottle

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was meant to hold hot water. The bottle burst when water was poured into it and injured his wife. It was held that the chemist shall be liable to pay damages to P, as he knew that the bottle was purchased for the purpose of being used as a hot water bottle.

Where the article can be used for only one particular purpose, the buyer need not tell the seller the purpose for which he required the goods. But where the article can be used for a number of purposes, the buyer should tell the seller the purpose for which he requires the goods, if he wants to make the seller responsible.

In ***Bombay Burma Trading Corporation Ltd. vs. Aga Muhammad***, timber was purchased for the express purpose of using it as railways sleepers and when it was found to be unfit for the purpose, the Court held that the contract could be avoided.

2. **Goods purchased under patent or brand name:** In case where the goods are purchased under its patent name or brand name, there is no implied condition that the goods shall be fit for any particular purpose [Section 16(1)].
3. **Goods sold by description:** Where the goods are sold by description there is an implied condition that the goods shall correspond with the description [Section 15]. If it is not so, then seller is responsible.
4. **Goods of Merchantable Quality:** Where the goods are bought by description from a seller who deals in goods of that description there is an implied condition that the goods shall be of merchantable quality. The rule of Caveat Emptor is not applicable. But where the buyer has examined the goods this rule shall apply if the defects were such which ought to have not been revealed by ordinary examination [Section 16(2)].
5. **Sale by sample:** Where the goods are bought by sample, this rule of Caveat Emptor does not apply if the bulk does not correspond with the sample [Section 17].
6. **Goods by sample as well as description:** Where the goods are bought by sample as well as description, the rule of Caveat Emptor is not applicable in case the goods do not correspond with both the sample and description or either of the condition [Section 15].
7. **Trade Usage:** An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade and if the seller deviates from that, this rule of Caveat Emptor is not applicable [Section 16(3)].**Example:** In readymade garment business, there is an implied condition by usage of trade that the garments shall be reasonably fit on the buyer.
8. **Seller actively conceals a defect or is guilty of fraud:** Where the seller sells the

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goods by making some misrepresentation or fraud and the buyer relies on it or when the seller actively conceals some defect in the goods so that the same could not be discovered by the buyer on a reasonable examination, then the rule of Caveat Emptor will not apply. In such a case the buyer has a right to avoid the contract and claim.

2.4 Performance of Contract of sale

2.4.1 CONTRACT OF SALE HOW MADE (SECTION 5)

According to section 5(1), a contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery or payment by instalments, or that the delivery or payment or both shall be postponed.

Further, as per sub-section (2) of section 5, subject to the provisions of any law for the time being in force, a contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties.

Analysis:

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.

2.4.2 SUBJECT MATTER OF CONTRACT OF SALE

1) Existing or future goods (section 6):

a) The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or future goods.

b) There may be a contract for the sale of goods the acquisition of which by the seller depends upon a contingency which may or may not happen.

Example: A contract for sale of certain cloth to be manufactured by a certain mill is a valid contract. Such contacts are called contingent contracts.

c) Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods.

2) **Goods perishing before making of contract (Section 7):** Where there is a

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contract for the sale of specific goods, the contract is void if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description contract.

Example: A agrees to sell B 50 bags of wheat stored in the A's godown. Due to water logging, all the goods stored in the godown were destroyed. At the time of agreement, neither parties were aware of the fact. The agreement is void.

3) **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 as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided.

2.4.3 ASCERTAINMENT OF PRICE (SECTION 9 & 10)

1) Ascertainment of price (Section 9):

a) The price in a contract of sale may be fixed by the contract or may be left to be fixed in manner thereby agreed or may be determined by the course of dealing between the parties.

b) Where the price is not determined in accordance with the foregoing provisions, the buyer shall pay the seller a reasonable price. What is a reasonable price is a question of fact dependent on the circumstances of each particular case?

Analysis:

'Price' means the monetary consideration for sale of goods [Section 2 (10)]. By virtue of Section 9, the price in the contract of sale may be-

(1) fixed by the contract, or
(2) agreed to be fixed in a manner provided by the contract, e.g., by a valuer, or
(3) determined by the course of dealings between the parties.

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

(1) Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of third party and such third party cannot or does not make such valuation, the agreements are thereby avoided:

Provided that, if the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price therefore.

(2) Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in default.

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Analysis

Section 10 provides for the determination of price by a third party. Where there is an agreement to sell goods on the terms that price has to be fixed by the third party and he either does not or cannot make such valuation, the agreement will be void. In case the third party is prevented by the default of either party from fixing the price, the party at fault will be liable to the damages to the other party who is not at fault. However, a buyer who has received and appropriated the goods must pay a reasonable price for them in any eventuality.

Example: P is having two bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price. As such P ask S to return the bike already delivered while S claims for the delivery of the second bike too. In the given instance buyer S shall pay reasonable price to P for the bike already taken. As regards the Second bike, the contract can be avoided.

2.5 Rights of Unpaid Vendor

2.5.1 UNPAID SELLER

A contract comprises of reciprocal promises. In a contract of sale, if seller is under an obligation to deliver goods, buyer has to pay for it. In case buyer fails or refuses to pay, the seller, as an unpaid seller, shall have certain rights.

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

(a) The whole of the price has not been paid or tendered and the seller had an immediate right of action for the price.

(b) 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.

The term 'seller ' here includes any person who is in the position of a seller, as, for instance, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price [Section 45(2)].

Example 1: X sold certain goods to Y for Rs. 50,000. Y paid Rs. 40,000 but fails to pay the balance. X is an unpaid seller.

Example 2: P sold some goods to R for Rs. 60,000 and received a cheque for a full price. On presentment, the cheque was dishonored by the bank. P is an unpaid seller.

2.5.2 RIGHTS OF AN UNPAID SELLER

1. **Unpaid seller's right (Section 46):** Subject to the provisions of this Act

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and of any law for the time being in force, notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of goods, as such, has by implication of law-

(a) a lien on the goods for the price while he is in possession of them.

(b) in case of the insolvency of the buyer a right of stopping the goods in transit after he has parted with the possession of them.

(c) a right of re-sale as limited by this Act. [Sub-section (1)]

Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer. [Sub-section (2)]

An unpaid seller has been expressly given the rights against the goods as well as the buyer personally which are discussed as under:

(d) **Rights of an unpaid seller against the goods:** The right of unpaid seller against goods can be categorized under two headings.

2.5.3 RIGHT OF UNPAID SELLER AGAINST THE GOODS

The unpaid seller has the following rights against the goods:

1. **Seller's lien (Section 47):** According to sub-section (1), subject to the provisions of this Act, the unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases, namely:-

   (a) where the goods have been sold without any stipulation as to credit.

   (b) where the goods have been sold on credit, but the term of credit has expired.

   (c) where the buyer becomes insolvent.

   According to sub-section (2), the seller may exercise his right of lien notwithstanding that he in possession of the goods as agent or bailee for the buyer.

   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.

2. **Termination of lien (Section 49):** According to sub-section (1), the unpaid seller of goods loses his lien thereon-
   a. when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.

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b. when the buyer or his agent lawfully obtains possession of the goods.

c. by waiver thereof.

The unpaid seller of goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree for the price of the goods. [Sub-section (2)]

Analysis of section 47, 48 and 49

Rights of lien: An unpaid seller has a right of lien on the goods for the price while he is in possession, until the payment or tender of the price of such goods. It is the right to retain the possession of the goods and refusal to deliver them to the buyer until the price due in respect of them is paid or tendered.

The unpaid seller's lien is a possessory lien i.e. the lien can be exercised as long as the seller remains in possession of the goods.

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

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

Example: A sold certain goods to B for a price Rs. 50,000 and allowed him to pay the price within one month. B becomes insolvent during this period of credit. A, the unpaid seller, can exercise his right of lien.

Seller may exercise his right of lien even where he is in possession of the goods as agent or bailee for the buyer.

The term insolvent refers to "a person is said to be insolvent who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not".

Termination of lien: However, the unpaid seller loses his right of lien under the following circumstances:

(i) 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.

(ii) 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.

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Exception: The unpaid seller of the goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree for the price of the goods.

Example: A, sold a car to B for Rs. 1,00,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now A cannot exercise the right of lien.

3. Right of stoppage in transit (Section 50 to 52):

Right of stoppage in transit (Section 50): Subject to the provisions of this Act, when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit, and may retain them until paid or tendered price of the goods.

Duration of transit (Section 51):

(1) Goods are deemed to be in the course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.

(2) If the buyer or his agent in that behalf obtains delivery of the goods before their arrival at the appointed destination, the transit is at an end.

(3) If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent, the transit is at an end and it is immaterial that a further destination for the goods may have been indicated by the buyer.

(4) If the goods are rejected by the buyer and the carrier or other bailee continues in possession of them, the transit is not deemed to be at an end, even if the seller has refused to receive them back.

(5) When goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in the possession of the master as a carrier or as agent of the buyer.

(6) Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf, the transit is deemed to be at an end.

(7) Where part delivery of the goods has been made to the buyer or his agent in that behalf, the remainder of the goods may be stopped in transit, unless such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of the goods.

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4. How stoppage in transit is affected (Section 52)

(1) The unpaid seller may exercise his right of stoppage in transit either by taking actual possession of the goods, or by giving notice of his claim to the carrier or other bailee in whose possession the goods are. Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case the notice, to be effectual, shall be given at such time and in such circumstances, that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.

(2) When notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall re-deliver the goods to, or according to the directions of, the seller. The expenses of such re-delivery shall be borne by the seller.

Analysis of section 50, 51 and 52

Meaning of right of stoppage in transit: The right of stoppage in transit means the right of stopping the goods while they are in transit, to regain the possession and to retain them till the full price is paid.

When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right of asking the carrier to return the goods back, or not to deliver the goods to the buyer.

This right is the extension of the right of lien because it entitles the seller to regain possession even when the seller has parted with the possession of the goods.

However, the right of stoppage in transit is exercised only when the following conditions are fulfilled:

(a) The seller must be unpaid.

(b) He must have parted with the possession of goods.

(c) The goods are in transit.

(d) The buyer has become insolvent.

(e) The right is subject to provisions of the Act. [Section 50]

Example: B at Delhi, orders goods of A, at Mumbai. A consigns and forwards the goods to B. On arrival at Delhi, they are taken to B's warehouse and left there. B refuses to take these goods and stop payment. The goods are in transit and the unpaid seller can take them back.

Duration of transit: The goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.

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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 that he holds the goods as soon as the goods are loaded on the ship unless the seller has reserved the right of disposal of the goods.
- If the carrier wrongfully refuses to deliver the goods to the buyer.
- Where goods are delivered to the carrier hired by the buyer, the transit comes to an end.
- Where the part delivery of the goods has been made to the buyer, there 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, the transit comes to an end. [section 51]

5. **How stoppage in transit is affected:** There are two modes of stoppage in transit-



Where the notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall re-deliver the goods to, or according to the directions of, the seller. The expenses of such re-delivery shall be borne by the seller.

6. Distinction between Right of Lien and Right of Stoppage in Transit

(i) The essence of a right of lien is to retain possession whereas the right of stoppage in transit is right to regain possession.

(ii) Seller should be in possession of goods under lien while in stoppage in transit (i) seller should have parted with the possession (ii) possession should be with a carrier, & (iii) buyer has not acquired the possession.

(iii) Right of lien can be exercised even when the buyer is not insolvent, but it is not the case with right of stoppage in transit.

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(iv) Right of stoppage in transit begins when the right of lien ends. Thus, the end of the right of lien is the starting point of the right of stoppage in transit.

7. **Effects of sub-sale or pledge by buyer (Section 53):** The right of lien or stoppage in transit is not affected by the buyer selling or pledging the goods unless the seller has assented to it. This is based on the principle that a second buyer cannot stand in a better position than his seller. (The first buyer).

   The right of stoppage is defeated if the buyer has transferred the document of title or pledges the goods to a sub-buyer in good faith and for consideration.

   Example: A sold certain goods to B of Mumbai and the goods are handed over to railways for transmission to B. In the meantime, B sold these goods to C for consideration. B becomes insolvent. A can still exercise his right of stoppage in transit.

   Exceptions: (a) When the seller has assented to the sale, mortgage or other disposition of the goods made by the buyer.

   Example: A entered into a contract to sell cartons in possession of a wharfinger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now B sold goods to C and C duly paid to B. But anyhow B failed to make the payment to A. A wanted to exercise his right of lien and ordered the wharfinger not to make delivery to C. Held that the seller had assented to the resale of the goods by the buyer to the sub-buyers. As a result, A's right to lien is defeated. ***(Mount D. F. Ltd. vs Jay & Jay (Provisions) Co. Ltd).***

   (b) When a document of title to goods has been transferred to the buyer and the buyer transfers the documents to a person who has bought goods in good faith and for value i.e. for price, then, the proviso of sub-section (1) stipulates as follows:

   (i) If the last-mentioned transfer is by way of sale, right of lien or stoppage in transit is defeated, or

   (ii) If the last-mentioned transfer is by way of pledge, unpaid seller's right of lien or stoppage only be exercised, subject to the rights of the pledgee.

   However, the pledgee may be required by the unpaid seller to use in the first instance, other goods or securities of the pledger available to him to satisfy his claims. [Sub-section (2)].

8. **Effect of stoppage:** The contract of sale is not rescinded when the seller exercises his right of stoppage in transit. The contract still remains in force and the buyer can ask for delivery of goods on payment of price.

9. **Right of re-sale [Section 54]:** The right of resale is a very valuable right given to an unpaid seller. In the absence of this right, the unpaid seller's

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other rights against the goods that is lien and the stoppage in transit would not have been of much use because these rights only entitled the unpaid seller to retain the goods until paid by the buyer.

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

(i) **Where the goods are of a perishable nature:** In such a case the buyer need not be informed of the intention of resale.

(ii) **Where he gives notice to the buyer of his intention to re-sell the goods:** If after the receipt of such notice the buyer fails within a reasonable time to pay or tender the price, the seller may resell the goods.

It may be noted that in such cases, on the resale of the goods, the seller is also entitled to:

(a) Recover the difference between the contract price and resale price, from the original buyer, as damages.

(b) Retain the profit if the resale price is higher than the contract price.

It may also be noted that the seller can recover damages and retain the profits only when the goods are resold after giving the notice of resale to the buyer. Thus, if the goods are resold by the seller without giving any notice to the buyer, the seller cannot recover the loss suffered on resale. Moreover, if there is any profit on resale, he must return it to the original buyer, i.e. he cannot keep such surplus with him [Section 54(2)].

(iii) **Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods:** The subsequent buyer acquires the good title thereof as against the original buyer, despite the fact that the notice of re-sale has not been given by the seller to the original buyer.

(iv) **A re-sale by the seller where a right of re-sale is expressly reserved in a contract of sale:** Sometimes, it is expressly agreed between the seller and the buyer that in case the buyer makes default in payment of the price, the seller will resell the goods to some other person. In such cases, the seller is said to have reserved his right of resale, and he may resell the goods on buyer's default.

It may be noted that in such cases, the seller is not required to give notice of resale. He is entitled to recover damages from the original buyer even if no notice of resale is given.

Where the property in goods has not passed to the buyer: the unpaid seller has in addition to his remedies a right of withholding delivery of the goods. This right is similar to lien and is called "quasi-lien".

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

Rights of unpaid seller against the buyer: An unpaid seller can enforce certain rights against the goods as well as against the buyer personally. Rights of unpaid seller against the buyer are otherwise known as seller's remedies for breach of contract of sale.

The rights of the seller against the buyer personally are called rights in person am and are in addition to his rights against the goods.

The right against the buyer are as follows:

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

   (a) Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods. [Section 55(1)]

   (b) Where under a contract of sale the price is payable on a day certain irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract. [Section 55(2)].

2. **Suit for damages for non-acceptance (Section 56):** Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. As regards measure of damages, Section 73 of the Indian Contract Act, 1872 applies.

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 contract'.

4. **Suit for interest [Section 61]:** Where there is specific agreement between the seller and the buyer as to interest on the price of the goods from the date on which payment becomes due, the seller may recover interest from the buyer. If, however, there is no specific agreement to this effect, the seller may charge interest on the price when it becomes due from such day as he may notify to the buyer.

   In the absence of a contract to the contrary, the Court may award interest to the seller in a suit by him at such rate as it thinks fit on the amount of the price from the date of the tender of the goods or from the date on which the price was payable.

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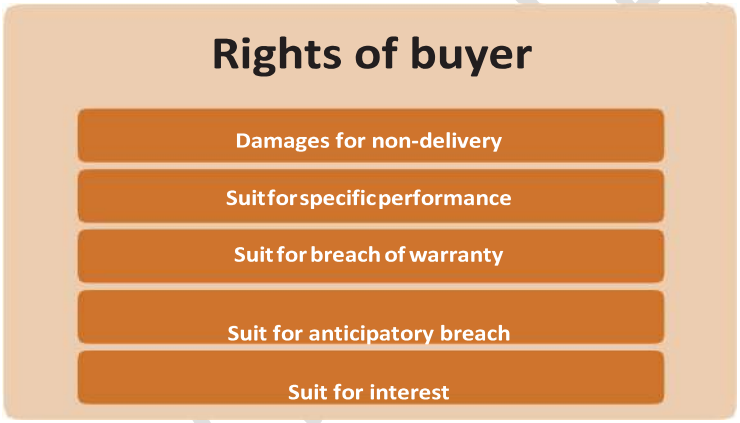
2.5.5 REMEDIES OF BUYER AGAINST THE SELLER

Breach of contract by seller

Breach of contract by seller, where he-	Fails to deliver the goods at the time or in manner
Breach of contract by seller, where	Repudiates the
Breach of contract by seller, where	Deliver non-conforming goods and buyer rejects and revokes

If the seller commits a breach of contract, the buyer gets the following rights against the seller:



1. **Damages for non-delivery [Section 57]:** Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.

   Example: 'A' a shoe manufacturer, agreed to sell 100 pairs of shoes to 'B' at the rate of Rs. 1050 per pair. 'A' knew that 'B' wanted the shoes for the purpose of further reselling them to 'C' at the rate of Rs. 1100/- per pair. On the due date of delivery, 'A'failed to deliver the shoes to'B. In consequence, 'B'could not perform his contract with 'C'for the supply of 100 pairs of shoes. In this case, 'B'can recover damages from 'A'at the rate of Rs. 50/- per pair (the difference between the contract price and resale price).

2. **Suit for specific performance (Section 58):** Where the seller commits of breach of the contract of sale, the buyer can appeal to the court for specific performance. The court can order for specific performance only when the goods are ascertained or specific.

   Example: 'A' agreed to sell a rare painting of Mughal period to 'B'. But on the due date of delivery, 'A' refused to sell the same. In this case, 'B' may file a suit against 'A' for obtaining an order from the Court to compel 'A' to perform

the contract (i.e. to deliver the painting to 'B' at the agreed price).

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

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

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

4. **Repudiation of contract before due date (Section 60):** Where either party to a contract of sale repudiates the contract before the date of delivery, the other may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.

5. **Suit for interest:**

   (1) Nothing in this Act shall affect the right of the seller or the buyer to recover interest or special damages, in any case where by law interest or special damages may be recoverable, or to recover the money paid where the consideration for the payment of it has failed.

   (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 in a suit by him for the refund of the price in a case of a breach of the contract on the part of the seller-from the date on which the payment was made.

   Example 1: In case of a sale of cigarettes which turned out to be mildewed and unfit for consumption, damages were awarded on the basis of the difference between the contract price and the price released.

   Example 2: In case of absence of transfer of title or registration the purchaser cannot claim damages for breach of conditions and warranties relating to sale.

2.6 Auction Sales

An 'Auction Sale' is a mode of selling property by inviting bids publicly and the property is sold to the highest bidder. An auctioneer is an agent governed by the Law of Agency. When he sells, he is only the agent of the seller. He may, however, sell his own property as the principal and need not disclose the fact that he is so selling.

Rules of Auction sale: Section 64 of the Sale of Goods Act, 1930 provides following rules to regulate the sale by auction:

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

(b) Completion of the contract of sale: The sale is complete when the

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auctioneer announces its completion by the fall of hammer or in any other customary manner and until such announcement is made, any bidder may retract from his bid.

(c) **Right to bid may be reserved:** Right to bid may be reserved expressly by or on behalf of the seller and where such a right is expressly reserved, but not otherwise, the seller or any one person on his behalf may bid at the auction.

(d) **Where the sale is not notified by the seller:** Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person; and any sale contravening this rule may be treated as fraudulent by the buyer.

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

(f) **Pretended bidding:** If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.
Example: P sold a car by auction. It was knocked down to Q who was only allowed to take it away on giving a cheque for the price and signing an agreement that ownership should not pass until the cheque was cleared. In the meanwhile, till the cheque was cleared, Q sold the car to R. It was held that the property was passed on the fall of the hammer and therefore R had a good title to the car. Both sale and sub sale are valid in favour of Q and R, respectively.

2.6.1 INCLUSION OF INCREASED OR DECREASED TAXESIN CONTRACT OF SALE (SECTION 64A)

Where after a contract has been made but before it has been performed, tax revision takes place. Where tax is being imposed, increased, decreased or remitted in respect of any goods without any stipulations to the payment of tax, the parties would become entitled to read just the price of the goods accordingly. 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

The buyer would have to pay the increased price where the tax increases and may derive the benefit of reduction if taxes are curtailed. Thus, seller may add the increased taxes in the price. The effect of provision can, however, is excluded by an agreement to the contrary. It is open to the parties to stipulate anything regard to taxation.

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3. The Negotiable Instruments Act, 1881

3.1 Introduction

- The Act was introduced on **1st March,1881.**
- The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881.
- **Applicability :-** whole of India and to all person's resident in India, whether foreigners or Indians.
- The Act was amended several times. Recent two amendments made in the N.I. Act were the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 and the Negotiable Instruments (Amendment) Act, 2015 and shall be deemed to have come into force on the **15th day of June 2015.**

3.1.1 Meaning and Characteristics of Negotiable Instrument

Meaning: A Negotiable Instrument is a transferrable written piece of paper creating a right of a person to receive money and a corresponding liability of a person to pay money.

3.1.2 Characteristics:

1. It should be in writing
2. Freely transferable.
3. It should create a right of a person to receive money and a corresponding liability of a person to pay money.
4. Holder's title is free from defects. A **holder in due course** acquires a good title irrespective of any defect in a previous holder's title. Conditions:
   (i) for consideration
   (ii) without notice as to the defect in the title of the transferor; i.e in good faith and
   (iii) before maturity
5. A negotiable instrument can be transferred infinitum, i.e., can be transferred any number of times, till its payment.

3.1.3 Types of N.E.:

section 13 of the Act mentions only three kinds of negotiable instruments namely,

(i) Promissory Notes
(ii) Bills of Exchange
(iii) Cheque.

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Promissory Note

Meaning:	As per **Section 4**, An instrument in writing (not being bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to a certain person or to the order of a certain person.
Example	"I promise to pay B Rs. 500 and all other sums which shall be due to him."
Parties to Promissory Note:	**Maker:** The person who makes the promissory Note. He is Debtor who is liable to pay. **Payee:** The person to whom amount is payable. He is creditor who has a right to receive money.
Essential requirements of a valid promissory note.	**Written Promise to pay.** However, notice that the use of the word promise is not essential to constitute an instrument as promissory note. **Definite and unconditional promise.** The promise to pay must not be conditional. Therefore, instruments payable on performance or non-performance of a particular act or on the happening or non- happening of an event, are not promissory notes. However, the promise to pay may be subject to a condition, which according to the ordinary experience of mankind, is bound to happen. **Certain sum of money.** **The maker and payee must be certain person.** The maker and payee of the instrument must be certain, definite, and different persons. A promissory note cannot be made payable to the bearer (Sec. 31 of RBI Act). Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'. **Signature.** The promissory note must be signed by the maker, otherwise it is incomplete and ineffective. **Promise in money only.** **Stamping.** A promissory note must be properly stamped in accordance with the provisions of the Indian Stamp Act and such stamp must be duly cancelled by maker's signatures or initials or otherwise.

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Bills of Exchange

Meaning:	As per **Section 5**, An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money to a certain person or to the order of a certain person or to the bearer of the instrument.
Parties to Bill of Exchange:	**Drawer:** The maker of a bill of exchange is called the drawer. **Drawee:** The person directed by the drawer to pay is called the 'drawee' **Acceptor:** The person who accepts the bill of Exchange. Normally acceptor and drawee are same. **Payee:** The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid, is called the payee.
Essential requirements of a valid Bill of Exchange.	The bill of exchange must be in writing. This order must be unconditional, as the bill is payable at all events. A conditional bill of exchange is invalid. However, the bill may be subject to a condition, which according to the ordinary experience of mankind, is bound to happen. The drawer must sign the instrument. The drawer, the drawee (acceptor) and the payee are the necessary parties to a bill and are to be specified in the instrument with reasonable certainty. All these three parties may not necessarily be three different persons. One can play the role of two. But there must be two distinct persons in any case. The sum must be certain The medium of payment must be money and money only.

Cheque

Meaning: Section 6 defines a cheque as

- a bill of exchange
- drawn on a specified banker and not expressed to be payable otherwise than on demand.
- includes the electronic image of a truncated cheque and a cheque in the electronic form.

Parties to Cheque:

Drawer: The person who draws a cheque i.e. makes the cheque. (Debtor)
Drawee: The specific bank on whom cheque is drawn.

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Payee: The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid, is called the payee.

Note 1:

Truncated Cheque	Cheque in electronic form
It means **the cheque whose electronic image has been created** during the course of clearing cycle, to substitute the further physical movement.	The cheque is drawn and signed electronically by the use of digital signature.

Note 2:

- The expression "Banker" includes any person acting as a banker and any post office

saving bank **[Section 3]**

- "clearing house" means the clearing house managed/recognized by the Reserve Bank of India
- expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have the same meanings respectively assigned to them in the Information Technology Act, 2000

3.1.4 Acceptance-Drawer and drawee Section 7

Meaning: The acceptance is the signature of the drawee of a bill who has signed his assent upon the bill and delivered it. Thus, an **acceptor** is the drawee who has signed his assent upon the bill and delivered it to the holder	
Essentials of valid Acceptance:	In writing, Signed by the drawee or his agent, On bill of exchange, Completed by delivery to the holder Writing the word 'Accepted' is immaterial. An oral acceptance or writing of the word 'Accepted' without the drawee's signature is not an acceptance.

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Bill can be accepted by following people:

Drawee, i.e., the person directed to pay.

Where more than 1 drawees are specified, then any or all can accept it. Only those who accept are liable to pay.

Drawee in case of need: When in the bill, the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a 'drawee in case of need'.

An acceptor for honour: When a bill of exchange has been dishonoured by non-acceptance and any person accepts it for honour of the drawer or of any indorsers, such person is called "an Acceptor for honour". The payment which he makes is known as "payment for honour"

Agent of any of the persons mentioned above.

Acceptor by estoppels: When no drawee has been named in a bill, but a person accepts it, he may be estopped from denying his liability as an acceptor.

3.1.5 HOLDER, HOLDER IN DUE COURSE, PAYMENT IN DUE COURSE (Section 8-10)

Holder (Section 8)	The "holder" of a promissory note, bill of exchange or cheque means— any person entitled in his own name to the possession thereof, and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction. There may/may not be any value and consideration in return.
Holder in due course (Section 9)	A holder in due course is one who receives the instrument: **for consideration** (ii) without notice as to the defect in the title of the transferor; i.e in good faith and before maturity His rights and title are independent on the transferor He has a right to demand and receive and also have a right to sue.

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

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

But where a signature on the negotiable instrument is forged, it becomes a nullity. The

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holder of a forged instrument cannot enforce payment thereon.	
Payment in due course (Section 10)	payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof under circumstances, which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

3.1.6 CLASSIFICATION OF INSTRUMENTS

1.Bearer and Order Instruments:	**Bearer Instrument:** It is an instrument where the name of the payee is blank or Where the name of payee is specified with the words "or bearer" or Where the 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 fill Such instrument can be negotiated by indorsement and delivery.
2. Inland and Foreign Instruments: (Section 11 & 12)	**Inland Instrument:** Any instrument drawn or made in India **and** Either payable in or drawn upon any person resident in India shall be deemed to be an inland instrument. Example (i) A promissory note made in Chennai and payable in Delhi. (ii) A bill drawn in Pune on a person resident in Jaipur (although it is stated to be payable in London) **(iii)** The Negotiable Instruments Act is applicable.
	Foreign Instruments: Instrument which is not an inland instrument.

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3.Inchoate and Ambiguous Instruments	**Inchoate Instrument (section 20):** It means an Instrument that is incomplete in certain respects. (i) The person gives a blank instrument with authority to the holder to complete it with appropriate amount up to the stamp value of the instrument. (ii) Delivery of such a paper is essential by the signer to the authority/holder. (iii) The person signing and delivering the inchoate instrument is liable both to a holder and holder in due course. However, there is a difference in their respective rights. The holder of such an instrument cannot recover the amount in excess of the amount intended to be paid by the signor. The holder in due course can, however, recover any amount on such instrument provided it is covered by the stamp affixed on the instrument. **Example,** a person signed a blank acceptance and kept it in his drawer and some person stole it and filled it up for Rs. 20,000 and negotiated it to an innocent person for value, it was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument Holder in due course can recover the amount from person liable.
	Ambiguous Instrument (Section 17): An instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note, is an Ambiguous instrument. In other words, such an instrument may be construed either as promissory note, or as a bill of exchange. Regarding such instruments, **Section 17** provides that the holder may, at his discretion, treat it as either and the instrument shall thereafter be treated accordingly. **Where amount is stated differently in figures and words [Section 18]** : The amount stated in words shall be the amount undertaken or ordered to be paid.

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4. Demand and Time Instruments:

Demand Instruments (Section 19):

A promissory note or bill of exchange

in which no time for payment is mentioned is payable on demand.

Note:

Bills and notes are payable either on demand or at a fixed future time.

Cheques are always payable on demand (ie, when presented for payment by the drawee. Such date is not fixed.)

(Section 21) A bill or promissory note is payable on demand when it is

expressed to be payable on demand, or

the expression "at sight" or "on presentment" are stated on it.

Time instrument (Section 22):

Instrument payable after a certain period either in 'x' days or 'x' months. Three days are allowed as days of grace. **(Section 22).**

Calculation of maturity [Section 23]:

Time at which instrument is payable	Maturity period
When a note or bill is made payable, a stated number of months **after date**	when the period stated termina day of the month which corresp the day on which the instrumen
When it is made payable after a stated number of months **after sight/ after a certain event**	The period terminates on the c month which corresponds with on which it is presented for ac or sight or noted for non-acce protested for non- acceptance.

Note:

If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Eg: A negotiable instrument dated 29th January,2017, is made payable at one month after date. The instrument is at maturity on the third day after the 28th February,2017.

Calculating maturity of bill or note payable so many days after date or sight [Section 24] The day of the date, or of

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	presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, **shall be excluded.** The 3 days of grace shall begin from the next day after presentment. **Example:** Bharat executed a promissory note in favour of Bhushan for Rs. 5 crores. The said amount was payable three days after sight. Bhushan, on maturity, presented the promissory note on 1st January 2017 to Bharat. Bharat made the payments on 4th January 2017. Bhushan wants to recover interest for one day from Bharat. Advise Bharat, in the light of provisions of the Negotiable Instruments Act, 1881, whether he is liable to pay the interest for one day? Solution: 3 days shall be counted from 2nd. Date of presentment shall be ignored. Bharat was required to pay only on the 4th and interest shall not be levied. **When day of maturity is a public holiday [Section 25]: T**he instrument shall be deemed to be due on the next preceding business day. The expression "Public Holiday" includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.

3.2 INDORSEMENT OF INSTRUMENT (Section 15)

3.2.1 Meaning:

When the **maker or holder** of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed, he is said to indorse the same and as called the **indorser.**

The person to whom the instrument is indorsed is called the **indorsee.**

Example : X, who is the holder of a negotiable instrument writes on the back thereof : "pay to Y or order" and signs the instrument. In such a case, X is deemed to have endorsed the instrument to Y. If X delivers the instrument to Y, X ceases to be the holder and Y becomes the holder.

3.2.2 Various Classes / Kinds of Indorsements:

(i) Indorsement in Blank: Where the indorser just puts his signature without specifying the indorsee, the indorsement is said to be in blank **(Section 16).** The effect of such an indorsement is to render the instrument payable to bearer even though originally payable to order **(Section 54).**

(ii) Indorsement in Full: Where along with indorser's signature, the name of the

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indorsee is specified, the indorsement is called 'indorsement in full' **(Section 16).** Thus, where the instrument states, 'Pay X or order' and is signed by A, the payee, it constitutes 'indorsement in full'.

(iii) Conversion of indorsement in blank into endorsement in full [Section 49]

The holder of a negotiable instrument endorsed in blank may—

- without signing his own name,
- by writing above the indorser's signature a direction to pay to any other person as endorsee, convert the indorsement in blank into an indorsement in full; and

Note: the holder does not thereby incur the responsibility of an indorser.

(iv) Effect of indorsement [Section 50] The indorsement of a negotiable instrument followed by delivery transfers to the indorsee the property therein with the right of further negotiation.

Except: where the NI is endorsed to exclude right to further negotiate. Example: "pay the contents to C only", "pay C".

(v) Who may negotiate? [Section 51] Every sole maker, drawer, payee or indorsee, or all of several joint makers, drawers, payees or indorsees, of a negotiable instrument may, indorse and negotiate the same.

(vi) Indorser who excludes his own liability or makes it conditional [Section 52]

The indorser of a negotiable instrument may,

- ✓ by express words in the indorsement,
- ✓ exclude his own liability thereon, or
- ✓ make such liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

  Where an indorser so excludes his liability and afterwards becomes the holder of the instrument all intermediates indorsers are liable to him.
- ✓ Example :

  -The endorser of a negotiable instrument signs his name, adding the words "without recourse". Upon this endorsement he incurs no liability.

  -A is the payee and holder of a negotiable instrument. Excluding personal liability by an endorsement, "without recourse", he transfers the instrument to B, and B endorses it to C, who endorses it to A. A is not only reinstated in his former rights, but has the rights of an endorsee against B and C.

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3.3 NEGOTIATION OF INSTRUMENT

3.3.1 Introduction

(i) Meaning: According to **section 14,** 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.**

(ii) Delivery [Section 46] The making, acceptance or indorsement of a promissory note, bill of exchange or cheque is completed by delivery. Delivery can be

- actual (physical transfer of NE in real time)or
- Constructive (to authorised agent).

(iii) Modes of negotiation of instrument

A N.I. payable to bearer is negotiable by the delivery thereof **(Section 47).**

Exception : A N.I. delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

A N.I. payable to order is negotiable by the holder by indorsement and delivery thereof **(Section 48)**

(a) **Instrument obtained by unlawful means or for unlawful consideration [Section 58]**

- ✓ When a negotiable instrument has been lost, or
- ✓ has been obtained from any maker, acceptor, or holder thereof by means of an offence or fraud, or for an unlawful consideration,
- ✓ no possessor or indorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or indorsee is a holder thereof in due course.

(b) **Instrument acquired after dishonour or when overdue [Section 59]** The negotiable instrument, can be transferred even after dishonour or maturity but the person obtaining it can never become holder in due course.
However, if it is within understanding between parties, the endorsee may accept. He may demand interest for the overdue period.

(c) **Instrument negotiable till payment or satisfaction [Section 60]** A negotiable instrument may be negotiated (except by the maker, drawee or acceptor after maturity) until payment or satisfaction thereof by the maker, drawee or accepter at or after maturity, but not after such payment or satisfaction. Interest may be demanded for the overdue payment.

3.3.2 PRESENTMENT

(i) Meaning: Presenting the bill to the drawee for payment of money on the due date.

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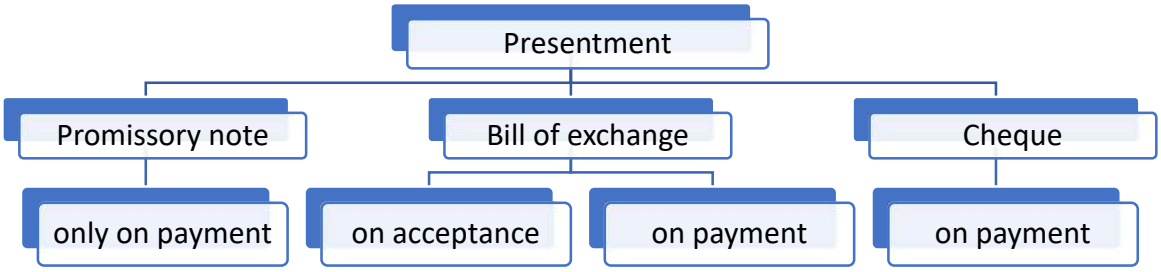
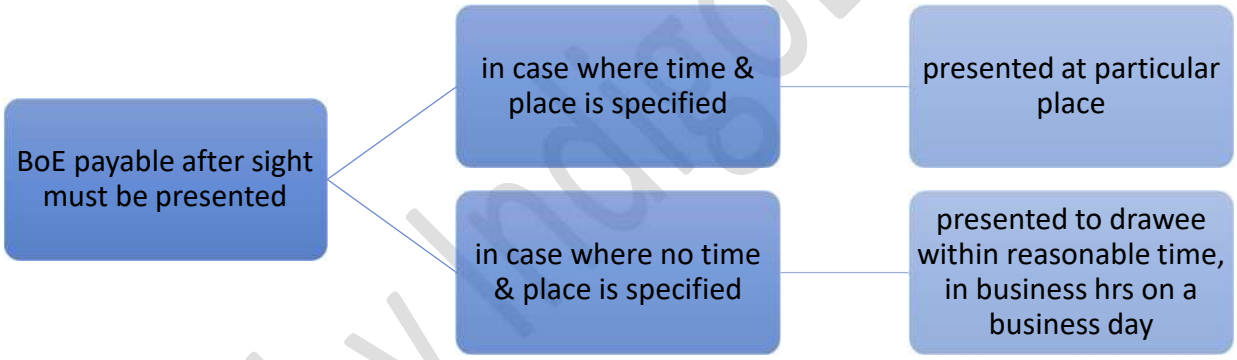


- within a reasonable time after it is drawn, and
- in business hours
- on a business day.

Otherwise it shall **not** be deemed **dishonoured.**

(ii) Presentment for acceptance [Section 61]



In default of such presentment, no party thereto is liable thereon to the person making such default.

Exception: If the drawee cannot, after reasonable search, be found, the bill is dishonoured.

(iii) Presentment of promissory note for sight [Section 62]

A promissory note, payable at a certain period after sight, must be

- presented to the maker thereof 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.

In default of such presentment, no party thereto is liable thereon to the person making such default

(iv) Presentment for payment [Section 64]

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Promissory notes, bill of exchange and cheques must be presented for payment to the maker, acceptor, or drawee thereof respectively, by or on behalf of the holder as hereinafter provided. In default of such presentment, the other parties thereto are not liable thereon to such holder.

Hours for presentment:

- during the usual hours of business and,
- if at a banker's, within banking hours.

Presentment of cheque to charge drawer: Subject to the provisions of section 84, a cheque must, in order to charge the drawer, be presented at the bank on which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer.

Presentment of instrument payable at demand: 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.

(v) 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 holder and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate, presentment must be made within reasonable time.

3.3.3 When presentment unnecessary:

No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:

(a) if the maker, drawee, or acceptor intentionally prevents the presentment of the instrument, or

✓ If the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or

✓ If the instrument being payable at some other specified place, neither he nor any person authorized to pay it attends at such place during the usual business hours, or

✓ If the instrument not being payable at any specified place, he cannot after due search be found.

(b) if the maker has agreed to pay even without presentment.

(c) if the maker has done the part-payment/promises to pay even without presentment.

(d) Maker waives his right to presentment

(e) if the drawer could not suffer damage from the want of such presentment.

3.3.4 **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

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negligently or improperly keeps, he must compensate the holder for such loss

3.4 LIABILITIES OF PARTIES

3.4.1 Capacity to incur liabilities (Section 26):

(i) Every person **capable of contracting** may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.
Minor being incompetent to contract, cannot bind himself by becoming a party to a negotiable instrument. Whether he is the drawer, maker, acceptor or indorser, he is not liable on the instrument.

(ii) Liability of an agent (Section 27 & 28):

Every person capable of legally entering into a contract, may make, draw, accept indorse, deliver, and negotiate a N.I., himself or through a duly authorised agent.

Generally, an agent does not have the power to indorse bills of exchange so as to bind his principal.

Exception:

- where he is authorised to do so. And
- he indicates that he signs as an agent and does not intend to incur personal liability

(iii) Liability of Legal Representative (Section 29):

A legal representative' of a deceased person, who signs his own name on an instrument, is

- personally, liable for the entire amount.
- but he may expressly limit his liability to the extent of the assets received by him as legal representative.

(iv) Liability of Drawer (Section 30):
Usually, the liability of the drawer of a bill or cheque → secondary and conditional the liability of the acceptor/drawee of the cheque → primary and unconditional.
The drawer's liability arises if

- Bill dishonoured by the drawee or acceptor. AND
- notice of dishonour has been served on the drawer

(v) Liability of drawee Bank of cheque (Section 31): Wrongful dishonour of customer's cheque entails exemplary damages against banker and the amount of damages is inversely related to the amount of the cheque dishonoured. Smaller amount of the cheque, higher shall be the damages awarded.

(vi) Liability of drawee of Bill of Exchange/ Maker of Promissory Note (Section 32): The maker of a promissory note is bound to pay the amount at maturity. The liability of the drawee only arises when he accepts the

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bills. Drawee's liability is primary and unconditional. He is liable for Principal amount along with interest and noting/ protesting charges if any.

(vii) Prior party a principal in respect of each subsequent party (Sections 38): As between the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party.

Eg: A draws a bill payable to his own order on B, who accepts. An afterwards endorses the bill to C, C to D and D to E. As between E and B, B is the principal debtor, and A, C and D are his sureties.

(viii) Discharge of indorser's liability (Section 40): Where the holder of a negotiable instrument, without the consent of the indorser, destroys or impairs the indorser's remedy against a prior party (strikes off name of any prior endorsers names), the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. Any party liable on the instrument may be discharged by the intentional cancellation of his signature by the holder.

(ix) Effect of forged indorsement on acceptor's liability (Section 41): An acceptor of a bill of exchange already indorsed is not relieved from liability by reason that any of the future indorsement is forged.

(x) Liability of acceptor of a bill drawn in a fictitious name (Section 42): The acceptor is not relieved from liability by proving that the drawer is fictitious.

(xi) Liability on an instrument made drawn etc. without consideration (Section 43): An instrument made, drawn, accepted, indorsed, or transferred without consideration creates no obligation of payment between the parties to the instrument. But if any such party has transferred the instrument with or without endorsement to a holder for a consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor

(xii) Partial absence or failure of money-consideration [Section 44]:

When the consideration for which a person signed a NI **consisted of money**—

- which was originally absent in part, or?
- has subsequently failed in part,

the sum which a holder standing in immediate relation with such signer is entitled to receive from him is **proportionally reduced**. However, other endorsers liabilities are not affected.

Example : A owes a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due, payable by him. B fills up fraudulently the amount larger than the amount due, payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. → B who is a party in immediate relation with the drawer of

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the cheque is entitled to recover from A only the exact amount due from A and not the amount entered in the cheque. However, the right of C, who is a holder for value, is not adversely affected and he can claim the full amount of the cheque from B

(xiii) Partial failure of consideration not consisting of money [Section 45]: Where a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, **though not consisting of money**, is ascertainable in money without collateral enquiry, and there has been a failure of that party, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

3.4.2 RIGHTS AND OBLIGATIONS OF PARTIES TO AN INSTRUMENT OBTAINED ILLEGALLY.

(i) Holder's right to duplicate of lost bill [Section 45A] Where a bill of exchange has been lost before it is overdue,

- the person who was the holder of it may apply
- to the drawer to give him another bill of the same tenor, giving security to the drawer, if required,
- to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again.
- If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so.

3.5 DISCHARGE FROM LIABILTY

Discharge of Party

of party of Instrument

When the liability of one/few parties ceases to exist

When the liability of primary party ceases to exist

Eg: A→B→C→B. Here C is discharged. Eg: A→B→C. C cancels B's name. Then, only B is discharged.	Eg: A→B→C. C cancels A's name. Then, the instrument is discharged. Eg: A→B→C→A. Here instrument is discharged.

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3.5.1 Modes of discharge:

One or more parties to a negotiable instrument may be discharged from liability in either of the following ways :

(i) **Sec. 82 - By cancellation, Release or Payment :**

By cancellation: Cancellation of acceptor's name will discharge the instrument and cancellation of any other party will discharge the party.

By release (waiver): Release of acceptor will discharge the instrument and release of any other party will discharge the party.

By payment: When the amount due on the instrument is paid by the party primarily liable on the instrument, the instrument is discharged.

(ii) **Sec. 83 By allowing drawee more than 48 hours:** If the holder of a bill of exchange allows the drawee more than 48 hours, exclusive of public holiday(s) to consider whether he will accept the same, all previous parties not consenting to such allowance are discharged from liability to such holder.

(iii) **Sec. 84 By delay in presenting cheques:** If a cheque is not presented within a reasonable time of its issue, and the bank fails and drawer suffers actual damages through such delay, he is discharged from the liability to the holder to the extent of such damage.

(iv) **Sec. 85. Forgery of Indorser's signature in case of Cheque :** The Bank is discharged by payment in due course even if the signature of indorser is forged.

Example : A cheque is drawn payable to "B or order". It is stolen and the thief forges B's endorsement and endorses it to C. The banker pays the cheque in due course. Can B recover the money from the banker ?

Answer : According to Section 85, the drawee banker is discharged when he pays a cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the endorsement of Mr. B is forged, the banker is protected, and he is discharged. The true owner, B, cannot recover the money from the drawee bank.

(v) **By material alteration (Sec 87).:**Any **material alteration** of a negotiable instrument renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties.

NA → where alteration is not material. Eg: adding word 'A/c payee' 'or order' to NI as it is authorised by the act → does not require authentication from previous parties.

(vi) **Discharge of Bank:** As per **Section 89**, bank is discharged by payment in due course in case of alteration not apparent from records.

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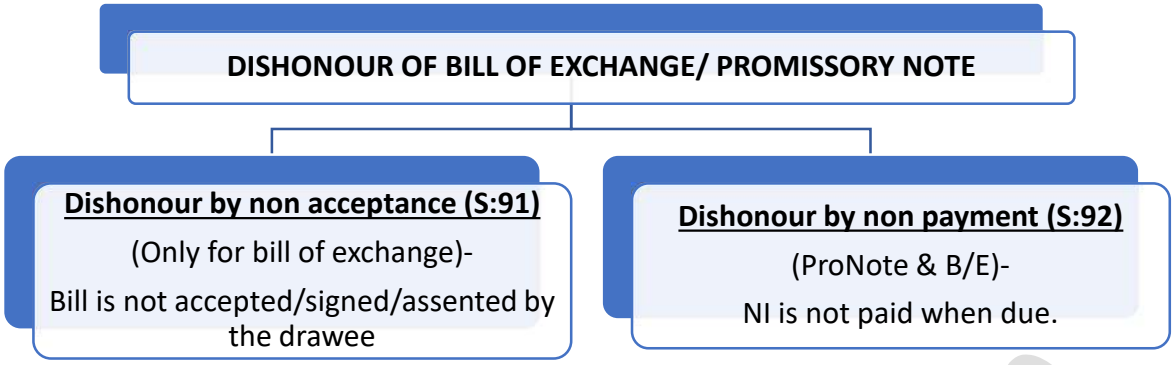
3.5.2 DISHONOUR OF BILL OF EXCHANGE/ PROMISSORY NOTE



(i) Dishonour of bill of exchange by non-acceptance (Section 91):
In the following circumstances bill shall be considered as dishonoured by non-acceptance:

1) When the drawee does not accept it within 48 hours from the time of presentment for acceptance.
2) When presentment for acceptance is excused and it remains unaccepted. Presentment for acceptance is excused under the following circumstances:
   (i) Where the drawee cannot, after reasonable search, be found (Section 61).
   (ii) Where the drawee is a fictitious person.
   (iii) Where though presentment is regular, the acceptance is refused on some other ground.
3) Where drawee is incompetent to contract, e.g., minor or lunatic.
4) Where the acceptance is qualified/conditional.
5) Where one or more of the several drawees (not being partners) refuse to accept the bill.

(ii) Dishonour of bill of exchange/ promissory note by non-payment (Section 92): An instrument is dishonoured by non- payment when the party primarily liable, makes default in payment.

3.5.3 Notice of dishonour (Section 93 & 94):

(i) By whom notice to be given: When an instrument is dishonoured either by non-acceptance or by non-payment, the holder thereof or some party thereto who remains liable thereon must give notice of dishonour.

(ii) To whom notice is to be given: Notice must be given to such parties whom the holder proposes to charge with liability severally or jointly, e.g., the drawer and the indorsers. Notice may be given either to the party himself or to his agent, or to his legal representative on his death, or to the official assignee on his insolvency. It is not necessary to give notice to the maker of a note or the drawee or acceptor of a bill or cheque (because they dishonoured it hence, they will obviously be aware of it).

(iii) Effect of non-service of notice: If a notice of dishonour is not sent to any prior party who is entitled to such notice within a reasonable time, he is

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discharged from liability.

(iv) **Requirements of valid notice:** Notice must give an exact description of the instrument dishonoured.

(v) **Mode of service of notice** written/ oral. The notice, if written, may be given by post at the place of business or at the residence of party for whom it is intended.

(vi) **Transmission of notice of dishonour by party receiving it (Section 95):** if the prior party receives notice of dishonour otherwise than from holder, no such communication is necessary from holder.

(vii) **Notice of dishonour is not required in the following cases (Section 98):**

1. When there is no intention to make prior party liable.
2. When prior party is discharged.
3. When drawer and drawee are same
4. When drawer is fictitious.
5. When the prior party has signed the indorsement 'without recourse'.
6. When the party entitled to notice cannot, after reasonable search, be found.
7. Where the party liable to give notice is unable, without any fault of its own to give it, e.g., death or serious illness of the holder or his agent or any other accident.
8. When the prior party is incompetent.

3.5.4 PAYMENT AND INTEREST

To whom payment should be made (Section 78): Payment of the amount due on a N.I. must, in order to discharge the maker or acceptor, be made to the holder of the instrument. If payment is made to any person other than the holder, the holder can claim payment over again from the maker or acceptor.

3.5.5 Payment of interest

Where interest rate is expressly made payable on P/N, BoE	When no rate of interest is specified in the instrument
Interest shall be calculated at the rate specified on the amount of the principal money due thereon, from the date of the instrument, until tender or realization of such amount, or until such date after the institution of a suit to recover such amount as the court directs.	Interest on the amount due thereon shall be calculated at the rate of 18% per annum, from the date at which the same ought to have been paid by the party charged, until tender or realization of the amount due thereon, or until such date after the institution of a suit to recover such amount as the court directs. Person liable is liable to pay interest only from the time that he receives notice of the dishonour.

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3.5.6 NOTING AND PROTESTING

Noting Sec 99	Protest Sec 100
P/N, BoE, Cheque has been dishonoured by non-acceptance or non-payment— the holder may cause such dishonour to be noted by a notary public upon- the instrument, or upon a paper attached thereto, or partly upon each	P/N or BoE has been dishonoured by non-acceptance or non-payment— the holder may, cause such dishonour to be noted, and certified by a notary public
Noting is a minute recorded by a notary public on the dishonoured instrument. Notary Public who presents it once again for acceptance or payment, as the case may be; and if the drawee or acceptor still refuses to accept or pay the bill, it is noted It is mere recognition of dishonour.	The Court may not recognize noting however it is bound to recognize a protest. In protest, a suitable investigation is done to check if the NI is actually dishonoured and accordingly certificate is issued. It is more useful where the parties are looking to take legal action against parties.

3.5.7 DISHONOUR OF CHEQUE (V.Imp.)

Sections 138 to 142 provides for criminal penalties in the event of dishonour of cheques for insufficiency of funds.

1) **Dishonoured due to insufficiency of funds (Sec. 138):** The drawer, under Sec. 138, may be punished with
   - imprisonment up to 2 years or
   - fine up to twice the amount of the cheque or
   - both.

   Following conditions must be satisfied for levy of penalty:

(a) The cheque should have been dishonoured due to insufficiency of funds in the account maintained by him with a banker for payment of any amount of money to another person from out of that account.
   As per the Case laws, following are deemed dishonoured due to insufficiency of funds:
   (i) stop-payment unless stop-payment can be justified.
   (ii) dishonour due to closure of account
   (iii) directing the payee not to present

(b) The payment for which the cheque was issued should have been in discharge of a legally enforceable debt or liability in whole or part of it.

(c) The cheque should have been presented within 3 months from the date on which it is drawn.

(d) Complaint is filed by the holder in due course/payee within 1 month from expiry of period given below

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(e) No penalty shall be levied if all these conditions are followed:

- ✓ Cheque presented within validity period/3 months
- ✓ Payee/holder in due courses **notifies** in writing to the drawer **within 30 days** of receipt of information by him from the bank regarding dishonour and asks for payment **and**
- ✓ Drawer makes the payment within 15 days of notice

Note:

- Where a cheque is dishonoured the second time, and there was no complaint filed the first time it was dishonoured, then the complaint cannot be filed the second time.

2) **Presumption in favour of holder [Section 139]** 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.

3) **Defence which may not be allowed in any prosecution under section 138 [Section 140]** It shall not be a defence in a prosecution of an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

3.5.8 Offences by Companies(Section 141)

If the person committing an offence under section 138 is a company, every person who, at the time the offence was committed—

- ✓ was in charge of, and
- ✓ as responsible to the company for the conduct of the business of the company,

as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Exception:

- if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent
- director nominated by CG or SG

3.5.9 Cognizance of offences [Section 142]

1) Court shall take cognizance of any offence punishable under section 138 only if it is in writing.[cognizance of any offence--> means consider any case on an offence]

Time limit for filing the complaint is 1 month.

No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under section 138.

2) Place of Jurisdiction of court for the trail of offence : The offence under section 138, which deals with the dishonour of cheque, shall be inquired into, and tried only by a court within whose local jurisdiction,—

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(a) if the cheque is delivered for collection through an account, the branch of the bank where the payee or holder in due course, as the case may be, maintains the account, is situated; **or**

(b) if the cheque is presented for payment by the payee or holder in due course, otherwise through an account, the branch of the drawee bank where the drawer maintains the account, is situated.

3) Validation for transfer of pending cases [Section 142A]

- ✓ All cases of cheque bouncing which were pending in any court, before the Act came into force, will be transferred to a court with the appropriate jurisdiction.
- ✓ The payee has filed a complaint against the drawer in a court with the appropriate jurisdiction, all subsequent complaints against that person regarding cheque bouncing will be filed in the same court. This will be irrespective of the mode of presentation of cheque.
- ✓ If more than one case is filed by the same payee against the same drawer before different courts, the case will be transferred to the court with the appropriate jurisdiction before which the first case was filed.

4) Power of Court to try cases summarily [Section 143]

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

Summary trial → means shortcut proceedings done in less time and hassle. They are allowed if prescribed conditions apply to a particular case.

5) Offences to be compoundable [Section 147]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 every offence punishable under this Act shall be compoundable.

Specimen of Promissory note

Rs. 10,000

Lucknow April 10, 2017

Three months after date, I promise to pay Shri Ramesh **(Payee)** or to his order the sum of Rupees Ten Thousand, for value received.

Stamp
Sd/-
Ram

To, Shri

Ramesh,

B-20, Green Park, Mumbai.

(Maker)

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Specimen of Bill of Exchange

Mr. A **(Drawer)**

48, MP Nagar, Bhopal (M.P.)

April 10, 2015

Rs. 10,000/-

Four months after date, pay to Mr. B **(Payee)** a sum of Rupees Ten Thousand, for value received.

To,

Mr. C **(Drawee)**

576, Arera Colony, Bhopal (M.P.)

Signature

Specimen of Cheque

Date :.....

Pay .....

a sum of Rupees.....

Rs.

A/c No. .....

ABC Bank

622, Vijay Nagar, Indore (M. P.)

Signature

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4. Indian Partnership Act, 1932

4.1 Nature of Partnership

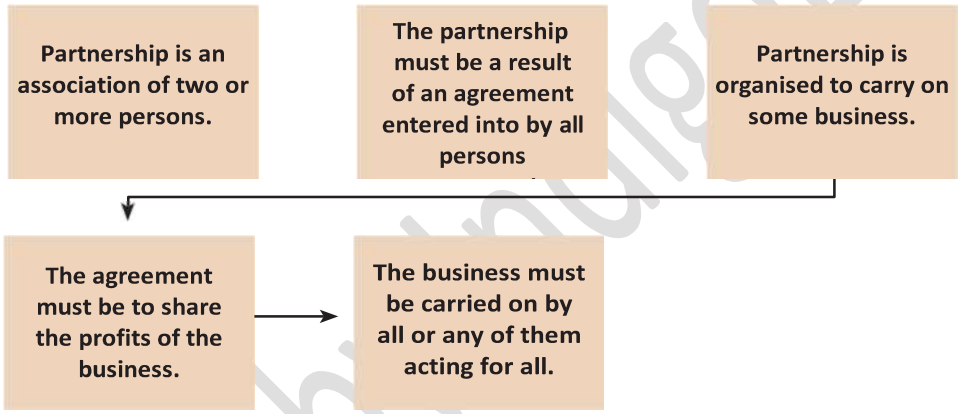
DEFINITION OF 'PARTNERSHIP', 'PARTNER', 'FIRM' AND 'FIRM NAME' (SECTION 4)



'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'.**

4.1.1 ELEMENTS OF PARTNERSHIP

The definition of the partnership contains the following five elements which must coexist before a partnership can come into existence.



We shall now discuss the afore-stated elements one by one.

1. **ASSOCIATION OF TWO OR MORE PERSONS:** Partnership is an association of 2 or more persons. Again, only persons recognized by law can enter into an agreement of partnership. Therefore, a firm, since it is not a person recognized in the eyes of law cannot be a partner. Again, a minor cannot be a partner in a firm, but with the consent of all the partners, may be admitted to the benefits of partnership.

   The partnership Act is silent about the maximum number of partners but section 464 of the Companies Act, 2013 has now put a limit of 50 partners in any association/partnership firm.

2. **AGREEMENT:** It may be observed that partnership must be the result of an agreement between two or more persons. There must be an agreement entered into by all the persons concerned. This element relates to voluntary contractual nature of partnership. Thus, the nature of the partnership is voluntary and contractual.

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An agreement from which relationship of Partnership arises may be express. It may also be implied from the act done by partners and from a consistent course of conduct being followed, showing mutual understanding between them. It may be oral or in writing.

3. **BUSINESS:** In this context, we will consider two propositions. First, there must exist a business. For the purpose, the term 'businesses include every trade, occupation and profession. The existence of business is essential. Secondly, the motive of the business is the "acquisition of gains" which leads to the **AGREEMENT TO SHARE PROFITS:** The sharing of profits is an of partnership. There can be no partnership where only one c entitled to the whole of the profits of the business. Partners share the profits in any manner they choose.



But an agreement to share losses is not an essential element. or more partners to agree to share all the losses. However, in losses, unless agreed otherwise, these must be borne in the p ratio.

Example 1:

Co-owners who share amongst themselves the rent derived from a piece of land are not partners, because there does not exist any business.

Example 2:

No charitable institution or club may be floated in partnership [A joint stock company may, however, be floated for non-economic purposes].

Example 3:

X and Y buy certain bales of cotton which they agree to sell on their joint account and to share the profits equally. In these circumstances, X and Y are partners in respect of such cotton business.

4. **BUSINESS CARRIED ON BY ALL OR ANY OF THEM ACTING FOR ALL:** The business must be carried on by all the partners or by anyone or more of the partners acting for all. *This is the cardinal principle of the partnership Law.* In other words, there should be a binding contract of mutual agency between the partners.

   An act of one partner in the course of the business of the firm is in fact an act of all partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He is an agent in so far as he can bind the other partners by his acts and he is a principal to the extent that he is bound by the act of other partners.

   It may be noted that the true test of partnership is *mutual agency* rather than sharing of profits. If the element of mutual agency is absent, then there will be no partnership.

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The Supreme Court has held that the two essential conditions to be satisfied are that:

(1) there should be an agreement to share the profits as well as the losses of business; and

(2) the business must be carried on by all or any of them acting for all, within the meaning of the definition of 'partnership' under section 4.

The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied.

Note:- The 'Partnership Agreement' is also known as 'Partnership Deed'.

4.1.2 TRUE TEST OF PARTNERSHIP

Mode of determining existence of partnership (Section 6): In determining whether a group of persons is or is not a firm, or whether a person is or not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.

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

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

1. **Agreement:** Partnership is created by agreement and not by status (Section 5).The relation of partnership arises from contract and not from status; and in particular, the members of a Hindu Undivided family carrying on a family business as such, or a Burmese Buddhist husband and wife carrying on business as such are not partners in such business.
2. **Sharing of Profit:** The sharing of profits or of gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such person's partners.

   The receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not of itself make him a partner with the persons carrying on the business; and in particular, the receipt of such share or payment-

(a) by a lender of money to persons engaged or about to engage in any business,

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(b) by a servant or agent as remuneration,

(c) by a widow or child of a deceased partner, as annuity, or

(d) by a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner with the persons carrying on the business.

As discussed earlier, sharing of profit is an essential element to constitute a partnership. But, it is only a *prima facie* evidence and not conclusive evidence, in that regard. The sharing of profits or of gross returns accruing from property by persons holding joint or common interest in the property would not by itself make such persons partners. Although the right to participate in profits is a strong test of partnership, and there may be cases where, upon a simple participation in profits, there is a partnership, yet whether the relation does or does not exist must depend upon the whole contract between the parties.

Where there is an express agreement between partners to share the profit of a business and the business is being carried on by all or any of them acting for all, there will be no difficulty in the light of provisions of Section 4, in determining the existence or otherwise of partnership.
But the task becomes difficult when either there is no specific agreement, or the agreement is such as does not specifically speak of partnership. In such a case for testing the existence or otherwise of partnership relation, Section 6 has to be referred.

According to Section 6, regard must be had to the real relation between the parties as shown by all relevant facts taken together. The rule is easily stated and is clear but its application is difficult. Cumulative Effect of all relevant facts such as written or verbal agreement, real intention and conduct of the parties, other surrounding circumstances etc., are to be considered while deciding the relationship between the parties and ascertaining the existence of partnership.

3. **Agency:** Existence of Mutual Agency, which is the cardinal principle of partnership law, is very much helpful in reaching a conclusion in this regard. Each partner carrying on the business is the principal as well as an agent of other partners. So, the act of one partner done on behalf of firm, binds all the partners. If the elements of mutual agency relationship exist between the parties constituting a group formed with a view to earn profits by running a business, a partnership may be deemed to exist.

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Santiranjan Das Gupta Vs. Dasyran Murzamull (Supreme Court)

In *Santiranjan Das Gupta Vs. DasyranMurzamull*, following factors weighed upon the Supreme Court to reach the conclusion that there is no partnership between the parties:

(a) Parties have not retained any record of terms and conditions of partnership.

(b) Partnership business has maintained no accounts of its own, which would be open to inspection by both parties

(c) No account of the partnership was opened with any bank
No written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership.

4.1.3 PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANISATION

Partnership vs. Hindu Undivided Family

Basis of difference	Partnership	Joint Hindu family
Mode of creation	Partnership is created necessarily by an agreement.	The right in the joint family is created by status means its creation by birth in the family.
Death of a member	Death of a partner ordinarily leads to the dissolution of partnership.	The death of a member in the Hindu undivided family does not give rise to dissolution of the family business.
Management	All the partners are equally entitled to take part in the partnership business.	The right of management of joint family business generally vests in the Karta, the governing male member or female member of the family. 1
Authority to bind	Every partner can, by his act, bind the firm.	The Karta or the manager, has the authority to contract for the family business and the other members in the family.
Liability	In a partnership, the liability of a partner is unlimited.	In a Hindu undivided family, only the liability of the Karta is unlimited, and the other coparcener are liable only to

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		the extent of their share in the profits of the family business.
Calling for accounts on closure	A partner can bring a suit against the firm for accounts, provided he also seeks the dissolution of the firm.	On the separation of the joint family, a member is not entitled to ask for account of the family business.
Governing Law	A partnership is governed by the Indian Partnership Act, 1932.	A Joint Hindu Family business is governed by the Hindu Law.
Minor's capacity	In a partnership, a minor cannot become a partner, though he can be admitted to the benefits of partnership, only with the consent of all the partners.	In Hindu undivided family business, a minor becomes a member of the ancestral business by the incidence of birth. He does not have to wait for attaining majority.
Continuity	A firm subject to a contract between the partners gets dissolved by death or insolvency of a partner.	A Joint Hindu family has the continuity till it is divided. The status of Joint Hindu family is not thereby affected by the death of a member.
Number of Members	In case of Partnership number of members should not exceed 50.	Members of HUF who carry on a business may be unlimited in number.
Share in the business	In a partnership each partner has a defined share by virtue of an agreement between the partners.	In a HUF, no coparceners has a definite share. His interest is a fluctuating one. It is capable of being enlarged by deaths in the family diminished by births in the family.

Difference between a partnership and a company

The following are the differences between the partnership and a company:

Basis	**Partnership**	**Company**
Legal entity	It is not a separate legal entity.	A company is a separate legal entity.
Liability	The liability of the partners is unlimited.	The liability of the members of the company is limited.

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Number of members	Minimum required is two. Maximum number can be 100 subject to some exceptions present Rules provide 50.	Minimum number of members for a private company is 2 and maximum 200. Minimum number of members for a public limited company is 7 and there is no limited for maximum.
Transfer of shares	A partner cannot transfer his share without the consent of other members	Transfer of shares in a public limited company is not a restricted one.
Management	The firm can be run by all or any of the partners.	The Board of Directors is having responsibility to run the management
Relationship	The relationship with partners is of that of agency.	No such relationship in the company.
Profit distribution	Profit is distributed according to the agreement entered between partners; if no agreement equal distribution.	No requirement of profit distribution to members. It is at the discretion of the management to declare dividend that too only out of profits.
Remedy to creditors	The creditors of a firm can proceed against the partners jointly and severally.	The creditors can proceed only against the company and not against shareholders.

Difference between partnership and limited liability partnership

Base	**Partnership**	**Limited Liability Partnership**
Legal entity	It is not a separate legal entity	It is a separate legal entity
Liability	The liability of the partners is unlimited.	The liability of the members of the LLP is limited.
Number of members	Minimum required is two. Maximum number is 100 subject to some exceptions	Minimum number of members for a LLP is 2 and no limit for maximum numbers.
Entering into contracts	Partnership is not a separate person and enter into contract on behalf of its partners	LLP is capable of entering into contracts and holding property in its own name
Compliance of law	Lesser compliance	More compliance under LLP Act.

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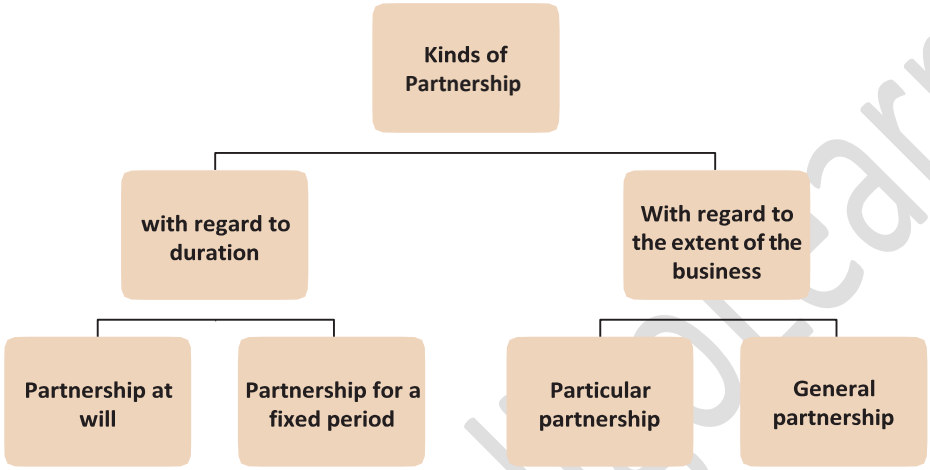
Dissolution	Firm can be dissolved on the eve of death of partner, retirement of partner etc., unless otherwise than agreed to in the agreement.	LLP can be dissolved by complying with the provisions of LLP (Winding up and Dissolution) Rules, 2012.

4.1.4 KINDS OF PARTNERSHIPS



1. **Partnership at will according to Section 7 of the Act, partnership at will is a partnership when:**
   1. no fixed period has been agreed upon for the duration of the partnership; and
   2. there is no provision made as to the determination of the partnership.

These two conditions must be satisfied before a partnership can be regarded as a partnership at will. But, where there is an agreement between the partners either for the duration of the partnership or for the determination of the partnership, the partnership is not partnership at will.

Where a partnership entered into for a fixed term is continued after the expiry of such term, it is to be treated as having become a partnership at will.

A partnership at will may be dissolved by any partner by giving notice in writing to all the other partners of his intention to dissolve the same.

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'. It is a partnership created for a particular period of time. Such a partnership comes to an end on the expiry of the fixed period.
3. **Particular partnership:** A partnership may be organized for the prosecution of a single adventure as well as for the conduct of a continuous business. Where a person becomes a partner with another person in any particular adventure or undertaking the partnership is called 'particular partnership'.

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A partnership, constituted for a single adventure or undertaking is, subject to any agreement, dissolved by the completion of the adventure or undertaking.

4. **General partnership:** Where a partnership is constituted with respect to the business in general, it is called a general partnership. A general partnership is different from a particular partnership. In the case of a particular partnership the liability of the partners extends only to that particular adventure or undertaking, but it is not so in the case of general partnership.

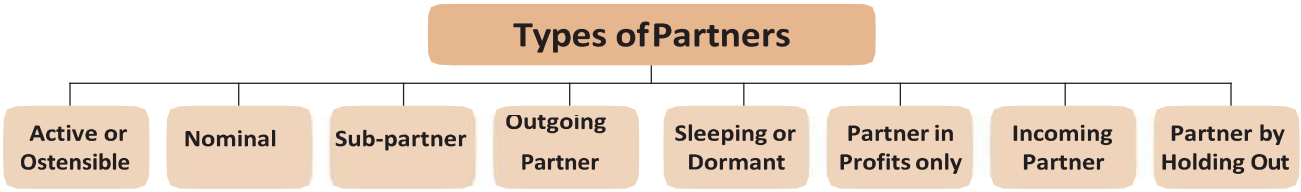
4.1.5 Partnership Deed

Partnership is the result of an agreement. No particular formalities are required for an agreement of partnership. It may be in writing or formed verbally. But it is desirable to have the partnership agreement in writing to avoid future disputes. The document in writing containing the various terms and conditions as to the relationship of the partners to each other is called the 'partnership deed'. It should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899. Where the partnership comprises immovable property, the instrument of partnership must be in writing, stamped and registered under the Registration Act.

Partnership deed may contain the following information:-

1. Name of the partnership form.
2. Names of all the partners.
3. Nature and place of the business of the firm.
4. Date of commencement of partnership.
5. Duration of the partnership firm.
6. Capital contribution of each partner.
7. Profit Sharing ratio of the partners.
8. Admission and Retirement of a partner.
9. Rates of interest on Capital, Drawings, and loans.
10. Provisions for settlement of accounts in the case of dissolution of the firm.
11. Provisions for Salaries or commissions, payable to the partners, if any.
12. Provisions for expulsion of a partner in case of gross breach of duty or fraud.
13. A partnership firm may add or delete any provision according to the needs of the firm.

4.1.6 TYPES OF PARTNERS



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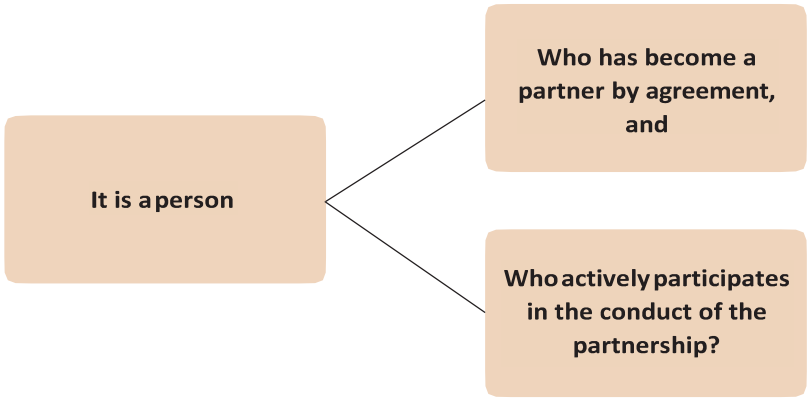
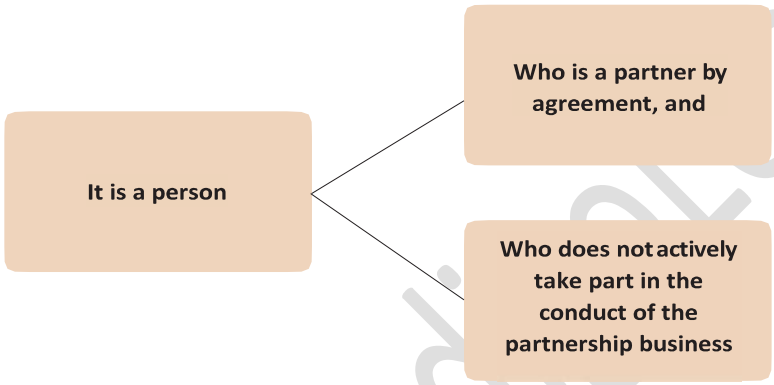
Active or Actual or Ostensible partner:



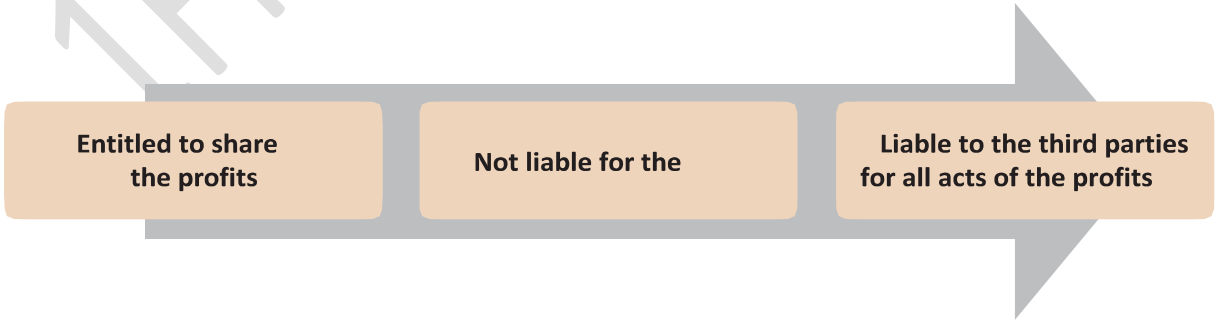
Sleeping or Dormant Partner:



Nominal Partner: A person who lends his name to the firm, without having any real interest in it, is called a nominal partner.

He is not entitled to share the profits of the firm. Neither he invest in the firm nor takes part in the conduct of the business. He is, however, liable to third parties for all acts of the firm.

Partner in profits only: A partner who is entitled to share the profits only without being liable for the losses is known as the partner for profits only and also liable to the third parties for all acts of the profits only.



Incoming partners: A person who is admitted as a partners into an already existing firm with the consent of all the existing partners is called as "incoming partner". Such a partner is not liable for any act of the firm done before his

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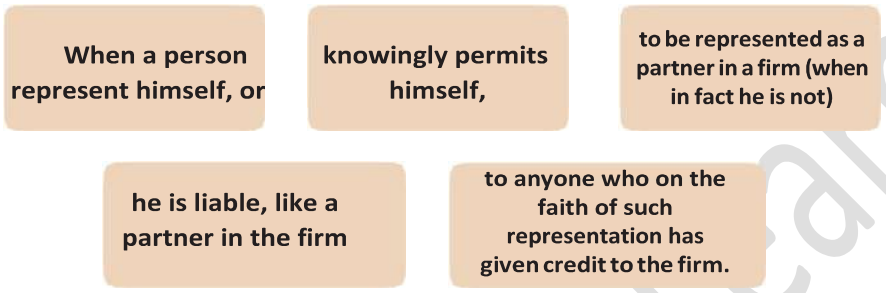
admission as a partner.

Outgoing partner: A partner who leaves a firm in which the rest of the partners continue to carry on business is called a retiring or outgoing partner. Such a partner remains liable to third parties for all acts of the firm until public notice is given of his retirement.

Partner by holding out (Section 28): Partnership by holding out is also known as partnership by estoppel. Where a man holds himself out as a partner, or allows others to do it, he is then stopped from denying the character he has assumed and



upon the faith of which creditors may be presumed to have acted.

A person may himself, by his words or conduct have induced others to believe that he is a partner or he may have allowed others to represent him as a partner. The result in both the cases is identical.

Example: X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. After expiry of credit period, Z did not get amount of T.V sets sold to the partnership firm. Z filed a suit against X and A for the recovery of price. Here, in the given case, A, the Manager is also liable for the price because he becomes a partner by holding out (Section 28, Indian Partnership Act, 1932).

It is only the person to whom the representation has been made and who has acted thereon that has right to enforce liability arising out of 'holding out'.

You must also note that for the purpose of fixing liability on a person who has, by representation, led another to act, it is not necessary to show that he was actuated by a fraudulent intention.

4.2 Rights and Liabilities of Partners

4.2.1 RELATION OF PARTNERS TO ONE ANOTHER

The Partnership Act contains various provisions regulating the relationship between partners.

1. **GENERAL DUTIES OF PARTNERS (SECTION 9):** Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative.

Analysis of 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. A partner must observe the utmost good faith in his dealings with the other partners.

All the partners are bound to render accounts to each other but where some of the accounts are kept by one of them, prima facie he would be the proper person to explain and give full information about them.

Example:

In a transaction between partners for the sale and purchase of a share in the business, if one of them is better acquainted with the accounts than the other, it is his duty to disclose all material facts.

2. **DUTY TO INDEMNIFY FOR LOSS CAUSED BY FRAUD (SECTION 10):** Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm.

Analysis of section 10: The partner, committing fraud in the conduct of the business of the firm, must make good the loss sustained by the firm by his misconduct and the amount so brought in the partnership should be divided between the partners.

An act of a partner imputable to the firm or the principles of agency, which is a fraud on his co-partners, entitles the co-partners, as between themselves, to throw the whole of the consequences upon him.

3. **DETERMINATION OF RIGHTS AND DUTIES OF PARTNERS BY CONTRACT BETWEEN THE PARTNERS (SECTION 11):**

(1) Subject to the provisions of this Act, the mutual rights, and duties of the partners of a firm may be determined by contract between the partners, and such contract may be express or may be implied by a course of dealing.

Such contract may be varied by consent of all the partners, and such consent may be express or may be implied by a course of dealing.

(2) **Agreements in restraint of trade-** Notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such contracts may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

Analysis of section 11:

Section 11(1) provides that, subject of the provisions of the Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners and such contract may be express or may be implied

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by a course of dealing. It further provides that such contract may be varied by consent of all the partners.

Section 11(2) clearly provides that, notwithstanding anything contained in section 27 of the Indian Contract Act, the contract between the partners may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

Partnership is a relation eminently depending on the consent of the parties, not only for its existence, but for the terms of the agreement in all things consistent with its essential nature and purpose; and an agreement to become partners in the first instance, or to vary the terms at any time, need not be manifested in any particular form.

4. **THE CONDUCT OF THE BUSINESS (SECTION 12):** Subject to contract between the partners-

(a) every partner has a right to take part in the conduct of the business.

(b) every partner is bound to attend diligently to his duties in the conduct of the business.

(c) any difference arising as to ordinary matters connected with the business may be decided by majority of the partners, and every partner shall have the right to express his opinion before the matter is decided, but no change may be made in the nature of the business without the consent of all partners; and

(d) every partner has a right to have access to and to inspect and copy any of the books of the firm.

Analysis of section 12

(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. This is because partnership business is a business of the partners and their management powers are generally coextensive.

Example: Now suppose this management power of the particular partner is interfered with and he has been wrongfully precluded from participating therein. Can the Court interfere in these circumstances? The answer is in the aflrmative. The Court can, and will, by injunction, restrain other partners from doing so. It may be noted in this connection that a partner who has been wrongfully deprived of the right of participation in the management has also other remedies, e.g., a suit for dissolution, a suit for accounts without seeking dissolution, etc.

The above mentioned provisions of law will be applicable only if there is no contract to the contrary between the partners. It is quite common to find a term in partnership agreements, which gives only limited power of

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management to a partner or a term that the management of the partnership will remain with one or more of the partners to the exclusion of others. In such a case, the Court will normally be unwilling to interpose with the management with such partner or partners, unless it is clearly made out that something was done illegally or in breach of the trust reposed in such 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, and every partner shall have the right to express his opinion before the matter is decided. But no change in the nature of the business of the firm can be made without the consent of all the partners. This means that in routine matters, the opinion of the majority of the partners will prevail. Of course, the majority must act in good faith and every partner must be consulted as far as practicable.

It may be mentioned that 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 whether active or sleeping is entitled to have access to any of the books of the firm and to inspect and take out of copy thereof. The right must, however, be exercised *bona fide*.

5. **MUTUAL RIGHTS AND LIABILITIES (SECTION 13):** Subject to contract between the partners-

(a) 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, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six percent 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

(ii) in doing such act, 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; and

(f)) a partner shall indemnify the firm for any loss caused to it by his wilful

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neglect in the conduct of business of the firm.

Analysis of section 13

(i) **Right to remuneration [Section 13(a)]:** No partner is entitled to receive any remuneration in addition to his share in the profits of the firm for taking part in the business of the firm. But this rule can always be varied by an express agreement, or by a course of dealings, in which event the partner will be entitled to remuneration. Thus, a partner can claim remuneration even in the absence of a contract when such remuneration is payable under the continued usage of the firm. In other words, where it is customary to pay remuneration to a partner for conducting the business of the firm, he can claim it even in the absence of a contract for the payment of the same.

(ii) **Right to share Profits [Section 13 (b)]:** Partners are entitled to share equally in the profits earned and so contribute equally to the losses sustained by the firm. The amount of a partner's share must be ascertained by enquiring whether there is any agreement in that behalf between the partners. If there is no agreement then you should make a presumption of equality and the burden of proving that the shares are unequal, will lie on the party alleging the same.

There is no connection between the proportion in which the partners shall share the profits and the proportion in which they have contributed towards the capital of the firm.

(iii) **Interest on Capital [Section 13 (c)]:** The following elements must be there before a partner can be entitled to interest on moneys brought by him in the partnership business: (i) an express agreement to that effect, or practice of the particular partnership or (ii) any trade custom to that effect; or a statutory provision which entitles him to such interest.

(iv) **Interest on advances [Section 13 (d)]:** Suppose a partner makes an advance to the firm in addition to the amount of capital to be contributed by him, in such a case, the partner is entitled to claim interest thereon @ 6% per annum. While interest on capital account ceases to run on dissolution, the interest on advances keep running even after dissolution and up to the date of payment.

(v) **Right to be indemnified [Section 13 (e)]:** Every partner has the right to be indemnified by the firm in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business of the firm as well as in the performance of an act in an emergency for protecting the firm from any loss, if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstances.

(vi) **Right to indemnify the firm [Section 13 (f)]:** A partner must indemnify

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the firm for any loss caused to it by wilful neglect in the conduct of the business of the firm.

4.2.2 PARTNERSHIP PROPERTY (SECTION 14)

1. **THE PROPERTY OF THE FIRM (SECTION 14):** Subject to contract between the partners, the property of the firm includes all property and rights and interest in property originally brought into the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business.

   Unless the contrary intention appears, property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm.

   Analysis of section 14:

   The expression 'property of the firm', also referred to as 'partnership property', 'partnership assets', 'joint stock', 'common stock' or 'joint estate', denotes all property, rights and interests to which the firm, that is, all partners collectively, may be entitled. The property which is deemed as belonging to the firm, in the absence of any agreement between the partners showing contrary intention, is comprised of the following items:

(i) all property, rights, and interests which partners may have brought into the common stock as their contribution to the common business.

(ii) 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

(iii) Goodwill of the business.

The determination of the question whether a particular property is or is not 'property' of the firm ultimately depends on the real intention or agreement of the partners. Thus, the mere fact that the property of a partner is being used for the purposes of the firm shall not by itself make it partnership property, unless it is intended to be treated as such. Partners may, by an agreement at any time, convert the property of any partner or partners (and such conversion, if made in good faith, would be Effectual between the partners and against the creditors of the firm) or the separate property of any partner into a partnership property.

Goodwill: Section 14 specifically lays down that the goodwill of a business is subject to a contract between the partners, to be regarded as 'property' of the 'firm'. But this Section does not define the term Goodwill.

'Goodwill' is a concept which is very easy to understand but difficult to define. Goodwill may be defined as the value of the reputation of a business house in respect of profits expected in future over and above

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the normal level of profits earned by undertaking belonging to the same class of business.

When a partnership firm is dissolved every partner has a right, in the absence of any agreement to the contrary, to have the goodwill of business sold for the benefit of all the partners.

Goodwill is a part of the property of the firm. It can be sold separately or along with the other properties of the firm. Any partner may upon the sale of the goodwill of a firm, 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 and notwithstanding anything contained in Section 27 of the Indian Contract Act, 1872. Such agreement shall be valid if the restrictions imposed are reasonable.

Property of a partner: Where the property is exclusively belonging to a person, it does not become a property of the partnership merely because it is used for the business of the partnership, such property will become property of the partnership if there is an agreement.

2. **APPLICATION OF THE PROPERTY OF THE FIRM (SECTION 15):** Subject to contract between the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business.

Analysis of section 15:
Section 15 provides that the property of the firm shall be held and used exclusively for the purpose of the firm. In partnership, there is a community of interest which all the partners take in the property of the firm. But that does not mean than during the subsistence of the partnership, a particular partner has any proprietary interest in the assets of the firm. Every partner of the firm has a right to get his share of profits till the firm subsists and he has also a right to see that all the assets of the partnership are applied to and used for the purpose of partnership business.

4.2.3 PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16)

According to section 16, subject to contract between the partners,-

(a) If a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm.

(b) If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

Analysis of section 16

Where 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

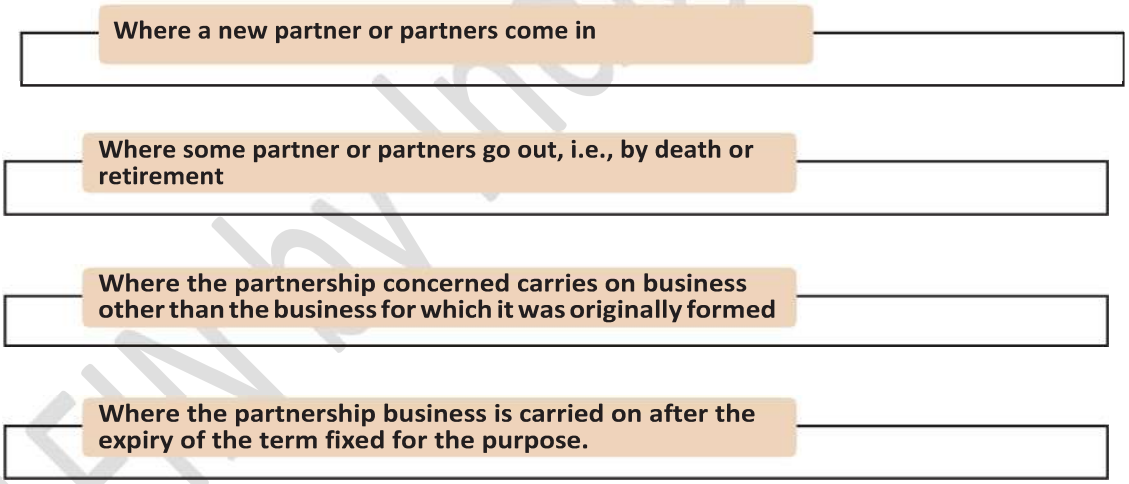
firm name, he must account for that profit and pay it to the firm.

Example: A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. It was held that A was bound to account to the firm for the profit so made by him. This rule, however, is subject to a contract between partners.

Where a partner carries on a competing business, he must account for and pay to the firm all profits made by him in that business.

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

Before going into rights and duties, we should first know how a change may take place in the constitution of the firm. It may occur in one of the four ways, namely,



According to section 17, subject to contract between the partners-

(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, as far as may be.

(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 as they were before the expiry, so far as they may be consistent with the incidents of partnership at will; and

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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 are the same as those in respect of the original adventures or undertakings.

4.2.5 RELATION OF PARTNERS TO THIRD PARTIES

1. **PARTNER TO BE AGENT OF THE FIRM (SECTION 18):** Subject to the provisions of this Act, a partner is the agent of the firm for the purposes of the business of the firm.

   Analysis of section 18:

   You may recall that a partnership is the relationship between the partners who have agreed to share the profits of the business carried on by all or any of them acting for all (Section 4). This definition suggests that any of the partners can be the agent of the others.
   Section 18 clarifies this position by providing that, subject to the provisions of the Act, a partner is the agent of the firm for the purpose of the business of the firm. The partner indeed virtually embraces the character of both a principal and an agent. So far as he acts for himself and in his own interest in the common concern of the partnership, he may properly be deemed a principal and so far as he acts for his partners, he may properly be deemed as an agent.

   The rule that a partner is the agent of the firm for the purpose of the business of the firm cannot be applied to all transactions and dealings between the partners themselves. It is applicable only to the act done by partners for the purpose of the business of the firm.

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

(1) Subject to the provisions of section 22, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm.

The authority of a partner to bind the firm conferred by this section is called his "implied authority".

(2) 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

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(h) enter into partnership on behalf of the firm.

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

Analysis of section 19 and 22:

At the very outset, you should understand what is meant by "implied authority". You have just read that every partner is an agent of the firm for the purpose of the business thereof. Consequently, as between the partners and the outside world (whatever may be their private arrangements between themselves), each partner is agent of every other in every matter connected with the partnership business; his acts bind the firm.

Sections 19(1) and 22 deal with the implied authority of a partner. The impact of these Sections is that the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm binds the firm, provided that the act is done in the firm name, or any manner expressing or implying an intention to bind the firm. Such an authority of a partner to bind the firm is called his implied authority. It is however subject to the following restrictions:

1. The act done must relate to the usual business of the firm, that is, the act done by the partner must be within the scope of his authority and related to the normal business of the firm.
2. The act is such as is done for normal conduct of business of the firm. The usual way of carrying on the business will depend on the nature and circumstances of each particular case [Section 19(1)].
   The act to be done in the name of the firm or in any other manner expressing or implying an intention to bind the firm (Section 22).

Example:

X, a partner in a firm of solicitors, borrows money and executes a promissory note in the name of firm without authority. The other partners are not liable on the note, as it is not part of the ordinary business of a solicitor to draw, accept, or endorse negotiable instruments, however it may be usual for one partner of firm of bankers to draw, accept or endorse a bill of exchange on behalf of the firm.

If partnership be of a general commercial nature,

(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.

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(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.

Section 19(2) contains the acts which are beyond the implied authority of the partners.

3. **EXTENSION AND RESTRICTION OF PARTNERS' IMPLIED AUTHORITY (SECTION 20):**

According to section 20, the partners in a firm may, by contract between the partners, extend or restrict implied authority of any partners.

Notwithstanding any such restriction, any act done by a partner on behalf of the firm which falls within his implied authority binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.

Analysis of section 20:

The implied authority of a partner may be extended or restricted by contract between the partners. Under the following conditions, the restrictions imposed on the implied authority of a partner by agreement shall be effective against a third party:

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)**

According to section 21, a partner has authority, in an emergency, to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm.

4.2.6 EFFECT OF ADMISSIONS BY A PARTNER (SECTION 23)

According to section 23, an admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary course of business.

Example: X and Y are partners in a firm dealing in spare parts of different brands of motorcycle bikes. Z purchases a spare part for his Yamaha motorcycle after being told by X that the spare part is suitable for his motorcycle. Y is ignorant about this transaction. The spare part proves to be unsuitable for the motorcycle and it is damaged. X and Y both are responsible to Z for his loss.

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4.2.7 EFFECT OF NOTICE TO ACTING PARTNER (SECTION 24)

According to section 24, notice to a partner who habitually acts in the business of the firm of any matter relating to the affairs of the firm operates as notice to the firm, except in the case of a fraud on the firm committed by or with the consent of that partner.

Example:

P, Q, and R are partners in a business for purchase and sale of second hand goods. R purchases a second hand car on behalf of the firm from S. In the course of dealings with S, he comes to know that the car is a stolen one and it actually belongs to X. P and Q are ignorant about it. All the partners are liable to X, the real owner.
The only exception would lie in the case of fraud, whether active or tacit.

4.2.8 LIABILITY TO THIRD PARTIES (SECTION 25 TO 27)

1. **LIABILITY OF A PARTNER FOR ACTS OF THE FIRM (SECTION 25):** Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner.
   Example:

   Certain persons were found to have been partners in a firm when the acts constituting an infringement of a trademark by the firm took place, it was held that they were liable for damages arising out of the alleged infringement, it being immaterial that the damages arose after the dissolution of the firm.
2. **LIABILITY OF THE FIRM FOR WRONGFUL ACTS OF A PARTNER (SECTION 26):** Where, by the wrongful act or omission of a partner in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefor to the same extent as the partner.
3. **LIABILITY OF FIRM FOR MISAPPLICATION BY PARTNERS (SECTION 27):** Where-
   (a) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or
   (b) a firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.

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

1. A transfer by a partner of his interest in the firm, either absolute or by

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mortgage, or by the creation by him of a charge on such interest, does not entitle the transferee, during the continuance of the firm, to interfere in the conduct of business, or to require accounts, or to inspect the books of the firm, but entitles the transferee only to receive the share of profits of the transferring partner, and the transferee shall accept the account of profits agreed to by the partners.

If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled as against the remaining partners to receive the share of the assets of the firm to which the transferring partner is entitled, and, for the purpose of ascertain that share, to an account as from the date of the dissolution.

2. On the dissolution of the firm or on the retirement of the transferring partner, the transferee will be entitled, against the remaining partners:

(a) to receive the share of the assets of the firm to which the transferring partner was entitled, and

(b) for the purpose of ascertaining the share, he is entitled to an account as from the date of the dissolution.

4.2.10 MINORS ADMITTED TO THE BENEFITS OF PARTNERSHIP (SECTION 30)

(1) A person who is a minor according to the law to which he is subject may not be a partner in a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

(2) Such minor has right to such share of the property and of the profits of the firm as may be agreed upon and he may have access to and inspect and copy any of the accounts of the firm.

(3) Such minor's share is liable for the acts of the firm, but the minor is not personally liable for any such act.

(4) Such minor may not sue the partners for an account or payment of his share of the property or profits of the firm, save when severing his connection with the firm, and in such case the amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in Section 48:

Provided that all the partners acting together or any partner entitled to dissolve the firm upon notice to other partners may elect in such suit to dissolve the firm, and thereupon the Court shall proceed with the suit as one for dissolution and for settling accounts between the partners, and the amount of the share of the minor shall be determined along with the shares of the partners.

(5) At any time within six months of his attaining majority, or of his obtaining

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knowledge that he had been admitted to the benefits of partnership, whichever date is later, such person may give public notice that he has elected to become or that he has elected not to become a partner in the firm, and such notice shall determine his position as regards the firm:

Provided that, if he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

Where any person has been admitted as a minor to the benefits of partnership in a firm, the burden of proving the fact that such person had no knowledge of such admission until a particular date after the expiry of six months of his attaining majority shall lie on the persons asserting that fact.

(6) Where such person becomes a partner,-

(a) his right and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership, and

(b) his share in the property and profits of firm shall be the share to which he was entitled as a minor.

(7) Where such person elects not to become a partner-

(a) his rights and liabilities shall continue to be those of a minor under this section up to the date on which he gives public notice,

(b) his share shall not be liable for any acts of the firm done after the date of the notice, and

(c) he shall be entitled to sue the partners for his share of the property and profits in accordance with sub-section (4).

(8) Nothing in sub-sections (7) and (8) shall affect the provisions of section 28.

(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. If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor. If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that Effect.

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(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 or on his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor partner has to decide whether he shall remain a partner or leave the firm.

Where he has elected not to become partner he may give public notice that he has elected not to become partner and such notice shall determine his position as regards the firm. If he fails to give such notice he shall become a partner in the firm on the expiry of the said six months.

(a) When he becomes partner: If the minor becomes a partner on his own willingness or by his failure to give the public notice within specified time, his rights and liabilities as given in Section 30(7) are as follows:

(i) He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

(ii) His share in the property and the profits of the firm remains the same to which he was entitled as a minor.

(b) When he elects not to become a partner:

(i) His rights and liabilities continue to be those of a minor up to the date of giving public notice.

(ii) His share shall not be liable for any acts of the firm done after the date of the notice.

(iii) He shall be entitled to sue the partners for his share of the property and profits. It may be noted that such minor shall give notice to the Registrar that he has or has not become a partner.

4.2.11 LEGAL CONSEQUENCES OF PARTNER COMING IN AND GOING OUT (SECTION 31 – 35)

(i) INTRODUCTION OF A PARTNER (SECTION 31):

(1) Subject to contract between the partners and to the provisions of section 30, no person shall be introduced as a partner into a firm without the consent of all the existing partners.

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(2) Subject to the provisions of section 30, a person who is introduced as a partner into a firm does not thereby become liable for any acts of the firm done before he became a partner.

(ii) 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. The new firm, including the new partner who joins it, may agree to assume liability for the existing debts of the old firm, and creditors may agree to accept the new firm as their debtor and discharge the old partners. The creditor's consent is necessary in every case to make the transaction operative. Novation is the technical term in a contract for substituted liability, of course, not confined only to case of partnership.

But a mere agreement amongst partners cannot operate as Novation. Thus, an agreement between the partners and the incoming partner that he shall be liable for existing debts will not ipso facto give creditors of the firm any right against him.

In case of partnership of two partners: This section does not apply to a partnership of two partners which is automatically dissolved by the death of one of them.

(iii) RETIREMENT OF A PARTNER (SECTION 32):

(1) 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.

(2) A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by an agreement made by him with such third party and the partners of the reconstituted firm, and such agreement may be implied by a course of dealing between the third party and the reconstituted firm after he had knowledge of the retirement.

(3) Notwithstanding the retirement of a partner from a firm, 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:

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

(4) Notices under sub-section (3) may be given by the retired partner or by any partner of the reconstituted firm.

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Analysis of section 32:

A partner is said to retire when he ceases to be a member of the firm without bringing to an end the subsisting relations between the other members, or between the firm and third parties. The term 'does not cover the case where a partner withdraws from a firm by dissolving it, which should properly be referred as a dissolution and not as a retirement. Retirement of a partner from a firm does not dissolve it.

Vishnu Chandra Vs. Chandrika Prasad [Supreme Court]

The Supreme Court in *Vishnu Chandra Vs. Chandrika Prasad*, held that the expression 'if any partner wants to dissociate from the partnership business', in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from the partnership. The expression clearly indicated that in the event of retirement, the partnership business will not come to an end.

(iv) Liabilities of an outgoing partner: As we have already stated earlier, a retiring partner continues to be liable to third party for acts of the firm after his retirement until public notice of his retirement has been given either by himself or by any other partner. But the retired partner will not be liable to any third party if the latter deals with the firm without knowing that the former was partner.

The liability of a retired partner to the third parties continues until a public notice of his retirement has been given. As regards the liability for acts of the firm done before his retirement, the retiring partner remains liable for the same, unless there is an agreement made by him with the third party concerned and the partners of the reconstituted firm. Such an agreement may be implied by a course of dealings between the third party and the reconstituted firm after he had knowledge of the retirement.

(v) EXPULSION OF A PARTNER (SECTION 33):

(1) A partner may not be expelled from a firm by any majority of the partners, save in the exercise in good faith of powers conferred by contract between the partners.

(2) the provisions of sub-section (2), (3) and (4) of section 32 shall apply to an expelled partner as if he were a retired partner.

(vi) INSOLVENCY OF A PARTNER (SECTION 34):

(1) Where a partner in a firm is adjudicated an insolvent, he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is hereby dissolved.

(2) Where under a contract between the partners the firm is not dissolved by the adjudication of a partner as an insolvent, the estate of a partner so adjudicated is not liable for any act of the firm and the firm is not liable

for any act of the insolvent, done after the date on which the order of adjudication is made.

(vii) **LIABILITY OF ESTATE OF DECEASED PARTNER (SECTION 35):** Where under a contract between the partners, the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death.

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

(1) An outgoing partner may carry on business competing with that of the firm and he may advertise such business, but subject to contract to the contrary, he may not,-

(a) use the firm name,

(b) represent himself as carrying on the business of the firm or

(c) solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

Agreement in restraint of trade- (2) A partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within a specified period or within specified local limits and, notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such agreement shall be valid if the restrictions imposed are reasonable.

Analysis of section 36:

Although this provision has imposed some restrictions on an outgoing partner, it Effectively permits him to carry on a business competing with that of the firm. However, the partner may agree with his partners that on his ceasing to be so, he will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement will not be in restraint of trade if the restraint is reasonable [Section 36(2)]. A similar rule applies to such an agreement of sale of the firm's goodwill [Section 53(3)].

4.2.13 RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS (SECTION 37)

According to section 37, Where any member of a firm has died or otherwise ceased to be partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is

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entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm:

Provided that whereby contract between the partners, an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions

Example 1:

A, B and C are partners in a manufacture of machinery. A is entitled to three-eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. A's estate is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

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

According to section 38, a continuing guarantee given to a firm or to third party in respect of the transaction of a firm is, in the absence of an agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.

4.3 Formation; Reconstitution and Dissolution of Firms

4.3.1 REGISTRATION OF FIRMS

APPLICATION FOR REGISTRATION (SECTION 58): (1) The registration of a firm may be Effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating-

(a) The firm's name

(b) The place or principal place of business of the firm,

(c) The names of any other places where the firm carries on business,

(d) the date when each partner joined the firm,

(e) the names in full and permanent addresses of the partners, and (f) the

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duration of the firm.
The statement shall be signed by all the partners, or by their agents specially authorised in this behalf.

(2) Each person signing the statement shall also verify it in the manner prescribed.

(3) A firm name shall not contain any of the following words, namely:-

'Crown', Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or words expressing or implying the sanction, approval or patronage of Government except when the State Government signifies its consent to the use of such words as part of the firm-name by order in writing.

Analysis:

The registration of a partnership is optional and one partner cannot compel another partner to join in the registration of the firm. It is not essential that the firm should be registered from the very beginning. When the partners decide to get the firm registered as per the provisions of Section 58 of the Indian Partnership Act, 1932, they have to file the statement in the prescribed form.

When the Registrar is satisfied that the above mentioned provisions have been complied with, he shall record an entry of this statement in the register (called the Register of Firms) and shall file the statement.

Subsequent alterations in the name, place, constitution, etc., of the firm that may occur during its continuance should also be registered.

REGISTRATION (SECTION 59): When the Registrar is satisfied that the provisions of section 58 (above mentioned provisions) have been duly complied with, he shall record an entry of the statement in a register called the Register of Firms, and shall file the statement.

Analysis

When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the statement in a Register called the Register of Firms and shall file the statement. Then he shall issue a certificate of Registration. However, registration is deemed to be completed as soon as an application in the prescribed form with the prescribed fee and necessary details concerning the particulars of partnership is delivered to the Registrar. The recording of an entry in the register of firms is a routine duty of Registrar.
Registration may also be Affected even after a suit has been filed by the firm but in that case, it is necessary to withdraw the suit first and get the firm registered and then file a fresh suit.

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

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the time specified in sub-section (1A) of section 58, then the firm may be registered on payment, to the Registrar, of a penalty of one hundred rupees per year of delay or a part thereof.

4.3.2 CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

Under the English Law, the registration of firms is compulsory. Therefore, there is a penalty for non- registration of firms. But the Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration. However, **under Section 69**, non-registration of partnership gives rise to a number of disabilities which we shall presently discuss. Although registration of firms is not compulsory, yet the consequences or disabilities of non-registration have a persuasive pressure for their registration. These disabilities briefly are as follows:

(i) **No suit in a civil court by firm or other co-partners against third party:** The firm or any other person on its behalf cannot bring an action against the third party for breach of contract entered into by the firm, unless the firm is registered and the persons suing are or have been shown in the register of firms as partners in the firm. In other words, a registered firm can only file a suit against a third party and the persons suing have been in the register of firms as partners in the firm.

(ii) **No relief to partners for set-out of claim:** If an action is brought against the firm by a third party, then neither the firm nor the partner can claim any set-out, if the suit be valued for more than `100 or pursue other proceedings to enforce the rights arising from any contract.

(iii) **Aggrieved partner cannot bring legal action against other partner or the firm:** A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. But such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.

(iv) **Third party can sue the firm:** In case of an unregistered firm, an action can be brought against the firm by a third party.

Exceptions: Non-registration of a firm does not, however Effect the following rights:

1. The right of third parties to sue the firm or any partner.
2. The right of partners to sue for the dissolution of the firm or for the settlement of the accounts of a dissolved firm, or for realization of the property of a dissolved firm.
3. The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.

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The right to sue or claim a set-out if the value of suit does not exceed `100 in value.

The test applied in these cases was whether the plantiff satisfied the only two requirements of Section 69
(2) of the Act namely,

(i) the suit must be instituted by or on behalf of the firm which had been registered.

(ii) the person suing had been shown as partner in the register of firms. In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.

Now, in the above example, what difference would it make, if in 2017 B and C had taken a new partner, D, and then filed a suit against X without fresh registration?

Where a new partner is introduced, the fact is to be notified to Registrar who shall make a record of the notice in the entry relating to the firm in the Register of firms. Therefore, the firm cannot sue as D's (new partner's) name has not been entered in the register of firms. It was pointed out that in the second requirement, the phrase "person suing" means persons in the sense of individuals whose names appear in the register as partners and who must be all partners in the firm at the date of the suit.

4.3.3 DISSOLUTION OF FIRM (SECTIONS 39 - 47)

According to Section 39 of the Indian Partnership Act, 1932, the dissolution of partnership between all partners of a firm is called the 'dissolution of the firm'.

Analysis

Thus, the dissolution of firm means the discontinuation of the jural relation existing between all the partners of the firm. But when only one or more partners retires or becomes incapacitated from acting as a partner due to death, insolvency or insanity, the partnership, i.e. the relationship between such a partner and other is dissolved, but the rest may decide to continue. In such cases, there is in practice, no dissolution of the firm. The particular partner goes out, but the remaining partners carry on the business of the firm, it is called dissolution of partnership. In the case of dissolution of the firm, on the other hand, the whole firm is dissolved. The partnership terminates as between each and every partner of the firm.

Dissolution of Firm Vs. Dissolution of Partnership

S. No.	Basis of Difference	Dissolution of Firm	Dissolution of Partnership
1.	Continuation of business	It involves discontinuation of	It does not affect continuation of

		business in partnership.	business. It involves only reconstitution of the firm.
2.	Winding up	It involves winding up of the firm and requires realization of assets and settlement of liabilities.	It involves only reconstitution and requires only revaluation of assets and liabilities of the firm.
3.	Order of court	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
4.	Scope	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.
5.	Final closure of books	It involves final closure of books of the firm.	It does not involve final closure of the books.

4.3.4 Modes of Dissolution of a firm (Sections 40-44)

The dissolution of partnership firm may be in any of the following ways:

1. **DISSOLUTION WITHOUT THE ORDER OF THE COURT OR VOLUNTARY DISSOLUTION:**

It consists of following four types:

(i) Dissolution by agreement (Section 40):

A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners.

Analysis

Section 40 gives right to the partners to dissolve the partnership by agreement with the consent of all the partners or in accordance with a contract between the partners. 'Contract between the partners' means a contract already made.

(ii) Compulsory dissolution (Section 41):

A firm is compulsorily dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership:

Provided that, when more than one separate adventure or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

Example: A firm is carrying on the business of trading a particular chemical and a law is passed which bans on the trading of such a particular chemical.

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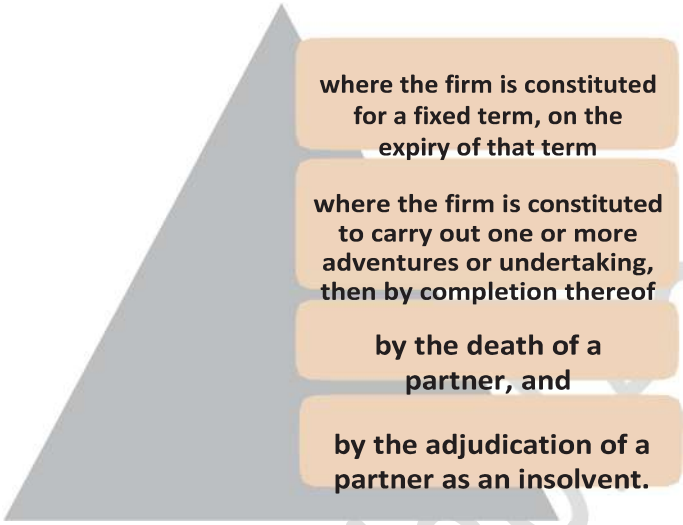
The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.

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

Subject to contract between the partners, a firm can be dissolved on the happening of any of the following contingencies-



(iv) Dissolution by notice of partnership at will (Section 43):

(1) Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

(2) If the date is mentioned, the firm is dissolved as from the date mentioned in the notice as the date of dissolution, or if no date is so mentioned, as from the date of the communication of the notice.

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

Court may, at the suit of the partner, dissolve a firm on any of the following ground:

(a) *Insanity/unsound mind:* Where a partner (not a sleeping partner) has become of unsound mind, the court may dissolve the firm on a suit of the other partners or by the next friend of the insane partner. Temporary sickness is no ground for dissolution of firm.

(b) *Permanent incapacity:* When a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner, then the court may dissolve the firm. Such permanent incapacity may result from physical disability or illness etc.

(c) *Misconduct:* Where a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of business, the court may order for dissolution of the firm, by giving regard to the nature of business. It is not necessary that misconduct must relate to the

conduct of the business. The important point is the adverse Effect of misconduct on the business. In each case nature of business will decide whether an act is misconduct or not.

(d) *Persistent breach of agreement:* Where a partner other than the partner suing, wilfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conduct himself in matters relating to the business that it is not reasonably practicable for other partners to carry on the business in partnership with him, then the court may dissolve the firm at the instance of any of the partners. Following comes into category of breach of contract:

- Embezzlement,
- Keeping erroneous accounts
- Holding more cash than allowed
- Refusal to show accounts despite repeated request etc.

Example: If one of the partners keeps erroneous accounts and omits to enter receipts or if there is continued quarrels between the partners or there is such a state of things that destroys the mutual confidence of partners, the court may order for dissolution of the firm.

(e) *Transfer of interest:* Where a partner other than the partner suing, has transferred the whole of his interest in the firm to a third party or has allowed his share to be charged or sold by the court, in the recovery of arrears of land revenue, the court may dissolve the firm at the instance of any other partner.

(f) *Continuous/Perpetual losses:* Where the business of the firm cannot be carried on except at a loss in future also, the court may order for its dissolution.
Just and equitable grounds: Where the court considers any other ground to be just and equitable for the dissolution of the firm, it may dissolve a firm. The following are the cases for the just and equitable grounds-

(i) Deadlock in the management.

(ii) Where the partners are not in talking terms between them.

(iii) Loss of substratum.

(iv) Gambling by a partner on a stock exchange.

4.3.5 CONSEQUENCES OF DISSOLUTION (SECTIONS 45 - 55)

Consequent to the dissolution of a partnership firm, the partners have certain rights and liabilities, as are discussed:

(a) Liability for acts of partners done after dissolution (Section 45): (1) Notwithstanding the dissolution of a firm, the partners continue to be liable as such to third parties for any act done by any of them which would have

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been an act of the firm if done before the dissolution, until public notice is given of the dissolution:

Provided that the estate of a partner who dies, or who is adjudicated an insolvent, or of a partner who, not having been known to the person dealing with the firm to be a partner, retires from the firm, is not liable under this section for acts done after the date on which he ceases to be a partner.

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

Analysis

Section 45 has two fold objectives-

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.

Example: X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution. In such a case, Y also would be liable for the amount because no public notice was given.

However, there are exceptions to the rule stated in above example i.e even where notice of dissolution has not been given, there will be no liability for subsequent acts in the case of:

(a) the estate of a deceased partner,

(b) an insolvent partner, or

(c) a dormant partner, i.e., a partner, who was not known as a partner to the person dealing with the firm.

(b) Right of partners to have business wound up after dissolution (Section 46): On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representative, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights.

(c) Continuing authority of partners for purposes of winding up (Section 47): After the dissolution of a firm the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners, continue notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise:

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Provided that the firm is in no case bound by the acts of a partner who has been adjudicated insolvent; but this proviso does not affect the liability of any person who has after the adjudication represented himself or knowingly permitted himself to be represented as a partner of the insolvent.

(d) Settlement of partnership accounts (Section 48): In settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:-

(i) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.

(ii) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, must be applied in the following manner and order:

(a) in paying the debts of the firm to third parties.

(b) in paying to each partner rateably what is due to him from capital.

(c) in paying to each partner rateably what is due to him on account of capital; and

(d) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Analysis of Section 48

It may be noted that *prima facie*, accounts between the partners shall be settled in the manner prescribed by partnership agreement. The above-mentioned rules apply subject to any agreement between partners. The rules laid down in Section 48, just specified, as to what will be the mode of settlement of accounts in the usual course of business. But if the partners, by their agreement, express any different intention as to the mode in which losses will have to be borne eventually or the manner in which capital or advances will have to be paid to any partner, such an intention must be given Effect to. However, any such agreement cannot affect the rights of the creditors of the firm.

The significance of the foregoing provisions is that if the assets of the firm are not sufficient to pay out the liabilities of the firm including the amount due to each partner on account of capital, each partner would individually be liable to contribute towards the losses, including deficiencies of capital, in the proportion in which he is entitled to share profits.

If in the above example, the agreement provided that on dissolution the surplus assets would be divided between the partners according to their respective interests in the capital and on the dissolution of the firm a deficiency of capital was found, then the assets would be divided between

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the partners in proportion to their capital with the result that X's estate would be the main loser.

(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.

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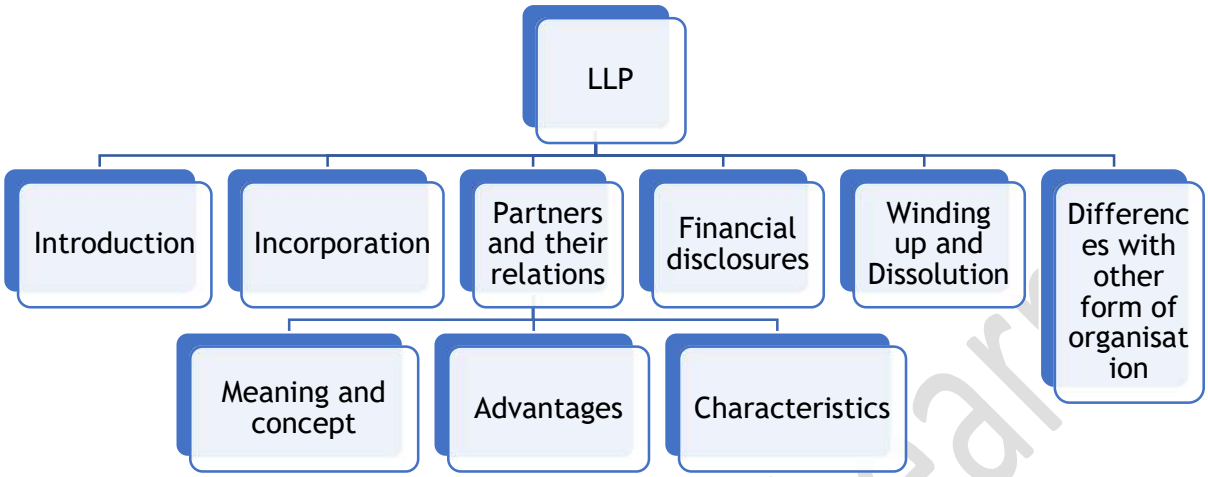
5. Limited Liability Partnership Act, 2008



5.1 Introduction

The Ministry of Law and Justice on 9th January2007 notified the Limited Liability Partnership Act, 2008.

The Parliament passed the Limited Liability Partnership Bill on 12th December,2008 and the President of India has assented the Bill on 7th January, 2009 and called as the Limited Liability Partnership Act, 2008.

This Act have been enacted to make provisions for the formation and regulation of Limited Liability Partnerships and for matters connected there with or incidental thereto.

The LLP Act, 2008 has 81 sections and 4 schedules.

- **The First Schedule deals** with mutual rights and duties of partners, as well limited liability partnership and its partners where there is absence of a formal agreement with respect to them.
- **The Second Schedule** deals with conversion of a firm into LLP.
- **The Third Schedule** deals with conversion of a private company into LLP.
- **The Fourth Schedule** deals with conversion of unlisted public company into LLP.

The Ministry of Corporate Affairs and the Registrar of Companies (ROC) are entrusted with the task of administrating the LLP Act, 2008. The Central Government has the authority to frame the Rules with regard to the LLP Act, 2008, and can amend them by notifications in the Official Gazette, from time to time.

It is also to be noted that the Indian Partnership Act, 1932 is not applicable to LLPs.

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5.1.1 Need of new form of Limited Liability Partnership



The lawmakers envisage the needs for bringing out creation of the Limited Liability Partnership to meet growth of the Indian economy. A need has been felt fo that would provide an alternative to the traditional par personal liability on the one hand and the statute-based governance structure of the limited liability company on the other hand, in order to enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.

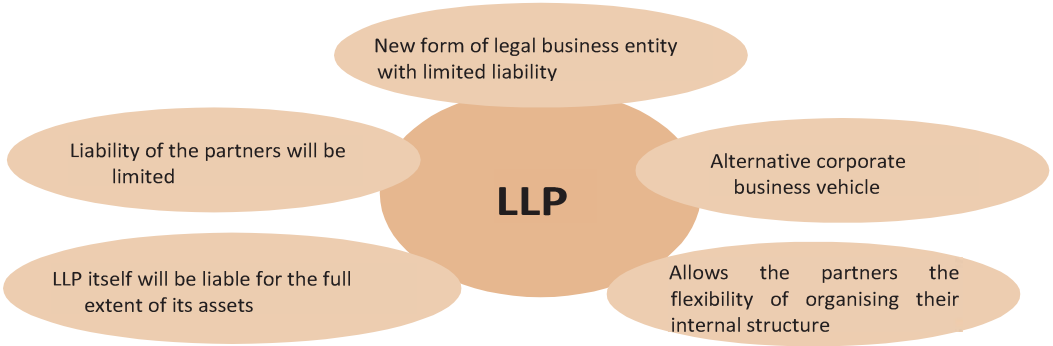
The Limited Liability Partnership (LLP) is viewed as an alternative corporate business vehicle. It provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form enables entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP is a suitable vehicle for small enterprises and for investment by venture capital.

5.1.2 LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT



Meaning: A LLP is a new form of legal business entity with limited liability. It is an alternative corporate business vehicle that not only gives the benefits of limited liability at low compliance cost but allows its partners the flexibility of organising their internal structure as a traditional partnership. The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of the partners will be limited.

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership.
Since LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure' LLP is called a hybrid between a company and a partnership.



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5.1.3 Important Definitions

1. **Body Corporate [(Section 2(d)]:** It means a company as defined in section 3 of the Companies Act, 1956 (now Companies Act, 2013) and includes—
   (i) an LLP registered under this Act.
   (ii) an LLP incorporated outside India; and
   (iii) a company incorporated outside India, but does not include—
   (i) a corporation soles.
   (ii) a co-operative society registered under any law for the time being in force; and
   (iii) any other body corporate (not being a company as defined in section 3 of the Companies Act, 1956 or a limited liability partnership as defined in this Act), which the Central Government may, by notification in the Official Gazette, specify in this behalf.
2. **Business [Section 2(e)]:** "Business" includes every trade, profession, service, and occupation.
3. **Designated Partner [Section 2(j)]:** "Designated partner" means any partner designated as such pursuant to section 7.
4. **Entity [Section 2(k)]:** ''Entity" means anybody corporate and includes, for the purposes of sections 18, 46, 47, 48, 49, 50, 52 and 53, a firm setup under the Indian Partnership Act, 1932.
5. **Financial Year [Section 2(l)]:** "Financial year", in relation to an LLP, means the period from the 1st day of April of a year to the 31st day of March of the following year.

   However, in the case of a LLP incorporated after the 30th day of September of a year, the financial year may end on the 31st day of March of the year next following that year.
6. **Foreign LLP [section 2(m)]:** It means an LLP formed, incorporated, or registered outside India which establishes a place of business within India.
7. **Limited liability partnership [Section 2(n)]:** Limited Liability Partnership means a partnership formed and registered under this Act.
8. **Limited Liability partnership agreement [Section 2(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(q)]:** Partner, in relation to an LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement.
10. **Non-applicability of the Indian Partnership Act, 1932 (Section 4):** Save as otherwise provided, the provisions of the Indian Partnership Act, 1932

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shall not apply to an LLP.

11. **Partners (Section 5):** Any individual or body corporate may be a partner in an LLP. However, an individual shall not be capable of becoming a partner of an LLP, if—
    a. he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force.
    b. he is an undischarged insolvent; or
    c. he has applied to be adjudicated as an insolvent and his application is pending.

12. **Minimum number of partners (Section 6):**Every LLP shall have at least two partners.

    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 during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period.

13. **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.
    (ii) If in LLP, all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such body's corporate shall act as designated partners.
    (iii) *Resident in India*: For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less than 182 days during the immediately preceding one year.

5.1.4 Characteristic/Salient Features of LLP

1. **LLP is a body corporate:** Section 2(1)(d) of the LLP Act, 2008 provides that an LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners and shall have perpetual succession. Therefore, any change in the partners of an LLP shall not affect the existence, rights, or liabilities of the LLP.

   Section 3 of LLP Act provides that a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.

2. **Perpetual Succession:** The LLP can continue its existence irrespective of changes in partners. Death, insanity, retirement, or insolvency of partners has

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no impact on the existence of LLP. It is capable of entering into contracts and holding property in its own name.

3. **Separate Legal Entity:** The LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. In other words, creditors of LLP shall be the creditors of LLP alone.

4. **Mutual Agency:** Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct. In other words, all partners will be the agents of the LLP alone. No one partner can bind the other partner by his acts.

5. **LLP Agreement:** Mutual rights and duties of the partners within an LLP are governed by an agreement between the partners. The LLP Act, 2008 provides flexibility to partner to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act, 2008.

6. **Artificial Legal Person:** An LLP is an artificial legal person because it is created by a legal process and is clothed with all rights of an individual. It can do everything which any natural person can do, except of course that, it cannot be sent to jail, cannot take an oath, cannot marry or get divorce nor can it practice a learned profession like CA or Medicine. An LLP is invisible, intangible, immortal (it can be dissolved by law alone) but not fictitious because it really exists.

7. **Common Seal:** An LLP being an artificial person can act through its partners and designated partners. LLP may have a common seal if it decides to have one [Section 14(c)]. Thus, it is not mandatory for an LLP to have a common seal. It shall remain under the custody of some responsible official and it shall be affixed in the presence of at least 2 designated partners of the LLP.

8. **Limited Liability:** Every partner of a LLP is, for the purpose of the business of LLP, the agent of the LLP, but not of other partners (Section 26). The liability of the partners will be limited to their agreed contribution in the LLP. Such contribution may be of tangible or intangible nature or both.

9. **Management of Business:** The partners in the LLP are entitled to manage the business of LLP. But only the designated partners are responsible for legal compliances.

10. **Minimum and Maximum number of Partners:** Every LLP shall have least two partners and shall also have at least 2 individuals as designated partners, of whom at least one shall be resident in India. There is no maximum limit on the partners in LLP.

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

5.1.5 Advantages of LLP form- LLP form is a form of business model which:

- is organized and operates on the basis of an agreement.
- provides flexibility without imposing detailed legal and procedural requirements
- Easy to form
- All partners enjoy limited liability
- Flexible capital structure
- Easy to dissolve

5.1.6 INCORPORATION OF LLP

A. Incorporation document (Section 11):

1) For an LLP to be incorporated:

(a) two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document.

(b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the Registrar of the State in which the registered office of the LLP is to be situated; and

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(c) Statement to be filed:

- there shall be filed along with the incorporation document, a statement in the prescribed form,
- made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the LLP and
- by anyone who subscribed his name to the incorporation document,
- that all the requirements of this Act and the rules made thereunder have been complied with,
- in respect of incorporation and matters precedent and incidental thereto

2) 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 for a term which may extend to 2 years and with fine which shall not be less than Rs. 10,000 but which may extend to Rs. 5 Lakhs.

B. Incorporation by registration (Section 12):

(1) When the requirements imposed by clauses (*b*) and (*c*) of sub-section (*1*) of section 11 have been complied with, the Registrar shall retain the incorporation document and, unless the requirement imposed by clause (*a*) of that sub-section has not been complied with, he shall, within a period of 14 days—

(a) register the incorporation document; and

(b) give a certificate that the LLP is incorporated by the name specified therein.

(2) The Registrar may accept the statement delivered under clause (*c*) of sub-section (*1*) of section 11 as sufficient evidence that the requirement imposed by clause (*a*) of that sub-section has been complied with.

(3) The certificate issued under clause (*b*) of sub-section (*1*) shall be signed by the Registrar and authenticated by his official seal.

(4) The certificate shall be conclusive evidence that the LLP is incorporated by the name specified therein.

C. 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

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and any other address specifically declared by the LLP for the purpose in such form and manner as may be prescribed.

(3) A LLP may change the place of its registered office and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.

(4) If the LLP contravenes any provisions of this section, the LLP and its every partner shall be punishable with fine which shall not be less than Rs. 2,000 but which may extend to Rs. 25,000.

D. 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 partnership firm or LLP or body corporate or a registered trademark, or a trademark which is the subject matter of an application for registration of any other person under the Trademarks Act, 1999.

E. 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—

the name of a proposed LLP

) the name to which a LLP proposes to change its name.

(2) Upon receipt of an application under sub-section (*1*) and on payment of the prescribed fee, the Registrar may, if he is satisfied, subject to the rules prescribed by the Central Government in the matter, that the name to be reserved is not one which may be rejected on any ground referred to in sub-section (*2*) of section 15, reserve the name for a period of 3 months from the date of intimation by the Registrar.

F. Change of name of LLP (Section 17):

(1) Notwithstanding anything contained in sections 15 and 16, where the Central Government is satisfied that an LLP has been registered (whether through inadvertence or otherwise and whether originally or by a change of name) under a name which —

(a) is a name referred to in sub-section (*2*) of section 15; or

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(b) is identical with or too nearly resembles the name of any other LLP or body corporate or other name as to be likely to be mistaken for it,

the Central Government may direct such LLP to change its name, and the LLP shall comply with the said direction within 3 months after the date of the direction or such longer period as the Central Government may allow.

(2) (i) Any LLP which fails to comply with a direction given under sub-section (*1*) shall be punishable with fine which shall not be less than Rs. 10,000 but which may extend to Rs. 5 Lakhs.

(ii) The designated partner of such LLP shall be punishable with fine which shall not be less than Rs. 10,000 but which may extend to Rs. 1 Lakh.

5.1.7 PARTNERS AND THEIR RELATIONS

Eligibility to be partners (Section 22): On the incorporation of a LLP, the persons who subscribed their names to the incorporation document shall be its partners and any other person may become a partner of the LLP by and in accordance with the LLP agreement.

Relationship of partners (Section 23):

(1) Save as otherwise provided by this Act, the mutual rights and duties of the partners of a LLP, and the mutual rights and duties of a LLP and its partners, shall be governed by the LLP agreement between the partners, or between the LLP and its partners.

(2) The LLP agreement and any changes, if any, made therein shall be filed with the Registrar in such form, manner and accompanied by such fees as may be prescribed.

(3) An agreement in writing made before the incorporation of an LLP between the persons who subscribe their names to the incorporation document may impose obligations on the LLP, provided such agreement is ratified by all the partners after the incorporation of the LLP.

(4) In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the LLP and the partners shall be determined by the provisions relating to that matter as are set-out in the First Schedule.

Cessation of partnership interest (Section 24):

(1) A person may cease to be a partner of a LLP in accordance with an agreement with the other partners or, in the absence of agreement with the other partners as to cessation of being a partner, by giving a notice in writing of not less than 30 days to the other partners of his intention to resign as partner.

(2) A person shall cease to be a partner of an LLP—

(a) on his death or dissolution of the LLP; or

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(b) if he is declared to be of unsound mind by a competent court; or
(c) if he has applied to be adjudged as an insolvent or declared as an insolvent.

(3) Where a person has ceased to be a partner of a LLP (hereinafter referred to as "former partner"), the former partner is to be regarded (in relation to any person dealing with the LLP) as still being a partner of the LLP unless—
(a) the person has notice that the former partner has ceased to be a partner of the LLP; or
(b) notice that the former partner has ceased to be a partner of the LLP has been delivered to the Registrar.

(4) The cessation of a partner from the LLP does not by itself discharge the partner from any obligation to the LLP or to the other partners or to any other person which he incurred while being a partner.

(5) Where a partner of a LLP ceases to be a partner, unless otherwise provided in the LLP agreement, the former partner or a person entitled to his share in consequence of the death or insolvency of the former partner, shall be entitled to receive from the LLP—
(a) an amount equal to the capital contribution of the former partner actually made to the LLP; and
(b) his right to share in the accumulated profits of the LLP, after the deduction of accumulated losses of the LLP, determined as at the date the former partner ceased to be a partner.

A former partner or a person entitled to his share in consequence of the death or insolvency of the former partner shall not have any right to interfere in the management of the LLP.

Registration of changes in partners (Section 25):

(1) Every partner shall inform the LLP of any change in his name or address within a period of 15 days of such change.

(2) An LLP shall—
(a) where a person becomes or ceases to be a partner, file a notice with the Registrar within 30 days from the date he becomes or ceases to be a partner: and
(b) where there is any change in the name or address of a partner, file a notice with the Registrar within 30 days of such change.

(3) A notice filed with the Registrar under sub-section (*2*)—
(a) shall be in such form and accompanied by such fees as may be prescribed.
(b) shall be signed by the designated partner of the LLP and authenticated in a manner as may be prescribed; and
(c) if it relates to an incoming partner, shall contain a statement by such partner that he consents to becoming a partner, signed by him, and authenticated in the manner as may be prescribed.

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(4) If the LLP contravenes the provisions of sub-section (*2*), the LLP and every designated partner of the LLP shall be punishable with fine which shall not be less than Rs. 2,000 but which may extend to Rs. 25,000.

(5) If any partner contravenes the provisions of sub-section (*1*), such partner shall be punishable with fine which shall not be less than Rs. 2,000 but which may extend to Rs. 25,000.

(6) Any person who ceases to be a partner of a LLP may himself file with the Registrar the notice referred to in sub-section (*3*) if he has reasonable cause to believe that the LLP may not file the notice with the Registrar and in case of any such notice filed by a partner, the Registrar shall obtain a confirmation to this effect from the LLP unless the LLP has also filed such notice.

However, where no confirmation is given by the LLP within 15 days, the registrar shall register the notice made by a person ceasing to be a partner under this section.

5.1.8 EXTENT AND LIMITATION OF LIABILITY OF LLP AND PARTNER

Partner as agent (Section 26): Every partner of a LLP is, for the purpose of the business of the LLP, the agent of the LLP, but not of other partners.

Extent of liability of LLP (Section 27):

(1) An LLP is not bound by anything done by a partner in dealing with a person if—
   (a) the partner in fact has no authority to act for the LLP in doing a particular act; and
   (b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.
   (c) The LLP is liable if a partner of an LLP is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the LLP or with its authority.

(2) An obligation of the LLP whether arising in contract or otherwise, shall be solely the obligation of the LLP.

(3) The liabilities of the LLP shall be met out of the property of the LLP.

Extent of liability of partner (Section 28):

(1) A partner is not personally liable, directly, or indirectly for an obligation referred to in sub-section (*3*) of section 27 solely by reason of being a partner of the LLP.

(2) The provisions of sub-section (*3*) of section 27 and sub-section (*1*) of this section shall not affect the personal liability of a partner for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the LLP.

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Holding out (Section 29):

(1) • Any person,

- who by words spoken or written or by conduct,
- represents himself, or knowingly permits himself to be represented to be a partner in an LLP
- is liable to any person
- who has on the faith of any such representation?
- given credit to the LLP, whether the person representing himself or represented to be a partner
- does or does not know that the representation has reached the person so giving credit.

However,

- where any credit is received by the LLP as a result of such representation, the LLP shall,
- without prejudice to the liability of the person so representing himself or represented to be a partner,
- be liable to the extent of credit received by it or any financial benefit derived thereon.

(2) Where after a partner's death the business is continued in the same LLP name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.

Unlimited liability in case of fraud (Section 30):

(1) In case of fraud:

- In the event of an act carried out by an LLP, or any of its partners,
- with intent to defraud creditors of the LLP or any other person, or for any fraudulent purpose,

  the liability of the LLP and partners who acted with intent to defraud creditors or for any fraudulent purpose.
- shall be unlimited for all or any of the debts or other liabilities of the LLP.

  However, in case any such act is carried out by a partner, the LLP is liable to the same extent as the partner unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.

(2) Where any business is carried on with such intent or for such purpose as mentioned in sub-section (*1*), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with

- imprisonment for a term which may extend to 2 years and
- with fine which shall not be less than Rs. 50,000 but which may extend to Rs.

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5 Lakhs.

(3) Where a LLP or any partner or designated partner or employee of such LLP has conducted the affairs of the LLP in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the LLP and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.

However, such LLP shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the LLP.

Whistle blowing (Section 31):

(1) The Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of an LLP, if it is satisfied that—

- such partner or employee of an LLP has provided useful information during investigation of such
  LLP; or
- when any information given by any partner or employee (whether or not during investigation) leads to LLP or any partner or employee of such LLP being convicted under this Act or any other Act.

No partner or employee of any LLP may be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his LLP or employment merely because of his providing information or causing information to be provided pursuant to sub-section (*1*).

5.1.9 DIFFERENCES WITH OTHER FORMS OF ORGANISATION

Distinction between LLP and Partnership Firm: The points of distinction between a limited liability partnership and partnership firm are tabulated as follows:

	Basis	LLP	Partnership firm
1.	Regulating Act	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
2.	Body corporate	It is a body corporate.	It is not a body corporate,
3.	Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
4.	Creation	It is created by a legal process called registration under the LLP Act, 2008.	It is created by an agreement between the partners.

5.	Registration	Registration is mandatory. LLP can sue and be sued in its own name.	Registration is voluntary. Only the registered partnership firm can sue the third parties.
6.	Perpetual succession	The death, insanity, retirement or insolvency of the partner(s) does not affect its existence of LLP. Members may join or leave but its existence continues forever.	The death, insanity, retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
7.	Name	Name of the LLP to contain the word limited liability partners (LLP) as suflx.	No guidelines. The partners can have any name as per their choice.
8.	Liability	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended up to the personal assets of the partners.
9.	Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
10.	Designated partners	At least two designated partners and at least one of them shall be resident in India.	There is no provision for such partners under the partnership Act, 1932.
11.	Common seal	It may have its common seal as its official signatures.	There is no such concept in partnership
12.	Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
13.	Annual filing of documents	LLP is required to file: (i) Annual statement of accounts (ii) Statement of solvency (iii)Annual return with the	Partnership firm is not required to file any annual document with the registrar of firms.

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		registration of LLP every year.	
14.	Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
17.	Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

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14. The Companies Act, 2013



Title	The Companies Act,2013
Extent	Whole of India
Applicability	Companies Registered under this act or any earlier Act Insurance/ Banking/ Electricity Companies Entities specified by Central Government

14.1.1 Introduction to Company Law

What is a Company?

Company is one of the many structures in which business can be done. Other forms of business structures include sole proprietor, partnership, societies, etc. The benefits offered by the company over other forms include separate ownership from management, longevity, expandability over generations, geographies & products & limited liability of investors.

Basic Features of a Company

i. Limited Liability
ii. Separate legal entity
iii. Perpetual succession
iv. Transferability of shares
v. Separation of ownership from management
vi. Lawful purpose
vii. Can sue and be sued
viii. Can buy & sell property on its own name

Law governing Companies

Act: Companies are governed by the Companies Act 2013. It contains 470 Sections divided into 29 Chapters where in sections relating to common topics are written together. Furthermore, it contains I to VII schedules.

Rules: Every chapter of the Companies Act has relevant Rules running parallel to it. They contain procedures to be followed in order to implement law.

Notifications: MCA brings out amendments in the existing law and rules through notifications in the official gazette. They must be read along with the Act. Laws are applicable from the effective date as mentioned in such notifications.

Judicial pronouncements: Even with laws & procedures in place, there may be disputes during or after implementation or the lack thereof. Such disputes are handled by courts. The judgements of the different suits are also to be read along with the Act & rules to fully understand law governing companies.

Judicial courts that handle disputes arising from Companies Act 2013 are:

NCLT → NCLAT → Supreme Court

(National Company Law Tribunal) (National Company Law Appellate Tribunal)

Administration machinery under Companies Act, 2013
Merely writing the law does not ensure its compliance. Hence, there is need for regulatory bodies to administer the compliance by companies. Such bodies include:

Ministry of Corporate Affairs: MCA is the ministry of government that regulates corporate affairs at central level through the Companies Act, 1956, 2013 and other allied Acts, Bills and Rules. It also protects investors and offers many important services to stakeholders.

Regional Directors: RD are in-charge of the respective regions, each region comprising a number of States and Union Territories. They supervise the working of the offices of the Registrars of Companies and the Official Liquidators working in their regions.

Registrar of Companies: ROC is vested with the primary duty of registering companies and LLPs, ensuring compliance with statutory requirements, maintaining registers and records, allowing their inspection on payment of the

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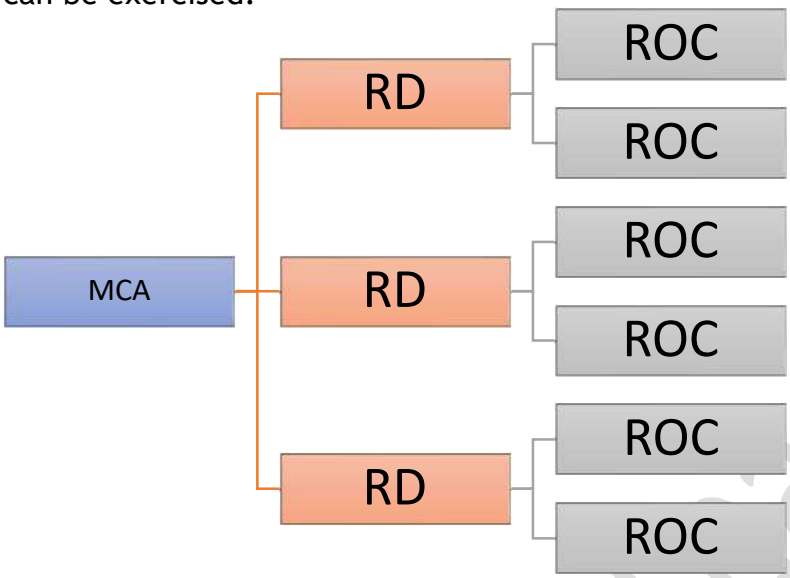
prescribed fee, etc. ROC's have prescribed jurisdiction within which their powers & functions can be exercised.



Section 1 - Short Title, Extent, Commencement and Application.

(1) This Act may be called the Companies Act, 2013.

(2) It extends to the whole of India.

(3) This section shall come into force at once and the remaining provisions of this Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act and any reference in any provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

(4) The provisions of this Act shall apply to—

(a) Companies incorporated under this Act or under any previous company law.
(b) Insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 (4 of 1938) or the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999).
(c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949 (10 of 1949).
(d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003 (36 of 2003).
(e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act; and
(f) Such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject

to such exceptions, modifications, or adaptation, as may be specified in the notification.

14.1.2 Incorporation of the Company

Section 4 -22

Incorporation of a Company means the process of registration of a company to bring it into existence as a separate legal entity.

Promoter:

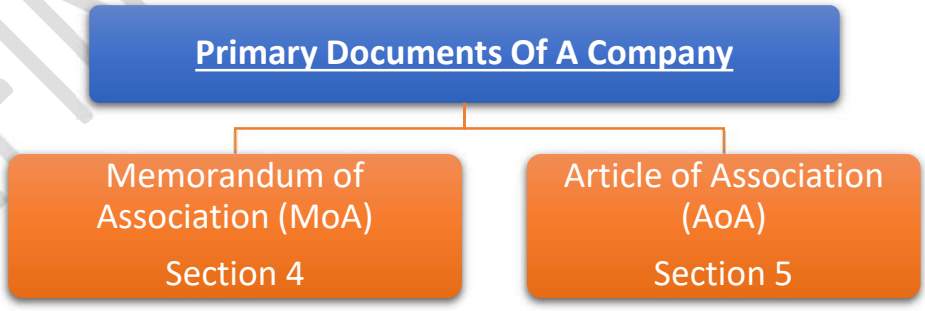
Persons who initiate promotion of a company are known as promoters. All persons who take steps for the registration of a company e.g., those associated with the preparation of a prospectus or in drawing up the Memorandum of Association of the company and assisting in its registration are regarded as promoters.

The registration procedure is undertaken by 'Promoter' of the company. Promoters are the founders of the company & they pitch the initial ideas for business.

Companies Act 2013 has defined the term **under Sec 2(69)**:A promoter is

a) Person named in prospectus or annual return as promoter or
b) 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.

But it does not include any person acting merely in professional capacity. (Eg: Banker, Chartered Accountant)



Section 4 - Memorandum of Association

MOA is a public document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders.

As per section 2(56) — *memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.*

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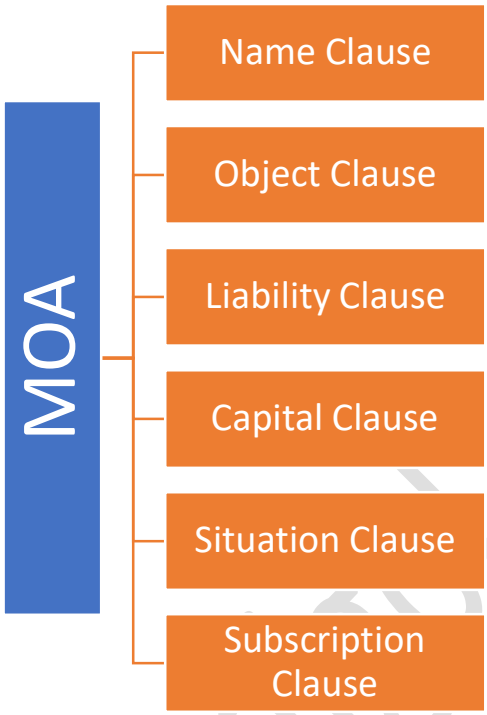
It is the base document for the formation of the company and along with the Articles of Association (AOA) is regarded as the Constitution of the Company.

It contains following clauses:



1. **Name Clause:**

- Clause contains the name of the company + suitable suffix like "Pvt Ltd."/ "Ltd."/ "producer Co. Ltd."/ "(OPC) Pvt. Ltd."/other
- Name of the company should **not** be
  - Offensive
  - Identical to existing Name of another company
  - Similar to existing Name of another company
  - Undesirable with respect to the objects of the company
  - Indicating association with Government of India (unless approved by Government)
  - Containing word "national" unless specific permission obtained from Central Government
  - Containing word "bank" unless it is involved in banking business.

- **Reservation of Name :**

Application must be sent to RoC in prescribed form & Fees RoC, if satisfied, may reserve the name of the company for a period of
(i) 20 days from the date of approval (in case name is being reserved for a new company) or
(ii) 60 days from the date of approval (in case of change of name of an existing company)

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During this period, the company is required to submit other documents for incorporation like MoA, AoA etc.

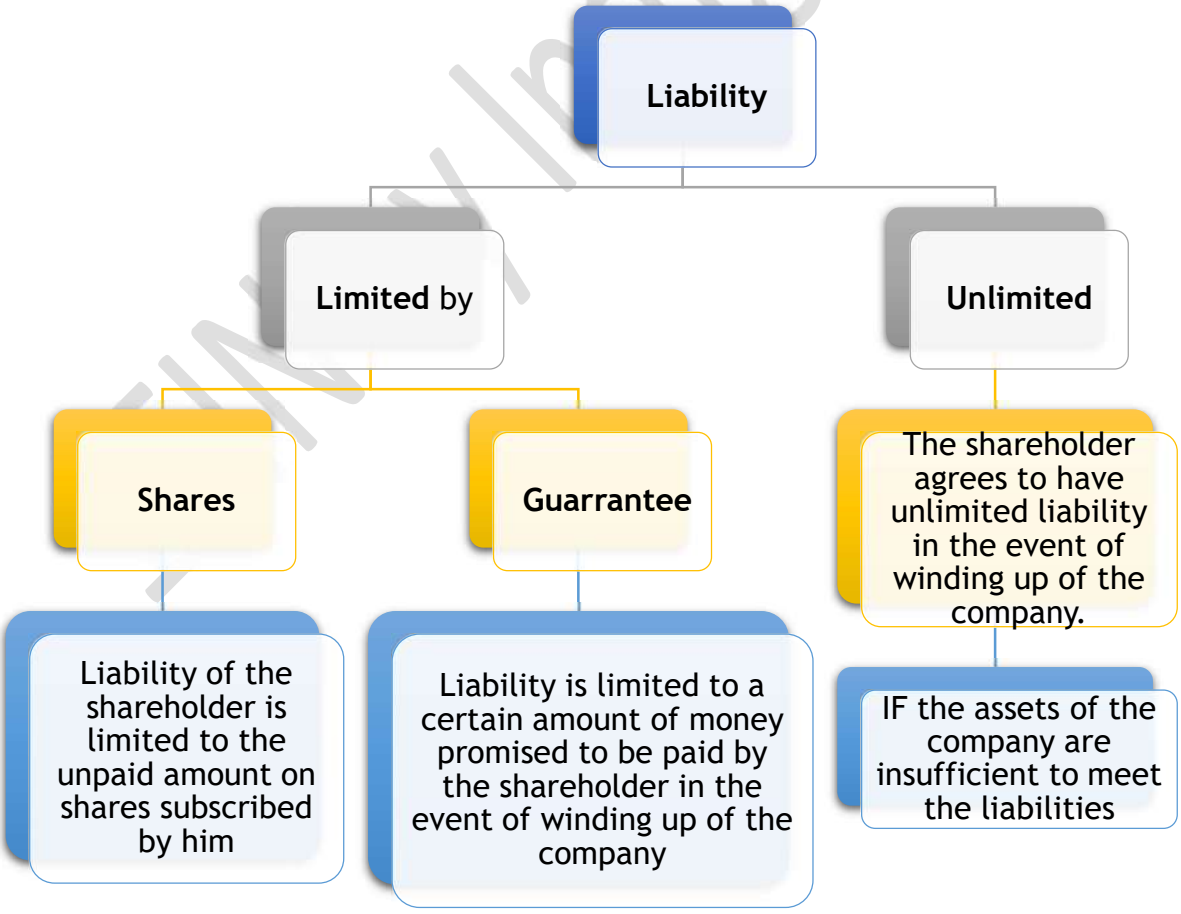
- Cancellation of name by ROC:
  - Before incorporation: If wrong information is provided by applicant or if time lapses
  - After incorporation: if name is not suitable, RoC allows reasonable opportunity to the applicant to justify, after which, RoC may,
  - require the company to alter the name within 3 months by passing Ordinary Resolution or
  - Strike off the name

2. Object Clause

It contains scope of business of the company, ie, main activity and ancillary activities.

3. Liability Clause

This clause covers details on the liability of members of the company, whether limited or unlimited. The clause shall also state liabilities as under -

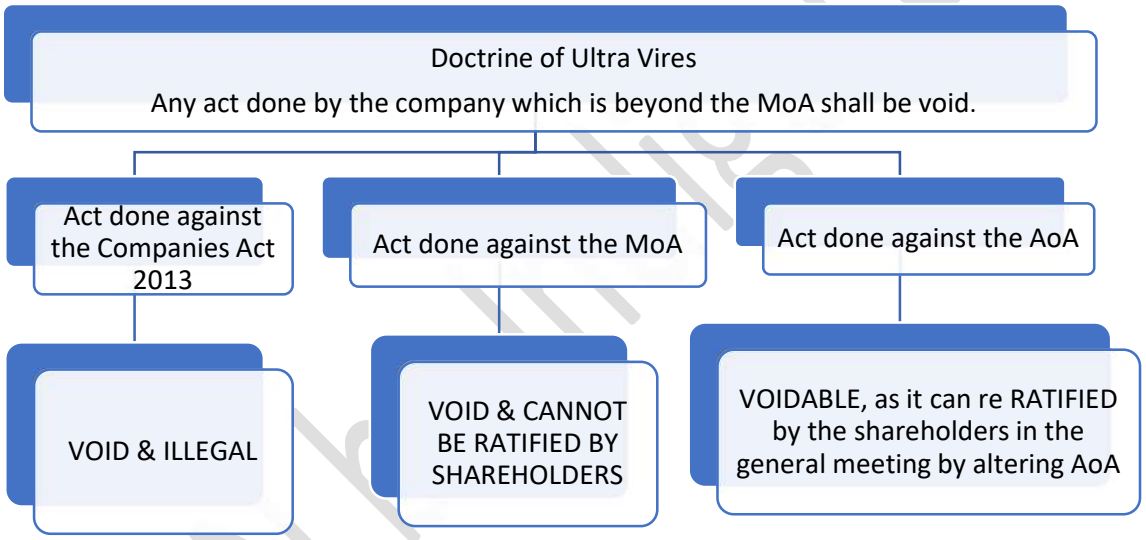


4. Capital Clause

- It states Authorised capital of the company & its division into types and number of shares.
- For an OPC, name of the nominee is mentioned in this clause.
  [NOTE: Authorised Capital means the maximum amount of the capital for which shares can be issued by the Company to shareholders. It is decided prior to the incorporation of the company and can be amended from time to time]

5. **Domicile/Situation Clause**
   It contains State in which registered office of the company is situated.

6. **Subscription Clause:**
   It states the purpose of the subscribers to incorporate the company wherein they agree to take the shares in the company based on the number written in the Memorandum. It contains signatures of such subscribers.



Section 5 - Articles of Association

- It contains the rules & regulations for the internal management of the company
- Model Articles have been specified in Table F, G, H, I and J in schedule I
- Company may include additional matters as per law
- Entrenchment Provision: It is such provision in AoA that makes certain amendments either more difficult or impossible to pass, making such amendments inadmissible. Overriding an entrenchment clause requires unanimous resolution in private company & SR in Public Company.

14.1.3 Doctrine of Indoor Management

It means that persons dealing with the company need not inquire whether the internal proceedings relating to the contract have been followed as long as they are satisfied that the transaction is as per the MoA/AoA.

This doctrine protects external stakeholders.

Exceptions to this Doctrine:

- Negligence on part of external party
- External party relies on a Forged document (Co. not responsible)
- External party has prior knowledge of irregularity

Section 6 - Companies Act Overrides
MoA, AoA, Agreement executed, or resolution passed by the company or board of directors.

Section 7 - Incorporation of the Company
Following documents must be filed with RoC under whose jurisdiction the company functions:

i. MoA signed by all subscribers
ii. AoA signed by all subscribers
iii. Declaration that all requirements of the act & rules have been satisfied by
   - Person named in AoA : Directors, secretary, Manager and
   - Persons engaged in formation of company: advocate/ CA/CS/cost accountant
iv. Affidavit from subscribers to MoA & first directors stating that:
   - They are not convicted of any offence in connection with formation of Company
   - Not guilty of misfeasance/breach under this or previous Companies Act
   - All documents & information contained in them are correct as per their knowledge
v. Address for correspondence till registered office is established
vi. Particulars and identity proof of subscribers to MoA
vii. Prescribed fees
viii. RoC shall issue fresh 'Certificate of Incorporation' & allot unique CIN (Corporate Identity Number)

If any person knowingly provides false information or suppresses any material facts: Liability u/s 447 attracted. Moreover, if a company is already formed with such information, application may be filed to tribunal. Tribunal shall give reasonable opportunity of being heard & accordingly pass following orders:

i. Changes in MoA, AoA in the interest of the company, members, creditors & public
ii. Direct liability of members to be unlimited
iii. Remove name of company
iv. Wind up of company
v. Other order as deems fit

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Section 9 - Effect of Registration

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, 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.

Section 10 - Effects of MoA, AoA registration:

Once registered, MoA & AoA shall bind the company & members. All monies payable by any member to the company under MoA/AoA, shall be debt due to company.

Section 10A - Commencement of business, etc.

Company incorporated after the commencement of Companies (Amendment) Ordinance, 2018 and having a share capital shall not commence any business or exercise any borrowing powers unless:

i. Declaration filed by directors within 180 days from incorporation stating that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him. Such declaration has to be signed by a Practicing CA/CS/CMA.
ii. Company has filed verification of registered office (U/S 12) with RoC
iii. Default: Company- 50K
Officer in default- Rs. 1000/ Day (Max 1 Lakh)
iv. Where conditions in i & ii are not followed, and RoC has reasonable cause to believe that company is not carrying on any business, it may initiate action for removal of name of company from register under chapter XVIII.

(Section 11 Omitted)

Section 12 - Registered office of the company

i. It should be a 'Physical Location' (Not a P.O. Box Number)
ii. Need for a registered office:
- To receive Communication from stakeholders/RoC
- To decide jurisdiction of RoC
- To decide nationality of the company
- Determination of place for conducting Annual General meeting
- Maintenance of records / registers

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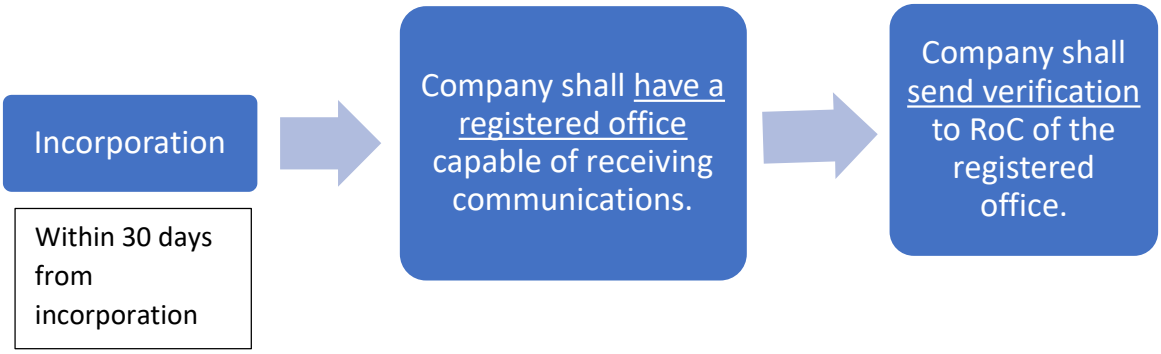

iii. Labelling:
The company's name with registered office address shall be mentioned outside the office, on business cards, bill head, official publications, seal (if any), business card etc.

iv. If name is changed in last 2 years, former name should be mentioned with the new name.

v. An OPC, must write in "One Person Company" in brackets under its name wherever it is printed.

vi. Change of registered office:

CHANGE OF REGISTERED OFFICE	COMPLIANCE NECESSARY
Within City/district/town/village	Notice to RoC within 30 days + Board resolution
Outside city/district/town/village	Special resolution
Outside the jurisdiction of RoC	Special resolution + RD Permission
Outside one State to another state	Special resolution + CG (RD) permission

Copies of SR and RD approval shall be sent to RoC.

vii. Default in complying with this section:

- **Officer in default**: Penalty Rs. 1000/day (Max 1 Lakh)

viii. If RoC has reasonable cause to believe that company is not carrying on any business, it may cause physical inspection of registered office after which it may initiate action for removal of name of company from register under chapter XVIII

Section 13 - Alteration of MoA

Special resolution In General Meeting is required to alter any clause of MoA. Other requirement with respect to changes in these clauses are as under:

I. **Name Clause:**
- Central government (RD) Approval along with
- Special Resolution in general meeting

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- No approval of CG required to merely delete/add 'Private ' after name of company
- No Alteration allowed [Companies (Incorporation) Rules, 2014] if:
- Annual return or financial statement not filed with RoC
- Amount due on matured Deposit, Debentures, or interest due thereon not paid
- RoC shall enter into register and issue a fresh 'Certificate of Incorporation'

II. Registered office:

CHANGE OF REGISTERED OFFICE	COMPLIANCE NECESSARY	Change in MOA
Within City/district/town/village	Notice to RoC	✗
Outside city/district/town/village	Special resolution	✗
Outside the jurisdiction of RoC	Special resolution + RD Permission	✗
Outside one State to another state	Special resolution + CG (RD) permission	✓

Other requirement for change of registered office from one state to another:
- Application must be sent to CG (RD) who shall dispose it off in 60 days
- CG (RD) shall verify that
- All debts have been discharged/provided for
- Adequate security has been provided for discharge of debts
- Consent of creditors, debenture-holders and other concerned persons has been taken
- File with RoC (within 30 days of order)- Copy of SR & Order of approval from CG (RD)
- RoC shall issue a fresh "Certificate of Incorporation"

III. Object Clause:
- Special Resolution in general meeting
- If the company has raised money from public through prospectus and has any amount unutilised out of such money raised, it can change its object for which money is raised by following all the given conditions:

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- passing special resolution by postal ballot
- publishing details in 2 newspaper (English and vernacular) & on company website
- Dissenting shareholders shall be given 'exit opportunity'

IV. Liability/Capital Clause:

Special resolution is required

Liability of any shareholder cannot be increased without his consent

V. Documents to be filled with RoC:

- Altered copy of MoA
- Special resolution Copy
- Order of CG (RD)

Section 14 - Alteration of AoA

i. Special Resolution in General Meeting

ii. In case of conversion of company from public to private or vice versa, Central Government permission is required. [Prior to 2 Nov 2018, tribunal permission was required. Hence, any pending application with tribunal shall be dispensed of by tribunal.]

iii. File with ROC within 15 days of receipts of order:
- Special Resolution
- Order of RD/Tribunal
- Copies of Altered AoA

Section 15 - Alteration of existing MoA & AoA

- Every alteration in MoA/AoA shall be noted in every copy.
- Default: Company/Officer in default- 1000 Rs / copy

Section 16 - Rectification of Name of the company

After Alteration of name: Notify RoC about such change along with:

- Copy of resolution
- Order of CG (RD)

Default: Company – Rs 1000 / day
Officer in default- 5000 to 1 lac

RoC shall issue fresh certificate of Incorporation & make suitable changes in MoA

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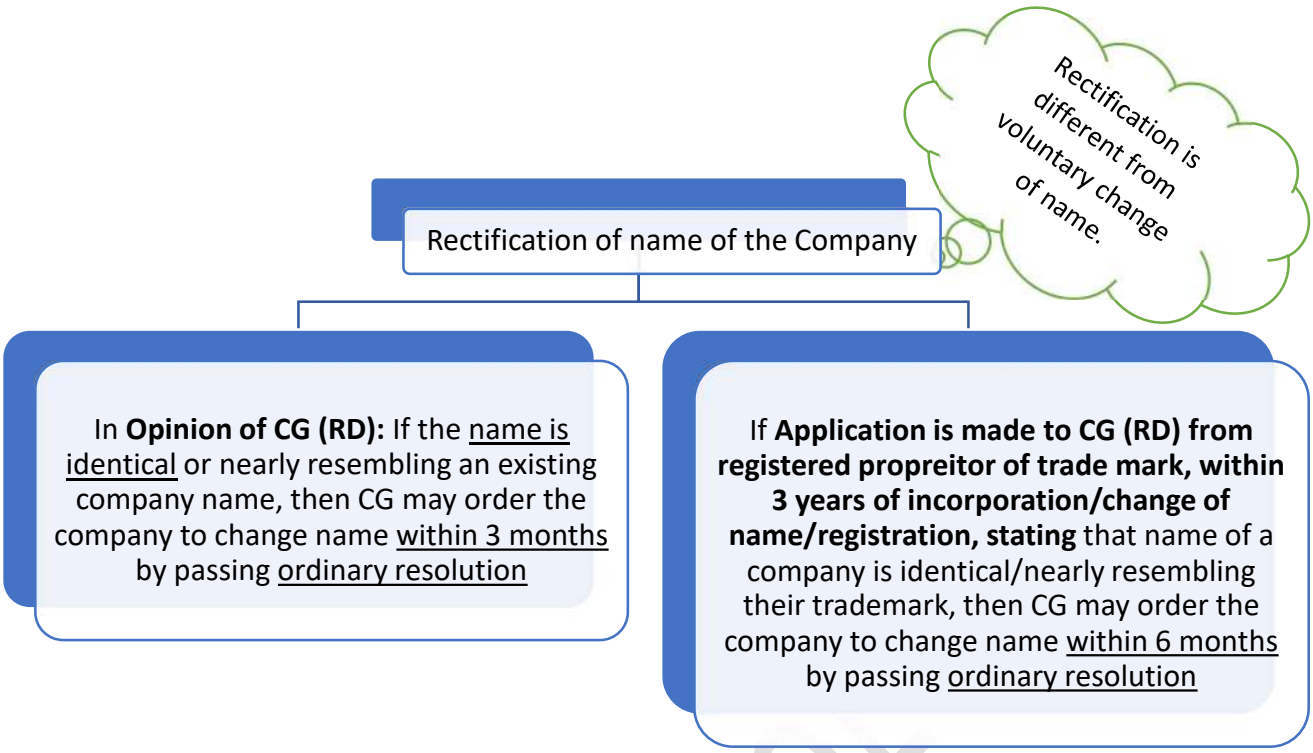

Section 17 - Copies of MoA, AoA, agreement, resolution u/s 117 given to Members

- Any member can request on payment of fees, the above documents.
- Company must send within 7 days of request
- Default: Company/Officer in default- Rs 1000 / day
- Maximum Rs. 1 lakh

Section 18 - Conversion of a registered company

Basic requirement to convert company to other class of company are:

i. Alter its MoA & AoA
ii. File an application to RoC
iii. RoC shall – verify documents submitted
-approve
-Issue fresh certificate of incorporation

Section 19 - Subsidiary Company cannot hold shares in Holding Company

- Company cannot obtain (by itself or through nominee) shares of holding company
- Holding company cannot allot/transfer shares to its subsidiary company
- **Exception:**

i. Shares held by subsidiary before it became subsidiary of holding (Voting: NOT allowed)
ii. Shares held as trustee (Voting: Allowed)
iii. Shares held as legal representative of deceased member of holding company (Voting: Allowed)

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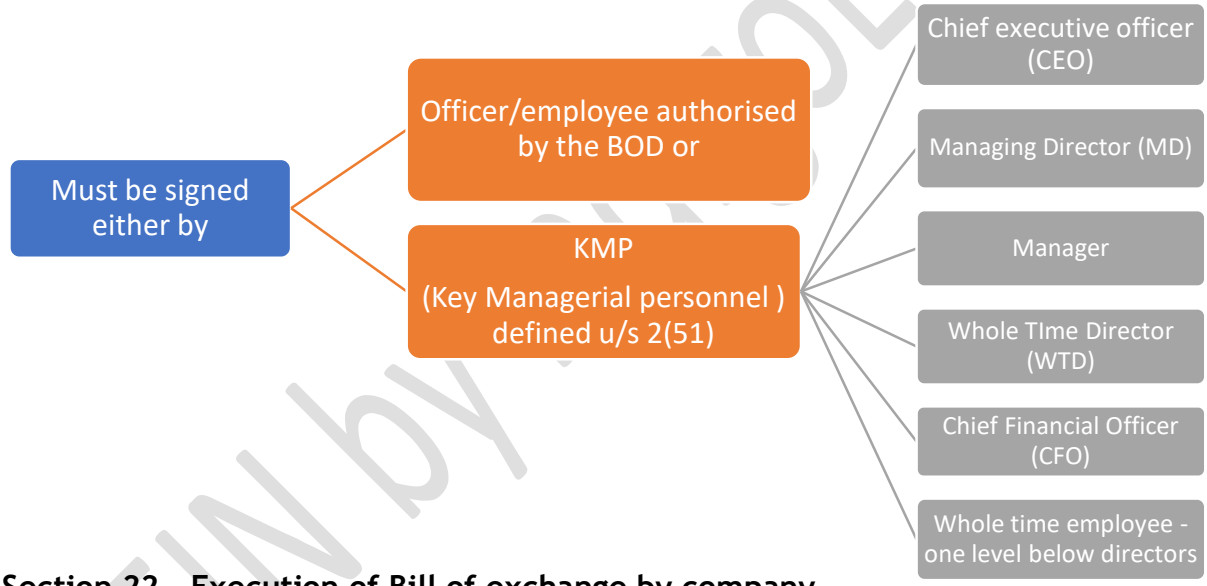
Section 20 - Service of Documents

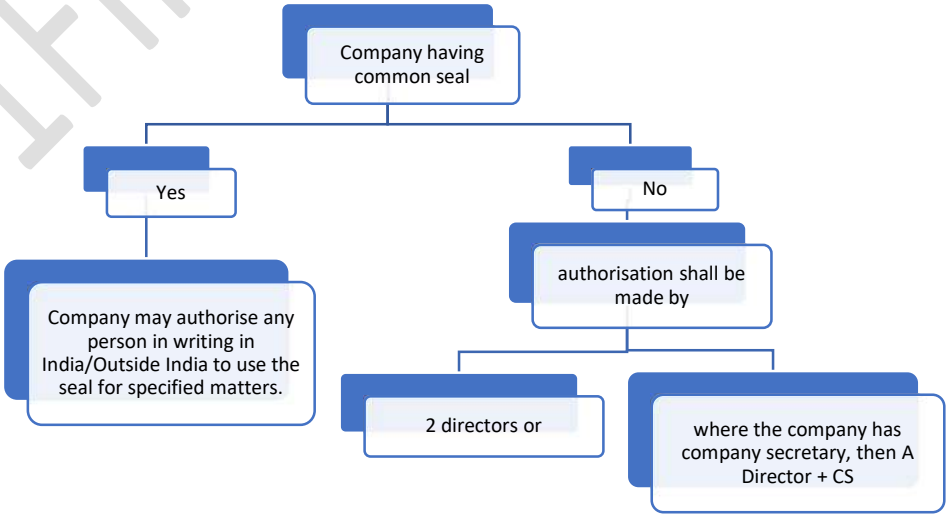
Documents are delivered from the company to various stakeholders and vice versa to conduct business in effective manner. The timing and mode of delivery are very crucial to avoid disputes/confusions in future. Hence, the Act has prescribed the following modes:-

- Speed post
- Registered post
- Courier
- Physical delivery
- Electronic Mode – Any mode using electronic media which is capable of retention, including, fax, through company's network, other.
- Members may request the delivery through any other mode on payment of required fees

Section 21 - Authentication of Documents/ Proceedings/ Contracts by company



Section 22 - Execution of Bill of exchange by company



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14.1.4 Types of Companies under the Act:

Companies have been classified into different sub types under the Act to serve different business needs.

Few types of companies are:

Private & Public Companies

Points of Difference	Private Company	Public Company
Minimum shareholders	2	7
Maximum shareholders	200	Unlimited
Minimum Directors	2	3
Maximum Directors	15 (Can be exceeded by passing special resolution)	15 (Can be exceeded by passing special resolution)
Transferability of shares	Restricted	Freely Transferable
Acceptance of public deposit	Not allowed	Allowed to Eligible public companies

Sec 3

Government Company

It is a company registered under the Indian Companies Act in which not less than 51% of paid up share capital is held by the central government or any state government or partly by central government partly by one or more state governments.

One-person Company (OPC) [Section 3]

- OPC has only one shareholder.
- Minimum number of directors in OPC is 1
- Name of an OPC ends with suffix "(OPC) Pvt. Ltd."
- Such shareholder cannot own shares of any other OPC. However, he may own shares of any other form of company.
- Such shareholder is required to appoint a nominee who shall become member of the company in the event of death of the subscriber.

Nominee:

- Must be a natural person who is a major (+18 age)
- Must be Indian Citizen
- Must be Indian resident who stayed in India for not less than 182 days in the preceding calendar year
- Cannot be nominee of any other OPC. However, he can be member of another OPC.

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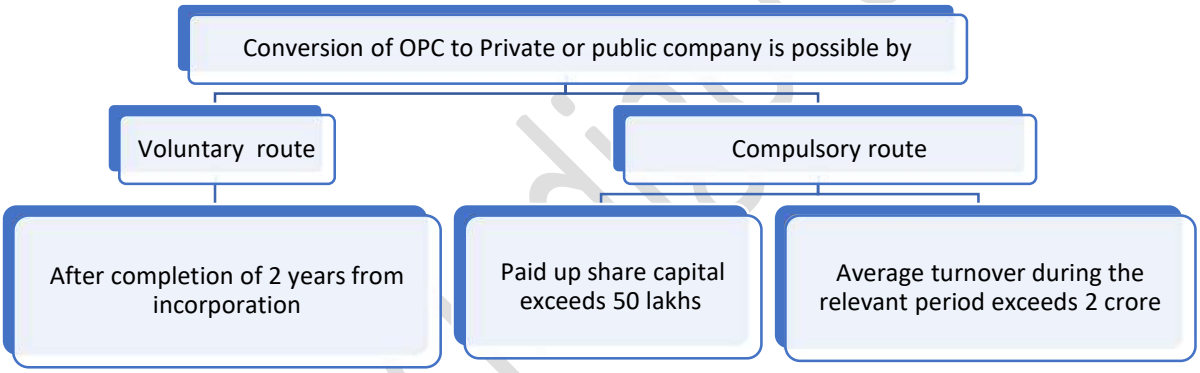
- If a nominee who is a member in another OPC, due to the death of the shareholder, becomes the member in 2 OPC at the same time, he will have to leave the membership of any one OPC in 182 days.
- is named in the Memorandum of Association (MoA)
- His consent must be filed with the RoC in prescribed form
- He may withdraw his consent at anytime
- The shareholder may change the name of the nominee any time after giving notice to the RoC & Company.

- Business of OPC: OPC cannot enter into Non- Banking Investment activities including investing in the shares of any other corporate
- Private company: For the purpose of the Act, OPC shall be treated as a private company.
- Minor: Minor cannot be member or nominee of OPC. He cannot hold shares even in beneficial interest.
- Conversion of OPC:



OPC cannot be converted to Section 8 Company.

Company formed for charitable purpose [Section 8]

- Section 8 Companies are formed to serve the charitable purpose for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object.
- Entire profits are to be reinvested to promote the objects
- No dividend can be paid to its members
- Any private/public company requires license from CG to operate as a Section 8 Company
- It cannot use 'Pvt Ltd.' Or 'Ltd.' after its name. Its name usually ends with words like foundation, trust, institution etc. However, it enjoys all the privileges of a limited company.
- Firm may be its member
- Alteration of MoA or AoA can be done with CG approval
- Reconversion into a private/public/other kind of company requires Special Resolution in general meeting& Central Government Approval
- Prior notice for general meeting: 14 days instead of 21 days

- Revocation of Licence by CG may be done if:
- Section 8 Conditions contravened
- Licence conditions contravened
- Affairs of the company conducted fraudulently, against public policy or against the objects.
  Written notice shall be served upon the company and an opportunity to be heard shall be allowed by RD. If the RD is satisfied, he may pass the order to:
- Wind up the company or
- Amalgamate the company with another section 8 company having similar objects or
- Convert the company to private/public company and change its name
- Contravention of this Section:
- **Company**- 10L to 1 Cr
  - **Officer in default**- Imprisonment up to 3 yrs. (or)
    - Fine 25K to 25L (or)
    - Both
- **If affairs of the company are conducted fraudulently: Section 447 shall apply.**

14.1.5 Prospectus & Allotment of Securities

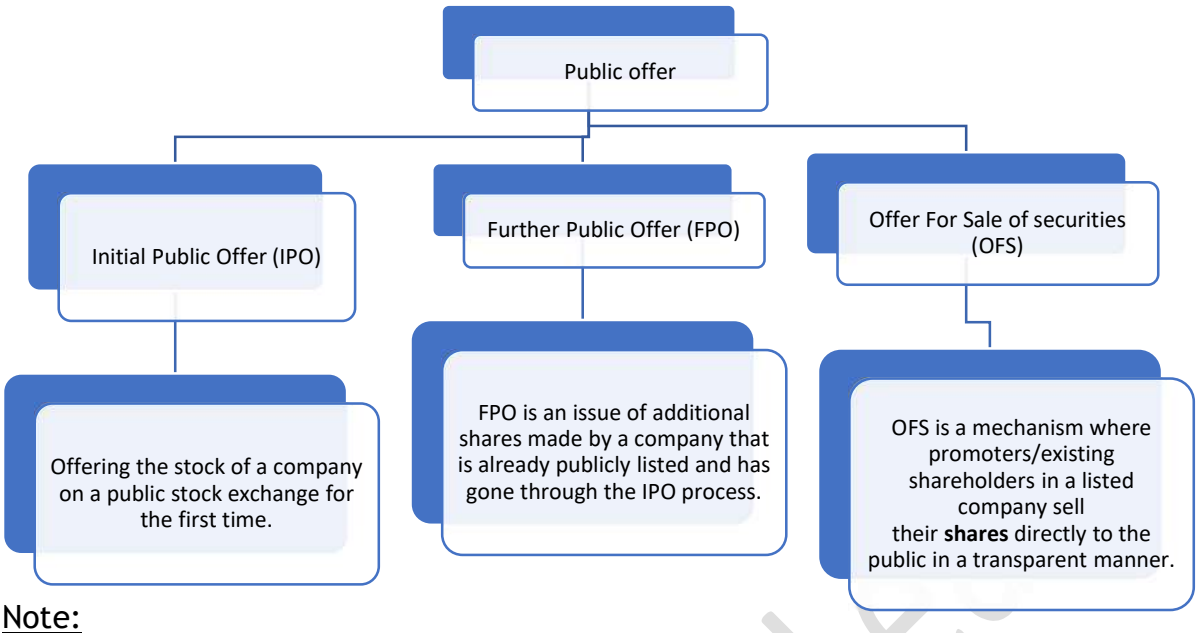
Section 23-42

Section 23 - Issue of securities

	Private Company	**Public Company**
Right Issue	Allowed	Allowed
Bonus Issue	Allowed	Allowed
Private Placement	Allowed	Allowed
Public Offer by issue of prospectus	Not- Allowed	Allowed to 'Eligible Companies'

Note:

i. Right Issue: It is a group of rights offered to existing shareholders to purchase additional stock shares in proportion to their existing holdings.
ii. Bonus Shares: It is an offer of free additional shares to existing shareholders in proportion to their existing holdings. (also known as 'capitalization of profits')
iii. Private Placement: It means the sale of securities to a relatively small number of selected investors.
iv. Public Offer: It is the offering of securities of a company or a similar corporation to the **public**. In order to do that the securities are to be listed on a stock exchange.

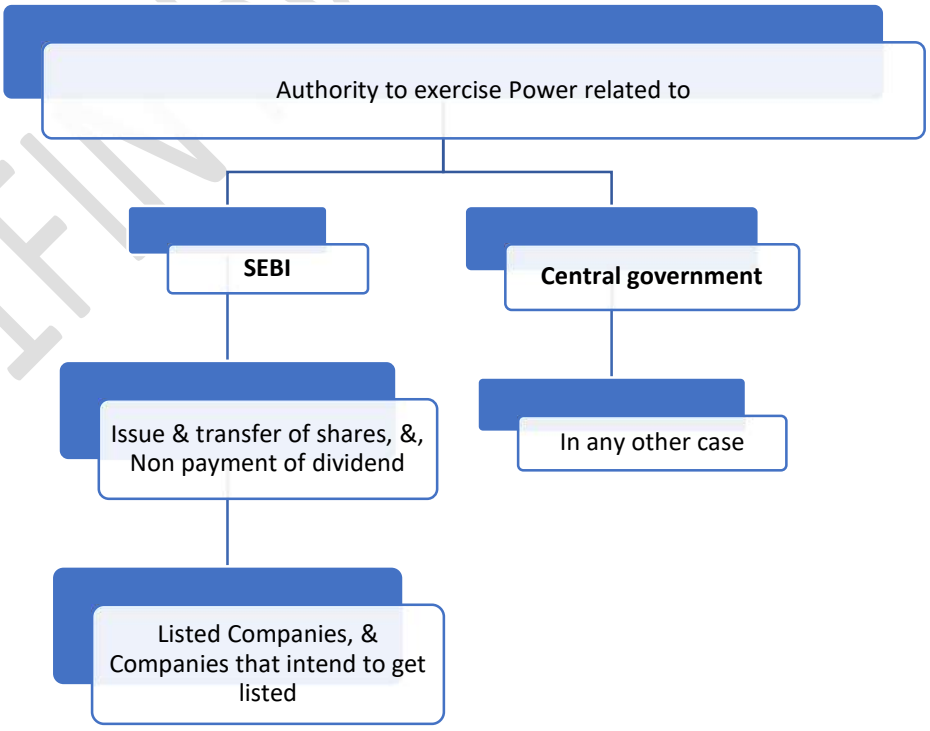


Note:

Securities has been defined u/s 2(81) as Securities means the securities as defined in clause (*h*) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

In crux, the definition in SCRA includes shares, debentured, derivatives, Mutual Fund, Collective investment scheme securities, Government securities, right in securities etc. Thus, in this chapter, the word security must be construed to include allotment of all the above types of instruments.

Section 24 - Power of securities and exchange board to regulate issue and transfer of securities



14.1.6 Prospectus

Definition of Prospectus u/s 2 (70):

- Any document described or issued as a prospectus and
- includes a red herring prospectus referred to in section 32 or
- shelf prospectus referred to in section 31
- or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate

Section 26 - Matters to include in Prospectus

26. (1) Every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall

(1) state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government:

Provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and regulations made thereunder; and

(2) Nothing in sub-section (1) shall apply—

(a) to the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of sec 62 in favour of any other person; or

(b) To the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

(3) Subject to sub-section (2), the provisions of sub-section (1) shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently.

Explanation— The date indicated in the prospectus shall be deemed to be the date of its publication.

(4) No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless on or before the date of its publication, there has been delivered to the Registrar for filing, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

(5) A prospectus issued under sub-section (1) shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management, of the company and has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for filing and a statement to that effect shall be included in the prospectus.

(6) Every prospectus issued under sub-section (1) shall, on the face of it,—

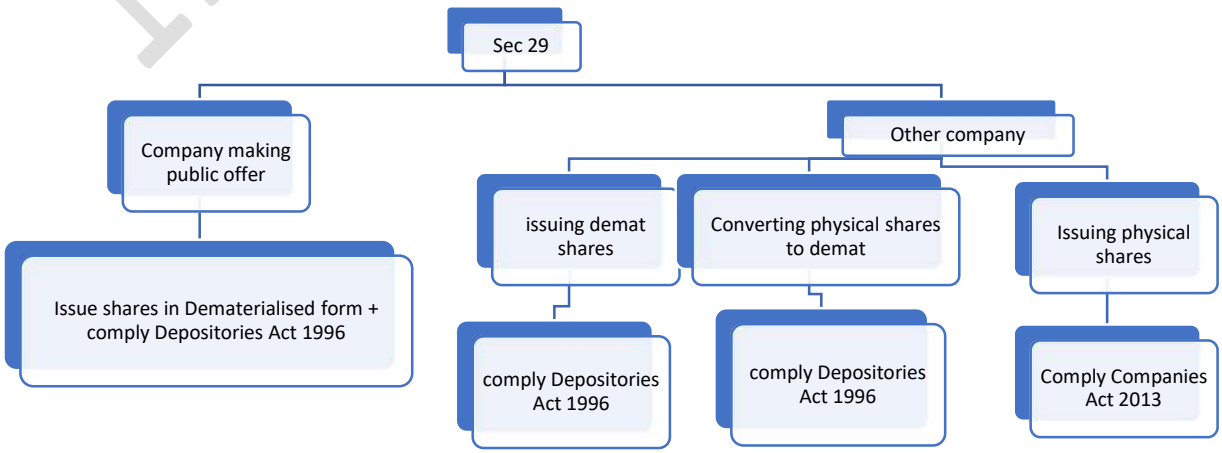
(a) State that a copy has been delivered for filing to the Registrar as required under sub-section (4); and

(b) Specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

(8) No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar under sub-section (4).

(9) If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both

Section 29 - Public Offer of securities to be in a dematerialized form



Section 31 - Shelf Prospectus

- *Meaning:* It is the prospectus with the shelf life, ie, a validity period. In this type of public offering, company is allowed to offer and sell securities to the public without a separate **prospectus** for each act of offering.
- *Max Period of validity*: 1 year
- *Info*rmation memorandum: Every subsequent offer requires issuing an 'information memorandum' containing the details of changes that took place from the previous issue.
  - Financial changed
  - New charges created
  - Other material facts
- *If Advance is received for further shares before the issue of Information memorandum:* then,
  - Company must intimate the investor of all changes using Info. Memo. and
  - Give an 'Exit Option' (Investor may withdraw his money. The refund shall be processed in 15 days.

Section 32 - Red Herring Prospectus

- *Meaning:* In this kind of public offering, the Price and quantity of shares to be allotted are not included in prospectus. Thus, the prospectus is incomplete.
- *Filling with RoC:* Red herring prospectus must be filled with RoC at least 3 days prior to issuing to public.
- *After closing of the offer:* Upon closing of the offer, the prospectus stating the total capital raised (by debt/share capital) and closing price of securities along with other prescribed details, shall be filled with RoC and SEBI.

Section 33 - Abridged Prospectus

- *Meaning:* It is a memorandum containing salient features of the prospectus as specified by SEBI.
- This summarized prospectus *shall be attached with every application form* for purchase of securities.

  Exception:

- Invitation to person to enter into underwriting agreement with company
- Securities not issued to public

- If any copy of such prospectus is requested by any person before closing of offer, it must be furnished by the company.
- *Default in complying with this section:*
  - Company- Fine 50K/each default

Section 25 - Offer for sale of securities (OFS)

- *Meaning:* Shares of existing shareholder are sold off in public to new shareholders. It does not involve issue of new securities.

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- *Objective:* To dilute promotors' holding or provide exit route to venture capitalists.
- The document inviting public to purchase such shares shall be *deemed prospectus* and all provisions applicable to normal prospectus would apply.
- All details u/s 26 shall be included in prospectus
- *Deemed OFS:*
  - If offer to sell securities to public is made within 6 months from original allotment or
  - At the time of making offer to public, the whole consideration has not been received on securities

  Hence, all requirement of issue of prospectus & this section must be followed.
- *Additional Matters to be disclosed:*
  - Consideration received/to be received in respect of securities offered
  - Time and place at which the allotment contract can be inspected

Section 28 - OFS for certain members of company

- Members may offer whole or part of their shareholding for sale to public *provided BoD approves*.
- Document offered to public inviting subscription shall be *Deemed Prospectus*. All provisions applicable to normal prospectus shall apply.
- Individuals/Body corporates whose shares are being OFS, shall
  - authorize company to do the same
  - reimburse company of all related expenses

Section 27 - Variation in terms of contract/objects in prospectus

Company may vary terms in the prospectus only by

- passing SR in general Meeting
- Notice in 2 Newspapers (English and vernacular)
- Giving 'exit option' to dissenting shareholders

Section 40 - Securities to be dealt with in Stock exchange

I. Listing of securities

- Before any public offer, the companies must apply to SEBI & Recognized stock exchanges for listing. Public offer cannot be made without listing.
- Prospectus must contain details of stock exchange on which securities shall be listed
- *Separate bank A/c* must be maintained by the company to receive monies from offer and adjust refunds (Not company's general bank account).
- Nothing can be written in the prospectus to waive this section.
- *Default in compliance:*
  - **Company**: 5L-50L

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- **Officer in default:**
  - Imprisonment up to 1 year or
  - Fine 50K – 3 L or
  - Both

II. Underwriting Commission:

- Meaning: Underwriting is the process through which an individual or institution takes on financial risk for a fee. In this case, such institutions agree to take over the un- subscribed portion of securities offered to public to meet minimum subscription.
- *Conditions for underwriting a public offer*:
  - AOA Authorizes
  - Underwriting Commission is paid out of
    - profit or
    - proceeds of issue of securities
  - Maximum Rate of commission

For shares	For Debentures
Rate mentioned in AoA or	Rate mentioned in AoA or
5 % of price at which shares are issued	2.5 % of price at which debentures are issued
Whichever is less	Whichever is less

- *Disclosure in the Prospectus:*
  - Name of underwriter
  - Rate of commission
  - Number of securities undertaken
- Commission cannot be paid if it is not a public offer
- Contract of payment of commission must be submitted with RoC

Section 30 - Advertisement of prospectus

Wherever there is advertisement of prospectus published, it must contain following details

- Share capital of company
- Liability of shareholders
- Object stated in memorandum
- Details of signatories to MoA & their share subscribed
- Capital structure

Section 39 - Allotment of Securities

Meaning: when the ownership of shared is given in the name of shareholder and entry is made in the register of members. It brings shares into existence.

Conditions prescribed for allotment of securities by company:

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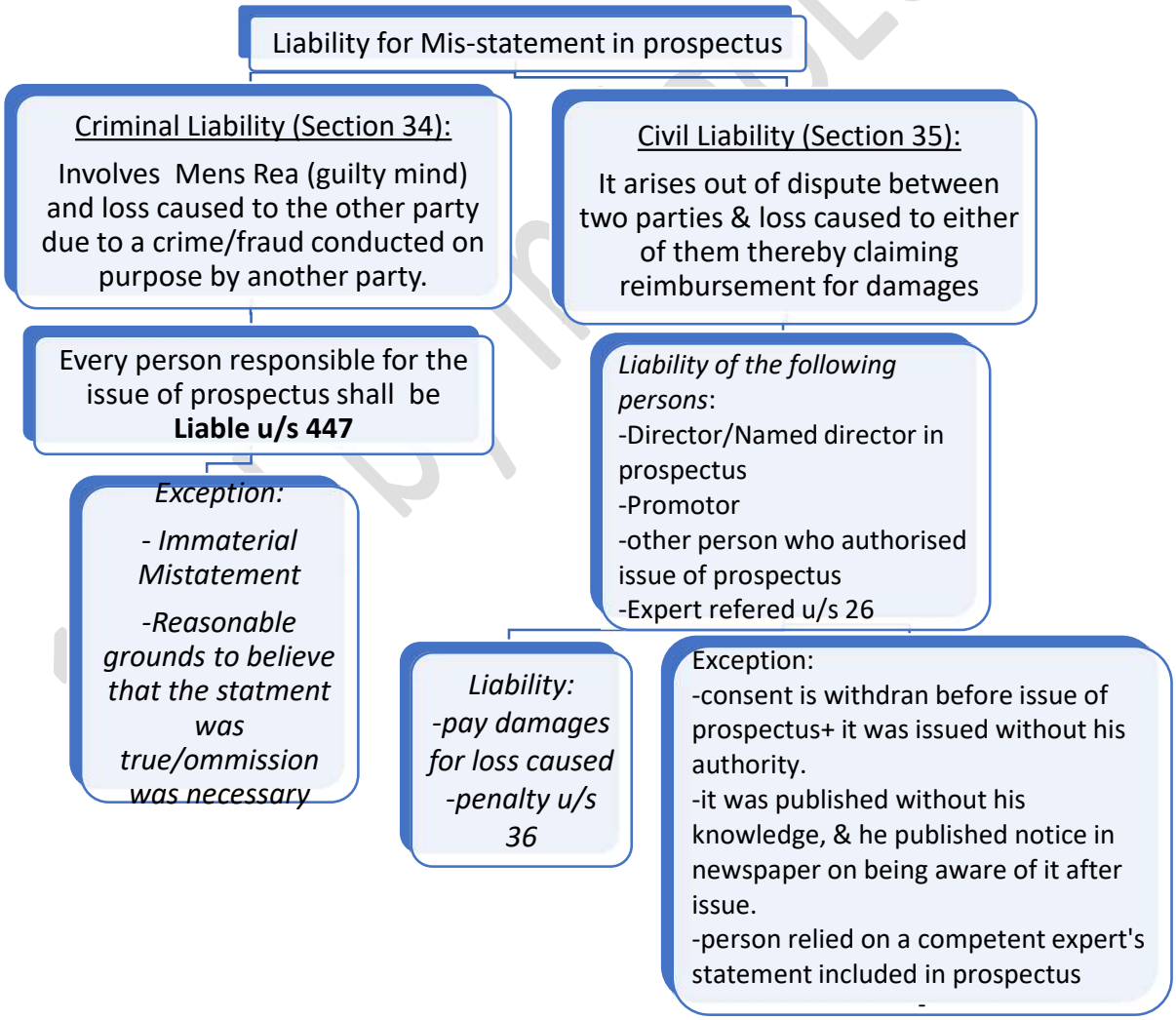
i. Minimum subscription amount stated in the prospectus and application money is received
ii. Amount payable on application is not less than 5% of nominal value of securities.
iii. If application money and minimum subscription is not received within 30 days of issue of prospectus (or longer period prescribed by SEBI), all moneys received must be refunded.
iv. After allotment, Return of Allotment must be filed with RoC
v. *Default in refunding money or filing Return of Allotment:* Company/officer in default: Rs 1000/day (Max 1 Lakh)

Section 34, 35 - Misstatement in Prospectus

Meaning: Stating false/inaccurate details in the prospectus, wilfully or by mistake. This may lead wrong decision made by the investors thereby leading to their financial/other losses.



Section 36 - Punishment for fraudulently inducing person to invest money

- Any person
- Knowingly/recklessly
- Promises/conceals deliberately/ misleads
- Another person to enter into
    i. Acquiring or underwriting securities
    ii. Enter into any agreement based on security price fluctuation to gain profit
    iii. Get credit from bank or financial institute

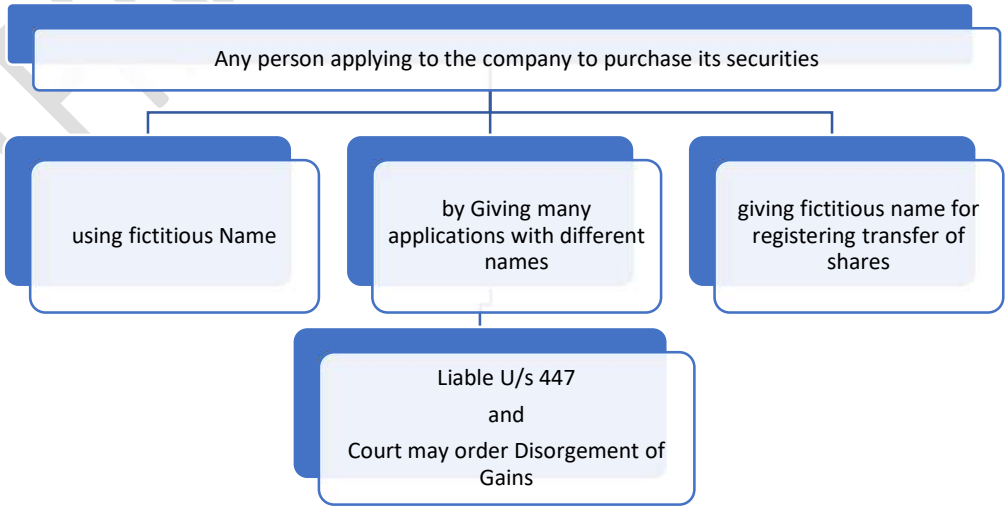


Section 37 - Action by Affected Persons

Any person aggrieved u/s 34, 35, 36 may file a

- Normal suit
- Class action suit [A group of parties having common grievance against another party, may file a single case together. In such case, representative of such group may attend the hearings and follow up with legal proceedings]

Section 38 - Punishment for personating for acquiring shares/securities



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- Company must state the provisions and penalties specified u/s 38 in the prospectus
- Amount received through disgorgement of gain shall be credit to IEPF Account [Investor Education & Protection Fund]
- *Disgorgement of gain* means recovering gains made unfairly by seizure/disposal of such securities.

Section 41 - Global Depository Receipt [GDR]

Meaning: These are instrument issued to the foreign investors to raise more capital. The share capital of the company is packed into depository receipts with suitable denomination and value to fit the needs of the foreign investor and market.

Relevant Rules: Companies (Issue of Global Depository Receipts) Rules, 2014

Conditions:

- ✓ Company is eligible as per FEMA Rules
- ✓ BoD Resolution in board meeting
- ✓ Special Resolution in general Meeting
- ✓ RBI regulations must be complied
- ✓ Domestic depository holds the original securities, which are issued in the name of international depositories
- ✓ BoD shall appoint a Practicing CA/CS/Cost accountant to oversee issue and compliances
- ✓ Listing of GDR: on international stock exchange
- ✓ They may be offered to public or private placement
- ✓ Backing/original securities may be fresh issue of securities or OFS of existing shares
- ✓ Right to vote by GDR Holder:
  - Depends on the agreement between GDR Holder, Company, and depository.
  - In the absence of any contract, GDR holder cannot vote unless GDR are converted to shares. Till then, the international depository votes on behalf of GDR holder.
- ✓ Proceeds of the issue may be collected by
  - Bank Account in India
  - Indian Bank operating in such country
  - Foreign Bank (Scheduled by RBI)
- ✓ Sections related to register of members, issue of shares and debentures and issue of prospectus are not applicable to GDR

Section 42 - Private Placement **Amended 7/8/18**

Meaning**:** Issuing securities to a selected group of people

Conditions for private placement:

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- ✓ 'Private Placement offer letter' must be issued. Such offer letter does not contain right to renunciation. (i.e., no other person is entitled to buy securities using such offer letter other than the person named in it)
- ✓ Special resolution in general meeting
  - o For every private placement offer in one Financial Year (FY)
- ✓ Offer can be made to maximum 200 persons in aggregate in a FY

Above limit Excludes:

- Employees offered securities under ESOP (Employee stock option plan)
- Securities issue to Qualified Institutional Buyers

- ✓ Company must maintain record of subscribers Bank Accounts (to adjust refund/allotment of security)
- ✓ No fresh offer/invitation can be made unless previous offers have been complied/withdrawn/abandoned
- ✓ Any offer made without complying this section shall be 'deemed public offer' and relevant provisions of the act, SEBI Act 1992 shall apply.
- ✓ Monies shall be received via
  - o Cheque
  - o Demand Draft
  - o Other Banking Channel
  - o NOT IN CASH
- ✓ Allotment shall be made within 60 days of receipt of application money. Otherwise, Refund within 15 days otherwise Interest 12% p.a. from the end of 60th day.
- ✓ Separate bank account must be opened by company to process such refund/allotment monies
- ✓ Details of private placement must be filed with RoC within 30 days circulation of offer letter.
- ✓ Public advertisement of the offer is NOT allowed.
- ✓ Return Of allotment shall be filed with RoC within 15 days of allotment. Company cannot use the monies raised by private placement unless such return is filed.
- ✓ Default in filing Return of allotment
  - o Company/Promoters/directors: Rs. 1000/ day (max 25L)
- ✓ Default :
  - o **Company/Promoters/directors**:
  - o Fine lower of
    - ▪ Amount involved in offer of invitation or
    - ▪ Rs. 2 crores
  - o Company shall refund monies in 30 days of order imposing penalty

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14.1.7 Share capital & Debentures

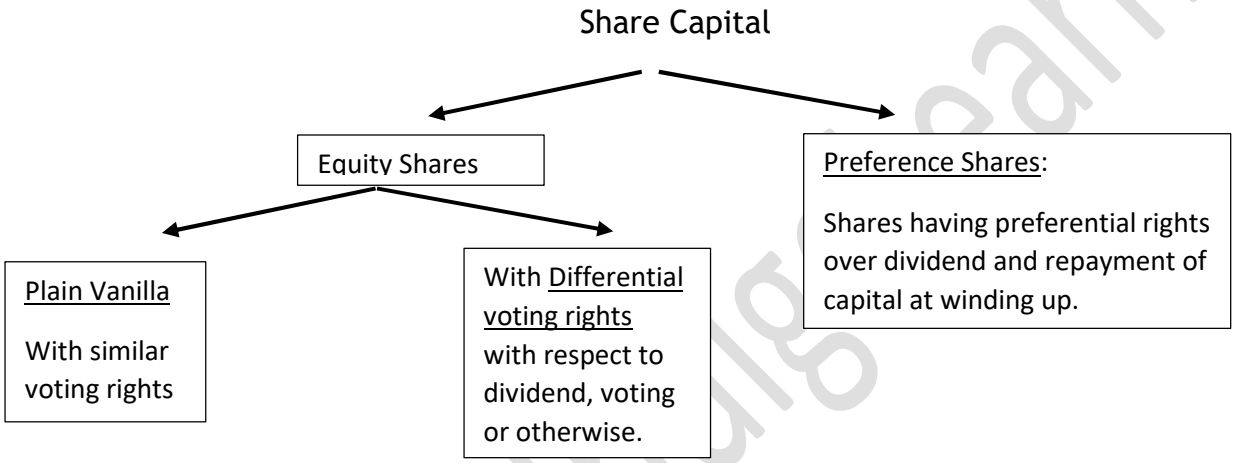
Section 43-72

Relevant Rules: Companies (Share Capital & Debentures) Rules, 2014

Sec 2(84) 'Shares':

- Shares in share capital of the company
- Includes stocks

Sec: 43 Types of Share Capital



Rule: 4 Conditions for issuing equity shares with differential Rights

- AoA should authorise
- Ordinary resolution (for listed companies- postal ballot mandatory)
- Differential right equity shares <= 74% of total voting power post issue
- In last 3 financial years:
  - No default in filing annual return & financial statement
  - Not penalized under/by
    - Court
    - NCLT
    - RBI Act
    - SCRA
    - SEBI Act
    - FEMA
    - Other Acts prescribed
- No subsisting default in paying
  - Dividend declared
  - Matured debentures/deposits/preference shares
  - Interest due on debentures/deposits
- In the last 5 years, there is no default in paying

- Preference Share dividend
- Term loan amount due to public/State Financial Institute/Scheduled Bank
- Statutory dues of Employees
- Sum due to be credited in IEPF

- Other provisions
- Company cannot convert existing equity shares to differential voting right shares
- Differential voting right shares have other rights common, i.e., bonus shares, right shares, etc.
- Register of members under Section 88 must be kept

Sec 45 & 46 - Basic requirements for issuing Share Certificate

- **Physical Share Certificate:**
- It is the prima facie evidence of ownership of shares
- Such share certificate should be
  - Numbered
  - Issued under common seal
  - Signed by – 2 Directors or 1 director & 1 Company secretary
  - Company may issue duplicate share certificate on request from the shareholder if the original is lost/in bad condition
- **D-Mat shares:** Provisions of share certificate not applicable on D-Mat Shares. The register of beneficiary owners maintained by depository is prima facie evidence of ownership in such shares.
- **Default:** Sec 447 attracted if share certificates issued are not as per above provisions
- **Case:** A obtains share certificate by forgery & transfers it to B who purchases it in good faith. Company refuses to register those in name of B. Is company correct as per Co. Act?
  Solution: Forgery is nullity in law. Hence share certificate of A itself is invalid. Company is correct in not registering such transfer. A will have criminal liability & liability to compensate B.

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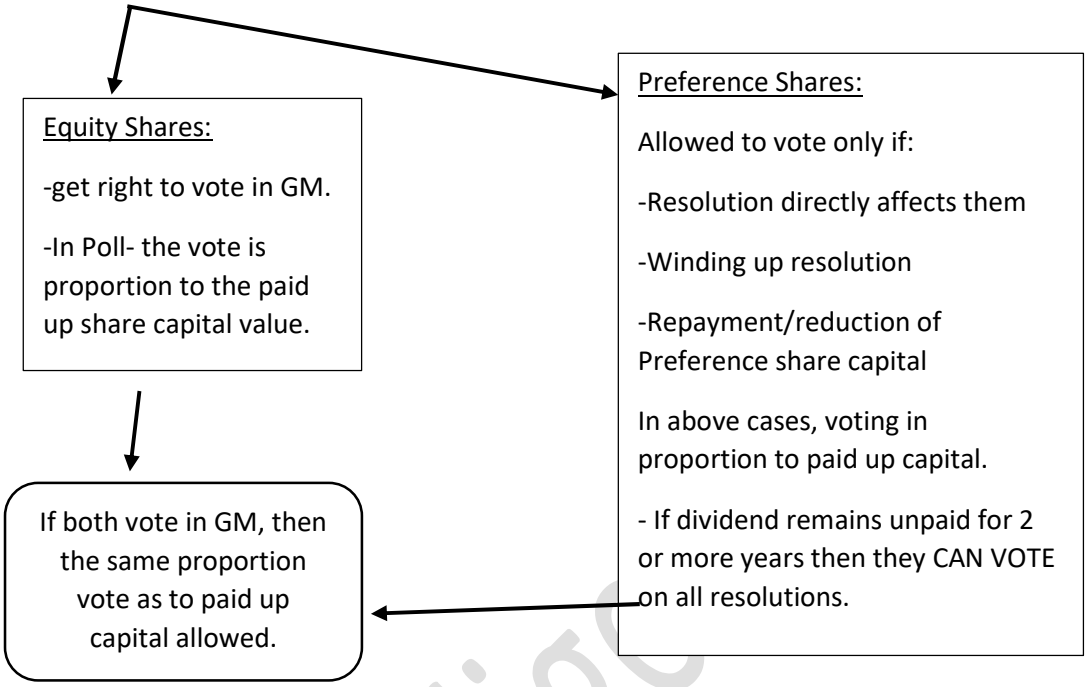
Section 47 - Voting Rights



Private company can modify AoA/MoA to change above rights as it likes.

Sec 48 - Variation of Shareholders' Rights

Conditions:

1) AOA must authorise variation (else, alter AoA u/s 14). It is not necessary to alter AoA if contract for the issue of shared authorise for variation of rights.

2) Special Resolution in Class Meeting of such shareholders whose rights are being affected.

3) Even after SR is passed, dissenting shareholders can apply to NCLT within 21 days of SR. Minimum shares required to be held by applicants : 10% of such amount of shares

4) NCLT's order must be followed by the company & filed with RoC within 30 days.

5) Default:

- **Company**: 25k to 5L
- **Officer in default:**

Imprisonment up to 6 months or

Fine 25k – 5L or

Both

(Note: Section is applicable on all types of shares: Preference & Equity)

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Sec 49 to 51 - Calls & Incidental Matters

If the shares of the company are partly paid up, then the company may call for the remaining amount due on such shares at any time. This is known as "calls" on shares.

Section 49 Company must make calls uniformly to all shareholders in one class of shares. (It cannot call for different amount of calls from different shareholders in the same class of shares)

Section 50 Shareholder can make advance payment for money due on calls/ subscription only if it is so authorised by AoA. However, no additional rights are allowed to such shareholder.

Section 51 Dividend must be paid based on number of shares. However, it may be paid proportional to paid up value if AoA authorise.

Sec 52 to 55 - Issue of Shares at discount or premium

The purpose for giving discount or premium on shares is to fairly price the shares based on its demand & supply.

Section 52 - Security premium

- Whenever shares are issued at a premium, such access amount must be transferred to 'Security Premium A/c'
- This section N/A on Debentures & bonds.
- Such 'Security Premium A/c' must be used only for the following purposes

i. Issuing bonus shares
ii. Buy back of shares
iii. Writing off preliminary expenses
iv. Writing off discount on issue of shares/ debentures
v. Providing for premium on redemption of preference shares/debentures
vi. Writing off commission paid on issue of shares/debentures

Section 53 - Issuing shares at discount **Amended 2/11/18**

Issuing shares at discount is STRICTLY PROHIBITTED EXCEPT

- Sweat equity shares u/s 54
- Discounted shares issued to creditors when its debt is converted to shares under 'statutory resolution plan' or 'debt restructuring scheme' as per RBI

Note: There is no such restriction on issue of debentures & bonds.

Default:

- Company/officer in default :Penalty equal to amount raised through the issue of shares at discount or Rs 5 lakh } whichever is less
- Company shall be liable to refund all the monies received with interest 12% p.a. from date of issue of shares

Section 54 - Sweat Equity shares

Sec 2(88) defines Sweat Equity Shares as such

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- equity shares issued by a company
- **to** its directors or employees
- **at** a discount or for consideration, other than cash,
- **For** providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

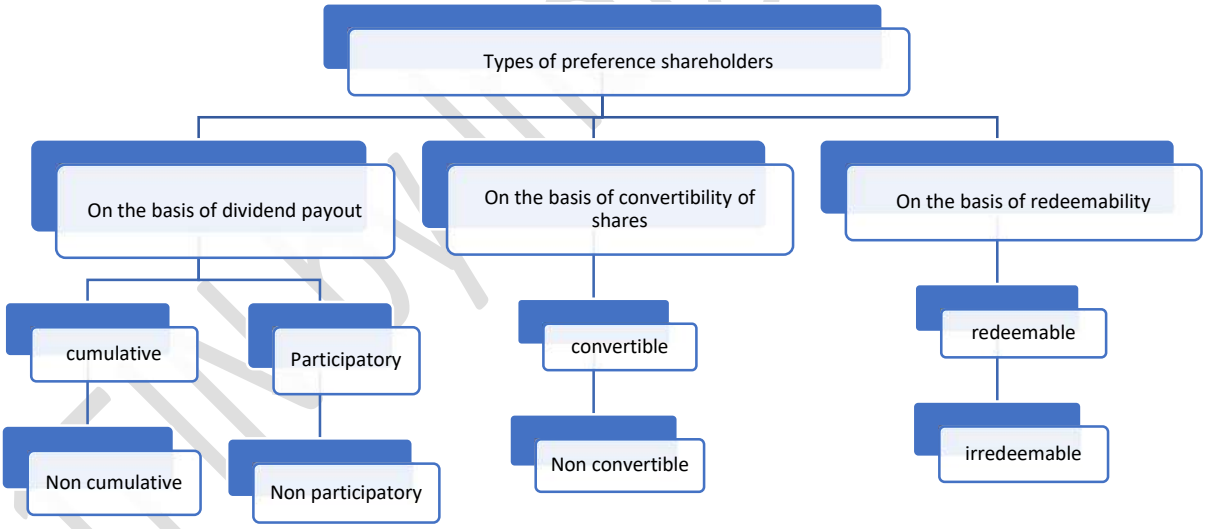
Such shares are issued with the purpose of motivating employees & to keep them engaged with the company for longer period.

Conditions for issue:

i. issues for existing class of shares
ii. special resolution passed in General Meeting
iii. SR must specify
- Number of shares
- Current Market value of shares
- Consideration
- Directors/ employees to whom shares issued

iv. Listed companies must follow relevant SEBI regulations & unlisted companies must follow Rule 8 of Companies (Share Capital & Debenture)Rules, 2014

Section 55 - Preference Shares: Issue & Redemption



Conditions for issue /redemption of preference shares:

1. Irredeemable preference shares are not allowed to be issued
2. Maximum Tenure for issue of PS- 20 Years
   - term specified in AoA

Whichever is less

Exception: Infrastructure Projects (specified in Scheduled VI have a maximum tenure of 30 years provided they redeem 10% beginning in 21st year at the option of the preference shareholders.

3. Source of redemption:

Free profits	Proceeds of a fresh issue of shares made for the purpose of such redeption

4. Redemption cannot be done unless preference shares are fully paid up.
5. If the redemption is out of profits, then after redemption, company must transfer nominal value of shares redeemed to Capital Redemption A/c (used to issue bonus shares only)
6. Deemed Redemption: If preference shares have matured but the company is unable to redeem them it may Issue further Preference shares in place of existing.
   Procedure:

- Consent of 3/4th of such class of preference shares,
- NCLT Approval and
- NCLT may pass order to redeem shares of dissenting shareholders

Section 56 to 59 - Transfer & Transmission of Securities & allied Provisions

Section 44 - Nature of shares or debentures

Shares/debentures/other interest of the member are movable property transferable as per AoA.

Section 56 - Transfer of securities between parties

- *Requirement to register transfer of securities:*
  - Mandatory
  - Proper instrument of transfer required between parties (Except if dematerialised shares are traded on stock exchange)
- *Procedure & timeline:* Within 60 days from execution of deed, following documents must be delivered to the company by transferor/transferee:
  - Transfer deed
  - Original letter of allotment or certificate of securities
- *Instrument lost/not delivered in prescribed time:* Company may allow to register the transfer on BoD decided terms to indemnify if found guilty of misrepresentation.
- *Transfer of partly paid securities:* If notice of transfer is given by transferor alone, then the company shall notify the transferee & he has no objection to registration of transfer of securities.
- *Certificate of securities:*

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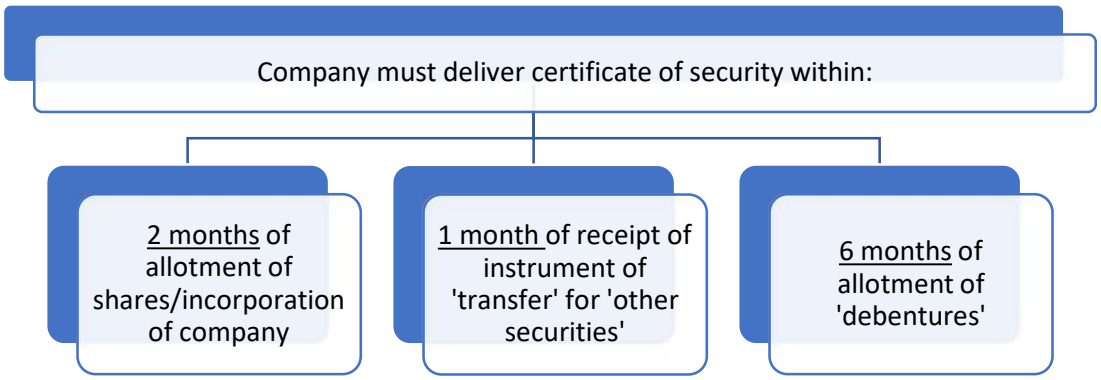
- 

- *Transfer of shares of deceased shareholder:* Allowed by legal representative
- *Default:* Company- 25K-5L
  Officer in default- 10K-1L
  Depository- Section 447 shall be attracted + Liability under Depositories Act' 1996

Section 57 - Punishment for personating shareholders

It means use of fake identity to obtain shares/warrants/other rights from the company.

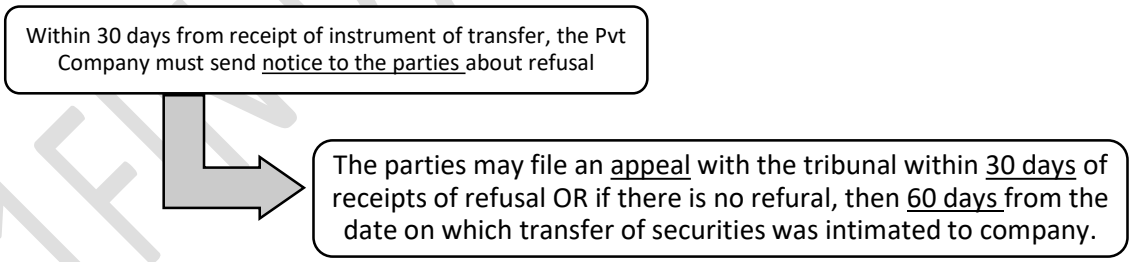
Punishment: Imprisonment 1 year -3 year

AND

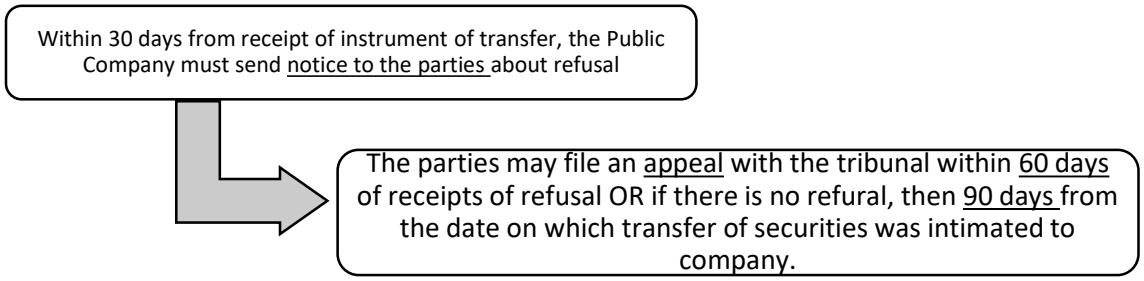
Fine 1L – 5L

Section 58 - Refusal of registration & appeal against refusal

- *Private Company Refuses registration of transfer/transmission of securities:*



- *Public Company refuses registration of transfer/transmission of securities for insufficient reasons:*



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- *Tribunal shall:*

- Hear both parties
- Mass suitable order Directing company to
  - Register transfer/transmission of securities within 10 days of order
  - Pay damages to affected parties
  - Rectify register of security holders

Contravention of order of the Tribunal:

- Imprisonment 1 Year – 3 Year

  And
- Fine 1L – 5L

Section 59 - Rectification of register of members

- Where the members name is not entered, incorrectly entered or there is delay in entering in the register of members then,
- Company/member/Legal representative of deceased member may apply to NCLT/competent court outside India.
- Tribunal shall hear both parties & pass following orders:
  - Register the name/rectify the register within 10 days of order
  - Company may be ordered to pay damages to aggrieved parties
  - If transfer is in contravention of SEBI/SCRA/other laws, tribunal may order to rectify such contraventions
- Member may transfer such shares anytime. However, the tribunal may hold its voting rights till the order is passed
- Default:-

- **Company**- 1L-5L
- **Officer in default-** Imprisonment up to 1 year (or)
  Fine 1L-5L (or)
  Both

Section 60 - Publication of authorised, Subscribed & Paid up capital

If the company is stating 'Authorised Capital' anywhere in notice/ad/business letters/bill heads, etc. then it MUST also clearly state its 'paid up capital' & 'subscribed capital'.

Default:

- **Company** – 10K every default
- **Officer in default**- 5k every default

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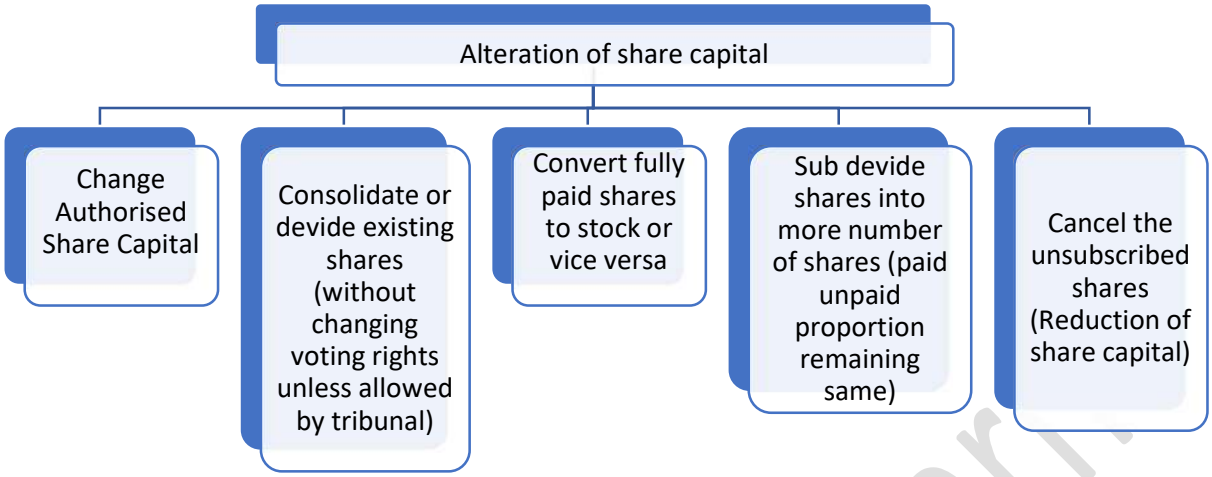
Section 61 - Alteration of share capital



AoA must authorise before any alteration. RoC must be intimated within 30 days of alteration.

Section 62 - Right Issue/Preferential Allotment

Meaning: Additional securities are issued to existing group of shareholders in proportion to their paid-up capital

Conditions:

- Special resolution in general meeting
- Notice/offer letter must be sent at least 3 days before opening of the offer by speed post/courier/e-mode
- Issue can be made only to existing shareholders in proportion to paid up value
- Offer letter must be sent to all such members.
- Offer must be open for minimum 15 days and maximum 30 days
- Private company may allow lesser time than 15 days provided 90% of such members consent in writing or via e-mode
- *Right to renounce:* Allowed if AoA do not restrict it & details are mentioned in the Notice and offer letter
- Amended 9/2/18 *Disposing shares that are not taken*: If right to purchase shares is not exercised nor renounced by the members within time, then BoD may dispose of the shares in such manner which is not dis-advantageous to shareholders and company to
  - Employees under a scheme of employees stock option plan (ESOP) provided prior Special Resolution must be passed in GM (Ordinary resolution for private companies)
  - *To any person* provided prior Special Resolution must be passed in GM
  - *Consideration* may be in cash or kind
  - *Sale price of shares* must be as per valuation repost of a registered valuer
- Section shall not apply to Conversion of Preference share/Debentures into shares

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- *Conversion of Debentures/Loan by government:* If debentures have been issued to government/loan was taken from government and the government orders to convert it into shares in public interest then,
- Company may oppose it by applying to tribunal within 60 days of such order
- Tribunal shall hear both parties and pass suitable order
- In case of conversion, the fresh issue of shares shall be deemed increase in 'authorised share capital' of the company. Accordingly, MoA shall be altered.
- Notice must be sent to RoC within 30 days of order

Section 63 - Bonus Shares

- *Meaning*: It means issue of shares for FREE to the existing shareholders in proportion to their share capital.
- *Source*: Company may issue Bonus shares out of its
- Free Reserve
- Secured Premium A/c
- Capital Redemption Reserve A/c

  Prohibition: Revaluation reserve cannot be used
- *Other conditions:*
- AoA must authorise the issue
- BoD approval in board meeting
- Ordinary resolution in General Meeting
- Company has not defaulted in payment of
  - Interest & principal of fixed deposits/debt securities
  - Statutory dues of employees
- Partly paid shares have been made fully paid
- Bonus shares cannot be issued in lieu of dividend
- Other prescribed conditions

Section 64 - Notice to RoC about Alteration of Share Capital

- Notice must be sent to RoC within 30 days of:
- Alteration of Share capital u/s 61
- CG or Tribunal order u/s 62
- Redemption of Preference Shares
- Default:
- Company/ Officer in default – Rs 1000/ day (Max 5L)

Section 65 - Reserve Capital

If an unlimited company having share capital converts itself into a limited company then it shall maintain reserve capital in any of the following ways:

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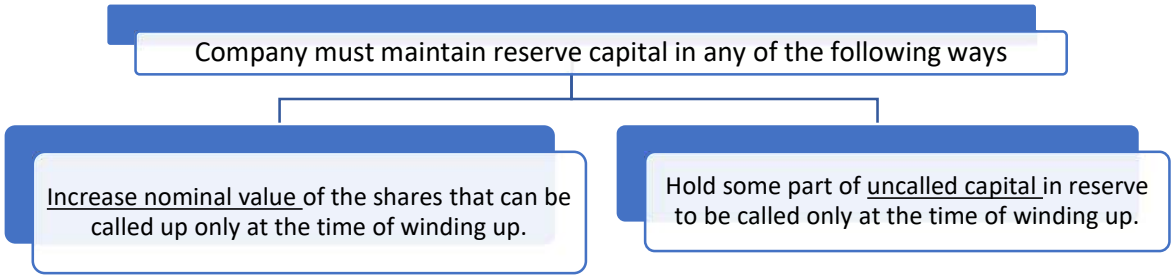
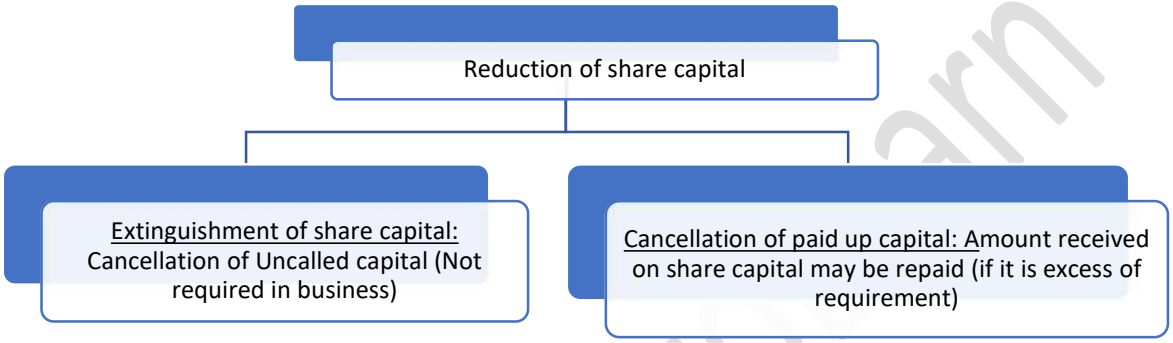


Section 66 - Reduction of Share Capital



Conditions:

- Applicability of this section: Company limited by shares or company limited by guarantee but having share capital
- AoA must authorise
- Special resolution in General Meeting
- NCLT permission required
- Company should not have any due & payable Interest & principle on deposits
- Tribunal notifies CG, Creditors & SEBI who may send recommendations/objections in this regard. Within 3 months, tribunal passes order as deem fit.
- Company must file with RoC within 30 days of Order: A copy of order & Copy of SR.
- NCLT Order must be published in newspaper
- If Officer conceals/ misrepresents names of creditors to NCLT then : Section 44 shall be attracted

Section 67 - Restriction on purchase by the company or giving loans by it for purchase of its shares

- Any company having share capital cannot buy its own shares (Exception: reduction of share capital as per Companies Act)
- Any *public company* cannot lend money/give financial assistance to any person to purchase its own shares/ shares of its holding company
- Exception to above:

- Banking Companies

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- Scheme approved by special resolution for employees
- Loan to employees for purchase of shares of company up to 6 months of their annual salary → Disclosure in board report must be made if such employees have not exercised voting rights.

• Default:
Company- Fine 1L – 25L
Officer in default- Imprisonment up to 3 years and Fine 1L – 25L

Section 68-70 Buy Back

Section 68 - Buy Back
Conditions:

• Sources of Buy back:
- Free profits/reserves
- Security premium Account
- Proceeds of fresh issue (not the same class of shares)

• AoA must authorise
• Special resolution must be passed in general meeting
Exception: If buy Back is up to 10% of paid up share capital and free reserves & BoD resolution is passed to approve it
• Maximum Buy Back in a financial year: 25% of aggregate Paid up share capital & Free Reserve
• Maximum Buy Back of *Equity shares* in a financial year: 25% of total equity Paid up share capital
• Post Buy Back
(Secured Debts + unsecured Debts) / Paid up share capita + free reserve → Less than 2
• Share must be fully paid up
• Listed companies must follow SEBI regulations
• Notice of the General meeting must include explanatory statement containing material details like
- Need for Buy Back of shares
- Class of shares being BB
- Amount
- Time limit for completion
- Other material facts

• Declaration of Solvency, signed by 2 Directors (including 1 Managing Director) must be filed with RoC & SEBI before making BB (Stating that company shall be able to fulfil its liabilities in the coming financial year after BB)
• Maximum time of completion of BB: 12 months from SR/BoD Resolution
• BB can be done from :
- Existing Shareholders
- Open Market or

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- Employees
- Bought back shares must be extinguished
- *Cooling Period:* Further issue of same class of shares cannot be made till 6 months from BB (*Except*: Bonus shares or conversion of debentures or preference shares)
- Company must maintain a register for Buy Back
- BB Return must be filed with RoC & SEBI within 30 days of completion of BB
- Default:
  - **Company** – Fine 1L-3L
  - **Officer in default** –

Imprisonment up to 3 years
(or)
Fine 1L – 3L
(or)
Both

Section 69 - Transfer of certain sums to Capital Redemption Reserve Account

- Where the company has bought back its own shares out of free reserve or securities premium account, then Nominal value of such shares bought back must be transferred to CRR A/c.
- *Not Applicable:* if proceeds of fresh issues are used for BB
- CRR is used only to issue Bonus shares

Section 70 - Prohibition for Buy Back in certain circumstances

Company cannot purchase directly/indirectly its own shares/securities

i. through
- its subsidiary companies
- investment companies

ii. If the company has made default in preceding 3 financial years in repayment of
- Interest or principal on deposits
- Redemption of preference shares/debentures
- Term loan/interest due thereon

from bank/financial institutions

& the Default is not made good

iii. If the company has defaulted in complying with the following sections
- Annual return (Section 92)
- Declaration of dividend (Section 123)
- Failure to pay Dividend (Section 127)
- Financial statement ((Section 129)

Section 71 – Debentures

Section 2 (30) Summarized points from Definition:

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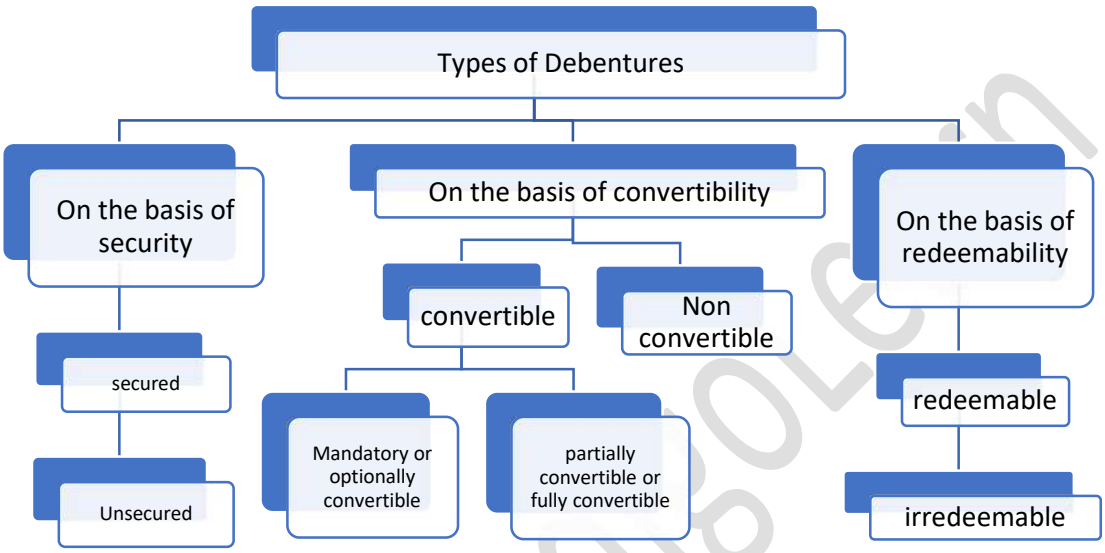
"Debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not; Amended 9/2/18 provided that following shall not be treated as debentures

a) The instrument referred to in Chapter III-D of the Reserve Bank of India Act, 1934 and
b) Such other instrument as prescribed



- Convertible debentures can be issued by passing special resolution in General Meeting
- At the time of issue of debentures, the company must create a '*Debenture Redemption Reserve A/c*' out of the free profits of the company that can be used only for redemption of debentures.
- Debentures with voting rights cannot be issued
- To issue secured debentures the company must follow conditions prescribed in Companies (Share capital & Debenture) Rules, 2014
- If company issues debentures to more than 500 subscribers, it can do so only after appointing a *Debenture trustee* as per prescribed rules.
- *Debenture Trustee:*

o He protects the interest of the debenture-holders & resolves their grievances
o He can file a petition with the tribunal if

- He comes to the conclusion that assets of the company are insufficient to meet its debts.
- NCLT may pass an order restricting the company from incurring any further liabilities
- debentures are maturing and unpaid

o Default in following NCLT order:
Officer in default- Imprisonment up to 3 yrs. or
Fine 2L – 5L or
Both

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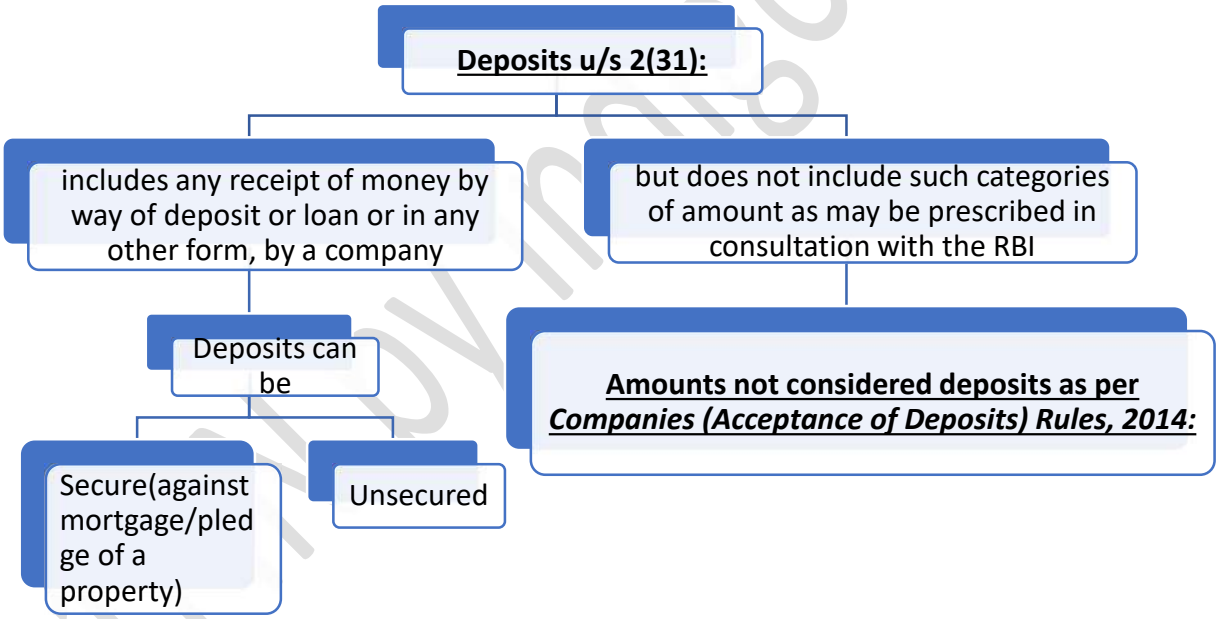
Section 72 - Power to Nominate

- Every holder of securities shall have right to nominate successor.
- In the event of death of the security holder, the nominated person shall be the deemed owner of the security (irrespective of any other law in force/Will).
- In case of *Joint Holders*, they must mutually nominate the successor. Such nominated person shall have right to own the shares in case of death of *all the joint holders*. {What if the joint holders do not agree on one nominee name? → Procedure mentioned in AoA shall apply}
- In case the nominee is a Minor, then the security holder may appoint another person to replace such nominee in case of his death during minority.

14.1.8 Acceptance of Deposits

Section 73-76A

Relevant Rules: Companies (Acceptance of Deposits) Rules, 2014



AMOUNTS NOT CONSIDERED AS DEPOSIT

Following categories of amounts are not considered as deposit *[Rule 2 (1) (c)]:*

(i) any amount received from the Central Government or a state Government, or from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature;

(ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions etc. subject to the provisions of

Foreign Exchange Management Act, 1999 and rules and regulations made thereunder.

(iii) any amount received as a loan or facility from any banking company or from State Bank of India or its subsidiary banks or from a notified baking institution or from any co-operative bank.

(iv) any amount received as a loan or financial assistance from Public Financial Institutions.

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India.

(vi) any amount received by a company from any other company.

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities (including share application money or advance towards allotment of securities, pending allotment), so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

It is clarified by way of Explanation that if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules.
However, unless otherwise required under the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or rules or regulations made thereunder to allot any share, stock, bond, or debenture within a specified period, if a company had received any amount by way of subscriptions to any shares, stock, bonds or debentures before the 1st April, 2014 and disclosed in the balance sheet for the financial year ending on or before the 31st March, 2014 against which the allotment is pending on the 31st March, 2015, the company shall, by the 1st June, 2015, either return such amounts to the persons from whom these were received or allot shares, stock, bonds or debentures or comply with these rules.

Further, *it is clarified that* any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company or a relative of the director of the private company.

However, the director of the company or relative of the director of the private company, as the case may be, from whom money is received, is required to furnish to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of

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funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report;

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III [1] of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within 10 years;
However, if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer.

(x) any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognized stock exchange as per applicable regulations made by Securities and Exchange Board of India.

(xi) any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest-bearing security deposit.

(xii) any non-interest-bearing amount received or held in trust.

(xiii) any amount received in the course of, or for the purposes of, the business of the company–

(a) as an **advance for the supply of goods or provision of services** accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance:

However, in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty-five days shall not apply.

(b) as advance, accounted for in any manner whatsoever, received in connection with **consideration for an immovable property** under an agreement or arrangement, provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement.

(c) as **security deposit** for the performance of the contract for supply of goods or provision of services.

(d) as advance received under **long term projects** for **supply of capital goods** except those covered under item (b) above.

(e) as an advance towards consideration for providing **future services** in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;

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(f) as an advance received and as allowed by any **sectoral regulator** or in accordance with directions of Central or State Government.

(g) as an advance for **subscription towards publication**, whether in print or in electronic to be adjusted against receipt of such publications.

However, *it is clarified that* if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules.

Further, by way of Explanation it is clarified that for the purposes of this sub-clause the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

(xiv) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to the fulfilment of following conditions:

(a) the loan is brought because of the stipulation imposed by the lending institutions on the promoters to contribute such finance.

(b) the loan is provided by the promoters themselves or by their relatives or by both; and

(c) Such exemption shall be available only till the loans of financial institution or bank are repaid and not thereafter.

(xv) any amount accepted by a **Nidhi** company in accordance with the rules made under section 406 of the Act.

(xvi) any amount received by way of subscription in respect of a **chit** under the Chit Fund Act, 1982.

(xvii) any amount received by the company under any **collective investment scheme** in compliance with regulations framed by the Securities and Exchange Board of India.

(xviii) an amount of twenty-five lakh rupees or more received by a **start-up company**, by way of a **convertible note** (convertible into equity shares or repayable within a period not exceeding five years from the date of issue) in a single tranche, from a person.

(xix) any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds, Infrastructure Investment Trusts, Real Estate Investment Trusts and Mutual Funds registered with the Securities and Exchange Board of India in accordance with regulations made by it.

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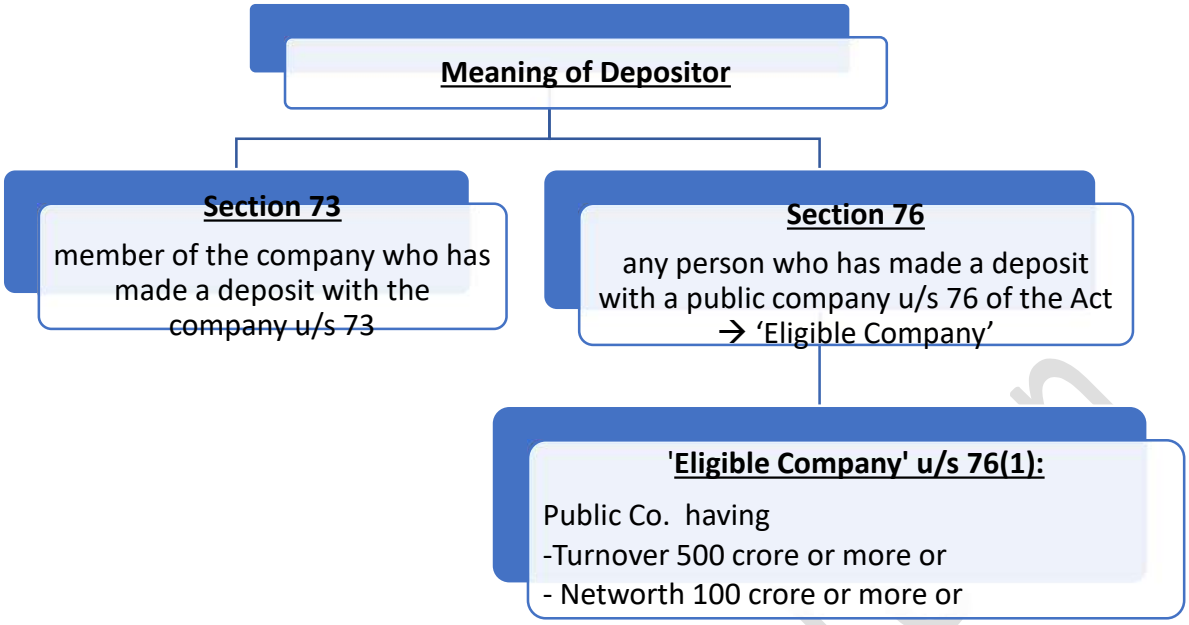

Section 73 - Prohibition from acceptance of Deposit on public

Any company may raise deposit from its **members** provided following conditions along with prescribed rules are satisfied.

Section N/A-

-Banking Co.

-NBFC (non- banking financial company)

-Registered Housing Finance Co.

-Other companies prescribed by government

Conditions:

1. Resolution at GM
2. RBI/CG regulations shall be followed
3. Circular must be sent to members stating-
   - ✓ financial position of company,
   - ✓ credit rating,
   - ✓ Number of depositors
   - ✓ Amount due to be paid to earlier depositors
   - ✓ Other prescribed details
4. Circular must be filed with RoC within 30 days of issue
5. **'Deposit Repayment Reserve A/c'** must be opened in a separate scheduled bank and 20% of deposits maturing in a FY and next FY shall be deposited in it (amended 15/8/2018).
6. Security shall be provided on deposits raise. Otherwise such deposits shall be mentioned as 'unsecured deposits' in the circular.

7. Company shall certify that it has not committed any default in the repayment of deposits accepted
   Above points N/A- Private Company if deposits raised are up to the [paid up capital + free reserve] of the company
8. Relevant rules must be complied with → Companies (Acceptance of deposit) Rules, 2014

Section 76 - Acceptance of deposit from public by certain companies

✓ Only **"eligible public companies"** are allowed to accept deposits from public along with members (refer definition is chart on earlier pages)
✓ Conditions :
- Compliance of conditions u/s 73
- Compliance of prescribed rule→ Companies (Acceptance of deposit) Rules, 2014
- Obtain credit rating from recognised credit rating agency at the time of acceptance of deposit
- Within 30 days of acceptance of deposit → charge must be created on assets of the company (not less than the amount of deposit accepted)
- Other conditions same as on any other deposit (remaining chapter applies mutatis mutandis)

Other conditions as per Companies (Acceptance of Deposits) Rules, 2014:

Terms & conditions for acceptance of deposit by companies [Rule 3]

1. Period

A company cannot accept the following deposit

- Demand deposit
- Deposits payable within 6 months or after 36 months from the date of acceptance.

Exception- For the short-term requirement of Funds Company may accept deposits less than 6 months but more than 3 months. The amount so accepted should not be more than 10% of net worth of the company.

2. Joint Depositor

Deposits may be accepted in joint name but not more than 3 joint depositors.

2. **Limits of amounts companies can accept as deposits (sub rule 3, 4 & 5)**

Particulars	Pvt Companies	Public Companies	Eligible Companies
Sources	From Directors & Members	From Directors & Members	From Directors & Members & Public

Director	No Limit, declaration required	No Limit, declaration required	No Limit, declaration required
Members	35% of (Paid up capital + free reserves.+ security premium) Compliance of section 73(2)	35% of (Paid up capital + free reserves.+ security premium) Compliance of section 73(2)	10% of (Paid up capital + free reserves.+ security premium) Compliance of section 73(2) & 76
Public	Not allowed	Not allowed	25% of (Paid up capital + free reserves.+ security premium). Compliance of section 73(2) **Govt. companies 35%** of (Paid up capital + free reserves.+ security premium).

4. Ceiling on rate of Interest & Brokerage

Interest rate on deposits & Brokerage shall not exceed the maximum rate on which a NBFC can pay on their deposits.

Form of Advertisement & Circular [Rule 4]

Companies Other than Eligible companies

Such kind of companies intending to invite deposits from its members must issue a circular in form of an advertisement

- Registered post, or
- Speed post, or
- Electronic Mode

In form No **DPT-1.**

Circular must also be published in

- English language in an English News paper
- Vernacular language in a vernacular news paper

Having its wide range of circulation in the state in which the registered office of the company is situated.

For Eligible companies

For eligible companies everything will be the same as above it is to be noted that

- It will be issued to the person from which the deposit is invited.
- Additional requirement for eligible companies→they have to upload the circular on their website.

Further conditions for both kind of companies

- Circular must be registered with ROC at least 30 days before the issue of circular
- Circular must be signed by majority of directors.
- Circular will be valid not be valid after the expiry of 60 days from the end of FY in which it has been issued OR till the date of AGM in which the accounts kept for approval, whichever is earlier.

Security [Rule 6]

After acceptance of deposit, every company within 30 days from such acceptance must provide a security either by way of Charge or by way of Mortgage. The amount of security must not be less than the amount of Unsecured Deposits.

Trustee [Rule 7, 8 & 9]

Companies accepting deposits must appoint one or more trustees at least 7 days before issuing of circular.

Written consent of the trustee must be obtained & trust deed must also be executed in form **DPT-2.**

Functions of trustee

- To protect the interest of Depositor & ascertain the appropriateness of the Security provided.
- To redress the grievance of the depositors.

Nominee Powers & Duties [Rule 11] & section 72

Every depositor has a right to nominate a person to whom the amount of deposit, powers & duties of the depositor will be received on the death of the depositor. The rule 11 shall be read with section 72 of this act.

Receipt of Deposit [Rule 12]

A receipt of acceptance of the deposit from the depositor must be issued, by the officer of the company duly authorized by board, within 21 days of such receipt.

Receipt must contain the following

- Date of Deposit
- Name & Address of depositor
- Amount received
- Interest rate
- Date on which it will become due for repayment

Maintenance of Liquid Assets [Rule 13]

For the purpose of this rule following conditions must be complied

- Deposit 20% of the total deposit maturing during the current year and in the following financial year,
- The amount should be kept in a scheduled bank,
- The account will be called '**Deposit Repayment Reserve Account**'
- The amount shall be deposit up to 30th of April every year
- The amount cannot be used for any purpose other than repayment of deposits.

Register of Depositors [Rule 14]

Every company accepts deposit must prepare a register in which the following particulars of depositor must be recorded

- Name & Address of the depositor,
- Date & amount of each deposit,
- Duration of deposit and the date when they become repayable,
- Rate of interest
- Due date of interest
- Other particulars relating to deposit

Premature Payment [Rule 15]

Following conditions are there for premature deposit

- 6 months must be expired from the date of receipt of deposit
- Depositor requests company for premature payment
- Rate of interest shall be reduced by 1%

Return of Deposit [Rule 16]

- Return of deposit shall be filed in form no. **DPT-3,**
- Return shall be filed up to 30th June of every year,
- Details of deposits as on 31st march shall be filed in the form
- Return shall be audited by the Auditor.

Penal interest [Rule 17]

If company makes default in repayment of principal amount of deposits or interest thereof then the company shall be liable to pay Penalty Interest @18% for the overdue period on the overdue amount.

Section 76A Contravention of Section 73 or 76 (amended 9/2/18)

I. Repayment of Principle + Interest due

II. Penalty:

a. Company → Fine
   - Minimum: 1Crore or twice the amount of deposit accepted → whichever is lower
   - Maximum: up to 10 crores

b. Officer in default →
   - Imprisonment up to 7 years AND
   - Fine 25L to 2 crores

III. In case of wilful default → officer in default shall be liable u/s 447

Section 74 & 75 Applicable before commencement of the Act

Section 74 - Repayment of deposit accepted before the commencement of the Act

If deposits are accepted before the commencement of the Act,

- ✓ Company shall File with RoC→Within 3 months from commencement of Act/payment becomes due→ a statement of all the deposits accepted by the company and sums remaining unpaid with interest due thereon
- ✓ Co. shall REPAY → Within 3 year from commencement of Act/payment becomes due → such deposits may be renewed as per rules (amended 15/8/18)
- ✓ Tribunal may allow further time (on sufficient grounds) Default in complying with this section:

I. Company shall repay the (principal + interest)

II. Following penalty shall be applicable:

- **Company** → 1Cr -10Cr
- **Officer in default** →
  - Fine 25L- 2 Crore (or)
  - Imprisonment up to 7 years (or)
  - Both

Section 75 - Damage for fraud

If there is Default in paying deposit amount u/s 74 in allowed time & intent to fraud is proved, then

- ✓ Penalty mentioned u/s 74 applicable +
- ✓ Penalty u/s 447 +
- ✓ Officer in default shall be personally liable to compensate for the losses or damages caused to affected parties +
- ✓ Aggrieved parties may file a case with tribunal

14.1.9 Registration of Charge

(Section 77 to 87)

Introduction:

Section 2(16) - "Charges":

-an interest/ lien
- created on property/assets
-of company/its undertaking/both
-as security/mortgage

Meaning: In order for the company to take loan from any financial institute/bank, it may be required to keep any of its asset as security. Fetching a loan on basis of the property is termed as "creating a charge on asset". This gives protection to the financial institute/bank. If the loan is not paid in due time, they have the right to sell the asset and recover the amount due.

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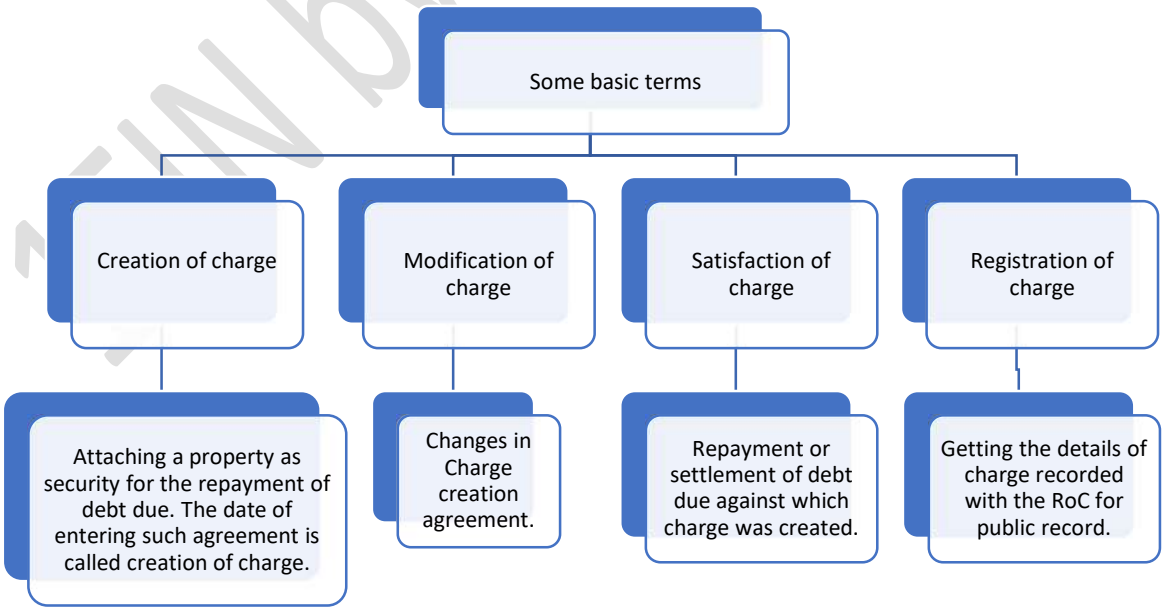
Types of Charges

BASIS FOR COMPARISON	FIXED CHARGE	FLOATING CHARGE
Meaning	Fixed charge refers to a charge that can be ascertained with a specific asset, while creating it.	Floating charge refers to a charge that is created on the assets of circulatory nature.
Nature	Static	Dynamic
Registration of charge	Compulsory	Compulsory
What is it?	A legal charge.	An equitable charge.
Preference	First	Second
Asset type	Non-Current Asset	Current Asset
Dealing in asset	The company has no right to deal with the property, but subject to certain exceptions.	The company can use or deal with asset, until crystallization.



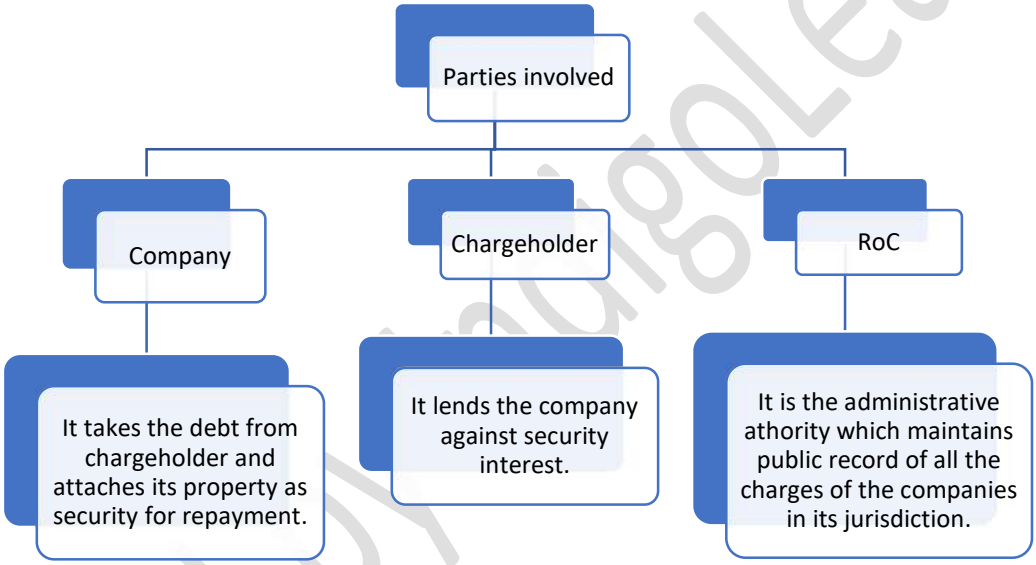
14.1.10 Registration of Charge:

Meaning: Getting the details of charge recorded with the RoC for public record.

Need:

- At the time of winding up of the company, the creditor is treated as secured only if the charge is registered. Otherwise, they are clubbed with unsecured creditors.
- It creates public record of loans taken on any asset of the company
- Binds parties to contract
- States' rights and obligation of parties.

Note: At the time of repayment of loan, the date of creation of charge is relevant to determine which creditor has first charge. The date of registration of charge is not to be considered unless it is winding up.



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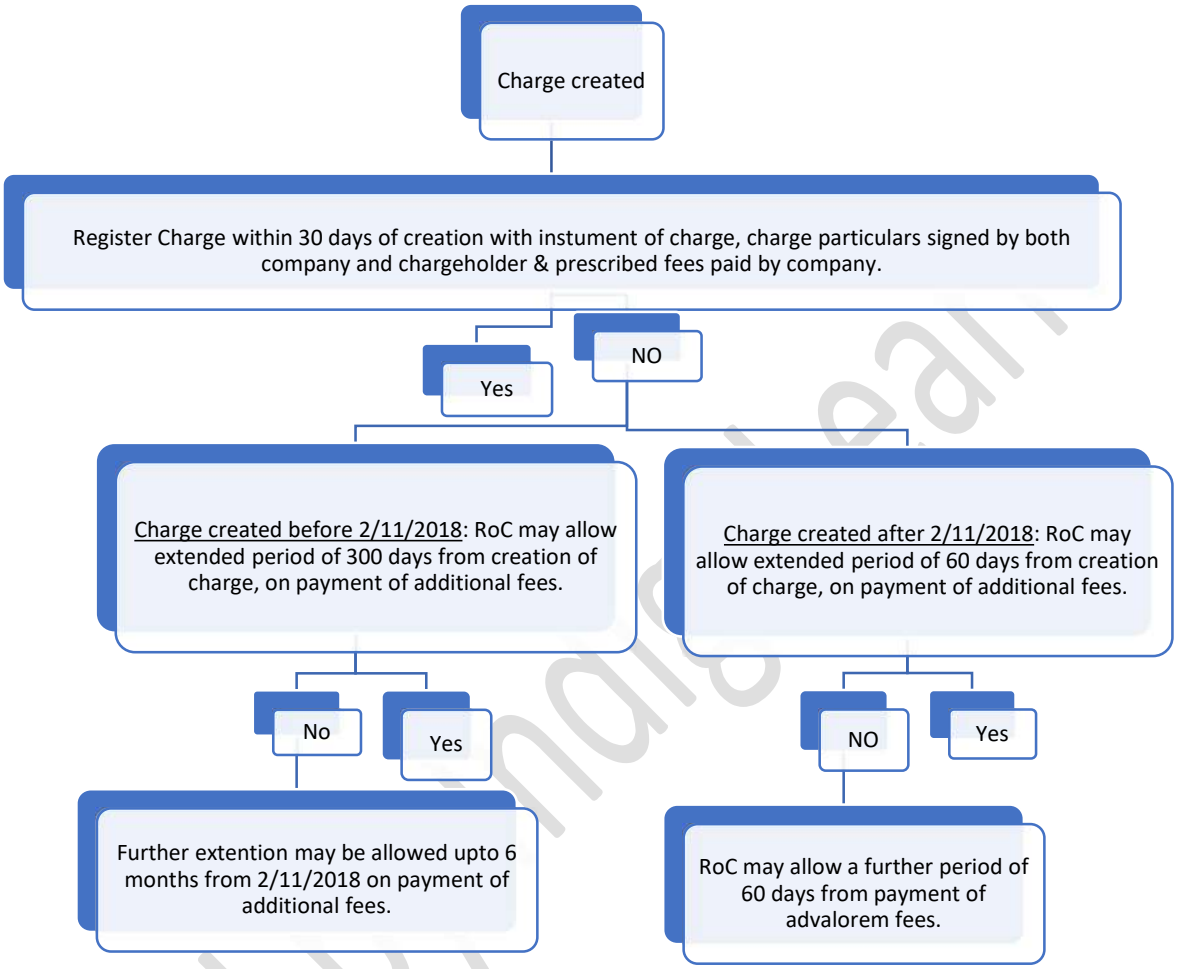
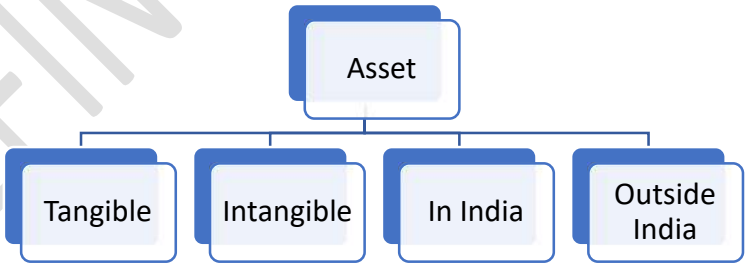
14.1.11 Registration Procedure

Sec: 77 - Registration of charge:



- it is mandatory for every company to register charge on Asset



- Its companies' responsibility to register, hence all cost & fees are to be borne by company.

Note:

1. Registration date does not affect rights of parties prior to registration.
2. On registration, Roc issues "Certificate of Registration of Charge" in the name of the Charge holder. (Copy is given to company.)

3. Section not applicable on charges prescribed in consultation with RBI.
4. Documents submitted with application for registration:

- Copy of document of Charge creation
- Certificate of verification signed by director/CS/Charge holder/Common seal verifying the existence of asset on charge.
- Fees prescribed
- particulars of charge in the prescribed form: Form CHG-1 or Form CHG-9 (in case of debentures)

Sec: 79 - Modification of Charges

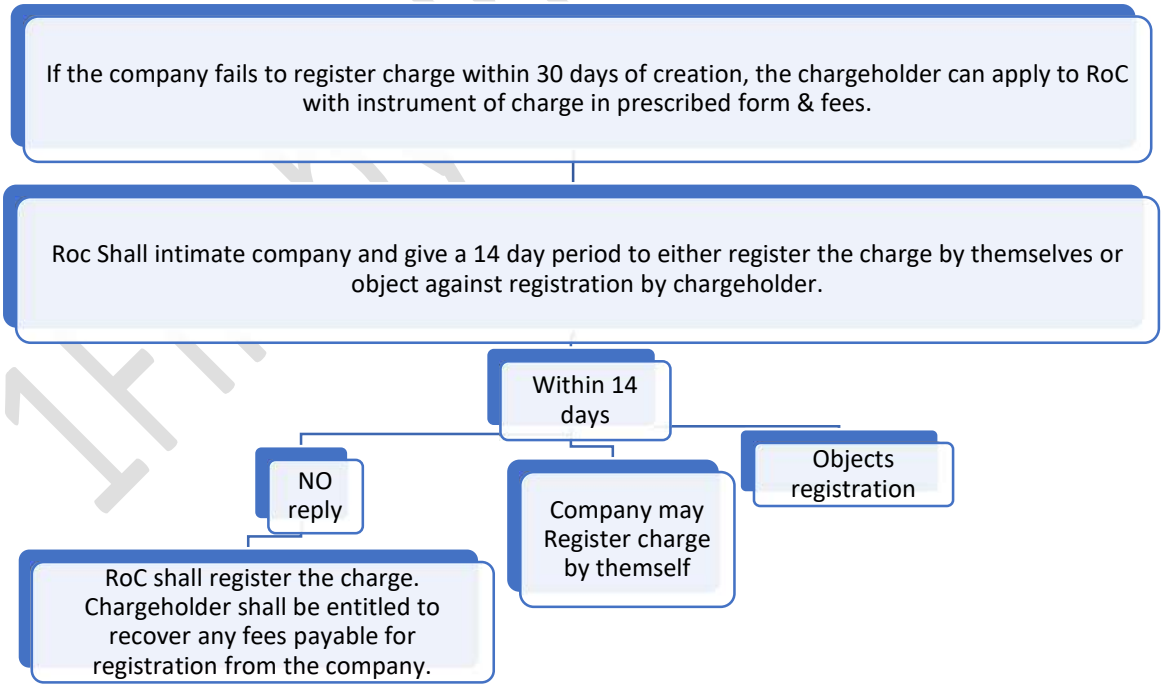
Meaning: Variation in the terms of the charge creation agreement. Eg: Change of interest rate or repayment schedule, inclusion of second or third charge on the asset, partial release of charge, etc.

Modification required mandatory registration by the company as per section 77 provision (mutatis mutandis). "Certificate of registration for Modification of charge" is issued by RoC.

Sec:80 - Person Acquiring Charged Property

Person acquiring charged property where such charge is registered with the RoC, shall be deemed to have knowledge of the charge from the date of registration of charge.

Sec: 78 - Application for Registration of Charge (Amended 7/5/18)



Register of Charges

Sec: 81 - Register of Charges maintained by RoC

- RoC maintains register of charges for every company containing details of charges on each asset, date of creation, amount, charge holder's details etc.

- Register is open for inspection by anyone on payment of fees.
- M.C.A.'s online site contains register of charges (Deemed RoC's register)

Sec: 85 - Register of Charge maintained by company

- Every company shall maintain Register of Charges
- Kept at registered office
- In format as per Form No. CHG-7
- Particulars maintained:
  - Creation of charge
  - Modification of charge
  - Satisfaction of charge
  - Properties acquired subject to charge
- Entries in Register to be authenticated by:
  - Director or
  - Secretary or
  - Person authorised by BoD
- Preservation of
  - Register: Permanently
  - Instrument of creation/modification of charge: 8 years from satisfaction.
- Inspection of Register:
  - Allowed during business hours
  - For Members/Creditors: NO fees
  - For Other person: Fees may be applicable

Satisfaction of Charge

Sec: 82 - Reporting the Satisfaction of Charge

Meaning: Where is the secured debt due is paid off/settled and thus the asset no longer is subject to charge.

Procedure: Sec: 83 - Power of RoC to enter in the Register about Satisfaction of Charges

If the company has not informed the satisfaction of charge to the RoC & RoC receives evidence of satisfaction of charge from other source.

RoC will enter in the Register of Charges himself as a memorandum and within 30 days, intimate affected parties.

Other Provisions

Sec: 84 - Intimation of Appointment of Receiver/Manager

Meaning of Receiver/Manager: Person appointed to manage companies' asset and liabilities.

At the time of Appointment:

- Intimation to : RoC & Company

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- Intimation By: Person appointing Receiver/Manager or person authorised to appoint them
- When: within 30 days of appointment
- Accordingly, the RoC shall record such facts in register of charges.

At the time of cessation of appointment:

- Intimation to : RoC & Company
- Intimation By: Person so appointed whose appointment is ceasing
- Accordingly, the RoC shall record such facts in register of charges.

Sec: 86 - Contravention of Chapter VI

- **Company**: Fine 1L – 10L
- **Officer in default**:
  - Imprisonment up to 6 months or
  - Fine 25K – 1L or
  - Both
- **Wilfully furnishing incorrect information/ knowingly suppresses material facts required u/s 77, shall be liable u/s 447**

Sec 87 - Rectification in Register of Charges by CG

If there is

- Omission or delay to intimate payment/satisfaction of charge
- Omission or misstatement in filing particulars of registration/ modification/satisfaction of charge

Due to

- Accidental/ Inadvertent mistake
- Not to prejudice the position of creditors/shareholders
- Sufficient cause

Then the company/other interested person may apply to CG for rectification of error or extension of time for intimation of satisfaction. CG may allow if it deems fit. This shall not affect the rights of the parties.

List of Forms to be filled with RoC

S.No.	E-Form	Purpose
1.	CHG-1	Creating or Modifying charge (for other than Debentures)
2.	CHG-2	Certificate of Registration of charge.
3.	CHG-3	Certificate of Modification of charge.

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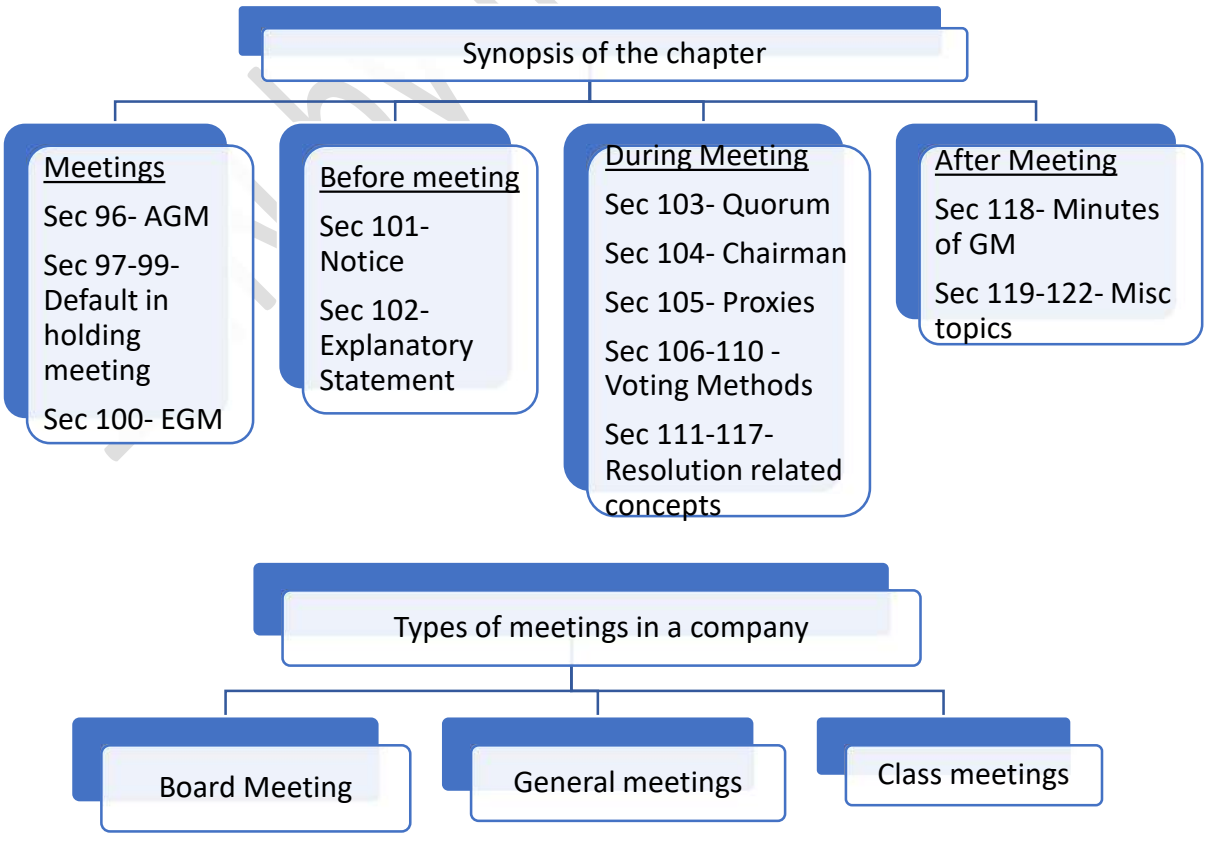
4.	**CHG-4**	Intimation of the satisfaction to the Registrar.
5.	**CHG-5**	Memorandum of satisfaction of charge.
6.	**CHG-6**	Notice of appointment or cessation or receiver or manager.
7.	**CHG-7**	Register of charges.
8.	**CHG-8**	Application for condonation of delay shall be filed the Central Government.
9.	**CHG-9**	Creating or modifying the charge in (for debentures including rectification)
10.	**CHG-10**	Application for delay to the registrar.

14.1.12 Management and Administration

Section 96-122



Section 101 - Notice of the Meeting

When: Notice must be sent at least

- *All other companies*: 21 clear days prior to GM
- *Section 8 Company*: 14 clear days prior to GM (General Meeting)

Note: (1) "Clear days" does not include

- Date of GM
- Notice serving date
- 2 days for transmission

(2) AoA cannot reduce this time

(3) **'Shorter Notice' (amended 9/2/18)** is allowed if it is ratified by

- ✓ For AGM: *95% of the members* entitled to vote in that meeting in writing or by electronic mode.
- ✓ Other Meeting:

Company having share capital: majority in number + representing 95% shares having voting rights

Company NOT having share capital: members representing 95% voting rights

To:

- Members
- Their legal heirs/ legal representatives
- Assignees of insolvent member
- Auditor
- Directors

Failure to send: Proceedings of GM shall be INVALID Except if it is an unintentional mistake and company proves the same.

Content of a Notice:

- Date, time, place of GM
- Agenda
- Right to appoint proxy
- Explanatory statement may be attached if special business will be conducted

Mode: It must be in Writing and sent via

- Post (Speed/registered)
- Courier
- Hand delivery
- Electronic via Email as text, attachment, providing electronic link or Uniform Resource Locator for accessing such notice

Provided: Such notice is placed on the website AND advance opportunity is given to members to update their email ids every FY.

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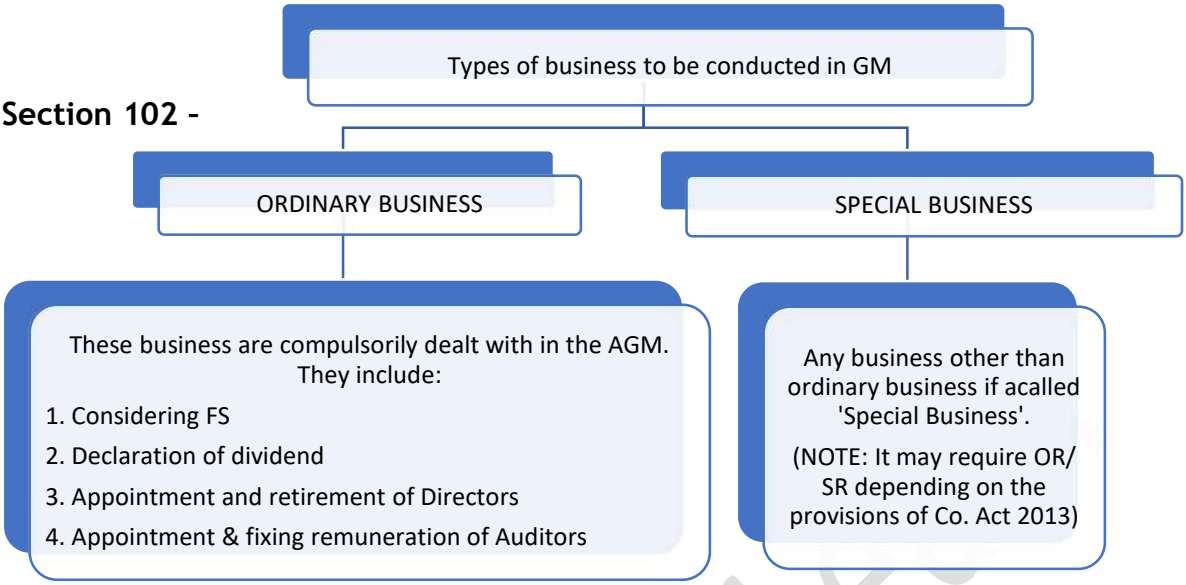
Section 102 -



Explanatory Statement

Where any special business is to be transacted at the company's general meeting, then an 'Explanatory Statement' should be annexed to the notice calling such general meeting, which must specify

- nature of concern/interest of every director/manager/KMP and their relatives.
- relevant & material information and facts related to such business
- details on how to inspect documents relating to Special business

Insufficient disclosure: any benefits received by promotor/Director/manager/KMP and their relatives must be compensated back by such officer

Contravention of sec 102: Every promoter, director, manager, or other key managerial personnel or any of their relatives:

- Fine 5L or
- 5 times of benefits accruing to them

Whichever is Lower

<u>Section 103 Quorum</u>

- Meaning: It is the minimum number of members that must be present in the meeting for it to be valid in the eyes of law.
- Quorum **u/s 103** for any GM

Company	Quorum
Private company	Minimum 2 members
Public Company having	
Up to 1000 member	5 members personally present

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1001-5000 members	15 members personally present
More than 5000 members	30 members personally present

- AoA may mention a higher quorum
- In case of a private company, quorum mentioned in AoA will prevail over the provisions of Companies Act.
- Quorum must be present within 30 minutes of commencement of GM, otherwise the meeting shall stand adjourned for the next week, same time and place or such other time/place as decided by the BoD.
- At Adjourned meeting: If quorum is not present within half an hour→ members present shall form the quorum. If only one member present→ Meeting cancelled
- Notice for Adjourned meeting→ not less than 3 days' notice before GM mandatory
- Meeting by Requisition u/s 100: If quorum is not present → meeting is deemed cancelled
- Quorum need not be present throughout the meeting. However, any business transacted in the absence of quorum shall be invalid.
- Who shall be considered for Quorum?
  - Proxies →
  - Authorised representative of company→
  - Joint holders→
  - Person in dual capacity→

Section 104 – Chairman

- *Election of Chairman*:
  - AoA may specify, otherwise
  - members, personally present, shall elect the Chairman among themselves by show of hands
- *Powers and functions of chairman:*
  - Manages GM
  - Must be impartial and fair
  - Maintains decorum of the GM
  - Has the power of Casting vote in board meeting and GM if so, allowed in AoA.If not mentioned in AoA, then ordinary resolution on which there is equality of votes is deemed to be dropped.
    {Meaning: in event of the equality of vote on a particular business being transacted at the meeting, the Chairman shall have a right to cast a second vote.}
  - Can demand a poll
- He must be present within 15 minutes in the GM, else, another chairman can be appointed by BoD/members.

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Section 105 – Proxies

- ***Meaning:*** Any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf in case he is unable to attend.
- ***Role of Proxy***
  - Cannot participate in discussion in GM
  - Cannot vote other than vote by poll
  - Is not counted for quorum
  - can demand a poll
  - can act as proxy for more than one member provided it is not more than
    - 50 members or
    - 10% of total voting power

    } Whichever less
    - If one of the members has more than 10% voting rights, then proxy cannot act as proxy of any other member except such member.
- ***Procedure to appoint proxy:***
  - every notice calling a meeting of a company shall state right of every member to appoint a proxy along with Form MGT- 11.
  - Such form of proxy shall be received 48 hours before the meeting will be valid
  - Such proxy shall be valid for adjourned meetings unless changed by member
- ***Inspection of proxies:***
  - Allowed to any member
  - In the meeting/within 24 hours prior to meeting
  - During business hours
  - 3 days' notice prior to inspection need to be given to the co. by member
- ***Who can be proxy?***
  - Generally, →Non-Member/Member of Co.
  - For Sec 8 Co. → Only Member of Co.
- If member attends GM himself→ Proxy is cancelled
- Proxy is valid even if the member dies/becomes insolvent
- Contravention of this section:
  - Failure to state in notice of meeting that a member is entitled to appoint proxy→ Fine up to 5K
  - issuing invitation to appoint named person as proxy→ Fine up to 1L
  - refusing the inspection → Fine up to 10K + 1K/day
  - all above offenses are compoundable in nature

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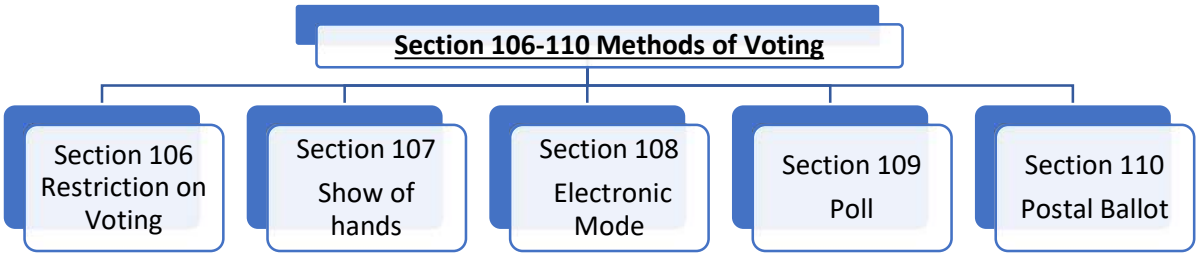

Section 106 - Restriction on Voting

- AoA may provide that no member shall exercise any voting right in respect of any share registered in his name on which
  - any amount due and payable from him on calls or
  - other sums payable or
  - company has exercised the right of lien.

  Such member cannot sign a requisition for an extraordinary general meeting.
- Company cannot restrict right to vote other than as specified above.
- In Poll →Member may use his votes as he likes
- Joint holders →
  - Must vote in consensus
  - Otherwise, procedure stated in AoA shall apply
  - In absence of any such procedure, order of seniority is determined on the basis of the order in which their names appear in the register of members/ shareholders

Section 107 - Show of hands

- Unless the voting is demanded by way of poll (u/s 109) or by electronic means (u/s 108), the voting should be by way of show of hands in the first instance.
- Declaration by Chairman in the minute's books → conclusive evidence that the resolution is passed.
- Insolvent member→ can vote in GM

Section 108 - Voting by E-Mode

- Mandatory option of E-voting must be given to members by following companies:
  - Listed Co. or
  - CO. having members 1000 or more
- Procedure/Steps:

i. **Notice of GM:**

- Must contain the usual details and sent as per section 101
- Must be placed on Co. website and 2 newspapers (vernacular and English)
- Additional disclosure:
  - Details about the option to vote via e-mode like time schedule, id, password generation method, procedure

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- ‘the members who have cast their vote by remote c-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again’
- Grievance redressal information of the Co. like email address/ phone number
- Details of web address of co. where copy of notice can be found

ii. Time limit for E-voting:

- Must be open for minimum 3 days
- Must close at 5 pm preceding the date of GM

iii. Who can vote?

- Member having physical shares or Dematerialised shares

iv. Scrutinizer:

- Appointed by BoD after E-Voting
- Can be 1 or more
- Practising CA/CS/ Cost Accountant/Advocate
- Should NOT BE EMPLOYEE OF Co.
- His function is to count the votes in a fair manner and prepare its report

v. After Voting at GM:

- Chairman along with the scrutinizer shall count all those members who are present at the general meeting but have not cast their votes by availing the remote e-voting facility. Such members shall be allowed to vote at GM
- The scrutinizer shall Count all the votes in the presence of at least 2 witnesses. Witness shall not be employee of company.
- He must prepare report within 3 days.
- Results shall be posted on the Co. Website. And sent to relevant stock exchanges
- scrutiniser shall maintain a register either manually or electronically to record the assent or dissent received with details of member
- register and all other papers shall remain in the safe custody of the scrutiniser until minutes are prepared
- Date of resolution → date of GM

Section 109 - Demand for Poll

- *Meaning:* A polling paper is circulated among the members present in the GM wherein they cast their votes. The voting is based on the % of share capital having voting rights held by the member
- *Who can demand a poll?*
  - Chairman or
  - Member/their proxies holding not less than 1/10h of the total voting power or
  - Member/their proxies holding shares on which an aggregate sum of not less than Rs, 5L has been paid – up
- Person demanding poll can withdraw the same at any time before it commences
- *Scrutinizer:*
  - Appointed by BoD

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- Can be 1 or more
- Practising CA/CS/ Cost Accountant/Advocate
- Should NOT BE EMPLOYEE OF Co.
- His function
  - ensure proper conduct of the polling process.
  - maintain proper records
  - submit a report to the Chairman of the meeting → containing details of votes cast in the favour and against the resolution.
  - ensure compliance of section 109 and Rules

➢ *Procedure of Voting:*

- Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies, other documents
- He shall arrange for Polling papers and distribute them to the members and proxies present
- Votes shall be collected in a locked and sealed empty polling box. Such box shall be open only after voting is complete by the scrutinizer in presence of 2 witness (not employees)
- If a member who has appointed a proxy has voted in person, the proxy's vote shall be disregarded.
- In case of ambiguity about the validity of a proxy, the Scrutinizers shall decide the validity in consultation with the Chairman.
- Scrutinizers shall count the votes and prepare a report addressed to the Chairman. Chairman shall counter sign such report.
- Voting shall include any E-Votes if any & company shall provide all the necessary support, technical and otherwise, to the Scrutinizers for purpose of counting such votes
- Chairman shall declare the result of Voting on poll in the meeting or within 7 days
- Poll must be conducted within 48 hours of demand

Section 110 - Postal Ballot

➢ *Meaning:* A post is sent to every member of the company along with the notice wherein the shareholder has the option to cast its vote and send the same back to the company within prescribed time. If the vote is casted through post, such member shall not be allowed to vote in GM.

➢ *Mandatory Postal Ballot instead of conducting business at GM:*

(a) alteration of the object's clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum.

(b) alteration of articles of association in relation to insertion or removal of provisions which, under sub-section (68) of section 2, are required to be included in the articles of a company in order to constitute it a private

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company.

(c) change in place of registered office outside the local limits of any city, town or village as specified in sub-section (5) of section 12.

(d) change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised under sub-section (8) of section 13.

(e) issue of shares with differential rights as to voting or dividend or otherwise under sub-clause (ii) of clause (a) of section 43.

(f) variation in the rights attached to a class of shares or debentures or other securities as specified under section 48.

(g) buy-back of shares by a company under sub-section (1) of section 68.

(h) election of a director under section 151 of the Act.

(i) sale of the whole or substantially the whole of an undertaking of a company as specified under sub-clause (a) of sub-section (1) of section 180.

(j) giving loans or extending guarantee or providing security in excess of the limit specified under sub-section (3) of section 186 :

- Companies that have to mandatorily provide the option of voting by E-Mode, may conduct the above business in GM instead of postal ballot
- *Following Companies not required to transact any business through postal ballot*
  - One Person Company
  - other companies having members up to 200
- Procedure:

✓ Co. shall send Notice to Shareholders stating

- Right to vote via postal ballot
- Procedure to vote
- Time limit of sending votes→ Votes must be cast within 30 days of dispatch of the notice
- Procedure to obtain copy of form if misplaced

✓ Advertisement should be published in 2 newspapers (English, Vernacular) stating the following matters, namely:-

(a) a statement → business is to be transacted by postal ballot which includes voting by electronic means.

(b) the date of completion of dispatch of notices.

(c) the date of commencement of voting.

(d) the date of end of voting.

(e) the statement → postal ballot received from the member beyond the said date will not be valid

(f) details on how to obtain a duplicate thereof; and

(g) contact details of the person responsible to address the grievances.

✓ Same shall be published on Co. Website

✓ Scrutinizer:

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- Appointed by BoD
- Can be 1 or more
- Suitably qualified
- Should NOT BE EMPLOYEE OF Co.
- His function is to count the votes in a fair manner and prepare its report
- Vote counting → after the meeting in presence of 2 witness (not employees)
- Report shall be prepared and submitted→ to the BoD → within 7 days of close of voting
- Shall hold relevant document/records till minutes are prepared
- maintains register of accent/dissent

✓ Result of voting → declared on Co. Website

Section 111-117 Matters related to Resolutions

Section 112 - Representation of The President & Governors in Meeting of Companies to Which They Are Member

President of India or the Governor of a State if he is a member of a company→ may appoint his representative at any meeting. Such Representative shall have all rights and powers of member

Section 113 - Representations of Corporations in Meeting of Companies and Creditors

Any Body Corporates who are members/creditor of a company→ may appoint their representative at any meeting by resolution of its directors or other governing body. Such Representative shall have all rights and powers of member

Section 111 - Circulation of Member's Resolutions

Members may request any resolution to be considered a meeting u/s 100 (EGM) and the company shall be bound to give notice to members of details of such resolution and consider the same at the GM.

Conditions:

- minimum 1/10th voting power should submit the request
- written request with signatures of members shall be submitted at Registered office
- a sum reasonably sufficient to meet the company's expenses must be submitted
- Time of submission:

(i) in the case of a requisition requiring notice of a resolution, not less than six weeks before the meeting.

(ii) in the case of any other requisition, not less than two weeks before the meeting.

Exception (No need for the company to circulate such notice):

- Application is submitted to CG by the company or other person aggrieved, AND

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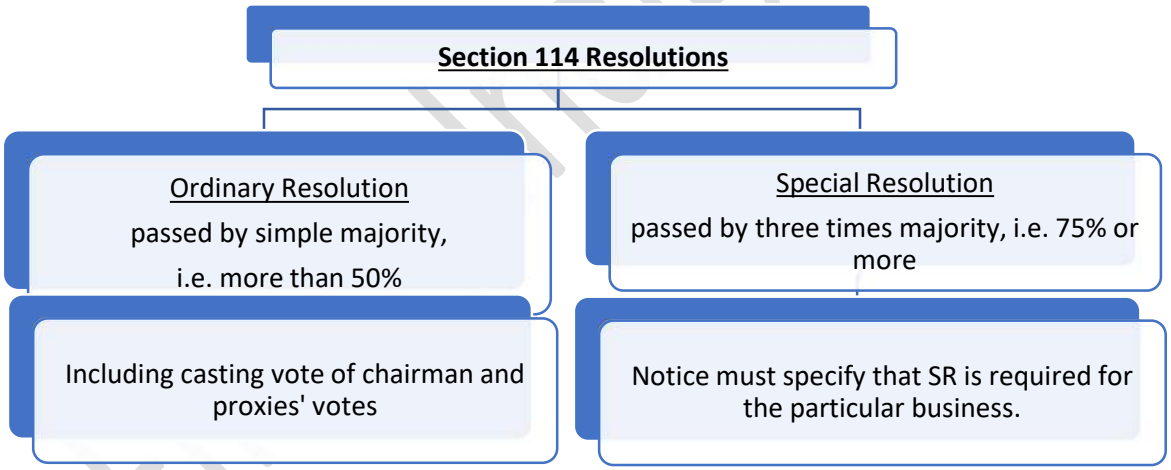
- CG, by order, declares that the rights conferred are being abused to secure needless publicity for defamatory matter.
- Then No need to circulate notice + cost incurred by the company shall be paid to the company by the requisitions
- *Default in Complying with Section:*
  Company/Officer in default= Fine 25K

Difference between Motion & Resolution

Motion	Resolution
Oral opinion or recommendation/proposals of resolution to be passed.	Actual votes in favour and against are cast to adopt a motion.
No need of quorum	Quorum is mandatory
No types	Types : OR/SR
Eg: fixing a date of adjournment of GM	Eg: Appointing Auditor/Director: OR required



Section 115 - Resolutions requiring special notice

- *Meaning*: In order to consider certain types of resolutions as mentioned under this section or AoA→special notice may be required to be given by the company to all shareholders in prescribed manner.
- u/s 115 Special notice is required to pass following resolutions:
- To appoint as auditor a person other than a retiring auditor – Section 140.
- To stand for directorship by a person other than retiring director 14 days' notice is required under section 160(1).
- To remove a director under section 169(2) or
- To appoint a person to fill the vacancy caused by the dismissal of a director

under section 169 at the same meeting.

- Other resolutions company may specify in its AoA

➢ Application to consider such resolution shall be made to the company

- *Signed by a minimum*:
  - members holding not less than 1% of the total voting power or
  - holding shares on which such aggregate sum not exceeding Rs. 5,00,000, has been paid-up
- *When*:
  - At least 14 days prior to the GM
  - Maximum 3 months prior to the GM
  - Excluding date of GM and notice given

➢ *On receipt of Application* →

- the company shall give its members, notice of the resolution → at least 7 days before the meeting (exclusive of the day of dispatch of notice and day of the meeting)
- Where it is not practicable to give the notice in the same manner→ Notice in 2 Newspapers (vernacular + English)+ Company Website {7 days prior to GM}

Section 116 - Resolutions passed at adjourned meeting

Date of resolution passed at an adjourned meeting (Gm/BoD Meeting/Class Meeting)→ date on which it is actually passed and not an earlier date

Section 117 - Resolutions and agreements to be filed(amended 2/11/18)

✓ Every Resolutions and agreements shall be filed with the RoC, together with the explanatory statement, within 30 days of its passing→ Form MGT- 14

✓ Any resolution/agreement that causes alteration of AoA→ shall be annexed to every copy of AoA

- Special resolution
- Unanimous resolutions
- Board Resolution for appointment/ reappointment of MD
- Resolution of class of shareholders
- Resolution u/s 180
- Winding up resolution
- Resolution u/s 179
- Other prescribed resolution/agreements

Default (amended 7/11/18):

- **Company**
  - Fine- minimum 1L
  - Continuing default - 500/day up to max 25L
- **Officer in default**
  - Fine minimum 50K
  - Continuing default - 500/day up to max 5L

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Section 96 - Annual General Meeting (AGM)

- Every company must have 1 AGM every FY
- Section N/A on→ OPC
- Time Limits for holding AGM:
  - First AGM must be held → within 9 months from end of FY
  - Subsequent AGM Must be held → within 6 months from end of FY
  - Maximum gap between 2 AGM→ 15 months
  - Extension → Maximum 3 months extension may be allowed on application to RoC by showing sufficient cause (N/A to first AGM)
  - GM cannot be held on National Holidays (15 Aug, 26 Jan, 2 Oct, other declared public holidays)
  - Held during business hours between 9a.m.and 6p.m.
- Place of Holding (amended 13/6/18):
  Listed Co:
  - Registered office of company or
  - Any other place in the same city where Registered office is located
  Unlisted Co.
  - Any place in India provided *prior consent* is obtained from *ALL the members* → in writing or electronically
- CG may exempt any class of companies from above section.

Section 97 - Default is made in holding the AGM

- Application may be sent by any member of the company to → NCLT
- NCLT may call or direct an AGM and give such ancillary or consequential directions as it thinks fit.

Section 98 - Default is made in holding the EGM

If for any reason, it is impracticable to call an EGM→ NCLT may call so → on application of any director/member of the company/Suo Moto

Section 99 - Punishment for default in complying with the provisions of section 96-98

- **Company/Officer in default:**
  - Fine → up to 1L
  - Continuous default → 5K/day

Section 121 - Report on Annual General Meeting

A Report on AGM is mandatory to be filed

- by Listed Public Company
- to the RoC

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- In form MGT -15
- within 30 days of AGM
  Default (amended 2/11/18):
- Company : Fine minimum 1L - Maximum 500/day up to max 5L
- Officer in default : Fine minimum 25K -maximum 500/day up to max 1L

Section 100 - Extra-ordinary General Meetings
Who can call an EGM?

- BoD or
- Requisition from members holding at least 1/10th of total voting power
  Place of holding (amended 9/2/2018):
- Generally, for all Companies covered under Co. Act 2013→ Any place in India
- Wholly owned subsidiary of a company incorporated outside India→ In/Outside India
  Requisition by members
- Should set out all the matters for consideration at EGM
- Signed by all requisitions
- sent to the registered office of the company
- Reasonable expenses incurred shall be reimbursed by the requisitions. In case of default in holding meeting, the same expenses shall be deducted from salaries of directors in default.
  Default in holding EGM
- If the Board does not call a meeting within 21 days from the date of receipt of valid requisition (to be held not later than 45 days from receipt of requisition), then the requisitions may themselves call a meeting within a period of 3 months from the date of requisition.

Section 122 Applicability OF This Chapter to One Person Company

Sec 98, 100-111 → Not applicable to OPC

Sections related to holding board meeting → Not applicable to OPC

Section 118 Minutes of the Meeting
Meaning: It is the summary of the proceedings of the meetings conducted.

Time of preparation: within 30 days of GM/resolution

Contents:

Fair and correct summary of business transacted in GM

Consecutively numbered

Each page shall be initialled or signed and Last page should be Dated and signed

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All appointments made shall be included

If in opinion of chairman→Matters are defamatory of any person, irrelevant or immaterial to the proceedings, detrimental to the interests of the company→ may not be included in minutes

matter to be included or excluded in the minutes of the meetings shall be at the absolute discretion of the Chairman

Every company shall observe Secretarial Standards with respect to general and Board meetings, specified by ICSI

Minutes kept in accordance with the provisions shall serve as the evidence of the proceedings therein.

Signature by:

Chairman of the Meeting. OR

In the Event of Death or Inability of that Chairman: By any Director who was present in the Meeting and (+) duly authorized by the Board for the purpose, within 30 days of General Meeting

Place of keeping: Registered office

Preservation: Permanently { kept in the custody of the company secretary or any director duly authorised by the board}

Default:

- **Company**
- Fine of Rs 25000
- **Officer in default**
- Fine of Rs 5000

Penalty for tampering with minutes → Imprisonment up to 2 years + Fine 25K-1L

Section 119 - Inspection of Minute-Books of General Meeting
Allowed to → only members

Inspection at the registered office is allowed Without fees→During business hours (Minimum 2 hours per day should be allowed in AoA)

Member may request a copy of any minutes from Co.+ pay prescribed fees→ shall be furnished within 7 working days of request.

Default:

Company → 25K/each refusal

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Officer in default → 5K/each refusal

Section 120 - Maintenance and inspection of documents in electronic mode

Section refers to Rules w.r.t maintaining and inspecting document, record, register or minute in electronic form

{Rule 27} Mandatory for following companies to maintain document in E-format

Listed Co. or

Co. having 1000 or more security holders (debenture-holders/ shareholders/etc.)

{Rule 28} Persons responsible for maintaining:

MD

CS

Another director/officer authorised by BoD

{Rule 29} Company shall have the same responsibilities to make those records available for inspection or to provide copies of the whole/ part of those records.

Section 92 - Annual return (AR)

- *Relevant rules:* Companies (Management & Administration) Rules, 2014
- *Meaning:* This is a form containing details of major occurrences during the Financial Year that must be filed by every company with the RoC.
- *Form No.* : MGT 7
- *Particulars contained*:

- Details of registration
- Particulars of the company's registered office
- Principal business activities pursued by the company
- Particulars of Holding, Subsidiary and Associate Companies
- Particulars of the shares, debentures, and other securities of the company
- Particulars of turnover and net worth of the company
- Details of shareholding pattern.
- Indebtedness
- Details of members, debenture holders and another securities holder
- Details of shares/Debenture transfers of the particular financial year
- Particulars of promoters
- Particulars of directors
- Particulars Key Managerial Personnel
- Details of meetings of members/class of members/Board/Committees of the Board of Directors

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- Remuneration of directors
- Remuneration of Key Managerial Personnel
- Details on penalties/punishment/compounding of offences on company, directors, and other officers in default
- Details of matters pertaining to certification of compliances and disclosure
- Details in respect of shares held by or on behalf of the Foreign Institutional Investor (FII)
- Details of other pertinent disclosures

➢ *Time of filing AR with ROC:* Within 60 days from the
- AGM or
- Last date of holding AGM (with reasons for not holding an AGM)

➢ *Signing of AR:*
- 1 Director +
- CS of the company or Practising Company secretary (PCS)
  OPC/Start-up Co. : If there is not CS, then 2 directors may sign

➢ *Preservation of AR & related documents:* 8 years from the date of filing it with RoC

➢ *Certification of AR:*
Following companies need to certify the AR filed (MGT-7) from another PCS in FORM MGT-8 and file with RoC:
- Listed Company
- Other companies having
  - Paid up share capital not less than 10 crore or
  - Turnover not less than 50 crores

Note: the PCS who certifies MGT 8 should not be the same who certifies MGT 7

➢ *Extracts of AR:*
- It is the summary of key details in the AR.
- It needs to be attached with every board report by every company.
- FORM: MGT- 9

➢ *Contravention of this section (amended 2/11/18):*
- Company/Officer in default:
  Fine Minimum 50K to Rs 100/day up to maximum 5L
- Company Secretary in practice who certifies AR without confirming to this section: fine 50k – 5L

[Section 93: OMITTED]

14.1.13 Registers [Section 88-91, 94, 95]

Section 94 - Place of keeping Register, return, etc.

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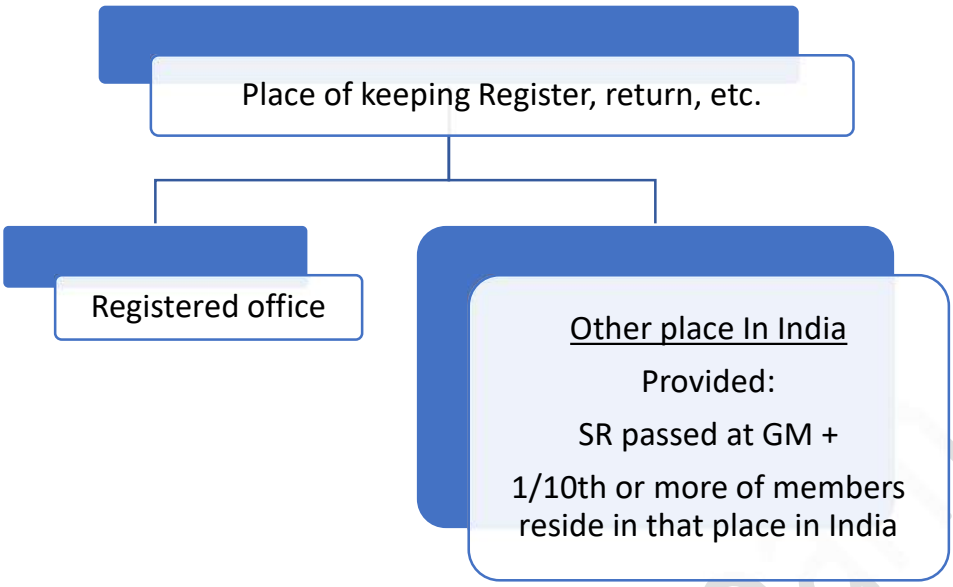
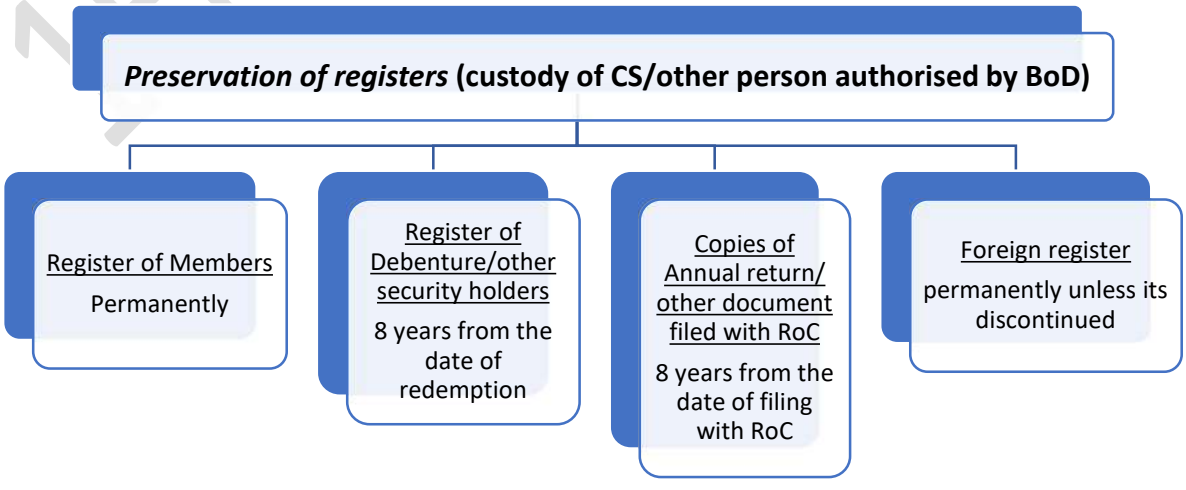


- *Inspection:*
  - Allowed to interested parties (debenture-holders, deposit holders, shareholders etc.)
  - During business hours
  - On payment of fees
  - BoD may fix a few hours of the day for inspection (NOT less than 2 Hrs/day)
  - Photocopies can be taken
  - (Amended 13/7/18) Certain prescribed particulars of registers/ returns shall be not be available for inspection/taking copies
- *Default in allowing inspection:*

  - **Company/Every officer in default:**
    - Rs. 1000/day
    - Max 1L
- CG (RD) may order immediate inspection of documents/extracts to be given to any person.
- *Preservation of registers:*



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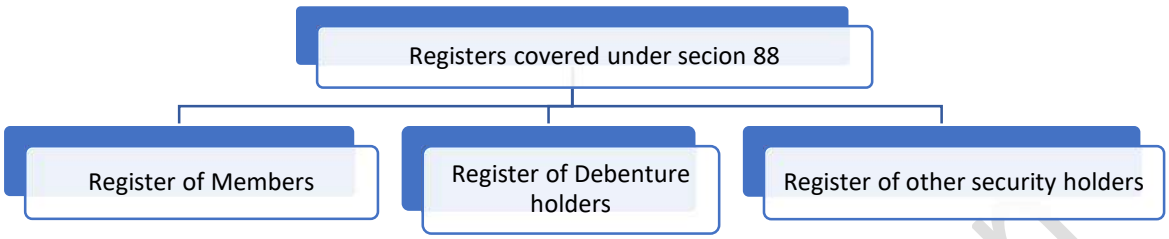
Section 95 - Registers, etc. to be evidence

All the registers. returns and its copies shall be *allowed as prime facie evidence* in the court of law.

Section 88 - Registers



❖ *Register of Members*

- Form No. MGT-1
- Contains following details
  - Members details: name, address, nationality, PAN, DOB, nominee details, email, joint holder name, if it is a minor then details of guardian
  - Shareholding details: Amount, share type (Equity/preference), details of hypothecation/pledge, court order related
  - Date of purchase
  - Date of cessation
  - Guarantee amount (if company limited by guarantee)
  - Notice relating to instruction given by shareholder
  - Any changed in above
- Preservation: Permanently

❖ *Register of Debenture-holder/ other security Holders:*

- Form: MGT- 2
- Mandatory for every company that issued debenture/ other security to maintain.
- Details contained
  - Security holders' details: name, address, nationality, PAN, DOB, nominee details, email, joint holder name, if it is a minor then details of guardian
  - Investment details: Amount, security type, details of hypothecation/pledge, court order related
  - Date of purchase
  - Date of cessation
  - Notice relating to instruction given by shareholder
  - Any changed in above
- Preservation: 8 years from redemption

❖ *Register Index of Beneficial owners:*

Beneficial owners mean the investor who purchase dematerialised shares from stock exchange.

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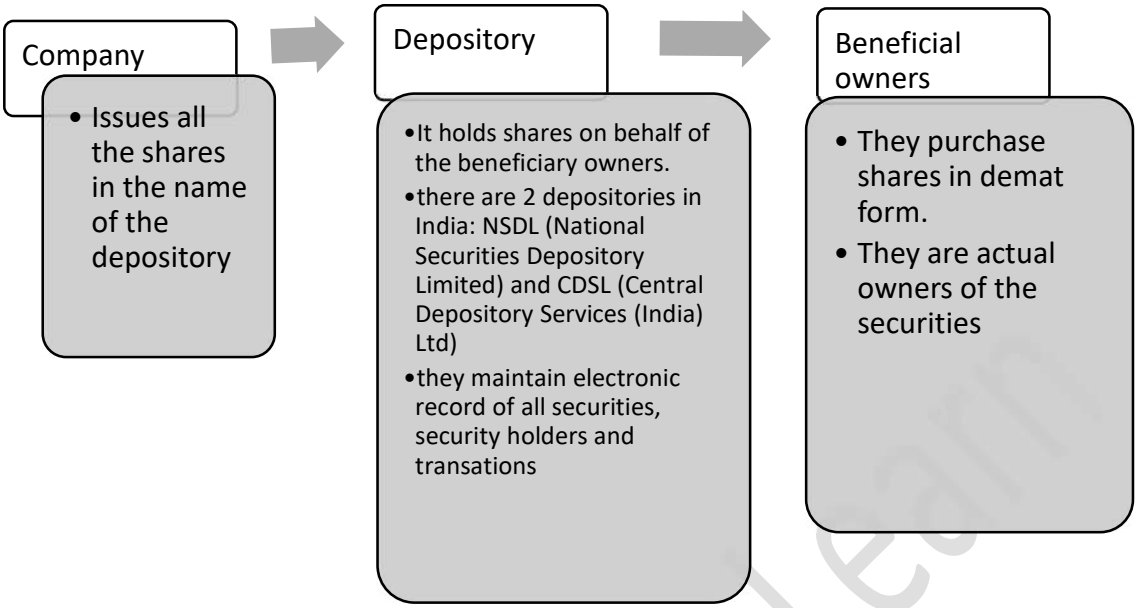

Register maintained by the Depository is "deemed register" and in compliance with section 88.

❖ Foreign Registers

- *Meaning:* Separate Register maintained outside India to record the transactions of foreign security holders.
- It is deemed part of the principal register.
- Company may maintain such register provided following conditions followed:

Opening foreign register

- *AoA must authorise (else alter AoA)*
- *Open Foreign register and send a copy to registered office in home country*
- *Within 30 days of receipt of register in home country, RoC must be informed in form No. MGT 3-*
  - *address where foreign register is maintained*
  - *change in address*
  - *discontinuance details*

Discontinuing foreign register

- Form MGT – 3 must be filed with Roc
- Such facts of closing must be published before closing in 2 newspapers circulating in the place where foreign register is maintained
- All entries fo foreign register must be merged in principal register

Procedure for New entry in foreign register

- *Entries* must be authorised by the BOD and then within 15 days they must be entered in the Register.
- Copy of the entries must be sent to Indian registered office

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❖ Default in complying with section 88

- Company/office in default:
  - Fine 50K -3L
  - Rs 1000/day if default continues

Compoundable offence

Section 89 - Declaration in respect of Beneficial Interest in any shares

➢ Beneficial Interest {meaning for section 89 & 90}
- Right of the person
- directly / indirectly
- Alone or with others
- Through contract/ arrangement/ otherwise
- To → receive dividend/bonus shares/right shares/ exercise other rights attached to such shares
  {Crux: the ultimate benefits of ownership of the shares are directed towards such individual}

➢ Name entered in Register but not holding beneficial interest: File MGT 4 to company within 30 days from date of entry in register

➢ Any changes in above: registered owner shall File MGT 4 to company within 30 days from date of change

➢ Person acquiring/already holding beneficial interest but not required to file declaration above: File MGT 5 to company within 30 days from date of acquiring beneficial interest

➢ Any changes in above: Person acquiring/already holding beneficial interest shall File MGT 4 to company within 30 days from date of change

➢ Company shall
- maintain register of such declaration received and
- file details of such declaration to RoC within 30 days of receiving them with fee

➢ Default:
Person required to file declaration:
- Fine up to 50K
- Continuing failure: Rs 1000/day after first penalty
- Rights relating to shares shall not be enforceable unless declaration filed (Exception: Dividend payment is not affected. CO. shall pay dividend irrespective)

Company/Officer in default:
- Fine Rs. 500-1000
- Continuing failure: Rs 1000/day after first penalty

Section 90 - Investigation of beneficial ownership of shares in certain cases amended 13/6/18

➢ *Declaration to Company:*

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- Any individual (alone/with other person or trust→In/outside India)
- having beneficial interest in shares of company of not less than 25%/significant influence or control over the company
- must file declaration
  - Form BEN-1 to company
  - within 30 days of acquiring interest
  - Content of declaration: nature of interest, amount, date of creation etc.
  - CG may exempt certain class of person
- ➢ Register of declarations of beneficial interest
- shall be maintained by Co.
- Contents : name, DoB, address, details of ownership
- Inspection: allowed to members on payment of fees
- ➢ Return with RoC:
- Return of significant beneficial owners shall be filed by Co. to RoC
- Form BEN-2 + fees
- within 30 days from receipt of declaration

- **Company fails to maintain register/file information with RoC/allows inspection shall be liable to**
  - Fine 10L- 50L
  - If failure continues, Rs. 1000/day after first penalty
- **Any person wilfully furnishing wrong information/suppressing facts→ Section 447**

Section 91 - Power to Close Register

Company can close the register of members/debenture-holder/ other security holders provided following conditions are followed:

- Prior Notice of 7 days must be
- published in 2 newspapers (English & vernacular)
- sent to every members/debenture-holder/ other security holders and
- published on website (if it is a listed company)
- Maximum period for closing register:
- 30 days at a stretch and
- 45 days in full financial year
- Contravention by company/ officer in default :
- Fine Rs 5000/day (Max 1Lakh) Compoundable offence

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