ਜਗਤ ਗੁਰੂ ਨਾਨਕ ਦੇਵ
ਪੰਜਾਬ ਸਟੇਟ ਓਪਨ ਯੂਨੀਵਰਸਿਟੀ
ਪਟਿਆਲਾ

The Motto of Our University
(SEWA)
SKILL ENHANCEMENT
EMPLOYABILITY
WISDOM
ACCESSIBILITY

JAGAT GURU NANAK DEV
PUNJAB STATE OPEN UNIVERSITY, PATIALA

(Established by Act No. 19 of 2019 of the Legislature of State of Punjab)

B. COM (HONS.)
(ACCOUNTING AND TAXATION)

SEMESTER-II

BCB31202T
BUSINESS LAW

Head Quarter: C/28, The Lower Mall, Patiala-147001
Website: www.psou.ac.in

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The Study Material has been prepared exclusively under the guidance of Jagat Guru Nanak Dev Punjab State Open University, Patiala, as per the syllabi prepared by Committee of Experts and approved by the Academic Council.

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PREFACE

Jagat Guru Nanak Dev Punjab State Open University, Patiala was established in December 2019 by Act 19 of the Legislature of State of Punjab. It is the first and only Open University of the State, entrusted with the responsibility of making higher education accessible to all, especially to those sections of society who do not have the means, time or opportunity to pursue regular education.

In keeping with the nature of an Open University, this University provides a flexible education system to suit every need. The time given to complete a programme is double the duration of a regular mode programme. Well-designed study material has been prepared in consultation with experts in their respective fields.

The University offers programmes which have been designed to provide relevant, skill-based and employability-enhancing education. The study material provided in this booklet is self-instructional, with self-assessment exercises, and recommendations for further readings. The syllabus has been divided in sections, and provided as units for simplification.

The University has a network of 80 Learner Support Centres/Study Centres, to enable students to make use of reading facilities, and for curriculum-based counselling and practicals. We, at the University, welcome you to be a part of this instituition of knowledge.

Prof. G.S. Batra
Dean Academic Affairs

B. Com (Hons.)
(Accounting and Taxation)
CORE COURSE (CC)
SEMESTER-II
(BCB31202T): BUSINESS LAW

MAX. MARKS: 100
EXTERNA: 70
INTERNAL: 30
PASS: 40%
Credits: 6

Objective:

The objective of the course is to impart basic knowledge of the important business Legislation along with relevant case law.

Course Outcomes:

CO 1:	To understand the fundamentals of contracts to draft agreements and contracts and Recognize and distinguish the unique contracts.
CO 2:	To equip the students about the legitimate rights and obligations under The Sale of Goods Act.
CO 3:	To equip the students with the abilities to launch business initiatives as LLP
CO 4:	Understand the meaning, characteristics, and elements of different kinds of Negotiable instruments.

Section A

Block I: The Indian Contract Act, 1872

The Indian Contract Act, 1872, General Principles of Contract: - Contract- meaning, characteristics and kinds, Essentials of a valid contract - Offer and acceptance, consideration, contractual capacity, free consent, legality of objects. Void agreements.

Block II: Discharge of a contract and Specific Contracts

Discharge of a contract and Specific Contracts– modes of discharge, breach and remedies against breach of contract. Contingent contracts, Quasi – contracts

Specific Contracts: Contract of Indemnity and Guarantee, Contract of Bailment**,** Contract of Agency.

Block III: The Sale of Goods Act, 1930

The Sale of Goods Act, 1930, Contract of sale, meaning and difference between sale and agreement to sell. Conditions and warranties.

Transfer of ownership in goods including sale by a non-owner, Performance of contract of sale, Unpaid seller – meaning, rights of an unpaid seller against the goods and the buyer.

Section B

Block IV: The Partnership Act, 1932

The Partnership Act, 1932, Nature and Characteristics of Partnership**,** Registration of a Partnership Firms**,** Types of Partners**,** Rights and Duties of Partners**,** Implied Authority of a Partner**,** Incoming and outgoing Partners**,** Mode of Dissolution of Partnership.

Block V: The Limited Liability Partnership Act, 2008

The Limited Liability Partnership Act, 2008: Salient Features of LLP**,** Differences between LLP

and Partnership, LLP and Company**,** LLP Agreement, Partners and Designated Partners**,** Incorporation Document**,** Incorporation by Registration**,** Partners and their Relationship**.**

Block VI: The Negotiable Instruments Act, 1881

The Negotiable Instruments Act 1881: Meaning, Characteristics, and Types of Negotiable Instruments: Promissory Note, Bill of Exchange, Cheque**,** Holder and Holder in Due Course, Privileges of Holder in Due Course. Negotiation: Types of Endorsements**,** Crossing of Cheque**,** Bouncing of Cheque.

Suggested Readings:

1. Kuchhal, M.C. and Kuchhal, Vivek (2017), *Business Law*, Vikas Publishing House, New Delhi.
2. Singh, Avtar (2018), *Business Law*, Eastern Book Company, Lucknow.
3. Kumar Ravinder (2021), *Legal Aspects of Business*, Cengage Learning, Noida.
4. Maheshwari, S.N. and Maheshwari,S.K.(2018), *Business Law*, National Publishing House, New Delhi.

INSTRUCTIONS FOR THE CANDIDATES:

Candidates are required to attempt any two questions each from the sections A and B of the question paper and any ten short questions from Section C. They have to attempt questions only at one place and only once. Second or subsequent attempts, unless the earlier ones have been crossed out, shall not be evaluated.

JAGAT GURU NANAK DEV PUNJAB STATE OPEN UNIVERSITY, PATIALA
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B. COM (HONS.)

(ACCOUNTING AND TAXATION)

SEMESTER II

BCB31202T: BUSINESS LAW

COURSE EDITOR: DR. ROHIT KUMAR

COURSE COORDINATOR: DR. SULAKSHNA

SECTION A

UNIT NO.	**UNIT NAME**
UNIT 1	ESSENTIALS OF A VALID CONTRACT, OFFER AND ACCEPTANCE, CONSIDERATION
UNIT 2	CONTRACTUAL CAPACITY, FREE CONSENT, LEGALITY OF OBJECTS, VOID AGREEMENTS
UNIT 3	DISCHARGE OF CONTRACT, REMEDIES FOR BREACH OF CONTRACT, CONTINGENT AND QUASI CONTRACTS
UNIT 4	SPECIAL CONTRACT – INDEMNITY, GUARANTEE, BAILMENT AND AGENCY
UNIT 5	SALE OF GOODS ACT 1930
UNIT 6	TRANSFER OF OWNERSHIP

SECTION B

UNIT NO.	**UNIT NAME**
UNIT 7	NATURE OF PARTNERSHIP, REGISTRATION OF FIRM AND TYPES OF PARTNERS
UNIT 8	RIGHTS AND DUTIES OF PARTNERS, DISSOLUTION OF PARTNERSHIP FIRM
UNIT 9	LIMITED LIABILITY PARTNERSHIP ACT, 2008
UNIT 10	NEGOTIABLE INSTRUMENT: MEANING, BILLS OF EXCHANGE AND PROMISSORY NOTES
UNIT 11	CHEQUES-MEANING AND CROSSING, PARTIES TO THE NEGOTIABLE INSTRUMENTS
UNIT 12	TRANSFER AND DISHONOUR OF NEGOTIABLE INSTRUMENT

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT-I ESSENTIALS OF A VALID CONTRACT, OFFER AND ACCEPTANCE, CONSIDERATION

STRUCTURE

1.0 OBJECTIVES

- To understand the meaning of contract
- To study the essential elements of a valid contract
- To discuss the types of various types of contracts that can be formed under the Indian Contract Act,1872
- To understand the meaning of Offer and acceptance
- To discuss the essentials of valid offer
- To discuss the essentials of valid Acceptance
- To study the different types of offer
- To understand the meaning of Consideration
- To discuss the essentials of Valid Consideration
- To explain the exceptions when consideration may not be present

1.1 INTRODUCTION

Contracts have become indispensable part of our lives. When we are purchasing milk or bread in the morning or boarding a bus or booking a railway ticket, we are entering a contract, though we may not be aware of it. Indian Contract Act codifies the way we enter into a contract, perform a contract, and implement provisions of the contract and effects of breach of a contract. Law of Contract is the most vital and primary part of Mercantile Law. It is the basis for many other laws falling under the category of Mercantile Laws.

Indian Contract Act is one of the oldest Acts. Initially, the Act contained the provisions in respect of Sale of Goods Act and Partnership Act. Later, Chapter VII in the Contract Act(Sections 76 to 123) was repealed and a separate Sale of Goods Act was passed in 1930.The break-up of the sections is as follows:

SECTION

General Principles of Law of Contract	1 to 75
Contracts relating to Sale of Goods	76 to 124
Special kinds of Contracts	
(for example, indemnity, guarantee, bailment & pledge	125 to 238
Contracts relating to Partnership	239 to 266*

*These sections were repealed from the Contract Act 1872 and two new Acts were enacted for the same:

(1) Sale of Goods Act.1930

(2) Partnership Act.1932

The Indian Contract Act in its present form may be divided into two parts. The first part (Sections 1 to 75) deals with the general principles of the law of contracts which apply to all types of contracts irrespective of their nature. The second part (Sections124 to 238) deals with special types of contracts namely Indemnity and Guarantee, Bailment and Pledge, Agency etc.

Besides laying down the general principles, the Contract Act deals with certain special types of contracts, for example indemnity, guarantee, agency etc.

1.2 <u>DEFINITION OF CONTRACT</u>: A contract is an agreement to do or not to do an act. It is a legally binding agreement, which is, enforceable at law.

According to Halsbury, __an agreement between two or more persons which is intended to be enforceable at law and is constituted by the acceptance by one party of an offer made to him by the other party to do or to abstain from doing some act.‘‘

According to Salmond __Contract is an agreement creating and defining obligations between the parties.‘‘

Section 2(h) of the Contract Act defines a Contract as __an agreement enforceable by law.‘‘

Thus, there are two essential elements of a contract:

(1) An Agreement (2) Its enforceability at law.

These two components together constitute the basis for a contract and are explained as follows:

1. **AGREEMENT**. An agreement is defined under Section 2 (e) as __every promise or every set of promises forming the consideration for each other.‘‘

A promise is defined in section 2(b) as, __a proposal when accepted becomes a promise.‘‘An agreement involves proposal or offer by one party and acceptance of the same by the other party. It requires existence of two or more persons i.e. plurality of persons because a person cannot enter into an agreement with himself.

It also implies that the parties have a common intention about the subject-matter of their agreement. The two contracting parties should be thinking of the same thing in the same sense at the same time. Thus, an agreement is the outcome of two consenting minds i.e. _consensus ad idem.‘

Thus, Agreement = Offer+ Acceptance

2. **ENFORCEABLE AT LAW:** An agreement to become a contract must create a legal obligation. The common acceptance formed and communicated between the two parties must create legal relations and not merely the relations which are purely social or domestic in nature.

For Example, Mr.Ram invites Mr. Sham to a dinner at his house. Mr. Sham accepts the invitation. It is purely social agreement. If Mr. Sham fails to arrive at the dinner or Mr.Ram has to go out and is not available at his home at the dinner time due to some urgency, either of the parties cannot sue other for not fulfilling the promise. This is because there was no intention between two parties to create any legal obligation.

In the above circumstances there was, in the eye of law, no contract between Ram and Sham . Other kinds of obligations which do not constitute a contract are the agreements made between husband and wife. Such agreements are purely domestic and are not intended to create legal relationships.

The Leading case on this point is**: Balfour v. Balfour(1919)**

Mr. Balfour was employed in Ceylon, Mrs. Balfour owing to ill health, had to stay in England and could not accompany him to Ceylon. Mr. Balfour promised to send her 30 per month

while he was abroad. But Mr. Balfour failed to pay that amount. The court held that it was a mere domestic agreement and that the promise made by the husband in this case was not intended to be legal obligation.

In this case, the intention not to create a legal obligation was clear from the conduct of the parties.If the parties specify or the circumstances indicate that the parties intend to create legal relationship through it, even an agreement between husband and wife will be legally enforceable. On the contrary, if the two parties do not create lawful obligation explicitly, the agreement will be unenforceable though it may be a trade agreement.

The Law of contract creates rights in personam as distinct from rights in rem. _Rights in rem‘ means a right against or in respect of a thing. This right is available against the whole world. _Right in personam‘ means a right against or in respect of a particular person/persons.

Examples: 1. If Mr. Andy owns a plot of land and Mr. Brown is the immediate neighbor, Mr. Andy has a right of complete possession and enjoyment of land not only against Mr. Brown but against the whole world. This right is right in rem.

2. Mr. X is entitled to receive a sum of money from A. This right can be exercised by Mr. X only and that too against Mr. A. only. This is right in personam.

1.3 ESSENTIAL ELEMENTS OF A VALID CONTRACT

All agreements are not contracts. Agreement which is enforceable at law is a contract. An agreement which is not enforceable at law cannot be a contract. Thus, the term agreement is broader in scope than contract. All contracts are agreements but all agreements are not contracts.

An agreement to be enforceable by law, must possess the vital elements of a valid contract as contained in Section 10 of the Indian Contract Act. According to Section 10, __All agreements are contracts if they are made by the free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void.‘‘ The following are the essential elements of a valid contract:

1. OFFER AND ACCEPTANCE. In order to create a valid contract, there must be a _lawful offer‘ by one party and _lawful acceptance‘ of the same by the other party. The adjective _lawful means‘offer and its acceptance ‘must confirm to the rules laid down in the India Contract, Act regarding valid _offer and acceptance‘ and its communication.

2. INTENTION TO CREATE LEGAL RELATIONSHIP. In case, there is no such intention on the part of parties, there is no contract. Agreements of social or domestic nature do not imply legal relations.

The leading case in this context is Balfour vs. Balfour(1919).

3. LAWFUL CONSIDERATION. Consideration has been defined in various ways.

Consideration is known as quid-pro-quo or something in return. Consideration is a vital element in a contract. Promises made for nothing are unenforceable under the Indian Contract Act. The law enforces only those promises which are made for consideration. An agreement without consideration, subject to certain exceptions is void. In the absence of consideration, a promise or undertaking is purely gratuitous and, however, sacred and binding, creates no legal obligation. The legal maxim being Ex nudo pacto non oritur action (out of a bare agreement no action arises). Consideration may be in the form of money, goods, services, a promise to marry, a promise to forbear from suing the promise etc. Consideration can be past, present or future. But it must be real and lawful.

4. CAPACITY OF PARTIES. The parties to an agreement must be competent to contract. If either of the parties does not have the capacity to contract, the contract is not valid.

According to 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.‘‘

The following persons are incompetent to contract:

(a) minors, (b) persons of unsound mind, and

(c) persons disqualified by law to which they are subject.

5. FREE CONSENT: _Consent‘ means the parties must have agreed upon the same thing in the same sense. According to Sec.13. __Two or more person are said to consent when they agree upon the same thing in same sense.‘‘ This is called Consensus ad idem in English Law.

Example: X who owns two cars, one Indigo and the other Swift, offers to sell Y one car.

A intend to sell Indigo car. Y accepts the offer thinking that it is the Swift.

There is no consensus between the two parties and hence no contract.

According to Section 14, Consent is said to be free when it is not caused by-

(1) Coercion, or (2) Undue influence, or (3) Fraud, or

(4) Mis-representation, or (5) Mistake

An agreement should be made by the free consent of the parties.

6. LAWFUL OBJECT: The object of an agreement must be lawful. Object has nothing to do with consideration. It means the intent or purpose of the contract. Thus, when one hires a house for use as a gambling house, the object of the contract is to run a gambling house and is unlawful. The object is said to be unlawful if-

(a) it is forbidden by law;

(b) it is fraudulent;

(c) it is of such nature that if permitted it would defeat the provisions of any l aw;

(d) it involves an injury to the person or property of any other;

(e) the court regards it as immoral or opposed to public policy.

7. CERTAINTY OF MEANING. According to Section 29, "Agreements the meaning of which is not certain or capable of being made certain are void."

The terms of the contract must be clear and certain. It cannot be left ambiguous. A contract may be void due to uncertainty. Thus, clearly a purported acceptance of an offer to buy a building _on hire-purchase terms‘ does not constitute a contract if the hire-purchase terms are never clearly mentioned and agreed upon. Similarly, an agreement _subject to war clause‘ is too vague to be enforceable.

8. POSSIBILITY OF PERFORMANCE. If the act is impossible in itself, physically or legally, it cannot be enforced at law. For Example, Mr. X agrees to grow mangoes within two hours. Such Agreement is not enforceable as this is practically impossible.

9. NOT DECLARED TO BE VOID OR ILLEGAL: The agreement though satisfying all the essentials for a valid contract must not have been expressly declared void by any law in force in the country. Agreements mentioned in sections 24 to 30 of the Act have been

expressly declared to be void for example agreements in restraint of trade, marriage, legal proceedings etc.

10. Legal Formalities. An oral contract is a perfectly valid contract, except in those cases where writing, registration etc. is required by some statute. In India, writing is required in cases of sale, mortgage, lease and gift of immovable property, negotiable instruments; memorandum and articles of association of a company, etc. Registration is required in cases of documents coming within the scope of section 17 of the Registration Act.

All the aforesaid elements must be present in order to constitute a valid contract. If any one of them is absent the agreement does not become a contract.

1.4 TYPES OF CONTRACT

1. VALID CONTRACT. An agreement enforceable at law is a valid contract. An agreement becomes a contract when all the essentials of a valid contract as laid contract as laid down in Section 10 are fulfilled. Mohan offers to sell his car for Rs.3 lakhs to Sohan. Sohan agrees to buy it for this price. It is a valid contract. A contract to enter into a contract is, however, not a valid contract.

Agreements not meeting the legal requirements of section 10are Invalid Contracts.

2.VOID CONTRACT. An agreement which was legally enforceable when entered into but which has become void due to impossibility of performance.A void contract is not necessarily unlawful, but is devoid of legal effects. The law will not enforce such a contract, nor can it be made valid by the parties.

3.VOID AGREEMENT. According to Section 2(g), ‗‗An agreement which is not enforceable by law by either of the parties is void.''

No legal rights or obligations can arise out of a void agreement. It is void ab initio i.e. from its very inception, for example an agreement without consideration or with a minor.

VOID CONTRACT AND VOID AGREEMENT

A void contract should be distinguished from void agreement. An agreement not enforceable at law is a void agreement. In the case of a void agreement no contract comes into existence. An agreement with a minor is void. But in the case of void contract, a contract does come into existence but subsequently ceases to be enforceable by law. An agreement which is void

never matures into a contract. An agreement which becomes illegal in the course of performance is a case of a void contract, while an agreement which is null and void ab initio is a case of a void agreement.

4. VOIDABLE CONTRACT. According to Section 2(i), ‗‗An agreement which is enforceable by law at the option of one or more of the parties but not at the option of the other or others is a voidable contract.'' This is due to the absence of Free consent in the contract. This is because the rights and duties are created and the contract is valid-until the option to avoid it is exercised by the person whose consent to the agreement was not free, as it was obtained by coercion, undue influence, fraud or misrepresentation. The other party who induced the consent cannot take advantage of his own fraud because Thus, a voidable contract is valid and enforceable until it is rescinded by the party entitled to avoid it.

DISTINCTION BETWEEN VOIDABLE CONTRACT AND VOID AGREEMENT

A void agreement is devoid of legal effects right from the beginning. It is unenforceable at law. A voidable contract is one which one of the parties may accept or discard at his option. It is valid and enforceable till it is repudiated or rescinded.

The defect in the case of voidable contract is curable and may be condoned. But a void agreement is void ab initio and its defects are incurable. In the case of a void agreement even a third party cannot acquire any right from person claiming under such contract while in the case of voidable contract, a third party can acquire a valid title from a person claiming under such a contract.

5. UNENFORCEABLE CONTRACTS. It is a contract which is otherwise valid, but cannot be enforced because of some technical snag like absence of a written form or absence of a proper stamp. Such contracts must be sued upon by one or both of the parties. Such contracts cannot be proved in the court. Such contracts will not be enforced by the courts until and unless the defect is corrected.

6. ILLEGAL AGREEMENT. A contract which is either prohibited by law or otherwise against the policy of law is an illegal agreement. It is void ab initio. Thus, a contract to commit robbery in a bank is an illegal contract and cannot be enforced at law. An illegal contract should be differentiated from a void contract. All illegal agreements are void but all void agreements or contracts are not necessarily illegal.

Agreement with a minor is void but not illegal. Every void agreement is not illegal unless its object or consideration is(a) immoral (b) opposed to public policy etc. A void contract does not affect a collateral contract. An illegal agreement is like an infectious disease and is fatal not only to the main contract but to collateral contracts as well.

DISTINCTION BETWEEN ILLEGAL AND VOID AGREEMENTS

Void Agreements are broader in scope. Such agreements may be void due to some reason other than illegality. All illegal agreements are void. Parties to a void agreement may not be punished but parties to an illegal agreement may be liable for punishment.

Transactions collateral to void agreement is enforceable by law. However, transactions collateral to illegal agreements are also tainted with illegality and hence become void because there can be no cause of action out of illegal agreement.

1.5 <u>CONTRACTS ACCORDING TO FORMATION</u>

1. **EXPRESS CONTRACT.** An express contract is one entered into by words either spoken or written. Where the proposal and acceptance is made in words, it is an express contract.

2. **IMPLIED CONTRACT**. Where the proposal or acceptance is made otherwise than in words, it is an implied contract. Implied contracts can be sensed from the immediate circumstances,customs ,usage and the conduct of the parties who made them. So, where a person orders food in a restaurant, law implies that he has to pay for the food.

3. **CONSTRUCTIVE OR QUASI- CONTRACT.** It is a contract in which operations of law create rights and obligations and not agreement between the parties. In these contracts,there is no intention on either side to make a contract, but the law imposes a contract. Thus, a finder of lost goods is under an obligation to search out for the true owner and return the goods.

4. **E-COM CONTRACTS/CONTRACTS OVER INTERNET.** These contracts are entered into between the parties using internet. These are known as EDI contracts or cyber contracts or mouse click contracts.

5. **STANDARD FORM CONTRACTS.** Business firms have to enter numerous contracts daily. For the sake of convenience, firms may use standard form of contracts

e.g. an insurance company may draft an insurance policy contract, railways/airport authorities may print various terms and conditions in Time Tables. Similarly, dry-cleaner receipts, hotel-tickets may have terms and conditions printed on them/their back. The contract in such a case is not made by process of negotiation.

There is no legal bar on such contracts,if consent is free with full understanding of terms and conditions of the contract and there is no attempt by one dominating party to take undue advantages at the cost of weaker party. Such contracts carry a binding condition and it is essential to highlight it by a sufficient notice e.g. ‗‗For conditions see back'' or obtaining signatures on the document containing the terms etc.

1.5.1 SELF-CHECK EXERCISE1

(i) A..... agreement has from the very beginning no legal effects.

(ii)A …… contract is one which one of the parties may affirm or reject at his option.

(iii) A Contract which is otherwise valid, but cannot be enforced because of some technical defect like absence of a written form or absence of a proper stamp is ……..

(iv) The contract which is not made by process of negotiation is called…….

1.6 CONTRACTS ON THE BASIS OF PERFORMANCE

Contracts may be classified on the basis of extent of their performance. Such contracts may be:

1. **EXECUTED CONTRACT.** An executed contract is one where both the parties have completed their obligations or carried out the terms of the contracts. In other words, it is a completed contract.

   Example: E sells a refrigerator to F for Rs. 10,000. F makes the payment and E gives the refrigerator to F.

2. **EXECUTORY CONTRACT.** Where the contract is yet to be discharged either wholly or partly or one or both the parties have yet to complete their obligations, the contract is executory contract.

Example: G agrees to make almirah for H for Rs. 8,000 Mr. G has yet to make the almirah. Mr. H has not made the payment. So, both G and H are yet to perform their obligations. Suppose G makes the almirah but H has yet to make payment, it is executed on G‘s part by executory on H‘s part.

Thus, executory contracts are of two types:

(1) Unilateral (2) Bilateral

(1) UNILATERAL CONTRACT. A unilateral contract is one in which a promise on one side is exchanged for an act on the other side.In this contract one party has performed his obligation either before or at time of entering into contract.

Example: Mr. X, a labourer cleans the godown at the request of Mr. Y on a specific day. On finishing the cleaning, it is Y‘s obligation to pay him wages because X has already discharged his obligation.

(2) BILATERAL CONTRACT. A promise made by one party is exchanged for a promise by the other party.

1.6.1 SELF-CHECK EXERCISE 2: TRUE/FALSE

(i) Completed contract is called Executory contract.

(ii) Bilateral Contract is a contract where a promise on one side is exchanged for a promise on the part of other party.

(iii) Where the contract is yet to be performed either in its entirety or partly or one or both the parties have yet to discharge their obligations, the contract is executed contract.

(iv) A unilateral contract is one in which a promise on one side is exchanged for an act on the other side.

1.7 CONCLUSION

The law of Contracts is one of the oldest and most basic form of commercial contracts and forms the basis of modern commerce and business. The Indian Contract Act,1872 provides the essential elements to constitute a valid contract in order to be enforceable in the eyes of law.The different types of contracts can be formed under this Act on the basis of

performance,validity and formation.With the changing modes of commerce in contemporary business transactions,the Act accepts E-contracts as valid.

1.8 KEYWORDS

CONTRACT: A contract is a legally binding agreement to do or not to do an act.

VOID CONTRACT. An agreement which was legally enforceable when entered into but which has become void due to supervening impossibility of performance .

AGREEMENT: An agreement involves proposal or offer by one party and acceptance of the same by the other party.

FREE CONSENT: It means the parties must have agreed upon the same thing in the same sense.

VALID CONTRACT: An agreement becomes a contract when all the essentials of a valid contract as laid contract as laid down in Section 10 are fulfilled.

VOIDABLE CONTRACT. An agreement which is enforceable by law at the option of one or more of the parties but not at the option of the other or others is a voidable contract.

EXPRESS CONTRACT. An express contract is one entered into by words which may be either spoken or written.

IMPLIED CONTRACT. Where the proposal or acceptance is made otherwise than in words, it is an implied contract.

EXECUTED CONTRACT. An executed contract is one where both the parties have performed their obligations or carried out the terms of the contracts.

EXECUTORY CONTRACT. Where the contract is yet to be discharged either wholly or partially or one or both the parties have yet to perform their obligations, the contract is executory contract.

1.9 INTRODUCTION

A contract is an agreement enforceable by law. An agreement matures when an offer is reciprocated with its acceptance. An agreement is every promise and every set of promises forming the consideration for each other [Section2(e)]

Section 2(b) defines a promise as, "A proposal, when accepted, becomes a proposal." It means an agreement is an accepted proposal. Therefore, these must be proposal or offer by one party and its acceptance by the other party for making an agreement.

For example: X offers to sell his Santro car to Mr. Y for Rs. 2 lakhs. Y accepts the offer. It will result into a contract.

So, offer and its acceptance subsequently is the universally accepted process for creating a contract whether it is express or implied.

1.10 MEANING OF PROPOSAL OR OFFER

Offer or proposal is the starting point in the formation of a contract. Section 2(a) defines proposal as,"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."

The word proposal is synonymous with the English word 'Offer'. The person making the proposal is called the proposer or offeror and the person to whom the proposal is made is called the offeree.

Example: C offers to sell his motor cycle to D for Rs. 5,000. D agrees to pay C Rs. 5,000 for the motor cycle .Here C is called the offeror or promisor and D the offeree or promisee.

Thus, a proposal is an expression of will or intention. A person making the proposal expresses that he is willing to contract on the terms stated in it provided the other party to whom the proposal is made will similarly express his assent to the same terms. Section 2(a) enlists 3 vital elements in an 'offer ':

(a) Expression of willingness to do or not to do something.
(b) made to another person i.e. a person cannot make an offer to himself.
(c) with the object of gaining the consent of the other person to such act or abstinence.

Thus, a casual enquiry, information, a statement of fact or statement of mere intention, lacking the above mentioned three essentials are not offers.

`1.11 KINDS OF OFFER:

Offers or Proposals may be categorized on the basis of:

(1) Formation of an offer
(2) To whom an offer is made?

1. **FORMATION OF AN OFFE**R: An offer may be either **express or implied** from the conduct of the parties. An express offer is one which may be made by words spoken or written such as letter, telegram telex, fax message, e-mail or through internet. Thus, where C offers to sell his Mobile to D Rs.6000; it is an express offer. An implied offer is one which is tacit and has to be understood from the deportment of the party or the circumstances of the case. Thus, where a person goes to a doctor for treatment, his conduct implies an offer that if the treatment is given, the offeree or will pay the usual charges. Similarly, stepping into a local bus, consuming eatables at a restaurant, without being asked to do so etc. create implied promises for the benefits enjoyed.

2. .**TO WHOM AN OFFER IS MADE**: An offer made to a certain person is called a **specific offer.** A specific offer can be accepted only by the persons to whom it is made. On the contrary, if an offer is addressed to the whole world, it is called a **general offer**. A general offer is open to be accepted by any member of the public. Where X promises to give Rs. 500 to Z if he brings back his missing dog, this is a specific offer and can only be accepted by Z ;but if X issues a public advertisement to the effect that he would give Rs. 500 to anyone who brings back his missing dog, such an advertisement amounts to a general offer and any member of the public can accept the offer by searching for and bringing back his missing dog. Such an advertisement amounts to a general offer and any member of the public can accept the said offer by searching for and bringing back X's missing dog.

THE LEADING CASE IN THIS REGARD IS CARLIL VS. CARBOLIC SMOKE CO.(1983).

Carbolic Smoke Ball Co. offered by advertisement a reward of £ 100 to any person who should contract influenza after having used the smoke ball three times daily for two weeks according to the printed directions .It was added that £ 100 were deposited in the bank showing its sincerity in the promise. The plaintiff, Mrs. Carlill, used the smoke-ball according of the directions to the company but contracted influenza. It was held that she could recover the reward because the advertisement was not a mere invitation to offer but an offer at large. Performance of the conditions is a sufficient acceptance without notification.

AN OFFER MUST BE DISTINGUISHED FROM

(a) A mere expression of intention, e.g. , an announcement of a forthcoming auction sale.

(b) An invitation to offer e.g. an advertisement in a newspaper, the display of goods in shop window with prices marked upon them; the display of priced goods in a self-service store.

(c) Communication of information in the course of discussions eg. statement of the lowest price made in answer to a query as to the lowest price for sale.

A catalogue of goods for sale e.g. a book – seller's catalogue of books with the prices stated.

(d) A casual enquiry e.g. "Do you intend to sell your computer?" is not an offer.

(e) A prospectus inviting the public to subscribe to the shares or debentures of a company.

(f) Advertisement for the tenders.

1.12 ESSENTIALS OF A VALID OFFER

1. offer must be capable of creating lawful relations. The offer or must intend the creation of legal relations. He must intend that if his offer is accepted a legally enforceable agreement shall be formed.

C accepts an invitation to dine at D‘s place on a certain date but does not come on the fixed date.D cannot be sued for breach of a contract, because in contracts regulating societal or domestic arrangements, the presumption is that parties do not intend legal consequences to arise from the breach of a contract. The essential element is that there must be an express or implicit reference to the legal relations of the consenting parties.

The leading case is in this context is **Balfour Vs. Balfour**

2. offer must be certain, definite and not vague. No contract can come into existence if the terms of the offer are ambiguous and unclear. Both the parties should be clear about the legal consequences arising out of contract.For eg. the words __P to receive a reasonable share of the profits‘‘ do not constitute a valid offer.The leading case in this regard is **Taylor Vs. Portington (1855)**

X agreed to take Y‘s house on rent for two years at the rent of 9 per annum provided the house was put into through repair and the drawing rooms were decorated __according to present style‘‘.

It is an ambiguous term, because the term __present style‘‘ may mean one thing to X and another to Y. Hence the agreement was void on the ground that the terms of offer were vague and uncertain.

3. offer must be communicated to the offeree. There can be no offer by a person to himself. It must always be communicated to the offeree. If there is no communication of an offer, there is no acceptance resulting in the contract. Thus, if J writes a letter to K offering to sell his mobile for Rs. 20000 but never posts the letter and keeps it on his desk, it is not an offer and K can never accept it.

The leading case on this point is **Lalmam Shukla Vs Gauri Dutt (1913)**

D sent his servant P to trace his missing nephew. D, in the meantime announced a reward for providing information about the missing boy. P, in ignorance of the announcement traced the boy and informed D. P later on came to know of the reward and he claimed it. His claim was dismissed on the ground that he was ignorant of the offer. It was further held that it was the duty of the servant to search for the boy.

4. Offer must be made with a view to obtaining the assent of the other party. An offer must be distinguished from mere expression of intention.

5. Lapse of an offer. An offer lapses

(a) If either offeror or offeree dies before acceptance.

(b) If it is not accepted within(i) the specified time, or (ii) a reasonable time, if no time is specified. Reasonable time depends on the circumstances. Five months has been held to be an unreasonable delay in accepting an offer to buy shares in a company.

(c) If the offeree does not make a valid acceptance, for example, he makes a counteroffer or conditional acceptance or if a particular manner of acceptance has been requested, he accepts in some other manner for example by sending a letter by mail when a reply by hand was requested.

(d) An offer can also lapse by revocation. A person who makes an offer can withdraw it at any time before acceptance. A proposal may be made for a certain period. The offer will automatically lapse if it has not been accepted till then. Where no time limit has been specified, the offer will lapse after a reasonable time.

6. An invitation to offer does not constitute an offer. An offer must be distinguished from an invitation to offer. In the case of an __invitation to offer‘‘ the aim is merely to spread information of readiness to discuss business with anybody, who on such information comes to the person sending it. Such invitations are not offers in the eyes of law and do not become promises on acceptance.

1.13 <u>STANDING or OPEN OFFER</u>: Where large quantities of goods are required by railways or other bodies from time to time, it is usual to call tenders for the supply of such goods. An advertisement inviting tenders is not an offer but a mere invitation to offer. It is the person who sends a tender for the supply of such goods is deemed to have made an offer. An offer for the continuous supply of a certain article at a certain rate over a definite period is called a standing offer. Such offers though accepted do not give rise to contract unless an actual order is placed. The offeror can withdraw his offer at any time before an order is placed with him. A, by means of an offer agrees to supply coal to B at a particular rate for a period of two years. B accepts the tender. In this case B is not bound to place an order for all the coal which he requires nor A is bound to keep that offer alive during the course of two years unless there is an extra-consideration.

The leading case on this point is **Hyde Vs. Wrench (1840)**

A offered to sell a farm for 1,000pound. X said he would give 950pound. A refused and X then said he would give 1,000pounds and when A declined to adhere to his original offer tried to obtain specific performance. Held there was no contract as X‘s offer to pay 950 pounds was a refusal of the offer and a counter-offer; and that when he later said he would pay 1,000pounds he was making a new offer, which would have to be accepted by A before a binding contract could come into existence.

<u>COMMUNICATION OF SPECIAL CONDITIONS</u>

When special terms and conditions are to be included in a contract, they must not only be specifically stated but also communicated to the concerned party. It is the duty of the person who delivers a document to give adequate notice to the offeree of the terms and conditions contained in the document. When this is not done the acceptor will not be bound by such terms.

<u>SELF-CHECK EXERCISE1</u>

(i) is the starting point in the formation of a contract.

(ii) An offer made to a definite person is called a..... offer.

(iii) When an offer is addressed to the whole world, it is called a..... offer.

(iv) An offer for the continuous supply of a certain article at a certain rate over a definite period is called a .....offer.

1.14 ACCEPTANCE

When the person to whom the proposal is made indicates his affirmation, it is an acceptance of the proposal. An accepted proposal is called a promise or an agreement. [Section 2 (b)] An application for the shares in a company is in the nature of offer while the allotment of the shares by the company is an acceptance resulting into a contract. An acceptance must be communicated to the offeror in order to complete the acceptance. Mental acceptance is no acceptance .A common example of an act amounting to acceptance is the fall of the hammer in the case of an auction sale.

Example: L offers to sell his horse to M for Rs.800. M accepts the offer to buy the horse for Rs. 800. This is acceptance.

Acceptance may be express or implied. Thus, where a person boards a train or bus, he impliedly accepts to pay the usual fare. Similarly, when a person goes to a hotel and eats some food, he impliedly accepts to pay for it.

Who may accept? An offer can be accepted only by the person to whom it is made. It means that only the offeree can alone accept it. It cannot be accepted by another without the consent of the person making it. Thus, where offer is made by A to B, the acceptance by C would be inoperative.

1.15 ESSENTIALS OF VALID ACCEPTANCE

1. Acceptance must be total and unconditional. An acceptance must be unconditional and unqualified. Accepting an offer with conditions, variations and reservations amounts to counter offer and rejection of the original offer.

2. Acceptance must be communicated to the offeror. If the offeree remains silent and does nothing to show that he has accepted the offer, no contract is formed. The acceptor should something to signify his intention to accept. Acceptance must be communicated to the offeror himself. A communication to any other person is as ineffectual as if no communication has been made.

Ramsgate Victoria Hotel Co.Vs. Montefiore(1866)

A person applied for shares in a company in June. He cannot be bound by an allotment made late in November.

3. It must be according to the mode prescribed or usual or reasonable mode.

Acceptance has to be made in the mode indicated by the offeror. Section 7(2) states that if the acceptance is not made in the manner prescribed, the proposer may within a reasonable time after the acceptance is communicated to him, insist that the acceptance must be made in the manner prescribed. Failure on the part of the offeror to do so, will imply that he has given his assent although it is not in the desired manner.

Example: A sold his business to his manager B without disclosing the fact to his customers. C, a customer who had a running account with A, sent an order for the supply of goods to A by name. B received the order and executed the same. C refused to pay the price. It was held that there was no contract between B and C because C never made any offer to B and as such C was not liable to pay the price to B.

4. Acceptance must be given before the offer lapses or before the offer is revoked. It means that acceptance must be made while the offer is operative i.e. before the offer has been withdrawn or lapsed.

A prospective resignation to quit a post is an offer and it can be withdrawn before the resignation is accepted by a competent authority.

5.Acceptance cannot be implied from silence. Pankaj told Radha**,** _I offer you my car for Rs.40,000. If you don‘t reply in ten days‘ time, I shall assume that you accept the offer‘‘ Ram kept silent. It was held that there was no contract.

6. Acceptance cannot be implied from silence. A contract cannot be formed if the offeree remains silent and does nothing to indicate that he has accepted the offer.

EFFECT OF SILENCE ON ACCEPTANCE

Proposal made to another cannot mature into an agreement merely because the offeree makes no reply even though the proposal states that silence will be taken to amount to acceptance. Thus, mental acceptance is no acceptance.

1.16 COMMUNICATION OF OFFER, ACCEPTANCE AND REVOCATION

When the contracting parties are physically present and discuss in person, an agreement comes into existence the moment, the offeree gives his total and unconditional acceptance to the proposal made by the offeror. When the parties are far away and the offer and acceptance are exchanged through post, rules contained in sections 4 and 5 apply. These rules are discussed below.

1. COMMUNICATION OF AN OFFER (SECTION 4)

The communication of a proposal is complete as soon as it comes to the knowledge of the offeree. Section 4 clearly indicates that actual communication of the offer is not necessary. It is sufficient if the offer comes to the knowledge of the offeror. Then it is for the latter to accept or reject the offer.

When an offer is sent by post, its communication will be complete when the letter making the offer reaches the offeree. The offer is completed not at the place from where it was sent but where it was received. Thus X from Madras offers by a letter to sell his TV set to Y at Delhi, the communication of the offer will be complete only when Y receives the letter at Delhi.

2. COMMUNICATION OF ACCEPTANCE (SECTION 4)

Communication of an acceptance is complete (a) as against the proposer when it is put in course of transmission to him, so as to be out of the power of the acceptor to withdraw the same,(b) as against the acceptor when it comes to the knowledge of the proposer.The leading case in this regard is **Dunlop Vs. Higgins(1848).**

D in an answer to an enquiry as the price of pig iron wrote to H,__We shall be glad to supply you with 2000 tons of pig iron at 65s per ton‘‘, and after further correspondence wrote on the 28th January, that the price was 65s net. H received this on the 30th January and on the same day wrote __We will take the 2000 tons pig iron you offer us‘‘. The post was then delayed and the acceptance was received six hours later than the scheduled hour. D refused to sell the

iron. It was held that the posting of the letter was an acceptance of the offer and that D could not refuse to supply the iron.

Communication of acceptance shall be complete against the acceptor himself when the letter reaches the offeror. It means that when the letter or acceptance is received by the offeror, acceptor cannot revoke his acceptance, because communication against the acceptor has been completed.

3. COMMUNICATION OF REVOCATION OF PROPOSAL (SECTION 5)

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

An offer can be evoked at any time but before its acceptance is complete against the proposer. Therefore, the letter revoking the offer must be received before the letter of acceptance is posted by the acceptor. Once the letter of acceptance is posted, offer cannot be revoked.

1.17 MODES OF REVOCATION OF OFFER (SECTION 6)

According to Section 6 of the Act, a proposal may be revoked in any of the following ways.

1. BY NOTICE OF REVOCATION: Offer may be revoked by a communication of a notice of revocation by the offeror to the other party before acceptance is complete against the offeror himself. A notice of revocation to be effective must be communicated to the offeree.

2. BY LAPSE OF TIME: A proposal will come to an end by the lapse of time prescribed in such proposal for its acceptance or, if no time is so prescribed by the lapse of reasonable time.

3. BY NON-FULFILLMENT OF CONDITION PRECEDENT: A proposal is revoked when the acceptor fails to fulfil a condition precedent to the acceptance of the proposal which was conditional offer.

4. BY DEATH OR INSANITY: A proposal is revoked by the death or insanity of the proposer if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance.

In addition to the four modes of revocation given above, an offer will also be revoked in the following cases.

5. BY COUNTER OFFER: An offer comes to an end when the offeree makes a counter offer or rejects the offer. Qualified acceptance amounts to a counter offer. An offer once rejected cannot be revived.

6. BY THE NON-ACCEPTANCE OF THE OFFER ACCORDING TO THE PRESCRIBED OR USUAL MODE: The offer will also stand revoked if it has not been accepted according to the mode prescribed.

7. BY SUBSEQUENT ILLEGALITY: An offer lapses if it becomes illegal after it is made and before it is accepted. Thus, where an offer is made to sell 10 bags of wheat for Rs. 2500 and before it is accepted, a law prohibiting the sale of wheat by private individuals is enacted, the offer comes to an end.

1.18 COMMUNICATION OF REVOCATION OF ACCEPTANCE (Section 5)

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

Where an acceptance is sent by post, it stands complete against the acceptor when the letter reaches offeror. It means that acceptance can be revoked before the letter actually reaches the offeror.

Therefore, the communication of revocation of acceptance must reach the offerer before acceptance.

SELF-CHECK EXERCISE2 TRUE/FALSE

(i) Acceptance must be absolute and unconditional.

(ii) Acceptance can be implied from silence**.**

(iii) An offer comes to an end when the offeree makes a counter offer or rejects the offer.

(iv) When an offer is sent by post, its communication will be complete when the letter is posted by the offerer.

1.19 CONCLUSION

The foremost requirement of a contract is a valid offer followed by its acceptance unconditionally. A valid offer and acceptance are the first condition for an agreement to mature into a contract. Offer or proposal is the starting point in the formation of a contract to be followed by its absolute acceptance. Mere silence does not amount to acceptance when the offer is made. The acceptance has to be communicated as mental acceptance is no acceptance.

1.20 KEYWORDS

OFFER: 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.

ACCEPTANCE: When the person to whom the proposal is made signifies his assent, it is an acceptance of the proposal.

PROPOSER/OFFEROR: The person making the proposal is called the proposer or offeror.

OFFEREE: The person to whom the proposal is made is called the offeree.

STANDING/OPEN OFFER: An offer for the continuous supply of a certain article at a certain rate over a definite period.

SPECIFIC OFFER: An offer made to a definite person is called a specific offer.

GENERAL OFFER: When an offer is addressed to the whole world, it is called a general offer.

CONSIDERATION

1.21 INTRODUCTION

Consideration is the foundation of every contract. The law enforces only those promises which are made for consideration. Where one party promises to do something, it must get something in return. This _something in return‘ is called consideration. Consideration is the

very life-blood of every contract. In the absence of consideration a promise or undertaking is purely gratuitous. However, sacred and binding in honour, it creates no legal obligation.

1.22 DEFINITION Consideration has been defined in many ways. It is something which is of some value in the eyes of law. It may be some benefit to the plaintiff. It is also used in the sense of quid pro quo i.e. something in return. A most commonly accepted definition of consideration is given in the famous English case **Currie v. Misa** as __Some right , interest, profit or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other.'

Section 2(d) of the Indian Contract Act defines consideration as-

(a) when at the desire of the promisor,

(b) the promisee or any other person,

(c) has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing.

(d) something, such act or abstinence or promise is called a consideration for the promise.

Consideration is something of value which the promise has given, gives or promises to give in return for the promise. It does not mean payment of money only. Forbearance to sue is good consideration. A promise can be a consideration for another promise. A single consideration may support more than one promise. It can also consist in performance. Settlement of dispute can be a good consideration for the promise. But the mere doing of a thing which a person is already legally bound to do is no consideration for a new promise in his favour.

Examples: (a) Jack agrees to sell his horse to Max for Rs.7,000. Here Jack's promise to sell his horse is for Max's consideration to pay Rs. 7,000. Similarly, Max's promise to pay Rs.7,000 is for Jack's consideration to sell his horse to Max.

(b) A agrees to give Rs.1,000 to B as a voluntary donation for a temple building. This promise is not binding on A because there is no reciprocal consideration for his promise. However, if B has undertaken any liability on the faith of A's promise, the contract is binding on A.

(c)A promises to maintain B‘s child and B promises to pay Rs. 20,000 yearly for this purpose. Here the promise of each party is the consideration for the promise of the other party.

1.23 ESSENTIALS OF A VALID CONSIDERATION

It must move at the desire of the promisor. The first essential characteristic of consideration is that the act or abstinence must have been done at the desire of the promisor. It follows that any act performed at the desire of a third party cannot be consideration. The desire of the promisor may be express or implied. A gratuitous service rendered by the promisee without any request of the promisor does not constitute a consideration enforceable at law. But it is not necessary that what is done by the promise by way of consideration should benefit the promisor. Any benefit conferred by B on C at the request of A would be good consideration for A‘s promise.

Example: X sees Y drowning and saves his life. X cannot demand payment for his services as it is a voluntary act on his part and Y never asked him to do so.

The leading case on this point is: **Durga Prasad Vs. Baldeo (1880)**

D promised to pay P a commission on articles sold by him in a bazaar in which he occupied a shop in consideration of P having expended money in the construction of such bazaar. The money had not been spent by P at the request of D but was spent by him at the desire of the Collector of the District. In a suit by P it was held that there was no consideration for the promise made by D and hence no contract.

A promise to subscribe to a public or a charitable object is unenforceable because there is no benefit to the promisor. But where the other party has undertaken a liability on the faith of the promise made by the promisor, it is enforceable.

2. It must move from the promisee or any other person. As long as there is a consideration for a promise, it is immaterial who has given it. It may move from the promisee, or if the promisor has no objection, from any other person. This is wider than the concept in England, where consideration can move only from the promise. Consideration may move from a stranger but it must flow at the desire of the promisor.

The leading case is: Chinayya Vs. Ramayya (1882)

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 the annuity. The daughter did not, however, pay the annuity and the uncle sued to recover. It was held that there was sufficient consideration for the uncle to recover the money from the daughter.

Example: X, Y and Z enter into an agreement under which X pay Rs. 4,00,000 to Y and Y agreed to build a house for Z. Here, Z is a party to the contract but stranger to consideration and can enforce the contract.

3. **Consideration may be past, present or future.** The words, ‗‗has done or abstained from doing; or does or abstains from doing: or promises to do or do abstain from doing'' indicate that consideration may be past, present or future.

4. **Past consideration.** When the consideration for a present promise was given before the date of the promise, it is said to be past consideration. A past consideration, if given at the request of the promisor will support a subsequent promise. A past consideration is as good as present or future consideration. Under the English law consideration must be present of future, and there is no such thing as past consideration.

Present consideration . When the consideration for a promise is given simultaneously with the promise it is called present consideration. A present consideration consists in doing or abstaining from doing something. A promise to give time to a debtor is good consideration.

Example: X sells computer to Y for Rs.50,000 and Y in return gives Rs.50,000 to X. In this case, the performance by both the parties (seller and buyer) is simultaneous.

Future consideration. A future or executory consideration is a promise to do or give something in return in future for the promise then made. It is also called a promise for the promise. Mutual promises to marry, a promise to do work in return for promise of payment are examples of future consideration.

4. It need not be adequate. It is not essential that consideration should be commensurate to the promise. Sufficiency has to be decided by the parties at the time of making the agreement. Inadequacy of consideration is no ground for refusing the performance of the promise, unless it is evidence of fraud. It should be of some value in the eyes of law. Even a smallest consideration is sufficient provided it has some value. If a man

gets what he contracted for, the court will not inquire whether it was an equivalent to the promise which he gave in return. Where in an agreement the consent of the promisor has been freely given, an inadequacy of the consideration will not render it unenforceable.

5. Consideration must be real. Though consideration need not be adequate, yet it must be actual and not illusory. Thus, a promise to do that which a person is by law bound to do, does not amount to consideration. Consideration has also to be competent. If it is physically impossible, vague or legally impossible, the contract cannot be enforced. Thus, a promise by a man to grow mango within two days is no good consideration.

6. Consideration must be lawful. The consideration for an agreement must be lawful. An agreement is void, if it is based on unlawful consideration. The consideration of an agreement is lawful unless-

(i) is of such a nature that if permitted it would defeat the provisions of any law; or

(ii) it is forbidden by law; or

(iii) is fraudulent; or

(iv) involves or implies injury to the person or property of another; or

(v) the court regards it as immoral or opposed to public policy.

7. It must be something which the promisor is not already bound to do. A promise to do what one is already bound to do, either by general law or under an existing contract, is not a good consideration for a new promise. There will be no detriment to the promise or benefit to the promisor over and above their existing rights or obligations.

1.24 STRANGER TO CONSIDERATION

Under the Indian Contract Act 1872 consideration for a contract may move from the promise or any other person i.e., a stranger to the consideration can also enforce the contract,.In India the consideration may move from a stranger. This law was established in the case of **Chinayya Vs. Ramayya.**

STRANGER TO CONTRACT

It is a general law of contract that a person who is not a party to the contract cannot sue upon it. This means that unless there is a privity of contract, a party cannot sue on it. Privity of

contract means the relationship subsisting between the parties to a contract. It means that no one but the parties to a contract can be bound by it or be entitled under it.

Example: A had mortgaged some property to X. A then sold his property to B, B having agreed with A to pay off the mortgage debt to X. X brought an action to recover the mortgage money against B. The Privy Council held there was no contract between X and B. X could not enforce the contract to recover the amount from B.

The leading Case is:**Dunlop Pneumatic Co. Vs. Selfridge & Co. (1915)**

A sold a large quantity of tyres to B at a certain price on entering into a covenant not to sell the tyres below the price mentioned in price list supplied by A. B sold the tyres to C a retail dealer under a contract stipulating the same covenant as between A and B. C sold the tyres at less than the list price. A sued C for the breach. It was held that A could not sue C A was not a party to the contract between B and C.

4. Where a charge is created in favour of a stranger on specific immovable property. A stranger to a contract can sue for the money made payable to him by it where the money is charged on immovable properties.

5. Where the promisor has by his conduct created privity of contract with the stranger. If A admits to C, that he had received money from B for payment to C, he constitutes himself as the agent of C, who can successfully recover the amount from A. Similarly, where under an agreement between a tenant and his sub-tenant the latter was paying the rent directly to the landlord, the landlord was allowed to recover unpaid rent from sub-tenant.

6. Where it is conducive to justice.

7. Contract entered into by an agent can be enforced by the principal.

8. Covenants Running with the land. At the time of transfer of immovable property, a notice that the owner of land is bound due to certain obligations created by an agreement relating to land, the new purchaser will be bound by them though he was not a party to the original covenant.

1.25 IMPORTANCE OF CONSIDERATION : Consideration is the foundation of every contract. The law insists on the existence of consideration if a promise is to be enforced as creating legal obligations .A promise without consideration is null and void. It is called a

naked promise or "Nudum Pactum". Thus, if A promises to pay B Rs. 1,000 without anything in return, this constitutes a bare promise and gives no right of action.

Section 25 of the Indian Contract Act provides that agreement without consideration is void, subject to certain exceptions.

SELF-CHECK EXERCISE1

(i) Consideration must move from the …….

(ii) A gratuitous service rendered by the promisee without any request of the promisor is not ……. at law.

(iii) Unless there is a ……. of contract, a stranger to contract cannot sue on it.

1.26 <u>NO CONSIDERATION NO CONTRACT: EXCEPTIONS</u>

Every contract to be enforceable at law must be supported by valid consideration. An agreement made without consideration is void and is unenforceable except in certain cases. Section 25 specifies the cases where an agreement though made without consideration will be valid. These are as follows:

1. Natural love and affection [Sec.25(1)]

An agreement though made without consideration will be valid if it is in writing and registered and is made on account of natural love and affection between parties standing in a near relation to each other. An agreement without consideration will be valid provided -

i. it is expressed in writing;
ii. it is registered under the law for the time being in force;
iii. it is made on account of natural love and affection; and
iv. it is between parties standing in a near relation to each other.

All these essentials must be present to enforce an agreement made without consideration. The presence of only one or some of them will not suffice.

Example: A for natural love and affection, promises to give his son B, Rs. 1,000 . A makes a promise to B into writing and registers it. This is a contract.

The mere existence of a near relation between the parties without the moving force of natural love and affection will not make an agreement enforceable even though it is in writing and registered. Thus, where an agreement for separate residence and maintenance was arrived

at between a husband and wife but the cause was constant quarrels between the two, it was held that the agreement was void. Proximity in relationship does not essentially imply natural love and affection.

2. COMPENSATION FOR SERVICES RENDERED [SEC.25(2)]

An agreement made without consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something which the promisor was legally compellable to do. To apply this rule, the following essentials must exist:

(a) The act must have been done voluntarily;

(b) for the promisor or it must be something which was the legal obligation of the promisor;

(c) the promisor must be in existence at the time when the act was done;

(d) the promisor must agree now to compensate the promisee.

Examples: (a) A finds B's purse and gives it to him. B promises to give A Rs.100 This is a contract.

(b) A supports B's infant son. B promises to pay for A's expenses incurred for this purpose. This is a contract.

A promise to pay for past services voluntarily rendered would be enforceable under this rule. If, however, something has not been done voluntarily, this clause will not apply.

3. TIME-BARRED DEBT [SEC.25(3)]

A promise to pay a time -barred debt is also enforceable. But the promise must be in writing and be signed by the promisor or his agent authorized in that behalf. The promise may be to pay the whole or part of the debt. A verbal promise to pay a time-barred debt is unenforceable.

The clause does not apply to promises to pay time-barred debts of third persons. The debt must be such which the creditor might have enforced in law for recovery of the payment. The promise to pay referred to in section25(3) must be express.An acknowledgement of a debt coupled with an agreement to pay interest has been held to be an agreement with a promise to pay covered under Section 25(3).Even a statement in a balance sheet of a partnership firm signed by a partner showing that the firm is liable to particular person in respect of stated sum has been held to be an implied promise to pay.

4. COMPLETED GIFTS : The rule _No consideration, No contract' shall not affect validity of any gifts actually made between the donor and the donee. Thus, if a person

gives certain properties to another according to the provisions of the Transfer of Property Act, he cannot subsequently demand the property back on the ground that there was no consideration.

5. **AGENCY (SE.185):** There is one more exception to the general rule. It is given in section 185 which says that no consideration is needed to create an agency.

6. **GUARANTEE (SEC 127):** A contract of guarantee is made without consideration.

7. **REMISSION (SEC 63):** No consideration is required for an agreement to receive less than what is due. This is called remission in the law.

Doctrine of Promissory Estoppel. The person making the representation or promise becomes bound by the same, if another person has acted on the faith of such promise or representation. The promisee can ask for enforcing the promise even if there is no consideration.

Example: Mr. X establishes an industrial unit on the faith of tax concession announced by a State Govt. for a particular specified period. The state is bound by estoppels and cannot withdraw tax concession earlier than promised by it.

SELF-CHECK EXERCISE 2: TRUE/FALSE

(i) An agreement though made without consideration will be valid if it is made on account of natural love and affection between parties standing in a near relation to each other.

(ii) A promise to pay a time -barred debt is not enforceable.

(iii) Consideration is needed to create an agency.

1.27 CONCLUSION

Consideration must be present to constitute a valid contract. Consideration is the main motive of the promisor to get the work done under a contract. The cons ideration may move from a stranger. A stranger to a contract can sue only in case of trust, marriage settlement and partition. Consideration is not required in cases of natural love affection, compensation for services rendered,

Time-barred debt,gifts ,agency ,guarantee and remission.

1.28 KEYWORDS

Consideration: Some right , interest, profit or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other.‘‘

Stranger to contract: A person who is not a party to the contract, is stranger to contract and cannot sue upon it.

Privity of contract: It means the relationship subsisting between the parties to a contract.

1.29 ANSWERS TO SELF-CHECK EXERCISE

Self-check Exercise 1(i)Void(ii)Voidable(iii)Unenforceable(iv)Standard

Self-check Exercise 2(i)False(ii)True(iii)False(iv)True

QUESTIONS FOR EXERCISE

i.Discuss the meaning and essentials of a valid contract under the Indian Contract Act,1872.

ii.Explain the different types of contracts that can be formed under the Indian Contract Act,1872.

iii.Define

a.Void Contract

b.Quasi-contract

c.Express contract

d.Distinguish between Void Contract and Void Agreement.

e.Standard form Contract

ANSWERS TO SELF-CHECK EXERCISES:

Self-Check Exercise1(i)Offer(ii)Specific(iii)General(iv)Standing

Self-Check Exercise2 (i)True(ii)False(iii)True(iv)False

QUESTIONS FOR EXERCISE

i.Explain the essentials of a valid offer.

ii.Discuss the requirements for a valid Acceptance.

iii.Discuss the rules of communication of Offer and acceptance.

iv.Define

a.Specific Offer

b.Standing offer

c.Modes of Revoation of Offer

ANSWERS TO SELF-CHECK EXERCISES

Self-check Exercise 1(i)Promisee(ii)Enforceable(iii)Privity

Self-check Exercise 2(i)True(ii)False(iii)False

QUESTIONS FOR EXERCISE

1. Define consideration and explain its essentials.
2. Explain the exceptions to the rule‖No Consideration No Contract‖.
3. ‘Consideration may be executed,executory or past.‘Explain.
4. ‘ A Stranger to consideration can sue but a stranger to contract cannot sue‘.Discuss.

RECOMMENDED READINGS

Mercantile Law by M.C.Kuchal

Mercantile Law by N.D.Kapoor

Taxmann‘Business and Corporate Laws by V.S.Datey

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT II CONTRACTUAL CAPACITY, FREE CONSENT, LEGALITY OF OBJECTS, VOID AGREEMENTS

STRUCTURE

Check Your Progress 3

- **Short answer questions**
- **Long answer questions**

Answers to Check Your Progress

Let Us Sum Up

Key Words

Terminal Questions

Suggested Reading

2.0 OBJECTIVES

After studying this chapter the learner should be able:

1. To define the contractual capacity, free consent, legality of objects and idea about void agreements.

2. To ascertain the important attributes of valid contract.

3. To find out the legality of objects in contract.

2.1 INTRODUCTION OF CONTRACTUAL CAPACITY

The parties to a contract must be competent to contract. If any one of them is incompetent to contract, the agreement shall be void, i.e., it cannot be enforced by law according to Section 10 of the Indian Contract Act, 1872. In this unit, you will learn as to who are competent to contract and what shall be the exact position of a contract in case any one of the parties thereto is incompetent of contracting.

2.2 WHO IS COMPETENT TO CONTRACT?

Section 11 of the Contract Act requires that parties must be competent to contract. Competence of the parties to make a contract is one of the most essential elements of a valid contract.

Competence to contract is defined in Section 11 of the Indian Contract Act, 1872:

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

Thus, section 11 declares the following persons to be competent to contract:

1. Who attained the Age of Majority
2. Who is of sound mind
3. Who has not been disqualified by law.

2.3 RULES RELATING TO AN AGREEMENT WITH A MINOR

• 2.3.1 WHO IS MINOR?

According to Section 3 of the Indian Majority Act, a person is deemed to have attained majority (i) when he completes 18 years or (ii) where a guardian of person or property or both has been appointed by a Court of Law (or where his property has passed under the superintendence of the Court of Wards), he attains majority on completion of 21 years. In other words, normally a person shall be treated as minor if he has not attained the age of 18 years. In the following two cases, however, he is treated as minor until he attains the age of 21 years.

i) where a guardian of a minor's person or property is appointed under the guardians and Wards Act, 1890, or

ii) where the superintendence of minor's property is assumed by a Court of Wards.

2.3.2 POSITION OF AGREEMENTS WITH A MINOR

The law relating to minor‘s agreements and effects thereof can be summed up as under:

- **AN AGREEMENT WITH A MINOR IS VOID:** An agreement with a minor is void from the very beginning and void absolutely. In other words, an agreement wan a minor does not create any legal rights and obligation between the concerned parties.
- **THE RULES OF ESTOPPEL DOES NOT APPLY TO A MINOR:** A minor is not bound by his misrepresentations. But if a minor enters into a contract by fraudulently representing himself to be a major, he cannot be prevented from pleading minority as defense. The rule of estoppel cannot be applied against the minor.
- **A MINOR‟S AGREEMENT CANNOT BE RATIFIED BY MINOR ON HIS ATTAINING MAJORITY:** Ratification implies approval or confirmation. A minor cannot confirm an agreement made by him during minority on attaining majority. This is because ratification relates back to the date of making of the contract and therefore a contract which was void from the very beginning cannot be made valid by subsequent ratification.
- **MINOR‟S LIABILITY IN TORT:** The term _tort‘ implies a civil wrong for which a suit can be filed by the affected party. If a minor enters into an agreement by misrepresenting his age, he cannot be sued either for damages for breach or in the form of damages for tort (i.e., deceit) because this would be indirectly enforcing the

agreement which is void. However, if wrongful act (i.e.tort) of minor is independent of the contract, then minor is liable for damages in tort. In the ease of Burnard vs Haggis, A, a minor borrowed a mare from B for riding only under instructions not to jump it. He lent the horse to his friend who jumped and killed her. He was held liable for tort.

- **BENEFICIAL CONTRACTS:** A minor can be a beneficiary or promisee. In other words, if a contract is beneficial to a minor, it can be enforced by him. In Raghava Chariar vs. Srinivasa, A executed a mortgage in favor of B (a minor) who advanced a certain sum of money to A. The court in this case held that the mortgage is enforceable by minor as the transaction was for his benefit.
- **MINOR"S LIABILITY FOR NECESSITIES:** Section 68 of the Indian Contract Act, provides that _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'. So if a minor or his dependents are supplied necessities by someone, minor's property is liable.
- **POSITION OF MINOR"S PARENTS OR GUARDIAN:** Minor's contract does not impose any liability on his parents or guardian even if the contracts are for necessaries. However, when the minor acts as an agent of his parents or guardian, they can he held liable for his acts.
- **MINOR AGENT:** A minor can act as an agent but he Will not be personally liable for any of his acts. The principal will be liable to the third parties for the acts of the minor agent which he does in the ordinary course of dealings.
- **MINOR PARTNER:** Section 30 of partnership Act provides that a minor may be admitted to benefits of partnership with the consent of all other partners. His liability is limited to his share in partnership. He cannot take part in management.
- **MINOR AS AN INSOLVENT:** A minor cannot be declared as an insolvent. This is so because all agreements with a minor are void. Moreover, the minor is not personally liable for any debt incurred during the period of his minority.
- **MINOR SHAREHOLDER:** A minor cannot become shareholder in a company since, he is incompetent to enter into a contract. A company can also refuse to register, transfer or transmission of shares in favor of a minor unless the shares are fully paid. In case a minor inherits certain shares, he may become a shareholder acting through his lawful guardian.
- **MINOR UNDER NEGOTIABLE INSTRUMENTS ACT:** Minor can draw or negotiate negotiable instruments (i.e. Bill of Exchange, Promissory Note, Cheque). But he incurs no personal liability in such cases. A negotiable instrument drawn in favor of a minor can be enforced by him. A minor can be a promisee or payee. He can also become an endorsee by transfer of a negotiable instrument.

2.4 RULES RELATING TO AN AGREEMENT WITH PERSON OF UNSOUND MIND

2.4.1 WHO IS A PERSON OF UNSOUND MIND?

According to Section 11 only a person of sound mind can make a contract. Section 12 further defines the term sound mind in these words, –A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of

understanding it and of forming a rational judgment as to its effect upon his interest.‖ Thus two essentials of _Sound mind‘:

- Capacity to understand
- Capacity to make a rational judgment

There must be free and full consent of the parties so as to bind them to the contract. Consent is an act of reason accompanied by deliberations. It is due to the absence of rational and deliberate consent that conveyance and contracts of persons of unsound mind are deemed to be invalid. In **Mohori Bibee v. Dharmodas Ghosh,** a minor Dharmodas Ghosh mortgaged his immovable property to Brahmo Dutt a money lender to secure a loan of Rs. 20,000. The actual amount was not paid by the plaintiff as he paid Rs. 8000 only and refused to pay the rest amount. Minor‘s mother said that his son is not liable to pay the sum as he was a minor. The privy council held that the minor contract is void and accordingly the Brahmo Dutt‘s appeal was dismissed.

A person of unsound mind may be divided into two broad categories:

IDIOTS: An Idiot is one who has lost mental powers completely, i.e., his brain has not developed enough to enable him, at all to understand the contract or of forming a rational judgment of its effects upon his interest. Hence an agreement with him is always void. However, he can be sued for necessaries of life supplied to him or to anybody dependent upon him.

LUNATIC: Lunacy arises from the illness of the brain or mental or bodies distress. The essential element of lunacy is that the mental powers of the lunatic are so deranged that he cannot make a rational judgment of any subject the period of lunacy.

2.5 PERSONS DISQUALIFIED FROM CONTRACTING

Apart from minors and persons of unsound mind, there are also other persons such as Foreign sovereigns, convicts, alien enemy, insolvents and so on are disqualified from contracting partly or wholly or they are not competent to contract. Therefore, contracts by such persons are void. These are explained as:

ALIEN ENEMY: A citizen of a foreign country is known as an alien.
Foreign sovereigns and their Ambassadors: Foreign sovereigns and their Ambassadors in India can enter into contracts with Indian citizens and can sue them in Indian courts but no suit can be filed against them in local courts unless the permission of the Central Government.
CORPORATION: A corporation is an artificial person created by law. Being a legal person only, it cannot act by itself. It has to act through some agent.

INSOLVENTS: When a person is adjudged as insolvent, he loses contractual powers over his property.
Convicts: A person against whom a sentence of imprisonment is passed loses the capacity to contract.

MARRIED WOMEN: A married woman used to suffer from certain disabilities with regard to making of contracts under English Law before 1935. A woman, married or single, in Indian Law, is under no disability as regard, entering into contracts with regard to the property that belongs to her (e.g. Stridhan of a married women). Her contracts can be enforced against her husband's property if he has failed to provide necessaries of life to her and the contract relates to necessaries of life.

CHECK YOUR PROGRESS 1

STATE WHETHER FOLLOWING STATEMENTS ARE TRUE OR FALSE

i) A contract with a minor cannot be enforced by a minor even for his benefit .....

ii) A minor cannot recover the price of his goods sold on credit to a major person .....

iii) A person of sound mind can make a valid contract even when he is so drunk that he is incapable of forming a rational judgement. .....

iv) An alien friend can acquire property in Indian ship. .....

v) A company, though an artificial person, can make all such contracts that an individual can. .....

- **SHORT QUESTIONS**

1) Who is competent to contract? State the position of contracts with a minor.

2) What shall be the effect on a contract where a minor, a party to the contract, is guilty of deliberate misrepresentation with regard to his age.

3) Examine the legal position of (i) a minor as a promisee, (ii) a minor as an agent.

- **LONG QUESTIONS**

1) Name persons who are treated as persons of unsound mind. State the legal Positions of contracts with such persons.

2) Enumerate persons forbidden under other laws for the time being in force and state the legal position of the contracts with them

ANSWERS TO CHECK YOUR PROGRESS 1

TRUE OR FALSE

(i) False

(ii) True

(ii) False

(iv) False

(v) True (with the exception of contracts of personal nature e.g., a contract to marry).

2.6 INTRODUCTION TO FREE CONSENT

2.6.1 MEANING OF CONSENT

The concept of _Consent' has been defined in Section 13 of the Act as two individuals agreeing to the same thing in the same sense. While it is important for both parties to give their consent to the rights and obligations imposed in the contract.

2.6.2 CONCEPT OF FREE CONSENT

The said consent should be free in nature and not be caused by coercion, undue influence, fraud, misrepresentation and mistake. The definition of free consent has been mentioned in Section 14 of the Act. It lays down the elements or causes which

can exclude freedom of consent. If there are two consenting parties to a contract but the consent of one is not free, then the contract is voidable at the option of such party.

2.7 COERCION

2.7.1 WHAT IS COERCION?

Coercion as defined in Section 15 of the Act includes instances in which an individual commits or threatens to commit an act which is forbidden by the Indian Penal Code, or detains an object unlawfully or threatens to do so with the intention of forcing someone to enter into a contract. The enforcement of the Indian Penal Code in the place where the coercive act was performed is immaterial.

In the case of *Chikkam Ammiraju v. Chikkam Seshama*, the Court was posed with the question of whether the threat to commit suicide could be considered to be a constituent of coercion. The facts of this case were that a husband was threatening his wife that he'll commit suicide. This was done with the intention of inducing and coercing the wife and the son to execute a release in favour of his brother with respect to properties over which rights were claimed by the wife and the son. The Court in its judgement opined –that the threat of suicide amounted to coercion within Section 15 and the release deed was, therefore, voidable‖.

2.7.2 EFFECT OF COERCION

It is quite obvious that the contract entered into due to the effect of coercion do not have free consent. In this way, the following instances are possible:

- The contract brought about due to coercion becomes voidable, at the option of the aggrieved party.
- With respect to the result of rescission i.e. revocation of a voidable contract, the party who revokes a void contract, have to restore any benefit received from the other party.
- If due to coercion money has been paid or certain stuff is provided, it must be repaid or returned.

It must be noted that mere threat by one party to other to prosecute does not result in coercion. The aggrieved party must have entered into a contract out of that threat, which can be avoided on account of coercion.

2.7.3 BURDEN OF PROOF

The burden of proof lies with the party defending the coercion. The burden of proof is heavier on him. This is because pure probability or fear is not a threat. In order to create coercion, a person must show that there was a risk that was prohibited by law and that forced him to enter into a contract that he would not otherwise have.

2.8 UNDUE INFLUENCE

2.8.1 WHAT IS UNDUE INFLUENCE?

- A contract is said to be induced by "undue influence" under section 16 of Indian Contract Act, where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.
- In particular and without prejudice to the generality of the foregoing principle, a person is deemed to be in a position to dominate the will of another-

-where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or

-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.

- Where a person who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

2.8.2 EFFECT OF UNDUE INFLUENCE

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 there under, upon such terms and conditions as the Court may deem, just (Sec 19 A). Only a party to the contract can avoid or rescind the contract. This right does not lie in the hands of a third party.

2.8.3 DISTINCTION BETWEEN COERCION AND UNDUE INFLUENCE

	Coercion	**Undue Influence**
1.	Consent is obtained by threat of an offence. The person is forced to give his consent.	Consent is obtained by the dominating will of the other.
2.	It is mainly of physical character.	Consent is given in good belief, but under moral influence
3.	It is of violent character.	Confidence is reposed, but betrayed It is most subtle in character.

2.9 FRAUD

2.9.1 WHAT IS FRAUD?

Section 17 defines ―fraud‖ as under:
Fraud means and includes any of the following acts committed by (a) a party to a contract: or (b) with his connivance; or (c) by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract –

- Fraud must be committed by a party to the contract directly or indirectly or by his agent. However, where the contract was a result of a 3rd person being instrumental for his own ulterior motives, the contract cannot be avoided;
- Intention to deceive or inducing the other party to contract is a must.
- In a suit against fraud, to claim relief, the plaintiff has to show that the defendant made fraudulent representations and the plaintiff was in fact deceived and acted to

his prejudice. In lay terms, a plaintiff cannot claim any right to redress in cases of both deceit without damage and damage without deceit.

2.9.2 DOES SILENCE AMOUNT TO FRAUD?

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 duty of the person keeping silence to speak, or unless his silence is, in itself equivalent to speech.

e.g. A and B, being traders, enter upon a contract. A has private information of change in prices which would affect B's willingness to proceed with the contract. A is not bound to inform B.

2.9.3 CONSEQUENCES OF FRAUD

When consent has been obtained by fraud, the contract becomes voidable u/s 19 of the Indian Contracts act. Thus, the party defrauded has an option either to rescind the contract or insist that the contract be performed to place him in such a position as he would have been if the misrepresentation had been true. If the defrauded party chooses to avoid the contract, he is liable to restore the benefit received (if any) back to the fraudulent party u/s 64 and may claim damages. The consequences of Fraud has been explained as -

- the Defendant is bound to make reparation for all the damage directly flowing from the transaction;
- although such damage need not have been foreseeable, it must have been directly caused by the transaction;
- in assessing such damage, the Plaintiff is entitled to recover by way of damages the full price paid by him, but he must give credit for any benefits which he has received as a result of the transaction;
- as a general rule, the benefits received by him include the market value of the property acquired as at the date of acquisition; but such general Rule is not to be inflexibly applied where to do so would prevent him obtaining full compensation for the wrong suffered;
- although the circumstances in which the general Rule should not apply cannot be comprehensively stated, it will normally not apply where either (a) the misrepresentation has continued to operate after the date of the acquisition of the asset so as to induce the Plaintiff to retain the asset or (b) the circumstances of the case are such that the Plaintiff is, by reason of the fraud, locked into the property;
- In addition, the Plaintiff is entitled to recover consequential losses caused by the transaction; (7) the Plaintiff must take all reasonable steps to mitigate his loss once he has discovered the fraud.‖

2.10 WHAT IS MISREPRESENTATION?

Section 18 of The Indian Contract Act, 1872 defines –Misrepresentation‖ means and includes:

- 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;
- any breach of duty which, without an intent to deceive, gains an advantage of the person committing it, or any one claiming under him, by misleading another to his prejudice, or to the prejudice of any one claiming under him;

- 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.

e.g. A is entitled to succeed to an estate at the death of B; B dies: C, having received intelligence of B's death, prevents the intelligence reaching A, and thus induces A to sell him his interest in the estate. The sale is voidable at the option of A.

2.10.1 ESSENTIALS OF MISREPRESENTATION

- The misrepresentation must be of material facts.
- The misrepresentation must be false, but the person making it honestly believes it to be true.
- The misrepresentations must induce the other party to enter into contract.
- The misrepresentation must have been addressed by one party to the party misled.

2.10.2 EFFECT OF MISREPRESENTATION

According to Section 19, when consent to an agreement is caused by misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused. A party to a contract whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representations made had been true.

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.

2.10.3 DISTINCTION BETWEEN FRAUD AND MISREPRESENTATION

Fraud means a willful misrepresentation of a material fact while **Misrepresentation** means a bonafide representation which is false. The former is an untrue statement given by one party that induces other party to enter to the contract, whereas the latter is the statement of fact, made by one party, believing that it is true, then this is innocent misrepresentation.

	Fraud	**Misrepresentation**
1.	In a fraud, the party making the representation knows that the statement is not true.	In misrepresentation, the party making the representation believes the statement made by him is true, which subsequently turned out as false.
2.	The aggrieved party, has the right to claim for damages.	The aggrieved party has no right to sue the other party for damages.
3.	The contract is voidable even if the truth can be discovered in normal diligence.	The contract is not voidable if the truth can be discovered in normal diligence.
4.	Section 2 (17) of the Indian Contract Act, 1872.	Section 2 (18) of the Indian Contract Act, 1872.

2.11 MISTAKE

A mistake refers to an incorrect belief that is innocent in nature which leads one party to misunderstand the other. It usually takes place when the parties to the contract are not completely aware of the terms of the agreement and understands the terms in a different

sense. Therefore there is no *consensus ad-idem* i.e. meeting of minds between the parties and thus do not understand the same thing in the same sense. *The Indian Contract Act,1872* states two kinds of mistakes -

- **Mistake of Law (Section 21)**
- **Mistake of Fact (Section 20 &22)**

2.11.1 MISTAKE OF LAW

The Latin maxim *Ignorantia Juris Non Excusat* means that ignorance of the law is no excuse. Therefore under Section 21of the *Indian Contract Act, 1872*, a contract cannot be said to be voidable due to the mistake of the parties in understanding any laws that are in force in India. Hence the parties to the contract cannot claim relief on the grounds that they were unaware of the Indian law. **For Example**, A man was caught by a ticket conductor for traveling on a train without a ticket. The man cannot claim that he was not aware that a ticket is required while traveling and shall be punished under of *The Indian Railways Act, 1989 (Section 138).*

2.11.2 MISTAKE OF FACT

The maxim *Ignorantia Facti Excusat which* means that the Ignorance of fact excuses. Therefore under Section 20 of the *Indian Contract Act, 1872*, a contract is said to be void when both the parties to the agreement are under a mistake as to a matter of fact.

A mistake of Fact can be of two kinds -

- Bilateral Mistake - Section 20

Section 20 will only apply when the following three conditions are fulfilled:

- The mistake must be committed by both the parties i.e. must be mutual.
- The mistake must be regarding some facts.
- It must relate to a fact which is essential to the contract.

Therefore if the mistake is made regarding the existence of the subject matter or a fact essential to the contract, it would be a void contract since there is *no consensus ad idem.*

But an incorrect opinion regarding the value of the thing which forms the subject matter of the agreement is not said to be a mistake of fact and is considered inconsequential to the agreement.

Types of Bilateral Mistakes

- Mistake regarding the existence of the subject matter

Sometimes the existence of the subject matter of the contract ceases to exist before the agreement was made and the parties to the contract may not be aware of this fact. If the subject matter on which the contract exists is not present, it is considered that the contract has perished and hence the agreement would be considered void.

In the case of *Galloway vs. Galloway(1914)*, A man and woman believed that they were married and therefore made a separation agreement but it was later discovered that the man's first wife was alive. **It was held that the separation agreement was void as it had been entered into on the basis of the common assumption that the parties were married to each other.**

- Mistake regarding the quality of the subject matter

If the parties to the contract are not mistaken regarding the subject matter of the contract but regarding its quality, the contract would be said to be valid.

In the case of Smith Vs. Hughes (1870), The plaintiff agreed to buy certain Oats from the defendant believing that they were old when in reality they were new. **It was held that the defendant cannot avoid the contract on the ground that he was mistaken as to the oldness of the oats.**

- Mistake regarding the quantity of the subject matter

If both the parties to the contract are under a mistake as to the quantity of the subject matter, the agreement is said to be void.

For Example, Vishal agreed to buy a car from Sarvesh based on his letter in which the price mentioned was ₹70000 instead of ₹7lakhs due to a typing error. The said agreement is considered void due to a mistake as to the quantity of the subject matter.

- Mistake regarding the title of the subject matter

Sometimes the buyer of said property or good may already be the owner of what the seller wishes to sell. Both the parties here might be under a mutual mistake as to the title of the said good or property. Since in such a case there is nothing that the seller can transfer, there is no contract which subsequently becomes void.

- Unilateral Mistake - Section 21

Section 21 of the act says that a contract cannot be said to be voidable just because one of the parties to the contract was under a mistake as to a matter of fact concerned to the contract. Therefore a unilateral mistake does not affect the validity of the contract and cannot be a ground for setting aside the contract in the court of law.

In the case of Tapline Vs. Jainee (1880),The buyer at an auction brought a property described with reference to a plan. The buyer was under the assumption that he was well versed with the property and therefore did not refer to the plan. Later he discovered that a garden plot which he thought was a part of the property was not in fact included in the plan. It was held that the buyer cannot revoke the contract on the grounds of the unilateral mistake made by him and was bound by the contract.

2.11.3 EFFECT OF MISTAKE

A contract is not voidable because it was caused by a mistake as to any law in force in India; but a mistake as to a law not in force in India has the same effect as a mistake of fact under Section 21 of Indian Contract Act, 1872. In case of unilateral mistake, the contract will not be void. So the Section 22 of the Act states that just because one party was under a mistake of

fact the contract will not be void or voidable. So if only one party has made a mistake of fact the contract remains a valid contract.

CHECK YOUR PROGRESS 2

State whether the following statements are True or False.
i) In the absence of consent, there can be no contract. ; .....
ii) A threat amounting to coercion must necessarily proceed from a party to the contract. .....
iii) When consent is obtained by coercion, the contract is void. .: .....
iv) A threat to commit suicide amounts to coercion .....
v) Undue influence involves use of moral pressure .....
vi) There is a presumption of undue influence in the relationship of creditor and debtor. .....
vii) Undue influence can be exercised only by a party to the contract. .....
viii)When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true, there is misrepresentation.
ix) A contract induced by fraud is voidable at the option of either party to the contract.
x) A mere attempt to deceive is fraud whether the other party has been deceived or not.
xi) Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud.
xii) If there is no damage, there is no fraud.
xiii) The aggrieved party in case of active fraud loses the right to rescind the contract if he had the means of discovering the truth by ordinary diligence.

- **SHORT ANSWER QUESTIONS**

1) Define consent.

2) When is consent said to be free?

3) What is coercion ?

4)Define 'Fraud'.

5) What is 'Misrepresentation'?

LONG ANSWER QUESTIONS

1. Define Consent. When Consent is said to be free?
2. What is the effect of coercion on the validity of the contract?
3. Define fraud and point out its effects on the validity of the contract.
4. Mere silence as to facts is not fraud". Explain with examples.
5. Distinguish between :
    i) Coercion and undue influence
    ii) Fraud and Misrepresentation

ANSWER KEY

i) True, ii) False, iii) False, iv) True, **v)** True, vi) False,
vii) True viii) True, ix) False, x) False, xi) True, xii) True, xiii) False

2.12 LEGALITY OF OBJECT AND CONSIDERATION

Section 23 of the Indian Contract Act, 1872 specifies three issues, for example, consideration for the agreement, the object of the agreement and the agreement in essence. The word ―Object‖ used in Section 23 indicates and signifies ―purpose‖ and doesn't imply importance in a similar sense as ―consideration‖. Therefore, despite the fact that the consideration of an agreement might be legal and genuine, that won't stop the agreement from being unlawful if the purpose (object) of the agreement is illicit.

For a contract to be a valid contract two things are absolutely essential – lawful object and lawful consideration. So the Indian Contract Act, 1872 gives us the parameters that make up such lawful consideration and objects of a contract. Let us take a look at the legality of object and consideration of a contract.

LAWFUL CONSIDERATION AND LAWFUL OBJECT

Section 23 of the Indian Contract Act clearly states that the consideration and/or object of a contract are considered lawful consideration and/or object unless they are

- specifically forbidden by law
- of such a nature that they would defeat the purpose of the law
- are fraudulent
- involve injury to any other person or property
- the courts regard them as immoral
- are opposed to public policy.

2.12.1 AGREEMENTS OPPOSED TO PUBLIC POLICY

Certain types of agreements are harmful to Society. Such agreements are called agreements opposed to public policy. Such agreements are declared as Void by Status. The following are the agreements opposed to public policy.

- Agreements in Restraint of Trade
- Agreements in Restraint of Marriage
- Agreements in Restraint of Personal Freedom
- Agreements in Restraint of Parental Rights
- Agreements with regard to Compromise of offence
- Agreements with regard to sale of Public Offices and Titles
- Agreements with Alien Enemy
- Agreements based on Bribes
- Agreements to form Monopoly
- Agreement to Commit a Crime
- Agreements to defraud Creditors

- Agreements to defraud Government

2.13 VOID AGREEMENTS

The Indian Contract Act, 1872 defines a void agreement as ―an agreement that is not enforceable by law‖. There can be many times of void agreements, some of which we have covered in the previous articles. But the contract states certain agreements that are expressly declared as void agreements.

2.13.1 AGREEMENT IN RESTRAINT OF MARRIAGE

Any agreement that restrains the marriage of a major (adult) is a void agreement. This does not apply to minors. But if an adult agrees for some consideration not to marry, such an agreement is expressly a void agreement according to the contract act.

e.g. A agrees that if B pays him ₹50,000/- he will not marry such an agreement is a void agreement.

2.13.2 AGREEMENT IN RESTRAINT OF TRADE

An agreement by which any person is restrained from plying a trade or practicing a legal profession or exercising a business of any kind is an expressly void agreement. Such an agreement violates the constitutional rights of a person. However, there are a few exceptions to this rule. If a person sells his business along with the goodwill then the buyer can ask the seller to refrain from practicing the same business at the local limits. So if according to such an agreement as long as the buyer or his successor carries on such a business the agreement to restrain the trade of the seller will be valid.

One point to keep in mind regarding the above agreements is that the terms of such an agreement have to be reasonable. Such reasonable terms are not defined under the act but are to be judged according to each unique situation and circumstance.

For example the case of physician A who employs B as his assistant for three years. For this duration of three years, B agrees not to practice medicine anywhere else. This is a valid agreement even though it is in restraint of trade.

But A a lawyer sells his legal practice to B along with the goodwill. And A agrees never to practice as a lawyer anywhere in the state for the next 20 years. This is not a valid agreement since the terms are completely unreasonable.

2.13.3 AGREEMENT IN RESTRAINT OF LEGAL PROCEEDINGS

An agreement that prevents one party from enforcing his legal rights under a contract through the legal process (of courts, arbitration, etc) then such an agreement is expressly void agreement. However, there are exceptions like, if the agreement states that any dispute between parties will be referred to arbitration and the amount awarded in such arbitration will be final will be a valid contract. Also if the parties agree that any dispute between them in the present or the future will be referred to arbitration, then such an agreement is also valid. But such a contract has to be in writing.

2.14 UNCERTAIN AGREEMENTS

An agreement whose meaning is uncertain cannot be a valid agreement, it is a void agreement. If the essential meaning of the contract is not assured, obviously the contract cannot go ahead. But if such uncertainty can be removed, then the contract becomes valid.

Say for example A agrees to sell to B 100 kg of fruit. This is a void contract since what type of fruit is not mentioned. But if A exclusively sells only oranges then the agreement would be valid because the meaning would now be certain.

2.15 WAGERING AGREEMENTS

According to the Indian Contract Act, an agreement to wager is a void agreement. The basis of a wager is that the agreement depends on the happening or non-happening of an uncertain event. Here each side would either win or lose money depending on the outcome of such an uncertain event.

The essentials of a wagering agreement are as follows. If all elements are met then the agreement will be void.

- Must contain a promise to pay money or money‘s worth.
- Is conditional on the happening or non-happening of a certain event.
- The event must be uncertain. Neither party can have any control over it.
- Must be the common intention to bet at the time of making the agreement.
- Parties should have no other interest other than the stake of the bet.

The following agreements are not considered wagering agreements,

i. Chit Fund
ii. Commercial Transactions, i.e. Transactions of the Share Market.
iii. Athletic Competition and Competitions involving Skills
iv. Insurance Contracts

2.16 AGREEMENTS TO DO IMPOSSIBLE ACTS

Section 56 of Indian Contract Act, 1872 defines an agreement to do an act impossible in itself is void. Contract to do act afterwards becoming impossible or unlawful: A contract to do an act which, after the contract is made, becomes impossible or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

Compensation for loss through non-performance of act known to be impossible or unlawful: Where one person has promised to be something which he knew or, with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise.

e.g. A contracts to act at a theatre for six months in a consideration of a sum paid in advance by B. On several occasions A is too ill to act. The contract to act on those occasions becomes void.

Section 56, the following conditions must be filled for agreements to do impossible acts:

- There should be a valid and subsisting contract between the parties,
- There must be some part of the contract yet to be performed,
- The contract after it is entered becomes impossible to be performed,
- The impossibility is by reason of some events which the promisor could not prevent, and
- The impossibility is not induced by the promisor or due to his negligence.

2.17 CONTINGENT CONTRACTS

Under Section 31 of the Indian Contract Act, 1872 contingent contracts are defined as follows: ―If two or more parties enter into a contract to do or not do something, if an event which is collateral to the contract does or does not happen, then it is a contingent contract.‖
e.g. Ankur is a private insurer and enters into a contract with Jayanth for fire insurance of Jayanth's house. According to the terms, Ankur agrees to pay Jayanth an amount of ₹5 lakh if his house is burnt against an annual premium of ₹ 5,000. This is a contingent contract.

ESSENTIALS OF CONTINGENT CONTRACTS

- Depends on happening or non-happening of a certain event.
- The event is collateral to the contract.
- The event should not be a mere will of the promisor.
- The event should be uncertain.

2.17.1 RULES REGARDING ENFORCEMENT OF CONTINGENT CONTRACTS

Sections 32 to 36 of the Indian Contract Act, 1872, list certain rules for the enforcement of a contingent contract.

- **RULE 1 – CONTRACTS CONTINGENT ON THE HAPPENING OF AN EVENT**

A contingent contract might be based on the happening of an uncertain future event. In such cases, the promisor is liable to do or not do something if the event happens. However, the contract cannot be enforced by law unless the event takes place. If the happening of the event becomes impossible, then the contingent contract is void. This rule is specified in Section 32 of the Indian Contract Act, 1872.

e.g. Parekh promises to pay Johan ₹ 50,000 if he can marry Julia, the prettiest girl in the neighborhood. This is a contingent contract. Unfortunately, Julia dies in a car accident. Since the happening of the event is no longer possible, the contract is void.

- **RULE 2 – CONTRACTS CONTINGENT ON AN EVENT NOT HAPPENING**

A contingent contract might be based on the non-happening of an uncertain future event. In such cases, the promisor is liable to do or not do something if the event does not happen. However, the contract cannot be enforced by law unless happening of the event becomes impossible. If the event takes place, then the contingent contract is void. This rule is specified in Section 33 of the Indian Contract Act, 1872.

Rajeev promises to pay Sumesh ₹ 50,000 if the ship named Titanic which leaves on a dangerous mission does not return. This is a contingent contract. This contract is enforceable by law if the ship sinks making its return impossible. On the other hand, if the ship returns, then the contract is void.

- **RULE 3 – CONTRACTS CONTINGENT ON THE CONDUCT OF A LIVING PERSON WHO DOES SOMETHING TO MAKE THE EVENT OR CONDUCT AS IMPOSSIBLE OF HAPPENING**

Section 34 of the Indian Contract Act, 1872 states that if a contract is a contingent upon how a person will act at a future time, then the event is considered impossible when the person does anything which makes it impossible for the event to happen.

Rajeev promises to pay Sumesh ₹ 5,000 if he marries Julia. However, Julia marries Oliver. Julia‘s act thus renders the event of Sumesh marrying her impossible. (A divorce is still possible though but the happening of the event is considered impossible.)

- **RULE 4 – CONTRACTS CONTINGENT ON AN EVENT HAPPENING WITHIN A SPECIFIC TIME**

There can be a contingent contract wherein a party promises to do or not do something if a future uncertain event happens within a fixed time. Such a contract is void if the event does not happen and the time lapses. It is also void if before the time fixed, the happening of the event becomes impossible. This rule is specified in Section 35 of the Indian Contract Act, 1872.

Rajeev promises to pay Sumesh ₹ 5,000 if the ship named Titanic which leaves on a dangerous mission returns before June 01, 2019. This contract is enforceable by law if the ship returns within the fixed time. On the other hand, if the ship sinks, then the contract is void.

- **RULE 5 – CONTRACTS CONTINGENT ON AN EVENT NOT HAPPENING WITHIN A SPECIFIC TIME**

Contingent contracts might be based on the non-happening of an uncertain future event within a fixed time. In such cases, the promisor is liable to do or not do something if the event does not happen within the said time. The contract can be enforced by law if the fixed time has expired and the event has not happened before the expiry of the time. Also, if it becomes certain that the event will not happen before the time has expired, then it can be enforced by law. This rule is specified in Section 35 of the Indian Contract Act, 1872.

Rajeev promises to pay Sumesh ₹ 5,000 if the ship named Titanic which leaves on a dangerous mission does not return before June 01, 2019. This contract is enforceable by law if the ship does not return within the fixed time. Also, if the ship sinks or is burnt, the contract is enforced by law since the return is not possible.

- **RULE 6 – CONTRACTS CONTINGENT ON AN IMPOSSIBLE EVENT**

If a contingent contract is based on the happening or non-happening of an impossible event, then such a contract is void. This is regardless of the fact if the parties to the contract are aware of the impossibility or not. This rule is specified in Section 36 of the Indian Contract Act, 1872.

Rajeev promises to pay Sumesh ₹ 50,000 if the sun rises in the west the next morning. This contract is void since the happening of the event is impossible.

2.17.2 DIFFERENCE BETWEEN A CONTINGENT CONTRACT AND A WAGERING AGREEMENT

	Factors	Contingent Contract	Wagering Agreement
1.	**Meaning**	It is a contract to do or not to do something with reference to a collateral event happening or not happening.	It is a promise to give money or money‘s worth with reference to an uncertain event happening or not happening.
2.	**Reciprocal promises**	It may not contain reciprocal promises.	It consists of reciprocal promises.
3.	**Uncertain event**	The event is collateral.	The uncertain event is the core factor
4.	**Nature of contract**	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.
5.	**Interest of parties**	Contracting parties has interest in the subject matter in a contingent contract.	The contracting parties have no interest in the subject matter.
6.	**Mutuality of loss and gain**	Contingent contract is not based on the doctrine of mutuality of loss and gain.	A wagering contract is a game, losing and gaining alone matters.
7.	**Effect of contract**	Contingent contract is valid.	A wagering agreement is void.

CHECK YOUR PROGRESS 3

Are the following contracts valid and enforceable by law?
i) A contracts to pay B Rs. 10,000 if B's house is burnt.
ii) A contracts with B to buy B's horse ifA survives ***C.***
iii) A ,agrees to pay B Rs, t0,000, if he makes two parallel lines meet.

- **SHORT ANSWER QUESTIONS**
- What is Wagering agreements?
- Explain contingent contracts.
- **LONG ANSWER QUESTIONS**
  - "An agreement in restraint' of trade is void". Examine this statement mentioning exceptions, if any.
- Discuss the law regarding wagering agreements under the Indian Contract Act.

ANSWER KEYS

i)Yes ii) Yes iii) No, restraint of trade

LET US SUM UP

For a valid contract, capacity to contract is an essential element. The person incompetent to contract like minor, unsound mind and persons disqualified by law are not eligible to contract and contract with such type of person is unenforceable by law. Not only that, an agreement with a minor cannot be ratified even after he attains majority. He cannot become partner in a firm but can be admitted to the benefits of the firm. He can, however, become a shareholder in a company provided the shares held by him are fully paid up and the articles of association do not prohibit it. A person is said to be of a sound mind if, at the time of contracting, he is capable of understanding the terms of the contract and of forming a rational judgement as to its effects upon his interests. The consideration or object of a contract shall be unlawful where: i) it is forbidden by law, ii) if permitted would defeat the provisions of any law, iii) it is fraudulent, iv) it involves or implies injury to the person or property of another, and v) the court regards it as immoral, or opposed to public policy.

KEY WORDS

ALIEN: A resident of a foreign country.
CONVICT: A person found guilty of an offence.
IDIOT: A person so mentally deficient by birth as to be incapable of ordinary reasoning or rational conduct.
LUNATIC: A person affected by lunacy or of an unsound mind. A person can become lunatic at any stage of his life.
MINOR: A person who has not attained the age of 18 years (21 years in some situations).
AGGRIEVED PARTY: The party to an agreement whose consent is not free.
BILATERAL MISTAKE: Where both the contracting parties are working under common mistake.
COERCION: Threatening to commit any act forbidden by the Indian.
Penal Code or detaining or threatening to detain any property of another to his prejudice with the intention of causing him to enter into an agreement.
FREE CONSENT: Consent to an agreement without influence or pressure of any type.
FRAUD: A false representation made wilfully with a view to deceive the other party.

MISREPRESENTATION: **A** false representation made innocently, without any intention to deceive the other party
NECESSARIES: Items necessary for living suitable to the condition in life of an individual and to his actual requirement at the time of sale and delivery.
VOID-AB-INITIO: Void from the beginning.
COLLATERAL TRANSACTION: A transaction which is helping or subsidiary to the main transaction.
PRIMA FACIE: Latin expression which means on the face of it.
TRIBUNALS: Courts and other judicial machinery., Void-ab-initio: Latin expression which means unenforceable from the beginning.

TERMINAL QUESTIONS

1) Who is competent to contract? State the position of contracts with a minor.
2) What shall be the effect on a contract where a minor, a party to the contract, is guilty of deliberate misrepresentation with regard to his age.
3) What are necessaries? When is a minor liable on **a** contract for necessaries?
4) Examine the legal position of (i) a minor as a promisee, (ii) a minor as an agent.
5) Name persons who are treated as persons of unsound mind. State the legal positions of contracts with such persons.
6) Enumerate persons forbidden under other laws for the time being in force and state the legal position of the contracts with them.

Define fraud and point out its effects on the validity of the contract.
7) "Mere silence as to facts is not fraud". Explain with examples.
8) Distinguish between :
i) Coercion and undue influence
ii) Fraud and Misrepresentation
9) Define mistake and explain various types of mistakes.
10) Explain and illustrate the effect of a 'mistake of fact' on contracts:
11) On whom 'the burden of proof lie in case of undue influence? State the cases in which undue influence is presumed.

WEB LINKS

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SEMESTER II

COURSE: BUSINESS LAW

UNIT 3 DISCHARGE OF CONTRACT, REMEDIES FOR BREACH OF CONTRACT, CONTINGENT AND QUASI CONTRACTS

Discharge of Contract

STRUCTURE

3.0 LEARNING OUTCOMES:

After reading this unit, the learner should be able to:

1. **What is Discharge of Contract?**
2. **What is Breach of Contract**
3. **Enlist the remedies in case of breach of contract**
4. **Define quasi contracts and describe various types of Quasi contracts**
5. **Define Contingent contracts**
6. **Understand the basic purpose of remedies**

3.1 INTRODUCTION:

When all the obligations related to a contract come to an end then it is said to be discharged. In other words, discharge of contract means all the contractual relations between the parties is terminated. There are various modes of discharge of contract. It is either in positive way i.e., by performance or negative by breach or failure to perform contractual obligation by either of the parties.

3.2 DISCHARGE OF CONTRACT:

It refers to the way in which contract comes to as end. Contract comes into existence when both the parties give assent and are ready to perform their contractual obligations. When the parties to contract leave the contract, it is called discharge of contract. It means two or more than two parties form a contract by framing different rules and regulations and thereafter, if any of the parties to contract do not obey or follow the set rules, contract would be in a condition of discharge.

3.3 METHODS OF DISCHARGE OF CONTRACT:

3.3.1) DISCHARGE BY PERFORMANCE: When parties to contract perform their promises then contract is said to be discharged in a natural mode, i.e., discharge by performance. If only one of the concerned parties perform his part of his promise, then he is said to be discharged from the contract. He can take action against other party who is guilty

of breaching the contract. For example; two parties P and Q make a contract to build a mall in a city. P is the municipal authority of the city and Q is the construction company. Due to unavoidable reasons, the contract dets discharged. Therefore, both the parties are free from the obligations of contract, i.e., the rights and obligations of the parties come to an end.

Performance may be of two types:

- Actual performance
- Attempted performance

a) Actual performance: when all the concerned parties related to contract complete the contract according to the terms of agreement, then contract is said to be discharged by performance. For example; T and S entered into a contract to build a railway bridge. S builds the bridge in the prescribed manner and T provides the consideration to S. Both the parties performed their obligations and rights. Contract comes to an end by the performance.

b) Attempted performance or Tender: tender being not an actual performance is only an offer to perform the obligation in the contract. When the promisor offers to perform his obligation, but the promisee refuses to accept the performance, tender is identical to actual performance, except in case of tender of money. The effect of a valid tender is that the contract is considered to have been performed.

3.3.2) DISCHARGE BY AGREEMENT: It is the agreement between the parties which creates a legal binding between them; therefore, contract can be discharged by having further agreement. It can be said that contractual obligation may be discharged by creating an agreement which can be expressed or implied.

There may be cases of discharge of contract by mutual agreement dealt in sections 62 and 63.

a) NOVATION: It means substituting the legal prevailing contract with a new contract and the transfer is mutually agreed upon by the concerned parties to the contract. In case of novation the original contract becomes void. Section 62 of Indian Contract Act, 1872 states that ‑if the parties to the contract agree to substitute a new contract for it or to rescind it or alter it, the original contract need not to be performed.‖ Novation takes place if, new contract has been substituted between one of the same parties of the contract with the third party on same terms. The contract is withdrawn in terms of consideration. For example; a creditor on the request of a debtor agrees to take another person as his debtor in place of the original debtor. Consideration is the means to discharge the old contract. Novation should take place before time lapses for the performance of original contract otherwise it would be breach of contract.

b) RECISSION: Recission means all or some of the terms of the contract are cancelled and parties to contract may decide not to enter into new contract to replace the original contract. Promise of performing the contract is not demanded from each other.

It may be:

(i) by mutual consent of the parties concerned

(ii) when one of the parties to contract fails to perform his obligation and another party may revoke the contract without claiming compensation for breach of contract. e.g., Amrita and Bhavya enter into a contract that Amrita will deliver the goods to Bhavya on 15th April, 2021 and Bhavya will pay the price on May 1, 2021. Amrita does not supply the goods. Bhavya can revoke the contract and need not to pay the price.

Recission of contract can be partial or total. Total recission means contract is discharged entirely and partial recission means that original contract will be replaced with some variations either by withdrawing some of the terms of the contract or by replacing new terms in the original contract or by adding new terms without revoking the original contract.

c) ALTERATION: One or more of the terms of the original can be altered by mutual agreement of the parties concerned to the contract. In this case original contract is discharged. For example: Madhuri enters into a contract with Disha to deliver 100 meters of white cotton at her boutique next month. Both may alter the terms of the contract by mutual consent.

d) REMISSION: Remission means accepting of lesser fulfilment of promise, it means giving concession. For example; paying 80% of the debt in discharge of 100% debt. It is not necessary that consideration will be considered for remission time can also be extended to perform the contract. For example; P encourages B to enter

e) WAIVER: When parties to contract agree to that there is no longer any contract or agreement between them, it is called discharge of contract by mutual consent. For example; X promises to paint a picture for Z. Z afterwards prohibits him to do so. X is no longer bound to perform the promise.

f) MERGER: Merger takes place when inferior rights accumulating to a party in contract mergers into a superior right to the same party under the same contract or same another contract.

3.3.3) DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE: After the establishment of the contract, sometimes, though not because of anybody‘s fault performance of contract becomes impossible, or illegal, or fundamentally different from the original one.

However, if whatsoever happens to prevent the performance of the contract

a) has not been caused by either of the parties to contract,
b) could not have been foreseen, and
c) its effect could destroy the origin of the contract,

Court will state that performance of the contract has become impossible because of the death or incapacity of the parties to contract or main subject matter of the contract has been destroyed or change in the contract renders the performance of the contract illegal. The performance of the contract becomes impossible and contract is said to be discharged.

For example; X promises Q to sell his pet on June 1st, 2021 but before that day, the pet dies. Now it is impossible to fulfill the performance due to impossibility of performance. Such

impossibilities in which at the time of contract, contract was capable of being performed, but subsequently, its performance becomes impossible, it is called –Supervening Impossibility.‖

3.3.4) DISCHARGE BY LAPSE OF TIME: The contract must be performed within a specified period, called period of limitation. If the promisee on non-performance of contract does not take action within time, cannot claim for remedy. It can be said that contract is terminated. For example: if goods sold on credit to be paid within three years and expiry of fixed period of credit would make the debt time-barred and hence declared as irrecoverable.

For example; the period of limitation to file a money suit is 3 years. If within 3 years the creditor fails to file the suit to recover his amount, the debtor is discharged.

3.3.5) DISCHARGE BY OPERATION OF LAW: A contract may be discharged at the wish of the parties to contract, by operation of law. It includes discharge:

a) BY DEATH: A contract may be terminated on the death of the person concerned (promisor) if the contract is based upon his personal skill or liability. Otherwise, rights and obligations of the deceased promisor pass on to the legal beneficiaries of the departed person.

b) BY INSOLVENCY: If one of the parties to contract is adjudged insolvent, then he is discharged from the obligations of the contract incurred prior to his clearing of insolvency.

c) BY UNAUTHORIZED ALTERATION IN THE TERMS OF A WRITTEN AGREEMENT: If any of the practices to contract makes any material alteration in the contract with the consent of all the parties concerned, the contract becomes void if material alteration made has changed the legal character of the contract. Immaterial alteration does not lead to discharge of contract.

d) BY RIGHTS AND LIABILITIES BECOMING VESTED IN THE SAME PERSON: When the rights and liabilities in a contract vest in the same person the contract is discharged for other parties.

3.3.6) DISCHARGE BY BREACH OF CONTRACT: When obligation related to contract has not been fulfilled it is called breach of contract. Breach can be done by not fulfilling contractual obligations without any lawful excuse.

Breach can be of two parts:

i) ACTUAL BREACH OF CONTRACT:

- It may take place at the time when actual performance of contract is due and one of the parties to contract refuses or fails to perform his obligations under the contract. For example; X agrees to deliver 5 bags of rice to Z on Jan 1st. He fails to do so. There is a breach of contract by A.
- It may take place during the performance of the contract and one of the parties to contract refuses to perform his obligation. Refusal can be expressed or implied. When one of the concerned parties to contract personally refuses by his words to continue the contract, the contract is said to be discharged. And on the other hand, when party to contract make the

performance of the contract impossible, then only it effects to the breach of contract and other party is discharged from the contract.

ii) **ANTICIPATORY BREACH OF CONTRACT**: Anticipatory breach: when the party concerned to the contract asserts his intention of non-performance of the contract before the due date of the contract either by

- particularly abandoning his obligation under the contract, or
- enacting through his performance so as his promise becomes impossible.

For example; X promises to sell his house to B on before 1st May, 2021. X sells his house to Z. Here X performed such a voluntary act that the performance of his obligation towards B is impossible and Anticipatory Breach by impossibility is committed.

The aggrieved party has the right in case of attempted breach either by treating the contract as discharged, or can take immediate legal action against breach of contractor could wait till the time the act was to be done.

He can expressly revoke the contract or by doing an act which makes the performance of the contract impossible. It does not necessarily discharge the contract until promisee to the contract chooses to do so. If he does so, then promisor may perform the contractual obligations. And if contract is alive and happening of a particular event discharges the contract on legal terms then promisor may take an advantage to discharge the contract. The promisee loses his right to be compensated. If contract is kept alive till the date of performance of contractual obligations of the contract, the damages will be the difference between price presently prevailing on the date of performance and the contract price.

SAQ 1
STATE WHETHER FOLLOWING STATEMENTS ARE TRUE OR FALSE

i) If only one party to a contract performs his promise, the contract is discharged.

ii) In case of anticipatory breach, the promisee has to wait till the time the act was to be done to take legal action for breach of contract.

iii) When all or some of the terms of a contract are altered, rescission takes place.

iv) Novation means substitution of a new contract for an old one.

FILL IN THE BLANKS:

i) As long as all terms have been carried out properly and completely, the contract is discharged by_____.

ii) A court's award that reimburses a buyer for reasonable expenses when the seller has breached a contract is_____damages.

iii) After reaching the age of majority, a person may _____a contract made during minority by using, selling, or keeping the item, or by making payments.

iv) _____occurs when one party to a contract does not do what he or she agreed to do.

v) People sometimes enter into_____contracts without saying a word.

3.4 BREACH OF CONTRACT:

3.4.1 MEANING:

When a promisor does not observe the contractual obligation or he fails to perform the contract, it is called breach of contract. Where there is a right, there is a remedy. When either of the parties to contract breaches the contract, it gives the right to aggrieved party to sue him for remedy.

Contract gives correlative right and obligations if one of the party of parties to contract breaches the contract then the aggrieved party has right to get remedy. Remedy is given by law to the person who bears the loss. It is a means given to enforce the right to get compensated.

3.5 REMEDIES FOR BREACH OF CONTRACT:

There are many remedies which injured party can use to get compensation. Following are some of the remedies:

3.5.1 RESCISSION: One of the parties to a contract which has been discharged by breach of contract may sue to repeal the contract and further refuse to performance. In such situation, he is free from all the obligations of the contract.

Example: X promises to Amrita to supply 20 bales of cotton on a certain day. Amrita agreed to pay the price after the receipt of the cotton. X doesn‘t supply cotton. Amrita is discharged from the liability to pay. The court may grant rescission if contract is voidable and moreover if the contract is unlawful.

3.5.2 DAMAGES: Monetary compensation allowed to the aggrieved party by the court for the injury suffered by him by breach of contract is known as damages. The object behind rewarding the damages to the injured party is to put him in a position as if he had not been injured. It is called doctrine of restitution. The foundation of modern law of damages, both in India and England has been found in the judgement in the case of Hadley vs. Baxendale, (1854). The main facts of the case were: X‘s mill was stopped by the breakdown of a shaft. Shaft was sent to a manufacturer through a common carrier, Y, to copy it to make a new one and did not tell Y that delay would lead to loss in profits. Because of negligence of Y shaft‘s delivery was delayed in transit beyond the reasonable time. Y was not entitled to loss of profits as he was not prior conveyed that delay would lead to loss of profits to mill. Section 73 of Contract Act which deals with compensation of loss caused by breach of contract is based on the judgement of the above case.

When a contract has been broken the aggrieved party is entitled to:

- the damages which arose in usual course of things from such breach. It related to ordinary damages
- such damages which were known to the parties when they entered into the contract, to be likely to result from the breach, called special damages. But:

- such compensation should not be given for any indirect loss sustained by reason of the breach; and
- such compensation for damages arising from breach of a quasi-contract shall be same as in any other contract.

The rules relating to damages are as:

a) **ORDINARY DAMAGES ARISING NATURALLY**: Ordinary damages are proximate consequences of the breach of contract. When contract is discharged in breach of contract, then the aggrieved party can recover the compensation from the other party which arose naturally in the usual course of things from the breach.
Example: X promises to sell and deliver 100 quintals of wheat to Amit at Rs 775 per quintal, price to be paid at the time of delivery. But price rises to Rs 800 per quintal and X refuses to sell the wheat. Amit can claim the damages @ Rs 25 per quintal.

b) **SPECIAL DAMAGES:** Damages which cannot be claimed as a matter of right are called special damages. These can be claimed when special circumstances occur because of special loss in case of breach and are brought into the notice of the other party.

c) **EXEMPLARY DAMAGES**: There are the damages given in the form of compensation for the loss suffered and not by way of punishment. These damages have no place in law such as breach of a promise to marry.

d) **NOMINAL DAMAGES:** When the injured party has not in fact injured by breach of contract or the damages are very small.

e) **DAMAGES FOR LOSS OF REPUTATION**: When breach of contract damages the reputation and is generally irrecoverable.
EXAMPLE: If banker wrongfully refuses to honor a customer cheque which otherwise is bonafide.

f) **DAMAGES FOR DISCOMFORT:** - Damages may be recovered for the physical discomfort and are measured but no affected the motive of the breach.

g) **MITIGATION:** Aggrieved party cannot claim the compensation which is not because of breach of contract but due to his own negligence to mitigate the loss after breach of contract.

h) **DIFFICULT TO ACCESS:** Though the damages which cannot be assessed and recovered but precession does not prevent the aggrieved party from recovery then the court‘s decision to estimate the loss may be taken into account.

i) **COST OF DECREE:** The aggrieved party is entitled to get the cost of getting decree for damages. Cost for suit for damages is in the discretion of court.

j) **DAMAGES AGREED UPON IN ADVANCE OF BREACH:** If amount to be paid in case of breach is mentioned in the contract the injured party would be recovering the reasonable amount as compensation not exceeding the amount mentioned in contract.

QUANTUM MERUIT: Literally meaning of Quantum Meruit is ‒as much as earned‘ or in proportion to work done‖. When one of the parties to contract has per formed a part his contractual obligation and the contract has been discharged because of the default of other

party and contract has become void. The remedy is not an original contract but it is an implied promise made by other party to pay for what has been done or not on the original contract which has been discharged.

3.5.3 SPECIFIC PERFORMANCE: In some of the situations of breach of contract, many a times money is not an adequate remedy. Rather, court may in such cases, ask for the party in breach to perform his promise according to the terms of the contract. Here court gives specific performance.

There are many cases where court can ask the party in breach to perform the contractual obligation. Only specific performances are granted:

a) Where compensation in monetary terms or the non-performance of the contract is not adequate relief.
b) When actual damages cannot be ascertained.
c) When aggrieved party probably would not get the compensation for non-performance of the contract.

There are some cases where specific performance is not granted:

a) Where damages are adequate remedy.
b) Where contract is inadequate to all the parties to contract.
c) Contract is revocable in nature.
d) Where trustees made the contract in breach of the trust.
e) Where contract is personal in nature.
f) Where contract made by the company in excess of its powers mentioned in Memorandum of Association and
g) Where court cannot supervise it carrying out.

3.5.4 INJUNCTION: When breach of contract is in negative terms of the contract then court may, restrain the concerned party to do what he promised not to do. Such an order is called injunction

Example: Anita, a dancer, agreed to perform for Sony‘ TV exclusively for a year and nowhere else. During the year she made a contract to act in Dubai. She was restrained by injunction from doing so.

SAQ 2

STATE WHETHER FOLLOWING STATEMENTS ARE TRUE OR FALSE

a) The most common remedy for a breach of contract is an award of equitable remedies.
b) Substantial performance occurs when there has been a material breach of contract.
c) A material breach of a contract occurs when a party renders inferior performance of his or her contractual obligations that impairs or destroys the essence of the contract.
d) If a contract has been breached, the law places a duty on the innocent non-breaching party to make reasonable efforts to mitigate the resulting damages.
e) Where there is a right, there is a remedy.

FILL IN THE BLANKS:

a) The rule on special damages was for the first time laid down in the case of. .....
b) The measure of ordinary damages is the difference between. ..... .price . and the. .....price.
c) Specific performance of a contract will not be granted where the contract is of a.. .....
d) Quantum Meruit means.....
e) Actual breach of a contract may take place (a) at the time when performance is due, or (b). .....

3.6 QUASI CONTRACTS

3.6.1 INTRODUCTION:

In a train, if a shoe shiner comes to you and without saying starts polishing your shoes. When shoe-polish is done he asks for money. Whether you are obliged to pay the money? Or you would tell him, ―Did I ask you to polish my shoes anyway?‖

In another situation, if somebody‘s Amazon package with payment already done, is delivered at your doorstep. Will you be excited to get it by saying, ―Wow, free gift!‖ or you would make an effort to find out the real owner?

These are the situations in which certain obligations arise but are not absolute contracts one or the other basic elements of the valid contract are missing. But these obligations are still enforceable. These obligations under Indian Contract Act are known as quasi contracts. Firstly, it should be noted that before contract, it is necessary that there must be an agreement. No agreement no contract. But there are many uncommon situations where people are under some obligations but they do not have any agreement originally. These obligations are not known as contracts but are necessarily enforceable under law.

Quasi-contracts are based on the principle of ―Nemo debet locupletari ex aliena jactura**‖,** which means ―No man should grow rich out of another person‘s loss. Therefore, liability in the case of quasi-contractual obligations is based on the principle of ―unjust enrichment‘. It essentially means that no man should get unjustly enriched at the cost of another person‘s loss. The term Quasi Contract is derived from the Roman Law ***"Obligatio quasi ex contractu".*** Quasi Contract is not real Contract entered into by parties intentionally. It resembles a contract in which law imposes on obligation on a person to perform an obligation on the ground of equity.

Quasi contracts are based on the principle of unfair enrichment. No man should grow rich out of another person‘s loss. Under quasi contracts, the liability arises on the principle named unfair enrichment. No one should earn unjustly. The origin of the quasi contracts does not lie in the offer and acceptance. Parties to quasi contracts do not enter into contract intentionally. Law imposes an obligation on the persons concerned on the ground of equity. These contracts are rather based on good concise, equity and justice.

According to Salmond, "There are certain obligations which are not in truth contractual in the sense of resting on agreement, but which the law treats as if they were."

For example: Amrita leaves her wristwatch at Jiya‘s house by mistake. Here Amrita has Quasi-contractual obligation to return it to Jiya.

3.6.2 TYPES OF QUASI CONTRACTS:

There are five kinds of contractual obligations which are identified as quasi contracts. Section 68 to Section 72 of the Indian Contract Act, 1872 deals with Five Kinds of Quasi-Contract which are as follows –

1. **SUPPLY OF NECESSARIES:** Person who provides necessaries to the persons or to his dependents, incompetent to contract can claim the price from that person‘s property. The claims and be compensated only if necessaries have been supplied. Supplies of luxuries cannot be claimed.

   For example: If Amit supplies necessaries to Ajay, an insane, or to his family to whom Ajay is liable to provide necessaries of life. In such situation Amit can claim the price of the goods supplied from the property of Amit. But Amit has to prove that the goods supplied were actually required by Ajay and his family. Supply of luxuries cannot be claimed.
2. **PAYMENT BY INTERESTED PERSON:** Person who has paid an amount of money for another person who is indebted to pay, is entitled to be reimbursed by the later provided that sum of money which has been paid by the former was to protect his own interest. But the payment made should be the protection of one‘s interest in a bonafide sense. It must not be paid by the former willingly and the later must be assured by the law to pay the said money under law. For example: the goods which belonged to Wasim were wrongfully delivered to Government in an order which were the arrears of the government‘s revenue due to Akram. Wasim paid the amount to save the goods from sale. It was held that Wasim was entitled to recover the amount from Wasim.
3. **OBLIGATION TO PAY FOR NON-GRATUITOUS ACTS:** When lawfully a person does something for another person or delivers some goods to him, not with gratitude and another person enjoys the benefits of the goods delivered to him, is bound to pay for those delivered goods as he restores the goods which are not delivered to him intentionally. But if the purpose of the person is to show gratitude towards another person to whom he helps and circumstances has shown that the former has been carrying a gesture of gratitude then no reward can be demanded. For example: Amrita leaves a packet of jewelry at Neelima‘s house by mistake, which she bought for her sister. Neelima treated that packet as a gift for her own from Amrita. But Neelima is bound to pay for the jewelry.

4. **RESPONSIBILITY OF FINDER OF GOODS:** A person, if finds the goods which otherwise belongs to another person and he takes the goods in his custody, should take care of the goods in his custody, should take care of the goods as he would have been taking care of his own goods. He should find the real owner of the goods. The finder can sell the goods in certain circumstances such as:
   a) if goods found are of perishable nature
   b) if by putting all possible efforts, owner cannot be found
   c) if owner found, but refused to pay the charges to the finder and
   d) If the lawful charges to be paid to the finder for the goods found are two-third of the value of the goods found.

   5) MISTAKE OR COERCION: Person to whom goods have been delivered or money paid by mistake or under coercion should repay or return it to the person who has delivered or paid by mistake. For example: Rishi delivers goods to Mahira by mistake. It actually belongs to Mansi. Mahira must return the goods to Rishi. However, Mansi cannot recover the goods from Mahira as they do not carry privity to contract.

   It can be said that quasi contracts are not contracts as per Indian Contract 1872 but obligations imposed by law and only in certain situations. Quasi contracts only creates obligation so that there is no unjust enrichment on one party.

SAQ 3

STATE WHETHER FOLLOWING STATEMENTS ARE TRUE OR FALSE:

a) Quasi contract is not a contract at all.
b) A finder of the lost goods can hold the goods against the whole world except the true owner.
c) Any person, who voluntarily makes a payment on behalf of another, can recover it.
d) A person to whom money has been paid by mistake or under coercion must repay or return it to the person who paid it by mistake.

3.7 CONTINGENT CONTRACTS

3.7.1 INTRODUCTION:

A contract is known as absolute contract when promisor executes it without any condition whereas, where the contract is executed by the promisor with a certain condition met it is called as contingent contract. For example; Z enters into a contract with P to pay him ₹ 10,000 on delivery of hard disks. This is not a contingent contract as Z has an obligation to pay for an event that is part of contract but not a collateral contract.

Section 31 of the Indian Contract Act, 1872 defines the term contingent contract as follows: _A contingent contract is a contract to do or not to do something if some event collateral to such contract does or does not happen.‘

Pollack 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.

In simple words contingent contracts are the contracts in which the acceptor performs his obligation when certain conditions are met.

The essentials of the contingent contract are:

1) The performance of the contingent contract depends upon happening or non-happening of as event. For example: Vinay promises to pay Ajay ₹ 15,000 if the train reaches Delhi on time. This is a contingent event.
2) The collateral event attached to the contract must be uncertain. If event to be performed will be certain then contract will become due to be performed and then it is not a contingent contract. For example: Amrita promises to pay Deepali ₹ 10,000 if it rains in Punjab in the month of July. This does not constitute a contingent contract as in July, rains are certain in Punjab.
3) The event must not be the part of the contract. The event should be collateral to the contract. It cannot be the promise to be performed or must not be the consideration for a promise. For example: Anant enters into a contract with Ajay and promises him to deliver 10 LEDs to him. Ajay promises to pay him ₹ 1,50,000 on delivery. This is not a contingent contract as Ajay‘s obligation depends upon the event which is a part of the contract and not a secondary event.
4) The event must not be a will of the promisor. For example; Amit promises to pay Heena ₹ 50,000 if India wins the world cup 2018. This is not a contingent contract rather it is not a contract at all. Another example is Puneet promises to pay Anil ₹ 50,000 if he leaves Delhi for Singapore on August 16, 2019. This is a contingent contract. Going to Singapore can be Ajay‘s will but it is not merely his will.

3.7.2 RULES REGARDING CONTINGENT CONTRACTS:

1. Contingent contracts depend on the happening of an uncertain collateral event which cannot be enforced until unless the event has happened. Contract becomes void if that event becomes impossible.
2. Performance of a contingent contract depends on non-happening of a particular event.
3. If a specified uncertain event does not happen within a fixed time, it may be enforced if the event does not happen or becomes impossible to happen before the expiry of the time.
4. If the happening of the event becomes void whether or not the facts are known to the parties to contract.
5. If a contract is contingent on the behavior of a person at an unspecified period of time, the event become impossible that he should act within a definite period of time.

3.7.3 DIFFERENCE BETWEEN CONTINGENT CONTRACT AND A WAGERING CONTRACT

Basis of Difference	**Contingent Contract**	**Wagering Contract**
Meaning	A contract in which enforceability depends upon to do or not to do	Promise to give money or money‘s worth for an uncertain

	something is called contingent contract. It is related to the happening or not happening of a collateral event.	event's happening is called a wagering agreement.
Effect of Contract	It is a valid contract.	It is void contract.
Nature of Contract	Contingent contract may or may not be a wagering contract.	A wagering contract is necessarily a contingent in nature.
Uncertain Event	The uncertain event is collateral in a contingent contract.	The uncertain event in a wagering agreement is a core factor.
Interest of Contracting party	In contingent contract, the parties to contract have interest in subject matter.	In wagering agreement, the parties to contract have no interest in subject matter.
Reciprocal Promises	Contingent contract may or may not have reciprocal promises.	Wagering agreements have reciprocal promises.

3.8 CONCLUSION:

A contract is an agreement which is enforceable by law. For every contract, there should be an agreement which is made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object. The agreement should not be declared void hereby to form a contract. Every contingent contract is a contract primarily. Like any other contract, it is also a contract to do or not to do something. It is not an absolute and unconditional one, without any reservations or conditions, which is to be performed under any event. Its performance is dependent on some event's happening or not happening- the contingency. The performance of the contract must be conditional. The said event must be collateral to such contracts and the event should not be at the discretion of the promisor. These are some rules that have to be followed for a contingent contract to be enforceable. For instance, on the happening of an event, on the event not happening and, on the event, not happening within a specified time. There are some situations when a contingent contract becomes void. Some of them are: the event being impossible, not happening of event within fixed time, agreements contingent on impossible events and on the conduct of a living person.

TEST YOUR KNOWLEDGE:

VERY SHORT ANSWER QUESTIONS

1. Write notes on:
   a) Anticipatory breach
   b) Rescission
   c) Quasi Contract
   d) Quantum Meruit
   e) Suit for Injunction

SHORT ANSWER QUESTIONS

1. Explain the anticipatory breach of contract.
2. Distinguish between general damages and special damages.
3. What are Quasi Contracts? Discuss its nature and kinds.
4. Define contingent contracts.
5. Distinguish between contingent contracts and wagering agreements.
6. Discuss the finder of goods?

LONG ANSWER QUESTIONS:

1. What do you understand by anticipatory breach of contract'? State the legal position of the parties in such a case.

2 What are the rules under the Indian Contract Act for estimating the loss or damage arising from a breach of contract'?

3 What is 'Breach of Contract? What remedies are available to an aggrieved party on the breach of a contract?

4 "Compensation is not to be given for any indirect loss or damage sustained by reason of the breach of contract‖ Discuss.

5 Explain the terms 'Penalty' and 'Liquidated Damages' clearly indicating the difference between the two.

6 What are the Quasi contracts? Enumerate the type of such contracts dealt within the Indian Contract Act.

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B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 4 – SPECIAL CONTRACT – INDEMNITY, GUARANTEE, BAILMENT AND AGENCY

STRUCTURE

4.0 OBJECTIVES

After studying the Unit, students will be able to

- Understand the Meaning of special contracts.
- Know the meaning of contract of indemnity.
- Describe the rights available to indemnity holder and indemnifier.
- Find out meaning of contact of guarantee.
- Appraise themselves about rights of surety and termination of the agency.
- Understand the difference between indemnity and guarantee.
- Define the meaning of contract of Bailment.
- Find the rights and duties of Bailor and Bailee of the contract.
- Understand the meaning of Bailee‘s Lien
- Contrast between general and particular lien.
- Explain the meaning of Agency
- Discuss the rights and duties of the Principal and Agents.
- Explain various methods of termination of the agency.

4. 1 INTRODUCTION:

Indian contract act is one of the important act and may considered as mother of a number of other acts that take its basics from the Contract Act. This act deals with a

number of contracts. Broadly we can divide these contract in two categories i.e General Contracts that are covered in section 1 to 123 of the contract and special contracts that are been covered in sections 124 to 238 of the Indian Contract Act. The term special contract here means that these section deals with specific types of contracts. These special contracts includes contract of Indemnity, Guarantee, Bailment, Pledge and contract of Agency. In this unit we will study all these special contracts one by one.

4.2 CONTRACT OF INDEMNITY (SECTION 124- 125)

The term indemnity is a special type of contract covered under the Indian Contract Act. Indemnity is a contract in which one person gives assurance to the other person that if there is some loss to him due to any event or any situation, person giving the assurance will compensate the person who has incurred the loss. Contract of Insurance can be one of the best example of contract of indemnity. In Insurance contract, insurance company gives assurance to policy holder that if there is some loss to policyholder, insurance company will compensate such loss.

4.2.1 DEFINITION (SECTION 124)

According to Sec. 124 of the Contract Act, the contract of indemnity has been defined as:

"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".

There are two parties involved in the contract of indemnity:

- **INDEMNIFIER:** Indemnifier is the person who give assurance to other person to compensate his loss like in the example of insurance contract insurance company gave assurance to other party so it is indemnifier.
- **INDEMNITY-HOLDER:** He is the person to who assurance is given under the contract of Indemnity. So in the insurance example policyholder is the Indemnity Holder as he gets the assurance from the insurance company.

4.2.2 CHARACTERISTICS OF A CONTRACT OF INDEMNITY

The important features of an Indemnity Contract are as follows:

1. **ESSENTIALS OF A VALID CONTRACT:** Contract of indemnity is also a contract like any other contract and is also covered under the Contract Act. So, all the essentials of contract act like free consent, consideration, capacity of party, lawful object etc are also applicable on the indemnity contract. If these features are not there, contract of indemnity is invalid.
2. **EXPRESS OR IMPLIED:** The contract of indemnity like any other contract may be a express contract or a implied contract. Further this contract may be oral contract or written contract.
3. **COMPENSATION OF LOSS:** In contract of indemnity one party assures other party to compensate the loss, this is most important feature of contract of indemnity. Without this feature contract of indemnity is not valid.

4.2.3 RIGHTS OF AN INDEMNITY HOLDER (SECTION 125) :-

Following are right of Indemnity holder according to section 125 of the contract act:

1. **RIGHT TO RECOVER DAMAGES: -** In contract of For example in a partnership firm A give guarantee to his partner B that his profit will not be less than Rs. 50000 in any case, but the amount of profit earned by B is Rs. 40000, in such case B can recover Rs. 10000 from Partner A.
2. **RIGHT TO RECOVER COST**: The indemnity holder has right to recover any cost incurred by him on any matter incidental to the act done by him related to the matter of indemnity.
3. **RIGHT TO RECOVER ALL SUM PAID: -** He can also recover any amount paid under the compromise of any suit related to sach indemnity. However, it is necessary that such compromise must be done by him as per directions of the indemnifier.

4. **SUIT FOR SPECIFIC PERFORMANCE: -** Indemnity Holder can file suit agains indemnifier for specific performance of the contract agreed upon under the contract of indemnity.

4.2.4 RIGHTS OF AN INDEMNIFIER:

1. **RIGHT TO SUBROGATION**: - Once indemnifier pays the amount of loss to the indemnity holder right of subrogation. It means the indemnifier will take the right vested in the goods to the indemnity holder. For example if insurance company pay the amount of loss by theft of car to the owner, but later the car was found, insurance company will be treated as owner of the car.
2. **RIGHT TO EQUITIES**: - In case more than one indemnifier, then one indemnifier has the right to recover proportionate amount from other indemnifier.
3. **RIGHT TO REFUSE INDEMNITY**: Indemnifier has right to refuse any amount of loss that is not covered under the provisions of the contract. For example if an insurance company has given fire insurance to a person but good are damaged due to excessive heat of summer season, it is not covered in the contract and indemnifier could refuse the payment.

4.3 CONTRACT OF GUARANTEE (SECTION 126-147)

Guarantee is a special type of contract covered under the Indian Contract Act 1872. Under the contract of guarantee some amount is payable by one person to the other person. In such case a third person give assurance to the person to whom amount is due that if the person by whom amount is payable fails to pay the amount, then he will pay such amount. Section 126 of the Contract Act define the term guarantee as:

"A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default."

Normally any contract involve two parties, but in the contract of guarantee there are three parties involved in the contract. three parties are are surety, principal debtor and creditor.

- **SURETY:** Surety is the person who gives guarantee to other person for making the

payment in case of default by Principal Debtor..

- **PRINCIPAL DEBTOR**: Principal debtor is the person by whom amount is originally payable under the contract. If he fails to make the payment then surety will be liable to make the payment. It is not necessary that principal debtor must be a person competent to enter into a contract. Even if he is minor, guarantee will be valid.
- **CREDITOR:** The person by whom amount is receivable under the contract is called creditor.

EXAMPLE: Abhay give money to Ratan as loan on the request made to him by Rajan. Rajan promised to Abhay that if Ratan fails to repay the amount due then hewill make the payment. This contract is a guarantee contract and Rajan is surety in this contract, abhay is creditor and the Ratan is Principal debtor in the contract.

4.3.1 CHARACTERISTICS OF A CONTRACT OF GUARANTEE

The essential features of a contract of guarantee are as follows:

1. **THREE PARTIES:** The most important feature of contract of guarantee is that there are three parties that are involved in the contact, these are principal debtor, creditor and surety.
2. **EXISTENCE OF A LIABILITY:** In a contract of guarantee there must exist some liability due from one party to another party. On failure to meet this liability the contract of guarantee will be performed.
3. **CONSENT OR IDENTITY OF MIND:** In the contract of guarantee all the three parties must show their consent on the same subject matter. They must have consensus on the same subject matter. For example if A has taken two loans from B, C gives gurantee to B in respect of first loan but B is thinking that guarantee is for second loan then this guarantee is not valid.
4. **PRIMARY AND SECONDARY LIABILITY:** In the contract of guarantee the primary liability of making the payment is of Principal debtor. The liability of surety is secondary. Only after Principal Debtor fails to make the payment, the liability of surety will arise.
5. **NO MISREPRESENTATION:** There must not be any misrepresentation by one party to other in the contract of guarantee. If there is some misrepresentation then the contract of guarantee will not be valid.
6. **ESSENTIALS OF A VALID CONTRACT:** The contract of guarantee will be valid only if it possesses all the essential characteristics of a valid contract.
7. **SURETY'S LIABILITY MUST BE CONDITIONAL:** The liability of surety in the contract of guarantee is conditional and will arise only if there is default in payment by principal debtor.
8. **NO CONCEALMENT:** No party should hide material information related to the contract of guarantee from other party. Material information means some important information which could have bearing on the contract. For example. A has taken the loan from B and defaulted the payment. Now he is again seeking the loan from B and C is giving the guarantee to B for making payment in case of default by A without having knowledge of the fact that A has defaulted the payment earlier also. It is liability of B to inform C about

earlier default by A. If he fails to do so the contract of guarantee will be invalid.

4.3.2 KINDS OF GUARANTEE

1. **SPECIFIC GUARANTEE:** Specific guarantee is the guarantee given for a particular transaction. Normally this guarantee is only for single transaction and the very moment that transaction is complete the guarantee is also over.
2. **CONTINUING GUARANTEE:** Continuing guarantee is not for a single transaction rather it is for a series of transaction. This type of guarantee will continue until it is revoked by the surety.
3. **ABSOLUTE GUARANTEE:** in absolute guarantee there is no condition that is to be fulfilled for completing the guarantee. In other words, this guarantee is without putting any condition.
4. **CONDITIONAL GUARANTEE:** Conditional guarantee is the guarantee in which surety will make only E payment after some condition is fulfilled. For example A gives guaranteed to B that he will make payment in case of default of payment by C due to his insolvency. Now if C is not insolvent but he defaulted the payment due to some other reason, A will not be liable to make the payment.
5. **RETROSPECTIVE GUARANTEE:** If some transaction has already been carried and guarantee is given at the later stage, it is called retrospective guarantee.
6. **PROSPECTIVE GUARANTEE:** If some transaction is yet to be carried and guarantee is given for such transaction, it is called prospective guarantee.
7. **FIDELITY GUARANTEE:** This type of guarantee is given for the honesty or good conduct of the person. For example A give employment to B on the guarantee of C, that he will make good any loss arising due to fraud or misappropriation by B. This guarantee is Fidelity Guarantee.
8. **LIMITED OR UNLIMITED GUARANTEE:** In Limited guarantee, the guarantee is not given for the full amount involved in the transaction rather it is given only for a part of the amount involved in the transaction. Whereas in case of unlimited guarantee, there is no limit on the amount for which guarantee is given.

4.3.3 REVOCATION OF CONTINUING GUARANTEE

A person can revoke the continuing guarantee in the following manners.

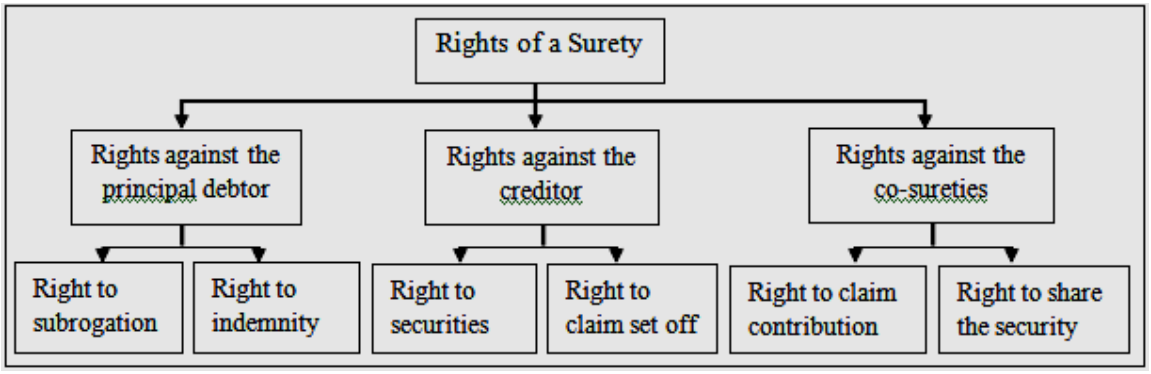
1. **BY NOTICE OF REVOCATION BY THE SURETY**: - According to Section 130 of the Act any Surety could revoke the continuing guarantee anytime. But for this purpose he has to give due notice to the creditor. Further, this revocation will be for future transactions and not for the transitions that have already been carried..
2. **BY THE DEATH OF THE SURETY**:- As per sec.131, In case of death surety the guarantee will be revoked. However, it is important to mention here that the property of the surety will be responsible for all the transactions that have been carried before the death of surety.
3. **BY NOVATION: -** Novation means entering into a new contract in place of the old contract. So, if there is some new contract between the parties that has been ratified by

all the parties, the old contract automatically comes to an end..

4. **BY ALTERING THE TERMS OF CONTRACT**: According to Sec 133 Any change in contract between principal debtor and creditor could take place only with the consent of surety. If principal debtor and creditor make any change in the contract unilaterally without consent of surety, the guarantee will be automatically revoked.
5. **BY RELEASE OF PRINCIPAL DEBTOR**: If creditor in the contract release the principal debtor, means he forego the payment from principal debtor, the surety is also been discharged from the contract.
6. **BY CREDITORS ACT OF OMISSION:** According to Section 139 of the act, any thing done by the creditor which result into loss of remedy available to Surety against Principal debtor, will result into revocation of the guarantee.

4.3.4 RIGHTS OF SURETY

The Act recognizes certain rights of the surety, besides imposing liability on him by virtue of Section 128. This right may be studied under the following three heads:



1. RIGHTS OF THE SURETY AGAINST THE PRINCIPAL DEBTOR

a) RIGHT OF SUBROGATION [SECTION 140]: If there is default by principal debtor due to which surety makes the payment to the creditor, the surety will take place of the creditor. In other words he will get all the rights that were available to the original creditor.

b) RIGHT TO CLAIM INDEMNITY [SECTION 145]: In the contract of guarantee, there is implied acceptance by principal debtor to the surety of compensating him for any amount rightfully paid by him to the creditor. However, this right is only four rightful payment and not for any excess payment.

2. RIGHTS OF THE SURETY AGAINST THE CREDITOR

a) RIGHTS TO CLAIM SECURITIES: If principal debtor has given something as security for the transaction, surety has right to claim that security from creditor once he clears the amount due to creditor..

b) RIGHT TO CLAIM SET-OFF: If any amount is due by creditor towards the surety under the same transaction, the surety has right to set off such amount.

c) RIGHT TO SHARE REDUCTION: Out of the amount payable by surety under the contract of guarantee, he can claim reduction of the part of amount that has been claimed by creditor from Principal Debtor.

3. RIGHTS OF THE SURETY AGAINST THE CO-SURETIES:

It may be possible that more than one surety is involved in the contract of guarantee. These sureties involved in the contract are called co-sureties. Now in such case a single surety cannot be compelled to make the whole payment due under the contract. Following are the rights of a surety against the co-surety:

a) RIGHT TO CONTRIBUTION [SECTION 146]: If more than one surety is involved in the contract, he has right to ask the agreed contribution from the other co-surety. In case no particular contribution was decided, all the sureties will contribute equally in the contract.

b) RIGHT TO SHARE BENEFITS OF SECURITIES: As discussed earlier, the surety has right to claim any thing given by security to the creditor by principal debtor once he clears the debe. In case such security is received by on co-surety, other co-sureties have right to clasim their share from such security.

4.3.5 DISCHARGE OF SURETY FROM LIABILITIES:

The following are the circumstances under which a surety is discharged from his liability.

1. **REVOCATION BY GIVING NOTICE**: - If there is continuing guarantee by one person to the other, such surety is relieved from the guarantee once he give notice of revocation to the creditor. However, this revocation will be for future transactions.
2. **REVOCATION BY DEATH OF SURETY: -** , In case of death surety the guarantee will be revoked. However, it is important to mention here that the property of the surety will be responsible for all the transactions that have been carried before the death of surety.
3. **VARIANCE IN TERMS OF CONTRACT: -** Any change made in the contract by debtor and creditor without consent of surety, will discharge the surety from the contract.
4. **NOVATION:** Any new contract entered in by the debtor and creditor in place of the old contract without the consent surety will revoke the liability of the surety.
5. **RELEASE OR DISCHARGE OF THE PRINCIPAL DEBTOR: -** If creditor in the contract release the principal debtor, means he forego the payment from principal debtor, the surety is also been discharged from the contract.
6. **IMPAIRING SURETY‟S REMEDY**:- Any thing done by the creditor which result into loss of remedy available to Surety against Principal debtor, will result into revocation of the guarantee.
7. **LOSS OF SECURITIES**: ***:*** If principal debtor has given something as security for the transaction to the creditor and such security is lost by him, the surety will be discharged from the guarantee up to the amount of value of such security
8. **GUARANTEE OBTAINED BY MISREPRESENTATION**: There must not be any misrepresentation by one party to other in the contract of guarantee. If there is some misrepresentation then the contract of guarantee will not be valid.
9. **GUARANTEE OBTAINED BY CONCEALMENT-:** No party should hide material information related to the contract of guarantee from other party. Material information

means some important information which could have bearing on the contract. In any concealment is there, the surety will be discharged.

10. **FAILURE OF CONSIDERATION**: There must be consideration present in the contract of guarantee. If consideration is missing, the contract of guarantee will be invalid.
11. **LACK OF ANY ESSENTIAL ELEMENT OF CONTRACT:** The contract of guarantee will be valid only if it possesses all the essential characteristics of a valid contract. In such case the Surety will be discharged from his liability.

4.3.6 DISTINCTION BETWEEN A INDEMNITY AND GUARANTEE:

The following are the differences between contract of indemnity and guarantee:

Basis	Contract of Indemnity	Contract of Guarantee
1. Number of Parties	In this contract there are two parties involved that are indemnifier and the indemnified.	In this contract there are three parties involved that are creditor, principal debtor and surety.
2. Number of Contracts	In this there is only one contract between indemnifier and the indemnified.	The contract of guarantee comprise of three sub contracts that are first between principal debtor and creditor, second between cireditors and surety, third between principal debtor and the surety.
3. Nature of Liability	Indemnifier has primary liability and such liability is unconditional.	Surety has secondary liability which occur only on failure of principal debor.
4. Subrogation	Indemnifier does not get the right of subrogation. He cannot sue the third party in his own name.	Surety gets the right of subrogation. He can sue the third party in his own name.
5. Request	In indemnity contract it is not necessary that the indemnifier will act on the request made by the indemnified.	In case of Guarantee, the surety always act on the request made y the principal debtor.
6. Existence of Risk	The liability of indemnifier will only arise on happening of certain event or contingency.	The liability in case of guarantee contract is already existing.
7. Rights of Parties	Indemnifier has no right to file a suit against a third party without any assignment of claim in his favour.	Surety can file suit against the principal debtor immediately he clears the debt towards the creditor.
8. Parties Interests	Indemnifier may have own interest in the contract of indemnity.	The surety has no own interest in the transaction except the guarantee.
9. Purpose	The main objective of the contract of indemnity is to save the indemnity holder from loss due to some event.	The main objective of the contract of guarantee is to save creditor from loss in case of default by debtor.

4.4 TEST YOUR UNDERSTANDING (A)

1. Mark the right answer
   a. There are_____number of contracts in guarantee.
      - Two
      - Three
      - Four
      - Five
   b. Following is not necessary condition for contract of indemnity.
      - It must have essentials of valid contract.
      - It must be legal
      - It must be for saving one party from losses.
      - It must be in writing
   c. In the contract of Guarantee the person who undertakes the guarantee is known as
      - Principal Debtor
      - Creditor
      - Surety
      - Indemnifier
   d. The guarantee given for the minor‘s debt is
      - Valid
      - Voidable
      - Void
      - Illegal
   e. The liability of the surety is
      - Primary
      - Secondary
      - Coextensive
      - Surety has no liability

2. Write True or False
   a. Contract of Insurance is an example of contract of indemnity.
   b. Fidelity guarantee is a continuing guarantee.
   c. A person cannot revoke continuing guarantee.
   d. Continuing Guarantee can be revoked retrospectively.
   e. Co-sureties will share equal burden of guarantee.
   f. Guarantee obtained by concealing material facts is valid.
   g. The release of Debtor by creditor will also release the surety.

3. Write Five difference between Indemnity and Guarantee:

No.	**Indemnity**	**Guarantee**
1.		

2.		
3.		
4.		
5.		

4.5 CONTRACTS OF BAILMENT (SECTION 148-171)

In our daily life, we often see many practices under which one person gives something to another person of his or her purpose and after the said purpose is fulfilled, that item is returned to him, such as a book given to friend to read, to give scooter for service, to give clothes to the tailor for sewing etc. This type of events are called 'Bailment'. Bailment' is also considered to be a special kind of contract under the Contract Act. Sections 148 to 181 of the Indian Contract Act gives special provisions related to Bailment of items.

4.5.1 MEANING AND DEFINITION OF BAILMENT

The delivery of items for some specific purpose by one person to another is called ' Bailment ' in English. This term originated from the French word 'Bailor' which literally means 'to deliver'. But in the legal language, it means 'voluntary transfer of something by one person to another person'.

According to Section 148 of the Indian Contract Act , "If one person delivers goods to another person for a specific purpose on the contract that the goods will be returned on completion of the purpose or will be disposed off as per his order." Then such a contract would be called a Bailment contract. Thus the person who delivers the goods is called 'Bailor' and the person to whom such goods are is called 'Bailee'. For example – Ragini gives cloth to _Mahila Boutique ' for stitching her suit, then the contract between Ragini and _Mahila Boutique is a Bailment contract in which Ragini is a Bailor and _Mahila Boutique is a Bailee.

4.5.2 CHARACTERISTICS OF CONTRACT OF BAILMENT

1. **TWO PARTIES -** There are two parties in agreement Bailment like any other contracts, one who delivers the goods and the other who pick up said goods.
2. **DELIVERY OF GOODS** - Delivery of goods is must in the contract of Bailment. Delivery of goods refers to the transfer of the possession of goods by one person to another person by their will but it is not transfer of ownership. Generally, goods can be supplied in the following three ways.
    - **ACTUAL DELIVERY** - When goods are actually moved from one person to another person's it is called actual delivery. Just like 'Ajay' gives its phone for repair to 'Bihari', it is the real delivery of the goods.
    - **CONSTRUCTIVE DELIVERY** – If goods are already in the possession of person and he agrees to keep the goods with him under Bailment, though no actual delivery take place but still it will be considered as delivery. In this case it is called

Constructive Delivery. For example Radha buys a Sewing Machine from Gupta and leaves it at his shop with the instruction that the machine will be delivered to her house it is Constructive Delivery. Here even though Radha did not give any real delivery to Gupta. Radha would be considered a Bailor and Gupta as Bailee.

- **SYMBOLIC DELIVERY** – Some time goods are very heavy to actually deliver. In such case doing some action that represent transfer of goods is also delivery. Such delivery is known as Symbolic Delivery. For example sale of Car by Ravi to Rajat, in this case handing over keys of car is symbolic delivery.

3. **TEMPORARY PURPOSE** - In Bailment delivery of goods is for a temporary purpose. As Manav gives his mobile for repair to mechanic who will returns it to Manav after repairing the mobile.
4. **TRANSFER OF POSSESSION** –There must be transfer of goods. Merely guarding or taking care of goods cannot be called Bailment in the absence of transfer of goods such as a servant taking care of the goods of his master is not bailment as there is no transfer.
5. **RIGHT OF RETURN OF GOODS** -Bailment delivery of goods is subject to the condition that Bailee has to return the goods after completion of the object for which these are delivered or otherwise dispose off the goods as per instructions of the Bailor.
6. **OWNERSHIP IS NOT TRANSFERRED** - Bailment agreement deals with the transfer of goods, not ownership. Ownership of goods always remains with the Bailor and on the basis of this, he can retrieve his goods.
7. **BAILMENT OF MOVABLE GOODS ONLY** - Bailment can only be of movable property, immovable property, such as houses, land etc. are not covered in Bailement.
8. **MAY NOT BE IN SAME STATE** - Materials to be returned in not necessarily in the same state. There may be change in appearance or form of goods. Like giving cloth for stitching and getting back the suit.

4.5.3 KINDS OF BAILMENT

1. **BAILMENT ON THE BASIS OF CHARGES OR REWARD**
   a) **GRATUITOUS BAILMENT:** In case goods are delivered by one person to another under Bailment without making any charges or payment, it is known as gratuitous bailment.
   b) **NON-GRATUITOUS BAILMENT:** Where the persons involved in bailment charge certain amount, remuneration, or payment, it is called non-gratuitous Bailment.
2. **BAILMENT ON THE BASIS OF BENEFITS**
   a) **BAILMENT FOR THE EXCLUSIVE BENEFIT OF BAILOR:** When goods are transferred under Bailment for the exclusive benefit of the person who is transferring the goos, it is a contract of bailment for the benefit of the bailor. In this case bailee does not gets any benefit from such transfer. For example A given his computer to his friend for uploading some software, who will not charge any amount from A for this service.
   b) **BAILMENT FOR THE EXCLUSIVE BENEFIT OF BAILEE:** It is a transaction in the bailee only will get some benefit and the bailor is not benefitted. For example ‗A' give his computer game to his friend ‗B' who will return the game

after playing. A is not making any charge for this.

c) **BAILMENT FOR THE MUTUAL BENEFIT OF BOTH PARTIES:** It is a transfer of goods under the contact of bailment in which both the parties will get some benefit. For example A has given his computer for repair to mechanic.

3. **BAILMENT ON THE BASIS OF USE**
   a) **BAILMENT FOR SAFE DEPOSIT** - When depository submits goods aimed at protecting goods, it is known as deposit for security. For example, jewelery or other important documents kept in a bank locker.
   b) **BAILMENT FOR USE** - When goods are given for use by one person to other. The delivery is on the condition that the object will be returned to the transferor at the end of the specified purpose or specified time. For example, if Prince gives his Bike to his friend Raghave for one day for going to Chandigar, it will be Bailment for use.
   c) **BAILMENT FOR HIRE** - When such goods are given on rental basis, it is called delivery for hire, for example rental of tent and crockery on marriage.
   d) **BAILMENT BY PLEDGE** - When a debtor assigns the creditor as a pledge anything for the purpose of security of the loan, it iss called Bailment by Pledge.
   e) **BAILMENT FOR REPAIRS** - If an object is assigned by the person for repair, it is called Bailment for repair.
   f) **BAILMENT FOR CARRIAGE** - When an object is delivered to the person fro transport from one place to another, it is called transportation-related Bailment.

4.5.4 DUTIES OF BAILOR

1. **TO DISCLOSE KNOWN DEFECTS IN THE GOODS:** According to section 150, it is the important duty of a Bailor to disclose to the Bailee all the defects which he has knowledge and which impedes the use of the goods by the Bailee or may put him in extraordinary distress while depositing using the goods. If the Bailor does not perform its duty, it will be liable for direct loss to the Bailee due to such defects. If the Bailement of goods is non gratitutious, then the Bailor shall be liable to the Bailee for all such defects which he may or may not have knowledge of. For example, Sharma gives his car to his friend Gupta to drive. The car is unsafe, But Sharma has no idea about it. If Gupta gets hurt due to the car being unsafe, then Sharma will not be responsible for it as he has no knowledge of defect. If Sharma had rented his car, he would have been responsible for Gupta's injury due to the car being unsafe even if he is not having any knowledge of defect.
2. **TO BEAR ORDINARY EXPENSES:** The Bailor is obliged to pay all such necessary expenses as the Bailee may have incurred for the purpose of Bailment. For example, Rahul gives his Horse to Amit to take to his city. On the way, Rahul pays the necessary expenses for fodder for the horse. Amit will be bound to pay the expenses paid by Rahul.
3. **TO BEAR EXTRAORDINARY EXPENSES:** In case of non-gratuitous bailment,

when goods are given by Bailor to Bailee after charging some amount, it is the duty of the Bailee to bear normal expenses. However, in case there are some abnormal expenses, these are to be borne by Bailor. For example it a gives his car to B for going to other city, the expense of petrol etc will be borne by the B. But if there occurs some problem in the car which in not routing type, and B incur some expense on repair, he will get back such amount.

4. **TO INDEMNIFY BAILEE:** In case Bailor has defective title of the goods and due to his defective title Bailee has to incur some loss, it is the duty of the Bailor to indemnify the Bailee. For example it a gives his car to B for going to other city and as the document related to car has some defect, B has to pay some amount as fine. In such case B has right to recover amount from A.
5. **TO RECEIVE BACK THE GOODS:** Bailment is an agreement where goods are given by one party to other for some particular purpose. Once that purpose is complete it is duty of the Bailor to get back such goods. He cannot refuse to take back the goods given by him under the Bailment.
6. **TO BEAR THE RISKS:** Under the Bailment it is duty of the Bailee to take good care of the goods just like he takes care of his own goods. Once it is done by the Bailee, any loss arising to goods due to some reason will be borne by Bailor. For example A give his horse to B under Bailment. Though B took good care of the horse, still horse died. It was held that loss is to be borne by A.

4.5.5 DUTIES OF BAILEE

1. **TO TAKE REASONABLE CARE OF THE GOODS BAILED:** It is the duty of a Bailee to take as much care of the deposited goods as a man of ordinary intelligence does in the same circumstances with his own goods of the same variety and value. If the Bailee has taken such care of the deposited object, he will not be generally liable to lose, destroy or spoil the object. There is no difference between paid and free Bailment from this point of view. If the deposited goods are not so well taken care of by the Bailee, he is bound to compensate the Bailor.
2. **NOT TO MAKE ANY AUTHORIZED USE OF GOODS BAILED:** In accordance with Section 153 it is duty Baille that he must comply fully with the terms of the Bailment Agreement. If the Bailee performs any act in relation to the deposited goods that is against the terms of the Bailement contract, the Bailor may terminate the contract at its will and withdraw the bailed goods. For example, 'A' gives 'B' his car for a personal use and 'B' runs the said car on hire basis, A can terminate the contract.
3. **NOT TO MIX GOODS BAILED WITH HIS OWN GOODS:** Under the Bailment contract it is necessary that the Bailee keep goods he get under Bailment separate from his own goods. He must not mix his own goods with the goods he got on Bailment basis. If he mix the goods, following could be circumstances.
   a) **MIXING OF GOODS WITH BAILOR'S CONSENT:** In case Bailee mix the goods with his own goods with the consent of Bailor, the mixed goods will be distributed among both the parties in ratio of the original goods. For example if A mix 60 Kg. of rice of Bailor with his own rice 40 Kg. with his consent, in such

case the mixed rice will be distributed among Bailor and Bailee in ratio of 60:40 even if there was difference in quality of the goods.

b) **MIXING WITHOUT BAILOR'S CONSENT, BUT GOODS CAN BE SEPARATED:** If the bailee mixes the goods he got on bailment basis with his own goods but no consent was given by the bailor, but goods are of such nature that these can be separated, than it is responsibility of Bailee to get goods separated and any expense or loss on such separation shall be borne by him. **(Section 156)**.

c) **MIXING OF GOODS WITHOUT BAILOR'S CONSENT, GOODS ARE NOT SEPARABLE:** If the bailee mixes the goods he got on bailment basis with his own goods but no consent was given by the bailor and goods are of such nature that these cannot be separated, than it is responsibility of Bailee to compensate the Bailor for any loss incurred by him due to such act of Bailee. For example A mix 60 Kg. of rice valued at Rs. 50 per kg of Bailor with his own rice 40 Kg. valued at Rs. 30 per Kg. with his consent, in such case he shall pay any loss incurred by Bailor due to such mixing. (Section 157).

4. **TO RETURN THE GOODS AFTER ACCOMPLISHMENT OF OBJECTIVE:** It is responsibility of Bailee under the contract act that he must return the goods to the Bailor who has given him the goods after the objective for which goods are given is accomplished or the time period for which goods are lent is over.
5. **NOT TO SET UP ADVERSE TITLE:** The Bailment give right to Bailee for use of good and it does not makes him owner of the goods. So, he cannot his own title or a third party‘s title on the goods which he got on Bailment basis.
6. **TO GIVE BACK ANY ACCRETIONS TO THE GOODS:** In the absence of any contrary contract, if goods are given by Bailor to Bailee and there is some accretion to the goods, such accretion belong to Bailor and not the Bailee. For example A give his cow to B and calf is born to the cow, such calf belong to A and not B.

4.5.6 RIGHTS OF BAILOR

1. **RIGHT TO CLAIM DAMAGES IN CASE OF NEGLIGENCE (SECTION 152):** Every bailee must take normal care of the goods or in case of special contract he must take special care of the goods. But if he fails to do so and due to his negligence goods are lost or destroyed, Bailor has right to claim damages.
2. **RIGHT TO TERMINATE THE BAILMENT(SECTION 153):** Bailee must use the goods bailed to him only as per the instruction given by the bailor. In case he does not use the goods as per the instructions of the Bailor and have some unauthorized use of goods, bailor has right to terminate the bailment.
3. **RIGHT TO CLAIM COMPENSATION FOR UNAUTHORIZED USE OF GOODS (SECTION 154):** If Bailee have some unauthorized use of goods and due to that there is some damage to goods, Bailor can claim compensation for the same.
4. **RIGHT TO CLAIM SEPARATION OF GOODS (SECTION 154):** It is responsibility of bailee not to mix the goods bailed to him with his own goods. In case he mix the goods, Bailor has right to ask Bailee to separate both of the goods.
5. **RIGHT TO CLAIM COMPENSATION WHEN GOODS ARE NOT**

SEPARABLE (SECTION 157): If bailee mix his own goods with the goods of Bailor with his permission and the nature of goods is such that goods cannot be separated, Bailor has right to claim compensation from the bailee for any loss incurred by him due to this.

6. **RIGHT TO DEMAND RETURN OF GOODS (SECTION 158):** In bailment goods are given to bailee for some particular purpose. Once the purpose for which goods are given is over, Bailor has right to ask Bailee for return of the goods.
7. **RIGHT IN CASE OF UNAUTHORIZED RETENTION:** It is the responsibility of bailee to return the goods after the purpose for which goods are bailed is accomplished. If he does not return the goods and due to his unauthorized retention goods are destroyed or deteriorated, Bailor has right to claim compensation from the Bailee.
8. **RIGHT TO FILE A SUIT AGAINST WRONG-DOER:** If there is any wrong doing by the bailee that is against the provisions of the contract, Bailor has right to file the suit against the Bailee.
9. **RIGHT TO CLAIM ANY ACCRETION (SECTION 163):** if goods are given by Bailor to Bailee and there is some accretion to the goods, such accretion belong to Bailor and he has right to claim such accretion.

4.5.7 RIGHTS OF BAILEE

1. **RIGHT TO ENFORCE BAILOR DUTIES:** If bailor does not fulfill his duties under the contract of Bailment, bailee has right to file a suit against the Bailor.
2. **RIGHT TO CLAIM COMPENSATION IN CASE OF FAULTY GOODS (SECTION 150):** It there is some defect in the goods bailed by bailor to the bailee and due to such defect there is some injury to the bailee, he can claim compensation for the same. In case of gratuitous bailment the bailor is responsible for only those defects that were known to him. But in case of non-gratuitous bailment, bailor is responsible whether the defect is known to him or not.
3. **REIMBURSEMENT OF EXPENSES (SECTION 158):** If Bailee incur any expense on the goods bailed to him by the bailor, he can claim reimbursement of such expenses from the Bailor. In case of gratuitous bailment he can claim only ordinary expenses while in case of non-gratuitous bailment he can claim reimbursement for both ordinary as well as extra ordinary expenses.
4. **RIGHT TO BE INDEMNIFIED FOR PREMATURE TERMINATION (SECTION 159):** If in case of gratuitous bailment, if bailor terminate the contract before completion of the bailment and the loss to bailee is more than the benefit derived by him from such bailment, he can claim compensation for the same.
5. **RIGHT TO RECOVER LOSS IN CASE OF BAILOR"S DEFECTIVE TITLE (SECTION 164):** It the right of Bailor over the goods is defective and due to this bailee incur some loss, he can claim compensation for the same from Bailor.
6. **LOSS DUE TO BAILOR"S REFUSAL TO TAKE GOODS BACK (SECTION 164):** It is responsibility of the Bailor to take the goods back after the accomplishment of the objective for which goods are bailed. If he refuse to take the goods back and

there is some loss to bailee, he can claim the compensation from the bailor.

7. **RIGHT TO RETURN THE GOODS TO ANYONE OF THE JOINT BAILERS (SECTION 165):** In case of Joint owner of the goods, bailee must return the goods to the owner which is mentioned in the agreement. But in case of absence of agreement, he can return goods to any of the joint owner.
8. **RIGHT OF ACTION AGAINST THIRD PARTIES:** A bailee must use the goods peacefully and if any third party wrongfully deprive him from this right, he can take action against the third party also even though he is not the owner of the goods bailed.
9. **RIGHT OF LIEN:** In case Bailee has done some work on the goods that needs some labour or skill, he has right of lien over the goods till he receives such payment. For example A gave his mobile to B for repair. Now B has right of lien over the phone till he gets remuneration for repair of the phone.

4.5.8 BAILEE"S LIEN

Right of lien is a special right in which a person who is not the owner of the good can retain the possession of goods until any amount payable to him by the owner of the goods is cleared. For example A gave his mobile to B for repair. Now B has right to keep possession of the phone till he gets remuneration for repair of the phone.This right of B is called right of lien. Lein can be divided into two categories that are particular lien and general lien.

a) **PARTICULAR OR SPECIAL LIEN [SECTION 170]:** Particular lien is available only for those goods against which some amount is due by the bailor to the the Bailee. In this Bailee can keep the possession of that particular item for which amount is due and not the other items of the Bailor. For example, A has given his mobile phone and his watch for repair to B. B has repaired both the items and A has made the payment of repair charges in respect of the mobile phone but failed to pay the repair charges of the watch. In such a case A has right of lien only on the watch in respect of which the remuneration is due. He does not have any right of lien over the mobile phone. Bailee has the right of lien, only if the following conditions are satisfied.
   i. The Bailee has done some work on the goods which involve some labour or skill.
   ii. this work is done by the Bailee as per terms of the contract for bailment.
   iii. The bailee still has possession of the goods bailed to him.
   iv. There is no condition in the contract of bailment that the payment will be made in future.
   v. In case bailee has done the work on credit basis he does not have the right of lien till the credit period allowed is over.
   vi. This right is available to Bailee only if some contrary contract is not there. For example if the contract of bailment bears some condition that Bailee will not be having the right of lien, then such right is not available to the bailee.

b) GENERAL LIEN [SECTION 171]: A general lien is a situation in which Bailee is having the right of lien not only in respect of the goods for which some amount is due, rather he has the right of lien over all the items bailed to him by the Bailor. For example, A has given his mobile phone and his watch for repair to B. B has repaired both the items and A has made the payment of repair charges in respect of the mobile phone but failed to pay the repair charges of the watch. In such a case if A has right of general lien then he can keep possession of both mobile and watch even though the amount related to repair of mobile is already paid by bailor to him. He will have this right until full amount due to him is paid by the bailor. In absence of any agreement, normally a bailee has particular lien only. According to law a few persons only have the right of general lien that include Bankers, Policy brokers, Factors, Wharfinger etc.

Basis	**Particular lien**	**General lien**
Goods	This is available for only those good for which some amount is due by Bailor to the bailee.	It is regarding all the goods of bailor until the whole amount due is cleared by the Bailor.
Entitled person	This lien is available to every type of bailee.	This lien is available to a few bailees only that include Bankers, Policy brokers, Factors, Wharfinger etc.
Nature of exercise	This can be exercised only on those goods for which amount is due.	It can be exercised on all goods that are in the possession of bailee.

4.5.9 FINDER OF LOST GOODS

Sec. 71 of the contract act put some special provisions for the Finder of the Lost goods. Goods of a person are lost and some other person finds such goods, there is no liability of the finder of the goods if he does not pick the goods. But in case goods are picked by him then he becomes finder of the Lost goods as per contract act and is treated as Bailee of the goods. In such cases the Contract Act has given some rights to the finder of the goods but at the same time it has also put some obligations on the finder of the Lost goods. Following are the rights and duties of Finder of the Lost goods in this regard

RIGHTS OF THE FINDER OF LOST GOODS

1. **RIGHT OF LIEN [SECTION 168]:** The finder of the Lost goods has a right of lien over the goods until the owner of the goods make payment to him for the expenses incurred by him in respect to following matters
   a) Any expense incurred to preserve the goods

b) Any expense incurred to find the owner of the goods.

2. **RIGHT TO SUE FOR REWARD [SECTION 168]:** In case some reward is announced by the owner of the goods for finding the goods, the Finder of the lost goods has right to sue the owner of the goods if he refugees to make payment of the reward.
3. **RIGHT TO SELL [SECTION 169]:** Normally the finder of the goods has no right to sell the goods as he is not the true owner of the goods. But in following cases the right to sell the goods is available with the finder of the Lost goods.:
   a) if the finder of the goods fails to find the true owner even after putting diligent efforts; or
   b) The owner of the goods refuse to pay the genuine expenses incurred by finder of the Lost goods on preservation of the goods or on finding the true owner of the goods; or
   c) The goods are of perishable nature and cannot be preserved for long; or
   d) If the expenditure incurred by Finder of the Lost goods already exceeded two third of the value of the goods found by him.

DUTIES AND LIABILITIES OF THE FINDER OF LOST GOODS

1. It is responsibility of the finder to take reasonable care of the goods found by him.
2. Once the true owner is found and he make the payment of expenses incurred by the finder, it is the responsibility of the finder to return the goods to the owner..
3. A finder of the goods cannot use goods for his own purpose.
4. The finder of goods must keep the goods found by him separate and he must not mix such goods with his own goods.
5. In case of some accretion to the goods, the finder must also return such accretion to the owner.
6. The finder must put genuine efforts to find the true owner of the goods.

4.6 TEST YOUR UNDERSTANDING (B)

1. Mark the right answer
   a. Bailment can be done for .
      - Movable goods only
      - Immovable goods only
      - Both movable and immovable goods
      - None of the above
   b. State in which of the following situation the bailment is not termianted.
      - When object is over.
      - When Bailor is declared insolvent
      - When time period of Bailment expired.
      - On death of Bailor
   c. Who has right of General lien.

- Buyer
- Bailor
- Pledger
- Banker

d. Any Accretion of goods belongs to
   - Bailor
   - Bailee
   - Government
   - Both Bailor and Bailee

e. A gives his mobile for repair to B, than B is
   - Pledger
   - Pledgee
   - Bailor
   - Bailee

2. Write True or False
   a. In Bailment there must be actual Delivery of goods.
   b. Putting jewellery in bank locker is Bailment .
   c. The Bailee has general lien.
   d. Founder may sell the goods if his expense exceeds two third of the value of goods.
   e. Founder of owner may sue owner for award.
   f. Gratuitous Bailment is for benefit of both the parties.
   g. In non-gratuitous bailment, bailor is responsible for all the defects that are known to him or not known to him.
3. Write four Rights of Bailor.

No.	**Rights of Bailor**
1.	
2.	
3.	
4.	

4.7 CONTRACT OF AGENCY (SECTION 182-238)

In a contract, normally two parties are involved in the contact. One party makes the offer to the other party and on acceptance of offer by the other party, a contract is made. However, it is not necessary that a person himself must enter into the contract, a person may enter into contract through some other person also. In other words, we can say that if a person may enter into contract on behalf of other person if he is authorised to do so. When a

person enters into a contract through some other person, normally it is said that he has done the contract through his agent. A person for whom contract is done is known as _Principal' and the person who is entering into contract on behalf of principal is known as _Agent '. Section 182 of the Contract Act defines an _agent' as –a person employed to do any act for another or to represent another in dealings with third parties‖.

4.7.1 ESSENTIALS AF A CONTRACT OF AGENCY

1. **EXISTENCE OF AGREEMENT:** The contract of agency can be done only if there is an agreement between the principal and the agent in this regard. It is important to mention here that it is not necessary to have an express contract of agency, this contract may be implied also.
2. **COMPETENCY OF THE PRINCIPAL**: Contract of agency is valid only if the Principal is competent to enter into a contract. In case principal does not fulfill conditions of competent person for entering into a contract, the contract of agency will be void.
3. **ANY PERSON MAY BECOME AN AGENT (SECTION 184):** As for as agent is concerned, there is no condition regarding competency of agent for entering into contract. According to the Contract Act, any person is eligible to be appointed as agent. Even a minor can be appointed as an agent.
4. **NO CONSIDERATION IS REQUIRED TO CREATE AGENCY (SEC. 185):** There cannot be any contract without presence of consideration in the contract. However, the contract of agency is an exception to this rule. The presence of consideration is not necessary for making any person agent of other person.

4.7.2 CREATION OF AGENCY

1. **AGENCY BY EXPRESS AGREEMENT (SEC. 187):** When agency is created by an express contract between the Principal and the agent, it is known as express agency. Law does not provide that such contract must be in written form only. It may be an oral contract also.
2. **AGENCY BY IMPLIED AGREEMENT (SECTION 187):** Sometime there is no express contract of creation of agency, rather agency is created by implied contract between the Principal and the Agent, it is known as Implied agency. Depending on the circumstances many a time Parents, Spouse or the Servant is treated as an agent of the person.
3. **AGENCY BY ESTOPPEL (SECTION 237):** Sometime a person knowingly say to some other person that he is agent but in reality he is not agent. Such conduct is shown by the person willfully by using some words. This is known as Agency by Estoppel. For example A himself said to B that C has appointed him as an agent whereas in reality C has not appointed A as an agent. Now A will be treated as Agent by Estoppel.
4. **AGENCY BY HOLDING OUT:** In many circumstances the conduct of the person is such that it gives impression to other person that he is agent of some person. Though he may not be using any words in such case but his conduct is such that the

impression is created in the mind of other person that he is agent of some person. For example A in presence of B said to C that B is his agent but in reality A has not appointed B as an agent. B does not deny the fact before C. Now B will be treated as agent by Holding out.

5. **AGENCY BY NECESSITY: NORMALLY AGENT IS BEEN APPOINTED BY PRINCIPAL. But s**ometime due to emergency a person is forced to act as an agent of other person. Such agency is known as Agency by Necessity. In this case principal does not appoint the agent rather the person is assumed as an agent. Following are some of the conditions for Agency in necessity.
   - **(a)** This agency is created only in case of emergency on behalf of Principal, in normal situation it cannot be created.
   - **(b)** Circumstances were such that it was not possible for the agent to contact with the Principal.
   - **(c)** The agent in this case must act in bonafide manner in the best interest of the Principal.
   - **(d)** Agent must take reasonable care in this case and must adopt the most practical approach to deal with emergency.
6. **HUSBAND AND WIFE RELATIONS:** There is implied agency between Husband and Wife. Law allows the wife to purchase household necessities on the credit basis from the market and in such case husband is bound to make the payment for the same.
7. **AGENCY BY OPERATION OF LAW:** Sometime agency is not created by the persons himself rather agency is created due to certain provision of the law it is known as Agency by operation of the law. For example in a partnership firm there is a concept of mutual agency and each partner is treated as agent of other partner.
8. **AGENCY BY RATIFICATION:** Sometime a person act as agent of other person without having authority of being agent. But later on his act is approved by the Principal. This is known as Agency by Ratification. For example A made a contract to sell car of B for Rs. 3,00,000 to C, but B never asked A to sell his car. Later on when B came to know about the deal, he approved the deal. It is agency by ratification

4.7.3 SUB-AGENT [SECTION 191]

Sub agent is the person appointed by Agent under the contract of agency and he acts under the control and supervision of the agent. In other words agent of the agent is known as Sub-Agent. According to Contract Act, in following cases sub agent can be appointed:

1. If this appointment is done as per the custom of the trade.
2. Sometime such appointment becomes necessary due to the nature of the business.
3. Sub-Agent can be appointed in such a case where the competency or the discretion is not required for doing the job.
4. Sub agent can be appointed with the permission of the principal.
5. If there is any emergency situation, Sub-Agent can be appointed.

4.7.4 DIFFERENT KINDS OF AGENTS

1. **GENERAL AGENT:** When a person is not appointed as agent for a particular task rather he is responsible for carrying out many acts of Principal, it is called General Agent. For example a servant appointed by a person is his general agent as he is responsible to do number of acts for the principal.
2. **SPECIAL AGENT:** When a person is appointed to perform a particular task, it is known as Special Agent. The authority of agent in this case is restricted to that task only. For example A appointed to B as an agent to sell his car. In this case B is authorized to sell only car of A, he is not authorized to perform any other activity.
3. **UNIVERSAL AGENT:** Universal agent has unlimited authority. All the act done by the Universal Agent are binding on the Principal. Universal agent has authority to act anything on behalf of the Principal.
4. **COMMERCIAL OR MERCANTILE AGENT:** Mercantile agents are appointed for carrying out business transactions of the principal. they are normally responsible for buying and selling of goods or for collection of money from the customers. They can also raise the money on security of the goods. Following are some of the mercantile agents.
5. MA mercantile agent is a person having authority either to sell the goods or to consign the goods or to raise money on the security of goods. Mercantile agents may be of several kinds which are as follows:
   a) **BROKER:** Broker is the person responsible for buying and selling the goods on behalf of the principal. Generally he will be selling the goods on behalf of the principal and in return he will get some amount as Commission or Brokerage. Normally the amount of brokerage depends upon the sales made by him.
   b) **FACTOR:** The main responsibility of Factor is to collect the money from customers. The principal will be selling the goods to customers and the factor is responsible for collecting the sales proceeds from customer. In return he will be getting some commission.
   c) **AUCTIONEER:** The main responsibility of the Auctioneer is to carry out the auction of the goods on behalf to the Principal. He will get commission for auctioning of the goods.
   d) **COMMISSION AGENT:** Commission agent is a broader term. In business terminology this term is used for both Brokers as well as Factors.
   e) **BANKER:** Banks also act as Agent for the customers. As agent they are responsible for collection of funds for the customers, making certain payment, collect dividend etc .
   f) **DEL-CREDERE AGENT:** A del- credere agent gives guarantee to the Principal for collection of funds from the third party. In case of non payment by the third party, loss in not borne by the Principal rather agent bears the loss and in return he is eligible to get certain commission.
6. **NON-MERCANTILE AGENT:** These are the persons who are appointed as agent not for business purpose rather some non business purpose. For example advocate, wife etc

are Non-Mercantile agents of the person.

4.7.5 DUTIES OF AN AGENT

1. **TO CONDUCT BUSINESS AS PER DIRECTIONS OR CUSTOM OF TRADE [SECTION 211]:** The main responsibility of the agent is to work as per the directions given by the principal. As the agent is working on behalf of the principal, he is bound by all the directions given by the principal. In case no direction is given by the principal, the agent must act according to the customs of the trade.
2. **TO ACT WITH REASONABLE CARE, SKILL AND DILIGENCE [SECTION 212]:** It is expected from the agent that he will carry out any act with reasonable care, due diligence and using his skill. agent must take same care when he is acting on behalf of the principal, as he might have taken when he is acting on his own behalf.
3. **DUTY TO RENDER PROPER RECORDS [SECTION 213]:** An agent must render record of all the transactions carried on by him whenever the principal ask him to share such record.
4. **TO COMMUNICATE WITH PRINCIPAL [SECTION 214]:** There is some problem or difficulty, it is responsibility of the agent to have communication with the Principal and obtain instructions from him regarding the problem or difficulty.
5. **DUTY NOT TO DEAL ON HIS OWN ACCOUNT [SECTION 215 & 216]:** When a person is acting as an agent, he must carry out transactions on behalf of principal only and he must not deal on his own account. It is his responsibility to bring all the material facts in the knowledge of principal. In case an agent wants to deal on his own behalf, he must get permission from the principal.
6. **DUTY TO PAY SUM RECEIVED [SECTION 218]:** An agent must render all the payment received by him on behalf of the principal to the Principal. However, out of such amount due, he can deduct any lawful expenditure incurred by him for the agency and he can also deduct the amount of agreed commission as per the Contract.
7. **TO PROTECT AND PRESERVE THE INTEREST [SECTION 209]:** In case of death of the principal or the principal became the person of unsound mind, it is a responsibility of the agent to take all the necessary steps that are required to protect the interest of properties entrusted to him by the principal.
8. **NOT TO DELEGATE AUTHORITY [SECTION 190]:** When a person appoints another person as his agent, it is the responsibility of the Agent not to delegate his authority further. In other words, an agent cannot appoint sub agent without the permission of the principal. However, in case of custom of trade or nature of work is such that needs appointment of sub agent, the sub agent may be appointed.
9. **DUTY NOT TO SET UP ADVERSE TITLE:** If any property is entrusted to the agent by the principal, agent must not create the adverse title of the property without the consent of the Principal.
10. **DUTY NOT TO LEAK THE INFORMATION:** Agent might be getting some information when he is acting on behalf of the principal. It is his responsibility not to share such information to the third party and must maintain secrecy of the information.
11. **DUTY NOT TO MAKE ANY SECRET PROFIT FROM AGENCY**: An agent

must render true account of the funds related to the agency to the principal. He must not make any secret profit out of transactions carried on behalf of the agency.

4.7.6 RIGHTS OF AN AGENT

1. **RIGHT OF RETAINER [SECTION 217]:** An agent can deduct any lawful expenditure incurred by him for the agency and he can also deduct the amount of agreed commission as per the Contract. In case he made any advance to the Principal, he can deduct the amount of advance also.
2. **RIGHT TO RECEIVE REMUNERATION [SECTION 219 & 220]:** In case there is agreement between the Principal and the Agent for payment of some commission by the Principal to the Agent, agent has right to claim such commission. In case of absence of such agreement, the commission will be paid as per the usage of the trade.
3. **RIGHT OF LIEN [SECTION 221]:** An agent has right of lien on any of the goods or property entrusted by Principal to him until any amount payable by principal to him is cleared. Once all the amounts are cleared, his right of lien will be over.
4. **RIGHT TO INDEMNIFICATION [SECTION 222]:** If agent is take due care and diligence, still some loss is incurred by him while doing some act of the agency, it is responsibility of the principal to compensate such loss to the agent.
5. **RIGHT TO BE INDEMNIFIED AGAINST CONSEQUENCES OF FACTS DONE IN GOOD FAITH [SECTION 223]:** If an agent is working in the good faith for the principal and as consequences of the act of agency he got some loss, that loss will be indemnified by the principal. For example A sent some smuggled goods to B and B in good faith sold those goods to C, later B has to pay some penalty for this act. In such case B has right to get compensation from A.
6. **RIGHT TO COMPENSATION [SECTION 225]:** If there is some defect in the goods and due to that defect, agent got some injury, agent has the right to get compensation for such injury.

4.7.7 DUTIES OF PRINCIPAL

1. It is duty of the principal to pay due remuneration to the agent as per agreement. In case of no agreement, remuneration will be paid as per customs of the trade.
2. It is duty of the principal to indemnify the agent for any loss incurred by him when he is acting on behalf of the agency and has take due care and diligence.
3. It is duty of the principal to indemnify the agent for any loss incurred by him when agent is acting in good faith.
4. If there is some defect in the goods and due to that defect, agent got some injury, it is duty of the principal compensate the agent for such injury.

4.7.8 RIGHTS OF PRINCIPAL

1. Principal can demand the accounts of all the transactions carried on by the agent from him.
2. Principal can check whether the agent is carrying out the transactions as per his

instructions. In case no instructions are given by him, than the agent must carry out all the acts as per the usage of trade.

3. In case of negligence of the agent, non exit application of due diligence or care by him, if some loss is incurred by the principal, he can ask the agent to compensate such loss.
4. Whenever there is an difficulty, principal has the right to give instructions to the agent.
5. Principal can clean all the benefits profits earned by the agent when he has carried out any transaction on behalf of the principal..
6. Principal has the right to cancel any transaction in which some material information is concealed by the agent. However, if such transaction is with the third party, then he cannot cancel such transaction.
7. Principal can receive any money collected by the agent from any transaction related to the agency. In such case agent will be authorised to deduct any lawful expenses, Commission aur advance made by him.
8. Principal has right to stop the remuneration of Agent unless the act is completed by him. However, in case of any contrary contract, this right will not be available to the principal.
9. Principal has right to refuse payment of remuneration to the agent in case agent is found guilty of any misconduct.

4.7.9 LIABILITY OF AGENT TO THIRD PARTIES [AGENT PERSONALLY LIABLE]

As agent is entering into the contract not on his behalf rather on behalf of the principal, he is not liable to the third party for performance of the contract. But there are some situations in which agent is personally held liable for the performance of the contract. Following are such situations:

1. **WHERE THE AGENT ACTS FOR A FOREIGN PRINCIPAL [SEC. 230 (L)]:** In case the principal is living abroad and agent enters into a contract on his behalf, it will be personal responsibility of the agent to complete the contract..
2. **WHERE THE AGENT ACTING FOR A PRINCIPAL WHO CANNOT BE SUED [SEC. 230 (2)]:** Some time the position of the principal is that the third party cannot sue him for example a foreign sovereign, person of unsound mind, company before incorporation, the agent will be personally liable for any contract enter on behalf of such principal.
3. **WHERE AN AGENT ACTS FOR A NON- EXISTENT PRINCIPAL:** In case the principal is a fictitious person and agent acts on behalf of such principal, he will be personally liable for the contract.
4. **WHERE THE AGENT ACTS FOR AN UNDISCLOSED PRINCIPAL [SEC. 231]:** Sometime agent does not reveal the name of the principal before the third party and enters into the contract in his own name with the third party, he will be personally liable for the contract..
5. **WHERE THE AGENT EXPRESSLY PROVIDES [SEC. 230]:** It there is any express condition in the contract that agent will personally be held liable for the contract entered into by him on behalf of the principal, he shall be help personally liable for the contract.

6. **WHERE THE AGENCY IS ONE COUPLED WITH INTEREST:** It the agent has some interest in the subject matter of the contract, he will be personally liable for the contract. However, in such case his liability will be limited to his interest in the subject matter only.
7. **WHERE THE AGENT EXCEEDS HIS AUTHORITY:** If agent does not comply with the instructions given to him by the principal and his acts exceeds the authority provided to him by the principal, he will be personally liable for such acts.
8. **WHERE THERE IS TRADE USAGE OR CUSTOM:** Sometime it is usage of trade that agent is personally liable for some acts. In such case it will be personal liability of the agent to perform the contract.
9. **WHERE AN AGENT RECEIVES MONEY BY MISTAKE OR FRAUD:** If third party has made some payment to the agent by mistake or agent has taken some payment from the third party through fraud, it is his personal liability to return such money.
10. **WHERE THE AGENT SIGNS THE NEGOTIABLE INSTRUMENT IN HIS OWN NAME:** An agent must sign negotiable instrument on behalf of his principal by disclosing the fact that signs are on behalf of the principal, if he fails to do so and signs instrument in his own name, he will be personally liable for the same..
11. **PRETENDED AGENT [SECTION 235]:** If a person pretends to be agent of some other person, but in reality he is not the agent, he will be personally liable to compensate the third party for any loss due to his such act.

4.7.10 LIABILITIES OF PRINCIPAL TO THIRD PARTIES

1. **WHERE THE AGENT ACTS WITHIN THE SCOPE OF HIS AUTHORITY [SEC. 226]:** If agent work as per directions given by the principal and does not exceeds his authority, principal will be liable to the third party for any act done by the agent.
2. **WHERE THE ACT WITHIN AGENT'S AUTHORITY IS SEPARABLE FROM THAT WHICH IS BEYOND HIS AUTHORITY (SEC. 227):** If agent does some act which was not in his authority, but his act is separable from what was authorized to him, principal will be liable to third party upto the limit he gave authority to the agent. Beyond that he will not be personally responsible.
3. **LIABILITY OF PRINCIPAL FOR MISREPRESENTATION OR FRAUD OF THE AGENT (SEC.238):** if agent do some fraud or made some misrepresentation to the third party, principal will be liable for such act of the agent provided such act was within the authority of the agent.
4. **WHERE THE AGENT ACTS FOR AN UNNAMED PRINCIPAL:** Sometime agent enters into some act in which he discloses to the third party that he is agent but does not disclose the name of the principal, the principal will be liable for such act of the agent.
5. **RESPONSIBILITY OF PRINCIPAL EVEN WHERE THE AGENT IS PERSONALLY LIABLE:** As discussed earlier in some cases the agent has personal

liability towards the third party. But in such cases the liability of principal also co-exists with the liability of the agents.

6. **BOUND BY NOTICE GIVEN TO AGENT [SECTION 229]:** If some party gives some notice to the agent, it will be assumed that such notice has been served to the principal. In such case principal shall be liable to the third party.

4.7.11 TERMINATION OF AGENCY

1. TERMINATION BY THE ACT OF PARTIES:

A contact of agency can be terminated by the parties with their mutual agency or the one party unilaterally in certain cases. Further in some cases agency can be terminated by the operation of law also.

a) **BY AGREEMENT BETWEEN THE PARTIES:** If both the parties mutually agree to terminate the agency, the agency will be terminated. But in this case all the contracts entered before termination of agency will remain valid.
b) **BY REVOCATION OF AUTHORITY BY THE PRINCIPAL:** Law provides power to the principal to revoke any authority that he has given to the agent. But such revocation can take place only before agent use such authority.
c) **BY RENUNCIATION OF AGENCY BY THE AGENT:** After giving the due notice, renunciation of the agency can take place any time by the principal.

2. TERMINATION BY OPERATION OF LAW:

Some time agency is terminated due to some legal provisions. Following are such situations:

a) **COMPLETION OF THE BUSINESS OF AGENCY:** If agency is created for some specific task and such task is completed, agency will be terminated automatically.
b) **EXPIRY OF TIME:** Some time agency is created for a specific term. Upon completion of that term, agency is automatically terminated. However, if principal wants, he can extend the agency also.
c) **DEATH OR INSANITY OF THE PRINCIPAL OR AGENT:** In case of death of the principal or he becomes person of unsound mind, agency is automatically terminated.
d) **INSOLVENCY OF THE PRINCIPAL:** If any principal is declared insolvent, it will result into termination of the agency.
e) **DESTRUCTION OF THE SUBJECT MATTER:** If the subject matter for which agency is created is destroyed, agency is automatically terminated. For example A appointed B to sell his car but his car is totally destroyed in an accident, in such case agency will be terminated.
f) **DISSOLUTION OF COMPANY:** If the principal is a company, on dissolution of such company, agency is automatically terminated.
g) **PRINCIPAL BECOMING AN ALIEN ENEMY:** In case the principal and agent are from two different countries and due to war with that country, government declared that country as enemy country, agency is automatically terminated.
h) **TERMINATION OF THE SUB-AGENT‟S AUTHORITY:** If a person terminate the agency of the agent, in such case the sub agency will also be terminated.

4.8 TEST YOUR UNDERSTANDING (C)

1. Mark the right answer
   a. Which of following statement is true.
      - Principal must be competent to contract
      - Agent must be competent to contract
      - Both must be competent to contract
      - None must be competent to contract
   b. Which of the following is not the right of Agent.
      - Right to be indemnified.
      - Right of Remuneration
      - Right of Lien
      - Right to resell the goods
   c. What is liability of Del Credere Agent.
      - Purchase of goods
      - Sale of Goods
      - Finding appropriate goods
      - Ensuring collection from debtors
   d. When Agency cannot be terminated
      - Completion of Agency
      - Insolvency of Prinicpal
      - Agent exceeds authority
      - Death of Agent
   e. After revocation of agency
      - Principal is not bound by act done prior to revocation
      - Principal is not bound by acts done after revocation
      - Principal is bound by all acts
      - Principal is not bound for any act.

2. Write True or False
   a. Minor can become Principal but he cannot become agent.
   b. There cannot be any agency possible without consideration .
   c. Agent can go beyond his authority in case of emergency.
   d. Normally sub agent is not under direct control of principal
   e. Agent can never appoint sub agent
   f. Termination of agent automatically results into termination of sub agent.
   g. Agency can be revocated for future acts only

3. State whether following are agents or not?
   a. Servant engaged by Mr. A
   b. Contractor who is constructing of building for Mr. A

c. Wife of Mr. A purchasing household item on credit.
d. Mr. A appointed Mr X to purchase goods for him for 10% commission.
e. Mr. A appointed Mr X to purchase goods for him for without commission.

4.9 LET US SUM UP

- Contract act has some special contracts like indemnity, guarantee, bailment, agency etc.
- In indemnity one party ensure other party to compensate the loss incurred by him.
- There are two parties in indemnity that are indemnity holder and indemnifier.
- In guarantee one party give assurance to other that if third party fails to make the payment, payment will be made by him.
- It has three parties, Creditor, Principal Debtor and Surety.
- Principal Debtor has primary liability.
- The liability of surety is secondary.
- Guarantee may be one time or continuing.
- Continuing .guarantee cannot be revoked retrospectively.
- Fidelity guarantee is for the honesty of the third party.
- In bailment goods are given by one person to other for specific purpose.
- It has two parties Bailor and Bailee.
- Bailment may be gratuitous or non gratuitous.
- Gratuitous bailment is for benefit of one party which may be bailor or bailee.
- In agency one person act on behalf of other known as agent and the person on behalf of whom he is working is known as principal
- Principal must be person who is capable of contract.
- Any person can be appointed as agent including Minor.
- Normally agent has no personal liability to third party but in some cases he has personal liability towards third party.

4.10 KEY TERMS

- **INDEMNITY CONTRACT:** –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".
- **INDEMNIFIER:** Indemnifier is the person who give assurance to other person to compensate his loss like in the example of insurance contract insurance company gave assurance to other party so it is indemnifier.
- **INDEMNITY-HOLDER:** He is the person to who assurance is given under the contract of Indemnity. So in the insurance example policyholder is the Indemnity Holder as he gets the assurance from the insurance company.
- **GUARANTEE CONTRACT:** –A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default.‖
- **SURETY:** Surety is the person who gives guarantee to other person for making the payment in case of default by Principal Debtor.

- **PRINCIPAL DEBTOR**: Principal debtor is the person by whom amount is originally payable under the contract. If he fails to make the payment then surety will be liable to make the payment. It is not necessary that principal debtor must be a person competent to enter into a contract. Even if he is minor, guarantee will be valid.
- **CREDITOR:** The person by whom amount is receivable under the contract is called creditor.
- **SPECIFIC GUARANTEE:** Specific guarantee is the guarantee given for a particular transaction. Normally this guarantee is only for single transaction and the very moment that transaction is complete the guarantee is also over.
- **CONTINUING GUARANTEE:** Continuing guarantee is not for a single transaction rather it is for a series of transaction. This type of guarantee will continue until it is revoked by the surety.
- **RETROSPECTIVE GUARANTEE:** If some transaction has already been carried and guarantee is given at the later stage, it is called retrospective guarantee.
- **PROSPECTIVE GUARANTEE:** If some transaction is yet to be carried and guarantee is given for such transaction, it is called prospective guarantee.
- **FIDELITY GUARANTEE:** This type of guarantee is given for the honesty or good conduct of the person. For example A give employment to B on the guarantee of C, that he will make good any loss arising due to fraud or misappropriation by B. This guarantee is Fidelity Guarantee.
- **CONTRACT OF BAILEMENT:** "If one person delivers goods to another person for a specific purpose on the contract that the goods will be returned on completion of the purpose or will be disposed off as per his order."
- **GRATUITOUS BAILMENT:** In case goods are delivered by one person to another under Bailment without making any charges or payment, it is known as gratuitous bailment.
- **NON-GRATUITOUS BAILMENT:** Where the persons involved in bailment charge certain amount, remuneration, or payment, it is called non-gratuitous Bailment.
- **PARTICULAR OR SPECIAL LIEN [SECTION 170]:** Particular lien is available only for those goods against which some amount is due by the bailor to the the Bailee. In this Bailee can keep the possession of that particular item for which amount is due and not the other items of the Bailor.
- **GENERAL LIEN [SECTION 171]:** A general lien is a situation in which Bailee is having the right of lien not only in respect of the goods for which some amount is due, rather he has the right of lien over all the items bailed to him by the Bailor.
- **AGENT:** –a person employed to do any act for another or to represent another in dealings with third parties‖.
- **AGENCY BY EXPRESS AGREEMENT (SEC. 187):** When agency is created by an express contract between the Principal and the agent, it is known as express agency. Law does not provide that such contract must be in written form only. It may be an oral contract also
- **AGENCY BY IMPLIED AGREEMENT (SECTION 187):** Sometime there is no express contract of creation of agency, rather agency is created by implied contract

between the Principal and the Agent, it is known as Implied agency. Depending on the circumstances many a time Parents, Spouse or the Servant is treated as an agent of the person.

- **AGENCY BY ESTOPPEL (SECTION 237):** Sometime a person knowingly say to some other person that he is agent but in reality he is not agent. Such conduct is shown by the person willfully by using some words. This is known as Agency by Estoppel.
- **AGENCY BY HOLDING OUT:** In many circumstances the conduct of the person is such that it gives impression to other person that he is agent of some person. Though he may not be using any words in such case but his conduct is such that the impression is created in the mind of other person that he is agent of some person.

4.11 REVIEW QUESTIONS

1. Write a detailed note on contract of Indemnity.
2. What is contract of Guarantee? Distinguish between indemnity and guarantee.
3. What are rights and duties of surety.
4. Give different types of guarantees.
5. When surety is discharged from his liability.
6. How guarantee can be revocated?
7. What is Bailment? Give its essential features.
8. Give different types of Bailment.
9. Give rights and duties of Bailor.
10. Give rights and duties of Bailee.
11. What is Bailee‘s Lien. Give different types of lien.
12. How termination of Bailment take place?
13. What are contract of Agency? Give salient features of contract of Agecny.
14. What are different types of Agents.
15. Give different modes of creation of agency.
16. What are rights and duties of agents?
17. What are rights and duties of Principal?
18. Give liability of the agent towards third party.
19. Give liability of the Principal towards third party.
20. Give the method of termination of agency.

4.12 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

1 (a) Three

1 (b) It must be in writing.

1 (c) Surety

1 (d) Valid

1 (e) Secondary

2 (a) True
2 (b) True
2 (c) False
2 (d) False
2 (e) True
2 (f) False
2 (g) True

TEST YOUR UNDERSTANDING -B

1 (a) Movable
1 (b) When Bailor is insolvent.
1 (c) Banker
1 (d) Bailor
1 (e) Bailee

2 (a) False
2 (b) False
2 (c) False
2 (d) True
2 (e) True
2 (f) False
2 (g) True

TEST YOUR UNDERSTANDING -C

1 (a) Principal must be competent to contract
1 (b) Right to resell the goods.
1 (c) Ensuring collection from debtors
1 (d) Agent exceeds the authority
1 (e) Principal is not bound by acts done after revocation

2 (a) False
2 (b) False
2 (c) True
2 (d) True
2 (e) False
2 (f) True
2 (g) True

2 (a) Servant is employee not the agent.

2 (b) Independent contractor is not an agent.

2 (c) Wife purchasing household items on credit is an agent.

2 (d) Mr. X is agent as he is acting on behalf of Mr. A

2 (e) Mr. X is agent as he is acting on behalf of Mr. A whether he is getting commission or not is not necessary.

4.13 FURTHER READINGS

1. M.C. Kuchhal, and Vivek Kuchhal, *Business Law*, Vikas Publishing House, New Delhi.
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3. Aggarwal S K, *Business Law*, Galgotia Publishers Company, New Delhi.
4. P C Tulsian and Bharat Tulsian, *Business Law*, McGraw Hill Education
5. Sharma, J.P. and Sunaina Kanojia, *Business Laws*, Ane Books Pvt. Ltd., New Delhi

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 5 SALE OF GOODS ACT 1930

STRUCTURE

5.1 OBJECTIVES

After reading this chapter, students will able to

- Define the meaning of contract of sale
- Describe essential elements of contract of sale
- Differentiate between sale and agreement to sell
- Explain the meaning of conditions and warranties relating to contract of sale
- Distinguish between condition and warranty
- Know the situations when a condition can be treated as a warranty.
- Describe Express and Implied conditions and warranties.

5.2 INTRODUCTION

Sale of Goods is one of the important types of contract which is regulated by law in India. Initially, it was the part of Indian Contract Act 1872. But later on, it was deleted from the Indian Contract Act and passed as a separate Act. The act came into force on July 1, 1930 and it is applicable to the whole of India except the state of Jammu and Kashmir. Although this law has its provisions related to the sale of movable goods yet it also includes general principles of the Indian Contract Act 1872 such as free consent, the capacity of a person to enter into a contract, consideration, lawful object, etc.

5.3 SALE OF GOODS ACT 1930

5.3.1 MEANING OF CONTRACT OF SALE OF GOODS

As per Section 4 of the Sale of Goods Act 1930,

–A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to a buyer for a price.‖

5.3.2 TYPES OF CONTRACT OF SALE

- **ABSOLUTE SALE**
  When property in goods is transferred from seller to buyer immediately, it is known as an absolute sale. For example, if A goes to a grocery shop of B and buys 10 Kg of Basmati rice and makes payment for it immediately. It is called as an absolute sale.
- **CONDITIONAL SALE**
  When the property in goods is transferred from seller to buyer on some future date after fulfilling some conditions then it is called an agreement to sell. For example, Bharat has a bakery shop. Ram orders a birthday cake to Bharat and Bharat promises to deliver that cake in the evening after preparing it as per the specifications of Ram. It is called a conditional sale.

5.3.3 ESSENTIAL ELEMENTS OF CONTRACT OF SALE OF GOODS

- **TWO PARTIES**
  There must be at least two parties in a contract of sales such as seller and buyer. The seller is the person who sells the goods or promises to sell the goods in future and buyer is the person who buys the goods or promises to buy the goods in future.
- **GOODS**
  Goods must be the subject matter of the contract between buyer and seller. Goods must be of movable nature but it does not include money and actionable claims. Goods can be in form of stock and shares, growing crops, grass, wood etc.

  TYPES OF GOODS

  - **EXISTING GOODS**

  Goods that are in the possession of seller at the time of contract of sale are called existing goods.

Example: Basmati rice available in a grocery store.

TYPES OF EXISTING GOODS

- **SPECIFIC GOODS**

  Goods that are identified and agreed upon at the time of contract of sale are called specific goods.

  EXAMPLE: Pushap wishes to sell a car of a certain model and year of manufacture to Kamal and Kamal agrees to buy at that time. Here, car is an ascertained good with specific model and year of manufacture.

- **ASCERTAINED GOODS**

  Goods that are identified and agreed upon after the contract of sale as per the terms decided between buyer and seller are called ascertained goods.

  EXAMPLE

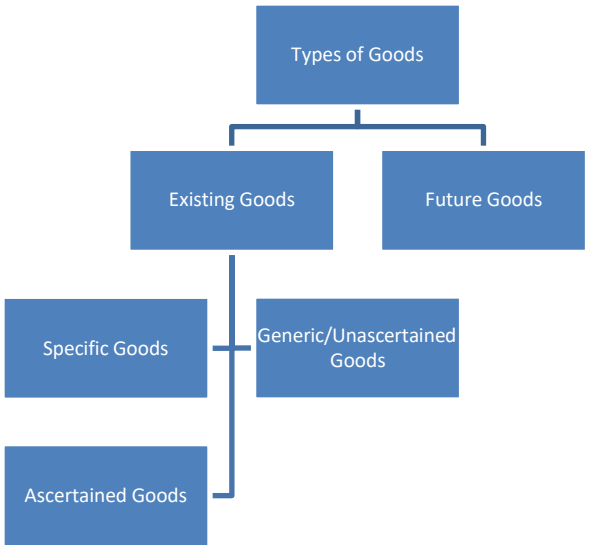
  Ruchi wishes to buy 20 air coolers for his office. Shopkeeper makes a contract with Ruchi to supply 20 air coolers. Ruchi then selects 20 air coolers out of 100 air coolers which are available at the shop of seller. This is called ascertained goods. In other words, goods which are identified after contract of sale is made are called ascertained goods.

  The basic difference between specific goods and ascertained goods is that in case of specific goods, goods are identified by the buyer before the contract of sale is made. Whereas in case of ascertained goods, goods are identified after the contract of sale is made between parties.

- **GENERIC/ UNASCERTAINED GOODS**

  Goods that are not specifically identified but are indicated by description are called generic/unascertained goods.

  EXAMPLE: Krishan goes to a grocery store to buy 10 Kg of sugar. The grocery store has 100 Kg sugar in his container at that time. But the owner of grocery store will give only 10 Kg of sugar to Krishan. In this case, sugar is an unascertained good as it cannot be identified or ascertained.

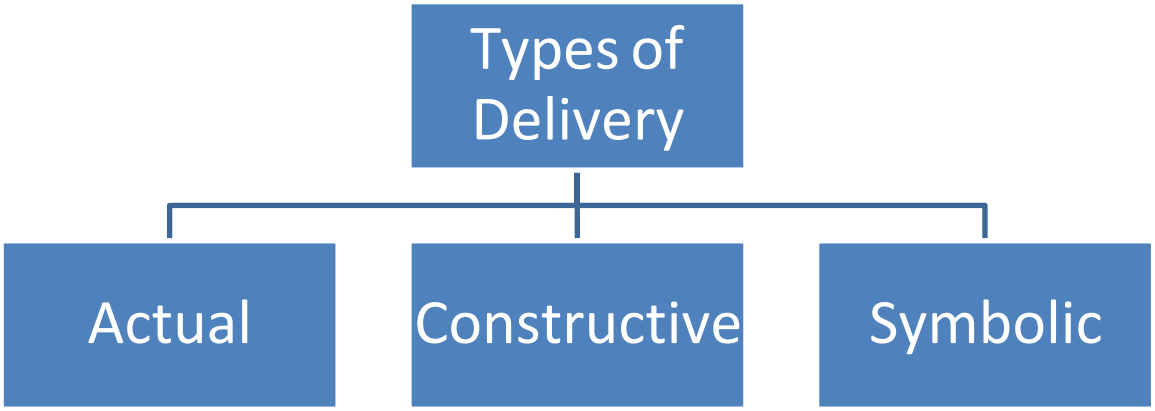


- **FUTURE GOODS (SECTION 2 (6)**

Goods that a seller does not possess at the time of contract of sale are called future goods. These goods are yet to be manufactured or produced by the seller in the future.

EXAMPLE: A sweet shop owner will prepare sweets for his customers on their orders and supplies to them in future.

- **PRICE**
  A price must be decided between the parties in consideration of selling of goods. Without money consideration, the sale is not completed. Goods must be exchanged for a fixed price. Exchanging goods with other goods is not a contract of sale, it is a barter system. But in case the consideration is partly in cash and partly in goods, this forms a valid contract of sale.
  EXAMPLE:
  A seller ready to sell a new mobile to buyer as an exchange offer in which the buyer will give his old mobile to seller and make part payment in cash or by cheque is a valid contract of sale. The price may be fixed by the parties themselves at the time of contract, or by some third party, or may be determined by the parties later based on some circumstances.
- **TRANSFER OF PROPERTY/DELIVERY OF GOODS**
  The transfer of property from seller to buyer must take place. In other words, the possession of goods must be transferred from seller to buyer to complete a contract of sale. Seller can also give authority to third party to receive delivery of goods on his behalf.
  TYPES OF DELIVERY



  - **ACTUAL DELIVERY**
    When possession of goods are actually transferred from seller or his authorized agent to buyer or his authorized agent at the time of sale then it is called actual delivery of goods.
    EXAMPLE: Rabia goes to a shop to buy LED bulb and gets delivery of LED bulb at the same time after making payment of Rs 500.
  - **CONSTRUCTIVE DELIVERY**

When possession of goods is not directly transferred from seller to buyer at the time of sale but ownership of goods is transferred then it is called constructive delivery. Third party is involved in constructive delivery.

EXAMPLE: If Karan gets the delivery of a parcel on behalf of Arjun, it is called constructive delivery.

- **SYMBOLIC DELIVERY**

  When goods are not actually delivered to buyer but he obtains the right to use the goods, it is known as symbolic delivery. Such type of delivery is possible in case of heavy weight goods.

  EXAMPLE: When bulky goods are kept in a warehouse and in spite of transferring these goods physically, seller gives the keys of warehouse to buyer.

- **NATURE OF CONTRACT OF SALE**

  Contract of sale must be absolute or conditional. Absolute contract of sale means that property in goods transfers to the buyer immediately after the contract is completed. Conditional contract means that property in goods will be transferred to the buyer only after fulfilling all conditions.

- **ESSENTIALS OF A VALID CONTRACT**

  This contract must fulfill the essentials of a valid contract as free consent, consideration, lawful object, the capacity of parties to enter into a contract etc.

  EXAMPLE:

  Suppose A wishes to sell a new Air Conditioner to B for Rs. 80, 000. In this example, two parties are involved such as A and B. A is a seller and B is a buyer. The subject matter of the contract is an Air Conditioner. This is a contract of Sale between A and B.

5.4 DIFFERENCES BETWEEN SALE AND AGREEMENT TO SELL

Both are the types of Contract of Sale, yet there are some differences between sale and agreement to sale which are explained as below:

S. No.	Basis of Differences	Sale	Agreement to Sell
1	**Transfer of property in goods**	Property in goods is transferred from seller to buyer immediately at the time of sale.	Property in goods is transferred from buyer to seller after fulfilling some conditions or on some future date.
2	**Nature of Contract**	It is an executed contract. In other words, it is a contract which has been completed now.	It is an executory contract. In other words, it is a contract which has not completed yet.
3	**Right to Resell**	A seller cannot resell the goods as the property in goods is with the buyer.	A seller can resell the goods as the property in goods lies with him. The seller can become

			liable for breach of contract but the subsequent buyer gets the good title.
4	**Risk of Loss**	As the goods are transferred from seller to buyer immediately, the risk of damage of goods is borne by the buyer only.	The risk of loss due to damage of goods is borne by the seller only till the property in goods is transferred from seller to buyer.
5.	**Breach of Contract**	In case of breach of contract by buyer, the seller can ask for the price of goods or damages both.	In case of breach of contract by buyer, the seller can sue for damages only and not for the price.
1.	**Insolvency of Buyer**	If the buyer becomes insolvent, the seller can only recover a proportionate amount from the official receiver for the price of goods. He cannot get back delivery of goods.	If the buyer has not made payment for goods, the seller can refuse transfer of property in goods to the official receiver.
7	**Insolvency of Seller**	If buyer has made payment for the goods to the seller, the buyer has the right to receive the goods from the official assignee.	As ownership of goods has not been transferred to the buyer, the buyer is entitled to only a rateable dividend but not the goods.

TRACK YOUR PROGRESS I

1. What do you mean by Contract of Sale? Explain different types of Contracts of Sale.

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…….

2. Write a detailed note on essential elements of the Contract of Sale.

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……
……..…

3. Discuss the differences between Sale and Agreement to Sale.

……
……
……

4. STATE WHETHER FOLLOWING STATEMENTS ARE TRUE AND FALSE

a). The Sale of Goods Act 1930 deals with the law relating to sale of goods in India.

b). The terms Sale and Agreement to sale are similar and have same meanings.

c). In order to make a valid contract of sale, all the essentials of a valid contract must be fulfilled.

d). The subject matter of contract of sale such as Goods can be of immovable nature.

e). There is difference between transfer of possession of goods and transfer of ownership of goods.

Answers: a. True b. False c. True d. False e. True.

5. FILL IN THE BLANKS

a). A contract of Sale is an_____contract.

b). An agreement to sale is an_____contract.

c). The goods which are identified before the contract of sale are called_____goods.

d). There are two parties in a Contract of Sale_____and_____.

e). Sale of Goods Act was passed in_____.

Answers: a. Executed b. Executory c. Specific d. Seller, Buyer e. 1930

5.5 CONDITIONS AND WARRANTIES

Sometimes seller appreciates his product in front of buyer to sell his product to the buyer. If the statement is not much meaningful then it is just an expression of opinion called a 'puff'. But in case if statement is given by the seller about an important feature of good and the presence of such feature is mandatory for buyer to buy the product then the statement is known as 'stipulations'. In some situations, these stipulations are called conditions and in other situations, they are called Warranties.

EXAMPLE:

If a seller X sells a horse to buyer Y by saying that it is very lucky. If you buy this horse, something good will happen to you. Y buy the horse but nothing good will happen at his house. In this case, Y cannot take any action against X because X's statement was a mere expression of his opinion and does not amount to a stipulation.

5.5.1. MEANING OF CONDITION AND WARRANTY

MEANING OF CONDITION

When a stipulation is mandatory for the contract, it is called a condition. If the condition is not fulfilled by the seller at the time of sale then buyer has the right to cancel the contract and refuse to buy the goods. If buyer has paid some money to seller, then he can recover the amount from the seller for not fulfilling such condition. If buyer has suffered some losses due

to seller's breach of a condition related with good. The buyer has also the right to claim damages from the seller.

EXAMPLE

Sham runs an ice-producing factory. Ram sells a refrigerator to Sham for Rs 1,00,000 by saying that it produces ice quickly. Sham buys the refrigerator on believing this statement. But in reality, the refrigerator does not produce much ice. In this case ice production is an important reason for Sham to buy that refrigerator but this feature is not working in the refrigerator. So Sham has the right to return the refrigerator to Ram or he can claim damages or file a case against Ram for not fulfilling such condition.

MEANING OF WARRANTY

If a stipulation is a subsidiary promise and it is not mandatory for the contract of sale, it is called a warranty. In case of breach of a warranty, the buyer cannot cancel the contract, he can claim only damages.

EXAMPLE

Sunil went to a car dealer Saurav to buy a car. Saurav sells a car to Sunil by saying that the mileage of this car is 20 Km per liter. Sunil buys that car and when he runs this car on road, he found that the maximum mileage of this car is only 15 Km per liter. Sunil went to Saurav for breach of condition. But Saurav explains that it was just a breach of Warranty because no such condition was kept by Sunil in front of Saurav for buying a car. In this case, Sunil can recover only the damages for suffering some losses. He cannot cancel the contract.

5.5.2. DIFFERENCES BETWEEN CONDITION AND WARRANTY

The differences between condition and warranty can be explained as below.

Difference between Condition and Warranty

S. No.	Basis of Difference	Condition	Warranty
1	Meaning	When a stipulation is mandatory for the contract, it is called a condition.	If a stipulation is a subsidiary promise and it is not mandatory for the contract of sale it is called a warranty.
2	Non-fulfillment of Condition/Warranty	If the condition is not fulfilled by the seller at the time of sale then buyer has the right to cancel the contract and refuse to buy the goods. If buyer has paid some money to seller, then he can recover the amount from the seller for not fulfilling such condition.	In case of breach of a warranty, the buyer cannot cancel the contract, he can claim only damages.
3	Option	Breach of the condition can be treated as breach of	Breach of warranty cannot be treated as

		warranty by aggrieved party. But in this case, the party has the right to claim damages only. He cannot cancel the contract.	breach of condition

5.5.3. TREATMENT OF A CONDITION AS A WARRANTY

A condition may be treated as a warranty in the following cases:

- **WAIVER BY THE BUYER**

  If any condition is imposed on sale of goods and it is waived by the buyer then the condition is treated as a Warranty.

  EXAMPLE:

  Buyer goes to a shop to buy detergent powder. With a pack of detergent powder of Rs 100, the condition is that a detergent bar is free. At the time of sale, seller is not able to find free piece of detergent bar and buyer is ready to buy only detergent powder at the same price. In this case, the condition is treated as warranty.

- **ACCEPTANCE OF GOODS BY THE BUYER**
  - **ACCEPTANCE OF WHOLE OF GOODS**

    If a seller does not sell similar goods as per specifications given by the buyer and the buyer accepts the whole of goods without any objection then the condition is treated as a warranty. In that case, buyer cannot return the goods. He can only claim damages.

    EXAMPLE:

    Rashi orders a shopkeeper a red color cotton suit for her. But the shopkeeper delivers a pink color suit and Rashi accepts this pink suit without any objection. In this case, a condition is treated as a warranty. Now in this case, Rashi cannot return the suit. She can claim damages only.
  - **ACCEPTANCE OF THE PART OF GOODS**

    Sometimes a seller does not sell whole of goods and delivers only a part of goods. If these goods are not according to buyer‘s specifications but accepted by him without any objections then there can be two circumstances as follows:
    - If the goods are indivisible, buyer cannot return the other part of goods. He can claim damages only.
    - If the goods are divisible, the buyer can reject those part which he has not accepted yet.

    EXAMPLE:

    A asked B to deliver 100 Kgs of Basmati Rice to him. B delivers 50 kgs of rice to A but those rice were not of Basmati quality. B accepted 50 Kgs of rice but refuse to take delivery of other 50 Kgs of rice on the ground that rice were not of Basmati

quality. A can claim damages for first order of 50 Kgs rice and refuse to take delivery of other 50 Kgs. This is an example of divisible goods.

5.5.4. EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES

A brief explanation of express and implied conditions and warranties are given as follows:

- **EXPRESS CONDITIONS AND WARRANTIES**

  Express conditions and warranties are either in written or oral form. At the time of contract of sale, if some features or conditions are explained by buyer to seller by expressing their views in written or oral form, then these are called ‒express conditions or warranties‖.

  EXAMPLE

  If a Lenovo brand dealer sells a specific model of a laptop to a customer by explaining its configuration and price to buyer and buyer agrees to buy the laptop with the same configuration/ features, then it is an express condition. In this case, the dealer must sell the same laptop to buyer about which he has told to buyer. On the other hand, at the time of selling a ceiling fan of Crompton Brand, if seller gives a warranty for 6 months then it is an express warranty.

- **IMPLIED CONDITIONS AND WARRANTIES**

  Sometimes conditions and warranties are not explained by parties at the time of contract of sale. These are assumed to be incorporated by law in the contract of sale. Such conditions and warranties are called implied conditions and warranties.

IMPLIED CONDITIONS

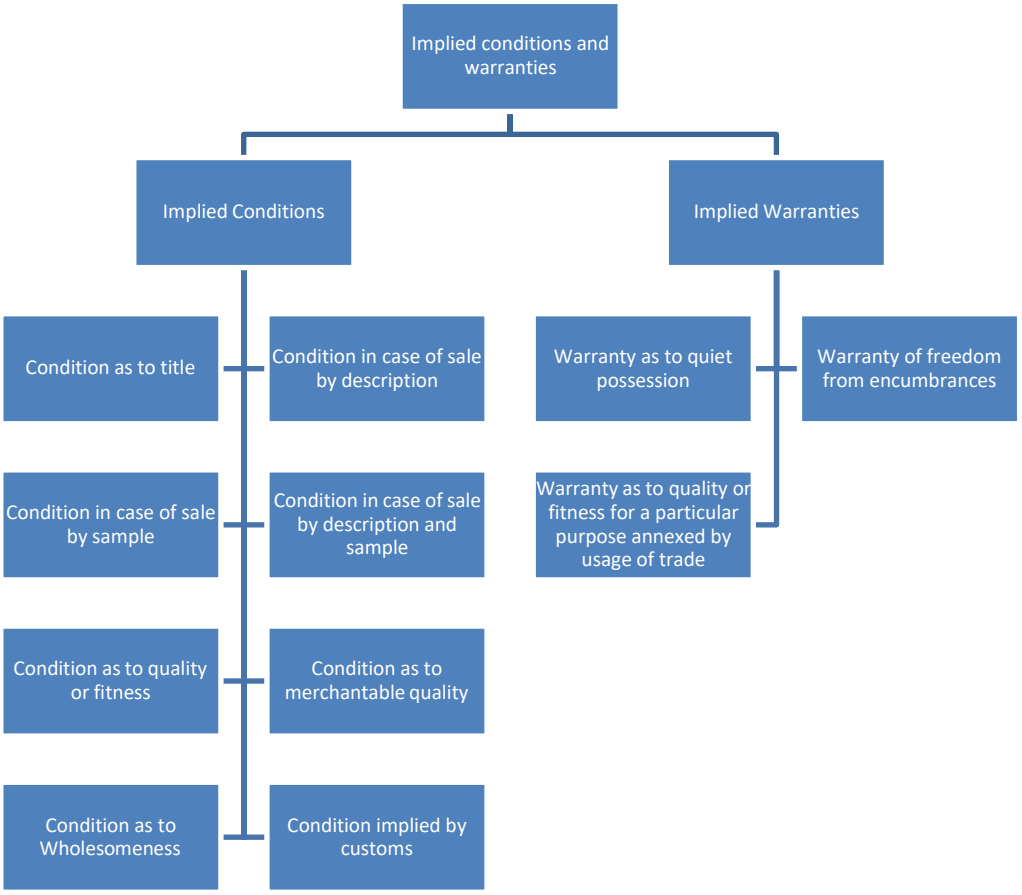
- **CONDITION AS TO TITLE (SECTION 14)**

  As per the Sale of Goods Act, there are implied conditions for every seller that:
  - In case of sale, he has ownership of goods and the right to sell the goods.
  - In case of an Agreement to sale, he will have a right to sell the goods when the property is to pass to buyer.

The buyer on the other hand has the right to return the goods if the title of good is defective.

EXAMPLE:

Amir buys a second-hand car for Rs 5,00,000 from a car dealer. He drives this car for two months. After two months, the original owner of the car came to Amir and claims for his car. He also shows the original documents of the car to Amir. Now as per law, Amir is bound to return car to the original owner. Amir returns the car to the original owner and he can now claims the purchase price of the car from car dealer.



- **CONDITION IN CASE OF SALE BY DESCRIPTION (SECTION 15)**

Sometimes in a contract of sale, goods are also sold by the owner of goods by describing its features to customers. So as per this implied condition, if some description is given by seller to a buyer then goods that are delivered to buyer must match with the description given by the seller. In case goods do not include those features for which description is given, the buyer can return the goods to seller and claim for his money.

EXAMPLE:

A is a seller who has a shop of home decoration material. At the time of selling an electric lamp to customers he explains that the body of the lamp is made of copper metal. But in reality, it was made with iron material. When the electric lamp is delivered to buyer, he did not find the copper body. In this case, he can return the electric lamp to seller as it is not as per description given by seller and claim his money back from him.

- **CONDITION IN CASE OF SALE BY SAMPLE (SECTION 17)**

  Businessmen sometimes also show some goods as sample to customers and then on the basis of sample, they take orders from customers for the bulk quantity of goods. In this case, there is an implied condition that ordered goods must match with sampled goods and buyer must have reasonable time and opportunity to compare sampled goods with ordered goods. In case supplied goods are different from sampled goods, the buyer has the right to return the goods and claim his money back from the seller.

EXAMPLE:

Suresh has a grocery store. Mukesh wishes to buy super quality Basmati rice from Suresh. He goes to a grocery store of Suresh and ask him to show super quality Basmati rice. He also buys 1 Kg super quality Basmati rice from grocery store and cooks those rice. After that, he orders Suresh for 10 Kg of the same super quality Basmati rice as he bought already from his grocery store. But those 10 Kg rice were not correspond with the 1 Kg rice. In this case, Mukesh can return 10 Kg rice to Suresh by saying that the quality of rice does not match with the quality of 1 Kg rice and claim his money back from Suresh.

- **CONDITION IN CASE OF SALE BY DESCRIPTION AND SAMPLE**

If a seller sells the goods to buyer by description as well as by sample then there is an implied condition that bulk of goods must match both with description as well as sample. In case, goods are matched with the sample but not with description or goods corresponds to description but those are not as per sample, the buyer has the right to repudiate the contract and can claim for refund of money.

EXAMPLE:

If a fabric painter shows a colored fabric to customer by claiming that while painting it, eco-friendly colors are used. On this statement, one customer orders 10 pieces of colored fabric. But later on, he found that it is a normal color and not eco-friendly color. As the color does not correspond with description given by fabric painter, the customer has right to cancel the contract and claim a refund.

- **CONDITION AS TO QUALITY OR FITNESS (SECTION 16 (1)**

Under a contract of sale, there is no implied condition as to the quality or fitness for any purpose of goods supplied. But if buyer explains the purpose of buying a product to seller then condition as to quality or fitness will apply. The implied condition as to the reasonable quality or fitness of goods would apply if the following conditions are satisfied:

a. The buyer requires goods for a special purpose.
b. The buyer explain the purpose of buying that good to the seller.
c. The buyer has strong faith in the skill and judgment of the seller.
d. Seller generally deals in those goods. Either he is a manufacturer or trade in those goods.

EXAMPLE:

Ramesh purchased a flask by telling to shopkeeper that he needs a water bottle in which hot water can be stored for 8-9 hours. The shopkeeper sells a flask to Ramesh. But the water will remain hot only for one hour in a flask. A breach of condition as to the quality was thus committed. Hence Ramesh can return that flask to shopkeeper and can claim for refund as well as for damages as he has already explained the purpose of buying a flask to a shopkeeper.

However, if buyer does not explain the purpose of buying a particular good or does not rely upon the skill and judgment of seller then there is no implied condition.

- **CONDITION AS TO MERCHANTABLE QUALITY (SECTION 16 (2)**

This condition is applied only if goods are sold by description by seller to buyer. As per this implied condition, goods shall be of merchantable quality. The ‒Merchantable quality‖ means goods should be free from defects and should be resalable in the market under the particular description by which they are known. In other words, if goods have some defects due to which they cannot be used properly or cannot be sold again to others or goods are such that a reasonable person knowing of their condition would not buy them, such goods lack merchantable quality.

- **CONDITION AS TO WHOLESOMENESS**

In case of the sale of eatables goods, there is an implied condition in a contract of sale that goods shall be wholesome or sound. In other words, the goods should be fit for consumption by human beings.

EXAMPLE:

Sanyam goes to a restaurant and orders a plate of pav bhaji. The pav bhaji was prepared one week before and is not fit for human consumption. But the restaurant owner serves him with stale pav bhaji. Sanyam consumes it and is diagnosed with a stomach infection. Later on, it was found that the major reason for stomach infection was the consumption of stale pav bhaji. In this case, there is a breach of condition as to the fitness of the eatables and the restaurant owner is liable to pay damages to Sanyam in this case.

IMPLIED WARRANTIES

- **WARRANTY AS TO QUIET POSSESSION (SECTION 14B)**

There is an implied warranty in case of a contract of sale of goods that buyer must have quiet possession of the goods. He has right to enjoy quiet possession of goods. In case if any other person has a superior title of goods other than seller, the buyer has a right to claim damages from the seller.

- **WARRANTY OF FREEDOM FROM ENCUMBRANCES (SECTION 14C)**

At the time of buying goods from seller, there is an implied warranty that goods must be free from any charge or encumbrances in favor of any third party. The buyer will not be liable for any charge which was imposed on goods before transferring the possession of goods from seller to buyer and at the time of sale, buyer was unaware of it. In case such a charge arises in near future, buyer can claim damages from seller. However, if seller informs the buyer about such encumbrances/ charges before transferring the possession of goods from seller to buyer then this warranty is not applicable.

- **WARRANTY TO DISCLOSE DANGEROUS NATURE OF GOODS**

Another important implied warranty is that the seller must disclose the dangerous nature of goods to buyer at the time of selling a product.

EXAMPLE:

Sunita went to a chemist shop to buy hand sanitizer. The sanitizer contains 70% alcohol which may catch fire. So seller warns Sunita to keep away this hand sanitizer from fire. Sunita keeps hand sanitizer near the gas stove and suddenly it catches fire and destroys some other products in Kitchen. Now, in this case, she cannot claim damages because seller has already told him about mixing alcohol in hand sanitizer and keep it away from fire.

- **WARRANTY AS TO THE QUALITY OF FITNESS FOR A PARTICULAR PURPOSE ANNEXED BY THE USAGE OF TRADE (SECTION 16(4)**

In case of contract of sale, there is an implied warranty as to quality of fitness for a particular purpose annexed by usage of trade.

TRACK YOUR PROGRESS II

1. What do you understand by Conditions and Warranties in case of contract of sale? Explain differences between Conditions and Warranties.

……
……
……

2. Explain those situations, in which a condition may be treated as a warranty. Give examples to support your answer.

……
……
……

3. Write a detailed note on express and implied Conditions and Warranties in a contract of sale.

……
……
……

4. STATE WHETHER FOLLOWING STATEMENTS ARE TRUE AND FALSE

a. When a stipulation is mandatory for the contract, it is called a condition.

b. There is no implied warranty in case of a contract of sale of goods that buyer must have quiet possession of the goods.

c. If a stipulation is a subsidiary promise and it is not mandatory for the contract of sale it is called a warranty.

d. If goods are bought by description from a seller who deals in goods of such description, there is no implied condition that goods shall be of merchantable quality.

e. The terms Implied conditions and Implied warranties are similar and have same meanings.

Answers: a. True b. False c. True d. False e. False

5. FILL IN THE BLANKS

a. Stipulations in contract of sale are known as_____and_____.

b. A condition is a stipulation which is_____to the main purpose of contract of sale.

c. Conditions and Warranties can be_____or_____.

d. In case of a contract for sale by sample, there is an implied condition that bulk shall _____with the sample.

e. There is an implied warranty in case of a contract of sale of goods that buyer must have quiet_____of the goods

Answers a. Conditions, Warranties b. Essential c. Express, Implied d. correspond

e. possession

5.6. SUMMARY

Sale of Goods Act 1930 protects the interests of consumers in a competitive business environment. This act explains the definition of sale, agreement to sale, essential elements of sale. The act provides information about express and implied conditions and warranties. Besides it also explains actions that customers may take in case of breach of express and implied conditions and warranties. As per this act, if there is any breach of express or implied conditions or warranties then the customer may claim damages. In certain cases, customers can also return goods to seller. The act also explains situations, in which a condition may be treated as a warranty.

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5.9. ANSWERS:

CHECK YOUR PROGRESS I

1. Refer Section 5.3.1 and 5.3.2.
2. Refer Section 5.3.3.
3. Refer Section 5.4.

CHECK YOUR PROGRESS II

1. Refer Section 5.5.1 and 5.5.2.
2. Refer Section 5.5.3.
3. Refer Section 5.5.4.

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 6 TRANSFER OF OWNERSHIP

STRUCTURE

Suggested Reading

Learning Outcomes:

After studying this unit, the learner should be able to:

1. Demonstrate the rules regarding the passing or transfer of property.
2. Understand how sale by non owners is done under Sale of Goods Act 1930.
3. Describe the rules relating to delivery of Goods.
4. Differentiate between Right of Lien and Right of Stoppage in transit
5. Illustrate the rights of a seller against goods and buyer personally.

6.1 INTRODUCTION

Transfer of property means the transfer of ownership of the goods from the seller to the buyer. The transfer of possession is different from transfer of ownership. A person may be in possession of goods but he may not be the owner of the goods. In other words, it can be stated that a buyer is having the ownership of the goods but the seller is in possession of the goods even after sale of the goods and a buyer may have the possession of the goods but the ownership still lying with the seller.

A contract of sale of goods involves transfer of Ownership in three important stages:

1. Passing of Property
2. Delivery of Goods
3. Passing of Risk

Sale of goods basically involves transfer of ownership from seller to buyer. It is very essential to ascertain the time at which the ownership of property or goods passes from the seller to buyer.

SIGNIFICANCE OF THE TIME OF TRANSFER

The general rule is that risk passes with the property. In case, if goods are damaged or lost, the burden of loss will be endured by the person who is the owner at the time when the goods are lost or damaged. When the goods are damaged by the act of third party, it is only the owner who can take the action. Seller can sue for price only when the property has passed to the buyer.

6.2 PASSING OF PROPERTY

Passing or transfer of property constitutes the most important factor to decide legal rights and liabilities of sellers and buyers. Passing of property means passing of ownership. If the property has passed to the buyer, the associated risk in the goods sold is that of buyer and not of seller, though the goods may still be in the seller‘s possession.

The rules regarding the passing of property depend upon the fact whether:

1. The goods are ascertained or
2. The goods are unascertained.

6.2.1 RULES REGARDING PASSING OF ASCERTAINED GOODS (SECTION 19)

When there is a contract for the sale of specific or ascertained goods, the property is transferred to the buyer at such times as the parties to the contract intend it to be transferred **[Section 19(1)].** Thus, the parties are left free to decide about the transfer of property according to their intensions. According to **[Section 19(2)],** intension of the parties can be gathered from:

(i) The terms of the contract
(ii) Conduct of the parties
(iii) Circumstances of the case.

STAGES OF GOODS WHILE PASSING THE PROPERTY

1. **SPECIFIC GOODS IN A DELIVERABLE STATE (SECTION 20):** When the goods are in deliverable state, the goods passes to the buyer immediately as the contract is made. It is immaterial whether the time of payment of the price or the time of delivery of the goods or both is postponed. The following three conditions must be fulfilled for the application of this rule:
   (i) The goods are specific i.e. goods have been identified and agreed upon at the time of making a contract.
   (ii) The contract of sale is unconditional.
   (iii) The goods are in deliverable state.

EXAMPLE: UNDERWOOD V. BURGH CASTLE CEMENT SYNDICATE (1922)

There was a sale of engine. It was to be delivered through railway. When the engine was being loaded on a rail, it got accidently damaged. The buyer refused to take delivery. Held, the buyer could reject the engine because property in engine had not passed to him since the engine was not in a deliverable state.

2. **SPECIFIC GOODS TO BE PUT INTO A DELIVERABLE STATE (SECTION 21):** When 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 that particular thing is done and 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):** When there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the

property does not pass until such act or thing is done and the buyer has notice thereof.

EXAMPLE: In a sale of goat skin, it was the seller's duty to see whether the bales contain the number specified in the contract. Before the seller had done this, the bales were destroyed by fire. The loss fell on the seller. **Zagury Vs Furnell (1809)**

4. **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-

1. When he signifies his approval or acceptance to the seller or does any other act adopting the transaction.
2. If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then
   (a) if a time has been fixed for the return of the goods, on the expiration of such time and
   (b) If no time has been fixed, on the expiration of reasonable time.

Thus, the essence of this rule is that the property passes either by acceptance or by failure to return goods.

In Elphick Vs Barnes case, the buyer took a horse on trial for 8days. The horse died within this time without the fault of the buyer. It was held that the property in the horse had not yet passed to the buyer and therefore, the seller could not recover the price from him.

6.2.2 RULES REGARDING PASSING OF UNASCERTAINED GOODS

Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained **(Section 18).** The contract of sale of unascertained goods is not a sale but an agreement to sell. Thus, the ascertainment of the goods is an essential condition for transforming an agreement to sell into a sale.

FOR THE TRANSFER OF THE UNASCERTAINED GOODS, THE FOLLOWING TWO CONDITIONS MUST BE SATISFIED:

1. The goods must be ascertained **(Section 18).**
2. The goods must be appropriated to the contract **(Section 23).**

6.3 APPROPRIATION OF GOODS

Appropriation of goods involves selection of goods with the intension of using them in performance of the contract and with the mutual consent of the seller and the buyer.

The essentials are:

(a) The goods should confirm to the description and quality stated in the contract.
(b) The goods must be in a deliverable state.

(c) The goods must be unconditionally (as distinguished from an intention to appropriate) appropriated to the contract either by delivery to buyer or his agent or the carrier.
(d) The appropriation must be by seller with the assent of buyer or by buyer with the assent of seller.
(e) The assent may be expressed or implied.
(f) The assent may be given either before or after appropriation.

6.4 RISK PRIMA FACIE PASSES WITH PROPERTY

Section 26 of Sale of Goods Act lays down the general rule that ―Risk Prima Facie‖ (i.e. at first sight) passes with property (Ownership). In other words, Risk always follows ownership. As a general rule, the goods remain at the seller's risk until the property therein is transferred to the buyer. But the moment the property is transferred to the buyer, the risk also passes to the buyer whether the goods are delivered to him or not.

EXCEPTIONS: The exceptions to the general rule ―Risk follows Ownership‖ are as follows:

i. Where the parties have agreed to the contrary, for example, where the seller agrees to deliver the goods at his own risk to the buyer who is at distant place and to whom ownership has passed.
ii. Where the delivery of goods have been delayed either through the fault of buyer or seller. In such circumstances, the goods are at the risk of the party in fault.

CHECK YOUR PROGRESS 1

STATE WHETHER FOLLOWING STATEMENTS ARE TRUE OR FALSE

i) The term 'property in goods' and 'possession of goods' means the same thing.
ii) Seller can file a suit for the price against the buyer only when the property in goods have passed to him.
iii) Risk follows ownership only when goods have been delivered.
iv) Property in goods can pass only in case of ascertained goods.

FILL IN THE BLANKS

(i) According to Section 26 of Sale of Goods Act 1930, Risk always follows _____.
(ii) Passing of property means passing of_____.
(iii) According to **Sec [19(2)],** intension of the parties can be gathered from:
(a)_____
(b)_____
(c)_____
(iv) The two conditions that must be fulfilled for the transfer of the unascertained goods:

(a) _____
(b) _____

6.5 SALE BY NON- OWNERS

According to **Section 27** of the Sale of Goods Act, 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. It gives protection to the buyer. If the title of the seller of the goods is good, the buyer shall get better title. Conversely, if the title of the seller is defective, the title of the buyer shall also be defective. This rule is expressed in the Latin maxim **"Nemo dat quad non habet"** which means that no one can give what he has not got.

EXAMPLE: Mr. A sold a gold ring to Mr. B for Rs 5000. It is known later on that the gold ring was a stolen property. Under the circumstances, the title of the seller (Mr. A) is defective. Therefore, the title of Mr. B is also defective. Mr. B will have to return the gold ring to the real owner although he has purchased the gold ring in full confidence and paid the right price.

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.

6.5.1 EXCEPTIONS:

1. TRANSFER OF TITLE BY ESTOPPEL [(SEC. 27)]

When the true owner of the goods by his conduct or words or by any act or omission leads the buyer to believe that the seller is the owner of the goods or has the authority to sell them, he cannot afterwards deny the seller's authority to sell. The buyer in such a case gets a better title than that of the seller.

EXAMPLE:

1. _O' who is the true owner of the goods, causes the buyer _B' to believe that _S' has the authority to sell the goods. _O' cannot afterwards question the seller's want of title on the goods. 2. _A' was the true owner of goods. _B' the seller told the buyer _C' that the goods belonged to him. _A' was present but remained silent. _C' purchased the goods from _B'. Now A cannot question the title of _C' over the goods.

2. SALE BY A MERCANTILE AGENT [PROVISO TO SEC. 27]

Sale of goods by a mercantile agent gives a good title to the purchaser even in cases where the agent acts beyond his authority, provided the following conditions are satisfied—

(i) The agent is in possession of the goods or of a document of title to the goods.

(ii) Such possession is with the consent of the owner.

(iii) The agent sells the goods in the ordinary course business.

(iv) The purchaser acts in good faith and has no notice that the agent had no authority to sell.

The Expression Mercantile agent means an agent who has authority in the customary course of business:

(a) To sell or buy the goods or

(b) To raise money on the security of goods.

Good faith means honestly, whether done negligently or not.

EXAMPLE: An agent was entrusted a car by the owner for sale at a stated price and not below that. Contrary to the authority the agent sold the car below the reserve price to a bona fide purchaser and misappropriated the proceeds. The plaintiff sued the defendant, (the buyer) to recover the car back from him. It was held though the agent acted without authority, yet the buyer had purchased the car from the mercantile agent in good faith, he had a good title and the plaintiff was not entitled to recover the car.

3. SALE BY ONE OF SEVERAL JOINT OWNERS [SEC. 28]

This section enables a co-owner to sell not only his own share but also of his other co-owners. If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them from such joint owner provided the buyer acts in good faith and without notice that the seller had no authority to sell.

Section 28 lays down three conditions for validating a sale by one of co-owners:—

(a) He must be in sole possession by permission of his co-owners.

(b) The purchaser acts in good faith *i.e*. with honesty.

(c) The purchaser had no notice at the time of the contract of sale that the seller had no authority to sell.

EXAMPLE: A, B & C own certain truck in common. A is in possession of the truck by permission of his co-owners. A sells the truck to X. X purchases bona fide. The property in the truck is transferred to X.

4. **SALE OF GOODS OBTAINED UNDER A VOIDABLE AGREEMENT [SEC. 29]**

When the seller of goods has obtained possession thereof under a voidable agreement but the agreement has not been rescinded at the time of sale, the buyer obtains a good title to the goods, provided he buys them in good faith and without notice of the seller‘s defect of title. It is to be noted that the above section applies when the goods have been obtained under avoidable agreement, not when the goods have been obtained under a void or illegal agreement. If the original agreement is of no legal effect (void *ab-initio*) the title to the goods remains with the true owner and cannot be passed on to anybody else.

EXAMPLE: X fraudulently obtains gold necklace 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 goods title and Y cannot recover the necklace from Z even if the contract is subsequently set aside.

5. SALE BY THE SELLER WHO HAS ALREADY SOLD THE GOODS BUT CONTINUES IN POSSESSION THEREOF [SEC. 30(1)]

Under this exception, a second sale by the seller remaining in possession of the goods will give a good title to the buyer acting in good faith and without notice. Three conditions should be fulfilled under this exception:

(a) The seller must continue in possession of the goods or of the documents of title to the goods as seller. Possession as a hirer or bailee of the goods from the buyer after delivery of the goods to him will not do.

(b) The goods must have been delivered or transferred to the buyer or the documents of title must have been transferred to him.

EXAMPLE: X sold certain goods to Y, but continued to remain in possession of them with the consent of buyer. Thereafter, X sold the goods to Z. Z bought the goods in the good faith and without any notice of prior sale. Held, Z had acquired the good title.

6. SALE BY BUYER IN POSSESSION OF GOODS OVER WHICH THE SELLER HAS SOME RIGHTS [SEC. 30(2)]

This exception deals with the case of a sale by the buyer of goods in which the property has not yet passed to him. When goods are sold subject to some lien or right of the seller (for example for unpaid price) the buyer may pledge, or otherwise dispose of the goods to a third party and give him a good title, provided the following conditions for sale, are satisfied:

(i) The first buyer is in possession of the goods or of the documents of title to the goods with the consent of the seller.

(ii) Transfer is by the buyer or by a mercantile agent acting for him.

(iii)The person receiving the same acts in goods faith and without notice of any lien or other right of the original seller.

EXAMPLE: The Furniture was delivered to X under an agreement that the price was to be paid in two installments, the furniture to become the property of X on payment of the second installment. X sold the furniture before second installment was paid. It was held that the buyer acquired a good title. [Lee v. Butler (1893) 2 Q.B.318].

7. SALE BY AN UNPAID SELLER [SEC. 54]

An unpaid seller of goods can, under certain circumstances, re-sell the goods. The purchaser of such goods gets a valid title of the goods.

8. SALE UNDER THE CONTRACT ACT

(a) A Pawnee may sell the goods of pawner if the latter makes a default of his dues. The purchaser under such a sale gets a good title. [Sec. 176 of Contract Act]

(b) A finder of goods can sell the goods under certain circumstances. The purchaser gets a good title. [Sec. 169 of Contract Act]

(c) Sale by an Official Receiver of Liquidator of the company will give the purchaser a valid title.

CHECK YOUR PROGRESS 2

1. Good Faith means_____
2. ―Nemo dat quad non habet‖ means_____
3. Section 28 lays down three conditions for validating a sale by one of co-owners:—
   (a) _____
   (b) _____
   (c) _____

4. Under Section 54, an unpaid seller of goods can, under certain circumstances, _____ the goods.

6.6 PERFORMANCE OF THE CONTRACT OF SALE (SECTION 31 TO 44)

6.6.1 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 goods. The performance on the part of the seller means that the seller must deliver the goods i.e. handover the possession of goods to the buyer. The seller may deliver the goods before or after transferring the ownership rights in the goods. Until the seller gives the possession of goods, the contract is not said to be performed by the seller. Section 31 states that, it is the duty of the seller to deliver the goods according to the contract of sale of goods.

Delivery of goods is done when one person who has possession of goods transfers the possession of goods to another person. Such transfer of possession is done voluntarily and lawfully.

6.6.2 TYPES OF DELIVERY:-

1. ACTUAL DELIVERY: It means actual physical delivery of the goods to the buyer or his authorized agent by the seller or his authorized agent.

2. SYMBOLIC DELIVERY: When goods are not physically delivered but the means of obtaining possession of goods is delivered to buyer. Symbol is used for delivery. **Example: Handing over of keys of warehouse where goods are safely kept etc.**

3. CONSTRUCTIVE DELIVERY: Third party is involved in delivery. Seller doesn‘t deliver the goods directly. **Example: Seller-----Warehouseman Buyer**

6.6.3 RULES RELATING TO DELIVERY OF GOODS:

(1) PAYMENT AND DELIVERY ARE CONCURRENT (SECTION 32): Payment and delivery are concurrent, which means both should be performed at the same time unless otherwise agreed. Example: Cash sale (this is not applicable for credit sale)

(2) DELIVERY OF GOODS AS AGREED UPON: The seller and buyer mutually decide upon when goods must be delivered, how payment is to be made and when

payment is to be made. As decided mutually, the goods must be delivered according to the terms of the contract.

(3) MODES OF DELIVERY (SECTION 33): Delivery of goods should be in a way which enables the buyer to exercise his control over the goods. In other words, through delivery the goods must be put in the possession of the buyer. Delivery can be:

- Actual Delivery
- Symbolic Delivery
- Constructive Delivery

(4) EFFECT OF PART DELIVERY (SECTION 34): IF the order placed is so big and delivery of goods takes place in parts so when buyer accepts the part delivery then that means, buyer is giving the acceptance to the whole delivery.

(5) BUYER TO APPLY FOR DELIVERY (SECTION 35): The seller is not bound to deliver the goods until the buyer applies for delivery. If the buyer never applied for delivery of the goods and the seller did not deliver the goods, then the buyer cannot hold seller liable for non delivery of goods. But the buyer can sue the seller for non delivery of goods if he had applied for the delivery of goods but the seller was unable to deliver the goods. Moreover, one thing is important that **buyer must apply properly.**

EXAMPLE: The contract of sale provided that the delivery of goods should be made in November on seven days' notice. The buyer gives a notice in early November. Held, the buyer is said to have applied properly and now, if the seller fails to deliver the goods in time, he would be liable for breach of contract**. [Juggemath Khan v. Maclachlan (1881)]**

(6) PLACE OF DELIVERY [SECTION 36(1)]: Place of delivery should be specified by the parties, in case when no agreement is there/ parties are silent about it then place of contract will be considered as place of delivery. Example: If place of contract is factory then place of delivery will also be considered as factory. In other words,:

(i) The goods must be delivered at the place which has been mutually decided between the parties.

(ii) If the parties have not decided upon the place of delivery then, goods should be delivered at the place where they are at the time of contract of sale.

(iii) For future goods, the place of delivery is the place at which they are manufactured or produced.

(7) TIME FOR DELIVERY OF GOODS [SECTION 36(2)]: Delivery should be done within specified time. If no time is specified then delivery should be completed within a reasonable time and reasonable hours.

Example: A contracts to sell and deliver the goods to B in the first week of January. The seller offered to deliver the goods on 4th January but at 9 pm. Held, the delivery of goods was not done at the reasonable hour.

(8) GOODS IN POSSESSION OF THIRD PARTY [SECTION 36(3)]: If goods are in possession of third party like warehouseman/ warehouse keeper then seller needs to acknowledge the sale to third person like warehouseman who will then deliver the goods to buyer.

(9) EXPENSES OF DELIVERY [SECTION 36(5)]: Seller will borne all the expenses to bring the product to deliverable state and for obtaining the delivery, buyer will borne all the expenses. In other words, if the parties have arrived at some agreement with respect to the expenses for putting the goods in deliverable state or the expenses incidental thereto the said agreement will be applicable regarding these expenses. However, the buyer is to bear all the expenses in connection with the receiving of the delivery.

(10) DELIVERY OF WRONG QUANTITY (SECTION 37): The seller is bound to deliver the same quantity of goods to the buyer as contracted for.

(i) **DELIVERY OF LESSER QUANTITY:** In case of short delivery by the seller, the buyer may either accept or reject the goods so delivered.

(ii) **DELIVERY OF LARGER QUANTITY:** In case of excess delivery, buyer may accept the whole goods or reject the whole or he may accept the contracted quantity and reject the excess.

(iii) **DELIVERY OF GOODS MIXED WITH OTHER GOODS:** When the seller delivers the goods contracted for mixed with goods of some different description, the buyer may reject the whole, or he may accept the goods which are in accordance with the contract and reject the remaining goods.

(11) DELIVERY THROUGH INSTALLMENTS (SECTION 38): When the parties to contract mutually agree that the delivery of goods shall be made through installments, then it should be done as agreed upon.

But where nothing was agreed upon for the delivery by installments, then the buyer is not bound to accept the delivery of goods through installments.

EXAMPLE: A buyer agreed to buy 30 articles, to be delivered through ship in the January-February shipment. The seller, however, shipped 20 parcels in February and 10 parcels in March. The buyer rejected the entire 30 parcels. The seller sued the buyer for non-acceptance. Held, the buyer could reject the entire lot as it was never agreed upon to deliver parcels through installments.

(12) 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)]**

(13) DETERIORATION DURING TRANSIT: When 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)**

(14) BUYER‟S RIGHT TO EXAMINE THE GOODS: When goods are delivered to the buyer, who has not earlier examined the goods, he is entitled to a reasonable opportunity of examining them in order to confirm whether they are in conformity with the contract. **(Section 41)**

6.6.4 RULES RELATING TO ACCEPTANCE OF DELIVERY OF GOODS (SECTION 42): Acceptance is deemed to take place when the buyer:

(i) Intimate to the seller that he had accepted the goods or
(ii) Does any act to the goods, which is inconsistent with the ownership of the seller or
(iii) Keeps goods even after the lapse of a reasonable time, without intimating the seller that he has rejected them.

BUYER NOT BOUND TO RETURN REJECTED GOODS (SECTION 43): When 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 he needs to intimate to the seller that he refuses to accept them.

LIABILITY OF BUYER FOR NEGLECTING OR REFUSING DELIVERY OF GOODS (SECTION 44): When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer dies not within a reasonable time after such request take delivery of the goods, he is liable to the seller for any kind of loss occurred by his neglect for taking delivery and also for a reasonable charge for the care and custody of the goods.

CHECK YOUR PROGRESS 3

(a) EXPLAIN VARIOUS TYPES OF DELIVERY.

(b) EXPLAIN DIFFERENT MODES OF DELIVERY.

(c) WHAT ARE THE RULES REGARDING PLACE OF DELIVERY?

6.7 RIGHTS OF AN UNPAID SELLER

An unpaid seller is defined under **Section 45(1)** as:

–The seller of goods is deemed to be an unpaid seller:

(a) When the whole of the price has not been paid.

(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 dishonor 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 41(2)].**

EXAMPLE: X sold goods to Y for Rs 60,000 and received a cheque for a full price. On presenting the cheque to bank, cheque was dishonored by the bank. X is an unpaid seller.

An unpaid seller has been expressly given the rights against the goods as well as the buyer personally which are discussed as under:

6.7.1 RIGHTS OF UNPAID SELLER AGAINST THE GOODS

(1) **SELLER‟S LIEN (SECTION 47):** The unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment has been done, in the following cases:
   (i) Where goods have been sold without any stipulation as to credit.
   (ii) Where the goods have been sold on credit, but the term of credit has expired.
   (iii) Where the buyer becomes insolvent.

Lien can be exercised only for non-payment of the price. Part payment of price cannot terminate right of lien.

PART DELIVERY (SECTION 48): Where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remaining goods unless such part delivery has been made under such circumstances as to show an agreement to waive the lien.

TERMINATION OF LIEN (SECTION 49): The unpaid seller of goods loses his lien:

(a) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
(b) When the buyer or his agent lawfully obtains possession of the goods.
(c) By waiver thereof.

EXAMPLE: The goods which were sold were handed over to the buyer‘s agent who put them on ship. They were landed back and returned to the seller for repacking. While the goods were still with the seller, the buyer became insolvent and seller exercised his lien for the price which was still due. It was held that the seller was not entitled to the lien as he lost the right when the goods were handed over to buyer‘s agent**. (Valpy Vs. Gilbson, 1847)**

(2). 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 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.

(4) If the goods are rejected by the buyer and the carrier 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.

HOW STOPPAGE IN TRANSIT IS EFFECTED (SECTION 52)

(1). The unpaid seller may exercise his right of stoppage in transit either by taking actual possession of goods or by giving notice of his claim to the carrier in whose possession the goods are.

2. When notice of stoppage in transit is given by the seller to the carrier 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.

RIGHT OF LIEN AND RIGHT OF STOPPAGE IN TRANSIT

Basis of difference	**Lien**	**Stoppage in transit**
1. Possession	Actual possession	Possession with carrier.
2. Insolvency	This right can be exercised even if the buyer is not insolvent.	Only when buyer is insolvent.
3. Mode	Right exercised by the seller himself.	Right exercised through a carrier.
4. Termination	As soon as goods go out of possession of the seller.	When buyer acquires the possession.
5. Nature of right	To retain the possession	To regain the possession
6. Commencement	When buyer makes default	When buyer becomes insolvent.

7. Essential element	Seller‘s possession.	Goods in transit.

RIGHT OF RESALE:

The unpaid seller has two important rights, namely, Right of Lien and Right of Stoppage in Transit. In case, he exercises any of his rights, he again gets the possession of the goods which had been sold earlier by him.

The unpaid seller can re-sell the goods under the following circumstances:

(i) Where the goods are of a perishable nature i.e. vegetables, milk and milk products.

(ii) Where the unpaid seller has exercised his right of lien or stoppage in transit and given notice to his buyer of his intension to resell the goods and where the buyer has not within a reasonable time paid or tendered the price.

(iii) Where the seller expressly reserves a right of resale in case the buyer should makes default. No notice of sale is required in this case.

6.7.2 RIGHTS OF AN UNPAID SELLER AGAINST THE BUYER PERSONALLY

In addition to the above mentioned rights of an unpaid seller against the goods, he has certain remedies against the buyer personally, which are given below:

1. **SUIT FOR PRICE:** This can be discussed under two specific conditions:
   (i) **WHERE THE PROPERTY HAS PASSED TO THE BUYER [SECTION 55(1)]:** When the property in the goods has passed to the buyer and the buyer refuses to pay for the goods as per given in the contract, the seller may sue him for the price of the goods.
   (ii) **WHERE PRICE IS PAYABLE ON A SPECIFIC DAY [SECTION 55(2)]:** Sometimes, the contract of sale stipulates that the price is payable on certain day irrespective of delivery but the buyer wrongfully refuses to pay such price. In such a case, the seller may sue the buyer for the price although the property in the goods has not passed and the goods have not been appropriated to the contract.
2. **SUIT FOR DAMAGES FOR NON-ACCEPTANCE OF DELIVERY (SECTION 56):** When the buyer wrongfully refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance of delivery of goods.
3. **SUIT FOR DAMAGES FOR REPUDIATION OF THE CONTRACT:** When either party to a contract repudiates the contract before the date of delivery, the other party to a contract has two options:
   (a) Either treat the contract as subsisting and wait till the date of delivery, or
   (b) Treat the contract as cancelled and sue for the damages for the breach.
4. **SUIT FOR INTEREST:** In the absence of any contract to the contrary, no interest shall be payable by the buyer on the delayed payment. Interest may be recovered only when there is a specific agreement in this respect. If, there is no such agreement, the seller may give notice to the buyer of his intension to charge interest on delayed payment.

6.7.3 RIGHTS OF BUYER AGAINST THE SELLER (SECTION 57 TO 61)

1. **DAMAGES FOR NON-DELIVERY (SECTION 57):** Where the seller wrongfully refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.
2. **SPECIFIC PERFORMANCE (SECTION 58):** Where the seller commits the 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.
3. **SUIT FOR BREACH OF WARRANTY (SECTION 59):** Where there is breach of warranty on the part of seller, the buyer is not entitled to reject the goods only on the basis of such breach of warranty. But he may-

(a) Set up against the seller the breach of warranty in diminution or extinction of the price or

(b) 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 treat the contract as subsisting and wait till the date of delivery or he may treat the contract as cancelled and sue for damages for the breach.
5. **SUIT FOR INTEREST (SECTION 61):** 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 seller from the date on which the payment was made.

AUCTION SALE (SECTION 64)

One of the methods of selling the goods is to sell them by auction. Auction sale means a public sale where intending buyers assemble at one place and offer the price at which they are ready to buy the goods. The offer of the price is generally called 'bid' and the other person who is making the bid is known as the 'bidder'. The owner of the goods may himself sell them by auction or appoints an 'auctioneer' to sell the goods on his behalf. The relationship between the owner of the goods and the auctioneer is that of the principal and agent. The rule of the auction says that the goods are sold to the highest bidder. When goods are to be sold by auction, the auctioneer gives information to the public regarding the time, date and place of sale. The bidders are given an opportunity to inspect the goods. The auctioneer is not bound to sell the goods on the date, time and place announced earlier, he can cancel or postpone the sale and the intending buyers have no right to sue the auctioneer since it was only an invitation. The various rules regarding auction sales are given in Section 64 of the Sale of Goods Act, they are as follows:

i) Where the 'goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale [Section 64(1)].

ii) The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner, for example, by saying "one, two and three".

iii) When the auctioneer announces the completion of the sale, the sale is complete and the property in goods, passes; immediately to the buyer.

iv) Since offers are invited from the public, before the sale is completed, the bidders have a right to withdraw their bid (offer). Until the announcement of the completion of sale is made, any bidder may retract his bid [Section 64(2)].

v) A right to bid may be reserved expressly by or on behalf of the seller. When the right to bid is reserved, the seller or any other person on his behalf may bid at the auction [Section 64(3)].

vi) If a seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer [Section 64(6)].

vii) Puffers are persons employed by the seller for the purpose of raising the price. A puffer has no intention to buy the goods. The seller can appoint only one puffer and not more.

CHECK YOUR PROGRESS 4

1. Under Section 49 of Sale of Goods Act, 1930, the unpaid seller of goods loses his lien in following cases:

(a) _____

(b) _____

(c) _____

2. The unpaid seller has two important rights:

(a) _____

(b) _____

3. When the buyer wrongfully refuses to accept and pay for the goods, the seller may sue him for _____

4. When either party to a contract repudiates the contract before the date of delivery, the other party to a contract has two options:

a. _____

b. _____

LET US SUM UP

The main aim of a contract of sale of goods is to **transfer the property** in terms of goods to the buyer. It should be noted here that property in goods means the ownership of the goods and not the possession of goods. The ownership of goods can pass to the buyer even though the goods have not been delivered or the buyer has not paid the price. It is very important to know the exact time as to when the ownership passes to the buyer because of these reasons: (i) risk passes with the ownership; (ii) right to take action against third party (iii) suit for the price; and (iv) in the event of insolvency of seller or buyer. In case of specific goods, the

ownership passes to the buyer when the parties intend it to pass. When the intention is not clear, following rules shall apply:

i) In case of specific goods in a deliverable state, the property passes immediately when the contract is made.

ii) In case the goods are specific but not in a deliverable state, the ownership passes when they are put in a deliverable condition and the buyer has notice for the same.

iii) When the seller has to do something to the goods to be sold for ascertaining the price, the ownership passes when the seller has done that and the buyer has been informed about this.

Delivery means voluntary transfer of possession of goods from one person to another.

Delivery may be made by doing anything which has the effect of putting the goods in possession of the buyer. Delivery may be actual, symbolic or constructive.

An **unpaid seller** is the one who has not received the full price or if the price is received in the form of a negotiable instrument, it has been dishonored. A seller who has been partly paid is also an unpaid seller.

An unpaid seller has two rights - against the goods and against the buyer personally.

KEY WORDS:

1. **AUCTION:** It is a public sale, where goods are sold usually to the highest bidder.
2. **BID:** It is the price offered by the intended buyer.
3. **Carrier:** One to whom the goods are delivered for transportation to the buyer.
4. **LIEN: A** right to retain possession of the goods until the amount due from another person is received.
5. **PUFFER:** A person who is employed by the seller to raise the price and who has no intention to buy the goods.
6. **RESERVE PRICE:** The price below which the goods are not to be sold.
7. **TRANSIT:** Transit means when the goods are neither in the possession of the seller nor in the possession of the buyer but are with an independent carrier.
8. **UNPAID SELLER:** A seller who has not received the price in full.
9. **GOOD FAITH** means honestly, whether done negligently or not.
10. **"NEMO DAT QUAD NON HABET"** means that no one can give what he has not got.

ANSWERS TO CHECK YOUR PROGRESS 1

TRUE OR FALSE

(i) False
(ii) True
(iii) False
(iv) True

FILL IN THE BLANKS

(i) Property (Ownership)
(ii) Ownership
(iii) (a) Terms of the Contract (b) Conduct of the parties (c) Circumstances of the case.
(iv) (a) The goods must be ascertained (b) The goods must be appropriated to the contract.

ANSWERS TO CHECK YOUR PROGRESS 2

1. **GOOD FAITH** means honestly, whether done negligently or not.
2. **"NEMO DAT QUAD NON HABET"** means that no one can give what he has not got.
3. (*a*) He must be in sole possession by permission of his co-owners.
   (b) The purchaser acts in good faith *i.e*. with honesty.
   (c) The purchaser had no notice at the time of the contract of sale that the seller had no authority to sell.
4. Re-sell

ANSWERS TO CHECK YOUR PROGRESS 3

(a) Refer to 1.6.2
(b) Refer to 1.6.3- point 3
(c) Refer to 1.6.3-point 6

ANSWERS TO CHECK YOUR PROGRESS 4

1. Refer to 1.7.1- Under Termination of Lien.
2. Right of Lien and Right of Stoppage in Transit.
3. Damages for non-acceptance of delivery of goods.
4. Refer to 1.7.2- point 3.

6.8 TEST YOUR KNOWLEDGE

SHORT ANSWER QUESTIONS

1. What do you understand by _Transfer of Ownership'?
2. Risk _Prima facie' passes with the ownership. Comment
3. What are the rules as to passing of property in case of unascertained goods?
4. What is the rule as to place of delivery of goods?
5. Who must bear the expenses of delivery of goods.
6. Define unpaid seller.

LONG ANSWER QUESTIONS

1. Discuss in brief the rules regarding the passing of property in
(a) Ascertained goods
(b) Unascertained goods
(c) Goods sold on approval or on sale or return
2. What are the effects of Part delivery, Installment delivery and delivery of Wrong quantity?
3. What are the rights of unpaid seller against goods and buyer personally?
4. How stoppage in transit is effected? Differentiate between Right of Lien and Right of Stoppage in Transit?
5. _No seller of goods can pass a better title than what he himself has'. Explain what are exceptions to this rule?

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B. COM (HONS.)
(Accounting and Taxation)
SEMESTER II

COURSE: BUSINESS LAW

UNIT 7 – NATURE OF PARTNERSHIP, REGISTRATION OF FIRM AND TYPES OF PARTNERS

STRUCTURE

7.15 Further Readings.

7.0 OBJECTIVES

After studying the Unit, students will be able to

- Understand the Meaning of Partnership.
- Describe Characteristics of a Partnership Firm.
- Explain key differences between Partnership and other forms of business.
- Find various types of Partners and various types of Partnership
- Appraise themselves about need of registration of the firm and consequences of non-registration.
- Understand the position of Minor as a partner in the partnership firm.

7.1 INTRODUCTION:

The need for partnership form of business arose from the limitations of sole-proprietorship. In sole-proprietorship, financial resources and managerial skills were limited and only one man could not supervise or manage all the business activities personally. Also risk bearing capacity of an individual was limited. Therefore, this results into Partnership.

A partnership is a kind of business where a formal agreement between two or more persons is made who agree to be the co-owners, distribute responsibilities for running a business organization and share the profits or losses that the business generates.

The Indian Partnership Act, 1932 governs all aspects and purposes of partnerships in India. The laws relating to partnerships were previously found in Chapter XI of the Indian Contract Act, 1872, which consisted of Sections 239 to 266. The need for new legislation on partnership was felt strongly. This Act is largely based on the English Partnership Act of 1890, with slight changes made to account for Indian conditions.

APPLICABILITY:

This Act applicable to Whole of India.

EFFECTIVE:

The provisions of this Act came with effect from 01.10.1932 except Section 69 which deals with the effect of non-registration. Section 69 of the Act came into effect with effect from 01.10.1933.

7.2 MEANING AND NATURE OF PARTNERSHIP:

As the name suggest, Partnership is a situation where two or more person they join hand to carry out some business together for their mutual benefit. The relation between these persons is of mutual faith as each person act as agent of other person. All the persons in the firm are bound by the act of other persons in the firm. So, It is not necessary that business is to be carried all the persons jointly even any or few persons can manage the business as all persons are acting on behalf of each other, but whosoever will be managing the business, that will be doing on behalf of all the persons. The definition of the Partnership is given in the Section 4 of the Indian Partnership Act.

According to the **Section 4 of the Partnership Act**, –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.‖

So from the definition it is very much clear that all the persons are jointly carrying out some business activity for the mutual profits and business can be managed by all of the persons or few of them on behalf of all the persons. The persons joining the business as owners are known as ‗Partners' and the business that they are carrying is known as ‗Firm'**.**

7.3 FEATURES OF PARTNERSHIP

On analysis of the above definition given under section 4 of the act, we can analyze some important characteristics of the partnership which are as follows:

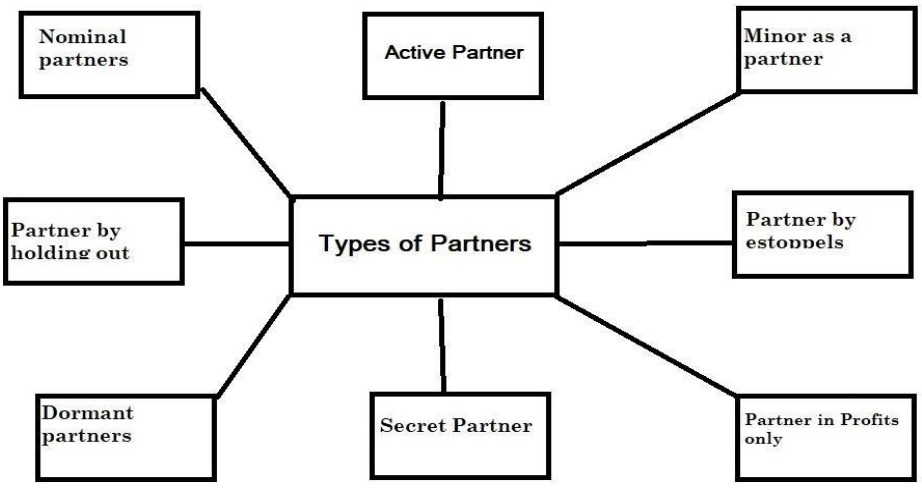
1. **TWO OR MORE PERSONS:** There always contain minimum two persons who are capable of being entering into a contract. One can't form a partnership relation with himself. The number of partners in the partnership firm does not exceed 50. If the number of partners exceeds the specified limit then in such case, it becomes an unlawful association of individuals.
2. **AGREEMENT**: Mere presence of two persons is not enough. Partnership is a sought of relation between the persons. However, this is not the natural relation like Father and Son or Mother and Daughter, rather it is contractual relation. So, whenever two or more persons enter into a contract for jointly carrying out a business activity, the Partnership is formed. However, it is necessary to mention here that it is not necessary that such agreement between the persons must be in writing only, even if two persons enters into an oral agreement, even than partnership is formed. But it is better to have written agreement as it avoids any future conflict. Mere sharing the profit is not enough proof of the partnership there must be joint ownership of the business. For example if a person is giving commission to manager out of profit, manager will not become partner just by sharing profit.
3. **LAWFUL BUSINESS**: A partnership will come into existence only for the purpose of running some lawful business with the motive of earning profits. Mere joint ownership of property is not partnership if some business activity is not there. So, joint ownership of land from which we are earning rent is not. The business must be lawful, if the purpose of the business is to do any Illegal acts such as theft, smuggling, dacoity, etc., the in such case it cannot be called as partnership.
4. **SHARING OF PROFITS:** Another important feature of the Partnership is Profit Motive. If any activity is carried without the profit motive, we may not treat such activity as Partnership. For example few persons join their hand to do some social work. We may not treat them as Partnership as profit motive is missing. Here it is important to mention that profit motive doesn't mean that partner always earn profits only, there could be losses also, but their objective must be to earn the profits.
5. **MUTUAL AGENCY:** The most important feature that give shape to the partnership is mutual agency. All persons in a partnership are principal and agent at the same time.

Each person is agent of other person in the partnership. All the persons in the firm are bound by the act of other persons in the firm. So, It is not necessary that business is to be carried all the persons jointly even any or few persons can manage the business as all persons are acting on behalf of each other, but whosoever will be managing the business, that will be doing on behalf of all the persons.

6. **UTMOST GOOD FAITH:** As in the partnership each person is working on behalf of the other there must be utmost good faith among them. In case the mutual faith and confidence is missing among them, the partnership cannot exist. So, every partner must act in manner most beneficial for the firm as a whole. He must not knowingly carry out any activity that could harm the interest of the firm. Moreover, he must present the true account of all the activities carried on by him without hiding any activity.
7. **UNLIMITED LIABILITY:** The members of the partnership have unlimited liability. It means if there is loss to the firm and assets of the firm are not sufficient to meet such loss, in that case the members need to contribute their personal assets to make such loss good. Here they have joint as well as individual liability. It means every member will contribute his share of loss, but in case personal assets of some member are not sufficient to meet his share of loss than other members should contribute for such loss.
8. **RESTRICTION ON TRANSFER OF INTEREST:** As partnership is mutual relation and trust between the partners, no partner is allowed to transfer his share to some other person unless the consent of all (not majority) is obtained.
9. **JOINT RISK BEARING**: In Partnership, not only the profits but also the losses are shared by the partners jointly. So, it results into minimization of risk as risk is divided among the partners.
10. **LIFE SPAN OF PARTNERSHIP:** The life span of a partnership is not fixed and it depends upon the will of the partners. Whenever a partner wants to leave the business he can do so after doing the formalities required. Further if there is death, insolvency or incapacity of one partner, other partners may continue to run business as per their will by having a new agreement. This situation is called dissolution of Partnership. However, this is not Dissolution of Firm as business is still continuing.

7.4 DIFFERENT TYPES OF PARTNERS:

The different types of partners are as discussed as follows:



1. **ACTIVE PARTNERS:** The partners who actively engaged or participate in the day-to-day operations or activities of the business are called as working or active partners. They contribute capital and are also entitled to share the profits along with liability for the debts of the firm.
   - A partner who is actively engaged in the day to day activities of the business of the partnership firm is known as _active partner‘.
   - When an active partner retires from the partnership firm, he has to give a public notice. Otherwise, in such case he will be held liable on the principle of _holding out‘.
2. **DORMANT PARTNERS:** Those partners who are not involved in to the day-to-day activities of the business firm are called as sleeping or dormant partners. They only contribute money in the business and take the share in the profits or contribute losses (if any) of the business.
   - A _Sleeping partner‘ is one who is not participating day to day activities of the business o.
   - Such partner joins the firm by an agreement and invests capital and shares in the profit of the firm business like the other partners.
   - Dormant partners are not liable for any act if, he/she don‘t give public notice of his retirement from the firm.
3. **NOMINAL PARTNERS:** As the name suggest, these partners only allow the firm to use their name in the business as a partner. However, they don‘t put any money in the business and are not directly involved in the business. They even don‘t participate in day to day activities of the business. They don‘t get any share in profit. However, they are liable to third parties for any act done by other partners as they allowed the firm to use their name and in the eyes of public they are partner of the business.
   - A partner who only lends his name to the business firm but otherwise has no direct interest in the business.
   - He does not contribute to the capital of the firm and is also not getting any profit in the business.

- He is liable to third parties for any act done by other partners as they allowed the firm to use their name and in the eyes of public they are partner of the business.

DIFFERENCE BETWEEN SLEEPING/DORMANT AND NOMINAL PARTNER: A nominal partner is known to the public as partner as firm is using his name as partner, though he has not contribute in the business and also not getting any profit out of the business. On the other hand, a dormant partner though invested funds in the business, getting the profits out of business but is not known to the public as partner.

4. **MINOR AS A PARTNER:** Any person under the age of 18 years is not eligible to become a partner. However, in some circumstances, a minor can be admitted as a partner with certain conditions that:
   - A Minor can be admitted to an existing firm only.
   - Minor can only share in the profit of the firm and doesn‘t share any losses.
   - There must be minimum two major partners in the firm.
   - In case of loss, his liability is limited to the extent of his capital contribution to the business.
5. **PARTNER BY ESTOPPELS:** When a person is not a partner in reality but by his words or by his conduct he shows that he is the partner in the business, such person is called partner by estoppels. represents Here he behaves in such a way that somebody can have an impression that such person is a partner and based on this impression transacts with that firm then that person is held liable to the third party/outsider, then the person who falsely represents himself as a partner is known as partner by estoppels.
   - Person knowingly act in a way that third party gets impression that the person is a partner in the firm.
   - Such representation must occur either by his words or by his conduct.
   - Believing on his representation, the third party dealt with firm or gave credit to the firm.
   - In such case this person though not partner in reality but is liable to the third party.
6. **PARTNER BY HOLDING OUT:** When a person is not a partner in reality but as a partner and he does not deny this even after becoming aware of it, then in such case he becomes liable to the third party who lent money or credit to the firm on the basis of such a declaration. Suppose Mr. A tells Mr. B in the presence of Mr. C that Mr. C is a partner in the firm _Mr. A Enterprises‘. Mr. C is not a partner and does not deny Mr. A‘s statement. Mr. B grants a loan of Rs 60,000 to Mr. A‘s Enterprises on the impression that Mr. C is a partner. Later on the firm is unable to repay the loan. Mr. C becomes liable to Mr. B and here Mr. C is a partner by holding out.
   - A person who is not actually a partner of a firm but knowingly allows himself or herself to be represented as a partner of the firm is known as partner by

holding out.

- Such partner does not take part in the management and other operation/activities of the business.
- Such partner can be held liable for the repayment of the amount of debt extended to the firm due to such representation.

7. **PARTNER IN PROFITS ONLY:** As the name suggest this person is a partner who is like every other normal partner doing all th activities of the business, shares the profits of the business but is not contributing to the losses of the business. Sometime the agreement of the firm provide that person will share profit but will not contribute to the losses of the business, such person is called partner in profits only . However, if any partner who is in ‒partner in profits only‖ deals with any of the third parties/outsiders then he/she will be e liable for the acts of profit only and not any of the liability.
   - He is not allowed to take part in management or any other business activities of the firm.
   - Such kinds of partners are associated with the firm for their goodwill and money.
8. **SECRET PARTNER:** In a partnership, the position of secret partner lies between the active and sleeping/dormant partner. The membership of the firm of a secret partner is to be kept secret from the third parties/outsiders.
   - His liability is unlimited since he holds a share in profit and also shares liabilities for any losses (if any) in the business.
   - He can even take part in business activities or operations.

7.5 TYPES OF PARTNERSHIPS:

According to the nature of the agreement among partners, the following are the different types of partnerships:

7.5.1 ACCORDING TO NATURE: According to the nature of the partnership, we can divide it into two categories:

a. GENERAL PARTNERSHIP: In the absence of an agreement, the provisions given in the Partnership Act 1932 are applicable for general partnerships in which the liability of each partner is unlimited.

- In this partnership, the liability of all partners is unlimited jointly and individually.
- The Registration of the partnership firm is not compulsory.
- All partners can participate in the day to day activities and operations of the business firm.
- Their acts are binding on each other as well as on the partnership firm.
- The partnership ends with the lunacy, death, insolvency, or retirement of the partner.

b. PARTNERSHIP AT WILL: Such partnership exists on the will of the partners,

i.e., it can be brought to an end whenever any of the partners gives notice of his intention to do so. This kind of partnership is formed to run a lawful business for an indefinite period of time.

- This type of partnership exists only at the will of the partners.
- It can continue as long as the partners want to do so. It is terminated when any partner gives notice of dissolution.

7.5.2 ACCORDING TO TERM: On the basis of term for which a partnership is formed we can divide it into two categories:

a. PARTICULAR PARTNERSHIP: Sometime a partnership is formed with the objective of carrying out a particular task, such partnership is known as Particular partnership. This type of partnership is automatically dissolved once the objective for which it is formed comes to an end.

- It is formed for a particular or any specific task.
- Firm remains till the task continues.
- Firm dissolves automatically after completion of that particular task.

b. PARTNERSHIP FOR FIXED TERM: Such a partnership is for a fixed period of time say 3 years, 6 years, or any other duration. It comes to an end automatically at the expiry of the period.

3. ACCORDING TO LEGALITY OF THE BUSINESS: On the basis of legality of the business carried on by the partners, we can divide the partnership in two categories:

a. **LEGAL PARTNERSHIP-** If the partnership is constituted as per the rules laid down in the Partnership Act of 1932 and it is not violating any rules of the country, it is called legal partnership.

b. Illegal Partnership: If the partnership is not constituted as per the rules laid down in the Partnership Act of 1932 or it ist violating any rules of the country, it is called illegal partnership.

4. ON THE BASIS OF LIABILITY:

a. **UNLIMITED LIABILITY PARTNERSHIP:** A partnership in which the liability of the partners is not limited upto amount of capital contributed by them is called unlimited liability partnership. In such case ever the personal assets of the partners will be liable for meeting any loss incurred by the firm. All the partnership firms covered under Indian Partnership Act, 1932 have unlimited liability in India.

b. **LIMITED LIABILITY PARTNERSHIP:** As the name suggest unlimited liability partnership is a partnership in which the liability of the partners is limited upto amount of capital contributed by them. In case of insolvency of firm, partners need not to contribute their personal assets to the firm. In India such firms are covered under the Limited Liability Partnership Act, 2008.

7.6 MINOR AS A PARTNER (SECTION 30)

i. Partnership is based on mutual contract between two or more persons and, therefore, only those persons who possess the capacity to contract can be partners in a partnership firm.
ii. According to the Indian Contract Act, 1872 an agreement by a minor is void ab-initio but he can enter into contract for the benefit only. It means that a minor can be admitted to the partnership only for the profits.
iii. So, a minor cannot become a full fledge or normal partner like any other adult partner; but he can be admitted as a partner in the business firm to the benefits of a partnership. He could have only share in the profits of the firm without contributing to losses.
iv. According to Section 30 of the Act a minor can't become a partner in a firm as he is not capable of entering into a contract, but, with the permission of all other partners, he may be admitted to the benefits of partnership.

7.6.1 RIGHTS OF MINOR PARTNER (SECTION 30):

The following are the rights of a minor partners given under section 30 of the act as under:

1. A minor partner can claim his share in the profits of the business as per agreement..
2. In case he does not get his share, he can sue the other members for payment of his share but in such case he cannot continue as partner he has to severe his relation with the firm.
3. He can have access to, inspect and copy the books of accounts of the firm.
4. On attaining the majority, within 6 months he must decide whether he wants to become a full fledged partner or not. In case he decide to become a partner, then he is entitled to get the share in the profits as entitled as a minor. But in case he does not want to become full fledged member, then he is not liable for any acts of the firm but he must give public notice for the fact that he is discontinuing as partner of the business.

7.6.2 LIABILITIES OF MINOR PARTNER (SECTION 30):

The following are the liabilities of the minor partner before and after attaining majority:

(i) BEFORE ATTAINING MAJORITY:

a) Until the minor partner attains majority, his liability will be confined to the extent of his share in the business only.
b) Its only Minor's capital that is liable for losses, he personally does not have nay liability for the debts of the firm which firm has raised during his minority.
c) A Minor partner cannot be declared insolvent as his risk is limited to his capital only not to his personal estate, however if the firm is been declared insolvent then share invested by him in the firm also vests in the Official Receiver.

(ii) AFTER ATTAINING MAJORITY:

i. Once the minor partner attains majority or he comes to know that he has attained the majority, within 6 months he has to decide whether he want to leave the firm or he wants to continue as a partner.
ii. Where he has decided to leave the frim, then he may give public notice regarding the fact of his leaving the firm. This notice is must and it will decide his relation with the firm and public.
iii. In case he fails to give public notice within 6 months of attaining the majority or getting the knowledge of attaining the majority, he shall be treated as partner and his rights and duties will be same as of full fledge partner.
iv. Such minor partner must also inform the Registrar about his decision of becoming or not becoming the partner.

(a) WHEN HE BECOMES PARTNER:

- Once he decide to become partner, he will be personally liable to outsiders for any act done by the firm or other partner starting from the date when he was admitted as partner for the benefits of partnership.
- Any amount contributed by him as capital and his share of profits will remain intact. That means there will be no change in his capital or profit ration unless some fresh agreement is entered upon.

(b) WHEN HE ELECTS NOT TO BECOME A PARTNER:

- He will enjoy same rights and liabilities that he enjoyed as minor until the date of giving public notice. But such notice can be given maximum within six month. After that he will be assumed as normal partner.
- He will not be liable for any acts done by the other partners or the firm once he gives such notice.
- He has right to sue the other partners or the business firm in case he is not allowed his share of profit or capital in the business.

7.7 DISTINCTION BETWEEN PARTNERSHIP FIRM AND JOINT STOCK COMPANY

Basis	Partnership	Joint Stock Company
Governing Act	The provision of Partnership are covered in the –Indian Partnership Act, 1932.‖	The provision of Comapny are covered in the –Indian Companies Act, 2013.‖
Agency	In a firm, there is the clause of mutual agency of the partners, that is every partner is responsible for the acts of others.	In a company, there is no mutual agency, members are not bound by acts of other members.
Distribution of profits	Any profit earned by the firm is distributed among the members in agreed ratio given in the partnership	Profit is distributed in ratio of their holding.

	deed or in case of no deed, than equally.	
Extent of liability	All partners in a firm has unlimited liability except minor partner.	In a company, the liability of the members in not unlimited rather it is limited upto the amount contributed by them.
Property	Any property owned by the firm is ―joint estate‖ of all the partners.	The property of the company is not joint estate of members, there is separation between company and its members.
Transfer of shares	The partners cannot transfer their share to others in a partnership firm without the consent of the other partners.	No consent is required, shares are transferable.
Management	Business is managed jointly by partners.	Members of a company cannot take direct part in the management of the business operations they participate through voting right by selecting the directors.
Registration	Registration is partnership firm is not mandatory, it depends upon will of the partners.	A company cannot be formed without having a valid registration under the Companies Act.
Winding up	A Partnership firm can be dissolved at any time whenever the partners agree.	A company have separate legal entity so it cannot be wound up just by agreement of the members rather it is wound up by the National Company Law Tribunal(NCLT) when its name is struck off from the Register of Companies.
Number of membership	According to Companies (Miscellaneous) Rules, 2014 the number of partners in a firm cannot exceed 50.	There is no restriction on maximum number of members in a public company but in a private company there may be maximum 200 members.
Duration of existence	Normally duration of firm is less and may be dissolved due to contract between partners, death, insolvency, retirement etc.	Normally company exists for long time and enjoys perpetual succession.

7.8 TEST YOUR UNDERSTANDING (A)

1. State whether following are True or False
    a. Partnership can be formed with a Minor.

b. Business must be carried on by majority of Partners.
c. All partners are liable for any act carried by other partners.
d. There is no restriction on maximum number of partners.

2. Write five differences between Firm and a company :

	Partnership Firm	**Company**
1.		
2.		
3.		
4.		
5.		

3. Recognize the type of Partner by reading the statement given below:

Statement	Type of Partners
a. A has invested money is business getting profit but he is not taking in routine activities of the business.	
b. Z has entered into an existing firm at the age of 17 years.	
c. Z requested his friend A to allow him to use his name as partner in the firm though A will not invest anything in the business and will not be eligible for any profit.	
d. M has invested money in business. Getting profits and also looking after routine business.	
e. W is not a partner with A, but he himself said to X that he is partner with A. On base of W's assertion X lend money to A.	
f. A in the presence of W said to X that W is his partner, though he is not and W does not denied the fact.	
g. W said to A that he is ready to invest money in business and will take part in business also provided that in case of any loss in the business, he will not be responsible. What type of partner W is.	

7.9 REGISTRATION OF PARTNERSHIP

As per provision given in the Partnership Act, 1932 it is not compulsory to register a partnership firm. The firm does not have a separate legal identity and registration will not alter this fact. However, registration is the definite proof of the existence of the firm and its legality. Non-registration of a partnership firm has some real life legal consequences for the partners and the firm itself and it may face some number of disabilities also. So, it is always advisable to draw up a written partnership deed and register the firm with the Registrar of

Firms.

7.9.1 REGISTRATION OF FIRMS (OPTIONAL):

The partnership Act provides for registration of the firm, but it does not make it mandatory for the firm. In simple words there is provision of registration for the firm but it is not compulsory that every firm get itself registered. Though registration is not compulsory under the act but the consequences of not getting registered are very severe which almost makes it compulsory for every firm to get registered without putting any legal compulsion for registration. .

7.9.2 PROCEDURE OF REGISTRATION (SECTION 58):

Registration of a firm may be done at any time i.e., before starting a business or anytime during the continuation of partnership firm. It is always advisable to register the firm since a registered firm enjoys some special rights which are not available to an unregistered firms. The procedure for such a registrations is given as follows:

1. **APPLICATION FOR REGISTRATION**: A Partnership firm can be registered by sending an application in Form No. 1. Along with the form, an amount of requisite fee and a true copy of the partnership deed also needs to be sent to the Registrar. The application must mention about:
   - Name under which firms wants to operate.
   - Nature of business firm wants to carry.
   - Place at which business will be carried.
   - Any other places where business can be undertaken.
   - Date on which each partner joined the business.
   - Full names of all the partners.
   - Address of the partners who joined the business.
   - Duration if any decided by the firm.

   The application for registration must bear signs of all the partners, or it may be signed by authorized agents of the partners..

2. **DOCUMENTS TO BE ATTACHED**: The following documents along with the prescribed fee must be submitted to the Registrar. It includes:
   - Duly filed affidavit
   - Certified and true copy of Partnership Deed
   - Rental or Lease Agreement or proof of ownership of the place of firm business

3. **NAMING A PARTNERSHIP FIRM:** The name of the firm should consider the rules, while choosing a name for the firm. The firm so registered must use brackets and the word (Registered) after its name. However, there is a restriction on selecting the names like:- Crown‘, Emperor‘, _Prime Minister‘, _Government‘, or any other words which gives impression to the public that firm is associated to the government of enjoys some patronage of Government unless Government itself gives its consent

in writing to the use of such words as part of the name of he firm.

4. **FEE FOR REGISTRATION:** According to Section 71 of the Act, the State government is free to make any such rules regarding the fees to be given to the Registrar along with the other documents for registration of the firm.

5. **VERIFICATION OF APPLICATION FOR REGISTRATION:** Registrar will verify all the particulars mentioned in the application form.

6. **ENTRY OF STATEMENT IN A REGISTER:** After the verification is done by Registrar, he makes an entry of the name of the firm in a register maintained by him called the register of firms. This is undertaken after the Registrar is satisfied that all the particulars of the application of registration complies with all the necessary provisions. The date on which the Registrar records and files the Statement is considered as the date of registration of the Partnership firm.

7. **ISSUE OF CERTIFICATE:** After all the above formalities are complete and entry is done in the register, the Registrar will issue a Certificate of Registration.

7.9.3 CHANGE OF PARTICULARS

With a view to keep the Registrar of Firms posted with up-to-date information regarding the particulars of the partnership firm, if any change takes place in any of the particulars given, then it should be notified to the Registrar, who shall thereupon incorporate the necessary change in the Register of Firms.

Further, the Registrar should also be informed when any partner ceases to be a partner by retirement, insolvency or death, or when a new partner is admitted or a minor having been admitted, elects to become or not to become a partner, or when the partnership firm is dissolved.

7.9.4 TIME OF REGISTRATION

The Registration of the firm may take place at any time during the continuance.

7.9.5 CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

The partnership Act provides for registration of the firm, but it does not make it mandatory for the firm. In simple words there is provision of registration for the firm but it is not compulsory that every firm get itself registered. Though registration is not compulsory under the act but the consequences of not getting registered are very severe. Following are the consequences on non-registration.

1. **NO SUIT IN A CIVIL COURT AGAINST THE FIRM OR CO-PARTNERS:** If there is any dispute or any conflict arises among the partners or between a partner and the firm or between a partner and former partners, and the dispute i.e., based upon the rights arising from contract (i.e., partnership deed) or upon the rights conferred by the provision given under the Partnership Act 1932, then partner cannot file a suit for settlement of such disputes if the firm is unregistered. However,

criminal proceedings can be brought by one partner against the other(s). Thus, if a partner steal the assets or any other property of the firm or puts fire to the buildings of the firm, then in such case any partner can prosecute him for the same.

2. **NO SUIT IN A CIVIL COURT AGAINST THIRD PARTY:** In case the third party has breached any contract with the firm or has some dispute with the firm, an unregistered firm cannot bring any suit in the civil court against such defaulting firm. But this provision is not applicable on third party. Their right of suit is not affected by the registration of the firm. So, a third party can bring suit against the unregistered firm.
3. **NO RELIEF TO PARTNERS FOR SET-OFF OF CLAIM:** If a third party sues the firm to recover a sum of money, then the firm cannot claim a set-off, i.e. the firm cannot say that the third party also owes money to the firm and the same should be adjusted against the claim in question. But this provision is not applicable on third party. Their right of set off is not affected by the registration of the firm. So, a third party can claim set off against the unregistered firm.

7.9.6 EXCEPTIONS:

There are certain exception which do not effect whether a firm is registered or not:

1. The third parties has right to sue the firm or any of its partner whether firm is registered or not.
2. The partners can file a suit for the dissolution of the firm or in case dissolution is already done than for the settlement of the accounts, or for realization of the assets when firm is dissolved.
3. Even if the firm is unregistered, the Official Receiver/Assignee or the Court, has the power to realise the property of an insolvent partner or partners and if need arise they can file the suit for the same.
4. Even if the firm is unregistered, suit for a set-off can be filed provided that the value of such suit must not exceed Rs.100 in value.

7.9.7 CONCLUSION:

Registration of a firm is never made compulsory, but it is extremely important part of the Partnership Act, 1932 as it has devoted an entire chapter to it. If a firm does not get itself registered, it may face certain disabilities like it loses the right to sue a third person or its partners in case of any violation of contractual rights. Hence, it is imperative to get the firm registered along with all its partners.

7.10 TEST YOUR UNDERSTANDING (B)

State the consequences in case of unregistered Firm.

1. M/s ABC wants to carry business as partnership firm without registration. W friend of A suggested that they cannot carry business without registration. Is W right.

2. M/s ABC sold goods to Mr. Z who failed to pay money when it becomes due, can M/s ABC file suit against Z.
3. M/s ABC was registered firm. C died and D was admitted in his place but same was not informed to registrar. They sold goods to Mr. Z who failed to pay money when it becomes due, can M/s ABD file suit against Z.
4. M/s ABC sold goods to Mr. Z for Rs. 50,000 who failed to pay money when it becomes due, on other hand Z sold goods for 30,000 to M/s ABC. Can ABC adjust the amount due to Mr. Z against amount due from him.
5. Partner A of M/s ABC got insolvent, can official receiver realise his property.
6. Mr. Z sold goods to M/s ABC who failed to pay money when it becomes due, can Mr. Z file suit against the unregistered firm.
7. M/s ABC sold goods to Mr. Z for Rs. 500 who failed to pay money when it becomes due, on other hand Z sold goods for 100 to M/s ABC. Can ABC adjust the amount due to Mr. Z against amount due from him.
8. Partners A and B are having some dispute. A wants to file suit against B. Is suit maintainable in the court of law.

7.11 LET US SUM UP

- Partnership in India is covered under Indian Partnership Act, 1932.
- Partnership is agreement between two or more persons.
- There is mutual agency of partners in a firm.
- Partners have unlimited liability.
- Partnership can be managed by all the partners collectively or few of them who will manage it on behalf of all the partners.
- There are different types of partners like active partner, sleeping partner, nominal partner, partner in profits only etc.
- Partnership may be general partnership or particular partnership.
- In case of Partnership at will, partner may leave anytime after giving notice to other partners.
- Even a minor can become partner in a existing firm.
- Minor can be partner in the benefits of the firm.
- In case of losses his loss is limited upto capital contributed by him in the firm.
- Registration of the firm is not compulsory, a firm may carry business even without registration.
- However, the consequences of non-registration are very serious.

7.12 KEY TERMS

- **PARTNERSHIP**: Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
- **ACTIVE PARTNERS:** The partners who actively engaged or participate in the day-to-day operations or activities of the business are called as working or active partners.
- **DORMANT PARTNERS:** Those partners who are not involved in to the day-to-day activities of the business firm are called as sleeping or dormant partners. They only

contribute money in the business and take the share in the profits or contribute losses (if any) of the business.

- **NOMINAL PARTNERS:** As the name suggest, these partners only allow the firm to use their name in the business as a partner. However, they don‘t put any money in the business and are not directly involved in the business. They even don‘t participate in day to day activities of the business. They don‘t get any share in profit. However, they are liable to third parties for any act done by other partners as they allowed the firm to use their name and in the eyes of public they are partner of the business.
- **PARTNER BY ESTOPPELS:** When a person is not a partner in reality but by his words or by his conduct he shows that he is the partner in the business, such person is called partner by estoppels. represents Here he behaves in such a way that somebody can have an impression that such person is a partner and based on this impression transacts with that firm then that person is held liable to the third party/outsider, then the person who falsely represents himself as a partner is known as partner by estoppels.
- **SECRET PARTNER:** In a partnership, the position of secret partner lies between the active and sleeping/dormant partner. The membership of the firm of a secret partner is to be kept secret from the third parties/outsiders.
- **LLP AGREEMENT:** Whenever any LLP is formed, the partners of LLP enters into agreement with each other, that agreement is called LLP agreement. Limited Liability Partnership (LLP) Agreement is very important and in a way we can say it is charter of the LLP. The rights and duties of the partners of LLP are decided by this agreement.
- **PARTNERS AND THEIR RELATIONS:** The partners of the LLP are not the mutual agent of each other and are responsible for own acts only.

7.13 REVIEW QUESTIONS

1. What is Partnership? Give its merits and limitations.
2. Give salient features of Partnership
3. Distinguish between Partnership and a Joint Stock Company.
4. Who is a Partner. Give different types of Partners.
5. Explain different types of Partnership.
6. Write about position of Minor as a partner in a firm.
7. Explain the rules applicable once Minor got the majority in partnership firm.
8. What is Registration of firm. Give procedure of Registration.
9. Is registration compulsory for a firm? Give consequences of non registration of the firm.

7.14 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

1 (a) False, Minor cannot form a partnership, he can be admitted to existing firm only

1 (b) False, any partners can manage business on behalf of all partners.

1 (c) True.

1 (d) True.

1 (e) False, as per Companies (Miscellaneous) Rules, 2014 maximum number of partners could be 50.

3 (a) Sleeping or Dormant Partner

3 (b) Minor Partner

3 (c) Nominal Partner

3 (d) Active Partner.

3(e) Partner by Estoppel

3 (f) Partner by Holding Out

3 (g) Partner in Profits only

TEST YOUR UNDERSTANDING -B

1. W is wrong, unregistered firm can carry on business.
2. M/s ABC cannot file suit against Z as unregistered firm cannot file suit against third party.
3. After death of C with admission of D there is change in partnership and as new partnership is not registered with the registrar, they cannot file suit against Z.
4. Unregistered firm cannot adjust claim against third party exceeding Rs. 100. As in this case amount is Rs. 30,000 M/s ABC cannot adjust the same without consent of Z.
5. Official Receiver has right to realize assets of partner of unregistered firm.
6. Third party has right to file suit against unregistered firm. So, Z can file suit against the firm.
7. Unregistered firm cannot adjust claim against third party exceeding Rs. 100. As in this case amount is Rs. 100 M/s ABC can adjust the same without consent of Z.
8. Partners of unregistered firm cannot file suit against each other.

7.15 FURTHER READINGS

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B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 8 – RIGHTS AND DUTIES OF PARTNERS, DISSOLUTION OF PARTNERSHIP FIRM

STRUCTURE

7.0 OBJECTIVES

After studying the Unit, students will be able to

- Understand Rights available to partners in a firm.
- Describe various liabilities of the Partners.
- Find out various authorities of partners that are implied under the act..
- Define the meaning of Partnership Deed.
- Make out a partnership Deed of Partnership firm.
- Appraise themselves about rights and duties of incoming and outgoing partner.
- Understand the meaning and reasons of dissolution of partnership firm.
- Know the consequences of Dissolution of firm.

8.1 RIGHTS OF PARTNERS:

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

1. **RIGHT TO TAKE PART IN MANAGEMENT [SECTION 12(A)]**: It is the right of every partner to take part in the management and day-to-day business activities of the firm business. This right is available to all partners unless they may provide by a contract, that this right shall not be available to some partners.
2. **RIGHT TO BE CONSULTED [SECTION-12(C)]**: Every partner enjoys the right of being consulted in all matters related to the business that could have effect on the business firm. However, every partner also has the right to express his/her opinion before any decision is taken by other partners. In case of any difference of opinion, then such matter will be settled by the majority of partners in case of an ordinary matter. But in case of fundamental matter, then it is to be settled by the consent of all of partners the partners i.e. unanimous consent.
3. **RIGHT TO HAVE ACCESS TO BOOKS [SECTION 12(D)]:** Every partner has the right to examine all the records, books of accounts of the partnership firm. Moreover, he/she can also have the copy of such records, books of accounts etc. However, this right is subject to a contract between the partners i.e., the partner may agree, by a contract that this right shall not be available to some of the partners.
4. **RIGHT TO SHARE PROFITS [SECTION 13(B)]**: Profits are shared in agreed ration but in absence of agreement every partner enjoys the right to have equal share in the profits of the business. Even if there are losses in the business the rule will remain same. So, if there is no agreement to the contrary, then in such case the profits and losses are shared equally.
5. **RIGHT TO INTEREST ON CAPITAL AND ON ADVANCES [SECTION 13(C) & 13(D)]:** Ordinarily, the partners have no right to receive any interest on their contribution towards their capital. However, the partnership agreement or partnership deed may contain such provision that the partners shall be entitled to

interest on capital at a certain rate. It may, however, be noted that where such interest is to be paid, it shall be paid out of profits only. Where in addition to the contribution towards the capital, a partner also advances a sum of money to the business of the firm then he can charge interest @ 6% per annum on such advance given by him. Such interest on advance is payable even if the firm suffers loss.

6. **RIGHT TO BE INDEMNIFIED [SECTION 13(E)]**: The partner of a firm has a right to be indemnified i.e., the right to recover all such expenses incurred and payments made by him in the following two circumstances.
   - A partner has a right to recover from the business if he has incurred any expense that are related to ordinary course of firm business.
   - Further he can recover from the firm all expenses which he incurred in order to protect the property of the firm from a loss arising in an emergency. No agreement can restrict this right to recover the expenses.
7. **RIGHT TO USE THE PARTNERSHIP PROPERTY [SECTION 15]**: It is the right of every partner to use the firm property. It may, however, it may be noted that the partnership firm property should be used exclusively for the purpose of the firm business.
8. **RIGHT TO BE CONSULTED AT THE TIME OF ADMISSION OF A NEW PARTNER**: It is the right of every partner to be consulted at the time of admitting a new partner in the partnership firm.
9. **RIGHT TO RETIRE FROM THE FIRM**: It is the right of every partner to retire from the partnership firm, if he/she finds it difficult to adjust with the other partners.
10. **Rights of retiring partner**: A partner can retire either by consent of all the partners or as the terms of contract states or by giving any such notice in case of partnership at will.
11. **Right not to be expelled [Section 33(1)]**: A partner enjoys the right to continue in the business as partner, he cannot be expelled from the firm by other partners. However, the partners may enter into a contract providing for the expulsion of a partner by majority of the partners.
13. **RIGHT TO DISSOLVE THE FIRM**: A partner firm can be dissolved by consent of all the partners. So, the partners has jointly right to dissolve the firm anytime. Normally they need not to get any legal permission for the same. In case of the partnership at, the firm may get dissolved even if one partner give notice in writing to the other partners that he wants to dissolve the firm.

8.2 DUTIES OF PARTNERS

Along with rights, the partners also have some duties which are as follows :

1. **DUTY OF GOOD FAITH:** It is the foremost and important duty of all the partners. Every partner should act in good faith, and he should be just and faithful in his dealings with the other partners.

2. **DUTY TO CARRY ON THE BUSINESS TO THE GREATEST COMMON ADVANTAGE:** Partners are mutual agents and enjoys utmost good faith of other partners, so it is responsibility of every partner to carry on the business for the maximum common benefit of all the partners. Partner must use his capability, skill, knowledge and experience for the common benefit and must not try to make any personal profits.

3. **DUTY TO RENDER TRUE ACCOUNTS:** It is duty of every partner that he should keep proper books of accounts, and render correct and true accounts of partnership firm.
4. **DUTY TO GIVE FULL INFORMATION:** It is also the duty of every partner that he should give full information of all things which are affecting the firm and to his co-partners. Thus, if a partner is in possession of more information about the affairs and property or assets of the firm, then he should not conceal the same from other members.
5. **DUTY TO INDEMNIFY ANY LOSS DUE TO FRAUD:** It is the duty of every partner to make good the loss suffered by the firm due to his fraud. Thus, if some amount of loss is caused to the firm due to the fraud of a particular partner, then in such case the firm has the right to recover the amount of loss from the same partner. It is an absolute duty and can't be excluded by an agreement to the contrary. However, the firm shall remain liable to the third parties/outsiders for fraud of its partners.
6. **DUTY TO ATTEND DILIGENTLY:** It is the duty of every partner that he should diligently (i.e., carefully) attend to the affairs of the business of the partnership firm. If a partner doesn't attend diligently the business of the firm, and due to this, the firm suffers any amount of loss due to his _willful neglect', then that partner is bound to make compensation to the firm.
7. **DUTY TO SHARE LOSSES:** It is the duty of every partner to share equally the losses (if any) suffered by the firm. However, the partners may also agree to share the losses in different proportions through a mutual agreement.
8. **DUTY TO ACCOUNT FOR PERSONAL PROFITS:** This duty is based on the principle of good faith, which requires that a partner shall not make personal or private profits at the expense of the firm. If any partner makes any such personal profits, he must give account of those profits and pay back the same to the firm.
9. **DUTY TO USE FIRM PROPERTY EXCLUSIVELY FOR FIRM:** It is the duty of every partner to use the firm property exclusively for the business of the partnership firm. Thus, the partners should use the partnership property for the firm's business only. This duty is also subject to an agreement to the contrary.
10. **DUTY TO ACT WITHIN AUTHORITY:** It is the duty of every partner that he should act within the scope of actual or implied authority.

8.3 IMPLIED AUTHORITY OF PARTNERS

Indian Partnership act provide some implied authority to all the members. Such authority is not subject to any agreement rather such authority is given by the act itself. This implied authority can bind the firm and the other members of the firm. Following acts are covered in the implied authority of the partner.

a. To buy, sell and pledge goods or services on behalf of the firm.
b. To raise loans or advances on the security of the assets.
c. To receive amount of payment from debts due to the firm.
d. To accept, make an issue bills of exchange, promissory notes, etc., on behalf of the firm.
e. To engage servants or employees for the firm‘s business.
f. To take on lease any property or premises on behalf of the firm.

However, a partner has no implied authority, unless otherwise given in the provisions of the partnership deed, in the following matters:

a. He cannot submit any dispute for arbitration without obtaining consent of other partenres..
b. He cannot compromise any claim made by the firm against the third party. He cannot relinquish any part of such claim.
c. He cannot withdraw any suit filed by him or other members on behalf of the firm. For this consent of all the partners is required.
d. He alone cannot admit any liability in a suit that is filed by any person against the firm.
e. He alone cannot open a bank account in the name of the firm.
f. He cannot acquire or purchase immovable property for the firm without having consent of the other partners.
g. He cannot sell immovable property of the firm.
h. He alone cannot enter into partnership on behalf of the firm.

8.4 PARTNERSHIP DEED

8.4.1 MEANING OF PARTNERSHIP DEED

Partnership firm can be formed with an agreement between the partners. This agreement may be written or spoken. An oral or spoken agreement may be the cause of dispute in future. So, it‘s better to have a written agreement in order to avoid future disputes. The written agreement was duly signed by all the partners is to be called as partnership deed or agreement. It is the written contract between the partners. It contains the term and conditions of the partnership.

Deed of partnership or partnership deed can be defined as a document that is drawn up by all the partners of a business which contains all the provision, rules and regulations guiding the business. It is also known as a document which clarifies the different positions and duties of the partners in the firm business. Partnership deed is also knows as **‗Partnership Agreement‘**.

8.4.2 MAIN CONTENT OF PARTNERSHIP DEED:

Some of the important clauses which are to be included in a partnership deed are as follows:

1. **NAME OF THE FIRM AND ITS ADDRESS**: The partnership deed should contain of the name of the firm and its place of business.

2. **NAME AND ADDRESS OF PARTNERS**: The deed should also contain the name and address of all partners.
3. **NATURE OF FIRM"S BUSINESS**: The nature of the business proposed to be carried and its limitation should be included in it.
4. **DURATION OF PARTNERSHIP**: If partnership is established for a fixed duration or for a particular task, then it should be stated in it.
5. **PARTNERS" CAPITALS**: The partnership deed should contain the total amount of capital and contributions by each partner.
6. **INTEREST ON CAPITAL**: If the partners decide interest on their capitals, then the rate should be given in the deed.
7. **DRAWING AND INTEREST ON THEM**: The deed should mention the limit of drawings by every partner and the rate of interest which is to be charged.
8. **DIVISION OF PROFIT**: Profit or Loss (if any) to be shared in an agreed ratio which is to be given in the deed. If it is not mentioned then the partners are authorized to share equally according to the provision of the Partnership Act.
9. **PARTNERS" SALARY AND COMMISSION**: If the partners decide to pay salary and commission to the partners, then the deed should mention the amount of salary or commission payable to such partner.
10. **RIGHTS AND DUTIES OF PARTNERS**: If any partner has some special rights and duties regarding to conducts the affairs of business or if the liability of any partner is limited to the capital invested by him/her, then these facts should also be given in it.
11. **ADMISSION AND RETIREMENT OF PARTNERS:** After the establishment of partnership, some new partners may be admitted and some partners may retire from the business.
12. **DEATH OF A PARTNER**: The procedure of calculating the amount due to a deceased partner and the method of its payment to the successors or legal heirs should also be decided and mentioned in the deed.
13. **VALUATION OF GOODWILL:** Normally the deed also describe that how to value the goodwill in case of any admission, retirement or death of a partner.
14. **REVALUATION OF ASSETS AND LIABILITIES**: The method of revaluation of assets and liabilities of the firm should also be clearly mentioned in the deed.
15. **ACCOUNTS AND AUDIT**: The procedure of keeping books of accounts and its audit should also be mentioned in the deed.
16. **DISSOLUTION OF PARTNERSHIP**: The partnership deed should contain the firm and the method of the final settlement of accounts on account of dissolution of partnership.

17. **ARBITRATION CLAUSE:** In case of disputes or any conflict among partners, the method of appointing arbitrators and their rights should be clearly mentioned.

8.4.3 IMPORTANCE OF PARTNERSHIP DEED:

The partnership deed is important because of the following reasons:

1. It provides permanent records of terms and conditions of the firm business.
2. In case of death of a partner, the deed will serve as a basis for settling the accounts.
3. It regulates the rights, duties, and liabilities of each and every partner.
4. It helps to avoid any misunderstanding or any conflict between the partners because all the terms and conditions of the partnership have been laid down beforehand in the deed.
5. It clears confusion as to what should be the profit and loss sharing ratio between partners.
6. It clearly mentions Individual partner‘s roles.
7. The Partnership deed can also contain clauses which clarifies what should be remuneration or salary given to the partners.
8. Sometime preparing Partnership Deed is a legal requirement also e.g. Registration of Firm, getting income tax or any other related benefits available to firm.

8.4.4 RULES TO BE FOLLOWED IN THE ABSENCE OF A PARTNERSHIP DEED:

In the absence of a partnership deed, the following rules have to be followed:

1. The partners are entitled to share the profits or losses equally as per the provisions given in the Partnership Act.
2. Partners are not entitled to any interest on capital.
3. No partner will be allowed salary, or any other remuneration.
4. No interest will be charged on partners‘ drawings.
5. Interest at 6% per annum will be allowed to partners on any loan or advances given to the firm by them.
6. If there is no agreement all the partners enjoys the right to take part in conduct of business, they can give their advice also.
7. In case all the partner did not give their consent, no person can be admitted as a new partner in the partnership firm.

8.5 INCOMING PARTNER

According to Section 31 of Indian Partnership Act 1932, a new partner can be admitted to the already existing partnership firm. Such partner is known as incoming partner. However, a new partner can be admitted only with the consent of all the existing partner. But this rule is applicable only if there is no provision regarding admission of a partner in the partnership deed. In case the partnership deed contains the provision regarding admission of the partner, then such provisions will applicable on admission. For example if partnership deed provide that any existing partner can admit a new partner, than

new partner need not to get consent from other partners. Even a third party can admit in new partner if such is provided in the partnership deed. The new partner is eligible for all the benefits of firm from the date of his admission.

8.5.1 LIABILITY OF INCOMING PARTNER

1. Any incoming partner is only liable from the date of his admission. He is not liable for any existing liabilities.
2. In case the new partner himself agrees to share existing liabilities, he will be liable for existing liabilities also.
3. However, the liability of new partner for existing obligations is towards other partners only and not for the third party. In other words, we can say that the third party cannot sue a new partner for liabilities that were existing before his admission.
4. If new partner has assumed existing liabilities and the creditors have also accepted this fact, in such case, new partner will be liable towards the third party also.

8.6 OUTGOING PARTNER (SECTION 32)

An outgoing partner is a person who ceases to be member of the partnership firm. So, any person who was earlier a partner of the firm but now he is not the partner in the firm, is known as an outgoing partner. Following are the ways in which a person may cease to be member of the partnership firm.

Retirement by consent: Any partner could retire from partnership firm at any time provided there is consent of all other partners regarding his retirement. So, if all existing partners give their consent, a partner may retire at any time.

1. **RETIREMENT BY AGREEMENT:** If the partnership deed provide the procedure for retirement of a partner, a partner may retire from the firm by following the procedure laid in the partnership deed.
2. **RETIREMENT BY NOTICE:** Sometime the partnership is _Partnership at Will‘. In such case, a partner may retire at any time by just giving notice to other partners regarding his retirement. In case of partnership at will, a partner may retire even if there are some pending contracts that are yet to be completed.
3. **BY INSOLVENCY:** if any partner is declared insolvent, his partnership will be ceased immediately when he is declared insolvent. However, partnership firm may continue the business after insolvency of a particular partner, but in such case insolvent partner‘s assets are not liable for any act done by the firm after he was declared insolvent.
4. **BY DEATH:** In case of death of a partner, his partnership will be over immediately and his legal Heirs have no right to claim a place in partnership in his place. His legal Heirs are eligible for amount contributed by him and his share of profit Till death.
5. **EXPULSION OF PARTNER**: According to section 35 of Indian Partnership Act, a partner may be expelled from partnership by majority of partners. This expansion is valid only if the other partners act in a bonafide manner and in good faith. Partner who is going to be expelled must be given an opportunity of being heard before his

expulsion.

8.6.1 LIABILITY OF RETIRING PARTNER

1. LIABILITY FOR ACTS DONE BEFORE RETIREMENT SECTION 32 (2): Following are the provisions regarding any act done by partner before his retirement:

a. A partner will remain liable for any act done by the firm or other partners before his retirement.
b. His liability for the acts before his retirement will remain towards the third party also.
c. In case other partners agreed to discharge him from the liability for acts done before retirement, he will not be liable for such acts.
d. However, this agreement is between partners only, third party has rifgt to make a retiring partner liable for acts done before his retirement.
e. If Third party accepts the agreement between partners to discharge a retiring partner, then it will lose its right to make a retiring partner liable for acts done before his retirement.

2. LIABILITY FOR ACTS DONE AFTER THE RETIREMENT SECTION 32(3)

a. A partner will continue to be liable fof Acts done after his retirement towards the Third party unless he gives a public notice for his retirement.
b. In case of sleeping partner there is no need of giving such public notice.
c. The public notice may be given by a retiring partner himself or the remaining partners.
d. If public notice is not given, the retiring partner will be liable for all the acts done by firm or other partners after his retirement.
e. In absence of public notice, the firm will also be liable for the acts done by retiring partner after his retirement.

8.6.2 RIGHTS OF A RETIRING PARTNER

1. RIGHT TO COMPETE SECTION 36: Following are the provisions of Indian Partnership Act in this regard:

a. A partner may compete with his old firm after his retirement.
b. If there is any agreement at time of retirement which restrict the partner from competing with existing business, in case partner may note complete with his old firm.
c. If the retiring partner is competing with his old firm,he cannot use the name of the Firm or he cannot represent himself as carrying on the business of the old Firm.

2. RIGHT TO SHARE SUBSEQUENT PROFITS SECTION 37: Following are the provisions in this regard

a. An outgoing partner is eligible for refund of the amount invested by him in the business along with profit he ceased to be member of the firm.

b. If the amount is kept by the firm without any agreement for the same, outgoing partner may claim profits earned by the firm after he ceased to be member in proportion of the amount invested by him in the firm.
c. If he does not want to get proportionate profits, he could also claim interest at the rate of 6% per annum on the amount due to him by the firm.

8.7 DISSOLUTION OF FIRM

According to Section 39 of the Partnership Act, –The dissolution of partnership between all the partners of a firm is called the Dissolution of the Firm.‖ If the firm has closed down routing operation it does not necessarily means dissolution of the firm, still the firm may continue with the objective of realizing the assets belonging to the firm.
According to the Partnership Act, dissolution is of 2 types:

a. **DISSOLUTION OF PARTNERSHIP:** The term _dissolution of partnership‘ may be defined as a change in the relations of partners, and not the extinction of partners relationship. In this case, the firm as a whole is not closed down. But only the relations between some of the partners come to an end, and the remaining partners continue to carry on the business activities of the firm. Thus, the _dissolution of firm‘ is different from _dissolution of partnership.‘ Example: X, Y and Z were partners in a firm. X retires. Only the partnership between X, Y and Z is dissolved and a new partnership between Y and Z comes into existence. The new firm is called the _reconstituted firm‘. Thus, only the relations between the partners are changed on X‘s retirement.
b. **DISSOLUTION OF FIRM:** Dissolution for firm take place when business ceases to exist, in other words it is complete closure of the business. As on one hand dissolution of partnership is only closure of relation between the partner which may take place even if firm is continuing like one partner left the business, this will change the relation among the partners. On the other hand dissolution of firm take place when firm is altogether closed. So, with dissolution of firm the partnership automatically comes to an end. Following are the difference between dissolution of the firm and the dissolution of the partnership.

Points to difference	**Dissolution of Firm**	**Dissolution of Partnership**
1.Continuation of business	It is complete closure of the business. Business cannot continue the operations.	Firm is continuing, this will change the relation among the partners
2. Winding up	It involves complete winding up of the operations of the so all the assets will be sold and liabilities will be settlemed.	No need of sale of or payment of the liabilities of the firm.
3. Order of court	It may take place on the order of the court.	It is not ordered by the court.

4. Scope	With dissolution of firm the partnership automatically comes to an end	Dissolution of parthership may or may not cover dissolution of firm.
5. Final closure of books of accounts	It need final closure of books of as operations are discontinued.	It does not need final closure as operations are continued.

8.8 MODES OF DISSOLUTION

8.8.1 DISSOLUTION WITHOUT THE INTERVENTION OF COURT

A firm may be dissolved without the intervention of the court i.e. without going to the Court of Law. It may takes place in any of the following ways:

1. COMPULSORY DISSOLUTION:

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

a. INSOLVENCY/DEATH OF ALL THE PARTNERS: Where all the partners of the firm become insolvent/death, then in such case the firm is dissolved. The firm is also dissolved when all the partners except one have become insolvent/died.

b. BUSINESS OF THE FIRM BECOMING UNLAWFUL OR ILLEGAL: Where an event happens which makes the business of the firm illegal or unlawful, then the firm is also dissolved. This includes the cases where the business of the firm is rendered unlawful by the outbreak of war, or when the object for which it was formed becomes unlawful or illegal.

2. OPTIONAL DISSOLUTION:

e. **DISSOLUTION BY AN AGREEMENT BETWEEN THE PARTNERS:** A firm may also be dissolved in accordance with a contract between the partners in the same way as a firm is established with the contract between the partners. There may be a separate contract for the dissolution of the partnership firm, or it may also be contained in the deed itself.

f. **DISSOLUTION BY GIVING A NOTICE:** A firm can also be dissolved by any partner by giving a notice of dissolution to the other partners where the partnership firm is **_at will „.**

g. **DISSOLUTION ON THE HAPPENING OF CERTAIN CONTINGENCIES:** Sometime firm is dissolved on happening of certain contingency. If any of the following event take place firm it will results in automatic dissolution.

- **EXPIRY OF FIXED PERIOD:** Sometime a firm is constituted for a fixed period of time, in such case the firm is dissolved automatically when period is expired. However, if the contract provides that the firm opt to continue, then it will not be dissolved.

- **COMPLETION OF THE UNDERTAKING:** Sometime a firm is constituted to carry out a particular task or adventure, in such case the firm is automatically dissolved on the completion of such task or adventure. However, if the contract provides that the firm opt to continue, then it will not be dissolved.
- **DEATH OF A PARTNER:** In case one or more partner dies, the firm will be dissolved on the death of the partner. However, the other partners if wish they can continue the operations.
- **INSOLVENCY OF A PARTNER:** When one of the partners is declared as insolvent by the court. In such cases, the firm is dissolved from the date of the order of insolvency. This is also subject to a contract to the contrary.

8.8.2 DISSOLUTION WITH THE INTERVENTION OF COURT

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

1. **INSANITY OF A PARTNER:** When one of the partner becomes of unsound mind. In such cases, the court may allow the dissolution. In this case the suit for dissolution of the firm may be filed any partner who are of the sound mind. Even the suit may also be filed by legal representative of the partner who became unsound mind.
2. **MISCONDUCT OF A PARTNER**: In case a partner is found guilty of misconduct, then court may order the dissolution of firm. In such case the suit can be filed by any partner other than the partner who is guilty of misconduct.
3. **PERMANENT INCAPACITY OF A PARTNER:** Sometimes a partner becomes permanently incapable of performing his responsibilities towards the firm. In such cases also, the court has the right to order dissolution of the firm. In such case the suit may be filed by any partner other than that partner who has become incapable and cannot perform his duties.
4. **PERSISTENT BREACH OF AGREEMENT:** Sometimes, a partner wilfully and persistently breach the partnership agreement and wilfully neglect his duties towards the business operations of the firm. Sometime he behaves in a way that it becomes difficult for other member to carry on the business with him. In such cases, the court may allow the dissolution of that firm. In such case the suit may be filed by any partner other than than the partner who commits the breach of agreements.
5. **PERPETUAL LOSSES IN BUSINESS:** Sometime the nature of business becomes such that there are continuous losses to the business and even in future there is no hope of earning the profits in the business. In such cases if the court is satisfied that the business of a firm cannot be carried on without incurring the loss, it may allow

dissolution of the firm. However, partners other than partner submitting application to the court for dissolution have right to appeal against the order of the court.

6. **TRANSFER OF INTEREST:** In a firm a partner cannot sell his share without the consent of all other partners. If one or more partner have transferred the whole of his interest or part of the share to a third party, then in such case the court may allow the dissolution of the firm.
7. **OTHER JUST AND EQUITABLE GROUNDS:** If some just and equitable ground ground is available which court thinks fit for dissolution of the firm, court has right to order the closure of the firm. A _just and equitable ground' means any reason which court thinks appropriate and in the benefit of society or partners.

8.9 CONSEQUENCES OF DISSOLUTION

Section 45-55 of the Act deals with the effects/consequences which results in the dissolution of the firm. These are as follows:

1. **LIABILITIES FOR THE ACTS DONE AFTER DISSOLUTION:** On the dissolution of a partnership firm, partners have to give a public notice of the dissolution. If it is not given, then the partners shall remain liable to the third party/outsiders for their acts done even after the dissolution of the firm.
2. **CONTINUING AUTHORITY FOR WINDING UP:** Even if dissolution take place, partners have authority that they can bind the firm for the acts done by them. However, this authority is limited for following tasks:
   (a) If it is necessary to wind up the business affairs of the firm.
   (b) If it is necessary to complete the transactions started but not completed at the time of dissolution.
3. **PARTNER"S RIGHT FOR UTILISATION OF ASSETS/PROPERTY:** Even if dissolution take place, partners have following rights:
   (a) Partners can use the property or assets of the business for making the payment of debts of the business.
   (b) In case any surplus is left after making the payments of the debts, that will be distributed among all the partners.
4. **MODE OF SETTLEMENT OF ACCOUNTS:** When the firm is dissolved, the accounts of that firm are settled as per the terms of partnership. If there are no specific terms or an agreement, then the accounts are settled according to the following provisions contained in the Indian Partnership Act.
   a) First of all, the assets shall be utilized in paying the **debts of the firm to the third parties/outsiders.**
   b) If there is any surplus, then the same shall be utilized in paying each partner the **amount of loan advanced** to the firm.
   c) If there is still any surplus, the same shall be utilized in paying each partner towards the **amount of his capital**.

d) If there is still any surplus, then the same shall be **divided among all the partners** in proportion to their share in the profits.

5. **PAYMENT OF FIRM"S DEBTS AND PARTNER"S PRIVATE DEBTS:** The Firm's property/assets shall be utilised first in payment of firm's debts then the surplus, if any, shall be used for payment of partner's private debts to the extent in which the concerned partner is entitled to the surplus.
6. **RETURN ON PREMIUM OF PARTNERSHIP"S PREMATURE DISSOLUTION:** Sometimes when a new partner is admitted to the firm he pays some premium for such admission. But if the dissolution of partnership take place earlier than the period fixed for it, then the partner who has paid the premium is entitled to get reasonable part of his amount of premium back . However if partnership is dissolved due to following reasons, this rule will not be applicable:
   (i) In case of death of one of the partners;
   (ii) If dissolution take place due to the misconduct of the partner who paid premium.
   (iii) Where the dissolution take place with consent of all the partners and it was decided that no amount of premium will be paid back..
7. **TREATMENT OF LOSS ARISING DUE TO INSOLVENCY OF A PARTNER:** Unless otherwise agreed it requires that:
   (i) The solvent partners should bring in cash equal to their shares of the loss on realization
   (ii) The solvent partners should bear the loss arising due to such insolvency of a partner in the ratio of their Last Agreed Capitals.

8.10 TEST YOUR UNDERSTANDING (B)

1. Settle the following claims of partners as per law in the absence of deed.

(a) Raja and Rani invested ` 5,00,000 and ` 2,50,000 as capital in the business. They want the profits to be distributed in the ratio of capital.

(b) Rani' carried out business alone for six month due to illness of Raja , She demanded salary 10,000 per month.

(c) Raja paid 8,000 as train fare for going on business tours. He claims reimbursement of this amount.

(d) Rani's advanced a loan of Rs. 1,00,000 to firm and wants interest on such loan at market rate which is 11%.

(e) Raja wants interest on drawing to be charged at market rate which is 11%.

2. Mr. A is a partner in a firm and he want to following acts for the firm, state whether these are in his implied authority as per Partnership Act or not.

Act	Implied Authority
1. He wants to engage Z as servant.	Yes / No
2. He has opportunity to buy a piece of land at very reasonable price.	Yes / No
3. Firm has some dispute with Mr. X, he wants to make	Yes / No

settlement of the dispute.	
4. Some goods are available at reasonable price, he wants to buy such goods.	Yes / No
5. Some amount is due from W and he is not making the payment. A wants to file a suit against W.	Yes / No

3. Write three difference between Dissolution of Firm and Dissolution of Partnership

Points to difference	**Dissolution of Firm**	**Dissolution of Partnership**
1.		
2.		
3.		

4. A, B, C, D and E are partners in a firm. A, B and C passed a resolution for dissolution of firm. State whether firm can be dissolved in following cases:
   a. Deed does not contain any provision related to dissolution.
   b. Deed provide that dissolution can be carried by mutual consent of the partners.
   c. Deed provide that majority of partners can take dissolution decision.

8.11 LET US SUM UP

- Partners have right to take part in business and have right to be consulted.
- Partnership have right to get share of profits of a business.
- Partners must work diligently for the business and must produce true account of the business.
- Partner have implied authority to buy movable goods, make or receive payment, engage servant or make suit against third party.
- Partner cannot buy immovable property or cannot produce suit for settlement.
- The written agreement between partners is known as Partnership Deed.
- In absence of provision in partnership deed, profits are divided equally between the partners.
- The rate of interest of partner‘s loan in absence of partnership deed is 6 p.a.
- In absence of agreement, a new partner can be admitted with consent of all the partners.
- New partner is liable for obligation of firm after his admission.
- A partner may be ceasing his membership due to retirement, death or expulsion.
- Once ceases to be member, he will still be liable for obligations of firm if he does not give public notice.
- Firm may be dissolved with or without intervention of the court.

8.12 KEY TERMS

- **IMPLIED AUTHORITY OF PARTNER**: Indian Partnership act provide some implied authority to all the members. Such authority is not subject to any agreement rather such authority is given by the act itself. This implied authority can bind the firm and the other members of the firm.
- **PARTNERSHIP DEED:** Partnership firm can be formed with an agreement between the partners. This agreement may be written or spoken. An oral or spoken agreement may be the cause of dispute in future. So, it‘s better to have a written agreement in order to avoid future disputes. The written agreement was duly signed by all the partners is to be called as partnership deed or agreement.
- **INCOMING PARTNER:** According to Section 31 of Indian Partnership Act 1932, a new partner can be admitted to the already existing partnership firm. Such partner is known as incoming partner.
- **OUTGOING PARTNER:** An outgoing partner is a person who ceases to be member of the partnership firm. So, any person who was earlier a partner of the firm but now he is not the partner in the firm, is known as an outgoing partner.
- **DISSOLUTION OF FIRM:** According to Section 39 of the Partnership Act, –The dissolution of partnership between all the partners of a firm is called the Dissolution of the Firm.
- **DISSOLUTION OF PARTNERSHIP:** The term ‗dissolution of partnership‘ may be defined as a change in the relations of partners, and not the extinction of partners relationship. In this case, the firm as a whole is not closed down. But only the relations between some of the partners come to an end, and the remaining partners continue to carry on the business activities of the firm.

8.13 REVIEW QUESTIONS

1. What are rights of a partner.
2. Give various duties of partners towards partnership firm.
3. What is implied authority of partner. What acts are covered in implied authority of the partner.
4. What acts are not covered in implied authority of the partner.
5. Write is Partnership deed? Give its significance.
6. Give the contents of Partnership Deed. What rules are applicable in absence of Partnership Deed.
7. Who is incoming partner. Give the liability of incoming partner.
8. Who is outgoing partner. Give the liability and rights of outgoing partner.
9. What is dissolution of partnership and dissolution of firm. Give difference between both.
10. Give various modes of dissolution.
11. What are consequences of dissolution of firm.

8.14 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

1. In the absence of deed, following provisions of Partnership Act, 1932 will apply to solve the disputes :

(a) Profit between Raja and Rani can not be shared in capital ratio. In the absence of partnership deed the profits will be shared in equal ratio.

(b) Rani can not claim salary in the absence of deed.

(c) Expenses incurred by Raja on behalf of firm are reimbursable as the reimbursement of reasonable expenses have nothing to do with partnership deed.

(d) Interest payable on Partner Loan in absence of deed is 6% p.a.

(e) No interest is chargeable on drawings.

2. (a) Yes, he can engage servant.
   (b) No, he cannot buy immovable property without consent of other partners.
   (c) No, he alone cannot make settlement of the dispute.
   (d) Yes, he can buy movable goods.
   (e) Yes, he can file a suit against third party.

4. (a) Firm cannot be dissolved by majority in absence of clause in partnership deed.
   (b) Firm cannot be dissolved by majority if partnership deed provide dissolution my mutual consent.
   (c) Firm can be dissolved by majority if partnership deed provide so.

8.15 FURTHER READINGS

1. M.C. Kuchhal, and Vivek Kuchhal, *Business Law*, Vikas Publishing House, New Delhi.
2. SN Maheshwari and SK Maheshwari, *Business Law*, National Publishing House, New Delhi.
3. Aggarwal S K, *Business Law*, Galgotia Publishers Company, New Delhi.
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B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 9 – LIMITED LIABILITY PARTNERSHIP ACT, 2008

STRUCTURE

9.16 Further Readings.

9.0 OBJECTIVES

After studying the Unit, students will be able to

- Understand the Meaning of Limited Liability Partnership.
- Describe Characteristics of LLP.
- Explain key differences between LLP and other forms of business.
- Find various steps involved in incorporation of LLP
- Appraise yourself about various documents required for incorporation of LLP.
- Understand various limitations of LLP form of Business.

9. 1 INTRODUCTION:

Partnership Act was implemented in India in the year 1932. The main objective of this act was to give pace to economic acceleration in India. As a result of this act in number of partnership work formed in the country and this set not only formalized the formation of partnership but also so decided the various rules and regulations to control and manage the partnership. However, with the passage of time it was felt that the basic structure of partnership suffers from some limitations. Following are the limitations of partnership.

- The biggest limitation of traditional form of partnership is its limited liability. In case of business loss partner need to make this loss Good even by contributing personal assets.
- In traditional form of partnership, partners have mutual agency in which one partner is legally bound by any act done by the other partner.
- Another problem with traditional form of partnership is that a partner cannot transfer their share to any other person. Some time this result into dissolution of the firm also.
- The number of partners is also limited so a partnership cannot expand its business beyond a particular limit.

All the above discussed limitation can be removed if a person opts for company form of business. But the problem with company form of business is that it needs a lot of formalities to start a company and then to manage a company. For a small or medium business it is very difficult to carry out all the formalities. So, the need was felt fjor a new type of form of business which have the benefits of both forms of business that are partnership firm and Company. As a result a new form of business was suggested by the government, that is limited liability partnership.

9.2 HISTORY OF LIMITED LIABILITY PARTNERSHIP.

The United States of America was first country to introduce the Limited Liability Partnership (LLP) in the year 1991. After that in number of companies adopted this form of business which includes Australia, United Kingdom, Singapore and many Gulf

countries. Indian government also felt the need to introduce such form of business in India. As a result, an expert panel was formed to suggest introduction of LLP in India. On the recommendations of the panel, Government of India published the LLP Act in the year 2008 in the official gazette. This act was based on United Kingdom LLP Act 2000 and Singapore LLP Act 2005. After completing the formalities, this act was implemented in India in the year 2009 and first LLP was formed under this act in the first week of April 2009. This Act is applicable to the whole of the country.

The Provisions of the LLP act are contained in in 14 chapters which have 81 sections and 4 schedule. Following is the brief detail of these four schedules.

• **FIRST SCHEDULE** – This Schedule decide the rights and duties of the partners of LLP. This schedule define that how partners will behave in the partnership. This schedule also gives the rules that can be applied if there is no agreement on particular item in the partnership deed.

• **SECOND SCHEDULE** – Second schedule deals with the rules how to convert an existing partnership firm into a limited liability partnership. LLP act allows the conversion of existing partnership into limited liability partnership.

• **THIRD SCHEDULE** – LLP act also allows to convert any existing private limited company into Limited Liability Partnership. These rules are contained in third schedule of the LLP act..

• **FOURTH SCHEDULE** – Even any existing unlisted public company can also be transferred to limited Liability Partnership. Schedule four of the Act provides the rules regarding conversion of unlisted public company into limited liability partnership.

9.3 CONCEPT AND MEANING OF LLP

Limited Liability Partnership (LLP) is a form of business that is combination of both partnership form of business and company form of business. On one hand it provides the benefit of company form like limited liability and separate legal entity, on the other hand it has flexibility of partnership for and is easy to form. Section 2 of the LLP act gives the definition of Limited Liability Partnership.

According to Section 2(1)(n) of the LLP Act, 2008 'limited liability partnership' as a partnership formed and registered under LLP Act.

However, this definition of Limited Liability Partnership is only a legal definition and does not explain anything about the LLP. So we need some comprehensive definition that could explain various aspects of the LLP. In simple words we can define LLP as:

'A limited liability partnership(LLP) is a body corporate, an artificial person which have separate legal entity than its owners perpetual succession having a common seal and the liability of the business is limited'.

9.4 SALIENT FEATURES OF LLP

1. **BODY CORPORATE:** Like any company, Limited Liability Partnership also needs corporation. Like company is incorporated under the companies act, similarly LLP is

incorporated under the Limited Liability Partnership Act, 2001. It is not possible to form LLP without incorporation.

2. **SEPARATE LEGAL ENTITY**: LLP has separate legal entity and has all the rights that are available to any artificial legal person under the law. Its entity is separate from the person who own it. A LLP can own any property in its own name and is also capable of entering into contract in its own name.
3. **PERPETUAL SUCCESSION:** The LLP **perpetual** succession. The term **perpetual** means continuous and the term succession means existence. So the LLP is not affected by entry or Leaving of the partners. Even if there is admission, retirement or death of any partner, still LLP can continue its business.
4. **NO MUTUAL AGENCY**: The major difference between partnership and LLP is that in LLP, there is no mutual agency of the partners. In traditional partnership form of business, every partner is bound by act of the other partners. However this is not the case in LLP. A partner cannot bind another partner with his acts in LLP.
5. **LLP AGREEMENT**: In LLP also partners are supposed to enter into an agreement known as partnership deed. the rights and duties of the partners are decided by this partnership agreement.
6. **COMMON SEAL:** Is LLP is an artificial person it cannot act by itself. LLP works through its partners. Under the LLP Act 2008, it is allowed to have a common seal. However it is not necessary that every LLP should have a common seal, LLP could operate without having the common seal also.
7. **LIMITED LIABILITY**: Biggest feature of LLP is its limited liability. In case of business losses, the partner of LLP have limited liability which is limited only upto the amount contributed by them as capital in the business.
8. **MANAGEMENT OF BUSINESS**: LLP operates through its partners. There is a misconception that only designated partner can operate the LLP. It can be operated by any partner but as far as legal compliance is concerned, designated partners are responsible for the same..
9. **MINIMUM AND MAXIMUM NUMBER OF PARTNERS**: Any LLP can be started with minimum 2 members. It is not necessary that these two members should be individual, even a body corporate can become partner in the LLP. However, there is a condition that every LLP should have minimum to individual that are declared designated partner. Every LLP should have at least one designated partner that is resident of India.
10. **BUSINESS FOR PROFIT ONLY:** Like any traditional partnership, LLP can also be formed only for the profit motive. If profit motive is not there, LLP cannot be formed. So in simple words we can say that LLP cannot be formed for any charitable purpose. .
11. **INVESTIGATION**: LLP Act 2008 gives the central government power to carry out any investigation against the business affairs of LLP..
12. **COMPROMISE OR ARRANGEMENT**: LLP wants to bring any type of compromise like amalgamation and Merger it can be carried out only as per the provisions of the act..

13. **CONVERSION INTO LLP:** AsLLP Act was enacted in the country in 2008, government does not want to deprive the existing Partnership Firms, Private Limited companies or Unlisted Public companies from the benefits of LLP. So, the government allowed existing Partnership Firms, Private Limited companies or Unlisted Public companies to convert their business into LLP form of organisation.

14. **E-FILLING OF DOCUMENTS**: In LLP form they are under obligation to file certain documents with the government. However, they need not to submit these documents in physical form rather e filing of the document is allowed. Documents may be filed on website www.mca.gov.in. LLP must file documents related to designated partners and use of digital signature by the partners..
15. **FOREIGN LLPS:** Section 2(1)(m) defines foreign limited liability partnership –as a limited liability partnership formed, incorporated, or registered outside India which established a place of business within India‖. In India there is no restriction foreign LLP becoming member in Indian LLP..
16. **NON-APPLICABILITY OF THE INDIAN PARTNERSHIP ACT, 1932-** there is a misconception in the mind of people that LLP is just extended form of partnership firm and rules of Indian Partnership Act, 1932 are applicable on LLP. The rules of Indian Partnership Act 1932 are not applicable on LLP as it has its own act.
17. **WINDING UP:** Winding up of the LLP can take place only after following rules laid out in the Act. This winding up may be voluntary winding up for winding up by the Tribunal..
18. **DESIGNATED PARTNERS**: Each LLP should have minimum two designated partner that are responsible for carrying out all the legal compliances required under the act.
19. **SCOPE OF LLP:** It is a misconception among the people that LLP can be formed only for carrying out professional services. LLP can be formed for any type of business.
20. **TRANSFER OF SHARE**: In LLP partners are allowed to transfer their share to some other person without getting the consent of the other partners.
21. **DESIGNATED PARTNER IDENTIFICATION NUMBER:** Lke in company form of business, in LLP also every designated partner is supposed to have a separate identification number which is known as Designated Partner Identification Number (DPIN) whcich is allotted by the central government.

9.5 ADVANTAGES OF LLP

The following are the advantages of the LLP:

1. **EASY TO FORM**: LLP is comparatively easy to form then company. It does not have the long list of formalities as are there in company form of organisation.
2. **LIMITED LIABILITY:** The biggest advantage of LLP is its limited liability. LLP can own the property in its own name and the debts of the LLP are met out of those properties.

3. **PERPETUAL SUCCESSION:** Like company LLP also has perpetual succession which is not affected with the entry or exit of partner.
4. **NO MANDATORY AUDIT**: There is a compulsion of audit in company form of organization but this is not compulsory in case of LLP.
5. **EASY TRANSFER OF OWNERSHIP**: In LLP form of business it is easy to transfer ownership from one person to another. This is done as per the provisions of the partnership deed.
6. **NO DIVIDEND DISTRIBUTION TAX**: In case of LLP there is no burden to pay dividend distribution tax:
7. **MORE FLEXIBILITY TO MANAGE**: The management of company form of business is subject to very strict rules under the Companies Act. As far as LLP is concerned the rules of Management are not that strict.
8. **EASY FINANCE**: LLP form of business is regulated as per the provisions of the act, so it is easy for them to raise finance from the market.
9. **CAPACITY TO SUE:** LLP can you sue any third party in its own name.
10. **SEPARATE PROPERTY:** LLP can own separate property in its own name.

9.6 DISTINCTION BETWEEN LLP AND PARTNERSHIP FIRM

	Basis	**LLP**	**Partnership Firm**
1.	Controlling Act	LLP is controlled by Limited Liability Partnership Act, 2008.	Partnership is controlled by Indian Partnership Act, 1932.
2.	Body corporate	LLP is a separate body corporate.	Partnership is not a separate body corporate.
3.	Separate legal entity	LLP has separate legal entity that is distinct from its members.	Firm does not enjoy the benefit of separate legal entity.
4.	Name	As per provisions of Limited Liability Partnership Act, 2008 every LLP must use the word _LLP‘ after its name. For example the name of business is M/s ABC, so it must write _M/s ABC LLP‘.	There is no restriction on selection of name by the partnership firm.
5.	Creation	LLP is artificial person hence it is created under the Limited Liability Partnership Act, 2008.	Partnership is the result of agreement between the partners. Such agreement can be oral agreement or the written agreement.
6.	Perpetual succession	Like in company, LLP also enjoys perpetual succession. The existence of LLP is not affected by admission, death, retirement or other ineligibility of the member.	Firm does not enjoy perpetual succession. The existence of Firm is affected by admission, death, retirement or other ineligibility of the partner.

7.	Liability	In LLP members enjoy limited liability that is limited upto the contribution made by the members. However, in case of any fraud etc, their liability is unlimited.	In Partnership firm, the liability of partners is unlimited. Even their personal assets are liable for any loss incurred in the business.
8.	Registration	LLP cannot be formed without registration.	In firm registration is not compulsory and it can be formed without registration also. However, if a firm is not registered, it has to beard certain consequences.
9.	Designated partners	Every LLP must have minimum two designated partners.	Under the Indian partnership Act, 1932 there is no such concept of designated Partners.
10.	Mutual agency	In LLP, one partner is not bound by the conduct of other partner. In other words there is no mutual agency of the members in case of LLP.	In firm every member is treated as the agent of other person. So, any act done in the business by one partner has binding effect on the other partner.
11.	Legal compliance	In LLP it is the responsibility of the Designated partner to ensure compliance to all the rules and regulations.	In partnership legal compliance is the joint liability of all the partners.
12.	Common seal	A LLP could have a common seal. However, it is not necessary to have common seal. LLP can also carry business without common seal.	Firm could not have common seal.
13.	Foreign partnership	There is no restriction on foreign national becoming the member of LLP.	A Foreign national is not allowed to become partner in a partnership firm.
14.	Annual filing of documents	Every LLP must file some document on the yearly basis with the registrar. Following are some of the prominent documents that need to be filed : (i) Annual statement of accounts. (ii) Annual return with the registration of LLP. (iii) Statement of solvency.	There is no obligation on behalf of the firm to file any document with the registrar of firms.
15.	Transfer of Interest	In LLP a partner can transfer his interest in favour of some other person.	In partnership a partner cannot transfer his interest to any other person, even if he transfer his interest to some other person

			with consent of all other persons, it will be treated as a new partnership.
16.	Minor as partner	In a LLP, a minor cannot become a member.	A minor can become partner in a partnership firm in the benefits of the firm, however for this purpose consent of all the partners (not majority) is required.
17.	Maximum number of members	There is no restriction on maximum number of members in a LLP.	As per rules 10 of Companies (Misc.) Rules, 2014, the number of partners in a firm cannot exceed 50.
18.	Voting Right	In a LLP, every member enjoys one vote irrespective of capital contributed by him.	No concept of voting right in the firm.
19.	Recording of Minutes	Every LLP is supposed to record minutes of the meetings within 30 days of the meeting.	There is no binding for recording of minutes.
20.	Audit of Accounts.	It is compulsory for every LLP to get accounts audited in case their turnover exceeds Rs. 40 Lac or if there is capital contribution exceeding Rs. 25 Lakh.	No audit is compulsory under the Partnership Act. However, some audit rules are there under the income tax act.
22.	Digital Signature	As most of the forms of LLP are filed online. There is compulsion that atleast on designated partner must have digital signature.	There is no need of digital signature.

9.7 DISTINCTION BETWEEN LLP AND JOINT STOCK COMPANY

	Basis	**LLP**	**Company**
1.	Regulating Act	LLP is controlled by Limited Liability Partnership Act, 2008.	A company is controlled as per provisions of Companies Act, 2013.
2.	Internal governance structure	The management of LLP, rights and duties of partners, emoluments of the partners is decided by agreement between the partners.	Any company is governed as per provisions of the Company Act, 2013.
3.	Designated Partners	Every LLP must have minimum two designated partners.	Under the Companies Act 2013 there is no such concept of designated Partners.

4.	Name	As per provisions of Limited Liability Partnership Act, 2008 every LLP must use the word _LLP‘ after its name. For example the name of business is M/s ABC, so it must write _M/s ABC LLP‘.	As per Companies Act every Private Limited company must write the word _Private Limited‘ or _Pvt. Ltd‘ after its name, whereas public company must write word _Limited‘ after its name.
5.	Members/Partners	LLP is formed with minimum two partners and there is no restriction on maximum number of members in a LLP.	A private company is formed with minimum two members and maximum 50 members. A public company needs minimum 7 members for formation and there is no restriction on maximum number of members.
6.	Management	Operations of the LLP are managed by partners of the LLP who are owner of the business.	Company is not managed by the shareholders who are the true owners of the company, rather it is managed by the directors that are elected by the shareholders.
5.	Minimum number of directors/ designated partners	Every LLP must have minimum two designated partners.	Company form does not have concept of Designated Partners. Company is managed by Directors. For private company there should be minimum two directors whereas in public company there should be minimum three directors.
7.	Voting Right	Every partner of the LLP enjoys one vote irrespective of the capital contributed by him.	In company each equity share carries one vote. So, the voting rights of person depends upon the number of shares held by him.
8.	Liability of members/partners	In LLP members enjoy limited liability that is limited upto the contribution made by the members. However, in case of any fraud etc, their liability is unlimited.	The liability of members is always limited upto the amount of share capital subscribed by them.

9.	Minimum Capital	No minimum capital is prescribed by LLP act for any LLP.	In private limited company the minimum capital prescribed is Rs. One Lac whereas for Public Company minimum capital prescribed is Rs. Five Lac.
10.	Accounting System	LLP could follow Cash System or Accrual System for maintaining accounts.	Company can follow only Accrual system of accounting.
11.	Memorandum and Article of Associations	No need to prepare Memorandum and Article of Associations in case of LLP.	Memorandum and Article of Associations is compulsory for every company.
12.	Public Subscription	LLP cannot invite public for subscription of capital.	Public company can invite public for subscription of capital.
13.	Transfer of Share	In case of death of any partner his legal heir can demand capital back or could demand share of profit to the date of death. But he automatically does not become partner of the LLP.	In company on death of member, his legal heir automatically becomes member of the company.
14.	Admission	A new partner can be admitted only if there is consent of all the existing partners.	No consent of other members is required for admission of new member.

9.8 INCORPORATION OF LLP

Following are some of the mandatory requirement under the LLP, Act 2008, without complying with following requirements, no LLP can be formed in India.

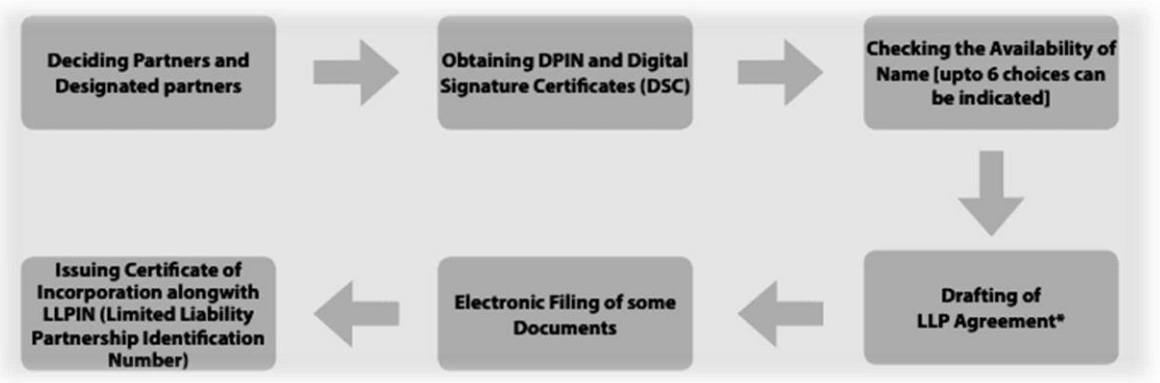
1. The registration of LLP is compulsory and for that the application form is submitted with the registrar. Under the LLP act only electronic submission of the form is possible. show any person desirous of applying for LLP must submit the form electronically.
2. As per LLP act, there must be minimum two partners in any LLP. So, for forming the LLP minimum two members should join their hands. However, it is important to mention here that members of LLP should not necessarily be individuals, rather even a body corporate can become a member in the LLP. Any person of unsound mind or a person against whom insolvency proceedings are pending cannot become member of LLP.
3. LLP has unique concept of designated partner. We should not confuse a designated partner with the working partner. Even a non designated partner could be a working

partner in the LLP. The main responsibilitys of designated partner is to ensure that all the statutory and legal requirements are met by the LLP. He is the person, who is responsible for complying with all the legal formalities related to LLP

4. LLP should have minimum two designated partners. Is important to mention here that only individuals can be appointed as designated partners. So, if any body corporate is member of the LLP, they can nominate any individual as the designated partner. Further out of the designated partners at least one designated partner should be resident of India.
5. Like in company every director should have director identification number, Any designated partner should have Designated Partner Identification Number. this number is allotted by Ministry of Corporate Affairs.
6. Like in partnership firm, LLP should also have agreement between the partners. This agreement between the partners will decide their rights and duties. In case there is no partnership agreement between the partners in a LLP, he LLP will be governed as per rules given in First schedule of LLP act
7. Any LLP should have a unique name. This name is approved by government before incorporation of the LLP. There are certain rules related to selection of names in the LLP.

9.9 INCORPORATION PROCESS (SECTION 11 TO 21)

The process of incorporation of LLP is given in the Limited Liability Partnership Act, 2008. There are some similarities in incorporation of LLP and a company. But the process of incorporation of LLP is not that cumbersome as that of a company. Following diagram shows the process of incorporation of LLP.



9.9.1 PARTNER: For formation of any LLP, first requirement is that there should be minimum two members. There is no restriction on a body corporate on becoming member of the LLP. In case a body corporate becomes the member of LLP, they need to appoint any natural person to look after the affairs of LLP. Following persons can become member of the LLP .

1. Any company can become member of LLP whether that company is incorporated in India or outside India.

2. A LLP could also become member in another LLP in India. That LLP may be incorporated in India or outside India.
3. Any individual whether resident of India not resident of India, can become member of LLP, provided he is not declared ineligible under the LLP act. Any person of unsound Mind or undischarged insolvent are not eligible to become member of LLP.

It is important to mention here that any LLP should have minimum 2 members. In case the number of members is reduced less than two and firm carries business with less than two persons for more than 6 months, the person who carried out all the activities, alone will be personally liable for the obligations that are incurred by LLP during such period of continuance.

9.9.2 CAPITAL CONTRIBUTION: Like any company has share capital, there is no share capital in LLP form of the business. However, the partner are required to make contribution to the LLP as per the provisions of the agreement between the partner. Such contribution may be in the form of cash, any property which may include movable property, immovable property, intangible assets etc. Even any contract by partner to perform some service may also be considered as capital contribution. Capital so contributed by the partners, is recorded in the monetary terms in the books of accounts of LLP.

9.9.3 DESIGNATED PARTNERS: A LLP should have minimum 2 designated partners. Normally a layman thinks that designated partner is a working partner. However this is not the reality. Even a person who is not a designated partner could be a working partner in the LLP. The designated partner is appointed with the objective of meeting statutory and legal compliances under the LLP Act. He is the person who is responsible for meeting all the legal formalities and other compliances as per the rules. Only in natural person can be appointed as designated partner. If a body corporate become the member of LLP, they can appoint any individual on their behalf as designated partner. LLP should have minimum 2 designated partner and out of such partners at least one partner should be a resident of India. The term resident here means that person should reside in India for at least 182 days during one year in the preceding year.

FOLLOWING ARE SOME OF THE IMPORTANT RESPONSIBILITIES PERFORMED BY A DESIGNATED PARTNER :

1. If there is any change in the partnership agreement it is responsibility of the designated partner to inform the registrar about such change.
2. If there is any change in the constitution of the firm, any partner is admitted or retired or there is change in the address of the partner, it is responsibility of designated partner to inform the registrar about such change.
3. According to LLP Act every LLP should have a registered office. In case of any change in the address of registered office, the same must be informed to Registrar by the Designated Partner.
4. It is responsibility of the designated partner to file annual returns, statement of account or other notified document as per the provisions of the act with the registrar.

5. Statement of Accounts and the Statement of solvency of LLP are issued under the signature of designated officer.
6. Designated partner must preserve the books of accounts of the firm and whenever these are asked by any authority he must produce such books of accounts before such authority.
7. Designated partner will sign all the requisite forms that LLP is forced to submit with the registrar. For this purpose, every designated partner must get digital signature authority from the government.

if any designated partner fails to perform any of the above mentioned up he is liable to pay a financial penalty as per rules of the LLP act.

Meaning	A Designated Partner means any partner designated as such as per provision given in Section 7 of the LLP Act.
Minimum Number	Every LLP must have minimum 2 individuals as designated partners and at least 1 of them must be a resident in India. The term "resident in India" means a person who has stayed in India for a period of a minimum 182 days during the immediately preceding 1 year. Note: Only Nominated individuals of body corporate partners of LLP can act as designated partners.
Who will be a Designated Partner? (Section 7)	As per Section 7 (1), if the Incorporation Document-specifies who are to be designated partners, then such persons shall be designated partners on incorporation or if it states that each of the partners from time to time of LLP is to be designated partner, then every partner shall be a designated partner in LLP.
Cease to be a Designated Partner	Once a person is declared as designated partner it does not mean that he will remain designated partner for all of his life. if a person desires he could cease to be Designated partner as per provision LLP act.
Prior Consent Section 7(3)	Every person who is declared as designated partner, must give his prior consent before becoming the designated partner. A person cannot be declared as designated partner without the prior consent.
Information with Registrar Section 7(4)	It is responsibility of LLP to file full particulars of the person who gave his consent for becoming designated partner with the registrar. Such information must be provided to the registrar within 30 days of the appointment of the person as designated partner.
Satisfy Conditions Section 7(4)	A person can be appointed as designated partner only if satisfy all the conditions that are prescribed under the LLP act.

Liabilities of Designated Patner (Section 8)	As discussed earlier, the main liability of designated partner is to ensure legal compliance of all the rules by the the LLP. every LLP is post to file certain documents and reports with the authorities and it is the duty of designated partner to file such documents anf reports.
Changes in Designated Partners (Section 9)	In case there is any vacancy of designated partner and the number of designated partners are reduced to less than 2, such vacancy must be filled within 30 days. In case LLP fails to fill such within prescribed time vacancy all the partners of the LLP shall be treated as designated partner till such vacancy is filled.
Punishment for contravention of Sections 7, 8 and 9	If any LLP does not follow the provisions given in the section 7, 8 or 9 of the LLP act, then every member of the LLP is liable to pay a financial penalty as per rules of the act. The minimum amount of penalty is Rs, 10,000 but this may go up to Rs. 5,00,000 also.

9.8.4 DESIGNATED PARTNER IDENTIFICATION NUMBER (DPIN): Every Designated partner is supposed to have a Unique Identification number that is known as Designated Partner Identification Number (DPIN). DPIN is a 8 digit number that is allotted by the central government and is valid throughout the country. Fo rgetting DPIN a person must apply online by filling the form number 7 and submitting the application along with necessary proof of identity and address. Person must also deposit the prescribed fees. Every designated partner of LLP is supposed to have separate DPIN. Some time it may be possible that a person is already having Director Identification Number (DIN) in such case the same number is allotted as DPIN and for this while making the application person must quote his present b DPIN in the application form. Once a person gets the DPIN, he can use same number in all the LLP in which he is the partner.

9.8.5 DIGITAL SIGNATURE CERTIFICATE (DSC): Every LLP is supposed to file certain documents and information with the authorities, and most of such information and documents are filed electronically online. However, there is a problem of authentication when such documents are filed electronically. When any document is submitted in the physical form, it is signed by the concerned partner. But in case of electronic filing such signature is not possible. Therefore, the LLP act provide that at least one of the designated partner must have Digital Signature Certificate. This certificate is allotted by the central government and is very important in authentication of documents.

9.8.6 CHECKING THE NAME AVAILABILITY: Name of the LLP it is very important as it is the identity of the business, but partners of LLP cannot decide any name of their choice for their LLP, the name that they intend to opt, must be e approved by the registrar. For this purpose they must apply to the Registrar on the prescribed form along with prescribed fees. Normally they can propose up to 6 names to the registrar in order of their preference. Upon receiving the application, Registrar will check that whether name proposed by LLP is available and it is not having resemblance to the name of any existing entity.

Further, he will check that name does not contain any prohibited word like government or state etc. Once he is satisfied that name is is unique and does not contain any prohibited word, he will reserve the name for the LLP for 3 months. If any LLP subsequently wants to change their name, they can do so by following prescribed procedure that is filing the prescribed Form and requisite fee. Every LLP is required to add words LLP behind its name . According to Section 17 if any name is allotted to the LLP and subsequently Registrar or Government finds that the name of LLP resembles to any existing entity, they can direct the LLP to change its name. In such case the LLP will carry out the required formalities within three months from getting the directions from the government.

Further Section 18 of the act provide that if any existing entity finds that it the name of newly formed entity resembles to their name they can put their request before the registrar. In such case the registrar will check the merit of the application and if it is found that really there is resemblance in the name, he can issue directions to the newly formed entity to change its name. However, existing entity can give such application only within 24 months of formation of new entity. In case the period of 24 months is already over, then such application cannot be given.

9.8.7 INCORPORATION APPLICATION: LLP is an artificial legal person and can be formed only by incorporation. For this purpose partners are required to submit necessary application in form 2 to the Registrar in whose jurisdiction the registered office of proposed LLP falls. Following are some of the rules in this regard.

1. Minimum two Subscribers	Every LLP must have two partners who are eligible to make contract and are not barred by any law. So, the application of the incorporation must be signed by atleast two persons who are ready to become partner of the proposed LLP.
2. Contents	Following are some of the formalities of incorporation application • Application must be in a prescribed form. • It must give the name of LLP which is already approved by the concerned Registrar. • Application must give the proposed business which LLP intend to carry. • It must contain the address of registered office of the LLP. • Application must contain the name and address of each person who give consent to become partner of the LLP. • It must also give the name and address of each person who give consent to become designated partners of LLP.

3. Required Documents	Following are required documents which must be attached to the incorporation application: • PAN Card of the Partners. • Any proof of identity of the partners. • Valid Proof of Address of the partners • Passport of the partner if partner is not resident of India. • Photograph of the partners. • Proof of Address of Registered Office • Digital Signature Certificate
4.Compliance Statement	Every application of the incorporation must be accompanied by the compliance certificate in the prescribed form. Such certificate can be issued by the Lawyer of the business, Chartered Accountant (CA), Company Secretary (CS) or a Cost Accountant (CMA. This certificate declared that all the required formalities have been fulfilled by the proposed LLP.
5. Filing of Application	Once the application form is filled, all the necessary documents and compliance certificate are attached the same must be filed with Registrar office along with prescribed fee under whose jurisdiction the registered office of the proposed LLP is situated.

9.8.8 REGISTRATION FEE: Every application of incorporation of LLP must be deposited along with requisite fee. This fee is not only applicable for new LLP but also if any existing partnership firm is changing its business to LLP or any existing private or unlisted company is changing it business to LLP. Following are the amount that business is supposed to deposit:

a) LLP where capital contribution does not exceeds Rs. 1 lakh	Rs.500/-
(b) LLP where capital contribution is more than Rs. 1 lakh but less than Rs. 5 lakhs	Rs. 2000/-
(c) LLP where capital contribution is more than Rs. 5 lakhs but is not more than Rs. 10 lakhs	Rs. 4000/-
(d) LLP where capital contribution is more than Rs. 10 lakh	Rs 5000/

7.8.9 LLP AGREEMENT:

- **MEANING:** Whenever any LLP is formed, the partners of LLP enters into agreement with each other, that agreement is called LLP agreement.
- **SIGNIFICANCE:** Limited Liability Partnership (LLP) Agreement is very important and in a way we can say it is charter of the LLP. The rights and duties of the partners of LLP are decided by this agreement. Normally this agreement is prepared when the registration of the LLP is done. In case this agreement was prepared before the registration of the LLP, in such case the partners must ratify the same at the time of incorporation of the LLP.
- **FIRST SCHEDULE:** Sometimes, partners fails to enter into LLP agreement at time of incorporation of the LLP. In such case the provisions of First Schedule of LLP act will decide the all the matters of LLP. However, later if

partners decide to enter into an agreement they can do so but they have to inform Registrar about their new agreement.

- **DRAFTING OF AGREEMENT**

  There is no prescribed performa of the LLP agreement. Further there is no compulsion on the contents of the agreement also. Normally any agreement contains the information about the nature of business, rights and duties of the partners, their capital contribution, profits sharing ratio etc. Following are some of the important contents that are generally covered in any LLP agreement.

  - ❖ Name of LLP
  - ❖ Name and address of all Partners including Designated Partners.
  - ❖ Capital contribution of the partners.
  - ❖ Partner‘s Remuneration.
  - ❖ Rights and Duties of Partners
  - ❖ Profit sharing ratio
  - ❖ Address of registered office.
  - ❖ Arbitration clause if any.
  - ❖ Rules for governing LLP.
- **FILING OF AGREEMENT:** Every LLP must file the LLP agreement within 30 days of incorporation of the LLP with the Registrar. Such filing must be done in the and Form 3.
- **AMENDMENT TO THE AGREEMENT:** In case there is any change in the LLP agreement the same must be informed to the Registrar in Form 3 within 30 days of such change in the agreement.

9.8.10 INCORPORATION BY REGISTRATION (SECTION 12): .Once all the formalities of registration are done by the LLP and verified by the registrar, certificate of Registration is issued to the LLP. The very moment such certificate is issued, LLP comes into existence. Following are some of the rules in this respect.

1. Certificate of Registration	After the application of registration is filed with the registrar, he will check that all the formalities laid in the section 11 of the act are cmplied by the LLP. After such checking certificate of registration will be issued ot the LLP within 14 days from completion of all formalities.
2. Signature	The certificate issued to the LLP must be signed by the Registrar.
3. Official Seal	Every certificate of registration must be issued to the LLP must bear the official seal of the registrar.
4. Conclusive Evidence	The certificate of incorporation is very important as it is the conclusive proof that the LLP is formed and the name mentioned in the certificate is the authentic name of the LLP.

After incorporation of the LLP is done, it is authorised to :

- ✓ Purchase, acquire and own any type of property whether movable or immovable, tangible or intangible.
- ✓ It is now legal entity and can sue any third party.
- ✓ LLP could have common seal but it is not compulsory that LLP should have common seal. It can be managed without common seal also.

9.8.11 PARTNERS AND THEIR RELATIONS: The partners of the LLP are not the mutual agent of each other and are responsible for own acts only. Following are some the provisions of LLP act regarding Partners and their relations.

1. Eligibility of Partner (Section 22)	According to this section a partner is a person who subscribe to the incorporation document of the LLP or a person who later become partner with consent of all the partners as per rules laid in the partnership agreement.
2. Mutual relations of the partners (Section 23)	• The rights and duties of the partners and their mutual relations are decided by the LLP agreement. • In case of any change in their rights and duties, it must be informed to Registrar with prescribed fee and in prescribed form. • In case the agreement was agreed before incorporation, it must be ratified by the partners after incorporation. • In case there is no agreement between partners, LLP will be governed as per the rules given in First schedule of LLP act.
3. Cessation of partnership interest(Section 24)	• If any partner wants to cease his partnership from LLP, it can be done as per provisions of the LLP agreement. In case of no provision in LLP agreement, he can cease to be member by giving minimum 30 days notice. • A person will cease his membership from the LLP in following cases - Death of the partner. - He became person of unsound mind. - He is declared insolvent. • Even if a person is ceased to be partner of the firm, he will still be liable in the LLP unless - He has given notice to his former partners. - He has given notice to the Registrar. • Even if any person cease to be member, still he will be liable for the obligations that were created when he was the partner of the LLP. • After a person cease to be member, he or his legal heir are eligible to the amount contributed by him and the share of profit to the date of cessation of membership. • A person is not having any right to interfere in the management of the Business after he ceases to be partner.

4. Change in Registration (Section 25)	• If there is change in name or address of any partner, he must inform the same to LLP within 15 days of such change. • LLP must inform Registrar about any change in name address of the partners. • The change must be informed in prescribed form along with prescribed fee.

9.10 DEMERITS of LLP

There are certain procedure to be followed by the LLP such as filing of Annual Returns, Solvency statements and accounts, etc. which might be difficult for a family run business. There are also certain demerits of LLP form of business given as follows:

a. LLP is regulated by provisions of LLP Act and is subject to some rules like annual filing of return, solvency statement etc, which are difficult to comply with.
b. In most of the cases, LLP is liable for audit of accounts.
c. The process of closing down of LLP is quite long and need lot of formalities.
d. LLP is new form of business and still not much popular in India.
e. The responsibility of Designated partners is more than other partners. They have to comply with all the legal formalities.
f. In case of mismanagement in the LLP, creditors don‘t have any remedy.
g. Transfer of interest by one partner to other is not easy.

9.11 TEST YOUR UNDERSTANDING

1. State whether following are True of False

a. A minor can become partner is a LLP
b. LLP could have maximum 50 members.
c. Rules of Indian Partnership Act are also applicable on LLP.
d. In LLP partner can transfer his interest.
e. Partners are mutual agents of each other in LLP.

2. FILL IN THE BLANKS

a. _____partner is liable to ensure legal compliance.

b. LLP must have minimum_____partners.

c. An Individual as well as_____can become member of LLP.

d. Online submitted documents of LLP are authenticated by_____.

e. If LLP agreement is not there, LLP is governed by provisions of _____.

3. Write five differences between LLP and Firm:

	LLP	**Partnership Firm**
1.		
2.		
3.		
4.		
5.		

9.12 LET US SUM UP

- LLP is a new form of business in India.
- LLP is governed by provisions of Limited Liability Partnership Act, 2008.
- LLP act provide that existing partnership, Limited company or unlisted company can also be converted into LLP.
- LLP must have minimum two partners and there is no restriction on maximum number of Partners.
- Any individual or body corporate can become member of LLP.
- Liability of partners is limited upto their capital contribution.
- Minor cannot become partner in LLP.
- LLP must have atleast two individuals as Designated Parnters.
- LLP is formed by incorporation.
- The rights and duties of LLP are decided by LLP agreement.

9.13 KEY TERMS

- **LIMITED LIABILITY PARTNERSHIP (LLP)**: A limited liability partnership(LLP) is a body corporate, an artificial person which have separate legal entity than its owners perpetual succession having a common seal and the liability of the business is limited.
- **DESIGNATED PARTNERS**: A LLP should have minimum 2 designated partners. The designated partner is liable to ensure that all meeting statutory and legal compliances under the LLP Act are met on time. He is the person who is responsible for meeting all the legal formalities and other compliances as per the rules. Only in natural person can be appointed as designated partner. If a body corporate become the member of LLP, they can appoint any individual on their behalf as designated partner.
- **DESIGNATED PARTNER IDENTIFICATION NUMBER (DPIN):** Every Designated partner is supposed to have a Unique Identification number that is known as Designated Partner Identification Number (DPIN). DPIN is a 8 digit number that is allotted by the central government and is valid throughout the country. For getting DPIN a person must apply online by filling the form number 7 and submitting the application along with necessary proof of identity and address.

- **DIGITAL SIGNATURE CERTIFICATE (DSC):** Every LLP is supposed to file certain documents and information with the authorities, and most of such information and documents are filed electronically online. Therefore, the LLP act provide that at least one of the designated partner must have Digital Signature Certificate. This certificate is allotted by the central government and is very important in authentication of documents.
- **INCORPORATION APPLICATION:** LLP is an artificial legal person and can be formed only by incorporation. For this purpose partners are required to submit necessary application in form 2 to the Registrar in whose jurisdiction the registered office of proposed LLP falls.

- **INCORPORATION BY REGISTRATION (SECTION 12):** .Once all the formalities of registration are done by the LLP and verified by the registrar, certificate of Registration is issued to the LLP. The very moment such certificate is issued, LLP comes into existence.
- **LLP AGREEMENT:** Whenever any LLP is formed, the partners of LLP enters into agreement with each other, that agreement is called LLP agreement. Limited Liability Partnership (LLP) Agreement is very important and in a way we can say it is charter of the LLP. The rights and duties of the partners of LLP are decided by this agreement.
- **PARTNERS AND THEIR RELATIONS:** The partners of the LLP are not the mutual agent of each other and are responsible for own acts only.

9.14 REVIEW QUESTIONS

1. What is Limited Liability Partnership (LLP)? Give its merits and limitations.
2. Give salient features of Limited Liability Partnership (LLP).
3. How a Limited Liability Partnership (LLP) is different from Partnership Firm.
4. Distinguish between Limited Liability Partnership (LLP) and a Joint Stock Company.
5. What is Designated Partner. Give rules regarding appointment and responsibilities of Designated Partner.
6. What is LLP agreement. What is its significance. Give its contents.
7. Write in detail procedure of incorporation of LLP.
8. What is Incorporation by registration? Give its rules.
9. Write a note on relation among the partners in LLP.

9.15 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

1 (a) False,
1 (b) False
1 (c) False,

1 (d) True.

1 (e) False.

2 (a) Designated

2 (b) Two

2 (c) Body Corporate

2 (d) Digital Signature

2 (e) First Schedule

9.16 FURTHER READINGS

1. M.C. Kuchhal, and Vivek Kuchhal, *Business Law*, Vikas Publishing House, New Delhi.
2. SN Maheshwari and SK Maheshwari, *Business Law*, National Publishing House, New Delhi.
3. Aggarwal S K, *Business Law*, Galgotia Publishers Company, New Delhi.
4. P C Tulsian and Bharat Tulsian, *Business Law*, McGraw Hill Education
5. Sharma, J.P. and Sunaina Kanojia, *Business Laws*, Ane Books Pvt. Ltd., New Delhi

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 10 – NEGOTIABLE INSTRUMENT: MEANING, BILLS OF EXCHANGE AND PROMISSORY NOTES

STRUCTURE

10.0 OBJECTIVES

After studying the Unit, students will be able to

- Understand the Meaning of Negotiable Instruments.

- Describe Characteristics of Negotiable Instruments.
- Explain presumptions available to Holder of Negotiable Instruments.
- Understand various Negotiable Instruments recognized by Law.
- Describe Meaning and Features of Promissory Notes
- Explain the Meaning and Features of Bills of Exchange.
- Distinguish Between Bills of Exchange and Promissory Note

10. 1 INTRODUCTION:

In India, use of Negotiable instruments is not new and it was prevalent during the time of kings also. We can see the use of ‗Hundi' in old time also which is almost similar to present time Bills of Exchange. The word ‗hundi', came from the Sanskrit word ‗hund', which means ‗to collect' , so it was an instrument which gave power to one person to collect money from other person. However, when British came to India, the number of commercial activities increased due to which there was more demand of money and other instruments. So, came the term Negotiable Instrument in use. The transactions related to Negotiable Instruments in India are regulated by a seprate law which is known as ‗The Negotiable Instruments Act'. This act was designed during the British rule in our country in the year 1881. Before 1881 all the matters related to Negotiable Instruments were covered under the ‗Indian Contract Act 1872'.

10.2 MEANING OF NEGOTIABLE INSTRUMENTS (SECTION 13):

The term ‗Negotiable Instrument' forms of two parts, ‗Negotiable' and ‗Instrument'. The word ‗negotiable' means any thing capable of free transfer by one person to any other person without much difficulty, and the word ‗instrument' here means ‗any written document' that creates legal right of one person over the other person. So, we can say the term ‗Negotiable Instrument' means any ‗ written document, through which a person gets the right over the other person and such right is easily transferable by him to other person.

Section 13 of the Negotiable Instruments Act, 1881 states, ―A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer.‖ A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one of two, or one or some of several payees.

In the words of Justice, Willis, ―A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it‖. So, from the definition following points becomes clear:

1. The instrument must be capable of free transfer (by delivery or by endorsement. and delivery) by one person to another; and
2. The person who gets the delivery of Negotiable Instrument in good faith by paying some consideration, gets valid title of the instrument free from all defects, and gets the right to recover the money in his own name.

Though in different parts of world, different types of Negotiable Instruments are in practice such as, share warrants that are payable to bearer, Debentures of the company payable to bearer and warrants of dividend etc. But, in India the Act treats only three instruments as Negotiable Instruments which include promissory note, a bill of exchange and cheque.

The Negotiable instrument Act works under the rules fixed by the Sections 31 and 32 of the Reserve Bank of India Act, 1934. According to Section 31 of the RBI Act, except Bank or the person having authority of RBI, no person in the country, shall issue, draw, make acceptance of any bill of exchange or promissory note payable to bearer on demand. The rules further provides that no person other than RBI or the Central Government of the country can issue any promissory note that is payable on demand. Under given are the effect of these section 31 and 32 of RBI Act:

- A promissory note that is payable to the bearer cannot be issued in the country, no matter whether it is demand promissory note or term promissory note.
- A bill of exchange that is payable to the bearer can be issued provided if this is a term bill. However a demand Bill that is payable to bearer cannot be issued.
- But a cheque can be made payable to bearer or demand as it is withdrawn on Bank.

10.3 CHARACTERISTICS OF NEGOTIABLE INSTRUMENTS:

a) **IN WITTING**: As per Negotiable Instrument Act, any negotiable instrument cannot be made by oral commitment and it must be in writing. Any oral promise to make payment by one party to another is covered under the Indian Contract Act and not under the Negotiable Instrument Act.

b) **SIGNED BY THE PARTIES:** Any negotiable instrument must be signed by the concerned party. In case signature on Negotiable Instrument are missing, it is not valid. So if A gives cheque to B without making any sign on it, this cheque is not valid.

c) **PAYABLE IN MONEY:** Negotiable Instruments are valid if it is payable in money only. If any instruments gives right to other person to supply something except money it is covered under the Indian Contract Act and not under the Negotiable Instrument Act. Further it must be payable in legal tender money only.

d) **UNCONDITIONAL PROMISE:** For any Negotiable Instrument to be valid, it must be unconditional. In case of a promissory note, it is valid it it contain an unconditional promise to make payment. Similarly in case of bill or cheque, it must be an unconditional order to make payment.

e) **FREELY TRANSFERABLE:** The most important feature of Negotiable Instrument is that it is freely transferable. The instrument must be freely transferable, i.e. the title to the ownership of the instrument could be transferred, from one person to any other person, without any restrictions. Such transfer of ownership can be done by way of mere delivery, in case the instrument is a bearer instrument, and by endorsement and after that delivery, if the instrument is an order instrument.

f) **ACQUISITION OF PROPERTY:** Any person, who is in possession a negotiable instruments in his own name, becomes the owner and is entitled to the money, mentioned in the instrument. If any instrument is payable to bearer, the title of the instrument passes

from one person to another person by just delivery of the instrument. However, If it is payable to order, the title passes by endorsement of the instrument, i.e. by putting signature of its holder on its back and than making the delivery.

g) **ACQUISITION OF GOOD TITLE:** In case of Negotiable Instruments, Holder‘s Title is Free from all Defects if he fulfills certain conditions. In case a person is ‗holder in due course‘ of a instrument, he gets good title. A ‗holder in due course‘ is a person who gets the ownership to the instrument, for some consideration and in good faith, without any information in regard to any defect in the title of the person who hands over instrument to him. So, the ‗holder in due course‘ will get the good title of the instrument even if there has been some defect in the title of the person who transfers such instrument if such defect in not in the knowledge of ‗holder in due course‘. This feature is not there in other acts like Sale of Goods Act etc. In that case if the title of transferor is defective, the title of transferee also becomes defective. So, in case of Negotiable Instrument if a person steals instrument of other and transfers it to other person for some value in good faith, other person will get good title of instrument.

h) **NO NEED OF GIVING NOTICE:** In case of transfer for Negotiable Instrument by one party to another, there is no need of serving the notice of transfer to the prior parties that are liable to pay the money.

i) **HOLDER IN DUE COURSE CAN SUE IN HIS OWN NAME:** The holder in due course of Negotiable Instruments is having the right to sue all the prior parties in his own name as regard to the instrument,

j) **TRANSFERRED ANY NUMBER OF TIMES:** A negotiable instrument is capable of being transferred innumerable number of times (i.e. any number of times, also referred to as infinitum) before it gets expired.

k) **CERTAIN PRESUMPTIONS:** Presumption are some suppositions that are made by law. In case of Negotiable Instruments unless contrary is proved, certain presumptions are made by the law. Consideration, Date of instrument, signature of persone, are some example, presumed in the case of Negotiable instruments. The presumptions are given in section 118 to 119.

10.4 EXAMPLES OF NEGOTIABLE INSTRUMENTS:

A. NEGOTIABLE INSTRUMENTS COVERED UNDER THE LAW :

1. Promissory Note
2. Bill of Exchange
3. Cheque

B. NEGOTIABLE INSTRUMENTS COVERED UNDER USAGE/CUSTOM:

1. Hundi
2. Dividend Warrant
3. Warrant of Shares
4. Bearer Debenture
5. Banker‘s Note
6. Draft issued by bank.

C. NON NEGOTIABLE INSTRUMENTS

1. Money Order
2. Postal Order issued by Post office
3. Deposit Receipt issued by any person or bank
4. Shares of a company

D. QUASI NEGOTIABLE INSTRUMENTS: Quasi Negotiable Instruments are the Instruments that are capable of being transferred by endorsement and delivery but in such case the transferee does not get a better title than a person who makes the transfer. So, we cannot term these instruments as Negotiable Instrument as the rules and regulations of the Negotiable Instruments Act are not applicable in case of these instruments. For example government promissory notes, railway receipts, bill of lading, Dividend warrants of a company or the share warrants issued by company.

1. Bill of Lading
2. Carriers Receipt
3. Dividend Warrant
4. Letters of Credit
5. Railway Receipt
6. Lorry Receipt
7. Dock Warrant

10.5 PRESUMPTIONS OF NEGOTIABLE INSTRUMENTS (SECTION 118)

A negotiable instrument is dealt with certain presumptions. These presumptions are given under the Negotiable Instrument Act under Sections 118 and 119. Presumptions are those presuppositions that are made by law in case of instruments. These are listed below::

1. **CONSIDERATION:** Unless contrary is proved, It is presumed in case of negotiable instrument that every instrument ismade or endorsed, or transferred against some consideration. In this case the holder need not prove that he made consideration. However, this presumption is not valid if it is proved that the instrument was obtained by a person under any offence, fraud, or for some unlawful consideration. However, one must be clearly understood that consideration is automatically presumed in all the cases. In simple words, the presumption regarding the presence of consideration in negotiable instruments also challengeable. This rule is based on the decsion made by the honorable judge of the Kerala High Court in the case of **Marimuthu Kounder vs Radhakrishnan** In such case that consideration is missing, the onus of proof, lies on the
2. **DATE:** It is presumed that every negotiable instrument is made on the date is written on the instrument. However, this presumption is not valid if contrary is proved.
3. **TIME OF ACCEPTANCE:** Under Negotiable Instruments Act is is assumed that every instrument is accepted within a reasonable time after its presentation and and before its became due for payment. Further, if the instrument is payable particular number of days or months after its date, its date of maturity is calculated from the

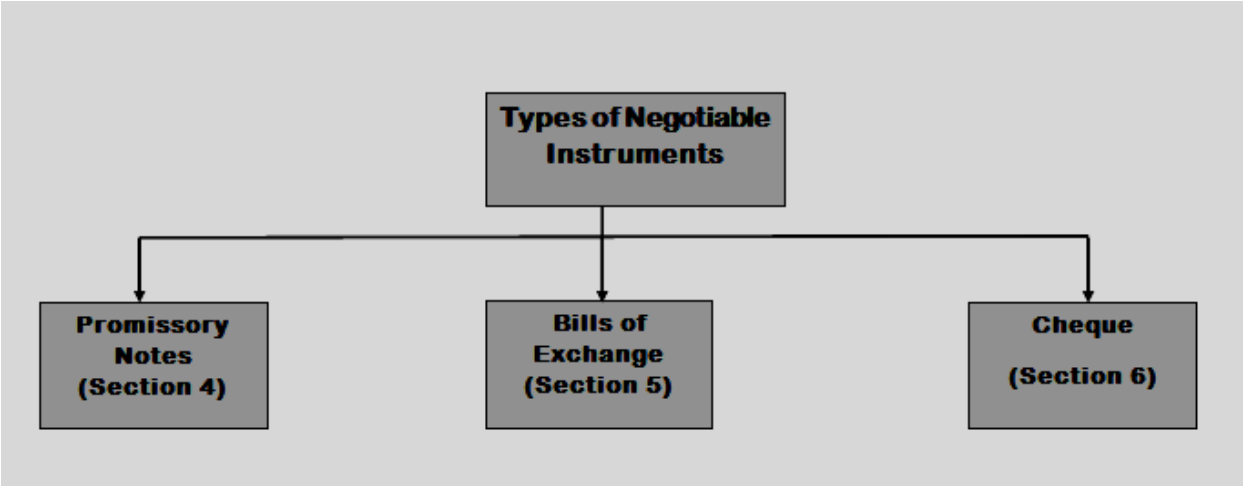
date appearing on the instrument. But, if it is payable certain days after its acceptance, it‘s date of maturity is calculated from the date of its acceptance.

4. **TIME OF TRANSFER:** In case of Negotiable Instruments, it is presumed that every transfer is made before the bill became due for payment. This presumption is applicable only in case of Time Bill, as in case of demand bill, there is no time limit, there is no time limit, there is no need of such presumption.

5. **ORDER OF ENDORSEMENTS:** In order to decide the liability of the various parties, the order of endorsement of instrument is very important. It is presumed that he endorsements are made in the similar order that appears on the instrument. However, if some evidence of contrary endorsements exist, than this presumption is not there.
6. **STAMP:** In case any negotiable instrument is lost, presumption will be made that instrument was duly stamped and the stamp was duly cancelled as per the rules of the Act.
7. **EVERY HOLDER IS A HOLDER IN DUE COURSE**: In absence of the contrary proof, it is always presumed that the holder of the negotiable instrument is a person in capacity of holder in due course. It is assumed that the holder gets negotiable against some consideration and has taken the instrument in good faith. But in case any instrument is taken from its lawful owner by using some offence or fraud, the holder has to prove that he has taken it in good faith.
8. **DISHONOUR OF INSTRUMENT:** In case a suit of dishonor of instrument is filed the in court along with the proof of Protest of the instrument, it will be assumed that the instrument was dishonoured.

10.6 TYPES OF NEGOTIABLE INSTRUMENTS:

There are many instruments that can be regarded as Negotiable Instruments. We can divide these instruments broadly in two categories, one instruments treated as Negotiable under the Act and second those instruments that are regarded Negotiable due to usage or custom of trade. According to Section 13 of the Negotiable Instruments Act only three instruments that is Cheque, Promissory Note and Bill of Exchange are considered as Negotiable instruments. However, there are some instruments that are considered Negotiable due to usage or custom of business, that included Hundi, Share warrants, Bankers draft Dividend Warrant and Railway receipts etc. However, our discussion in this section will be limited to Negotiable Instruments that are considered Negotiable under the Act.



10.7 MEANING OF PROMISSORY NOTES (SECTION 4)

Promissory note is one important Negotiable Instrument and is in practice since long may be in one form or other. Under the Negotiable Instruments Act, Promissory Note is a written document containing an unconditionaln promise by a person who writes such document (called the maker) to pay some other person (called the payee) a particular sum of money either on demand made by the person on a particular or ascertainable future date. Such instrument may be payable to the person bearing the instrument or to a person named in the instrument, or to the order of the person whose name is mentioned in the instrument.

According to the Section 4 of the Negotiable Instrument Act, 1881 –A Promissory Note is an instrument in writing not being a bank note or a current note containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or do the order of, a certain person, or to the bearer of the instrument.‖

On the basis of above definition, following points emerge related to Promissory Notes:

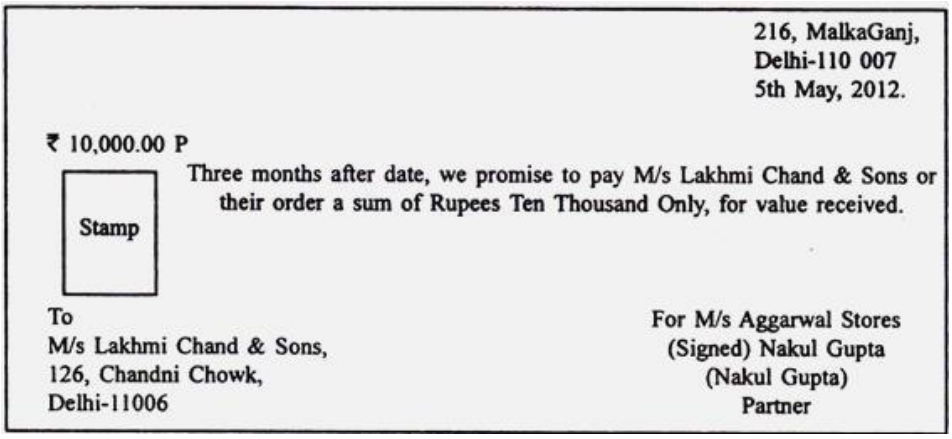
(a) It is an instrument in writing.
(b) It is not Bank note or currency note.
(c) It is always Unconditional.
(d) It is Promise to pay
(e) It is signed by maker.
(f) It is to pay money only

Though there are many things or conditions to make an Instrument a Promissory Note, but there is no hard or fast performa of Promissory note. It can be in any format.

Negotiable instruments act does not provide any legal performa for making Promissory Note. It can be written in any language or in any format. However, the conditions laid out by the act must be met to make it a valid Promissory Note. An Instrument signed by maker in any of the following terms is regarded as Negotiable Instrument:

(a) "I promise to Pay Gopala or his order Rs. 80,000".
(b) –I promise to pay Simran Rs. 6,500/- on 08-11-2020.

(c) "I acknowledge myself that I am indebted to Mahesh Kumar for a sum or Rs. 7,000, to be paid to him or order on demand, for the value that has already been received‖.


216, MalkaGanj,
Delhi-110 007
5th May, 2012.

₹ 10,000.00 P

Stamp

Three months after date, we promise to pay M/s Lakhmi Chand & Sons or their order a sum of Rupees Ten Thousand Only, for value received.

To
M/s Lakhmi Chand & Sons,
126, Chandni Chowk,
Delhi-11006

For M/s Aggarwal Stores
(Signed) Nakul Gupta
(Nakul Gupta)
Partner

10.8 PARTIES TO THE PROMISSORY NOTE

Generally there are two parties involved in any Promissory Note.

- **MAKER:** Maker is a principal party in the Negotiable Instrument. He is also known as the promisor, as he is the person who makes the promise to make the payment and draws the promissory note to pay the specified the amount as mentioned in the promissory note for such promise made.
- **PAYEE:** Payee is another important person in Negotiable Instrument. He is also known as the promisee, as he is the person to whom promise is made to pay the certain amount of money. Payee is the person who receives the payment under the Negotiable instruments act.

Though two important parties involved in Promissory note are Maker and Payee but still there are some persons who are involved in Negotiable Instrument. As any Negotiable Instrument can be transferred by a person to another any number of times, following are some of the parties involved in Negotiable Instrument.

(a) **THE HOLDER:** Holder is the original payee of the instrument. He is the person who holds the instrument in his own name and is authorized to get money mentioned in the instrument.

(b) **THE ENDORSER**: He is the person who transfers the instrument to another person. For example if Mr. A issues promissory note to Mr. B and Mr. B transfers this instrument to Mr. C, than Mr. B is the endorser of the Instrument.

(c) **THE ENDORSEE:** He is the person to whom the instrument is transferred. For example if Mr. A issues promissory note to Mr. B and Mr. B transfers this instrument to Mr. C, than Mr. C is the endorsee of the Instrument.

10.9 COMPONENTS OF A PROMISSORY NOTES

- **PRINCIPAL AMOUNT:** Principal amount is the amount due by maker to the promise. It is the amount for which either some value is received by maker or it is the amount borrowed by him.
- **INTEREST RATE:** Promissory note can be interest bearing promissory note or non interest bearing promissory note. In interest bearing promissory note some interest is charged on the principal amount. In such case this rate of interest is also mentioned in the instrument.
- **INTEREST:** Some time instead of mention of rate of interest, some fix amount of interest is mentioned in the instrument.
- **MATURITY DATE OR DUE DATE:** Promissory note can be demand promissory note or the term promissory note. In case of term promissory note it is payable on certain date. Such date is also mentioned in the instrument.
- **MATURITY VALUE:** Maturity value is the amount payable on the due date. In case of non interest bearing promissory note, principal amount and maturity amount is same. However, in case of interest bearing promissory note it is calculated by adding amount of interest in the principal amount.
- **PLACE OF ISSUE:** The place of issue of promissory note is also very important. It is also mentioned in the instrument.
- **DATE OF ISSUE:** It is the date on which promissory note is issued.

10.10 FEATURES/ ESSENTIALS OF A PROMISSORY NOTES

The essentials of a valid Promissory note

1) **MUST BE IN WRITING**: The most important feature of Promissory note is that it must be in writing. In case of a verbal promises to make a payment, it does not form a promissory note. The promise by the maker of the note should be made in writing clear words on the face of instrument itself. Maker must undertakes to pay a specified sum of money to the promisee or order or to the bearer.
2) **EXPRESS PROMISE TO PAY:** The promise to pay must not be vague and promise to pay must be express. Just acknowledgment of indebtness is not a promissory note. In the following cases, instrument is not considered as Promissory Notes even if it is in writing.
   (a) –Mr.Ganesh I owe you a sum of Rs. 700‖
   (b) –I am liable to pay you a sum of Rs. 1,100‖.
   (c) –I have borrowed from you Rs. 1,000, which I will pay in future‖
3) **THE PROMISE MUST BE UNCONDITIONAL:** The promise to pay money mentioned in the instrument must be unconditional. In case the promise to pay is after fulfilling some condition, it is not a valid promissory note. Such promise must not be dependent upon taking place of some event, or happening or certain event which is not sure etc. For example Ajay promises to pay a sum or Rs. 50,000 to Mahesh two month after his marriage with Poonam. It is not a valid promissory note because it is not necessary that Mahesh will marry the Poonam or not.

4) **THE MAKER OF THE PRO-NOTE MUST BE CERTAIN:** The instrument must clearly mention the name of the maker of the instrument. In order to avoid any confusion it must give further identification details like father‘s name or husband‘s name etc. For example Mahesh Kumar s/o Hari Parshad will pay a sum of Rs. 6,000 to Ravi one month after the date is a clear instrument. It is not necessary that name of the person is mentioned. It can be the designation of the person also. For example Chief Manager, Bank of Baroda, Model Town Branch, Ludhiana is a valid promissory note. Further it is important to note that no promissory note can be issued by any maker that is payable to himself. This types of promissory is not valid. However, in case such note is endorsed the maker to some other person, it will become a valid promissory note.

5) **IT SHOULD BE SIGNED BY THE MAKER:** One of the important condition of valid note is that it is signed by the maker of the note. Without the maker‘s signs on the note, it is incomplete and has no legal value. The signature is must even if the instrument is written by maker in his own handwriting. The term ‗signature‘ means that the maker puts his name or initial on the body of the note at particular place, with a objective to authenticating the note.

6) **THE AMOUNT MUST BE CERTAIN:** Promissory note is valid if the amount mentioned in it is certain. The amount should not be vague. For example the promise to pay money at market rate of interest is not valid as market rate of interest is not certain. However, promise to pay at the Prime Lending Rate of RBI is valid as prime lending rate of RBI is certain.

7) **THE PROMISE SHOULD BE TO PAY MONEY:** The note should undertake to pay money and money only. Any promise to make payments in the form goods, Assets, bonds, etc. is not valid. For example Ajay promise to Bina to pay a sum of Rs. 10,000 in cash plus a mobile phone is not a valid promissory note.

8) **THE PAYEE MUST BE CERTAIN:** According to RBI Act, in India it is not possible to issue a promissory note payable to bearer on demand. So promissory note must payable to a specified person or his order. However, the payee can be determined by his name or by his designation.

9) **MUST BEAR THE REQUIRED STAMP**: In order to make a promissory note valid, it must bear the necessary stamp as required by the Indian Stamp Act, 1889. The amount of stamp depends upon the amount for which the promissory note is drawn.

10) **IT SHOULD BE DATED:** Though it in not necessary that the note must bear the date on which it is drawn. However, some time it becomes important to mention the date of instrument. The date of promissory note is not important it the amount is payable on a particular date. However, in order to calculate the amount of interest if rate of interest is given or deciding the date of maturity if instrument is payable after a particular period the date of instrument becomes important. Further a note may be issued postdated.

11) **THE RATE OF INTEREST:** The mention of rate of interest in the instrument is not necessary. In csae the instrument specifies a particular rate of interest, instrument must paid along with the rate.

12) **PAYABLE IN INSTALMENTS:** A promissory note is not necessarily payable in one installment. It may be payable in any number of instalments, as provided under Section 5 of the Act.

10.11 TEST YOUR UNDERSTANDING (A)

Q STATE WITH REASON WHETHER FOLLOWING INSTRUMENTS CAN BE CATEGORIZED AS PROMISSORY NOTE OR NOT:

1. Raj make promise to pay Simran Rs. 10,000 through phone.
   ……..
   ……..
2. Pranav writes to Sandeep that he has received Rs. 3,000 from him**.**
   ……..
   .....
3. Ranveer promise to pay Deepika Rs. 7,000 in writing on their Marriage.
   .....
   ……..
4. Radhey promises ot pay Madhav Rs. 6,000 in writing in December 2022.
   ……..
   ……..
5. Harshit writes to Dhanumita, I owe you Rs. 4,500.
   ……..
   ……
6. I promise to pay an amount of Rs. 6,000 along with interest @ 10% p.a.
   ……..
   ……..
7. I promise to pay an amount of Rs. 6,000 along with interest.
   ……..
   ……..
8. I promise to pay an amount of Rs. 6,000 to Managing Director of Neelima Limited.
   ……..
   ……..
9. Raja promise to pay Rani Rs. 7,000 in writing on death of her father.

……..

……..

10.12 BILLS OF EXCHANGE (SECTION 5)

Bill of exchange is one of the important document in business. It is an instrument that gives right to one person to recover some amount from other person. It is a written order which give the drawer right to recover money from drawee. It is an unconditional written order issued by a person known as drawer to another person known as drawee to pay a fixed sum of money to him or a third party on some future date as mentioned in the instrument. A bill of exchange is always in writing and is signed by the concerned person. Bills of exchange are not only used in national trade but in international trade as well.

Bill of Exchange is an instrument that legally binds a person to pay money within a specified time frame or on the demand by the bearer bill of exchange. **As per Section 5** a ‒bill of exchange‖ is ‒an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.‖

On the basis of above definition, following points emerge related to Bill of Exchange:

(a) It is an instrument in writing.
(b) It is always Unconditional.
(c) It is order to pay
(d) It is signed by drawee.
(e) It is to pay money only
(f) The order to pay must be certain and not vague.
(g) It may be payable to order or beared.
(h) It may be payable after certain period or payable on demand.

T.P Mukherjee law Dictionary with pronunciation defines Bill of Exchange as under: ‒A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay, on demand or at a fixed or determinable future time, a sum certain in money to or the order of a specified person or to bearer.‖

126, Chandni Chowk,
Delhi-110 006
5th May, 2012.

₹ 10,000.00 P

Three months after date, pay to us or our order a sum of Rupees Ten Thousand Only, for value received.

Stamp

Accepted
For M/s Aggarwal Stores
(Signed) Nakul Gupta
5.5.2012
Partner

To
M/s Aggarwal Stores,
216, Malka Ganj,
Delhi-11007

For M/s Lakhmi Chand & Sons.
(Signed) Lakhmi Chand
(Lakhmi Chand)
Partner

10.13 PARTIES INVOLVED IN BILL OF EXCHANGE

1. **DRAWER:** The drawer is a creditor who has to take some money from the other person and he is the person who writes the bill of exchange and is having right of receiving the sum mentioned in the instrument.
2. **DRAWEE:** The drawee is the Debtor or a person who has to pay the money to the creditor. He is the person on whom the bill is written. He is the primary person liable to make the payment of the instrument.
3. **PAYEE:** Payee is the person who is authorized to receive the amount as mentioned in the bill of exchange. In case of Bill of Exchange the drawer can also be the payee of the instrument in case it is not endorsed by him to anybody else.
4. **OTHER PARTIES**: Besides the above mentioned three parties, some more persons are also involved in the bill of exchange. These includes:
   - **ENDORSER:** The person who transfers the bill of exchange to some other person, thus making him the owner of the instrument is known as endorser.
   - **ENDORSEE:** The person to whom the bill of exchange is transferred by the endorser is known as endorsee. After the endorsement of the bill, endorsee becomes the owner of the instrument.

10.14 ESSENTIALS OF A BILLS OF EXCHANGE

1) **NUMBER OF PARTIES**: There are main 3 parties involved in a bill of exchange:
   - the drawer, who draws the bill of exchange
   - the drawee, who has to make the payment
   - the payee, who is entitled to the payment.

   Many times the drawer and the payee are the one and the same person.
2) **IT MUST BE IN WRITING**: The most important feature of Bill is that it must be in writing. In case of a verbal order to make a payment, it does not form a valid Bill. The order by the drawer of the note should be made in writing clear words on the face of

instrument itself. The term _in writing' here means that it can be printed, typewritten, handwritten etc. Further, the bill of exchange can be written using a pencil or a pen. It is not necessary that it must be written using the ink. However, in order to ensure the safety of bill it is better to write it using the ink.

3) **EXPRESS ORDER TO PAY**: Order to pay is the most important condition of a bill of exchange. Bill must contain an _order by the drawer to the drawee to pay a certain sum of money to the order or bearer of the instrument either on a particular date or on demand by the person'. The order written must be a command to pay the money and not a request to pay the money. So, any wording like _Please pay Rs 50,000 to Anil on May 1 and oblige', written on the bill is a request to pay the money and not an order to pay. So, in this case it is not a valid Bill of Exchange.

4) **ORDER MUST BE UNCONDITIONAL**: The order to pay money mentioned in the instrument must be unconditional. In case the order to pay is subject to fulfilling some condition, it is not a valid Bill. Such order to pay must not be dependent upon taking place of some event, or happening or certain event which is not sure etc. For example A promises to pay a sum or Rs. 70,000 to Z three month after his marriage with Y. It is not a Bill because it is not sure that whether such marriage will take place in future or not.

5) **ORDER TO PAY MONEY ONLY:** The Bill should order to pay money and money only. Any order to make payments in the form goods, Assets, bonds, etc. is not valid. For example Meena promise to Bina to pay a sum of Rs. 20,000 in cash plus a piece of land is not a valid Bill.

6) **SUM PAYABLE TO BE CERTAIN:** The amount payable in the Bill of exchange must be certain. Though it is not necessary that such amount must be a fixed amount, but it must be certain amount. For example an order to pay Rs. 60,000 is a certain amount. Even an order to pay Rs. 50,000 along with interest of 10% is certain amount. But an order to pay adequate amount is not a bill as the amount is not certain.

7) **MUST BE SIGNED:** The Bill of exchange is complete only when it is signed by the drawee. In case the sign of drawee are missing, the bill of exchange is not valid. The signs of drawee authenticates the bill of exchange and makes him liable to make the payment of the bill.

8) **MUST BEAR THE STAMP:** A Bill of Exchange is only valid, if it bears the necessary stame as required by the Indian Stamp Act, 1889. The amount of stamp depends upon the amount for which the Bill is drawn. The stamp must also be properly cancelled. Following table shows the amount of stamp duty payable on a bill of exchange. This table is for the reference only need not to remember by the students.

Description of the Instrument	**Proper Stamp-Duty**
Bill of Exchange as defined by section 2(2) not being a BOND, bank-note or currency note- (a) repealed. (b) where payable otherwise than on demand – (i) where payable not more than three months after date or sight –	

if the amount of the bill or note does not exceed Rs.500;	One Rupee Twenty Five Paise
if it exceeds Rs.500 but does not exceed Rs.1,000;	Two Rupees And Fifty Naye Paise
and for every additional Rs.1,000 or part thereof in excess of Rs.1,000;	Two Rupees And Fifty Naye Paise
(ii) where payable more than three months but not more than six months after date or sight – if the amount of the bill or note does not exceed Rs.500;	Two Rupees And FiftyNaye Paise
if it exceeds Rs.500 but does not exceed Rs.1,000;	Five Rupees,
and for every additional Rs.1,000 or part thereof in excess of Rs.1,000;	Five Rupees
(iii) where payable more than six months but not more than nine months after date or sight – if the amount of the bill or note does not exceed Rs.500;	Three Rupees and Seventy Five NayePaise
if it exceeds Rs.500 but does not exceed Rs.1,000;	Seven Rupees and FiftyNaye Paise
and for every additional Rs.1,000 or part thereof in excess of Rs.1,000;	Seven Rupees and Fifty Naye Paise
(iv) where payable more than nine months but not more than one year after date or sight - if the amount of the bill or note does not exceed Rs.500;	Five Rupees
if it exceeds Rs.500 but does not exceed Rs.1,000;	Ten Rupees
and for every additional Rs.1,000 or part thereof in excess of Rs.1,000;	Ten Rupees
(c) where payable at more than one year after date or sight- if the amount of the bill or note does not exceed Rs.500;	Ten Rupees
if it exceeds Rs.500 but does not exceed Rs.1,000;	Twenty Rupees
and for every additional Rs.1,000 or part thereof in excess of Rs.1,000.	Twenty Rupees

9) **OTHER FORMALITIES:** There are some other formalities in the bill of exchange. These formalities are related to date of instrument, place at which instrument is drawn, presence of consideration in the instrument, etc. These formalities must also be fulfilled.

10) **REQUISITES OF A VALID CONTRACT:** Law of contract certain requisite to make a valid contract like free consent to the contract, legality of the object etc. As bill of exchange is also a contract between two parties, the various requisites of a valid contract must also be met in bill of exchange also.

10.15 DIFFERENCE BETWEEN BILLS OF EXCHANGE AND PROMISSORY NOTES

Particulars	Bill of Exchange	Promissory Note
Meaning	A bill of exchange is an order given by drawer of the instrument to the drawee to pay a certain amount to Drawer himself, person named in the instrument, order or bearer of the instrument.	A promissory note is an instrument bearing unconditional promise by the person who owes monty to the creditor to pay a certain sum of money to creditor or his order.
Negotiable Instrument Act	The definition of Bill of Exchange is given under section 5 of Negotiable Instrument Act.	The definition of Promissory Note is given under section 4 of Negotiable Instrument Act.
Parties	In case of bill of exchange there are three parties involved i.e. the drawer, the acceptor and the payee.	In Promissory Note there are two parties involved i.e. Maker and Payee
Drawn by	It is drawn by the drawer who is creditor.	It is drawn by the maker who is Debtor.
Liability	The liability of a drawer under the bill of exchange is not primary, he is liable to make the payment only if drawee fails to make the payment.	The liability of the maker of a promissory note is primary and he is liable to make the payment.
Acceptance	Bill of Exchange needs the acceptance by the drawee.	Promissory Note does not need any acceptance by the drawee.
Copies	In case of Bill of Exchange, generally a single copy is prepared. However in in case of foreign bills mostly 3 copies are prepared.	In case of Promissory note always only one copy is prepared.
Notice in case of dishonour	If the bill of exchange is dishonoured due to any reason, the holder must issue notice to all person to whom he wants to make liable to pay.	In case of dishonour of promissory note, there is no need of issue of notice to the maker of the instrument.
Stamps	In case of Bill of exchange stamping is necessary. However, no need of stamping for ‒bills payable on demand‖.	Stamping is necessary for promissory notes and there is no exceptions.
Payable to bearer	A bill of exchange can be drawn on order or bearer.	A promissory note cannot be payable to a bearer.
Payable to maker	In the case of bill of exchange, the drawer himself can be payee also.	In case of a promissory note, the maker himself cannot become the payee.

10.16 TEST YOUR UNDERSTANDING (B)

1. Write the three parties involved in Bill of Exchange.

……

……

……

……

2. Write five characteristics of Bills of Exchange.

……

……

……

……

3. Give three difference between Bills of Exchange and Promissory Note.

……

……

……

……

4. State whether following are true or false.
    a. Bill of Exchange can be oral or written.
    b. Bill of Exchange is a promise to pay certain Sum.
    c. Bill of Exchange is an order to pay money.
    d. The amount of Bill of exchange need note to be certain.
    e. The drawer writes the Bills of Exchange.

10.17 LET US SUM UP

- For dealing with Negotiable Instruments in India, we have a separate Act called Negotiable Instruments Act.
- Negotiable Instruments are the instruments that can be easily transferred by one person to another.
- If a person gets the possession of Negotiable Instruments in good faith, his title will be free from any defect even if the person who gives the possession is having bad title.
- In India there are only three Negotiable instruments allowed under the Act these are Cheque, Promissory Note and Bills of Exchange.
- There are many other Negotiable Instruments in the county which are popular in market but not under the act.
- Law gives some presumptions and benefit in case of the Negotiable Instrument.
- Promissory note is an unconditional promise by one person to another person to pay particular amount.
- It is always written.

- In Promissory note two parties are involved, that are Maker and the Payee.
- Bill of Exchange is an unconditional order by one person to another to make payment of a particular amount.
- In Bill of Exchange three parties are involved, that are Drawee, Drawer and the Payee.

10.18 KEY TERMS

- **„NEGOTIABLE INSTRUMENT"**: _Negotiable Instrument' means any _ written document, through which a person gets the right over the other person and such right is easily transferable by him to other person.
- **QUASI NEGOTIABLE INSTRUMENTS:** Quasi Negotiable Instruments are the Instruments that are capable of being transferred by endorsement and delivery but in such case the transferee does not get a better title than a person who makes the transfer.
- **PROMISSORY NOTE:** Promissory Note is a written document containing an unconditionaln promise by a person who writes such document (called the maker) to pay some other person (called the payee) a particular sum of money either on demand made by the person on a particular or ascertainable future date.
- **MAKER:** Maker is a principal party in the Negotiable Instrument. He is also known as the promisor, as he is the person who makes the promise to make the payment and draws the promissory note to pay the specified the amount as mentioned in the promissory note for such promise made.
- **PAYEE:** Payee is another important person in Negotiable Instrument. He is also known as the promisee, as he is the person to whom promise is made to pay the certain amount of money. Payee is the person who receives the payment under the Negotiable instruments act.
- **BILL OF EXCHANGE:** It is an unconditional written order issued by a person known as drawer to another person known as drawee to pay a fixed sum of money to him or a third party on some future date as mentioned in the instrument.
- **DRAWER:** The drawer is a creditor who has to take some money from the other person and he is the person who writes the bill of exchange and is having right of receiving the sum mentioned in the instrument.
- **DRAWEE:** The drawee is the Debtor or a person who has to pay the money to the creditor. He is the person on whom the bill is written. He is the primary person liable to make the payment of the instrument.
- **PAYEE:** Payee is the person who is authorized to receive the amount as mentioned in the bill of exchange. In case of Bill of Exchange the drawer can also be the payee of the instrument in case it is not endorsed by him to anybody else.

10.19 REVIEW QUESTIONS

1. What are Negotiable Instruments? Give characteristics of Negotiable Instruments.
2. What presumptions are available to Negotiable Instruments.
3. Give different types of Negotiable Instruments.

4. What are Promissory notes? Give essentials of valid Promissory Note.
5. Give various parties involved in Promissory Note.
6. What are Bills of Exchange? Give essentials of valid Promissory Note.
7. Give various parties involved in Bills of Exchange.
8. Distinguish between Bills of Exchange and Promissory Note.

10.20 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

1. No, as promise is oral.
2. No, Promise to pay is not express.
3. No, marriage is not certain to take place.
4. Yes
5. No, it is mere acknowledgement of Debt.
6. Yes
7. No, amount is uncertain as interest rate is not given.
8. Yes as M. D is a certain person.
9. Yes, Death is certain to take place.

TEST YOUR UNDERSTANDING B

4 (a) False, it cannot be oral.

4(b) False, it is order not promise.

4 (c) True

4 (d) False, amount should be certain.

4(e) True.

10.21 FURTHER READINGS

1. M.C. Kuchhal, and Vivek Kuchhal, *Business Law*, Vikas Publishing House, New Delhi.
2. SN Maheshwari and SK Maheshwari, *Business Law*, National Publishing House, New Delhi.
3. Aggarwal S K, *Business Law*, Galgotia Publishers Company, New Delhi.
4. P C Tulsian and Bharat Tulsian, *Business Law*, McGraw Hill Education
5. Sharma, J.P. and Sunaina Kanojia, *Business Laws*, Ane Books Pvt. Ltd., New Delhi

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 11 – CHEQUES-MEANING AND CROSSING, PARTIES TO THE NEGOTIABLE INSTRUMENTS

STRUCTURE

11.0 OBJECTIVES

After studying the Unit, students will be able to

- Understand the Meaning of Cheque.
- Describe various Characteristics of Cheques.
- Recognise various types of Negotiable Instruments in practice.

- Understand the meaning and benefit of Crossing of Cheque.
- Exhibit how to various types of Crossing.
- Explain the meaning of Holder and Holder in Due Course.
- Describe what are various Privileges available to Holder in Due Course.
- Distinguish between Holder and Holder in Due Course.

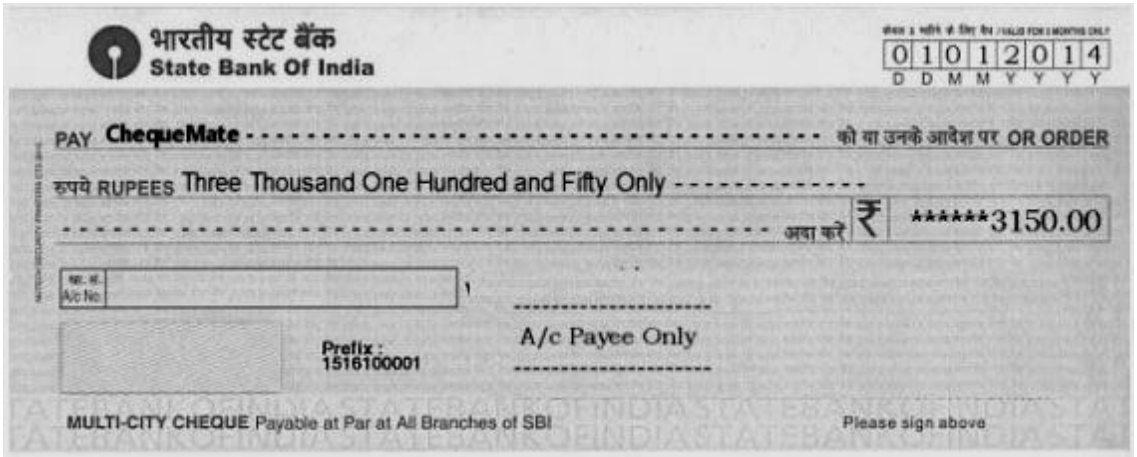
11.1 MEANING OF CHEQUE (SECTION 6):

Cheque is an instrument the use of which is very common in business. Rather it is the most common form of negotiable instrument. If a persons is having a savings or current account in any bank, bank issues a cheque book in the name of the person and such person can use such cheques for making the payment to the others. A cheque is an instrument drawn by the person on a specified banker and directing the bank to make payment to the person mentioned in the cheque or the bearer of the cheque. In other words cheque is lika a bill of exchange; but it is distinguished from Bill of Exchange due to the fcact that cheque is always drawn on a bank. The person issuing the cheque to other person is called the _drawer', and the person who is getting cheque for payment is known as _Payee'. The bank who is making the payment in this case is known as _Drawee'.

Section 6 of The Negotiable Instruments Act, 1881 defines a cheque „as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand".

On the basis of above definition, following points emerge related to Cheque:

- It is an instrument in writing.
- It is always Unconditional.
- It is order to pay
- It is signed by drawer.
- It is to pay money only
- It is always drawn on the Bank.
- It may be payable to order or bearer.
- It is always payable after the date mentioned on the cheque.



11.2 PARTIES TO THE CHEQUE

Generally there are three parties involved in Cheque:

(i) THE DRAWER: The person issuing the cheque to other person is called the ‗drawer'.

(ii) THE DRAWEE: The bank that is making the payment of the cheque is known as ‗Drawee'.

(iii) THE PAYEE: the person who is getting cheque for payment is known as ‗Payee'.

11.3 FEATURES OF CHEQUES

The essentials or features of a Cheque are:

1. **IN WRITING:** A cheque is always in writing. However, It is not necessary to write the cheque using a pen, it can be printed also.
2. **UNCONDITIONAL ORDER:** Every cheque is an unconditional order to the bank to make certain payment to the payee. A cheque containing conditional orders is not valid and the bank will dishonoured such cheque.
3. **CHEQUE IS DRAWN BANK:** A cheque is a negotiable that is always drawn on a particular bank which is mentioned in the cheque itself. When a person opens the saving or current account in the bank, bank provides him Cheque book facility. Customer can issue the cheque on the bank.
4. **SIGNED BY CUSTOMER:** Every cheque must be signed by customer who is issuing the cheque. Any cheque not signed by the customer is of no use and this cheque in not valid.
5. **PAYABLE ON DEMAND:** A cheque is always payable on demand. A cheque is presented by the payee to the banker for payment and upon receiving the cheque for the payment, bank makes the payment. Any cheque payable after the expiry of certain time period is not valid.
6. **EXACT AMOUNT TO BE PAID:** Cheques is always drawn for particular amount and that amount is mentioned in the Cheque itself. In case the certain amount is not mentioned in the cheque, cheque is not valid. Further cheque is payable in money only. Any cheque that is not payable in money is not valild. Such cheque cannot be drawn. Normally the amount of cheque is written in figures as well as words.
7. **PAYEE MUST BE CERTAIN:** Another important condition of the cheque is that the payee should be certain. However, it is not necessary that payee is a natural person. Even an artificial person like company can also be payee.
8. **CHEQUE MUST BE DULY DATED:** It is very important that the date of issue must be mentioned on the cheque. In case cheque doesn't bear any date, it is not valid. However, a person can issue post dated cheque also. In such case cheque cannot be presented to the bank till that date is approached. Normally the validity of a cheque three months starting from the date mentioned on the face of the cheque.
9. **CHEQUE HAS 3 PARTIES:** Drawer, Drawee & Payee:
    - Drawer: A drawer is a person, who draws a cheque.
    - Drawee: A drawee is a bank on whom a cheque is drawn.

- Payee : A payee is a person in whose favour a cheque is drawn

10. **DELIVERIES:** Delivery of the Cheque is Essential condition. Suppose a person issues the cheque but fails to make the delivery of the cheque to the other person, it is of no use. For example Mr. A issued a cheque but he does not delivered the cheque to the concerned party. Rather he kept the cheque in his almirah. This cheque is not valid.

11.4 TYPES OF NEGOTIABLE INSTRUMENTS

1. **TIME INSTRUMENT (SECTION 19)** – A bill of exchange or Promissory note is treated as time instrument, it the time for payment of the instrument is mentioned in the instrument itself. In such case it is mentioned that when the payment of the instrument is becoming due. So in the following examples the instrument shall be regarded as time instrument:
   a. Payable after specified period.
   b. Any instrument payable on particular date.
   c. Any instrument payable after happening of certain event.
      For example
      - Pay Murti Rs. 56,500 4 months after the date.
      - Pay Raj Rs. 8,000 10 days after death of Ravinder.
      - I promise to Pay Krishna Rs. 20,000 on August 1, 2021
2. **DEMAND BILL (SECTION 21) -** A Demand bill is one in which no specific date of payment or period of payment is mentioned. This type of instrument is payable on demand by the Payee. In other words whenever payee demands for the payment, payment of the instrument is done.
   a. This type of instrument can be presented anytime.
   b. Person making the payment does not get any grace period for making the payment.
   c. Cheque is an instrument that is always payable on demand.
      For Example
      - I promise to Pay Murti Rs. 56,500.
      - I promise to Pay Murti Rs. 56,500 on demand.
      - I promise to Pay Murti Rs. 56,500 on presentment of instrument.
      - I promise to Pay Murti Rs. 56,500 at sight of the bill.
3. **BEARER INSTRUMENT (SECTION 13) –** Any Negotiable instrument can be order instrument or bearer instrument. A negotiable instrument becomes Bearer Instrument when it is payable either to Bearer of the instrument or on its last endorsement it is endorsed in Blank. Any bearer instrument can be transferred by mere delivery. Holder of the instrument can ask for payment of such instrument.
   a. In India it is not allowed to issue Bearer Promissory Note.
   b. It is allowed to issue Bearer Bill of Exchange but such bill should be time bill not demand bill.

c. Bearer cheque can be issued in India.
   For Example
   - Pay to Mr. A or Bearer Rs. 13,000, is an Bearer instrument.
   - Pay to Bearer Rs. 10,000.

4. **ORDER INSTRUMENT (SECTION 13)** – A Negotiable instrument is treated as order instrument when it is payable to the person mentioned in the instrument or on order of the person mentioned in the instrument. It is a common misconception that order instrument cannot be transferred, the reality is that order instrument can also be transferred but it is transferrable by endorsement and delivery.
   a. It is payable to person mentioned in the instrument.
   b. It is payable on the order of person mentioned in the instrument.
      For example
      - Pay to Ajay Rs. 9,500
      - Pay to the order of Ajay Rs. 9,500
      - Pay to Ajay or his order Rs. 9,500
5. **INLAND INSTRUMENT (SECTION 11) –** A negotiable instrument can be inland instrument or foreign instrument. A negotiable instrument is considered as inland instrument if either it is drawn in India or it is payable in India. Any instrument if it is drawn or payable in India is Inland instrument even if it is endorsed outside India.
   Ecample
   - A Bill Drawn in Jalandhar payable in Tokyo is an Inland Negotiable Instrument.
   - A Bill drawn in Tokyo but payable in Jalandhar is an Inland Negotiable Instrument.
   - A Bill Drawn in Jalandhar payable in Amritsar is an Inland Negotiable Instrument.
6. **FOREIGN INSTRUMENT (SECTION 12) –** Any instrument is treated as foreign instrument if it is both drawn and payable outside India. If it is drawn in India and payable outside than it is inland instrument. Similarly if it is drawn outside but payable in India, still it is inland bill. For foreign instrument, it must be both drawn any payable outside India.
   Example:
   - Bill drawn in Tokyo and payable in London.
7. **INCHOATE INSTRUMENT (SECTION 20) –** Inchoate means incomplete. When due to some reason the instrument is not complete, it is treated as inchoate instrument. In following cases the instrument shall be treated as inchoate:
   a. If the instrument is either wholly or partially blank.
   b. If it is not adequately stamped.
   c. If it is not duly signed.
      In case of inchoate instrument, the person holding the instrument has the authority to complete the instrument upto his authority. For example if A give blank cheque to B and authorize him to fill any amount upto Rs. 10,000. B cannot write amount exceeding Rs. 10,000. However, if this cheque is endorsed by B to C, than C has

the authority to write any amount even more than Rs. 10,000. The instrument will remain valid.

8. **ACCOMMODATION BILL –** A bill of exchange or Promissory note is treated as accommodation instrument, when it is issued without any consideration with a view of helping the other person. In such case the party issuing the instrument cannot recover amount of the instrument from the other party once the amount is paid by him.
9. **DOCUMENTARY BILL –** It is a negotiable instrument with which some document is attached. For example Railway Receipt or Bill of Lading is attached with the Bill. Sometime the documents related to title of goods are attached to the Bill. Objective of this is that the drawee gets ownership of goods and he is able to sell the goods before making the payment.
10. **CLEAN BILL -** The clean bill is not accompanied by any document of title of goods.
11. **ANTE DATED CHEQUE –** Whenever any cheque is issued but the date on the cheques is not the present date but some previous date is written on the cheque, it is called Ante Dated cheque. For example a cheque is issued on 20th June 2021 but the date on cheque is mentioned as 5th June 2021, it is ante dated cheque. Normally the validity of a cheque three months starting from the date mentioned on the face of the cheque.
12. **POST DATED CHEQUE -** Whenever any cheque is issued for some future date, it is called post dated cheque. For example cheque is issued on June 20 but the date mentioned on the cheque is June 28, it is post dated cheque. Any such cheque cannot be presented to bank for payment till the date mentioned on the cheque is approached. Such cheque is valid for three months from the date mentioned on the cheque.
13. **STALE CHEQUE –** Any cheque is valid for 3 months from the date mentioned on the cheque. If any cheque becomes older than 3 months from the date, it is called Stale cheque. For example if a cheque is issued on June 20th, it will become stale on September 20th.

11.5 CROSSING OF CHEQUE

There are many risks associated with payments of a cheque to the wrong person. However, we can avoid this risks giving the instructions to the paying regarding the person to whom the cheque can be paid. This can be done by specifying certain instruction on the cheque. One such method is crossing of Cheque. A crossed cheque is a cheque that has been marked with some instructions about the method of its payment. With crossing of cheque, a cheque is no more payable on the counter of the bank rather amount is paid through the bank account of the payee. In this way one could later found that who was the person who got the payment of the cheque. So, crossing the cheque makes the cheque more safe. Though there is no fix method of crossing the cheque. The format and wording of crossing change between countries, but mostly two parallel lines are placed top left hand corner of the cheque to make it crossed.

Under Section 123, crossing has been defined as _Where a cheque bears across its face an addition of the words _and Company‘ or any abbreviation thereof (like _& Co.‘) between two parallel transverse lines, or two parallel transverse lines simply, either with or without the words _not negotiable‘, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally.‘

11.6 BENEFITS OF CROSSING THE CHEQUE?

1. **MINIMIZING THE RISK**: With the crossing of the cheque paying banker can pay the amount only through the banker of the payee and counter payment of the cheque cannot be done. It is an effective way to minimize the risk of payment to the wrong party as it easy to identify the payee.
2. **NO PAYMENT TO WRONG PERSON:** There are few type of crossing that makes the cheques non transferable. So even if the cheque is lost, wrong person cannot get the payment of the cheque.
3. **NOT NEGOTIABLE:** Some type of crossing makes the cheque non negotiable. So, it makes the cheque safe.

11.7 WHO CAN CROSS A CHEQUE?

According with the Sec. 125 of the Negotiable Instruments Act, the following persons are capable of crossing the cheque:

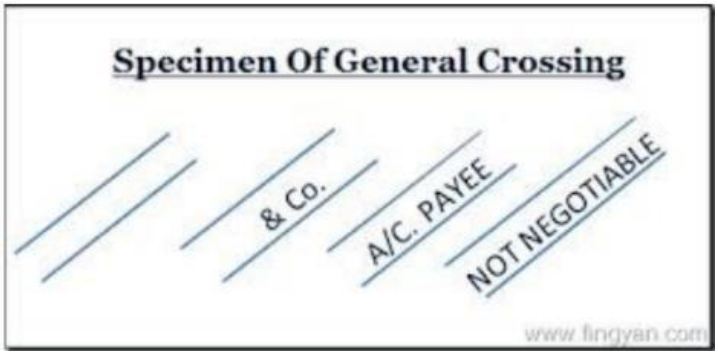
1. **THE DRAWER:** Drawer may cross the cheque generally or specially.
2. **THE HOLDER:** The holder of a cheque is the first person that is authorized to cross a cheque. He can make any type of crossing whether General of Special. In case a cheque is already having General Crossing, holder can make it Special Crossing. He can also add the the words ‒non- negotiable‖ to cheque that is already crossed to make it non negotiable.
3. **THE BANKER**: The banker where cheque is deposited can also cross the cheque in favour of some other banker for the purpose of collection. Such a crossing is known as Double-crossing.

11.8 TYPES OF CROSSING:

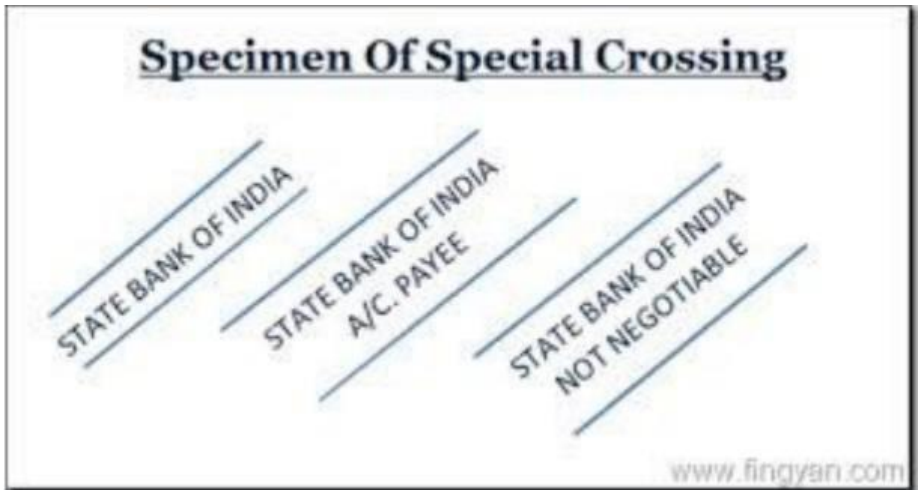
Crossing is of the following types:
(1) General crossing;
(2) Special crossing;
(3) Restrictive crossing:
(4) Not negotiable crossing.

1. GENERAL CROSSING: In general crossing, normally we put two parallel transverse lines, in the top left hand corner of the cheque. These lines may be put simply without

writing and words or the words like _& Co. _ or _and Company‘ may be added to the crossing. The effect of general crossing is that after the crossing the cheque will not be paid at the counter, rather it can be paid only through the account in a bank.



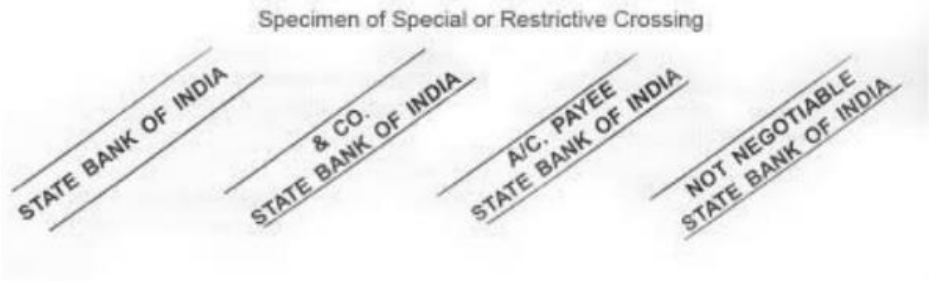
2. **SPECIAL CROSSING** – In general crossing cheque can be paid through any bank. However, some time drawer wants that the payment is to be made through a particular bank. In such case a cheque may be crossed specially. In a special crossing, we add the name of the bank also in the transverse lines through which we wants to make the payment. This can be done with or without the words 'not negotiable'. Further it should be noted that it is not necessary to put two transverse parallel lines for special crossing, however general crossing cannot be done without putting two transverse lines. The effect to special crossing is that the paying banker cannot make the payment through any bank bank named in the cheque.



3. **RESTRICTIVE CROSSING**: Besides the two crossing given in the negotiable instruments act and already discussed above, there is some more type of crossing that are in practice for example, restrictive crossing. In a restrictive crossing beside putting two transverse lines on the corner of the cheque, the words 'Account Payee' or Account Payee Only' are also added in the transverse lines. The effect of restrictive crossing is that once the restrictive crossing is done, the payment of the cheque can only be made by the bank to the collecting banker of the person whose name is mentioned in the cheque. In other words we can say that only the person whose name has been mentioned in the cheque is authorized to collect the payment. Now the payment cannot be done to any other person whose name in not mentioned in the cheque.

   It should be further noted that it is the duty of the paying banker to ensure that the payment is made to the bank account of person named. In case the collecting banker

collects the cheque for any other person other than the person whose name is written in the cheque, the collecting banker will be responsible to the true owner of the cheque.



4. **NOT NEGOTIABLE CROSSING (SEC. 130):** It is the misconception that once the cheque is crossed, it became non transferable or not negotiable. Even if a cheque is crossed, it remain transferable and negotiable also unless the restrictive crossing is done. Some time we want to make the cheque not negotiable. It means once the cheque became not negotiable it will remain transferable but the transferee will not get better title than the transferor. This can be done by adding the words _not negotiable‘ in the transverse lines. A person taking is cheque containing the words 'not negotiable' will not get a better title than that of the transferor. In other words the cheque is no more eligible for essential feature of negotiability. For Example: A cheque was drawn by Ajay in favour of a Vijay. The cheque was crossed 'not negotiable'; a person obtains the cheque by fraud from Vihay and endorsed the same to Mahesh in good faith. In such case Mahesh will not get better title of the cheque as the cheque is already marked not negotiable.([Fisher v. Roberst).

11.9 TEST YOUR UNDERSTANDING (A)

5. Write the three Features of Cheque.

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6. What is Time Bill.

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7. What is Restrictive Crossing.

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8. State whether in following cases Bill is Bearer or order.

f. Bill payable to Shyam or order. **…….**

g. Bill endorsed in blank by Radhey. **…….**

h. Bill payable to Mahant only. **…….**

i. Bill payable to Hema or Bearer. **…….**

j. Bill payable to Anuj. **…….**

9. State whether following are true or False

a. Cheque is always payable on Demand.

b. Law presumes that every Negotiable instrument is drawn for consideration.

c. Crossing of Cheque is Material Alteration.

d. Crossed Cheque can be paid on counter.

e. In Cheque drawer is always a Bank.

11.10 HOLDER OF NEGOTIABLE INSTRUMENT (SECTION 8)

A Negotiable instrument includes Bill of Exchange, Promissory Note cheque. According to the provisions of Negotiable Instrument Act, in every instrument there will be minimum two parties. It is not possible that instrument is having just one party. Holder of the instrument is one such party to the negotiable instrument. As per section 8 of the Negotiable Instruments Act, "the holder" means any person who legally keeps the instrument in his own name and is

eligible for the amount payable under the instrument. He a person who can cover the amount in his own name. In case the instrument is lost or destroyed, 'Holder' is the person who was in its possession at the time of such loss or destruction. " For becoming the holder under section 8, following two conditions are necessary.

1. The holder is the person who can have the possession of the instrument in his own name. Suppose any instrument is lost and some person finds the instrument, suc h person may not be treated as holder of the instrument as he has possession of the instrument, but he cannot have such possession in his own name. For example, a Bill of Exchange belonging to A is lost and B finds Bill, B cannot be treated as holder of the bill .
2. The second condition for becoming the Holder is that person must have the right to claim the amount mentioned in the instrument in his own name. Mere possession of instrument is not enough. For example, an agent holding the instrument cannot be treated as holder as he cannot recover the amount in his own name.

The position of Holder is important due to following reasons:

- He is the person who can sue the prior parties in case of dishonour of the instrument.
- Holder has the right to negotiate the instrument.
- He is the main person to whom all the prior parties are liable for the instrument.
- He is the only person who can give valid discharge of the instrument.
- Unless contrary is proved, every holder of the Negotiable Instrument will be presumed as holder in due course of the instrument.

11.11 HOLDER IN DUE COURSE (SECTION 9)

The concept of _Holder in Due Course‘ is very important in the Negotiable Instrument Act. Section 9 of the Negotiable Instruments Act define the term _Holder in Due Course‘. According to Section 9 –Holder in due course‖ means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or indorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words, holder in due course is a person who

(a) by giving some valuable consideration,
(b) gets the possession of the instrument that is payable to the bearer or order of the bearer,
(c) before the date when such amount becomes due for payment
(d) without having knowledge of the fact that the person who is giving him possess is having some defect in the title of the instrument.

Following examples will make this point clear:

A cheque was sent by one person to another person through ordinary mail, before the instrument reaches, a Robber stole the cheque and handed it over to another person, who get it for some valuable consideration without having any knowledge of defect in the routine

course of the business.In the court of law it was held that person is Holder in Due Course. ***Miller Vs. Race (1758)***

A person lost his cheque and a woman get the possession of the cheque. Five days after the cheque became due, woman presented the cheque to a shopkeeper in lieu of the payment for purchase of certain item. Next day, shopkeeper presented the cheque to Bank for payment and got the payment. A suit was brought in the court of law by the owner for recovery of amount of cheque from the shopkeeper. It was held that shopekeeper must return the amount to owner as he was not the Holder in Due Course as he got the possession of the cheque after it became due for payment. ***Down Vs. Halling (1825).***

11.12 CONDITIONS FOR HOLDER IN DUE COURSE:

1. **HOLDER:** For becoming the Holder in Due Course a person must be holder of the instrument. A person who does not fulfill the conditions of Holder cannot become Holder in Due Course.
2. **PERSON MUST BE HOLDER FOR VALUABLE CONSIDERATION:** A person can be treated as Holder in Due Course of the instrument if he gets the Possession for some valuable consideration. Consideration so paid should be legal and it should not be void or illegal. However, there is no condition that consideration paid must be adequate, even inadequate consideration is valid consideration. But if a person gets the possession of instrument as gift, he will not be treated as holder in due course as consideration is missing in this case..
3. **BEFORE THE DATE OF MATURITY:** For becoming theHolder in Due Course a person must get possession of the instrument befoer such instrument becomes due for payment. A person who gets the possession of instrument after the instrument became due, does not get rights of Holder in Due Course.
4. **GOOD FAITH:** Themost important condition of becomingHolder in Due Course is that person must get the possession of instrument in good faith without any knowledge of defect in the title of person who is transferring the instrument..If it is proved that person having possession of instrument was in knowledge of defect of instrument, he will not be treated as Holder in Due Course.
5. **COMPLETE AND REGULAR ON THE FACE:** A person becomes Holder in due course if instrument appears to be complete and regular on its face. for example, a promissory note was issued describing _F and F.N and Company‘ as Payee. But in this case endorser endorsed the instrument by writing _F and F.N‘ and forget to write _and Company‘ in the endorsement. It was held that person does not get the rights of _F and F.N as the payee and the endorser in this case seems to be two different persons and such instrument was not complete and regular on its face. Arab Bank Ltd Vs. Ross (1952).

11.13 PRIVILEGES OF A HOLDER IN DUE COURSE:

The position of The concept of _Holder in Due Course‘ is very important in the Negotiable Instrument Act. Once the negotiable instrument reaches in the hands of the Holder in Due

Course, it is cured from all the defects in the instrument. The Holder in Due Course enjoys certain privileges under the Negotiable Instruments Act. following are such privileges:

1. **PRESUMPTION (SECTION 118):** Negotiable Instruments Act every holder is presumed as holder in due course. The burden of proving that person is not the Holder in Due Course lies on the opposite party. In case party fails to prove this, the person will be treated as holder in due course.
2. **INCHOATE STAMPED INSTRUMENT (SECTION 20)**: The term ‗Inchoate' means incomplete. As per the conditions of Negotiable Instruments Act, appropriate stamp must be affixed on the instrument depending upon the amount covered in the instrument. Holder in Due Course has right to recover any amount mentioned in the instrument that is covered by the stamp affixed on the instrument. The person delivering the instrument can not claim that the amount filled in the instrument is beyond the authority given by him. So, theHolder in Due Course can claim whole amount even if if the amount filled in the instrument is more than the amount due towards him.

   For example, Amit gives a blank instrument duly stamped in favour of Vijay with authority to fill any amount uptoRs.10,000. However, Vijay fills rupees 25000 in the instrument and hands over the instrument to Radhey for value received. The stamp affixed on the instrument was sufficient to cover Rs. 25000. it was held that Radhey could claim full amount of the instrument.

3. **LIABILITY OF PRIOR PARTIES (SECTION 36):** All the prior parties whose name appears on the instrument are liable towards the Holder in Due Course. The Holder in Due Course have right to sue all the prior parties or any of the prior parties of the instrument.

4. **FICTITIOUS DRAWER OR PAYEE**: If a bill is drawn in favour of a fictitious drawer, acceptor of the Bill can not deny his liability for payment of the bill, if it is proved that the handwriting in which endorser put his signature and handwriting of the Drawer is same.

   Example: B accepted a Bill of exchange that was drawn in the name of A and later on it was found that A is a fictitious person. The same bill was endorsed to C. On due date B refused the payment on the context that Drawer is a fictitious person. It was held that C is eligible to get the payment as the handwriting of the endorser and drawer was same.

5. **CONDITIONAL DELIVERY OF THE INSTRUMENT (SECTION 46):** If an instrument is given by one party to other party on some condition and later such instrument reaches in the hands ofHolder in Due Course, the party issuing the instrument cannot deny the liability of the instrument on the context that the ondition under which instrument was issued is not fulfilled.

Example: Mr. X issued a promissory note to Mr Y on the condition that Mr Y will demand the payment only on the marriage of his son. The promissory note was endorsed by Mr. Y to Mr. Z, who is Holder in Due Course. Mr. X cannot deny the payment of the instrument on the context that condition on which such instrument was given is not fulfilled.

6. **INSTRUMENT CURED FROM ALL DEFECTS (SECTION 53):** Any instrument when reaches in the hands of Holder in Due Course is cured from all the defects. In such case, all the prior parties of the instrument are liable for payment of the instrument and cannot refuse payment on the context that instrument contained some defect prior to it reaches in the hands of Holder in Due Course. Further it is important to note that any instrument cured from the defects once is always free from the defects.

7. **UNLAWFUL MEANS FOR UNLAWFUL CONSIDERATION (SECTION 58):** Any person liable for the instrument cannot deny the payment of the instrument, due to the fact that the instrument was obtained through unlawful means or against unlawful consideration once such instrument reaches in the hands of Holder in Due Course.

   Example: Mr. X obtained a promissory note from Mr. Y through some fraud. Later he endorsed such promissory note to Mr. Z against some consideration before it became due for payment. It was held that Z is Holder in Due Course and can recover the amount from Mr. y.

8. **ESTOPPELS AGAINST DENYING ORIGINAL VALIDITY OF INSTR UMENT (SECTION 120**): When a suit it is filed by the Holder in Due Course against the maker of the Promissory Note or drawer of the Bill of Exchange or cheque, they cannot deny the liability of the instrument on basis of original validity of the instrument. In other words, the person cannot deny payment due to the fact that originally instrument was not valid. For example Mr X makes a promissory note without putting sufficient stamp and hands over the same to Mr Y. Mr Y endorsed the promissory note to Mr. Z who is Holder in Due Course after putting sufficient stamp on it. In such case Mr X cannot deny the payment of the instrument. However, it is important to mention here that this condition is applicable only if instrument is complete on its face. In case instrument is not complete on its face, such condition is not applicable.

9. **ESTOPPELS AGAINST DENYING CAPACITY OF THE PAYEE (SECTION 121):** When the holder in due course file any suit for recovery of amount due on some instrument, the Drawer of the Bill of Exchange/Cheque or Acceptor of the Note cannot deny the capacity of Payee to endorse such instrument like Payee was either minor or Insane so cannot endorse the instrument.

10. **ESTOPPEL AGAINST DENYING SIGNATURE OR CAPACITY OF PRIOR PARTIES (SECTION 122):** When the holder in due course file any suit for recovery of amount due on some instrument, the Drawer of the Bill of Exchange/Cheque or Acceptor of the Note cannot deny the validity of signature of the prior parties.

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11.14 DISTINCTION BETWEEN HOLDER AND HOLDER IN DUE COURSE

Basis	**Holder**	**Holder in Due Course**
1. Definition	Holder is a person who has right to possess the instrument in his own name and can recover the amount due in it in his own name.[Sec. 8]	Holder in due course is a person who gets the possession of the instrument in good faith against some lawful consideration before the instrument is due for payment. [Sec. 9]
2.Consideration	Person can become holder without paying any consideration	Person cannot become holder in due course without paying the consideration
3. Before maturity	A person can become holder by getting possession of instrument before or after the date of maturity.	For becoming holder in due course, it is must that person must get the possession before the instrument is due for payment.
4. Good faith	For becoming holder, it is not necessary that person gets the possession of the instrument in good faith.	a person becomes holder in due course only if he acquires the possession of the instrument in good faith without having any knowledge of defect in the instrument.
5. Inchoate Instrument	A holder can claim only the amount which was due for payment.	A holder in due course can claim any amount written in the instrument provided that it is covered by the stamp affixed on the instrument.
6. Right against prior parties	Holder get the right only against Person who endorsed the instrument or against the person who originally signed the instrument.	Holder in due course get right against all the prior parties whose name appears on the instrument.

7. Better Title	Holder of the instrument cannot get better title than the person who is transferring the instrument.	Holder in due course can get better title than the person who is transferring the instrument.
8. Negotiation	A person may become holder through negotiation or through assignment.	A person can become holder in due course only through negotiation.

11.15 TEST YOUR UNDERSTANDING (B)

1. Who is Holder?

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2. Two Conditions of Holder in due course.

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3. Three privileges of Holder in due course.

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4. State whether following are true or False
   a. Holder can get instrument after due date.
   b. Holder can get instrument without any consideration.
   c. Holder in due course can get instrument after the due date.
   d. Once cheque reaches Holder in due course it is free from all defects.
   e. All prior parties are liable to Holder in due course.

11.16 LET US SUM UP

- Cheque is the most used Negotiable instrument in the country.
- Cheque is like a bill of exchange which is drawn on the Bank. Person issuing the cheque is called Drawer and the person getting payment is called Drawee.

- Demand instrument is one that is payable whenever holder of the instrument demands the payment.
- Time instrument is payable on when time mentioned on the instrument is there.
- In case of Bearer instrument, person possessing the instrument can ask for the payment.
- In Case of order instrument, person whose name is mentioned or his order could get the payment.
- Holder is the person who is in possession of the negotiable instrument and who is eligible to get payment in his own name.
- Holder in due course is the person who gets the negotiable instrument before its due date against some consideration without having knowledge that some person who is giving him instrument, has bad title..
- Law provides some privileges to Holder in due course.
- Once instrument reaches in the hands of Holder in Due Course, it become free from all bad effects.

11.17 KEY TERMS

- **Cheque** : A cheque is an instrument drawn by the person on a specified banker and directing the bank to make payment to the person mentioned in the cheque or the bearer of the cheque.
- **Time Instruments:** A bill of exchange or Promissory note is treated as time instrument, it the time for payment of the instrument is mentioned in the instrument itself..
- **Demand Bill (Section 21) -** A Demand bill is one in which no specific date of payment or period of payment is mentioned. This type of instrument is payable on demand by the Payee.
- **Order Instrument**– A Negotiable instrument is treated as order instrument when it is payable to the person mentioned in the instrument or on order of the person mentioned in the instrument..
- **Bearer Instrument (Section 13) –** Any Negotiable instrument can be order instrument or bearer instrument.
- **Ante Dated Cheque –** Whenever any cheque is issued but the date on the cheques is not the present date but some previous date is written on the cheque, it is called Ante Dated cheque.
- **Post Dated Cheque -** Whenever any cheque is issued for some future date, it is called post dated cheque.
- **Crossing of Cheque:** A crossed cheque is a cheque that has been marked with some instructions about the method of its payment. With crossing of cheque, a cheque is no more payable on the counter of the bank rather amount is paid through the bank account of the payee.
- **Holder:** The holder is the person who can have the possession of the instrument in his own name. He can recover the money in his own name.
- **Holder in due course**: Holder in due course is a person who by giving some valuable consideration, gets the possession of the instrument that is payable to the bearer or

order of the bearer, before the date when such amount becomes due for payment without having knowledge of the fact that the person who is giving him possess is having some defect in the title of the instrument.

11.18 REVIEW QUESTIONS

1. What are Cheques. Give features of valid Cheque.
2. What is Crossing of Cheque. Who can cross the cheque. What are benefits of crossing the cheque.
3. Explain various types of Crossing of the Cheque.
4. Explain different types of Bills of Exchange and Promissory Notes.
5. Explain different types of Cheques.
6. Who is Holder of the Negotiable Instrument. How he is different from Holder in Due Course.
7. Who is Holder in Due Course? What Privileges are available to Holder in Due Course.
8. What are condition on satisfaction of which person becomes Holder in Due Course.

11.19 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

4 (a) Order.
4(b) Bearer.
4 (c) Order
4 (d) Bearer.
4(e) Order

5 (a) False
5(b) Truer
5 (c) False
5 (d) False .
5 (e) False
.

TEST YOUR UNDERSTANDING B

4 (a) True.
4 (b) Truee.
4 (c) False
4 (d) True.
4 (e) True.

11.20 FURTHER READINGS

1. M.C. Kuchhal, and Vivek Kuchhal, *Business Law*, Vikas Publishing House, New Delhi.
2. SN Maheshwari and SK Maheshwari, *Business Law*, National Publishing House, New Delhi.
3. Aggarwal S K, *Business Law*, Galgotia Publishers Company, New Delhi.
4. P C Tulsian and Bharat Tulsian, *Business Law*, McGraw Hill Education
5. Sharma, J.P. and Sunaina Kanojia, *Business Laws*, Ane Books Pvt. Ltd., New Delhi.

B. COM (HONS.)
(Accounting and Taxation)

SEMESTER II

COURSE: BUSINESS LAW

UNIT 12 – TRANSFER AND DISHONOUR OF NEGOTIABLE INSTRUMENT

STRUCTURE

12.0 OBJECTIVES

AFTER STUDYING THE UNIT, STUDENTS WILL BE ABLE TO

- Understand the transfer of Negotiable Instruments can be done.
- Explain the process of Negotiation
- Distinguish between Negotiation and Assignment.
- Carry out endorsement of Negotiable instrument.
- Know the meaning dishonor and its types
- Apply process of Noting.
- Describe the meaning of Protesting.

12.1 TRANSFER OF NEGOTIABLE INSTRUMENT

Negotiable instruments are those instruments which can be freely transferred from one person to another and there is no restriction on transfer of such instrument. The person who gets the possession of negotiable instrument in good faith become bona-fide owner of the instrument. bBy transfer of instruments we mean giving title of the instrument to some other person. There are two methods through which a negotiable instrument can be transferred from one person to another. These methods are:

- Transfer by negotiation
- Transfer by assignment

12.2 TRANSFER BY NEGOTIATION (SECTION 14)

Negotiation of instrument is one of the most common way of transfer of Negotiable Instrument from one person to another person under Negotiable Instruments Act. Section14 of the act deals with Transfer by Negotiation. Negotiation is a process through which possession of instrument is transferred from one person to another in the manner that person get the title of the instrument and becomes Holder thereof. The Negotiable Instruments Act define the term 'Negotiation' as " when a Promissory Note, Bill of Exchange or Cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated." So, we can say that negotiation is not just transfer of possession of instrument by one person to another rather it is transfer of title of the instrument by one

person to another. A negotiation is assumed as valid negotiation if following two conditions are satisfied:

1. Negotiation must include transfer of possession of the instrument by one person to another person.
2. The transfer instrument must be in such a way the person getting the possession must also get the title of the instrument. He must become Hoder of the instrument.

The term holder here means to get right to recover the money due in the instrument in his own name. For example, if Mr X give a cheque of Rs. 10,000 payable to bearer to keep it in safe custody, it is not transfer by negotiation. it is mere transfer of possession.

12.3 WHO MAY NEGOTIATE (SECTION 51)

Now a question arise that who can negotiate the instrument. An instrument can be negotiated by maker, drawer, endorsee or payee. However, negotiation will be valid only if the right of negotiation is not restricted. In case instrument bears any direction that restrict the right of negotiation, then negotiation will not be valid. Further, above mentioned persons can make negotiation only if they are holder of the instrument. Following are two modes of negotiation:

12.4 NEGOTIATION BY DELIVERY ONLY (SECTION 47)

When any instrument is payable to the bearer, it may be negotiated by mere delivery from one person to another. The person getting the delivery will become holder of such instrument. Such delivery of the instrument may be actual deliver y or constructive delivery. For example if Mr A give some instrument to agent of Mr B on B's behalf, it is constructive delivery. In case of negotiation by delivery the person making endorsement need not to put his sign on the instrument. It will be valid negotiation. However, in such case person making endorsement will not be liable in case of dishonour of the instrument as he has not put his credit to the instrument by adding his signature.

12.5 NEGOTIATION BY ENDORSEMENT AND DELIVERY (SECTION 48)

If some instrument is payable to order, it cannot be negotiated by just making the delivery. In such case negotiation can be done by Endorsement and Delivery. If any of these characteristics that is 'Endorsement' or 'Delivery' is missing, then such negotiation will not be valid. Therefore valid negotiation needs followed two formalities:

1. The holder must endorse the instrument by putting his signature on the instrument.
2. After the endorsement instrument must be delivered to the endorsee. If any instrument is endorsed but it is not delivered then negotiation will not be complete.

Following are the effects of negotiation by endorsement and delivery

1. The title of the instrument is transferred from endorser to the endorsee.
2. The endorsee will gets all the rights vested in the instrument.
3. In case of dishonour of instrument, endorsee can sue all the parties who have endorsed the instrument.

12.6 TRANSFER BY ASSIGNMENT:

Negotiation of the instrument is one method through which instrument can be transferred from one person to another under the negotiable instruments act. However, there is another method of transfer of instrument that is transfer by assignment. Any transfer by assignment is not done under negotiable instruments act rather it is done under transfer of property act. Transfer by assignment is a situation when a person transfer negotiable instrument to another person without making on the instrument. Here the person the sells the right of the instrument to another person by not making endorsement on the instrument rather by a separate deed in writing according to the provisions of transfer of property act. As assignment is not done under the negotiable instruments act, the transferee of the instrument does not get better title of the instrument than the title of the transferor. In other words, we can say that transferee does not become holder in due course the instrument.

12.7 DISTINCTION BETWEEN NEGOTIATION AND ASSIGNMENT

Basis	**Negotiation**	**Assignment**
1. Meaning	Negotiation is a process of transferring negotiable instrument by delivery in case of bearer instrument, transfer and delivery in case of order instrument.	Assignment is a process selling the right of the instrument to other person by separate deed in writing.
2. Formalities	It can be done by mere delivery or endorsement and delivery.	It need written agreement signed by the persons.
3. Notice	There is no need to give any notice to the debtor.	Assignee of the instrument must give notice to debtor otherwise assignment will not be complete.
4. Consideration	In case of negotiation consideration is presumed	In case of assignment consideration is not presumed whether it is to be proved
5. Scope	Negotiation can be done only for negotiable instrument.	It can be done for any document.
6. Title	Transferee of the document can get better title than the transferor.	Transferee of the document cannot get better title than the transferor.

7. Right to sue	In negotiation transferee can you even a third party in his own name.	In assignment transferee can you only the transferor.
8. Stamp duty	No stamp duty is required.	Stamp duty need to be paid as per rules.
9. Act	It is covered under negotiable instruments act.	It is covered under transfer of property act.

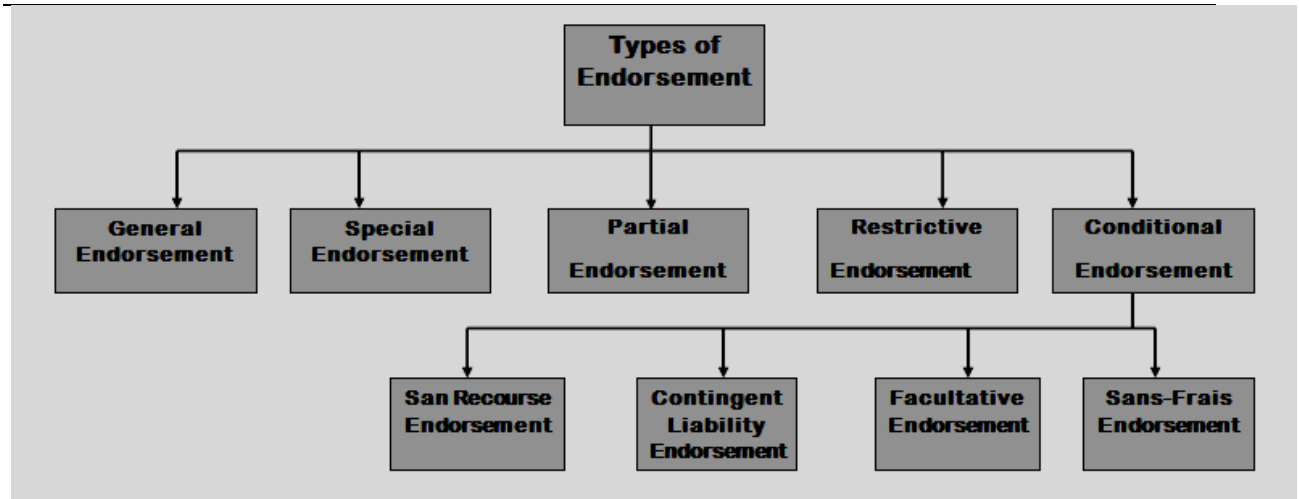
12.8 ENDORSEMENT (SECTION 15)

In general life, the term ‗Endorsement' means writing something on the back of the instrument. However, this term has different meaning under the negotiable instruments act. Endorsement is a way of negotiation of negotiable instrument. When the holder of the instrument writes the name of the person to whom he is going to transfer the instrument either on the face of the instrument or at the back of the instrument along with his signature, it is called endorsement. There is no prescribed format or special words required to make the endorsement. Even endorsement can be done by mere putting the signature by transferee either on face of instrument or at the back of the instrument. Sometimes space is not available on the instrument in such case a separate slip of paper may be attached to the instrument and endorsement can be made on such slip. This slip of paper attached to the instrument is known as ‗Allonge'. For valid endorsement it must be made by writing in ink only. Further, if a person is illiterate he can make endorsement by putting his thumb impression.

12.9 ESSENTIALS OF VALID ENDORSEMENT:

1. Endorsement is valid if it is made either on the face of the instrument or at the back of the instrument. However, if no space is available it can be made on the slip of paper attached to the instrument.
2. Endorsement can be made either by the payee of the instrument or by the holder of the instrument. A stranger cannot make any valid endorsement.
3. The person making the endorsement must put his signature on the instrument. However, an illiterate person can make endorsement by putting his thumb impression.
4. Endorsement can be made only for the instrument as a whole, endorsement for part of the instrument is not valid.
5. There are no specific words for making the endorsement.
6. Endorsement can be made by writing with ink only. Writing with the pencil or putting a rubber stamp does not make valid endorsement.
7. After making the endorsement holder must deliver the instrument to endorsee.

12.10 DIFFERENT TYPES OF ENDORSEMENT



1. **BLANK OR GENERAL ENDORSEMENT:** When the endorser while making the endorsement just put his signature on the back of the instrument, it is called Blank or General endorsement. In this type of endorsement the name of the endorser does not appear anywhere in the instrument. The benefit of general endorsement is that it converts the order instrument into the bearer instrument. Once the blank endorsement is done, endorsee of the instrument can transfer such instrument further without making any endorsement. As in this case endorsee is not putting his signature, he will not be responsible to the for other parties to whom endorsement is done.for example, Mr. X holds an order instrument and he endorsed such instrument to Mr Y by just putting his signature. Now the instrument has become bearer instrument and Mr. Y can further negotiate it without putting his signature.
2. **SPECIAL OR FULL ENDORSEMENT**: Sometime if a person wants to make endorsement in the name of particular person or his order. In case he can make special or full endorsement. It is a situation in which while making the endorsement name of the person to whom endorsement is made is also written on the instrument. For example

   _ Pay to Ajay or his order‘

   Sd/- Rohit

   After special endorsement now the instrument is payable only to Ajay or his order. In case he wants to make further endorsement, he cannot do so by just making the delivery. He has to endorse the document in favour of endorsee. If an instrument is endorsed in blank, it may be converted into full endorsement by writing the name of the person above the signature of the endorsee. For example, an instrument is endorsed by Mr A to Mr B in blank. Mr B added the words _ pay to Mr C order‘, above the signature of Mr A and endorsed the same to Mr C. Now the blank endorsement is converted into full endorsement and Mr B will not be responsible for payment as he did not put his endorsement anywhere on the instrument.
3. **PARTIAL ENDORSEMENT (SECTION 56):** Sometime endorsement is not made for the full amount mentioned in the instrument, rather it is made only for a part of the amount, it is called Partial Endorsement. As per provisions of Negotiable Instruments Act, partial endorsement is not allowed and it will make the instrument

invalid. Example Mr A has an instrument of Rs. 20,000 and he endorsed the same to Mr B by writing the words _pay Rs. 5000 to Mr B for his order‘. This is called partial endorsement.

4. **RESTRICTIVE ENDORSEMENT (SECTION 50):** Restrictive endorsement is a situation in which endorsement is made by one person to another but he puts the restriction on further endorsement of the instrument. If restrictive endorsement is made, the person to whom endorsement is done has right to receive the payment but he cannot make any further endorsement of the instrument. For example, following are the Restrictive endorsement;

   _ pay to Lal Bihari only;.

   _pay to Lal Bihari for my use‘.

   However, following endorsement cannot be treated as restrictive endorsement:

   _ pay to Lal Bihari‘

   _pay to Lal Bihari in State Bank of India account‘.

5. **CONDITIONAL ENDORSEMENT:** Conditional endorsement is one, which does not put restriction on the endorsement of the instrument, rather it put some condition or limit on the endorsement of the instrument. If the person making the endorsement put any condition in the endorsement, it is called conditional endorsement. Further, if person making the endorsement, limit his liability of the endorsement it is also called conditional endorsement. For example, following are conditional endorsement:

   _ Pay to Ajay on his divorcing Anu‘.

   _pay to Kamat on arrival of the goods in ship‘.

   In case of conditional endorsement, the liability of endorser arise only when search condition is fulfilled or such event is happened. Following are the manner in which conditional endorsement can be made:

   - **„SANS RECOURSE‟ ENDORSEMENT**: _Sans Recourse‘ Endorsement is one in which person making the endorsement will not be liable to endorsee or any further party in case of dishonour of the instrument. In simple words once _Sans Recourse‘ endorsement is made, person making the endorsement will not be held liable for payment of any amount on dishonour of the instrument. Following are considered as _sans recourse‘ endorsements:

     _pay to Lal Bihari sans recourse‘

     _pay to Lal Bihari or order without recourse on me‘

   - **CONTINGENT ENDORSEMENT:** When endorsement of the instrument depends upon happening of certain event it is called contingent endorsement. In such case if event mentioned in the endorsement happens, then endorsement will be valid but if the event mentioned in the endorsement does not happen, endorsement will be invalid. Following endorsements are example of contingent endorsement:

     _ pay to Ajay on his marriage to Anu‘.

     _pay to Kamat on arrival of the goods in ship‘.

     In the above case liability of endorser arise only on the happening of event mentioned. In case the event become impossible, and endorser liability comes

to an end. For example if the ship sinks in the above example the person making the endorsement is free from his liability. However, endorsee can sue all the prior parties who made endorsement before the contingent endorsement.

- **FACULTATIVE ENDORSEMENT**: It is called facultative endorsement if the person making the endorsement waives some of his rights available under the law. For example, as per Negotiable Instrument Act, in case of dishonour of instrument, the holder of instrument must give notice of dishonour to the prior parties to whom he wants to make liable for the instrument. In case Mr. A makes endorsement to Mr. B by writing the words _pay to Mr. B or order, notice of dishonour waived', in this case it is facultative endorsement. Now even if instrument is dishonoured B need not to give notice of dishonour to Mr A.

- **„SAIN FRAIS ENDORSEMENT":** In case endorser does not want the endorsee to incurr any expenses on the instrument, he can make _Sain Frais' endorsement. If such endorsement is made, endorsee will not be eligible for claiming any expenses incurred on the instrument.

12.11 CANCELLATION OF ENDORSEMENT:

As per provisions of Negotiable Instruments Act, the holder of the instrument has power to cancel endorsement of any person on the instrument. Cancellation of endorsement will not make the instrument invalid. However, if endorsement is cancelled all the what is whose name appears after the cancelled endorsement will be discharged from liability of the instrument. For example following endorsement appears on an instrument

First endorsement by Mr. Ajay
Second endorsement by Mr. Rohit
Third endorsement by Mr. Vinod
Fouth endorsement by Mr. Sunil

Now the holder of the instrument is Bala, who cancelled the endorsement of Mr. Vinod. Later the bill is dishonoured and Bala filedis a suit against Mr Sunil. It was held that Mr Sunil is not liable for the instrument as cancellation of endorsement of Mr Vinod hampers remedy which was available to Mr Sunil against Mr Vinod. However, the liability of Mr. Rohit and Mr. Ajay still exists.

12.12 NEGOTIATION BACK

Sometime it happens that the endorser of the instrument again become the Holder of the instrument. This is called 'negotiation Back'. If it happens all the intermediate parties are discharged from the liability. For example, an endorsement is made by Mr A to Mr B, Mr B to Mr C, Mr C to Mr D and Mr D back to Mr A. This is _negotiation back'. In this case, if instrument is dishonoured all the parties B, C, D are discharged from liability as A will file suit against D, D against C, C against B and B against A, so ultimately liability will fall again

on A. However, if at first endorsement A writes the word _sans recourse‘ now B, C and D are not discharged from liability even if it is negotiated back to Mr A.

12.13 TEST YOUR UNDERSTANDING (A)

10. Write the meaning of .Negotiation.

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11. Give four difference between Negotiation and Assginment.

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12. What is Full Endorsement.

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13. State the type of Endorsement in following cases.

    a. Rakesh‘s Sign only . ……

    b. Pay Madhuri on receipt of goods. ……

    c. Pay Kumar 2,000 (Bill amount 3,000). ……

    d. Pay Radha Sans Recourse.. ……

    e. Pay to Anil or order. ……

    f. Pay to Abhinav Sans Frais. ……

    g. Pay to Bina only. ……

14. State whether following are true or False

    a. Full endorsement cheque cannot be transferred further.

    b. Assignment of Instrument is covered under Negotiable Instruments Act.

    c. Endorsement is only method of Negotiation.

    d. _ Pay to Hari only; is a restrictive endorsement.

e. Bearer Instrument can be negotiated by Delivery only.

12.14 DISHONOUR OF NEGOTIABLE INSTRUMENT:

Negotiable Instruments whether Bill of Exchange, Promissory Note or Cheque are payable either by the acceptor or the drawee when these become due for payment. Sometimes an acceptor or Drawee fails to make the payment of these instruments when these become due, this is known as Dishonour of the Instrument. In other words dishonour means ‗failing to honour the instrument'. A Bill of Exchange may be dishonoured for non- acceptance or for non payment. However, Promissory Note or Cehque maybe dishonoured for non payment only. chapter 8, section 91 to 98 of the Negotiable Instruments Act deals with dishonour of the negotiable instrument. According to these sections, disorder may be categorised into two categories that are:

- Dishonour by Non Acceptance.
- Dishonour by Non Payment.

12.15 DISHONOUR BY NON ACCEPTANCE (SECTION 91)

Whenever a drawer draws a Bill of exchange on drawee, he send the same to drawee for acceptance. In case drawee fails to give his acceptance to the bill of exchange, it is known as Dishonour by non-acceptance. However, only a bill of exchange can be dishonoured by non acceptance. A promissory note or cheque may not be dishonored for own acceptance as there is no acceptance required in case of these instruments. A Bill of exchange may be dishonoured by non acceptance in following ways:

1. When drawer sends the bill to drawee for acceptance and drawee fails to give his acceptance within 48 hours of presentment of Bill.
2. When the presentment of bill is excused that is presentment of bill is not necessary and Bill remain unaccepted.
3. In case Drawee is a person who is incompetent to contract.
4. Sometime Drawee is a fictitious person
5. When it is not possible to find him after the reasonable search.
6. In case Drawee gives qualified acceptance to the instrument.
7. In case Drawee is declared insolvent by the authorities or has died.
8. When there are severalDrawees not being partner and one or more of them make default in acceptance.
9. When drawee in case of need refuses to accept the instrument.

12.16 DISHONOUR BY NON PAYMENT (SECTION 92)

According to Section 92 of the Negotiable Instruments Act ,any negotiable instrument whether Bill of exchange, Promissory Note or Cheque is said to be Dishonoured by non payment when the person responsible for making the payment that is drawee in case of Bill or

Cehque or maker in case of promissory note makes the default in payment when such instrument becomes due for payment. Following are the cases when it is assumed that the instrument is dishonoured by non payment:

1. When the instrument is duly presented by Holder for payment and the payment is refused or person fails to obtain the payment.
2. When the presentment of instrument is not necessary and instrument remains unpaid on the maturity.
3. In case the instrument has become overdue and it remained unpaid.

12.17 NOTICE OF DISHONOUR

Whenever a Negotiable Instrument is dishonoured for Non payment or for Non acceptance, a formal communication is sent to all the parties who are liable for the instrument and such formal communication is called Notice of Dishonour. The notice of dishonour must be sent immediately after the instrument is dishonoured. If the person fails to send the notice of dishonour to the concerned parties, then all the parties except the Principal Debtor or acceptor, would get discharged from the liability. Main objective of sending the notice of dishonour is not to ask the parties for the payment or the instrument rather it is to inform them about the dishonour of the instrument. It is information to them that Principal Debtor has defaulted the payment and now these parties are liable for the instrument. Such notice may be given in writing or in oral. The notice must be given within reasonable time and may be served at the place of business or at the residence of the party. In case notice is sent through the post and is lost in transit, the parties concerned are not get discharged from their liability.

12.17.1 REQUISITES OF VALID NOTICE:

1. Notice may be given in oral or in writing.
2. The notice must clearly contain the fact that the instrument has been dishonoured for non acceptance or for non payment
3. Notice must be issued within reasonable time.
4. Notice may be served at the place of business of the person or at the residence of the person.
5. If the notice is lost in transit, than the party to whom notice is to be served does not get discharged from the liability.

12.17.2 WHO CAN GIVE THE NOTICE OF DISHONOUR?

Following is the list of persons who can serve the notice of dishonour:

1. The holder of the instrument.
2. Any party that is liable for the instrument.
3. The agent of any party that is liable for the instrument.

4. The person who received the notice of dishonour can send the same to all the prior parties.

Under the Negotiable Instruments Act, it not necessary that only the holder can send the notice of dishonour, even a person getting the notice of dishonour may send the same to all the prior parties to make them liable for the instrument. So, it is not necessary that the party should get notice of dishonour from the holder only, even a party getting the notice may send the notice to others.

12.17.3 TO WHOM NOTICE OF DISHONOUR MAY BE SENT?

When a negotiable instrument get dishonoured, the notice of dishonour may be sent to the following parties:

1. To all the parties to whom the holder of the negotiable instrument wants to make liable for the instrument.
2. To the legal representative of a party in case the person died.
3. To the Official Receiver of the person,when a person is declared insolvent.

12.17.4 WHAT IS REASONABLE TIME

According to Section 15 of the Negotiable Instruments Act when any instrument get is founded the notice of dishonour must be served within the reasonable time. the reasonable time of serving the notice depends upon the nature of instrument at the usual course of dealing with such instrument, the distance at which parties are situated and the mode of communication through which notice is sent. in case of any public holiday it is not considered while calculating the reasonable time of serving the notice.

Section 106 of Negotiable Instruments Act give the following rule for determining reasonable time for serving the notice of dishonour:

1. If the holder and the person who is entitled to receive notice, have their place of business or place of residence at different places, the notice of dishonour must be sent through next post by next day after the dishonour of the instrument.
2. If the holder of the instrument and the person entitled to receive the notice have their business and or residence at same place then notice must reach on the next day after the dishonour of the instrument.

12.17.5 WHEN NOTICE OF DISHONOUR IS NOT NECESSARY:

Though notice of dishonour is sent to all the parties to whom holder wants to make liable for the instrument, however in following cases there is no need of sending the notice of dishonour:

1. When the notice of dishonour is waived by the person who is entitled to get such notice.
2. When the drawer of the cheque himself has countermanded the payment of the cheque.
3. In case it is proved that party entitled for notice cannot suffer damage for want of notice.
4. When the party entitled for notice cannot be found after a reasonable search.
5. When the drawer and acceptor of the instrument is a same person.

6. In case instrument is a promissory note that is not negotiable.
7. If the party entitle to receive the notice, promises to pay the amount due for the the instrument after it get dishonoured without putting any condition.
8. Where the holder cannot send the notice due to some reason which is beyond his control.

12.18 NOTING OF THE INSTRUMENT

In case any negotiable instrument is dishonoured, the holder of the instrument has right to sue the concerned parties after giving proper notice of dishonour. However, in such case law wants some authenticatie proof that the negotiable instrument was presented by the holder for acceptance or for payment and it was dishounered by the third party. Noting of the dishonoured instrument is one such proof that shows that negotiable instrument is dishonoured by the concerned party. However, it is important to mention here that only bill of exchange and promissory note needs the noting on Dishnonour. in case of a cheque there is no need of noting as when cheque is dishonoured Bank gives back the cheque giving the reason of dishonour in writing, which is a sufficient proof of dishonour.

When any bill of exchange or promissory note is dishonoured, the holder of the instrument bring such document to the the Notary Public who present it again for acceptance or for payment, as the case may be. If the concerned party still refuse to honour the instrument, Notary Public record thefact of dishonour in his register and also record the fact on instrument or the paper attached to the instrument. This process is called Noting of the instrument. Once Noting is done, it is a proof that instrument was dishonored. Noting of the fact in record of Notary Public is also known as _Minutes‘. Noting of the instrument must be done within reasonable time. Though there is no legal effect of the Noting or it is alos not compulsory under the act, but it is beneficial to get instrument Noted after its dishonour as it authenticated the dishonour.

CONTENTS OF NOTING

Following are the contents of Noting:

1. The fact of the dishonour.
2. Date on which instrument was dishonoured.
3. Reason of dishonour if any given by the person.
4. If there was no Express dishonour of instrument, than reason why Holder is treating the instrument as dishonored.
5. Amount paid as Noting charges.
6. Entry number of the Notary‘s register.
7. The signature and stamp of the Notary.

12.19 PROTESTING OF INSTRUMENT :

When any negotiable instrument is dishonoured and is noted by the notary public in his register, the holder of the instrument may ask for a separate certificate from the notary

public that authenticates the fact of dishonor. This formal certificate issued by Notary is called protesting. So, protesting is the formal certificate issued by notary public to the holder of the instrument which give the fact of dishonour of the instrument. In case of Inland bills there is no need of protesting but in case of foreign Bill the prtesting is must. So, if any foreign bill is dishonoured, the holder must get it protested. Noting and Protesting is done only for bill of exchange and promissory notes, it is not done for cheques.

CONTENTS OF PROTESTING

1. The literal transcript of the instrument.
2. Name of the holder for whom protesting is done.
3. Name of the person against whom protesting is done,.
4. The fact of dishonour.
5. The reason of dishonour if any.
6. Date on which instrument was dishonoured.
7. The signature of the notary.

12.20 COMPENSATION FOR DISHONOUR (SECTION 117) :

According to Section 117 of Negotiable Instruments Act, when any bill of exchange, promissory note or cheque is dishonoured, the aggrieved party is entitled for compensation. Following are the rules in this regard.

1. **COMPENSATION TO HOLDER**: On dishonour of the instrument, the holder is entitled to receive the amount due on the instrument and any amount spent by him on noting and protesting of the instrument.
2. **COMPENSATION TO ENDORSER**: When any negotiable instrument is dishonored and endorser make the payment for the same, he is entitled for amount paid by him on the instrument, any amount spent by him on noting and protesting of the instrument and interest at the rate of 18% per annum from the date on which he made the payment to the realisation of the amount.
3. **RE-EXCHANGE:** Re Exchange is the measrue to protect against difference in exchange rate. If the person to whom amount is payable lives in different plance than the place of payment of instrument, person is eligible to claim the compensation at current rate of exchange.
4. **REDRAFT:** Party that is eligible for compensation on dishonour of the instrument, can draw a fresh instrument against the defaulting party. Such instrument is called _Redraft‘. The new instrument can be drawn for the amount due together with all expenses chargeable from the party. Such new instrument is payable at sight or on demand. The new instrument must be accompanied by the dishonoured instrument and the proof of dishonour is any. In case new instrument is also dishonoured, the person will be eligible for compensation in the same manner as in case of original instrument

12.21 TEST YOUR UNDERSTANDING (B)

1. What is Dishonour by Non-Acceptance.

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2. Who can give the Notice of Dishonour.

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3. What is Noting of Negotiable Instrument.

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4. Write contents of Protesting.

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5. Varun draws a bill on Rajeev and gifted the same to Hans as gift. Later Hans endorsed the bill for consideration to Raj. Raj endorsed the same bill to Varun. Discuss the position of Varun if bill is Dishonoured on the due date.

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6. State whether following are true or False
   a. Cheque is never dishonoured for Non-Acceptance.
   b. On Dishonour of instrument, notice of dishonor must be given to all parties to whom holder wants to make liable.
   c. Noting of Instrument is legally compulsory.
   d. Notice of dishonor can be issued anytime.
   e. Protesting is generally done for foreign instrument.

12.22 LET US SUM UP

- Negotiable instruments are freely transferable.
- Negotiable instruments can be transferred by two methods, Negotiation and Assignment.
- Bearer instruments can be transferred by Delivery only.
- Order instruments can be transferred by Endorsement and Delivery.
- Blank endorsement makes the instrument Bearer instrument.
- Full endorsement will make the instrument order instrument.
- Restrictive endorsement puts some restriction on further endorsement.
- Partial endorsement is not valid.
- Negotiable instruments can be dishonoured for Non-Acceptance or for Non-Payment.
- Only bill of exchange may be dishonoured for non acceptance.
- When instrument is dishonoured, notice must be given to all parties to whom holder wants to make liable for dishonor.
- Notice must be given within reasonable time.
- Such notice may be oral or written.
- Noting of instruments is the authentication of dishonor of instrument.
- Noting is not legally compulsory but it is useful.
- Protesting is mostly done for foreign instruments only.

12.23 KEY TERMS

- **NEGOTIATION**: . Negotiation is a process through which possession of instrument is transferred from one person to another in the manner that person get the title of the instrument and becomes Holder thereof
- **NEGOTIATION BY DELIVERY:** When any instrument is payable to the bearer, it may be negotiated by mere delivery from one person to another..
- **ASSIGNMENT:** When person the sells the right of the instrument to another person by not making endorsement on the instrument rather by a separate deed in writing according to the provisions of transfer of property act.
- **ENDORSEMENT:** When the holder of the instrument writes the name of the person to whom he is going to transfer the instrument either on the face of the instrument or at the back of the instrument along with his signature.
- **BLANK OR GENERAL ENDORSEMENT:** When the endorser while making the endorsement just put his signature on the back of the instrument, it is called Blank or General endorsement.
- **SPECIAL OR FULL ENDORSEMENT:** It is a situation in which while making the endorsement name of the person to whom endorsement is made is also written on the instrument.
- **DISHONOUR BY NON-ACCEPTANCE -** Whenever a drawer draws a Bill of exchange on drawee, he send the same to drawee for acceptance. In case drawee fails to give his acceptance to the bill of exchange, it is known as Dishonour by non-acceptance.

- **DISHONOUR BY NON-PAYMENT:** when the person responsible for making the payment that is drawee in case of Bill or Cehque or maker in case of promissory note makes the default in payment when such instrument becomes due for payment.
- **NOTING:** When any bill of exchange or promissory note is dishonoured, the holder of the instrument bring such document to the the Notary Public who present it again for acceptance or for payment, as the case may be. If the concerned party still refuse to honour the instrument, Notary Public record thefact of dishonour in his register and also record the fact on instrument or the paper attached to the instrument. This process is called Noting of the instrument.
- **PROTESTING**: When any negotiable instrument is dishonoured and is noted by the notary public in his register, the holder of the instrument may ask for a separate certificate from the notary public that authenticates the fact of dishonor. This formal certificate issued by Notary is called protesting.

12.24 REVIEW QUESTIONS

1. What is Negotiation? How it is different from Assignment.
2. What is Endorsement? Give essential of valid Endorsement.
3. Give different types of Endorsement.
4. What is Dishonour of Negotiable instruments.
5. What is Dishonour for Non -Acceptance.
6. What is Notice of Dishonour. Give rules related to Notice of Dishonour.
7. What is Noting of instrument? Give its contents and importance.
8. What is Protesting. What is its need.
9. What compensation holder could claim on dishonor of instrument.

12.25 ANSWERS TO TEST YOUR UNDERSTANDING.

TEST YOUR UNDERSTANDING A

4 (a) Blank.

4(b) Conditional.

4 (c) Partial.

4 (d) Conditional.

4(e) Full.

4(f) Conditional.

4(g) Restrictive.

5 (a) False, it can be transferred further.

5(b) False, it is covered under Transfer of Property Act

5 (c) False, Bearer instrument is transferred by Delivery also.

5 (d) True.

5 (e) True.

TEST YOUR UNDERSTANDING B

5. Varun can sue Rajeev only. He cannot sue other parties as it will result into circularity.

6 (a) True.

6 (b) True.

6 (c) False, Not legally compulsory

6(d) False, within reasonable time only.

6 (e) True.

12.26 FURTHER READINGS

1. M.C. Kuchhal, and Vivek Kuchhal, *Business Law*, Vikas Publishing House, New Delhi.
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