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# S.Y.B. Com

# Business Law

**w.e.f. The Academic year 2015-2016 for IDOL**

**Dr. Sanjay Deshmukh**
Vice Chancellor,
University of Mumbai

**Dr. Ambuja Salgaonkar**
Incharge Director
Institute of Distance and
Open Learning
University of Mumbai, Mumbai

**Dr. D. Harichandan**
Incharge Study Material,
Institute of Distance and
Open Learning
University of Mumbai, Mumbai

**Programme and Course Co-ordinator** : **Dr. Madhura Kulkarni**
Asst. Professor-cum Asst. Director
IDOL, University of Mumbai,
Vidyanagari, Mumbai - 400 098.

**Course Writer** : **Prof. Mahendra Pachadkar**
Dept. of Business Law.
Prachladrai Dalmia Lions College of
Commerce and Economics.
Malad

: **Prof. Rajesh Thakkar**
Dept. of Commerce
S. N. College,
Bhayandar.

**Re-edited by** : **Prof. Mahendra Pachadkar**
Dept. of Business Law.
Prachladrai Dalmia Lions College of
Commerce and Economics.
Malad

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Tel. : 91 - 22 - 4099 7676

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# S.Y.B.Com Applicable for IDOL from the Academic year 2015-2016

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# Question Paper Pattern

**Total Marks 100**

**All Questions are Compulsory**

**SECTION I**

| | | |
|---|---|---|
| Q.No.1 | Explain the following terms (Any Five) | (10 marks) |
| Q.No.2 | Full length question (Any three out of six) | (30 marks) |
| Q.No.3 | Short notes on any two out of four | (10 marks) |

**SECTION II**

| | | |
|---|---|---|
| Q.No.4 | Explain the following terms (Any Five) | (10 marks) |
| Q.No.5 | Full length question (Any three out of six) | (30marks) |
| Q.No.6 | Short notes on any two out of four | (10 marks) |

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# 1

## MODULE-I

# THE INDIAN CONTRACT ACT 1872: INTRODUCTION TO LAW OF CONTRACT

**Unit Structure**



## 1.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of Law.
- Know the meaning of Agreement and kinds of Agreement.
- Explain the meaning Contract and essentials of valid contract.

## 1.1 INTRODUCTION

'Law in simple term means 'rules' or the system of rules which a particular country or community recognizes as regulating the actions of its members and which it may enforce by the imposition of penalties. It is a very wide term and includes different sets of rules regulating external human actions and conduct of individuals in their dealing with other individuals and with the Government.

- **Definitions of Law**

***Salmond*** defined law as "the body of principles recognized and applied by the State in the administration of justice"

***Holland*** defined law as “rule of external human action enforced by Sovereign Political Authority”.

***Austin***has defined law as “A law is a rule of conduct imposed and enforced by the Sovereign”.

The Indian Contract Act was passed and implemented to control various kinds of commercial and business activities. It deals with general principals of the Law of Contract and Special Contract.

The Contract Act came into force on 1st September 1872. The act is applicable to the whole of India except for the **State of Jammu and Kashmir**. The preamble of the Contract Act states where it is expedient to define and amend certain parts of the law relating to contracts. Therefore, this act is not a complete code of contracts.

The Law of Contract is the most important branch Business Law. It plays an important role in our day to day life and more in case of Trade, Commerce and Industry. The partnership Act, The sale of Goods Act, The Maharashtra Co-Operative Societies Act, The Negotiable Instruments Act, The Companies Act, Corporate Laws, The Consumer Protection act belongs to the law of contract but for technical reason are covered by separate Act

- **Meaning of Business Law:**

Business law may be defined as that branch of legal system that regulates business activates and provides for an orderly conduct of business affairs and also for settlement of genuine disputes in asystematic manner.

In commercial and ordinary life, promises are made. Promise arises out of the acceptance of an offer or proposal. Sometimes, promises are performed, sometimes breach is committed.The Law of Contract deals with such promises which create legal obligations. This excludes those promises made in common life which may be morally binding but create no legal obligation. These promises are made without a view to obtain the assent of the other. No value is given to such promises made. Such promises are not covered by the Indian Contract Act except for those provides under section 24 iof the Act. Certain promise do not create legal obligation. Promises which do not give rise to legal obligations are not contracts. *For example,* A promise B to attend the dinner and fails to attend. This promise certainly does not create a legal obligation on the part of A to enable B to sue A for the price of non- consumed food. Law of Contract thus deals with agreements which create obligation.The Law of Contractcreates *jus in personam and not jus in rem.*Right in personammeans a right against a particular person

or persons. Right in Rem on the other hand, is available against the whole world.

**Examples:**

1. Amit Sells his Vehicle to Balram for Rs. 2 lakh. Amit has right to recover the price of the car from Balram only.The right of Amit is a ‘‘right in personam’’ i.e against a particular person Balram. This is *jus in personam.*

2. Savitri buys a Car and becomes the owner of the car. She has right to have a quiet possession of the car and enjoy against the whole world.Nobody in the world can disturb her right. The right of Savitri is *jus in rem,* i,e right against the whole world.

## 1.2 MEANING OF AGREEMENTS

### 1.2.1 Meaning:

Section 2 (e) of the Indian Contract Act defines an agreement as under:

“Every promise andset of promises, forming the consideration for each other is an agreement”.

The term ‘agreement’ for a common man means “to agree”. Here, one person offers or proposes to another, and the later agrees to the offer or proposal made.This results in an agreement.

**Example: P** offers to take **Q** for Movie and **Q** agrees to with **P** this results in an agreement. in the above example . **P** may be called an ‘Offereor’ or ‘Proposer’ or ‘Promisor’ While**Q** may be called an ‘Offeree’ or Acceptor or ‘Promisee’.

It should be noted that a mere promise by two parties would not constitute an agreement. Offer and acceptance together constitute an agreement. Agreement is a promise or a set of reciprocal promises.

Hence: **Agreement = Offer + Acceptance.**

**Agreement can also be a set of Promises,** like **‘ P’** offers to take ‘**Q’** for movie and ‘**Q’** agrees to take **‘P’** to a restaurant after the show. Both agree**.**

The scope of an agreement is infinite, as one can enter into any kind of an agreement be it legal, illegal, impossible to perform etc.Though one can enter into any kind of agreement, all

agreements may not be enforceable in the court of law if any party does not fulfill his obligation. In the above example if **'Q'** fails to turn up at the theatreafter agreeing to come. 'P' cannot go to the court. On the other hand, contract is an agreement which is enforceable.So Contract is an offer which when accepted is enforceable in the court of law, if any of the party backs out of his obligation.

Hence: Contract=**Offer + Acceptance+ Enforceability**

**What is Enforceability?**

It means an agreement which create some legal obligation; if this agreement is not followed by any party to contract, he can be sued.

**1.2.2 Kinds of Agreements:**

**1. Valid Agreement:**

A valid agreement is one which is enforceable by law.

**2. Void Agreement:**

An agreement not enforceable by law is said to be void [U/s 2(g)]. It has not legal existence at all and is without any legal effect. It does not give rise to any rights and obligations. Unlawful agreements are examples of void agreements. A Void agreement is not enforceable by law as they are opposed to the public policy like agreements in restraints of trade or in restraint of marriage or in restraint of legal proceedings.

**3. Enforceable Agreement:**

An agreement enforceable by law is a contract [Sec. 2(h)]

**4. Voidable Agreement:**

A voidable agreement is one which is enforceable by law at the option of one or more of the parties thereto but not at the option of the other or others. A Voidable agreement is valid so long as it is not avoided by the party entitled to do so.

**5. Unenforceable Agreement:**

An unenforceable agreement is valid in law but is incapable of proof because of some technical defect, for example, Promissory note which is not at all stamped or is insufficiently stamped. Law recognizes the validity of the promissory note but cannot enforce

the same due to it being not at all stamped or insufficiently stamped.

**6. Illegal Agreement:**

An illegal agreement is something against the law and public policy. It is *void ab-inito.* Illegal agreement often involves a commission of crime. They are opposed to the public morals and as such, parties to such agreements are punishable under Indian Penal Code (IPC).

## 1.3 MEANING OF CONTRACT

### 1.3.1 Meaning:

Law of Contract is that branch of law which deals with making of legally valid agreements and also for interpreting these agreements. The law of Contract is the basis of business law because majority of the transactions in business, trade occupation, commerce and ever in profession and our day to day life are based on contracts.

In the words of Pollock **'every agreement and promises enforceable by law is contract'** Section 2(h) of the Indian Contract Act, 1872 states that **"an agreement enforceable by law is contract".** This definition gives us two ingredients are as under:

- An agreement
- Enforceable by law.

It means:**Contract=an agreement + enforceable by law**.

An agreement which is enforceable by a court or law is called a Contract. An agreement which is not enforceable by a court of law cannot be called contract. **For example:** An agreement between A & B to stab C and share the belongings of C acquired through such crime.

An agreement becomes a Contract when:-

1. Agreement is **not** declared void by law.
2. Agreement is made **for a lawful object**.
3. It is made by **free consent of parties**.
4. Parties are **competent to contract**.
5. Agreement is made for **lawful consideration.**

All of us enter into contracts everyday knowingly or unknowingly.

**For example**

a. Purchasing goods from a shop
b. Going to watch a Cinema
c. Boarding a train
d. Boarding a bus
e. Buying milk or newspaper in the morning.Etc.

### 1.3.2 ESSENTIAL ELEMENTS OF VALID CONTRACTS-SECTION 10:

An agreement, to be enforceable by law, must possess the essential elements of a valid contract as contained in section 10 of the Indian Contract Act. According to Section 10, "All agreements are contract 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."

**Essentials valid contracts:**

**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.

**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 contemplate legal relations.

**For Example:**

- P invites Q to have a dinner and Q accepts it. If P fails to serve the dinner, Q cannot sue 'P' for non-performance. The invitation for dinner is a social agreement.
- An agreement to have a cup of tea at a friend's house is a social agreement. A friendly agreement cannot be called Contract.
- 'A' gives a promise to his son to give him a pocket allowance of Rupees one hundredevery month. In case A fails or refuses to give his son the promised amount, hisson has no remedy against A.

**Case :-[Balfour vs. Balfour(1919)2 K.B.571].**

**Facts of the Case:** A husband agreed to pay £30 to his wife every month while he was abroad. As he failed to pay the promised amount, his wife sued him for the recovery of the amount.

Held: She could not recover as it was a social agreement and the parties **did not intend to create any legal relations**

**3. Lawful Consideration:**

In other words of Pollock, "Consideration is the price for which the promise of the another is brought."consideration is known as quid pro-quo or something in return. Consideration must be real and lawful. An agreement to do something for others without getting anything in return is not enforceable.

**Example:**P promises to pay Rs.1,00,000/- on a certain date to Q without any promise in exchange. This is not a valid contract**.**

**Example :** A agrees to sell his pen to B for Rs.300/- . Here for A, the consideration for the watch is the money he gets from B and for B, the consideration for the money he gives, is the watch**.**

Consideration may be …

- In cash or kind
- A promise to do or not to do something
- Past, Present, Future.

**4. Capacity of parties:**

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

According 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.A contract is made whenone personmakes an offer and another person accepts the offer. This acceptance of the offer should be made without any force or threat or coercion. According to Section 14, Consent is said to be free when it is not causedby-(a) Coercion (b) Undue influence (c) Fraud (d) Mis-representation, (e) Mistake.

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

**6. Lawful Object:**

The object of an agreement must be valid. Object has nothing to do with consideration. It means the purpose or design 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.

**For Example:** A promised to pay Rs.2,00,000/- to B to kill Q. The killing of a person is punishable under the IPC. Therefore the promiseis unlawful and void.

The Object is said to be unlawful if-

(a) It is forbidden by law;
(b) It is of such nature that if permitted it would defeat the provision of any law;
(c) It is fraudulent;
(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. Legal Formalities:**

An oral Contract is a perfectly valid contract, expect 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.

**8. Certainty of Meaning:**

According to Section 29,"Agreement the meaning of which is not certain or capable of being made certain are void." An agreement contains terms as decided by the parties. The terms of agreement must be certain and unambiguous. If the terms of an agreement are uncertain, it is not a valid contract.

**For Example:** A agreed to pay Rs.3 lakh to B for an ultra-modern decoration of his drawn room. The agreement is void because the meaning of the term ‘ultra- modern’ is not certain.

However, an agreement to agree is not a concluded contract [Punit Beriwala v. SuvaSanyal AIR 1998 Cal. 44]

**9. Possibility of Performance:**

If the act is impossible in itself, physically or legally, if cannot be enforced at law.

**For Example:** Mr. A agrees with B to discover treasure by magic. Such Agreements are not enforceable.

**10. Not Declared to be void or Illegal:**

The agreement though satisfying all the conditions for a valid contract must not have been expressly declared void by any law in force in the country. Agreements mentioned in Section 24 to 30 of the Act have been expressly declared to be void for example agreements in restraint of trade, marriage, legal proceedings etc.

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

## 1.4 QUESTIONS

1. What is an agreement?
2. Distinguish betweenAgreement and Contract.
3. Distinguish between Void Contract and Voidable Contract.
4. Enumerate the essentials of Valid Contract.
5. Explain the following terms:
   a. Business law
   b. Law
   c. Agreement
   d. Contract
   e. Voidable agreement
   f. void agreement
   g. Illegal Agreement
   h. unenforceable Agreement

*****

# 2

# KINDS OF CONTRACT: CLASSIFICATION OF CONTRACTS

**Unit Structure**



## 2.0 OBJECTIVES

After studying the unit the students will be able to:

- Classify the contracts on various bases.
- Understand the meaning of E contract
- Explain the meaning and essentials of Contingent Contract.

## 2.1 CLASSIFICATION OF CONTRACT ACCORDING TO VALIDITY OR ENFORCEABILITY

Following are the kinds of contract according to Validity of Enforceability:

**1. Valid Contract:**

A valid contract is one which has all essential elements and is enforceable by law.

**2. Voidable Contract:**

An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other

or others, is a voidable contract. A contract is voidable when one of the parties to the contract has not exercised his free consent. One of the essential elements of a formation of a contract for example, free consent, is absent. All voidable contracts are those which are induced by coercion fraud or misrepresentation. The person whose consent is not freely given may avoid a contract. It therefore continues to be valid till the party whose consent is caused by coercion, undue influence, fraud or misrepresentation chooses to avoid the contract within a reasonable time. Contract then is not binding on the other party.

**3. Void Contract:**

A contract which ceases to be enforceable by law becomes void, when it ceases to be enforceable. A void contract is a nullity from its inception. No rights accrue there under. A contract may also be originally valid when entered into but subsequently due to change in the events or circumstances, it may become void. It should be noted that there cannot be a void contract because when the contract is void, it is no contract at all. A void contract is not enforceable by the court of law.

**4. Unenforceable Contract:**

A contract which satisfies all the requirements of the contract but has technical defects is called unenforceable contract. A contract is said to have a technical defect when it does not fulfill the legal formalities required by some other act. When such legal formalities are complied with later on, the act becomes enforceable.

## 2.2 CLASSIFICATION OF CONTRACTS ACCORDING TO MODES OF FORMATION

**2.2.1** Following are kinds of Contracts according to its mode of formation:

**1. Express Contract:**

When the terms of a contract are reduced in writing or are agreed upon by spoken words at the time of its formation, the contract is express.

**For Example:** A says to B Will you purchase my SONY Television for Rs.30.000/-? by the words spoken or written.

**2. Implied Contract:**

The terms of a contract are inferred from the conduct or dealing between the parties. When the proposal or acceptance of

any promise is made otherwise than in words, the promise is said to be implied. Such an implied promise leads to an implied contract.

**For Example:**'A' boards a bus. It is implied from his conduct that A has entered onto an implied promise to purchase a ticket.

**3. Quasi-Contract:**

It is not a contract at all. It is deemed to be a contract, because, to form a valid contract, proper offer and acceptance is pre-requisite here in quasi contract offer and acceptance is absent. Certain relations resemble those created by a contract. Certain obligations which are not contracts in fact but are so in the contemplation of law. These are called Quasi-Contracts.

**For Example:'**A' supplies necessities to 'B' who is not capable of contracting and reimbursing to 'A'. 'A' is entitled to be reimbursed from B's property.

Quasi contracts rise out of obligation enjoyed by one person from the voluntary acts of the other which are not intended to be performed gratuitously. **An obligation that the law creates in the absence of an agreement between the parties**. **It is invoked by the courts where Unjust Enrichment, which occurs when appers on retains money or benefits that inall fairness belong to another,would exist without judicial relief.**

A quasi contract is a contract that exists by order of a court,not by agreement of the parties. Courts create quasi contracts to avoid the unjust enrichment of a party in a dispute over payment for a goods orservice. In some cases a party who has suffered a loss in a business relationship may not be able to recover for the loss with out evidence of a contract or some legally recognized agreement.

**Types of Quasi Contract:**

**a. Supply of Necessaries to incapable persons**:

This is supply of necessaries to a minor or a person of unsound mind. Here the minor on the person on unsound mind is personally liable. The property of the incapable person is liable. And were the in capable person is not own any property nothing shall be payable.

**Obligation of a person enjoying benefit of Non-Gratuitous Act.**

A non-gratuitous act means the act which is **not done free**. The person who does some non-gratuitous act another is entitled to recover the compensation for such act. The Obligation of a person

enjoying the benefit of the non-gratuitous act arises in respect of the **lawful act only**.

**For example:**

A pizza boy delivers a pizza at your doorstep by mistake instead of your neighbor who ordered it. You eat it having knowledge that it was order by your neighbor. You are required to pay for the same. You enjoyed something which was a non-gratuitous act.

**b. Finder of goods:**

A finder of goods means a **person who finds the goods belonging to another** and takes them into his custody is subject to the same responsibility as a bailee.

A finder of goods has the duty to find the real owner and returned the same. He can get the reimbursement of the expenses, which he has incurred in preserving and maintaining the goods from the real owner.

**c. Payment by Interested person:**

A person who is interested in the payment of money which another is bound by law, and who therefore pay it is entitled to be reimbursed by the other.

**For example :A** supplies to **B**, a lunatic, the necessaries for maintaining his life. Here, **A** is entitled to recover the amount from **B's** property.

**d. Money paid under mistake or delivery of goods under mistake:**

If certain amount of money is paid or goods delivered to a person under a mistake, the person receiving the money or goods must repay it.

**For Example:A and B jointly** own Rs 100 to **C**. **A** pays amount to **C** and not knowing this fact, **B** also pays Rs 100/- to **C.** Here **C** is bound to repay Rs 100 to B.

### 2.2.2 Difference between Quasi Contract and Contract.

| Quasi contract | Contract |
|---|---|
| It is not intentionally formed but law imposed upon the parties. | It is intentionally formed by the parties. |
| Quasi contract does not | Contract posses all the |

| | |
|---|---|
| possess all the requirement of valid contract. | requirement of valid contract. |
| Obligations are implied upon by the law. | Obligations are mutually created by the parties. |

## 2.3 CLASSIFICATION ACCORDING TO PERFORMANCE

Following is the classification of contract on the basic of performance:

**1. Executed Contract:**

Where both the parties have performed their obligation, it is an executed contract. Even when one party to the contract has performed his share of the obligation, the contract is executed through to the other party is still under an outstanding obligation to perform his part of the promise.

**For Example:** A sells his car to B for Rs.2.00 lakh. A delivered the car and B paid the Price. This is an executed contract.

**2. Executory Contract:**

Here neither party to the contract has performed his share of the obligation, for example, both the parties have yet to perform their promises, the contract is executory. In an executed contract one party has already performed his part of the agreement while the other party has to perform his par. In an executory contract both the parties have to perform their mutual promises and the fact that they have to perform their parts of the contract does not affect the validity of the contract.

**For Example:** A sells his car to B for Rs.2 lakh. If A is still to deliver the car and B is yet to pay the price, it is executor contract.

**3. Partly Executed and Partly Executory Contract:**

In a partly executed and partly executor contract, one party has already performed his promise and the other party has yet to execute his promise.

**For Example: '**A' sells his Vehicle to 'B'. 'A' has delivered his Vehicle; 'B' has yet to pay the price. For 'A' it is an executed contract whereas it is an executor contract on the part of 'B' since the price has yet to be paid.

**4. Unilateral Contract:**

A unilateral contract is also known as a one-sided contract. It is contract where only one party has to perform his promise. In such a contract, the promise on one side is exchanged for an act on the other side. After the formation of a unilateral contract, only one party remains liable to perform his obligation because the other party has already performed his obligation.

**For Example: Aruna** promises to pay Rs2000/- to anyone who finds his lost Golden Ring. **Varun** finds it and returns it to **Arun**. From the time **Varun** found the Golden Ring, the contract came into an existence. Now **Arun** has to perform his promise, that is the payment of Rs.2000/-

**5. Bilateral Contract:**

In a bilateral contract both the parties have to perform their respective promises. It is also known as a two-sided contract. Here, the obligation is outstanding on the part of both the parties.

**For Example: '**A' promises to sell his car to 'B' for Rs. 2.00 lakh and agrees to deliver the car on the receipt of the payment by the end of the week. The contract is bilateral as both the parties have exchanged a promise to be performed within a stipulated time.

## 2.4 DIFFERENCE BETWEEN AGREEMENT AND CONTRACT

| Differences | AGREEMENT | CONTRACT |
|---|---|---|
| **Definition** | An arrangement between two or more parties that is not enforceable by law. | A formal arrangement between two or more party that, by its terms and elements, is enforceable by law. |
| **Validity based on** | Mutual acceptance by both (or all) parties involved. | Mutual acceptance by both (or all) parties involved. |
| **Does it need to be in writing?** | No. | No, except for some specific kinds of contracts, such as those involving land or which cannot be completed within one year. |

| | | |
|---|---|---|
| **Consideration required** | No consideration is required. | Yes consideration is an essential factor. |
| **Legal effect** | An agreement that lacks any of the required elements of a contract has no legal effect. | A contract is legally binding and its terms may be enforceable in a court of law. |
| **One in another** | All agreements are not contract | All contracts are agreement. |

## 2.5 DIFFERENCE BETWEEN VOID AND VOIDABLE CONTRACT

| **Differences** | **VOID CONTRACT** | **VOIDABLE CONTRACT** |
|---|---|---|
| **Definition** | When a contract ceases to be enforceable at law, it becomes void contract | Voidable contract is a contract which is enforceable by law at the option of one or more parties thereof, but not at the option of others. |
| **Status** | A void contract cannot create any legal rights. It is a total nullity. | A voidable contract takes its full and proper legal effect unless it is disputed and set aside by the person entitled to do so. |
| **Nature** | A void contract is valid when it is made. But subsequently it becomes void due to one reason or the other. | A contract may be voidable since very beginning, or may subsequently become voidable. |
| **Rights** | A void contract is valid when it is made. But subsequently it becomes void due to one reason or the other. | A voidable contract gives rights to the aggrieved party to rescind the contract, and claim the damages, etc. in certain cases. |

## 2.6 E-CONTRACT

### 2.6.1 Meaning:

An E-Contract is a contract that is formed electronically. New laws are needed to govern these contracts however; today most courts have adapted traditional contract law principles and the provisions of the Uniform Commercial Code to cases involving e-contract disputes.

### 2.6.2 Forming Contracts Online

Online transactions can be identified in three ways:

- Business-to-Consumer transactions conducted via the Internet. (B2C )
- Business-to-Business transactions conducted via the Internet. (B2B)
- Consumer-to-Consumer transactions conducted via the Internet.( C2C)

### 2.6.3 Online Offers:

Sellers doing business via the Internet can protect themselves against contract disputes by making sure the terms of their online offers are clear and understandable. An important rule for a seller is to remember the offeror (one making the offer) controls the offer and the resulting contract. The seller should anticipate the terms he or she wants to include in a contract and provide for them in the offer.

At a minimum, the following provisions should be included in an online offer:

- A provision specifying the remedies available to the buyer if the goods turn out to be defective or if the contract is otherwise breached (broken) also any limitations of remedies should be clearly stated.
- The statute of limitations governing the transactions
- A clause that clearly indicates what constitutes the buyer's agreement to the terms of the offer.
- A provision specifying how payment for the goods and of any applicable taxes must be made.
- A statement of the seller's refund and return policies.
- Disclaimers of liability for the use of the goods.
- How the information gathered about the buyer will be used by the seller.

The seller's Web site should include a hypertext link to a page containing the full contract so potential buyers can review the contract terms prior to purchasing.

An online offer should also include some mechanism by which the customer may accept the offer. ("I agree") (I accept the terms of this offer")

### 2.6.4 E-Signatures:

An e-signature is an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.E-signatures can be created and verified on e-contracts.Digital signatures are transmitted electronically.

## 2.7 CONTINGENT CONTRACT

### 2.7.1 Meaning:

**Section 31** of the Indian Contract Act defines contingent contract as "A contract to do or not to do something if some event, collateral to such contract, does or does not happen "So in simple words, it may be defined as a **conditional contract.**

A Contract may be absolute or contingent. The contract is said to be absolute when the promisor binds himself to the performance in any event. **While contingent contract is the contract to do or not to do something, if some event collateral to such contract does or does not happen.**

In case where there is condition, then such contract is called Contingent Contract. Therefore Contingent Contract means Conditional Contract. When imposed and condition is fulfilled, the Contingent Contract becomes valid and then parties have to perform their obligations. If imposed and Condition is not fulfilled, the Contingent Contract become Void and then it need not be performed. So Contingent Contract is to be performed under some circumstances only.

- ***Example:*** A Contract exist between **Bhavna** and **Vibha** according to which **Bhavna** has to sell her goods which are in voyage, to **Vibha** if the ship reaches the harbor safely. Here condition can be seen and it is Contingent Contract. All indemnity contracts, guarantee contracts and insurance contracts are Contingent Contracts. According to Sec. 31 of Indian Contracts Act, a Contract performance of which depends upon happening or non-happening of an un-certain event is called Contingent Contract.

### 2.7.2 Essential Elements of Contingent Contract:

- There must be a **valid contract**.
- The performance of the contract **must be conditional**.
- The event must be **future & uncertain**.
- The event must be **collateral to the contract**.

**Example:**Amir agrees to deliver Sofa-cum-Bed and Salman agrees to pay the price only after the delivery. These are reciprocal promises it is not a contingent contract because the event on which Salman's promise depends is a part of the promise or consideration of the contract, and not a collateral event.

### 2.7.3 Rules regarding the enforcement of the Contingent Contract

- It depends on the happening of the specified uncertain event within the fixed time. So the contract will be enforced only if that uncertain event happenswithin the fixed time. (Section 35)
- It depends on the Non-Happening of the specified uncertain event within the fixed time. So the Contract will be enforced only if the happening of that uncertain event becomes impossible within the fixed time as that event cannot happen. (Section 35)
- Contingent Contract dependent on the impossible event is void and cannot be enforced by law as the impossible event will never happen. This will be void whether the impossibility of the event is known or not to the parties at the time of making the contract.

### 2.7.4 Types of Contingent Contracts:

### 1. Depending Upon Happening of an Uncertain Event:

Sometimes Contingent Contract depends upon happening of uncertain event. Then if such uncertain event takes place, the Contingent Contract becomes valid and if that uncertain event does not take place, the Contingent Contract is Void.

***Example:*** According to Contract formed between A and B, A has to sell goods to B, if ship comes there safely, their Contract is valid and if the ship gets drowned, their Contract is void.

### 2. Depending upon non-happening of an uncertain event:

At times the Contingent Contract may depend upon non-happening of uncertain event. Then if that event does not happen, the Contract is Valid and if that event takes place, the contract is void.

***Example:***There is a contract between A and B according to which A has to sell goods to B, if the ship does not come back. Here, if the ship comes back, the Contract is void and if the ship gets drowned away, then it is valid.

**3. Depending upon happening of an Uncertain event in a fixed period:**

At times Contingent Contract may depend upon happening of uncertain event in a fixed period. If such event happens within fixed period, the contract is Valid. If such event does not take place within fixed period, the contract is void.

***Example:*** As per the contract formed between A and B, A has to sell goods to B, if the ship comes back within 10 days. If it comes on 8th day (or) 9th day, the contract is valid and if it comes back on 12th day (or) 13th day, the contract is void.

**4. Depending upon non-happening of an uncertain event in a fixed period:**

At times the Contingent Contract may depend upon non-happening of uncertain event in a fixed period then if such event place within that fixed period, the contract is void and if that event does not takes place within agreed period, then it is valid.

***Example:***A has to sell goods to B if the ship does not come back within 10 days. If it comes on 8th day (or) 9th day, the contract is void and if it comes back on 12th day (or) 13th Day, the contract is valid.

**5. Depending upon an Impossible Event:**

Sometimes the Contingent Contract may depend upon impossible event. Such a type of Contingent Contract is void ab initio (Void since inception)

***Example:*** There is a contract between A and B where A will pay Rs.100000/- to B if B marries C. Assume that C was dead 5 years ago, now element of impossibility can be seen and their contract is void AB initio.

## 2.8 QUESTIONS

1. Enumerate various types of contracts.
2. Distinguish between Agreements & Contracts.
3. What is void and voidable contract?
4. What are the Contents of E-Contract?

5. What is Contingent Contract? What are the various types of contingent contract?
6. Distinguish between Contingent Contract and Wagering Agreement.

7. Short Note:
   a. Rules regarding enforcement of contingent contract.
   b. Essential elements of contingent contract.

8. Define the following terms:
   a. E-contract
   b. E-signature
   c. Contingent Contract
   d. Unilateral contract
   e. Executory contract

*****

# 3

# OFFER/PROPOSAL U/s 2(a) & ACCEPTANCE U/S 2(b)

**Unit Structure**



## 3.1 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning of and elements of offer.
- Discuss about the essentials of valid offer.
- Explain the types of offer.

## 3.2 INTRODUCTION

The words ‘offer’ and ‘proposal’ are synonymous and they mean one and the same thing. Offer is the first step in the formation of contract. When a valid offer is made and accepted, contract comes into existence, provided the other essential elements are present.

## 3.3 MEANING OF OFFER

### 3.3.1 Meaning:

**Section 2 (a) of the Contract Act** defines Offer 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, he is said to make an offer'.

### 3.3.2 Elements of Offer:

The analysis of the definition would show that the following elements are present in an offer:

**a.** There is an expression of willingness to do or abstain from doing something;

**b.** The expression is from one person to another;

**c.** The expression is for seeking the assent of that other person.

**d.** The person making the offer is called the ‘offerer’ and the person to whom the offer is made is called the ‘offeree’.

**e.** An Offer is the first step in the formation of contract. Offer or Proposal is a medium through which person **signifies to another his willingness to do not to do anything with a view to obtaining *assent of that other to such act or abstinence.

(*Assent: Means acceptance has been signified either in writing or by words of mouth or by performance of some act.).(** Signify Means: a sign , symbol)

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

- The person making the 'proposal' or 'offer' is called the '**promisor'** or '**offeror'**,
- The person to whom the offer is made is called the **'offeree' or Promisee**.or **Acceptor**

**Example:**Ram says to Shyam“Will you buy this Furniture for Rs.2,00,000/-?. Here Ram is making an offer to Shyam, because he signifies to Shyam his willingness to sell his furniture for Rs.2, 00,000/- with a view to obtaining Shyam’s assent to purchase furniture.

### 3.3.3 Modes of Giving an Offer:

An offer can be made by an act in the following ways:

#### a. By Spokenor By written(Express offer):

The written offer can be made by letters, telegrams, telex messages, advertisements, etc. The oral offer can be made either in person or over telephone.

**Examples**

- A proposes, by letter, to sell a house to B at a certain price. This is an offer by an act by written words (i.e., letter). This is also an express offer.
- A proposes, over telephone, to sell a house to B at a certain price. This is an offerby act (by oral words). This is an express offer

**b. By conduct.(Implied):**

The offer may be made by positive acts or signs so that the personacting or making signs means to say or convey.

However silence of a party can inno case amount to offer by conduct.An offer can also be made by a party by omission (to do something). This includes suchconduct or forbearance on one's part that the other person takes it as his willingness orassent.An offer implied from the conduct of the parties or from the circumstances of the caseis known as implied offer.

- BEST runs a bus on a particular route. It is an **implied offer** by the transport company to carry a passengers for a certain fare.
- A owns a motor boat for taking people from **Mumbai to Alibag**. The boat is in thewaters at the Gateway of India. This is an offer by conduct to take passengers from**Mumbai to Alibag**. He need not speak or call the passengers. The very fact that hismotor boat is in the waters near Gateway of India signifies his willingness to doan act with a view to obtaining the assent of the other. This is an example of animplied offer.

**3.3.4 To whom offer can be made?**

**a. To definite person-Specific Offer**.

**Example: Zahir** Proposes to sell his horse to **Mihir** for Rs. 80,000/- This offer is made to a **definite person** i,e to **Mihir.**

**X** offers to buy car from **Y** for Rs 1.0 lakh. This offer is a specific offer which has been made to a definite person **Y** No person other than **Y** can accept this offer

**b. To definite Class of Person**-

**Example:** School put up a notice to offer a reward of Rs.500/- to any students who returns the lost cell phone of a Teacher. This is an offer to a definite class of persons i,e **the Students of School.**

**c. To the world at large.- General Offer**:

A general offer is one which is not made to a definite person, but to the world at large or public in general. A general offer can be accepted by any person by fulfilling the terms of the offer. In case of general offer, the contract is made with person who having the knowledge of the offer comes forward and acts according to the conditions of the offer.

**Example:** X advertiser! the newspaper that he would pay Rs. 5,000 to anyone who traces his missing boy. Y who knew about the reward traced that boy and sent a telegram to X that he had found his boy; It was held that X was entitled to receive the amount of reward. [Harbhajan Lal v. Harcharan Lal (AIR All 539)]
**Case Laws:Carlill v. Carbolic Smoke Ball Co. [1893 1Q.B.256]**

### 3.3.5 Facts of the Case:

The Carbolic Smoke Ball Company, advertised in the several news papers, that a reward of 100 pounds would be given to any person who suffered from influenza after using smoke aball of the company according to its printed directons. The company's advertisements also stated that 1000 pounds had been deposited at a London bank as a sign of the company's good faith in offering such a reward.

Mrs. Louisa Carlill purchased one of the Carbolic Smoke Balls and, following the instructions as per the direction of given by the Co.( i.e. how to use the product), used it three times daily for a period of two months. She subsequently contracted influenza at the end of this period. Represented by her husband, a qualified solicitor, she attempted to claim the 100-pound reward from the company. **It was held**, she could recover the amount as, by using smoke balls, she had accepted the offer.

## 3.4 ESSENTIALS OF VALID OFFER

An offer to be valid must **satisfy** the following conditions. They are the essentials of a valid offer.

### 1. Offer may be express or implied:

An offer may be made either by words or by conduct. When an offer is made by words, written or spoken, it is called an express offer. When the intention to make an offer is gathered from the conduct of the person, it is called an implied offer.

**2. The terms of the offer must be certain:**

If the terms of the offer are not certain or definite, it is not a valid offer. It is rightly observed that unless all the material terms of the contract are agreed, there is no binding obligation. Therefore, the terms of the offer must not be loose or vague. They should not be capable of different or various interpretations and it must be possible to correctly ascertain the intention of the parties.

**3. Offer must be distinguished from invitation to make offer:**

An offer is different from 'invitation to offer'. In the case of invitation to offer, the person sending his invitation is merely calling upon the others to place their offers. Price Tags on a product is the good example of an invitation to make the offer. Similarly, an advertisement for sale of goods by auction, quotations, catalogues of prices are examples of invitations to offer.

**For Example** Job or tender advertisement inviting applications for a job or inviting tenders is an invitation to an offer.

**4. Offer may be general or specific:**

An offer is said to be general when it is made to the public at large and anyone may accept the same. A specific offer is made to a definite person or persons and hence can be accepted only by the person to whom it is made.

**For Example: A** offers to **B** to sell his Car for Rs.90, 000/-, it is a case of specific offer.

Where as **A** offers a reward of Rs. 5000/- to whosoever finds his lost scooter, .

**5. Offer must be communicated:**

Offer must be communicated to the offeree; otherwise it is not effective in the eyes of law. There cannot be any acceptance without the knowledge of offer. Thus, where **A** finds an article lying on a street and restores it to the owner without any knowledge about the reward offered by the **owner**, he **cannot claim** the reward from the owner because there was no **communication of offer to him.** A person cannot accept an offer as long as he is **unaware of its existence.**Unless an offeris properly communicated there cannot be an acceptance of it. An acceptance of an offer, in ignorance of the offer is no acceptance at all and does not create any legal rights or obligations.

**Case Law:Lalman Shukla vs Gauri Dutt.(1913) All LJ 489]**

**Facts of the Case:** Lalman Shukla is an employee with Pt. Gauri Dutt. When the nephew of Pt. Gauri Dutt was found missing, Lalman Shukla was sent for the search. It was announced later that who so ever finds the missing nephew will be rewarded with Rs. 501. Unaware of the announcement of the reward, Lalman Shukla located the the missing nephew and brought back.

It was held that Lalman Shukla has no right in the reward because he has no knowledge of the proposal. Hence, an action without the knowledge of the proposal is no acceptance at all.

**6. Offer must not thrust the burden of acceptance:**

Offer should not contain the term the non –compliance of which may be assumed to amount to acceptance.

**Example:**'X' writes to 'Y', I will sell you my motor car for Rs.50000/- If you do not reply I shall assume you have accepted the same.

**7. A statement of price is not an offer:**

A mere statement of price is not an offer to sell.

**Case Laws:Harvey V/s Facey**

The case involved negotiations over a property in **Jamaica**. The defendant, Mr.**LM Facey**, had been carrying on negotiations with the Mayor and Council of Kingston to sell a piece of property to Kingston City. On 7 October 1891, **Facey** was traveling on a train between Kingston and Porus and the **appellant, Harvey**, who wanted the property to be sold to him rather than to the City, sent Facey a telegram. It said,

**Q 1."Will you sell us Bumper Hall Pen?**

**Q 2. "Telegraph lowest cash price-answer paid"**.

Facey replied on the same day:**"Lowest price for Bumper Hall Pen £900."**

**Harvey** then replied in the following words. "We agree to buy Bumper Hall Pen for the sum of nine hundred pounds asked by you. Please send us your title deed in order that we may get early possession."

**Held:** No contract between **Harvey & Facey** because **Facey replied only Q no 2.** He supplied merely the information and no offer has been made by him to sell.

## 3.5 CLASIFICATION/TYPES OF OFFER

**1. Express Offer:**

The offer made by using words spoken or written is known as an express offer.

**Example.** Viral says to Kiran-" Will you purchase by Computer for Rs.10000/-

**2. Implied Offer:**

The offer which could be understood by a conduct of parties or circumstances of the cases is implied offer.

**Example-**Withdrawing money from the card holder from the ATM it creates an implied contract between the Card holder and Bank.

**3. General Offer:**

If the offer made to the world at large, it is known as the general or public offer. The general offer is one which is not made to a specific person. The General Offer can be accepted by any one.

**For Example**: An advertisement in a newspaper ' Anyone who will find my lost Envelop will be rewarded with Rs.5,000/-.

**4. Specific Offer:**

The offer made to a specific person or a particular person or two or more than two specific persons. The offer is made to an ascertained person.

**Example: '**A' offers to sell his house to 'B'for Rs. 40,00,000/- price. The offer has been made to a definite person, i.e., 'B'. It is only 'B' who can accept it [Boulton v.Jones (1857) 2H.and N. 64].

**5. Cross Offer:**

If two parties made offer to one another in ignorance of the offer made by other party, and terms-conditions in both the offer are same. Two cross offer do not conclude a contract.

**Example:** "A" by a letter offered to sell his car to "B" for Rs 2lacs. Without knowing about "A"s offer "B" also by a letter offered to buy "A"s same car for Rs 2lakhs. Both the offers cross each other.

**6. Continuous Offer: (standing offer)**

An offer of a continuous nature is known as 'standing offer'. A standing offer is in the nature of a tender.

**Example:** X Ltd. requires a large quantity of certain goods during the 12 months period and gives an advertisement inviting tender in the leading newspaper Z submitted the tender to supply those goods at a specific rate. Z's tender is accepted or approved. Now, Z's tender becomes a standing offer. Each order given by X Ltd. will be an acceptance of the offer.

**7. Counter Offer:**

Counter offer is the rejection of the original offer by the offeree and giving new offer.

**Example:** A offers to sell his car to B For Rs. 80,000/-, but B is ready to buy it for Rs.50,000/-. This new offer by B of Rs.50000/- to A is called a counter- offer. Now, it is for A to accept this new offer or reject it. If A accepts this offer, it will become a binding contract.

## 3.6 ACCEPTANCE OF AN OFFER

A contract comes into existence when a valid offer is validly accepted. Section 2 (b) of the Contract Act states that, 'when the person to whom the offer is made **signifies his assent** thereto, the offer is said to be accepted. (An offer when accepted becomes promise) A valid acceptance must be in conformity with the following rules:

**1. Acceptance must be given by the person to whom the offer is made:**

An offer can be accepted only by the person or persons to whom the offer is made; no one else can accept the offer. For Example if A intends to contract with B and therefore makes an offer to B, C cannot intervene and accept the offer made to B, without the consent of A.

**2. Acceptance must be by certain person:**

An offer may be made to an unascertained number or to the world at large but no contract can arise until it has been accepted

by a certain person who first gives information either by words or by conduct. Such an offer is known as **General Offer**. The general offer is closed as soon as it is accepted by a definite person.

**Example: A** gives an advertisement in the newspaper offering Rs.25,000/- to one who gives information of his lost daughter. B gives the information. **B** is entitled to have reward of Rs.25000/- Similarly, an offer to class of persons, can be accepted by any member of that class or group only and not by any other person not belonging to that group.

**3. Acceptance must be Absolute and Unconditional or Unqualified:**

An acceptance must be unconditional. A conditional or qualified acceptance is no acceptance in the eyes of law. Even a slight deviation from the terms of the offer would make the acceptance invalid. In fact, a conditional acceptance by itself is a counter-offer and not an acceptance.

**Example**: If A offers an article to B for Rs. 100/-, the acceptance by B to buy the article for Rs. 90/- is no acceptance in the eyes of law.

**X** inquires with **Y "**Will you purchase my dog for Rs.100"/-B replies, I shall purchase your dog for Rs.100/-, provided you should purchase my cat for Rs. 90/-

In this example, there will be no contract because the acceptance is **conditional.**

**4. Acceptance must be Communicated:**

Mere mental acceptance is not acceptance. But there is no requirement of communication of acceptance of the general offer. The general offer can be accepted by the performance of a condition.

**Example: Maria** tells **Peter** that she intends to marry **Stiven,** but does not tell anything to **Stiven**. There is no contract even if **Stiven** is willing to marry Maria.

**Case Laws:Brogden V/s Metropolitan Railway Company.**

**Facts of the Case:** The Manager of Railway Company received a draft agreement relating to the supply of Coal. The manager marked the draft with the words **" Approved",** and put the same in the drawer of his table and forgot all about it.

**Held:** There was no contract between the parties as the acceptance was not communicated. It may, however, be pointed out that the Court construed a conduct of parties, as railway company was accepting the supplies of coal from time to time.

**5. Mental Acceptance is not sufficient in Law:**

Silence cannot amount to acceptance. Mereun communicated or mental acceptance is not enough. Acceptance to be complete must becommunicated by words or conduct by an offeree to the proposer. Mental Acceptance is no acceptance at all. The proposer cannot prescribe that the offeree's silence shall be deemed to an acceptance.

**Example:** X tells Y that he intends to buy Z's house, but does not tell anything to Z of his intention. This is no contract.

**Case Law:*Felthouse v Bindley* [1862] EWHC CP J35**

A nephew discussed buying a horse from his uncle. He offered to purchase the horse and said if I don't hear from you by the weekend I will consider him mine. The horse was then sold by mistake at auction. The auctioneer had been asked not to sell the horse but had forgotten. The uncle commenced proceedings against the auctioneer for conversion. The action depended upon whether a valid contract existed between the nephew and the uncle. **Held:**There was no contract. You cannot have silence as acceptance.

**6. Acceptance must be expressed in some reasonable manner:**

If the terms of the offer stipulate certain period within which the offer has to be accepted, the acceptance must be effected within the time so stipulated. Acceptance may be made either by words or by conduct; It may also be expressed by post or telegram. If the proposer prescribes the manner in which the proposal is to be accepted and the acceptance is not made in such manner, the proposer may, within a reasonable time after the acceptance is communicated to him insist that his proposal shall be accepted in a prescribed manner, and not otherwise; but if he fails to do so; he accepts the acceptance. Therefore, if the proposer prescribes a method of delivery of goods at a particular place, he is not bound to accept delivery at any other place.

Usual and reasonable manner would mean the parties intended to perform the contract in the ordinary course of trade or business. The proposer is at liberty to prescribe the mode in which his offer or proposal shall be accepted. The proposer has the right

to prescribe the manner in which the proposal can be accepted but not the manner in which it may be refused.

**7. Acceptance must be given within a reasonable time:**

**M** offered to take share in a company on 9th June and received a acceptance on 24th November. **M** refused to take the shares. As the reasonable period of acceptance had elapsed, he was entitled to refuses to take the shares.

## 3.7 QUESTIONS

1. What is offer? Enumerate essentials of a valid Offer?
2. What are the various types of Offer?
3. State briefly the Ingredients of Offer.
4. What is acceptance of an offer?
5. What are the essential elements of acceptance of an offer?
6. Define the following terms:
   a. Offer
   b. Valid offer
   c. Cross offer
   d. Specific offer
   e. Implied offer

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# 4

# COMMUNICATION OF OFFER AND ACCEPTACE

**Unit Structure**



## 4.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand when the communication of offer is complete.
- Understand the communication of offer and acceptance of offer.
- Discuss about the meaning and modes of Revocation of proposal.

## 4.1 INTRODUCTION

The **offer**must be communicated to the other party so that its **acceptance** may constitute a contract.

An offer must be communicated to the person to whom the offer is made (the **offeree**) if the offer is to be effective. If an offer is sent in the post it will have no effect until it reaches the offeree, that is to say when it is communicated not when the offer letter is posted.

## 4.2 MEANING OF COMMUNICATION OF OFFER COMPLETE

**The communication of offer is complete** when it comes to the knowledge of the person to whom it is made. In case an offer is made by post, its communication will complete when the letter containing the offer reaches the offeree.

**Example**: **X** of Chennai sends a letter by post to **Y** of Madurai offering to sell his car far Rs 1,00,000. The letter is posted on 1st January and this letter reaches on 7th January. The communication of the offer is complete on 7th January.

**Note:** An offer accepted without its complete communication does not bind the offerer.

**Example**: In case of **Lalman V/s Gauri Dutt**, G sent his servant L to trace his lost nephew. When the servant had left, G announced a reward to anyone who traces the boy. L found the boy and brought him home. When L came to know of the reward, he claimed the reward. It was held that L was not entitled to the reward because he did not know about the offer when he found the missing boy.

A proposal is an expression of willingness to do contract on certain terms, made with the intention that it shall become binding as soon as it is accepted by the other person to whom it is addressed.

## 4.3 COMMUNICATION OF ACCEPTANCE

Let's try to understand the communication of offer and acceptance with the help of following example:-

**X** of Agra sends a letter by post to **Y** of Delhi offering to sell his car for Rs. 1,00,000. This letter is posted on 1$^{st}$ January and reaches Yon 7$^{th}$ January Y sends his acceptance by post on 10$^{th}$ January but X receives this letter of acceptance on 15th January. Answer each of the following questions.

(a) When is the communication of offer complete: - **7th January**

(b) When is the communication of acceptance complete as against the offeror: -**10$^{th}$ January**

(c) When is the communication of acceptance complete as against the acceptor:**15$^{th}$ Jan**

(d) If X sends a telegram on 8$^{th}$ January revoking his offer and this telegram reaches Y before the letter of the acceptance is posted. Is revocation of offer is valid? **Yes it is valid**

(e) If Y sends a telegram on 14$^{th}$ January revoking his acceptance and this telegram reaches X before the letter of acceptance is received by X. Is revocation of acceptance is valid? Yes it is valid

**As against the proposer:**

The communication of acceptance is complete, when it is put a course of transmission to him, so as to be out of the power of the

acceptor. In the case of acceptance through post, the contract is complete on the date when the letter of acceptance is posted. Whether or not the letter is received by the offeror is absolutely immaterial. The offeror, however, becomes bound only when a properly addressed and adequately stamped letter of acceptance is posted. The contract is complete when acceptance of offer is put in the course of transmission to the offeror.

**As against the acceptor:**

When it comes to the knowledge of the proposer.( Section 4)

**Example: 'B'**accepts **'A's** proposal by a letter sent by post. The communication of the acceptance is complete as against A, when the letter is posted, as against B, when the letter is received by A.

If communication of the acceptance is made by telephone, teleprinter, telex and fax machines, it completes when the acceptance is received by the offeror. The contract is concluded as soon as the offeror receives or hears the acceptance.

## 4.4 REVOCATION OF PROPOSAL SECTION: 5

### 4.4.1 MEANING

Revocation means**"taking back"** or **"cancellation"**.

**When can the proposal be revoked?**

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

**Example:** A proposal is sent by **Yameen** to **Yasir** and is accepted by **yasir** by letter. The proposal might have been revoked any time before the letter of acceptance was posted but it cannot be revoked after the letter is posted.

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

## 4.4.2 MODES OF REVOCATION OF PROPOSAL (SECTION 6)

**1. By notice of revocation:**

Offer may be revoked by a communication of a notice of revocation by the offeree to the other party before acceptance is complete against the offeror himself. An offer made in writing may be revoked by words of mouth. The notice of revocation may not always be express. 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 time of reasonable time is a question of fact depending upon the circumstances of each case. Where the subject matter of the contract is an article, like gold, the parties of which fluctuate daily in the market, very short period will be regarded as reasonable made late in November.

**3. By non-fulfillment of condition precedent**:

A proposal is revoked when the acceptor fails to fulfill a condition precedent to the acceptance of the proposal which was conditional offer. Thus, X may offer to sell certain goods to Y on a condition that Y pays a certain amount before a certain date.

**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.

**5. By counter offer:**

An offer comes to end when the offeree makes a counter offer or rejects the offer. Where an offer is accepted with some modification in the terms of the offer or with some other condition not forming part of the offer, such qualified acceptance amount to a counter offer.

**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 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 individual is entered, the offer comes to end.

### 4.4.3 REVOCATION OF ACCEPTANCE:

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

**Example: Shahid** Proposes by a letter sent by post to sell his Shop to **Bilal. Bilal** accepts the proposal by a letter sent by post. **Shahid** may revoke his proposal at any time before or at the moment when **Bilal** post his letter of acceptance, but not afterwards.

**Bilal** may revoke his acceptance at any time before or at the moment when the letter communicating it reaches **Shahid** but not afterwards.

### 4.4.4 Time for revocation of Proposal and Acceptance:

A Proposal may revoked at any time before the communication of the acceptance is complete as against the proposer and not afterwards.

**For Example:**'A' proposes by a letter sent by post to sell his house to 'B'. The letter is posted on 1st July, 2011. 'B' accepts the proposal by a letter sent by post on 4th July, 2014. The letter reaches 'A' on 6th July, 2014.

- **'A'**may revoke his offer at any time **before 'B'**posts his letter of acceptance i,e 4th July,2011 and not afterwards.

- **'B'**may revoke his acceptance at any time **before** the letter of acceptance reached **'A'**i,e before 6th July,2011 and not afterwards.

### 4.4.5 Communication of Revocation of an offer:

As far as the revocation of the offer is concerned , the offeror is bound by revocation of the offer as soon as he duly posts the letter of revocation of the offer. He cannot cancel the revocation made by him. But revocation of the offer is binding on the offeree

only if the letter of revocation of the offer is received by the offeree before the letter of acceptance is duly posted by the offeree.

## 4.5 QUESTIONS

1. What is Communication of Offer? Illustrate with suitable case laws.
2. Why Communication of offer is essential?
3. Short Note:
   a) Revocation of Acceptance.
   b) Modes of Revocation of Proposal.

*****

# 5

# CAPACITY OF PARTIES U/S 10-12

**Unit Structure**



## 5.0 OBJECTIVES

After studying the unit the students will be able to:

- Discuss about the meaning of Minor and effects of Minor agreement.
- Meaning of Sound mind and the effects of the agreement done by the unsound mind person.
- Know the capacity of contract.

## 5.1 INTRODUCTION

For construction of valid contract, the parties to a contract must have capacity i.e. competencey to enter into a contract. Every person is assumed to have capacity to contract but there are certain persons whose age, condition or status makes them incapable of binding themselves by a contract.

Section 11 of the Contract Act deals with the competency of parties and provides that "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 disqualified from contracting by any law to which he is subject."

Hence:Section 10 says, all agreements are contracts, if they are made by the parties competent to contract.

**Section. 10**require that the parties shall be competent to contract.

**Section .11** Who is competent to contract.-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

Hence:

**Following persons are not competent to contract.**

(a) Minor

(b) Person of unsound mind, and

(c) Person disqualified by any law to which they are subject. Contract entered into by the persons mentioned above are void.

**Every person is competent to contract who is:**

(a) Of the age of **majority.**

(b) Of **sound mind.**

(c) N**ot disqualified** from making a contract.

**Therefore the following persons are not competent to contract**

(a) A person who is a **minor.**

(b) A person of **unsound mind.**

(c) A person who is **disqualified** from making a contract.

Although the above mentioned categories of persons are not competent to contract, yet they may sometimes be making some bargains, taking some loans, or be supplied with some goods by third parties, or be conferred with some benefits etc., the position of such person in such like situations is being discussed below.

## 5.2 MEANING OF MINOR AND EFFECTS OF MINORS AGREEMENTS

### 5.2.1 Meaning of Minor:

A person who has not attained the age of majority is a minor. Section 3 of the Indian Majority Act, 1875 provides about the age of majority. It states that a person is deemed to have attained the age of majority when he completes the age of 18 years, except in case of a person of whose person or property a guardian has been

appointed by the Court in which case the age of majority is 21 years.

### 5.2.2 Effects of Minors Agreements:

A minor's agreement being void is wholly devoid of all effects. When there is no contract there should be no contractual obligation on either side.

**1. An agreement with or by minor is void:**

Section 10 of the Indian Contract Act requires that the parties to a contract must be competent and Section 11 says that a minor is not a competent. But either section makes it clear whether the contract entered into by a minor is void or voidable. Till 1903, court in India we were not unanimous on this point the privy council made it perfectly clear that a minor is not competent to a contract and that a contract by minor is void *ab initio.*

The leading case is:

**MOHRI BIBI V. DHARMO DAS GHOSE (1903)**

"A minor borrowed Rs. 20,000/- from B and as a security for the same executed a mortgage in his favor. He became a major a few months later and filled a suit for the declaration that the mortgage executed by him during his majority was void and should be cancelled. It was held that a mortgage by a minor was void and B was not entitled to replacement of money.

**2. No ratification:**

An agreement with the minor is completely void. A minor cannot ratify the agreement even on attaining majority, because a void agreement cannot be ratified. A person who is not competent authorize an act cannot give it validity by ratifying.

But if on becoming major, minor makes a new a new promise for fresh consideration, then this new promise will be binding.

**3. Minor can be a promise or beneficiary:**

If a contract is beneficiary to a minor it can be enforced by him. There is no restriction on a minor from bring a beneficiary, for example, being a payee or a promisee in a contract. Thus a minor is capable of purchasing immovable property and he may sue to recover the possession of the property upon tender of the purchase

money. Similarly a minor in whose favor a promissory note has been executed can enforce it.

**4. No estoppel:**

Where a minor by misrepresenting his age has induced the other party enter into a contract with him, he cannot be made liable on the contract. There can be no estoppel against a minor. It means he is not estoppel from pleading his infancy in order to avoid a contract.

**5. Liability for Torts:**

A trot is a civil wrong. A minor is liable in tort unless the tort in reality is a breach of contract. Thus, where a minor borrowed a horse for riding only he was held liable when the he lent the horse to one of his friends who jumped and killed the horse. But a minor cannot be made liable for a breach of contract by framing the action on tort. you cannot convert a contract into a tort to enable you to sue an infant.

**6. No insolvency:**

As he is incapable of contracting debts and dues are payable from the personal properties of minor and he is not personally liable. A minor cannot be declared insolvent

**7. Partnership:**

A minor being in competent to contract cannot be a partner in a partnership firm, but under Section 30 of the Indian Contract Act , he can be admitted to the benefits of partnership.

**8. Minor can be an agent:**

A minor can act as an agent. But he will not to be liable to his principal for his acts. A minor can draw, deliver and endorse negotiable instruments without himself being liable.

## 5.3 AGREEMENTS BY PERSONS OF UNSOUND MIND

As stated earlier, as per Section 11 of the Contract Act, for a valid contract, it is necessary that each party to it must have a 'sound mind'.

### 5.3.1 Meaning of Sound Mind:

Section 12 of the Indian Contract Act defines the term 'sound mind' as follows: "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 judgments as to its effects upon his interests."

Therefore, the person entering into the contract

- Must be a person who understands the terms of Contract.
- What he is doing and is able to form a rational judgments.

(i) A person who is **usuallyof unsound mind**, but **occasionally of sound mind**, may make a contract when he is of sound mind." Thus a patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals.

(ii) A person who is **usually of sound mind**, but **occasionally of unsound mind**, may not make a contract when he is of unsound mind." Thus, a same man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgment as to its effect on his interest, cannot contract whilst such delirium or drunkenness lasts.

In Halsbury's Laws of England, it is stated : "The general theory of the law in regard to acts done, contracts of unsound mind are generally deemed to be invalid; or in other words, (subject to exceptions), there cannot be a contract by a person of unsound mind."

**5.3.2 Unsoundness of mind may arise from:**

- **Idiocy** - It is permanent and congenital (by birth), and therefore he can never understand the contract and make rational judgments. The mental powers of an idiot are completely absent because of lack of development of the brain.

- **Lunacy or Insanity** - It is a disease of the brain. A lunatic loses the use of his reason due to some mental strain or disease. Of course he may have lucid intervals of sanity.

- **Drunkenness**–Drunken state of mind is a hurdle to enter into a contract. When a person is so drunk that he cannot form a rational judgments about the terms and conditions of the contract then such contract is a void contract. But if he can still understand the terms and conditions of the contract even though he has consumed alcohol then that contract is valid as he could understand the terms and conditions of the contract, that is why it is said that mere drinking is not an hurdle to contract.

- **Hypnotism** - It also produces temporary incapacity, till the person is under the impact of artificially induced sleep;

### 5.3.3 Effects of agreements made by persons of unsound mind:

An agreement entered into by a person of unsound mind is treated on the same as that of minor's and therefore an agreement by a person of unsound mind is absolutely void and inoperative as against him but he can derive benefit under it.

The property of a person of unsound mind is, however, always liable for necessaries supplied to him or to any one whom he is legally bound to support, under Section 68 of the Act.

## 5.4 CAPACITY TO CONTRACT: PERSONS DISQUALIFIED TO ENTER INTO A CONTRACT

The third type of incompetent persons, as per section 11, are those who are “disqualified from contracting by any law to which they are subject.”

**Who are disqualified Persons.**

**1. Alien Enemies:**

An alien that is citizen of a foreign country living in India can enter into contracts with citizens of India during peace time, by observing the restrictions imposed by the government in that respect. On the declaration of a war between his country and India, he will becomes an alien enemy and cannot enter into contracts.

**2. Foreign sovereigns and ambassadors:**

While entering into contracts with foreign sovereigns and ambassadors, one must be cautious because whereas they can sue others to enforce the contracts entered upon with them, they cannot be sued without obtaining the prior sanction of the central Government as they are in a privileged position and are ordinarily considered incompetent to contract.

## 5.5 QUESTIONS

1. Discuss briefly the capacities of parties to enter into a contract.
2. Short Note: Agreements by persons of Unsound Mind.

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# 6

# CONSIDERATION (SEC 2 AND 25)

**Unit Structure**



## 6.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning and definition of Consideration
- Know the essentials of valid consideration.
- Discuss the cases where an agreement though made without consideration will be valid.
- Explain the types of consideration.
- Know the meaning of Stranger to Contract and strange to consideration.

## 6.1 INTRODUCTION

Consideration is the foundation stone of every contract. The law enforces only those promises which are made for valid consideration. Where one party promises to do something, it must get something in return. This **'something in return'** is called consideration. Consideration is the **life-blood** of every contract.

If a promise is to be enforced as creating legal obligations, the law insists on the existence of consideration. A promise without consideration is null and void. It is called a naked promise or "***Nudum Pactum."*** Thus if A promise to pay B Rs. 1000 without anything in return, this constitute a bare promise and gives no right of action.

For a contract to be binding there must be valid consideration. Consideration is the promise given by both parties as the "price" of entering into the agreement. Without consideration there will be no contract.

**For example**, if **Anil** entered into an agreement with **Bhanu** for purchase of a Motor Car in exchange of nothing. Here there is no contract as the consideration value is nill.
In other case Anju entered into an agreement with Manu for Purchase of Motor car for Rs. 80,000/- , here the motor car is consideation for Manju and Rs.80,000/- is consideration for Anju. Hence here is a valid contract.
Consideration is in latin term ***quid pro quo*** means something in return, It means Price for the Promise.

## 6.2 MEANING AND DEFINITIONS CONSIDERATION

### 6.2.1 Meaning and Definition:

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

'When, at the desire of the promisor, the promisee or any other person (i) has done, or abstained from dong or (ii) does or abstains from doing, or (iii) promises to do or to abstain from doing something, such act or abstinence or promise is called a consideration for the promise'.

Section 23 provides that agreement without consideration is void.

- Definition. Consideration has been defined in many ways. According to **pollock"*Consideration is the price for which the promise of some other is brought and the promise thus given for value is enforceable*."**

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

(a) when at the desire of the promisor,
(b) the promise or any other person,
(c) has done or abstained from doing, or does or abstain 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.

**Example:-** A agrees to dell his horse to B for Rs. 1000. Here A's promise to sell his horse is for B's consideration to pay Rs. 1000 is A's consideration to sell his horse to B.

### 6.2.2 Essentials of Valid Consideration

Presence of consideration is one of the requisites of Valid Contract. Consideration must be of two directional nature. That means both parties should get benefited mutually. Then only the Contract becomes capable of creating legal relations. Consideration may be in the form of cash, goods, act or Abstinence.

**1. Consideration must move at the desire of the promissor.**

The consideration must move at the desire of the promisor. It is not necessary that it must be for the benefit of the promisor. It can be for the benefit of the third person also.

**Example:** Prof. Vinayak is employed by an Institution to teach Merchantile Law, but he teaches "Economics". Prof. Vinayak has done noting at the desire of the appointing authority I,e Promissor.

**2. Consideration may be Past, Present or Future:**

Consideration are of three types namely Past, Present and Future consideration.

- The consideration which is sent before formation of contract is called past consideration.
- The consideration which gets passed at the time of formation of contract is called Present Consideration.
- The Consideration which is to be passed in future i.e. after the contract is called Future Consideration. As per Indian Law three types of considerations are Valid. But as per England law Past Consideration is not valid.

**3. Consideration need not be adequate:**

Consideration need not be required to be adequate it can be inadequate. It means if a person sell a Mobile Phone worth Rs.10,000/- in Rs. 5,000/- , it is a valid contract, provided mutually agreed upon by both the parties.

**Example:** There is a Contract between A and B according to the terms of which A has to provide his house to B at a rent of one rupee. Court decides that it is a Valid Contract because Consideration need not be adequate.

**4. Consideration must be Lawful:**

Consideration must be lawful. Presence of unlawful consideration makes the contract illegal and hence Void.

**Example***:* There is a Contract between X and Z according to which Z has to murder Y for a Consideration of Rs. 10000 from X. Here Consideration from Z to X is unlawful and it is illegal contract.

**5. Consideration must be real and not illusory:**

Consideration must be real and of some value in the eyes of law. Consideration is not real when it is uncertain illusory or when it is physically or legally impossible to perform. Hence consideration should be possible to perform. An act does not recognize impossible performance. It may be physically impossible or can be legal impossible.

**Example:Ajay** promises to discover treasure by magic if **Atul** pays him Rs.5000/- Consideration from Ajay is void because it is impossible to perform the promise.

## 6.3 NO CONSIDERATION NO CONTRACT EXCEPTIONS

Every agreement 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.
Theyare as follow:

**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-

- it is expressed in writing;
- it is registered under the law for the time being in force;
- it is made on account of natural love and affection;
- 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.

**2. Compensation for services rendered [Sec. 25(2)]**

An agreement made without consideration will be valid if it is a promise to compensate wholly or in a 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 promiser;

(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.

**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. An oral promise to pay a time-barred debt is unenforceable.

**4. Promise to Charities:**

A mere promise to contribute to charity is not enforceable by law because it is without consideration.
If a person promises to contribute to charity and on this faith, the promise undertakes a liability to that extent not exceeding the promised substription, the contract shall be valid and enforceable by law.

**For Example:** Anurag promises to pay Rs.12,000/- to the Management Committee of the school by way of donation. The Management on the basis of Anurangs Promise, gets a Water Purifier system installed in the school at the cost of Rs. 8,000/- on credit. Now Anurag refuses to pay the donation.

In the above case Anurag will have to pay Rs. 8,000/- to the School on account of donation as the management had incurred a liability on the faith of Anurag. Here is valid contract eventhough the consideration is absent.

## 6.4 TYPES OF CONSIDERATION

There are three different types of consideration are as under:-

**1. Past Consideration.**

When something is done before the date of the agreement, at the desire of the promisor, it is called ‘past consideration.

**Let us discuss an example of this.**

**A** teaches the son of **B** at **B'**s request in the month of January, and in February **B** promises to pay **A** a sum of Rs 200 for his services. The services of **A** will be past consideration.

**2. Present consideration.**

Consideration which moves simultaneously with the promise, is called 'present consideration' or 'executed consideration'.

**Example : A** sells and delivers a book to **B,** upon **B**'s promise to pay for it at a future date. The consideration waiting from **A** is present or executed consideration since **A** has done his act of delivering the book simultaneously with the promise of **B.**

**3. Future Consideration.**

When the consideration on both sides is to move at a future date, it is called 'future consideration' or 'executory consideration'. It consists of an exchange of promises and each promise is a consideration for the" other.

**Example: X** agrees to sell a Sofa-cum-Bed for Rs. 20,000/- on first of the next month and **Y** agrees to pay the price 15 days after the date of delivery. In this contract, consideration for both the parties is future is future or executor.

## 6.5 STRANGER TO CONTRACT& STRANGER TO CONSIDERATION

### 6.5.1 STRANGER TO CONTRACT:

Stranger to Contract means the person who is not party to contract. The stranger to contract is also known as third party. The stranger to contract is cannot bring suit except in recognized cases.

It is general law of contract that a person who is not a party to the contract cannot sue upon it.

***Dunlop Pneumatic Tyre Co. v/s V. Selfridge & Co. (1915)***

A large quantity of tyres sold by X to Y at a certain price on entering into a agreement that he should not sell the tyres below the price mentioned in price list supplied by X. Y sold the tyres to Z a retail dealer under a contract stipulating the same covenant as betweenX and Y. Z sold the tyres at less than the list price. X sued

Z for breach of contract. It was held that X could not sue Z as X was not a party to contract between Y and Z.

### 6.5.2 STRANGER TO CONSIDERATION:

Under the Indian Contract Act 1872 consideration for a contract may move from the promisee or any other person i.e. a stranger to the consideration can also enforce the contract. But under the English Law the consideration for the contract must move from the promisee and promisee only, therefore a stranger to consideration cannot enforce it.

So, in India the consideration may move from stranger. This law was established in the case of **CHINAYYA Vs. RAMAYYA.**

**Facts of the Case:**

An old lady Laxhmi Rani gifted her property to her own daughter Ramayya, with the instructions to pay a certain sum of money annually to chinayya, her maternal uncle. On the same day Ramayya refused to honour the agreement on the ground that there is no consideration. Chinayya sued for the recovery of the annuity. It was held that there was sufficent consideration i.e. the property given to her by the sister of Chinayya.

## 6.6 QUESTIONS

1. What is consideration and state its essential elements of consideration?
2. *"No consideration No contract"* Discuss.
3. Short Notes:
   a Types of Consideration.
   b. Strangers to Contract.

*****

# 7

# FREE CONSENT & VOIDABLE CONTRACTSections. 13 to 19

**Unit Structure**



## 7.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning of consent
- Explain the meaning and effects of Coercion
- Know the Meaning and effects of Undue influence.
- Understand the meaning and effects of Misrepresentation.
- Know the Meaning and effects of Mistake.
- Explain the meaning and effects of fraud.

## 7.1 CONSENT

**As per Section 13."Consent" has defined** as -Two or more persons are said to consent when they agree upon the same thing in the same sense (i,e *Consensus ad idem*)

The word Consent means agreeing that something should be happen. An agreemtn is valid only when it is the result of the free consent of all the parties to it.

**Section.14 defines “Free consent" as,**
Consent is said to be free when it is not caused by-

- Coercion, as defined in section 15, or

- Undue influence, as defined in section 16, or (3) fraud, as defined in section 17, or (4)
- Misrepresentation, as defined in section 18, or
- Mistake, subject to the provisions of sections 20, 21 and 22. Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake.

Free consent is one of the most important essential elements of a valid contract. The term free consent refers to meeting of free and fresh minds of two parties of an agreement when two parties take and understand, purpose, subject matter and terms and conditions of the agreement in the same sense it is free consent. Both of them must take things in the same way. They must not understand it in different way.

Two persons are said to consent, when they agree upon the same thing in the same sense. It is also known as consensus-ad-idem, which means identity of mind.

## 7.2 COERCION (SECTION 15)

### 7.2.1 Meaning:

"**Coercion"** is the committing, or threatening to commit, any act forbidden by the Indian Penal Code under(45,1860), or the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

**Example,** "**A**" threatens to shoot "**B**" if she doesn't marry with him **"B**" marries "**A**" under threat. Since the marriage has been brought about by coercion, such marriage is not valid.

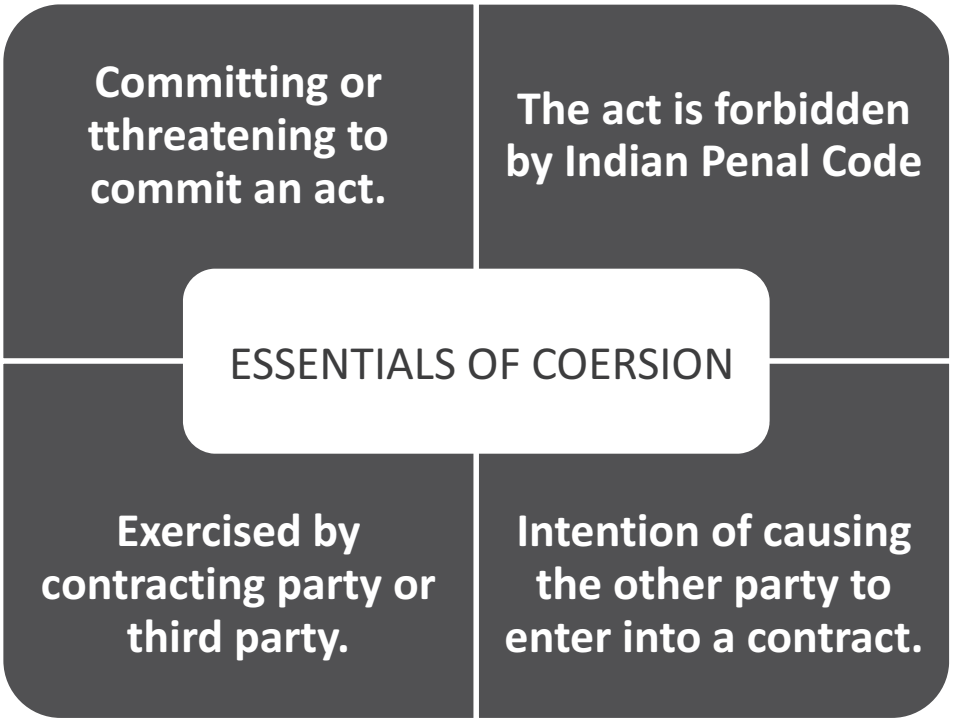
In simple words, coercion is the threat used by one party against another for compelling him to enter an agreement against his or her will. Section 15 of the Indian Contract Act defines coercion as the committing or threatening to commit any act forbidden by Indian Penal Code or an unlawful detaining or threatening to detain, any property of any person with the intention of inducing any person to enter into an agreement. It is immaterial whether the Indian Penal Code is or not in force in theplace where the coercion is employed.

When a **person was forced to enter into a contract** by use or under the threat of use of physical force by the other person committing or threatening to commit any act forbidden by Indian

Penal Code, Coercion is said to have been employed.

**EFFECT OF COERCION ON A CONTRACT:**

- The contact becomes **voidable** at the option of the aggrieved person/party, the aggrieved party has two options may compel the other party for sperformance.
- If the aggrieved party decides to set aside the contract he must compensate any benefits received by him under such contract.




## 7.3 UNDUE INFLUENCE (SECTION 16)

### 7.3.1 Meaning:

It is a wrong pressure put on some one which prevents that person from acting independently.

**(Section 16(2))** States that "A person is deemed to be in a position to dominate the will of another.

**For Example**-Spiritual adviser inducing his/her devotee to gift over the property for securing “moksha”.

**Undue influence means and includes:**

Under undue influence a party is compelled to enter into an agreement against his own will as a result of unfaur persuation by

other party. It includes mental, moral and physical domination that deprtives or makes unable the person to take his own judgement.

In dealings between parent and child, husband and wife, attorney and client, or doctor and patient, undue influence is generally presumed to have been exercised unless proven otherwise.

Following situation or circumstances, a person is deemed to be in a position to dominate the will of others.

- Where he holds **a real or apparent authority over the other**. For example, an employer may be deemed to be having authority over his employee.
  - An income tax authority over to the asessee.
  - Master and Servant
  - Parent and child

- Where he stands in a **fiduciary relationship** to other,
  - The relationship of Solicitor with his client,
  - Spiritual advisor and devotee.
  - Doctor and Patient
  - Guardian and Child.

- Where he makes a contract with a person whose **mental capacity is temporarily or permanently affected by the reason of age, illness or mental or bodily distress**"

### 7.3.2 EFFECTS OF UNDUE INFLUENCE:

When consent to an agreement is caused by undue influence, the contract is voidable at the option of the party whose consent was so caused. 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. Only a party to the contract can avoid or rescind the contract. This right does not lie in the hands of a third party.

***Illustrations:***

1) **A's** son has forged **B**'s name on a promissory note. **B,** under threat of prosecuting **A's** son, obtains a bond from **A**, for the amount of the forged note. If **B** sues on this bond, the Court may set it aside.

2) **A**, a money lender advances Rs 100 to **B**, an agriculturist and by undue influence, induces B to execute a bond for Rs 200

with interest at 6 per cent per month. The Court may set the bond aside ordering B to repay Rs 100 with such interest as may seem just.

| Basis | Coercion | Undue Influence |
|---|---|---|
| **Meaning** | It refers to physical threat or force used by one party against the other for making him to enter into a contract. | It is said to exist when one of the parties to the contract obtains, through dominance, consent of another party to enter into a contract. |
| **Nature** | Consent is obtained under the threat of an offence | Consent is obtained by the dominant will of another. |
| **Medium** | Consent is obtained by force. | Consent is given in good belief but under moral influence. |
| **Liability** | under the Indian Penal Code.Coercion is punishable | There is no criminal liability. |

## 7.4 FRAUD (SECTION 17)

### 7.4.1 Meaning:

"Fraud" means and includes any act or **an active concealment of material facts** or misrepresentation made knowingly by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto of his agent or **to induce him to enter into the contract.**

"A false representation of fact made with the knowledge of its falsehood without belief in truth with intention that it should be acted upon by the party and actually inducing him to act upon it."

It must have been committed by a party to the contract or by his agent in order to deceive the other party.

**Example 1:** Mr. Shah purchases the land from Mr. Khan, who has already sold his land to Mr. Rahul. In this example, Mr. Khan had committed fraud because he did not tell to Mr. Shah that i have already sold this land to Mr. Rahul.

**Example 2 :** Mr. Amur tells Miss. Jolly knowing it to be false that his cow is pregnant. On this suggestion Miss. Jolly agrees to buy cow Rs. 45,000. It is a fraud.

**Example 3 :** Miss. Tina borrow Rs. 10,000 from Mr. Nash and promises to return it after one month without any intention of performing it. In this example Miss. Tina has no intention to return the money when she promises to pay. It is also a fraud.

The term 'fraud' includes all acts committed by a person with an intention to deceive another person. Deceiption means to make the person to entre into a contract.

Fraud is the **willful, deliberate representation** made by a party to a contract with the intent to deceive the other party or to induce such party to enter into a contract. It means made knowingly or without belief in its truth or recklessly without caring whether is it true or false.

**Accordingly to Section 17, fraud means and includes any of the following acts done with intent to deceive or to induce a person to enter into a contract.**

### 7.4.2 ELEMENTS OF FRAUD:

1. **A False representation must be there.**

A False statement made recklessly without inquiring whether it is true or false would amount to fraud. But if a statement which turns out to be false is made in the honest belief that it is true there is no fraud.

2. **The Active concealment of material fact.**

If a person conceals a fact which is material to the contract and it is duty to disclose it, it will be a case of fraud. Mere non-disclosure is not a fraud, where there is no duty to disclose.

3. **A promise made without any intention of performing it.**

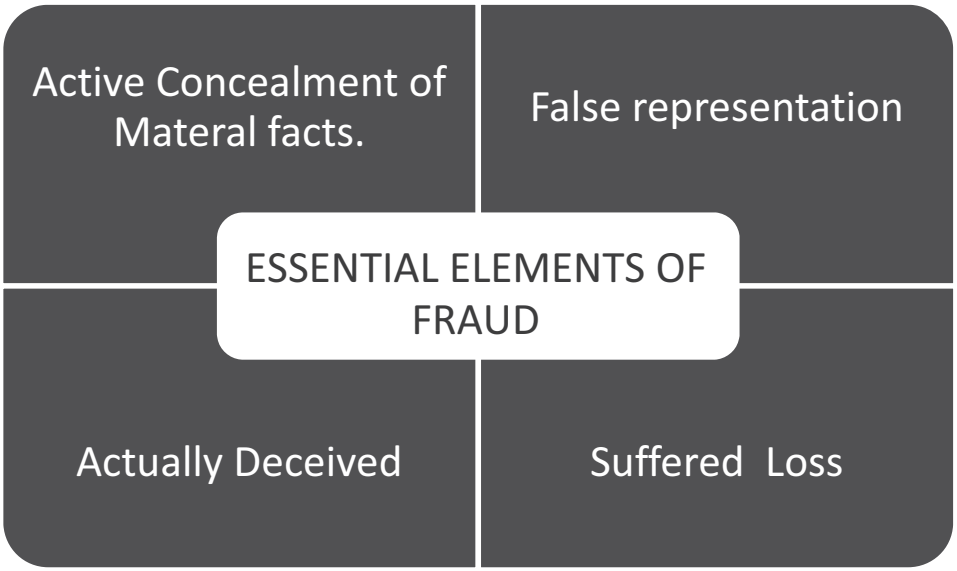
Where a person orders and obtains possession of goods with the intention of not paying for them, he commits fraud. The initial intention not to perform the promise that is being made is a necessary element to prove fraud.

4. **Any such act or omission as the law specially declares to be fraudulent.**

It is fraudulent to conceive of any act that attempts to deceive law. Thus, where a contract is based against the policy of insolvency law, or a secret agreement is formed between the insolvent and the party, it is nothing short of a fraud on insolvency law.

**5. Suffering Loss.**

The other party must have subsequently suffered some loss. There is no fraud without damage or damage without fraud does not give rise to an action.




**7.4.3 Whether mere Silence could leads to Fraud?**

Mere silence is not fraud. Unless it was the duty of the person to speak or to provide any information as per act. A contracting party is not obliged to disclose each and everything to the other party. There are two exceptions where even mere silence may be fraud, one is where there is a duty to speak, and then keeping silence is fraud. Or when silence is in itself equivalent to speech, such silence is fraud.

A silence to the contract is under no obligation to disclose the whole truth to the other party. 'CAVEAT EMPTOR' *i.e*., let the buyer beware is the rule applicable to contracts.There is no duty to speak is such cases and silence does not amount to fraud. Similarly there is no duty to disclose facts which are within the knowledge of both parties.

***Example : H sold to W some pings which to his knowledge suffering from fever. The pings were sold 'with all faults' and H did not disclose the facts of fever to W. Held there was no fraud. [Word v. Hobbs.) (1878) 4 AC 13]***

**Section17** makes it clear that mere silence as to the facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of the case are such that regard being had to them it is the duty of person keeping silence to speak, or unless silence is equivalent to speech.

**1. Mere silence is not fraud:**

A person is not bound to disclose the defect of his articles.

**Example:A** sells by auction to **B,** a horse which **A** knows to be unsound. **A** says nothing to **B** about the horse's unsoundness. It is not fraud.

**2. Silence is fraud if silence is equivalent to speech:**

Again where silence is equivalent to speech, silence amounts to fraud. For example, B says to A "If you do not deny it, I shall assume that the horse is sound." A says nothing. Here A's silence is equivalent to speech and as such, it is fraud.

**7.4.4 Duty or obligation to speak:**

In certain contracts, the law requires the parties to make full disclosure of material facts. Failure to disclose such facts would make the contract void or voidable. Such contracts are called ***Uberrimae fidei***, i.e., contracts requiring utmost good faith. In such contracts, party having any information regarding the subject-matter which is likely to affect the willingness of the other party to enter into transactions, is bound to disclose the information.

Following contracts are included in this category:

**1. Contracts of insurance:**

In contracts of insurance, the insured is required to disclose all material facts concerning the insurance which are likely to affect the risk and thus the willingness of the insurer. Failure to do so will result in avoidance of the policy. The policy can be avoided even if the mistake is innocent.

**2. Contract of immovable property:**

Under Sec. 55(i) (a) of the Transfer of Property Act, 1882, the seller is under an obligation to disclose to the buyer any material defect in the property or in the seller's title of which the seller is aware and the buyer is not aware, nor he (Buyer) could know with ordinary care.

**Example: A** knows that there is a crack in the Furnture. He sells this Furniture to **B** but does not disclose this defect to **B**. It is fraud.**B** can avoid the sale when he comes to know of the defect.

**3. Allotment of shares in companies:**

Companies Act requires the directors to make fullest possible disclosure in the prospectus to protect public interest,. If the directors do not disclose the specified facts, the agreement to take shares can be avoided.

**4. Contract of marriage:**

Each party to an agreement for marriage is duty bound to disclose every material fact, otherwise the party is justified in breaking off the engagement.

## 7.4.5 EFFECTS AND CONSEQUENCES OF FRAUD:

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

**A party whose consent to an agreement was caused by fraud has two remedies, namely:**

- He may rescind the contract, or
- He may insist that the contract shall be performed and that he shall be put in the position in which have been, if the representation made had been true.

**Example: A** fraudulently informs **B** that **A's** estate is free from encumbrance. **B** thereupon buys the estates. The estate is subject to a mortgage. **B** may avoid the contract or may insist on its carried out and the mortgage debt repaid by **A.**

Apart from the above, the person defrauded may obtain rescission, restitution for damages. The aforesaid remedies are subject to an exception. A contract cannot be avoided on the ground of misrepresentation or silence amounting to fraud.If a party to whom an untrue or misleading statement was made had the means of discovering the truth with reasonable diligence. The party whose consent was obtained by fraud has the following rights:

1. Aggrieved party can avoid the contract.
2. He may also claim damages.
3. He, instead of avoiding the agreement, may insist that the contract shall be performed and may claim the difference or loss due to fraud.

In case of fraud the contract is voidable at the option of defrauded party. A party has the following three options:

**1. Contract May be Avoided:**

Defrauded party may avoid itself from the contract where his consent was obtained by fraud. In case of fraudulent silence he cannot avoid if he had the means to discover the truth.

**2. Act upon the Contract:**

Second option for the defrauded party is that it may act upon the contract and may ask the other party to fulfill the terms and conditions of the contract.

**3. Claims for Damages:**

Third option for the defrauded party is that may claim for damages. Suit for damage can be filled.

## 7.5 MISREPRESENTATION (SECTION 18)

### 7.5.1 Meaning:

The Word '**Misrepresentation**' means a statement or positive assertion made by one party to the other, before or at the time of the contract relating to it.

Therefore, Misrepresentation is a false statement which the person making it **honestly believes** to be true or which he does not know to be false.

**Example: A** intends to sell his horse to **B** and says, "My horse is perfectly sound". **A** genuinely believes the horse to be sound, although he does not know that the horse has fallen ill yesterday. **B** there upon buys the horse. There is misrepresentation on the part of **A**.

Thus misrepresentation means false representation made innocently with an honest belief as to its truth by a party without any intention to deceive.

The leading case on this point is:

**DERRY V. PEEK (1889)**

**Facts of the Case:** A representation in the prospectus of the Company that the company has been authorized by a special Act of Parliament to runs trams by steam or mechanical power. The authority to use steam was, in fact, subject to the approval of the board of Trade, but no mention was made of this. The Board

refused consent and consequently the company was wound up. The plaintiff having bought some shares, sued the directors for fraud. But they were held not liable.

There is no fraud and they were not guilty of fraud as they honestly believed that once the parliament has authorized the use of steam, the consent of the board was practically concluded.

### 7.5.2 Essential Requirements of Mirepresentation:

- There should be a representation or positive assertion ;
- Such representation must relate to a matter of fact which has become untrue; and
- It was made before the finalization of transaction with a view to induce the other party to enter into contract.
- It must actually have been acted upon by the party.
- It must have been either by the party himself or by his duly authorized agent.

### 7.5.3 DISTINGUISH BETWEEN FRAUD AND MISREPRESENTATION.

| FRAUD | MISREPRESENTATION |
|---|---|
| An intentional, deliberate false statement made by the person to deceive the party. | In misrepresentation the person making the false statement honestly believes it to be true. |
| The purpose of the fraud is to deceive the other parties to the contract. | There is no intention to deceive the other party when there is misrepresentation of fact. |
| The contract is voidable | Misrepresentation renders the contract voidable at the option of the party whose consent was obtained by misrepresentation. |
| Fraud, In certain cases is a punishable offence under Indian penal code. | Misrepresentation is not an offence under Indian penal code and hence not punishable. |

## 7.6 MISTAKE (SECTION 20)

### 7.6.1 Meaning:

Mistake may be defined under **Section 20** of Indian Contract Act, 1872, as **"an erroneous belief about something"**. If the agreement is carried under an erroneous belief it cannot be said that the parties enjoyed free consent i.e. both the parties shall understand the same thing in the same sense.

**7.6.2 Mistake may be of two types:**

**1. Mistake of law:**

Mistake of law does not mean mistake in provisions of law but it means there is mistake in understanding or interpreting the provisions of any law by the party to contract. Hence mistake of law is where you are mistaken or ignorant about the law

**2. Mistake of fact:**

A mistake of fact is just that: a mistake pertaining to some fact. For example, if you are 35 years old but I think you are 34, I have made a mistake of fact.

A mistake of fact can act as a defense. Mistake of fact can be further divided as **bilateral** and **unilateral** mistake.

**A. Bilateral Mistake:**

As per Section 20 of the Act, where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement shall be void".

**Example: A** agrees to purchase **B's** Car for Rs. 90,000/- as a consideration. The day before execution of Contract the said car was destroyed by fire along with the garage. Both the partiy was unaware of the fact and still want to make a contract. This is a bilateral mistake from both the side and contract is not valid but void as the subject matter is destroyed.

**B. Unilateral Mistake:**

If the mistake is on the part of one person ( One of the parties to the contract) the contract is valid.

**Example: Amita** brought Pickle fro the shop keeper a sample of which had been shown to **Amita.** Errorneously **Amita** thought the pickle was old. The pickle was however new.

Hence bilateral mistake would avoid the contract whereas, unilateral mistake cannot.

Therefore one party to the contract is under a mistake of fact, the contract is not voidable. Unilateral mistakes do not affect the validity of the contract unless they concern some fundamental fact and the other party is aware of the mistake.

A unilateral mistake may be:-

- **Mistake as to the nature of the transaction:**

A contract shall be void if a party to the contract without any fault of his own makes a mistake about the changing nature of the contract. It may be because of blindness, illiteracy, or of the person entered the contract or due to the tacties or deliberate misrepresentation as to the nature of the document.

**Case Study:**'**Atul'** Agree to sell his horse to **'Bunty'.** But unknown to both the parties, the horse had already died at the time of making of the Contract. Is it a valid contract? Why

**7.6.3 EFFECTS OF MISTAKES**.

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 law not in force in India has the same effect as a mistake of fact.

**Illustration:**

**A** and **B** make a contract grounded on the erroneous belief that a particular debt is barred by the Indian Law of Limitation the contract is not voidable.

It is expected that every one is supposed to know the law of the land. Ignorance of law is no excuse. If a person wants to avoid the contract for the reason that there was a mistake, the relief will not be granted to him.

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

**Examples:**

- '**A'** agrees to buy from **'B'** a certain horse. The horse was dead at the time of the contract, though both the party was aware of the fact. The agreement is void.
- '**A'** being entitled to an estate for the property of **'B'** , agrees to sell it to **'C'** . '**B** 'was dead at the time of the agreement, but both the parties were ignorant of the fact. The agreement is void.

When the type of mistake contemplated is section 20 is present in an agreement, the agreement is void. Section 20 requires that :

- Both the parties to the contract should be under a mistake.
- Mistake should as regards a matter of fact.

- The fact relating to which the mistake is made should be requisite to the agreement.

### 7.6.4 Distinguish Between Unilateral Mistake and Bilateral Mistake.

| UNILATERAL MISTAKE | BILATERAL MISTAKE |
|---|---|
| One party is at mistake. | Both parties to contract is at mistake. |
| Contract is not Void or voidable. | Both parties to an agreement are under mistake of facts, agreement is void. |
| Provisions are applicable under section 22. | Provisionsare applicableunder section 20. |

## 7.7 QUESTIONS

1. Define consent. When consent said to be free?
2. What is undue influence? State the effects of undue influence on the contract.
3. What is Coercion? Differentiate Coercion with Undue Influence.
4. What is Fraud? What are its essential elements?
5. Enumerate the effects of Mistakes.
6. Define the following terms:
    a. Consent
    b. Unilateral Mistake
    c. Fraud
    d. Misrepresentation
    e. Undue influence
    f. Coercion

*****

# 8

# LEGALITY OF OBJECT &VOID AGREEMENTS: (SECTION.23-30)

**Unit Structure**



## 8.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of void agreements.
- Explain the considerations those are lawful and those are not lawful.
- Know the meaning and essentials of wagering agreement.
- Explain the difference between wagering agreement and Contingent agreement.

## 8.1 WHAT IS VOID AGREEMENT?

### 8.1.1 Meaning:

"An agreement not enforceable by law is said to be void" **[Sec.2(g)].** Thus a void agreement does not give effects to any legal consequences and is void ab-initio. In the eye of law such an agreement is no agreement at all from its begining.

One of the essentials of a valid contract is that the consideration and the object should be lawful. Every agreementof which the object or consideration is unlawful is void.Section 23 mentions the circumstances when the considerationor object of an agreement is not lawful.

### 8.1.2 Lawful Consideration And Objects:

Sec. 23 explains that What consideration and objects are lawful, andwhat not:: The consideration or object of an agreement is unlawful unless,

- It is forbidden by law, or
- Is of such nature that, if permitted, it would defeat the provisions of law, or
- Is fraudulent involves or implies injury to the person or property of another;or
- The court regards it as, immoral or opposed to public policy.

**Example:** Any contract that includes purchasing of a stolen item or an illegal drug or fraud, or harming someone would be void. The consideration as well as the object of an agreement must be lawful otherwise the agreement is void.

**Example :** A Peron transferred his property to a near relation for certain sum for being defeated to his creditors. Here, payment of money is the consideration and it is lawful, but, the object was unlawful as it against the provisions of insolvency law. Hence, the object and consideration both must be lawful; otherwise, the agreement is void.

### 8.1.3 What consideration and objects are lawful, and what not?

**Illustrations**

(a) **'A'** agrees to sell his house to **'B'** for Rs.12,000/-. Here, '**B**'s promise to pay the sum of Rs. 12,000/-is the consideration for **A'**s promise to sell the house and **A'**s promise to sell the house is the consideration for **B'**s promise to pay the 10,000 rupees. These are lawful considerations.

(b) **'A'** promises to maintain **B's** child, and '**B'** promises to pay '**A'** Rs.1,000/- yearly for the purpose. Here, the promise of each party is the consideration for the promise of the other party. They are lawful considerations.

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

(e) **'A'** promises to obtain for '**B'** an employment in the public service and B promises to pay Rs. 3,000/- to **'A**'. The agreement is void, as the consideration for it is unlawful.

(g) **'A'** agrees to let her daughter to hire to **'B'** for concubinage. The agreement is void, because it is immoral.

Every agreement of which the object or consideration or both are unlawful is void.

**1. If it is prohibited by Law.**

The agreement is unlawful if it involves doing of an act which is forbidden by any law. An act forbidden by law is punishable by the Criminal law or by a special act. The agreement to give bribe if some work will be performed is unlawful and hence unenforceable.

**2. Agreement in restraint of marriage.**(S.26)

Every agreement in restraint of the marriage of any person, other than a minor's marriage is void.

It is interesting to note that a promise to marry a particular person does not imply any restraint of marriage, and is, therefore, a valid contract.

**Examples:**

(a) '**A**'Agrees with **B** for good consideration that he will not marry **C.** It is a void agreement.
(b) '**A'** agrees with **B** that she will marry him only. It is a valid contract of marriage.

**3. Agreement in restraint of trade.**(S.27)

Every agreement, by which one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

**4. Agreement in restraint of legal proceedings.(S.28)**

Every agreement by which any party thereto is restricted from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary courts is void to that extent.

Section 28, as amended by the Indian Contract (Amendment) Act, 1996, declares the following three kinds of agreements void:

**Example:** An employee agreed with his employer **not** to sue for his wrongful dismissal. Held that the agreement was in restraint of legal proceeding and is void.

Restriction on Legal proceedings. As stated above Section 28 renders every agreement in restraint of legal proceedings are void.

**5. Agreements for uncertainty.(S.29)**

Agreements the meaning of which is not certain, ambigus are void.

**Example :A** agrees to sell to sell **B** a hundred ton of oil. There is nothing to show what kind of oil was intended. This agreement is void for uncertainty.

### 6. 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
- Agreement to Commit a Crime
- Agreements to defraud Creditors
- Agreements to defraud Government
- Champerty Agreement

### a. Agreements in Restraint of Trade:

The agreements which restrict trade business or Profession are called agreements in restraint of trade. One citizen cannot restrict lawful business of the other.

**Example:** A case on this point is Madhav V/s Raj kumar. A and B enters into a contract according to which B has to close down his business for which he would be paid amount by A. B closes his business but, A fails to pay B the agreed amount. B sues A for recovery and court decides that it is an agreement in restraint of trade and hence void.

### b. Agreements in Restraint of Marriage:

The agreements which create restriction on marriage are called agreements in restraint of marriage. One person cannot restrict the other from getting married.

**Example:**A case on this point is Lowe V/s Peerless. In this case an agreement gets formed between A and B according to which A should marry B only and B should marry A only. If only one of them

breaches the agreement a compensation of $ 2000/- is to be paid. Court decides that the language used in the agreement is creating restriction on marriage and hence void.

**c. Agreements in Restraint of Parental Rights:**

The agreements which restrict rights of Parents on their Children are called agreements in restraint of Parental Rights. By Virtue of an agreement, Parents cannot waive up their rights. Such agreements are harmful to Children.

**d. Agreements in Restraint of Personal Freedom*:***

The agreements which restrict Personal Freedom are opposed to public policy. For example: An agreement to do slavery falls under this group.

**Example:**Related case is Ramasastry V/s Ambela. In this case a contract of loan gets formed between A and B and their Contract Specifies that B has to join as slave at A's house till Settlement of debt. Court decides that the contract is void.

**e. Agreements with regard to sale of Public Offices and Titles:**

Titles and positions in Government will be given basing on personal talent. That person who has obtained them cannot transfer them to some other person by means of an agreement.

**Example:** In the case of S V/s Muthu Swamy. a Contract gets formed between A and B according to which A has to transfer his position in government. to B for certain consideration. It is opposed to Public Policy and hence held to be Void.

**f. Agreements with Alien Enemy:**

Agreements with aliens are Valid so long as there are good relations between two Countries. When War breaks out between the Countries that Contract becomes opposed to public policy and hence void.

**g. Agreements based on Bribes:**

Whenever there is involvement of Crime or Corruption, Such agreement is said to be opposed to public policy.

**Example:** There is an agreement between A and B according to which B has to pay Rs.15000 to A and for that A has to arrange for admission of A`s Son to a Medical College. The agreement is opposed to Public Policy and hence the same is void.

**h. Agreement to Commit a Crime:**

In case where objective of the agreement is to conduct a Crime like murder etc, it becomes opposed to public policy.

**i. Agreements to Defraud Creditors:**

If debtors form an agreement to defraud their Creditors, Such agreement is opposed to public policy.

**j. Agreements to Defraud Government:**

Agreements to evade taxes etc. create loss to government they are opposed to public policy.

**k. Champerty Agreement:**

It is the agreement where one party agrees to assist the other in receiving property with an object of sharing the profit out of litigation. This is a sort of gambling on litigation, and treated as against public policy, the champerty agreement is void**.**

**7. Agreement by way of Wager: (S.30)**

Under wagering agreements two persons holding opposite views normally touching the issue of uncertain events and the events must be future.

**Examples:**

- **A** and **B** mutually agree that if it rains today **A** will pay **B** Rs 100 it does not rain **B** will pay **A** Rs 100.

- **C** and **D** enter into agreement that on tossing up a coin, if it falls head upwards **C** will pay **D** and if it falls tail upwards **D** will **pay C** Rs 50; there is, a wagering agreement.

- **It is essential to a wagering contract that**.

**a.** each party may under it either win or lose,

**b.** whether he will win or lose being dependent on the issue of the event, and,

**c.** therefore, remaining 'uncertain until that issue is known,

**d.** If either' of the parties may win but cannot lose, or may lose but cannot win, it is not a wagering contract.

Wager is a game of chance in which the contingency of either gain or loss is wholly dependent on an **'uncertain event.**' An event may be uncertain, not only because it is a future event, but because it

is not yet known to the parties. Thus a wager may be made upon the result of the cricket match which is to take place", next month in Calcutta, or upon the result of an election which is over, if the parties do not know the result.

Secondly, the parties to a wager must have no interest in the event's '**happening or non-happening**. There is sole intention to gamble and to make the money.

- **Essential features of a Wagering Agreement.**

The essentials of a wagering agreement may thus be summarised as follows:

**a.** There must be a promise to **pay moneyor money's worth**,_

**b.** The **gain** of one party must be the **loss** of the other,

**c.** The promise **must be conditional on an event's happening or not happening**,

**d.** The event must be an uncertain one. If one of the parties has the event in his own hands, the transaction is not a wager.

**e.** Each party must stand to win or lose under the terms of agreement. An agreement is not a wager if one party- may only win and cannot lose, or if he may lose but cannot win, or if he can neither win nor lose.

**f.** No party should have a proprietary interest in the event. The stake must be the only interest which the parties have in the agreement.

**g.** The promise must be made with the sole intension to gamble i,e neither party should have any interest in the happening or non-happening of the e3vent other than the sum or stake he will win or lose.

Section 30 lays down that "agreements by way of wager are void; and no suit shall be brought or recovering anything alleged to be won on any wager.

**The Section makes an *exception* in favour of certain prizes for horse racing.**

**Special Cases.**

- **Lotteries.**

A lottery is a game of chance. Therefore, the business of lottery is a wagering transaction. Such a transactions has no legal force, because section 294-A of the Indian Penal Code states 'conducting of lottery a punishable offence'. If a lottery is authorized by the Government of that State, the only effect of such permission is that

the persons conducting the lottery will not be guilty of a criminal offence.

- **Games of Skill / Intelligence or Crossword puzzles.**

Where prizes depend upon a chance, it is 'a lottery and therefore a wagering transaction. Thus a crossword puzzle, wherein prizes are depends upon correspondence of the competitor's solution with a previously prepared solution, i**s a wager.** But if prizes depend upon **skill and intelligence**, it is a valid transaction. Thus prize competitions which are games of skill e.g., picture puzzles, literary competitions and athletic competitions are not wagers as there is an efforts are made to select the best competitor.

- **Insurance Contracts**.

Insurance contracts are valid contracts even though they provide for payment of money by the insurer, on the happening of a future uncertain event. Such contracts differ from wagering agreements mainly in three respects:

a. The contracts of Insurance are entered into to protect an interest. In a wagering agreement there is no interest to protect and the parties bet exclusively because they can thereby make some easy money
b. Contracts of Insurance are based on scientific and actual calculations whereas, wagering agreements are a gamble without any scientific calculation of risks.
c. Contracts of Insurance are regarded as beneficial to the public, whereas wagering agreements do not serve any useful purpose.

## 8.2 DIFFERENCE BETWEEN WAGERING AGREEMENT AND CONTINGENT CONTRACT

| Basis | Wagering Agreement | Contingent Contract |
|---|---|---|
| Reciprocal promises | It consists of reciprocal promises. | It does not contain reciprocal promises. |
| Nature | It is essentially of contingent nature. | It may not be of wagering nature. |
| Void or not | It is void. | It is valid. |
| Interest in subject matter. | Parties have no other interest in happening or non happeing of future uncertain events. | The parties have other interest also in the subject matter. |

| | | |
|---|---|---|
| Game of chance | It is purely a game of chance. | It is not a game of chance, though is dependent upon happening or non-happening of a certain event. |

## 8.3 QUESTIONS

1. Enumerate the agreements which have been expressly declared void by the Indian Contract Act.
2. What is Wagering Agreement? Describe its essential elements.
3. When an agreement in restraint of trade isvalid?
4. Short Note:-
   a. Agreements opposed to the public policy.
   b. Difffrence between Wagering Agreement and Contingent Contract.

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# 9

## MODULE II : SPECIAL CONTRACTS
# CONTRACT OF INDEMNITY& GUARANTEE

**Unit Structure**



## 9.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning and kinds of Contracts of Indemnity.
- Know the essentials of Contracts of Indemnity.
- Discuss about the Rights of indemnity-holder.
- Explain the meaning and features of contract of guarantee.

## 9.1 CONTRACT OF INDEMNITY

### 9.1.1 Definition & Meaning:

The **Contracts of Indemnity** has been defined as: "A Contract wherein one party promises to save the other from loss caused to him by the act of the promisor himself or by the act of any other person is called a **contract of indemnity**." In short Indemnity means and includes making good the loss or compensating a person for any loss.

Indemnity, in simple words, **is protection against future loss**.

The person who promises to save the other is called the **Indemnifier** and the person who is compensated is the

**Indemnified**. An indemnity can be defined as a sum paid by A to B by way of compensation for a particular loss suffered by B. A, the indemnitor may or may not be responsible for the loss suffered by the B, the indemnitee. Forms of indemnity include cash payments, repairs, replacement, and reinstatement. Contract of indemnities should all satisfy the conditions of a valid contract.

### 9.1.2 Example:

- **M** and **N** two friends goes to a shop. **M** says to the shopkeeper. "Let **N** have the goods; I shall see that you will be paid." Here is a contract of indemnity.

### 9.1.3 Kinds of Contract of Indemnity:

A contract of indemnity can be classified into two categories on the basis of expression of the parties at time of its formulation as express and implied.

**1. Express contract of Indemnity**:

When the parties to contract expressly agreed into a contract of indemnity. A party expressly promises to indemnify the other person from losses.

**Example: A** promise to compensate **B** if **B**'s goods are damaged due to the conduct of **C.**

**2. Implied contract of Indemnity**:

When the contract of indemnity deemed to have concluded by the acts of the parties or from the circumstances of the case, it is known as implied contract of indemnity.

**Example: Abhijit** hires a motorcycle from the **Abdul'**s shop to use for one day. The motorcycle gets damaged due to the accident. Here, **Abhijit** has to compensate for damage to **Abdul,** although he has not agreed expressly to do so.

### 9.1.4 Essentials or features of a Contract of Indemnity

A valid contract of indemnity should fulfill the following conditions:-

1. **Anticipated loss**: A contract of indemnity is a security for an anticipated loss.

2. **Requirements of valid contrac**t: Contract of indemnity being a species of contract must have all essentials of a valid

contract like free consent, competence of the parties, consideration, etc.

3. **To save other party**: There must be a promise to save the other party from some loss.

4. **Covers only the actual loss**: It covers only the actual loss may be due to the promisor himself or any other person and it covers only the loss caused by an event mentioned in the contract. The event mentioned in the contract must happen.

5. **Definition is not exhaustive**: As in the definition it is clearly stated that Contract of Indemnity covers only one kind of loss that is loss on account of human agency. While in fact losses could be by events beyond the control of human agency like on account of Tsunami, Earthquake etc.

### 9.1.5 Rights of indemnity-holder when sued:Sec. 125

**1. Right to Recover Damages:**

All compensations which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applicable.

**2. Right to Recover Costs:**

All costs which he may be compelled to pay in any suit if, in bringing or defending it, he did not act against the orders of the promisor and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.

**3. Right to Recover Amount paid in Compromise.**

A contract of indemnity is a kind of the general contract and as such, it must satisfy all the essentials of a valid contract like capacity of parties, free consent, lawful objects, etc. Thus if the object of a contract of indemnity is unlawful, it will be void.

**Example: Baku**l asks **Alexzander** to beat **Pauras** , promising to indemnify **Alexzander** against its consequences. **Alexzander** beats **Pauras** and in consequence is fined Rs. 50000/-. **Alexzander** cannot recover the amount from Bakul, as the object of this agreement is unlawful.

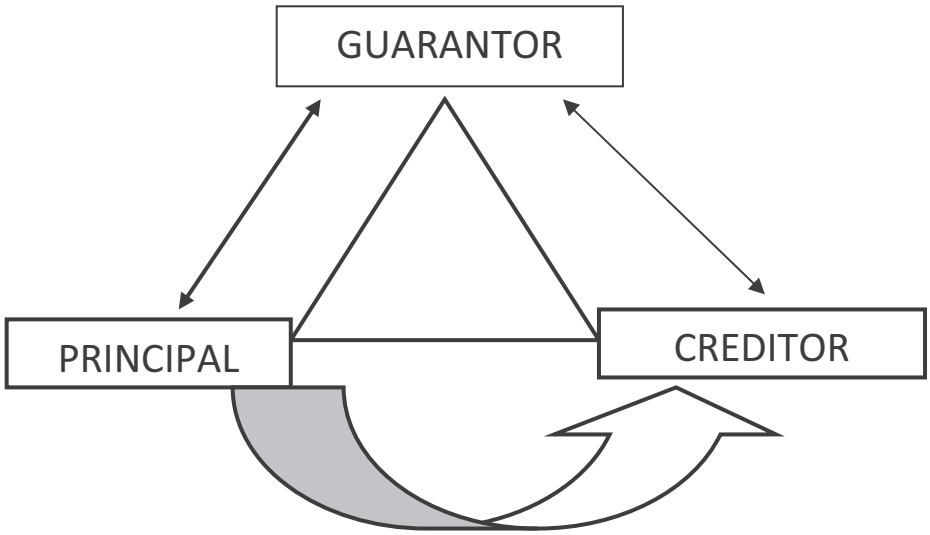
## 9.2 CONTRACT OF GUARANTEE

### 9.2.1 Meaning and definition:

A guarantee means a contract of a promise to be responsible for something, to perform the promise or to discharge the liability of a third person, in case of his default. Such a contract involves three parties. They are:

- **Creditor**: the person to whom the guarantee is given;
- **Surety**: the person who gives the guarantee.
- **Principal debtor**: the person, in respect of whose default, the guarantee is given.

**CONTRACT OF GUARANTEE**




**Section 126 of Indian Contract Act**, A contract of guarantee is a contract to perform the promise to discharge the liability of a third person in case of his default.

A clear definition was made regarding a guarantee by English Court in the case of Bricknyrs v. Darmell (1704), 'A contract of guarantee is a contract by one person to discharge the debt, fault or miscarriage of another.' A contract of guarantee is entered into with the object of enabling a person to get a loan or goods on credit or an employment.

**Example:**If 'A' advances a loan of Rs. 5000/- to 'B' and 'C' promises to 'A' that if 'B' does not repay the loan, 'C' will do so. Here, this is a contract of guarantee.

Here

- **A Creditor**

- **C is Surety**
- **B is Principal Debtor.**

It will be noticed that in a contract of guarantee there are three separate contracts, i.e.-

- between the principal debtor and creditor,
- between the creditor and surety, and
- between the surety and principal debtor,

Wherein the principal debtor requests the surety to act as surety and impliedly to indemnify the surety in case the surety incurs liability. Thus, the contract of guarantee is of tripartite nature.

The primary liability is of the principal debtor. The secondary liability is of the surety which arises only when the principal debtor defaults. ***PN.Bandak V/S Sri.Vikram Cotton Mills. (1970)***

**The surety must have to know all the facts regarding the contract.** If any alteration regarding the terms of the contract are made without the consent of the surety, it terminates automatically.

### 9.2.2 Characteristics or essentials of contract of guarantee

Following are the characteristics or essentials of contract of guarantee:

**1. Tripartite agreement:**

In a contract of guarantee, there are three parties namely: principal creditor, creditor and surety. Under this contract, three separate contracts are made among them and consent of all the three parties is necessary. The contracts connecting each-other as contract between:

a**. the principal debtor and creditor,**

**b. the creditor and surety, and**

**c. the surety and principal debtor**,

**2. Liability:**

Under such contract the primary liability is of the principal debtor and only secondary liability is of the surety. As a conditional contract, liability of the surety arises only when the principal debtor (primarily liable) defaults.

### 9.2.3 Essentials of valid contract:

It is also as same as other general contract in respect of essentials. All the requirements for valid contract, i.e. free consent,

consideration, lawful object, competency of the parties etc. are necessary to form this kind of contract. But, in respect of consideration, no direct consideration in the contract between the surety and creditor. Consideration of principal debtor is considered to be adequate for the surety.

### 9.2.4 Written form:

A contract relating to guarantee must be concluded in writing in Nepal and England. But, the Indian legal framework does not compel to form such contract in written form. Both written and oral is valid in India.

### 9.2.5 Features of a Contract of Guarantee:

A contract of guarantee is a type of general contract and as such all the essentials of a valid contract must be present. However, it has the following special features:

**1. Surety's Liability on principal-debtor's default:**

There must be a conditional promise to pay on the default of the principal debtor. If the promise is not conditional on default, it will not be a contract of guarantee but of indemnity.

**Examples:**

a) '**A**' asks '**B**' to sell certain goods on credit to **'C'** promising "I will pay the amount in case '**C**' fails to pay." It is a contact of guarantee as the promise is contingent on the default of '**C'**.

b) **'A'** asks a shopkeeper to sell certain goods to '**C'** promising, "I **will see that you are paid."** This is **not** a contract of guarantee as the promise of the guarantee is not conditional on default of the buyer. It is a contract of indemnity.

**2. Principal debtor need not be competent to contract:**

Although the creditor and the surety must be capable of entering into contract, yet, the principal-debtor need not be competent to contract. In such a case, the principal-debtor is not liable but the surety is liable as the principal- debtor.

**[Kashiba v/s Shripat],**

**3. Surety's Distrint Promis to be answerable:**

In order to constitute a turantee there must be a distinct promise on the part of surety to be answerable for the debt.

**Example:** A goes with B to TitanWatch Companu says to the proprietor " let B have this watch , and if he does not pay I will pay you". This is a contract of gurantee.

## 9.3 KINDS OF GUARANTEE

Contracts of guarantee may be

**1. Specific guarantee:**

Specific guarantee means a guarantee given for one particular transaction. In this case the liability of the surely extends only to a particular transaction and not other than that.

***Example:*** **A** guarantee payment to **B** of the price of 5 sacks of flour to be delivered by **B** to **C** and to be paid in a month. **B** delivers sacks to **C. C** pays for them. Afterwards **B** delivers four sacks to **C,** which **C** does not pay. The guarantee given by **A** was only a specific guarantee and accordingly he is not liable for the price of the four sacks.

**2. Continuing guarantee(Sec. 129):**

A continuing guarantee is that which extends to a series of transactions. When the guarantee is a continuing one surety can fix up a limit on this liability as to time or amount of guarantee,.

***Example:***(i) A, in consideration that B will employ C in collecting the rents of B,s zamindari, promises B to be responsible, to the amount of 5,000 rupees, for the due collection any payment by C of those rents. This is continuing guarantee.

**3. Retrospective guarantee:**

Retrospective guarantee is given for an existing debt.

**4. Prospective guarantee:**

Prospective guarantee is given for a future debt, i.e., a debt to be taken in future.

## 9.4 REVOCATION OF CONTINUING GUARANTEE

A continuing guarantee is revoked by any of the following ways.

1. ***By notice*** **(Sec. 130).** By giving an appropriate notice to the creditor a continuing guarantee may at any time be revoked or terminated by the surety as to future transactions.

**2. *By Death* (Sec. 131):** Death of the surety will operate as a revocation or termination of the continuing guarantee with regard to the future transactions. No notice of death need be given to the creditor. Heirs of the surety will not be liable for any fresh transactions entered into by the creditor with the principal debtor after the death of the surety without knowledge of such death.

## 9.5 NATURE OF SURETY'S LIABILITY

Whatever amount of money a creditor can legally realise from the principal debtor including interest, cost of litigation, damages etc., the same amount he can recover from the surety.

**Example: Anurag** guarantees to **Bhama** the payment of a bill of exchange by **Chatur,** the acceptor. The bill is dishonoured by **Chatur**. **Anurag** will be liable **not only for the amount of the bill also for any interest and charges which have become due on**

## 9.6 DIFFERENCE BETWEEN CONTACT OF INDEMNITY AND CONTRACT OF GUARANTEE

| POINTS | CONTACT OF INDEMNITY | CONTRACT OF GUARANTEE |
|---|---|---|
| **Meaning** | In the contract of indemnity one person promises to save the other from any loss. | Under Contract of Gurantee proformance of the contract is guaranteed. |
| **Number of Party** | There are two parties. | There are three parties. |
| **Liability** | Under indemnity contract the basic liability falls on the indemnifies. | In case of guarantee contract surety has the secondary liability. |
| **Number of Contracts** | Under the indemnity contract there is one contract between Indemnified and Indemnifier. | Under the contract of guarantee there are three contract between Surety and Principal debtor, Principal Debtor and Creditor & Creditor and Surety. |
| **Performance of Contract** | Contract of indemnity depends upon the possibility of risk or loss. | In case of guarantee there is an existing debt or duty performance about which guarantee is given. |

## 9.7 QUESTIONS

1. What are essential features of Contract of Indemnity?
2. DefineContract of Guarantee and enumerates essentials.
3. What are the rights of surety against the principal debtor?
4. What are the various kinds of Guarantees?
5. Distinguish between Contract of Indemnity and Guarantee
6. Short Notes:-
   a. Kinds of  Indemnity
   b. Rights of Indemnity holder
   c. Rights and duties of Indemnifier.
7. Define the terms:
   a. Contract of Guarantee
   b. Contract of Indemnity
   c. Invalid Guarantee
   d. Specific Guarantee

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# 10

# CONTRACT OF BAILMENT

**Unit Structure**



## 10.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of Bailment.
- Explain the Features of Bailment.
- Know the different types of Bailment.
- Discuss about the rights and duties of the Bailee.
- Explain the Duties of Bailor.
- Explain the rights of the finder of the goods.

## 10.1 MEANING AND DEFINITION BAILMENT

### 10.1.1 Definition of Bailment :

The term 'bailment' is derived from the French word 'bailler' which means to deliver a thing under a contract. The delivery of movable goods by one person to another person for a specific purpose with a condition to return the goods when the purpose is over or otherwise disposed off according to the direction of the person.

The person who delivers the goods is known as the '**Bailor'** and the person who receives the goods is known as the **'Bailee'** and the transaction is known as the '**Bailment'.**

**Definition:** Bailment is "the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them. The person delivering the goods is called the 'bailor'. The person to whom they are delivered is called the 'bailee'.

**Examples:-**

(i) 'A' lends his motor cycle to 'B' for his use.

(ii) 'A' gives a piece of cloth to a tailor to make it into a coat.

(iii) 'A' gives his radio set to a mechanic for repairs.

A bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished be returned or otherwise disposed', of according to the directions of the persons delivering them-Sec. 14.

The person delivering the goods it called the Bailor. The person to whom they are delivered is called the *Bailee.* The transaction is called *Bailment.*

**Examples :**

- 'P' lends his book to 'Q'.
- 'P' delivers a pen to 'Q' for repair.
- 'P' gives 'Q' his watch as security for a loan.
- 'P' gives a cloth to his tailor for stitching. It is bailment of the cloth. As soon as the cloth is stitched, it will be returned to 'P'.

In all these cases 'P' is the bailor and 'Q' is the bailee.

### 10.1.2 Characteristic Features or the Requisites of Bailment

1. **Delivery:**It is delivery of goods by one person to another.
2. **Purpose:**The goods are delivered for some purpose.
3. **Return:**It is agreed, that when the purpose is accomplished the goods are to be returned or otherwise disposed of according to the direction of the bailor.
4. **Contract:**Bailment arises from express or implied t contract. (n case of finder of goods bailment arises by implication tit' law.
5. **Ownership:** In bailment the bailor continues to be the owner of the goods. Therefore bailment does not cause any change of ownership.

6. **Movable goods**:**Bailment is concerned with only movable goods**. Money is not included in the category in movable goods. A deposit of money is not bailment.

   Deposit of money in a bank does not constitute bailment relationship between depositor and the bank is that of borrower and the lender.

7. **Possession:** A person already in possession of the goods may become a bailee by a subsequent agreement, express. or implied.

***Example :***

**'X'** is a seller of motor car, having several cars in his possession. '**Y'** buys a car and leaves the car in the possession of **'X'.** *After* the sale*is* complete, **'X'** becomes a bailee, although originally he was the owner.

**10.1.3 Different kinds of Bailment/ Classification of Bailment.**

**1. Bailment on the basis of Reward or Charge:**

**a. Gratuitous Bailment:**

A gratuitous bailment is the bailment without any charge or reward. Neither the bailor, nor the bailee is entitled to any remuneration.

**Examples:**

- Mohan lends his car to Sohan without any charges to go to his native place. ( No consideration)
- A' has given his scooter to the 'B' for two days and 'A'is not charging anything for that.

**b. Non- Gratuitous Bailment:**

It is the bailment for some charges or reward. The bailee is required to pay some charges to the bailor

**Example:**'A' has given his taxi to the 'B' for two days at the rate of hundred rupees per day. Now, in this 'A' is charging hundred rupees per day this is known as the non-gratuitous bailment.

**2. Bailment on the basis of Benefit**:

**a. Bailment for the exclusive benefit of the bailor:**

It is the bailment in which the goods are delivered by the bailor to the bailee only for the exclusive benefit of the bailor himself.

**Example:** Giving goods to a neighbor for safe custody.

**b. Bailment for the exclusive benefit of the bailee:**

It is the bailment in which the goods are delivered by the bailor to the bailee only for the exclusive benefit of the bailee.

**Example:** Lending a Scooter to a friend.

**c. Bailment for mutual benefit of bailor and bailee.**

It is the bailment in which the goods are delivered by the bailor to the bailee for the benefit of both the parties.

**Example:** Giving Television for repair, Giving watch for repair.

**3. According to Purpose:**

**a. Bailment by safe Custody:**

In such types of bailment, goods are bailed by one person to another person for safe custody.

**For example**: Having safe deposit locker in a bank.
**b.** Bailment by hire: Having a Car/ Vehicle on rent.

## 10.2 RIGHTS & DUTIES OF THE BAILEE

### 10.2.1 RIGHTS OF THE BAILEE

Following are the rights of the Baliee:

**1. Bailment by several joint owners:**

**"**If several joint owners of goods bail them, the bailee may deliver them back to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary.**"**-Sec. 165.

**2. Bailee not responsible on re-delivery to bailor without title:**

**"**If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to directions of the bailor, the bailee is not responsible to the owner in respect of such delivery.**"**Sec. 166.

**3. Bailee's Particular Lien:**

Lien means the rights to retain property until debt or claim is squred up. The right of lien is given by law in certain cases. Lien may be of two types **:**

General Lien and Particular Lien.

**General lien** means the right to retain **all the goods** of the other party until all the claims of the holder are paid.

**Particular lien** means the right to retain **particular goods** until claims on account of those goods are paid.

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

**10.2.2 DUTIES OF THE BAILEE:**

**1. Duty of reasonable care**

The bailee is bound to take care of the goods bailed to him. The degree of care to be taken by a bailee is that of a man of ordinary prudence. If he takes that amount of care, he will not be held responsible for loss, destruction or deterioration of the goods bailed. (Sec. 152). The degree of care required from the bailee is the same whether the bailment is for reward or is Gratuitous.

He is also not liable for the destruction or the loss of **goods due to an act of God**

**Example:** If 'A' bails his ornaments to ''B and 'B' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/ stolen in a riot, B will not be responsible for the loss to A.

**2. Bailee's liability for negligence of servants:**

For damages caused by negligence of the servants about the use or custody of the things bailed a bailee is liable, when acting in course of their employment. The bailee is also not liable for unauthorized acts of his servants outside the scope of their employment. Case:***Sanderson v/s Collins.***

**3. Unauthorised use of goods:**

If the bailee makes unauthorized use of goods bailed, i.e., uses them in a way not authorized by the terms of the bailment, he

is responsible for all damages to the goods and must pay compensation to the bailor. This liability arises even if the bailee is not guilty of any negligence, and even if the damage is the result of accident.-Sec. 154.

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

**4. Mixture of Bailor's goods with the Bailee's**

If the bailee mixes up his own goods with those of the bailor, the following rules apply :

(a) "If the bailee, with consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced."-Sec. 155.

(b) If the bailee, without the consent of the bailor mixes goods of the bailor with his own goods, and the goods can be isolated or divided, the property in the goods remains in the parties respectively ; but the bailee is bound to bear the expense of isolation or division, and any losses arising from the mixture.- **Sec. 156.**

**Example:** ***Hamid*** bails 100 bales of cotton marked with a particular mark to **Salim.*Salim*** without **Hamid's** consent mixes the l00 bales with other bales of his own, bearing a different mark. **Hamid** is entitled to have his l00 bales returned, and **Salim** is bound to bear all the expenses incurred in the separation of the bails, and any other incidental damage.

Without the consent of the bailor,If the bailee mixes goods of the bailor with his own goods, in such a way that it is impossible to segregate the goods bailed from the other that good, and returned them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.-Sec. 157.

**Example :D** bails superior flour worth Rs. 45 to ***B***. ***B,*** without **D's** consent . mixes the flour with inferior flour of his own, – worth only Rs. 25 ***B*** must compensate **D** for the loss of his flour.

**5. Duty of returning goods**

It is the duty of the bailee to return or deliver according the bailor's directions, the goods bailed, without demand, as soon as

the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished.--sec160.

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

**Example: G** agreed to carry certain goods of **B** in an efficient manner. The driver of the van which was carrying the goods left the van unattended for one hour for lunch. During that time the goods were stolen, **B** filed a suit for damages against **G**. Held, the carrier has a duty via to deliver the goods or return them. The carrier could not do so. The van driver's departure constitutes a fundamental breach of the contract to carry the goods forthwith to the destination. compensation, were awarded.

**6. Accretion to the goods bailed: -Sec. 163.**

The bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed

**Example : C** leaves a cow in the custody of ***B*** to be taken care of. The cow has a calf. **B** is bound to deliver the calf as well as the cow to **C**.

## 10.3 DUTIES OF THE BAILOR

Following are the duties of the Bailor

**1. Bailor's duty to disclose faults in goods bailed**

The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extra ordinary risk, and, if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

**Examples:**

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

(ii) A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. Bis responsible to A for the injury.

**2. Payment of expenses in Gratuitous Bailment:**

Where by the conditions of the bailment, the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.-Sec. 158.

**3. Responsibility for breach of warranty of title (Duty to indemnify the bailee for any loss):**

The bailor is responsible to the bailee for any loss which, the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give direction respecting them.-**Sec. 164.**

**Example: A** gives **B*'s*** car to **C** for use without **B's** knowledge of permission. ***B*** sues **C** and receives compensation. C is entitled to recover his losses fromA.

## 10.4 TERMINATION OF BAILMENT

A contract of bailment comes to an end under the following circumstances:

**1. Efflux of Time:**

If the contract of bailment is for a particular period, the bailment terminates as soon as the same period is expires.

**2. Destruction of the subject matter:**

A bailment is terminated when the subject matter of bailment is destroyed.

**3. Fulfillment of Purpose:**

If the bailment is for a specific purpose, the bailment terminates as soon as the purpose is fulfilled.

**4. Act Inconsistent with the terms :(Sec. 153.)**

If the bailee does any act, with regard to the goods bailed, which is inconsistent with the terms of the bailment, the bailment terminates.

**5. Goods Lent Gratuitously:** (**Sec. 159).**

A gratuitous bailment can be terminated any time but if premature termination causes any loss to .the bailee, the bailor must indemnify the bailee.

**6. Death**:**(Sec. 162.)**

A gratuitous bailment is terminated by the death either of the bailor or the bailee.

## 10.5 RIGHTS AND DUTIES OF FINDER OF GOODS

### 10.5.1 Meaning:

Finder of goods means a person who finds a goods belongs to others and takes the custody of the same.

Following are the rights and duties of the finder of goods:

### 10.5.2 Rights:

A finder of goods is in the position of a bailee if he takes charge of the goods. (See p. *132)* The rights of the finder of goods can be summarized as follows.-Sections 168 *and* 169:

1. **Possession :**He can retain possession of the goods against everybody except the true owner.
2. **Compensation and Lien :**He is entitled to get the compensation for the trouble and expense incurred by him for preservation of the goods and to find out the owner. He has a lien upon the goods for the payment of these sums i.e., he can refuse to return the goods until they are paid.
3. **Reward :** He can sue for any reward which the owner might have offered for the return of the goods lost.
4. **Sale:** If the goods found are commonly the subject-matter of sale and if the owner cannot with reasonable diligence be found or if he refuses to pay the lawful charges of the finder, the goods can be sold provided the following further conditions are fulfilled
   (a) When the thing is in danger of perishing or of losing the greater part of its value.
   (b) When the lawful charges of the finder amount to two thirds of its value.

### 10.5.3 Duties and Obligations:

The finder of goods is a bailee. Therefore, he has the following duties and obligations :

- He must try to find out the true owner of the goods
- He should take **reasonable care** of the goods (Sec. 151).
- He should not mix the finder's goods with his own goods *(Sec.* I55-157).

- The goods must be returned to the real owner *(Sec..* 160 & 161).
- If there is an growth or increase to the goods bailed, it must be given to the real owner (*Sec.* 163).
- He must not use the goods for his personal purpose.

## 10.6 LAW RELATING TO LIEN

### 10.6.1 Meaning:

A lien is a right of any one person to retain that, which is in his possession, belonging to another, until certain demands of a person in possession are fulfilled. In other words, a lien means the right to 'retain' the possession of the goods or property until the claim is paid or squared off. Possession is essential to create a right of lien.

Hence, Lien is a right of person to retain that which is in his possession and which belongs to another, until the demands of the person in possession are satisfied.

### 10.6.2 KINDS OF LIEN:

There are two kinds of liens:

(a) Particular lien,

(b) General lien.

### 1. Particular Lien or Specific lien (Section 170)

It is a right to retain custody or possesstion over those particular goods in connection with which the debt is in question. It is restricted to those goods which are subject matter of the contract and are liable for certain demands of the person in possession of those goods.

According to Section 170 where the bailee has, in accordance with the purpose of the contract of bailment, provides any services including an exercise of labour and skill in respect of the goods bailed, he has, in the absence of a contract to contrary, a right to retain such goods in his custody until he gets applicable or due remuneration in respect of them.

Besides the bailee, other persons who are entitled to exercise particular lien are unpaid seller of goods, finder of goods, pawnee, agents, etc.

**2. General Lien. (Section 171): [Holding goods until a debt has been paid]**

General lien is a kind of a special privilege which the law has granted only to few persons (i) bankers, (ii) factors (iii) wharfingers, (iv) attorney of the High Courts, (v) policy brokers, and (vi) others by agreement. These parties, can exercise general lien against any goods under their possession and for any sum legally due on a general balance of account.

It entitles a person in custody or possession of the goods to retain them until **all claims** of the person in possession against the owner of the goods are satisfied or paid off. It is not necessary that the demands should arise only out of the articles detained under possession. But where the goods are deposited for some **special purposes, e.g., safe custody**, they will not come under the spell of general lien.

**Example**

- **Parasbhai** deposited certain jewels with the Gujrat Bank to secure certain debt, after payment of this debt he demanded the return of these jewels from the bank. He was still indebted to the bank for certain other debts. On the bank's refusal to return, it was held that he was not entitled to recover unless he proved that the bank had agreed to give up its general lien. **(Kunhan V. Bank of Madras, 1895).**
- A solicitor has a general lien on all the papers of the client in his possession in his professional capacity as solicitor. He can claim a lien for all costs due to him from the client but not for money loans.

## 10.7 QUESTIONS

1. What is bailment?What are the essential elements of valid bailment?
2. Explain various types of bailment's
3. Short Notes:-
   a. Rights and duties of bailor and bailee.
   b. Rights and duties of Finder of Goods.
   c. Right of Lien.
4. Define the following terms:
   a. Lien b. Bailment
   c. Gratuitous bailment d. Specific lien
   e. General lien

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# 11

# CONTRACT OF PLEDGE
## (SECTION 172 TO 179)

**Unit Structure**



## 11.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning and features of valid pledge.
- Explain the concept Pledge by Non-owner.
- Know the concepts Pawnee and Pawnor and their rights and duties.
- Difference between Bailment and Pledge.

## 11.1 MEANING AND FEATURES OF VALID PLEDGE

### 11.1.1 Meaning:

A **Pledge** is a bailment that conveys possessory title to property owned by a debtor (the Pledgor) to a creditor (the Pledgee) to secure repayment for some debt or obligation and to the mutual benefit of both parties. The term is also used to denote the property which constitutes the security. A pledge is type of security interest.

In short Pledge is the bailment of goods as security for payment of a debt or performance of promise. Bailor in this case is called the **'Pawnor'** and the bailee is called the **'Pawnee'** (Sec. 172).

### 11.1.2 ESSENTIAL FEATURES OF A VALID PLEDGE.

**1. Bailment of Movable Property only:**

Only movable property like Valuables Jewellery or documents can be pledged. Immovable property like land and

building cannot be pledged, that can be treated separately under Transfer of Property Act.

**2. Delivery of possession:**

It is an essential and important element of a valid pledge that the Possession of the goods must be delivered by the Pawnor to the Pawnee. It may be noted that only the possession of the goods transfers from one person to the other and not the ownership. The ownership remains with the Pawnor. If the possession is not delivered then there cannot be a valid pledge.

**3. Actual delivery Or Constructive delivery:**

Actual delivery means the delivery of physical possession. And constructive delivery means when there is no change of physical possession. The delivery of keys of a godown where the goods are stored is the constructive delivery.

**4. Delivery should be for the purpose of security:**

The goods should be delivered by one person to another by way of a security. The pawnor should deliver the goods to the Pawnee as a security for the payment of a loan or for the satisfaction of an obligation.

**5. Delivery should be upon a condition to return:**

It is also an important element of a valid pledge. The goods should be delivered to the Pawnee as a security for some loan or for the fulfillment of the promise. When such loan is repaid or promise is fulfilled, the security should be returned to the pawner.

## 11.2 PLEDGE BY NON-OWNER. (Section: 178 & 179)

Pledge can be made only by the owner of the goods. But there are certain exceptions to this rule. Hence the following persons can also make a valid pledge:

**1. Mercantile agent:**

According to the Sale of Goods Act, 1930, "Mercantile agent means a mercantile agent having in the customary course of business as such agent authority either to sell goods.

A mercantile agent, who is in possession of the goods or documents of title of goods with the consent of the owner, can

make a valid pledge of the goods while acting as a mercantile agent in the ordinary course of the business.

**2. Pledge by persons in possession of goods under a voidable contract:**

A person who is in custody of goods under a voidable contract can make a valid pledge of the goods, if at the time of pledge the contract was not r cancelled . The Pawnee will get a good title to the goods provided he acts in good faith and without notice of the pawnor's defect of title (Sec. 178A).

**Example:**'**A**', by fraud, induced '**B**' to sell goods. **A** pledged these goods with **'C'** who acted in good faith and has no knowledge of the fraud. The pledge is valid.

**3. Pledge by a person having only a limited interest: (Section 179)**

Where a person pledges goods in which he has a limited interest, the pledge is valid to the extent of that interest only. In such cases it is not important that the Pawnee had no notice of the limited interest of the Pawnor in the property.

**Example:**'**A**' finds **B's** transistor on the road. In spite of making reasonable search, **A** could not find the true owner. **A** spent Rs. 20/-on its repair and pledged it for Rs. 100/- with **C**. **B** can get the transistor only on paying Rs. 20/-

## 11.3 RIGHTS AND DUTIES OF THE PAWNOR AND PAWNEE

### 11.3.1 Rights and Duties of the Pawnor

**Right to receive goods till sold [(Right to redeem)(Sec. 177)].**

If a time is assigned for the payment of the debt or performance of the promise, for which the pledge is made, and the Pawnor makes default in the payment of the dues or the performance of the promise at the assigned time he may redeem the goods pledged at any subsequent time, before their actual sale of them, but he must in that case pay, in addition, any expenses which might have arisen from his default.

### 11.3.2 Rights and duties of the Pawnee

**1. Right of retainer (Section 173- 174)**

As per **section 173**, the Pawnee may retain the goods pledged, not only for a payment of a debt or the performance of the

promise, but also for the interest of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

**2. Right to receive extraordinary expenses (Sec. 175).**

Pawnee is also entitled to receive from the Pawnor any extraordinary expenses which he has incurred for the preservation of the goods pledged.

**3. Right of sale (Section 176)**

The Pawnee may bring a suit against the pawnor upon the debt or the promise and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.

If the pawnor makes default in payment of the debt or performance at the stipulated time, of the promise, in respect of which the goods were pledged,

**4. Right of Particular lien (Sec. 174):**

Pawnee has no right to retain his possession over the goods pledged for any debt or promise other than the debt or promise for which they were pledged unless otherwise provided for, by a contract.

**5. Pawnee's right where Pawnor makes default (Sec. 176):**

In the case of default by the Pawnor in the payment of debt or the performance of promise at the stipulated time or on demand or within reasonable time, the Pawnee can exercise the following rights:

- He has a right to bring a suit on the debt or promise and can retain the goods pledged as a collateral security.
- He has also a right to sell the goods pledged after giving reasonable notice of sale to the Pawnor.

**6. Pawnee must not use the goods pledged:**

He must not use goods pledge unless they are such as will not deteriorate by wear

## 11.4 DIFFERENCE BETWEEN BAILMENT AND PLEDGE

| Bailment | Pledge |
|---|---|
| Bailment can be for many types from the reward to gratuitous. | A pledge is bailment done for a specific type of purpose, which is to secure a loan or performance of a promise |
| The bailee does not get a right to sell the goods | A Pawnee has a right to sell the goods in case of default. |
| A Pawnee has a right to sell the goods in case of default. | A Pawnee gets a right of retainer and a special interest in the goods, which is more than just the lien. |
| A Pawnee gets a right of retainer and a special interest in the goods, which is more than just the lien. | The Pawnee has no right to use the goods. |
| Bailment is the Transfer of movable property to the bailee | Here transfer of object, documents to someone as a security for loan. |

## 11.5 QUESTIONS

1. What are the rights and duties of the Pawnee and Pawnee under Contract of Pledge?
2. When the Non-owner can create the Pledge?
3. Distinguish between Bailment and Pledge
4. Short Notes:-
   a. Rights and duties of bailor and bailee.
   b. Rights and duties of Finder of Goods.Right of Lien.
   5. Define the following terms:
   a. Pawnee
   b. Pawnor
   c. Pledge

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# 12

# LAW OF AGENCY

**Unit Structure**



## 12.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of the term Agency and essentials for Valid Agency.
- Discuss about the modes of creating Agency.
- Know the Classification of Agents.
- Discuss about the rights and duties of the agent.
- Understand the Important conditions that should be fulfilled for a valid ratification.
- Know the meaning of Irrevocable agency.

## 12.1 MEANING AND ESSENTIALS OF LAW OF AGENCY

### 12.1.1 Definition & Meaning:

Section 182 of the Indian Contract Act defines an agent, as person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented is called the “principal”.

When a person employs another person to do any act for himself or to represent him in dealing with third persons, it is called a ‘**Contract of Agency’**. The person who is so represented is called the ‘principal’ and the representative so employed is called the ‘agent (Sec. 182). The duty of the agent is to enter into legal

relations on behalf of the principal with third parties. Principal shall be responsible for all the acts of his agent provided they are not outside the scope of his authority.

## 12.1.2 ESSENTIALS FOR A VALID AGENCY.

The legal definition of the term 'agency', discussed earlier, reveals the essential element of agency, and a valid agency must satisfy these essential requirements. The essential features of agency relationship are discussed below.

**1. There should be an agreement between the principal and the agent:**

It is an essential element of a agency. According to this element, the agency must be created by an agreement between the principal and the agent. The agreement may be express (i.e., by words of mouth or of the case.)

**2. The agent must act in the representative capacity:**

The agent must act as representative of principal, i.e., he must represent his relationshipof his principal with the third persons.Thus the true nature of the relationship should be seen if the agent acts in representative capacity and had the power to bind his principal with the third persons, the relationship is that of 'agency'.

**3. The principal must be competent to contract:**

The principal must be competent to enter into a valid contract, i.e., he must be of sound mind, and have attained the age of majority (i.e., he should have completed 18 years of age).

**4. The agent need not be competent to contract:**

An**y** person may become an agent and he need not be competent to contract [Section 184]. Even a minor can be appointed as agent, and the principal shall be bound by the acts of such an agent. It may, however, be noted that such an incompetent agent shall not be liable to the principal. Thus, the principal cannot recover any compensation from an incompetent agent for losses caused by misconduct or unauthorised acts of such agent.

**5. The consideration is not necessary:**

No consideration is essential for the establishment of a valid agency relationship [Section 185]. An agency is valid even without

consideration. Mostly, an agent is remunerated by way of commission for the services provided by him.

## 12.2 MODES OF CREATING AN AGENCY

In ordinary contracts, the parties to the contract act entirely by themselves. When instead another person is engaged to do the acts under the contract, it is called agency. Agency is a special type of contract. Section 182 of the Contract Act defines the terms Agent and Principal as follows:

1. **Agent** is a person employed to do any act for another or to represent another in relation with third persons.

2. The person for whom such act is done, is called **Principal.**

3. The contract which creates the relationship of 'Principal' and 'Agent' is called an **agency.**

- **Creation of agency:**

A contract of agency comes into existence in any of the following ways.

**1. Agency by Express Agreement: Section 186 & 187:**

Agency is created by a contract in writing. An Agency may be created by oral contract between principal and agent. The common form of an agreement in writing is "power of Attorney" whereby, authority is given to the power of attorney holder, either generally or specifically, to act on behalf of the Principal. A general power of attorney authorises the Agent to do all things on behalf of the Principal .

**2. Agency by Implied Agreement: Section 187**

Implied agency may arise by conduct of the parties of the circumstances of the case.When agency come in to an existence by the conduct of the parties it is called implied agency.

**Example:** A of Calcutta has a shop in Delhi. B, the manager of the shop, has been ordering and purchasing goods from C for the purpose of the shop. The goods purchased were being regularly paid for out of the funds provided by A. B shall be considered to be an agent of A by his conduct.

- Partners,
- Servants and

- Wives are regarded as agents by implications because of their relationship.

- **Wife as an implied agent to her husband**

**a.** When the husband and wife are living together the wife shall have an implied authority to pledge the credit of her husband for necessaries. The implied authority can be challenged by the husband only in the following situations

(1) The husband has expressly prohibits the wife from borrowing money or buying goods on credit.

(2) The things brought did not constitute necessities of her life.

(3) Husband had given requisite funds to the wife for purchasing the articles.

(4) The creditor had been instructed not to give credit to the wife.

**b.** When the wife lives separate from husband without her fault, she shall have an implied authority to bind the husband for necessaries, if he fails to provide her maintenance.

Such an agency may take any of the following forms:

**i Agency by Estoppel:**

Such an agency is based on the principle of estoppel. The rule of estoppel can be stated thus: Where a person, by his words or conduct, has willfully led another to believe that certain set of circumstances or facts exist, and that other person has acted on that belief, he is estopped from denying the truth of such statements. In other words, estoppel arises when one is precluded from denying the truth of anything which he has represented as a fact, although it is not a fact.

**ii Agency by Holding out:**

Such agency is based on the principle of holding out which is a part of the principle of estoppel. The only distinction is that in this case some affirmative conduct by the Principal is necessary. For example, a dealer in iron usually sent his employee to buy on credit and paid for it afterwards. On one occasion, he sent the employee with cash, who bought the iron on credit and pocketed the money. It was held that the iron merchant was liable to pay for the iron, as the previous dealings justified the seller in assuming that the Agent had authority to buy on credit. The employer's conduct in 'holding out' his employee to be his agent estops him from denying the existence of authority of the employee. However, if the Agent is held out as having only a limited authority to do acts, the Principal is not bound by an act outside the authority.

**iii Agency by Necessity:**

In certain circumstances, the law authorises a person to act as agent for another without any regard to the consent of the Principal. A wife deserted by her husband and forced to live separate from him, can pledge her husband's credit to buy all the necessaries of life according to the position of the husband even against the wish of the husband and the husband can be held liable for the same. In other cases where in order to save the property of another, one has to act before the instructions of the owner can be received, he is, by necessity, authorised to act as Agent and the consent of the owner as Principal is assumed in law. An Agent exceeding his authority, *bona fide*, in an emergency or the carrier of the goods acting as bailee and doing anything to protect or preserve the goods in an emergency, although there is no express authority, are the examples of implied agency by necessity.

**3. Agency by Ratification: Sections 196 and 197**

Ratification means the **subsequent adoption and acceptance of an act originally done without instructions or authority.** Thus, where an Agent exceeds his authority (except under emergency), the **acts of the Agent are not binding on the Principal**. The Principal, however, may afterwards confirm and adopt the contract so made and this is known as ratification. Section 196 of the Contract Act provides for ratification and states that 'where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority.

## 12.3 CLASSIFICATION OF AGENTS

Agents can be classified in various ways:

**1. Special Agents:**

Agent appointed to carry out a particular task only. The agency in such cases for a specific period of for a particular type of work. When the assigned work is got over the agency gets terminated. For example… An agent has appointed by B to sell Block number 420 in a particular area.

**2. Universal Agents:**

Universal agent is practically a general agent with very extensive rights. We can say that an universal agent is a substitute of principal for all those transactions where in principal cannot participate. Universal agent can look after all the work of agents in

his absent. For example: when a person leaves his country for a long time, he may appoint his son/daughter as his agent to act on his behalf in his absence.

**3. General Agents:**

The agent has a general authority in such a case. A general agent is one who has authority to do all the acts (generally related to business) in the interest of his principal.

**4. Co-Agents:**

When two or more persons have been appointed by the principal. It is generally treated as their authority is joint. But when their authority is several, any other of the co-agents can act without the concurrence of the other.

**5. Sub-Agents:**

A sub-agent would be a person employed and acting under the control of the original agent of the agency In simple words, sub-agent is an agent of the original agent. Agent is responsible to the principal for the acts of sub-agent.

**6. Factor:**

A Factor is one type of a mercantile agent who sells goods on behalf of his principal. He has wide authority powers to sell goods upon such terms and conditions as he thinks proper. If a factor does any act which is beyond his authority, but which is within the scope of his apparent authority, then his principal is bound by such act.

**7. Commission Agents:**

For selling or buying goods on behalf of his principal a commission agent is appointed. Such types of agents belong to a indefinite class of agents. He/She takes care to secure buyer for a seller of a goods and sellers for a buyer of goods and receives a commission in return for his work on the actual sales price.

**8. Broker:**

A broker is a special type of commercial agent who acts as a middleman between the buyer and the seller. We can say that he is employed to bring about contractual relationship between the principal and the third party. He usually gets commission for the work performed. His function ends when he brings the two parties

together. He is never in possession of the subject, therefore cannot exercise the right of lien.

**9. Auctioneer:**

Auction is usually a public sale of goods made in the highest of several bidders. An auctioneer is a mercantile agent who is appointed to sell goods on behalf of principal, compensated in terms of commission.

**10. Del Credere Agents:**

A Del Credere agent is a mercantile agent who is employed to sell goods on behalf of his principal. He undertakes to guarantee the payment of dues in consideration for an extra commission. We can say that besides being a mercantile agent a del credere agent finds himself into the shoes of a guarantor as well.

## 12.4 DUTIES AND RIGHTS OF AN AGENT

### 12.4.1 Duties of An Agent:

**1. Duty not to delegate- Section 190:**

The agent cannot delegate his authority to perform his act in express or implied manner unless the custom of trade or the nature of the agency so requires.

**2. Duty of Obedience [Duty to follow the instructions of Principal-Section 211]:**

Express instructions are paramount and any agent disobeying these will be automatically liable for any loss which is caused to the principal. This duty takes precedence over the duty to exercise all reasonablecare and skill. If the agent fails to act according to the direction or custom then he is liable to the principal for the loss suffered by the principal due to such an act of the agent.

Two important issues stem from this point of law. Firstly, it is wise to ask for all significant instructions to be given in writing, both at the initial undertaking and throughout the management of a property. Verbal instructions are more prone to ambiguity and can be forgotten. Secondly, the firm's management agreement should define the professional services provided and what actions will be taken in certain situations. In this way, the definition of 'reasonable care and skill' will be less open to interpretation by any aggrieved client.

**3. Duty to Account**

An agent is obliged to pay over or otherwise account for all monies in his possession where such monies have been received from the principal; that which he receives from a third party to hand over to the principal, and that which he is deemed to receive on behalf of the principal (**e.g. a secret profit)**. In connection with the agent's duty to account, it has been held that it is his duty to keep accurate accounts of all his dealings on behalf of the principal. If he does not, everything which is consistent with the proved facts is presumed against him. In accounting for such monies received, the agent may deduct whatever is due to him by way of commission and expenses.

**4. Duty of Care and Skill. Section 211**

An agent is under a duty to exercise reasonable care and skill which will be examined in the light of all the particular circumstances of the case. From a professional liability point of view, this duty is one of the most important to consider. It holds the highest penalty since professional negligence claims can be costly in time and any awards for damages made if a matter was to go to court.

**5. Duty of Loyalty [Duty not to make secret profit-Section 216]**

This arises automatically out of the fiduciary nature of the relationship between agent and principal. It is the duty of an agent not to make secret profit. If the agent makes secret profit, the principal can claim such a benefit from the agent.

Furthermore, the agent should not take secret profits (which are deemed to include bribes and commissions) without the prior knowledge and authorisation of the principal. The implication of this duty is that agents should declare any commissions that may be earned within their agency agreement or terms and conditions.

**6. Performance With Honesty :-**

It is the duty of an agent that he should deal the business honestly. If he conducts the business dishonestly then he is not entitled to receive the reward of his services.

**7. Communication With Principal :-**

It is the duty of the agent that he should give all the information's about the business to the principal. He should seek instructions from his principal. He should not keep anything secrets from his principal.

**8. Separate Account :**

An agent should not mix his account with the principal. It is the duty that he should keep the accounts of a principal separate.

## 12.4.2 RIGHTS OF AGENT:-

Following are the important rights of an agent :

**1. Right of Remuneration : Section 219 and 220:**

It is basic right of an agent that he should receive the remuneration of his services.He has also a right to claim remuneration as may be payable to him for acting as an agent. In the absence of any contract to the contrary, this right to claim remuneration will arise only when he has carried out the object of the agency in full without being guilty of misconduct (Sec. 219).

An agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of the part of that business which had been misconducted (Sec. 220)

**2. Right of Compensation:Section 225**

In case of injury caused to agent by the negligence of the principal may be compensated by the principal.

**3. Right to claim reimbursement for expenses: ( Right to retainer) Section 217**

Agent has the right to retain, out of the money received on behalf of the principal, money advanced or expenses properly incurred in conducting the agency business. The agent may have paid the money at the request of the principal, or on account of the understanding implied by the terms of the agency or through mercantile usage.In conducting the business if an agent advances or spends some money for the betterment of a business. He has also right to retain that amount from the total sum received by him on account of the principal.

**4. Right of Lien : Section 221:**

An agent has also a right to retain the goods or property of a principal till the payment in due is received by him.

**5. Right to indemnification against consequences of all lawful acts :(Sec. 222).**

An agent has a right to be indemnified by the principal against the consequences of all lawful acts done in exercise of his authority.

**Example:**Salim, a broker at Patna , by the orders of Ahmad, merchant there, contracts with Chamanbhai for the purchase of 10 casks of oil for Ahmed. Afterwards Ahmed refuses to receive the oil and Chamanbhai sues Salim. Salim informs Ahmad, who repudiates the contract altogether. Salim defends, but unsuccessfully, and has to pay damages and incurs expenses. Ahmad is liable to salim for such damages, costs and expenses.

**6. Right of particular lien:Section 221**

An agent is entitled to retain under the possession both movable and immovable of the property of the principal received by him until the amount due to him for commission, disbursements and services has been paid or accounted for him, provided the contract does not provide otherwise

## 12.5 TERMINATION OF AGENCY

An agency may be terminated either by –

1) Act of the parties, or

2) Operation of law.

**A. By act of the parties:**

**1. By agreement:**

An agency, like any other contract, can be terminated at any time by a mutual agreement between the Principal and the Agent.

**2. Revocation by the Principal:**

The Principal is empowered to revoke the authority of the Agent at any time. The agency stands terminated from the time such revocation is affected. Revocation can be express or implied.

- In the case of a continuous agency, it can be terminated by revocation only for the future. It cannot be revoked in relation to the acts already done by the Agent. In other words, revocation cannot be with retrospective effect. Reasonable notice should be given to the Agent and also the third parties before revocation.

- An agency, which is created for a fixed period, can be terminated by revocation even before the expiry of that period. However, the Principal is bound to pay compensation to the Agent, even if the authority is revoked after giving notice.

**3. Renunciation by the Agent:**

It is the termination of the agency at the instance of the Agent, when he no longer wishes to continue working as Agent. The Agent has to give a reasonable notice to the Principal of his intention to renounce the agency; otherwise he is liable to compensate the Principal for any loss due to renunciation without notice. Further, if the agency is for a fixed period and the Agent renounces it without sufficient cause before the expiry of the period, he shall have to compensate the Principal for the resulting loss, if any.

**B. By operation of law:**

An agency comes to end automatically by operation of law in the following conditions:

**1. Completion of business of agency:**

If the purpose for which the agency is created is served and achieved, the agency stands terminated, e.g. where an advocate is appointed to appear in a suit, his authority comes to end when the adjudication is complete and the judgment is delivered.

**2. Expiry of time:**

When the agency is created for a specified period of time, the agency comes to end with that period, even though the business or reason for which the agency was created continues.

**3. Death of the Principal or the Agent:**

An agency is terminated automatically on the death of the Principal or the Agent. In the event of the death of the Principal, the Agent must take all reasonable care to protect the interests of the deceased Principal, which were entrusted to him.

**4. Insanity of the Principal or the Agent:**

If the Principal or the Agent becomes of unsound mind, the agency is terminated automatically. Here also, in the case of insanity of the Principal, the duty of the Agent is the same as in the event of death of the Principal.

**5. Insolvency of the Principal:**

When the Principal becomes insolvent, the agency is terminated. However, the termination of agency on the insolvency of the Agent is at the discretion of the Principal.

**6. Destruction of the subject matter:**

Where the agency is created with reference to a particular property or subject matter, it stands terminated automatically with the destruction of that property.

For example an Agent is appointed for the sale of a house, the agency is terminated when the house is destroyed by fire.

**7. Dissolution of a Company:**

It is like the death of the Principal or the agent. When Principal or the Agent is an artificial person created only in the eyes of law (such as incorporated companies), the agency is terminated with the dissolution of that company.

**8. Becoming an alien enemy:**

If the Principal or the Agent is a citizen of another country and the war breaks between India and that country, the contract of agency is automatically terminated, as the continuance of the same is unlawful.

## 12.6 IRREVOCABLE AGENCY

Irrevocable agency means an agency which cannot be terminated. An agency is irrevocable in the following cases:

**1. Where agency is coupled with interest:**

Where the agent has himself an interest in the property which forms the subject-matter of agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest (Sec. 202).

**Example:**A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debt due to him from A. A cannot revoke the authority, nor can it be terminated by his insanity or death.
It is essential that the interest of the agency should be existing at the time of creation of agency. Therefore, if the interest was created subsequently, the agency can be revoked.

There is no absolute restriction on the termination of the agency even when it is coupled with interest but the agent should be compensated for the loss arising from such termination.

**2. Where the authority has been party exercised?**

The principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arisen from acts already done in the agency (Sec. 204).

**3. Where the agent has incurred personal liability?**

When the agent has purchased the goods on his personal liability, or where he made the payment of the good, the agency cannot be terminated.

**Example:Abhimanyu** authorized **Bhim** to buy 100 bales of cotton on behalf of Abhimanyu and to pay for it out of Abhimanyu's money in Bhim's hand. Bhim buys 100 bales of cotton in his own name so as to make himself personally liable for the price. Abhimanyu cannot revoke Bhim's authority so far as regards payment for the cotton.

## 12.7 QUESTIONS

1. What are the essentials of valid contract of Agency?
2. Explain the various modes of creation of Agency?
3. What are the different types of Agents?
4. Short Notes:-
   a. Agency by Ratification. b. Rights and duties of Agent.
   c. Termination of Agency
5. Define the following terms:
   a. Agency
   b. Irrevocable agency
   c. Agent
   d. Principal
   e. Del Creder Agent
   f. Universal Agent
   g. Factor
   h. Sub-agent.

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# 13

## MODULE-III
# SALE OF GOODS ACT 1930

**Unit Structure**



## 13.0 OBJECTIVES

After studying the unit the students will be able to:

- Define the fundamental concepts in the Sale of Goods ACT.
- Explain the essentials of Valid Sales.
- Distinguish between Sale and Agreement to Sale
- Distinguish between Sale and Hire purchase

## 13.1 INTRODUCTION

The sale of Goods Act 1930 deals with the law relating to sale of goods. The term Goods means every kind of movable property, other than Money and Actionable claims. The sale of Goods Act, 1930 is mainly based on the English Sale of goods Act, 1893.

Before the Sale of Goods Act,1930, the law relating to sale of goods was covered under the Chapter VII of Indian contract act, 1872, the provision of which werenot suffice the purpose or not adequate. Therefore new act called Sale of Goods Act, 1930 was passed. The presently act containing 66 sections came into force from 1stJuly, 1930 which extends to whole of India except the state of Jammu & Kashmir.

## 13.2 FUNDAMENTAL CONCEPTS

### 13.2.1 Definition of Contract of sale of goods:

**Section 2(1)** of the Act defines a contract of sale of goods as: a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price. Subsections (3) and (4) give different names to two transactions:(3) Where under a contract of sale the property in the goods is transferred from the seller to the buyer the contract is called a sale.

(4) Where under a contract of sale the transfer of the property in the goods is to take place at a future time or subject to some condition later to be fulfilled the contract is called an agreement to sell.

### 13.2.2 IMPORTANT CONCEPTS:-

**1. Buyer [Section.2(1)] :**

Buyer means a person who buys or agrees to buy the goods.

**2. Seller :-[Section 2(13)] :**

Seller means a person who sells or agrees to sell the goods.
**Example :-** Mr. Kashif sells the shop to Mr. Zahir. Mr. Kashif is a seller and Mr. Zahir is a buyer in this case.

**3. Goods :- [Section 2(7)]:**

Goods have been defined by Section 2, sub-section 7 of the Sale of Goods Act 1930 as “every kind of movable property, other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of land which are agreed to be served before sale or under a contract of sale.

**4. Delivery [Section 2(2)]:**

Delivery means voluntary transfer of the possession of goods from one person to another.

- **Kinds of Delivery:-**

**a. Actual or Physical Delivery:-**

When a seller delivers the goods physically to the buyer or his agent, to take the possession. It is called an actual delivery. If

the seller has received the price but does not deliver the goods to the buyer. The buyer can sue the seller for price with reasonable interest.

**Example :-** Mrs. Sapna sells a car to Mr. Vasu . Car is delivered to Mr.Vasu. It will be called the actual delivery.

**b. Symbolic Delivery:-**

If the key of any store is delivered to any person, it will be considered the goods in the store are also delivered to that person. It is a symbolic delivery.

**Example :-** Mr. Ram sells the car to Mr. Bharat which are kept in the "Show Room". Mr. Ram gives the key of show room to Mr. Bharat . It is a symbolic delivery.

**c. Constructive Delivery :-**

When there is a change in the legal character without any visible change in actual and visible custody it is called constructive delivery.

**Example :-** Mr. Narad has bus, which he has rented out to Mr.Narayana. It is in the custody of Mr. Narayana . Mr. Narad sells and transfers complete title to Mr. Krishna . The bus remained in the custody of Mr. Narayana. There is no change in the custodian. Here only the title of the property has changed. Now Mr. Narayana agrees to hold on behalf of the buyer. It is called constructive delivery.

**5. Price :-**

Price must be the consideration in the contract of sale. If goods are exchanged with goods it is barter and not a contract of sale.

**Example :-** "X" sells a book to "Y" for Rs. 300. It is a contract of sale.

**6. Transfer of Ownership :-**

To constitute the sale contract the seller must transfer or agree to transfer the property ownership to the buyers. So possession and ownership both will be transferred to buyer.

**Example :-** "X" sells the car to "Y" for 6 lac. The possession and ownership both will transfer to "Y".

**7. Sale :-**

When ownership and possession of the goods is immediately transferred from seller to buyer it is called contract of sale.

**Example :-** "X" buys a pen from the "Y" and pays the whole price on his hand. It is a sale.

**8. Agreement to Sell:-**

The contract is called agreement to sell, when the transfer ofownership in the goods is to take place at a future date.

**Example :-** Mr. X agrees to purchase Mr. Nitoo's bus for Rs. 30 lac. But the transfer of bus will take place after one year. It is agreement to sell.

Where under a contract of sale, the transfer of property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called 'an agreement to sell' [Sec. 4(3)]. It is an executory contract and refers to a conditional sale.

**Illustration:**

(a) On 1st January, **A** agrees with B that he will sell **B** his scooter on 15 January for a sum of Rs. 3,000. It is an agreement to sell, since A agrees to transfer the ownership of the scooter to **B** at a future time.

(b) **A** agrees to purchase **B'**s car for Rs. 50000, provided **B** stands surety for him with **C**. It is an agreement to sell for **B**. It becomes a sale when the condition is fulfilled by B.

## 13.3 ESSENTIALS OF VALID SALES

Section 4(1) of the Sale of Goods Act defines a contract of sale of goods as - "a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price."

This definition reveals the following essential characteristics of contract of sale of goods:

**1. Two parties:**

The first essential is that there must be two definite parties to a contract of sale, viz.., a buyer and a seller, as a person cannot buy his own goods.

**2. Parties:**

A minor or lunatic cannot be a transferor / vendor as he is not competent to contract under Section II of the Indian Contract Act, 1872. It has been held that a minor or a lunatic can be a transferee or purchaser in the case of transfer by way of sale or mortgage, represented by his Guardian.

**3. Transfer of property:**

'Property' here means ownership. Transfer of property in the goods is another essential of a contract of sale of goods. A mere transfer of possession of the goods cannot be termed as sale.To form a contract of sale the seller must either transfer or agree to transfer the property in the goods to the buyer.

**4. Goods:**

The subject-matter of the contract of sale must be 'goods', According to Section 2(7), "goods means every kind of movable property other than actionable claim and money; and

- Includes stock and shares,
- growing crops, grass,
- and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Goodwill, trademarks, copyrights, patents right, water, gas, electricity, decree of a court of law, are all regarded as goods. Shares and stock are also included in goods.

**5. Consideration:**

The consideration for a contract of sale must be money consideration called the price. If goods are sold or exchanged for other goods, the transaction is barter, governed by the Transfer of Property Act and not a sale of goods under this Act. If goods are sold partly for money and partly for goods, this is the contract of sale.

**6. Sale**:

Where under a contract of sale, the property in the goods is immediately transferred at the time of making the contract from the seller to the buyer, the contract is called a 'sale' [Sec. 4(3)]. It refers to an absolute sale. There is immediate transfer of the ownership and mostly of the subject-matter of the sale as well (delivery may also be given in future). It is an executed contract.

**7. Subject Matter:**

Subject matter is the transferable immovable property.

## 13.4 DISTINGUISH BETWEEN A SALE AND ANAGREEMENT TO SELL

| Basis of distinction | Sale | Agreement to sell |
|---|---|---|
| Transfer of ownership | Transfer of ownership of goods takes place immediately. | Transfer of ownership of goods is to take place at a future time |
| Executed contract or Executory contract | It is an executed contract because nothing remains to be done. | Here something remains to be done. Hence It is an executory contract. |
| Conveyance of property | Buyer gets a right to enjoy the goods against the whole world including seller. Therefore, a sale creates jus in rem (Right against property). | Buyer does not get such right to enjoy the goods. It only creates jus in personam (Right against the person). |
| Rights of seller against the buyer's breach | Seller can sue the buyer for the price.. | Even though the goods are in the possession of the buyer seller can sue the buyer for damages. (Compesation) |

## 13.5 DIFFERENCE BETWEEN SALE & HIRE PURCHASE

| SALE | HIRE-PURCHASE |
|---|---|
| Property in the goods is transferred to the buyer immediately at the time of contract. | The property in the goods passes to the hirer upon payment of the last installment. |

| | |
|---|---|
| The position of the buyer is that of the owner of the goods | The position of the hirer is that of a bailee till he pays the last installment. |
| Buyer is bound to pay the price of the goods hence cannot terminate the contract. | The hirer if he so likes, terminate the contract by returning the goods to its owner. |
| The buyer can pass a good title to a bonafide purchaser from him | The hirer cannot pass any title even to a bonafide purchaser. |
| Sales tax is levied at the time of the contract | Sales tax is not leviable until it eventually fit into a sale. |

## 13.6 KINDS OF GOODS

**1. Existing Goods:**

They are those goods which have actual existence at the time when the contract of sale is made.

Existing goods are again of the following kinds:-

**a. Ascertained Goods:**

Unascertained goods become ascertained when the seller decides which particular goods he is going to sell. This word is used as synonymous with specific goods but the difference between the two is that the ascertained goods may become identified only after a contract of sale has been made.

**b. Unascertained Goods** :

They are those goods which are not actually identified by the seller but are described by description alone

**c. Specific Goods:**

They have been defined by Section 2, Sub-section 14 as those goods which are actually identified and agreed upon when the contract is come into existence.

**For Example:** A Car, a radio, a watch, etc.

**2. Future Goods :**

A person may enter into an agreement to seal something to the other which may have no actual existence but which he is to

acquire, produce or manufacture in future. For example a cultivator may agree to sell the crop that he has sown.

**3. Contingent Goods:**

Are those the acquisition of which by the seller depends on a contingency which may or may not happen.

**Example:**An importer in Mumbai agrees to sell the consignment of goods which is on its way from Germany. This consignment is an instance of contingent goods because the acquisition of goods by the importer in Mumbai depends upon a contingency whether it arrives safe at its destination or not. Therefore contingent goods are also a special class of future goods.

## 13.7 EFFECTS OF DESTRUCTION OF GOODS - ALREADY CONTRACTED

There are various kinds of goods and the parties have various options to agree about the delivery of the goods. What shall be the fate of a contract if the goods are perished or destroyed?

**1. Destruction before making of contract :**

Where in a contract for sale of specific goods, at the time of making the contract, the goods, without knowledge of the seller, have perished as no longer to answer to their description in the contract, the contract shall become null and void. This is based on the rule of impossibility of performance. Since the subject matter of the contract is destroyed which is one of its essential ingredients

**2. Destruction After the Agreement to Sell but before Sale:**

Where in an agreement to sell a specific goods, if subsequently the goods, without any fault on the part of buyer, perish the agreement shall become void, provided the goods are perished before the ownership and risk passes to the buyer. This rule is based on the ground of impossibility of performance.

**Example:** A horse was delivered upon trial for 5 days. However, the horse died within 5 days without the fault of the buyer or seller. The seller must bear the loss as the contract was void.

## 13.8 QUESTIONS

1. Distinguish between Sale and Agreement to Sale?
2. Enumerate the essentials of Contract of Sale?

3. Short Notes:-
    a. Types of Goods.
    b. Effects of Destructions of Goods.
4. Define the following terms:
    a. Goods
    b. Delivery
    c. Symbolic delivery
    d. Future goods
    e. Agreement to Sale
    f. Hire purchase
    g. Constructive delivery.

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# 14

# CONDITION AND WARRANTY
## (Section 11-17)

**Unit Structure**



## 14.0 OBJECTIVES

After studying the unit the students will be able to:

- Define the terms Condition and Warranty
- Discuss about the Implied Conditions
- Explain Implied Warranties.
- Understand the circumstances when the conditions can be treated as warranty.
- Distinguish between Condition and Warranty.

## 14.1 INTRODUCTION

A condition is a stipulation essential to main purpose of the contract and hence it is the plinth or foundation of the contract. The effect of a breach of condition is that it gives the right to the distressed ( an aggrieved) party to treat the contract as void and also to claim damages ( compensation), if any.

A warranty is a term which is collateral to the main purpose of the contract and hence is only a subsidiary. The breach of warranty does not give right to the aggrieved party to treat the contract as void but entitles him to claim damages (Compensation) only.

In the following cases, the breach of a condition will be treated as breach of warranty only.

- When the buyer waives the condition or
- When the buyer treats the breach of condition as a breach warranty and does not treat the contract as void or
- Where the contract of sale is inseparable and the buyer has accepted the goods or part thereof or
- Where the contract is for specific goods, the property in which has passed to the buyer.

Condition and warranties may be express or implied, When they are definitely written in the contract, they are called express conditions and warranties. When they are not written,they are called implied conditions and warranties, in the contract and applied to the contract either by operation of law or by trade custom.

## 14.2 IMPLIED CONDITIONS

**1. Conditions as to Title to Goods*:* [Section 14(a)]:**

There is an implied condition that the seller has a right to sell in case of sale and that in the case of agreement to sell, he will have the right to sell the goods at the time when the property is to pass.

***Rowland Vs Divall:***

**A** purchased a car from **B** for a certain price and used it for some period. Subsequently, it was found that the car was stolen by **B** and therefore, **A** had returned back the car to the true owner. It was held that **A** could recover the full price paid to **B.**

**2. Sale by Description:(Section 15)**

The implied condition is that the goods delivered must correspond with the description.

**Example:** Where a machine was described as almost new and used very little but when delivered, was found to be an old and repaired one, it was held that the buyer was entitled to reject the machine.

**3. Sale by Sample: (Section 17)**

The implied condition is:

- That the goods delivered shall correspond with the sample

- That the buyer shall have a reasonable opportunity of comparing the bulk with the sample and
- That the goods shall be free from any defect rendering them un-merchantable, which would not be apparent on reasonable examination of the sample.

**4. Sale by sample as well as description:**

In the case of sale of goods by sample as well as description, the goods delivered must correspond with both sample as well as description.

**5. Conditions as to Quality or Fitness:**

The general rule is *"Caveat Emptor",* i.e. let the buyer beware. So, the seller need not disclose the faults in the goods he sells nor need the guarantee that the goods are fit for the purposes of the buyer. So, the buyer takes them as they come. But in the following cases, there is an implied condition as to quality or fitness of goods for any particular purpose.

- Where the buyer makes known the purpose to the seller, who is ordinarily dealing with sale of goods of that description and the buyer, relies on the judgments of the seller.
- Where the seller does not disclose the faults in his goods and such faults cannot be detected on reasonable examination.
- Where the seller makes a statement and the buyer relies upon it.

**Case Law:** A purchased a motor car from B for using it as a tourist car. **B,** the seller knew the purpose. The car turned out to be unfit for the purpose. Held, A the buyer could repudiate the contract.But there is not implied condition as to fitness or quality of goods when they are sold under the patent or trade name.

**6. Conditions As to Merchantability:(Section 16)**

In case of sale of good by description, there is an implied condition that the goods shall correspond with the description and also that they shall be of merchantable quality.

***Brant Vs Australian Knitting Mills Ltd***.:

The buyer was supplied woolen underpants by the manufacturers. The buyer wore them for some time and contracted a skin disease. Held, that the buyer was entitled to damages.

***Exception:*** If the buyer has examined the goods, there is not implied condition as to quality of goods as regards defects which such examination must have revealed.

**7. Conditions As to wholesomeness:**

In the case of the implied condition is that the goods must be suitable for human consumption and are fit for immediate use.

**For Example**: **A,** purchased a bun from **B** and injured his teeth by biting a stone in the bun. **B** was held liable.

## 14.3 IMPLIED WARRANTIES

A condition becomes a warranty when--

1. The buyer waives the conditions or opts to deal the breach of the condition as a breach of warranty ; or
2. The buyer accepts the goods or a part thereof, or is not in a position to dismissed the goods for being faulty.

**1. Implied Warranty of Quiet Possession-(Section 14)**

In every contract of sale, unless there is a contrary intention, there are implied warranties that the buyer's shall have and enjoy quiet possession of the goods. If the buyer's right to possession and enjoyment of the goods is in any way disrupted as a result of the seller's defective title, the buyer may sue the seller for damages for breach of this warranty.

**2. Implied Warranty of Freedom from Encumbrances-[Section. 14 (c)]**

The buyer is entitled to a further warranty that the goods shall be free from any chagres or nuisance, in favour of any third party or known to buyer before or inderance at the time when the contract is made.

**Example: A**, the owner of the watch, pledges it with **B**. After a week, **A** obtains possession of the watch from **B** for some limited purpose and sells it to **C**. **B** approaches **C** and tells him about the pledge affair. **C** has to make payment of the pledge amount to **B**.

There is breach of this warranty and **C** is entitled to claim compensation from **A**.

**3. Warranty of disclosing the dangerous nature of goods to the ignorant buyer:**

The third implied warranty on the part of the seller is that in case the goods sold are of dangerous nature he will warn the ignorant buyer of the probable danger.

**Example: C** purchases a tin of disinfectant powder from **A**. **A** knows that the lid of the tin is defective and if it is opened without special care it may be dangerous, but tells nothing to **C. C** opens the tin in the normal way whereupon the disinfectant powder flies into her eyes and causes injury. **A** is liable in damages to **C** as he should have warned **C** of the probable danger.

## 14.4 CIRCUMSTANCES WHEN A CONDITION CAN BE TREATED AS WARRANTY

Section 13 of this act provides for the situations in which the condition can be treated as a warranty. They are as follows.

1. Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may relinquish the condition or may elect to treat the breach of such condition as a breach of warranty and not as a ground for treating the contract as terminated.

2. Whether a stipulation in a contract of sale is a condition the breach of which may give rise to a right to treat the contract as cancelled, or a warranty the breach of which may give rise to a claim for damages or compensation but not to a right to reject the goods and treat the contract as terminated , depends in each case on the construction of the contract. A stipulation may be a condition though called a warranty in the contract.

## 14.5 DIFFERENCE BETWEEN CONDITION AND WARRANTY

| Matter | CONDITION | WARRANTY |
|---|---|---|
| Stipulation | A condition is a stipulation essential to the main purpose of a contract. | The warranty is collateral to the main purpose of contract. |
| Rights | Breach of condition gives right to the party to reject the contract. | Breach of warranty gives right to the party to claim the damages only. |
| Superiority of Condition | A breach of condition may be treated as a breach of warranty. | Breach of warranty may not be treated as a breach of condition. |
| Link With Contract | A condition has a direct link with the essential part of the contract. | A warranty has no direct link with the essential part of the contract. |

## 14.6 DOCTRINE OF CAVEAT EMPTOR.

### 14.6.1 Meaning:

In business laws, the phrase 'Caveat Emptor' stands for 'let the buyer beware.' It is a traditional attitude that the buyer takes the risk in respect of defects in the goods which he has brought. This implies that the responsibility of identifying goods and finding defects with them lies with buyer. It is the responsibility of the buyer that he should find the defects in the goods which he is going to buy. Seller will never specify the defects in his own goods. Buyer shoud keep his eyes and mind open while carry out purchasing. He should be finalizing the goods that he needs, it implies that the seller is not responsible to enquire what the buyer's requirements are and not required to reveal faults in his products or services. It the buyer relies on his own skill and judgement while making purchasing and found that the goods are faulty he cannot blame the seller for the same. Therefore buyer should take at most care while selecting the goods and should see that the goods which he brought must suffice the purpose.

**Example:** Ram bought 10 cows from a cattle broker. Out of those 10, 2 cows had defects. However, Ram did not know this because he didn't check all 10 cows though he paid for them. The 2 infected cows died within three days of the purchase. Now, as there was no implied condition that the cows would be in great health at the time of the sale, Ram cannot hold the cattle broker as responsible for having sold him those infected cows. It was Ram's basic duty to check the health of those cows and not expect the cattle broker to state all the defects.

In one interesting case, the buyer bought cloth for making uniforms. Unfortunately, the seller was not aware of the purpose of buying the cloth. Later, the buyer found that the cloth is not fit making uniforms. It was, however, fit for other normal purposes. The seller was not found guilty as the principle of 'Caveat Emptor' applied in this case.

However caveat emptor is subject to following exceptions:

### 14.6.2 EXCEPTIONS

The doctrine of caveat emptor is subject to the following exceptions:

- Where the seller makes a mis-representation and the buyer relies on it, the doctrine of caveat emptor does not apply. Such

a contract being voidable at the option of the innocent or faultless party, the buyer has a right to cancelled the contract.

- Where the seller makes a false representation amounting to fraud and the buyer relies on it, or where the seller actively conceals a defect in the goods so that the same could not be discovered on a reasonable examination, the doctrine of caveat emptor does not apply. Such a contract is also voidable at the option of the buyer and the buyer is entitled to avoid the contract and also claim damages or compensation for fraud.

- Where the goods are purchased by description from a seller who deals in such class of goods and they are not of 'merchantable quality', the doctrine of caveat emptor does not apply. But the doctrine applies, if the buyer has examined the goods, as regards defects which such examination ought to have revealed **[Sec. 16(2)].**

- Where the goods are bought by sample, the doctrine of caveat emptor does not apply if the bulk does not correspond with the sample, or if the buyer is not provided an opportunity to compare the build with the sample, or if there is any hidden or latent defect in the goods **(Sec. 17).**

- Where the goods are bought by sample as well as by description and the bulk of the goods do not correspond both with the sample and with the description, the buyer is entitled to dismissed the goods **(Sec. 15).**

## 14.7 QUESTIONS

1. What are the circumstances when conditions can be treated as warranty?
2. Distinguish between Condition & Warranty
3. Short Notes:-
   a. Implied Warranties.
   b. Doctrine of Caveat Emptor and its Exceptions.
4. Define the terms:
   a. Condition
   b. Warranty

*****

# 15

# TRANSFER OF PROPERTY IN CONTRACTS OF SALE OF GOODS (Section 18-26)

**Unit Structure**



## 15.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning of Transfer of Property.
- Understand the division of Transfer of Property.

## 15.1 INTRODUCTION

The important aspects the transfer of ownership is that it can take place only in case of ascertained and specific goods. According to Sec. 18 “No transfer of property in the goods can take place from the seller to the buyer unless and until they are ascertained”.

## 15.2 TRANSFER OF PROPERTY

Transfer of property can be divided in two broad categories:

**A. Transfer of Property in Specific and Ascertained Goods:**

According to Sec. 19 when there is a contract of sale of specific or ascertained goods, the property in them shall pass from the seller to the buyer where the parties have intended it to pass.

To find out the intention of parties in respect of transfer, consideration is to be given to the terms of the contract, conduct of the parties and the circumstances of case.

But if the parties fail to yield their intentions regarding the transfer of property in the goods, certain rules have been laid down to find out the intention of the parties as to the time at which the property in the goods is to pass to the buyer, which are specified under Secions. 20 to 24 . The provisons are as under.

**1. When goods are in a deliverable state:**

According to Section 20 where there is an unconditional contract for the sale of specific goods in a deliverable state the property in the good passes to the buyer when the contract of sale is made and it is immaterial whether the time of payment of the price or the time of delivery of the goods or both is delayed or postpond.

**Illustration :**

Where there is a contract between A & B for the purchase of a specific quantity of hemp stored on the premises of the seller A; price to be paid on 4th February and the delivery to be given on 1st of May while the contract is being made on 20th January the property in the specific lot of hemp shall be transferred from A to B on 20th January itself.

As goods under this rule are in such a state they can be immediately delivered to the buyer, there remains nothing which can prohibit to transfer of ownership. But if the parties in such cases themselves decide that no transfer of property shall take place till the entire price is paid, or till the delivery of goods has been given to the buyer, there would be no transfer of property in the goods even though the goods are specific and in a deliverable state.

**2. When goods are not in a deliverable state:**

According to Section 21 when there is a contract for the sale of specific goods the seller is bound put the goods in a deliverable state, property in them shall not be transferred until such thing is done by the seller and buyer has notice thereof.

**Illustration:**

There was a contract for the wood of Oak trees in a certain forest. The buyer purchased the wood from the seller selecting certain portion of trees and rejecting others. According to the custom of trade the seller was to separate the selected portions from the rejected portions. But the buyer threw upon himself the duty of separating the two portions. The court decided that no

transfer of ownership has taken places so far as wood is concerned.

**3. When goods are to be measured etc.:**

According to Section 22, where there is a contract for the sale of specific goods in a deliverable state the seller In order to determine the price, the seller is bound to measure, weight or count the goods till such act is done and the buyer has notice thereof.

**B. Transfer of property in unascertained goods:**

According to section 18 no transfer of property can take place from the seller to the buyer in unascertained goods. Therefore some acts have got to be done in order to convert unascertained goods into ascertained or specific goods. Such acts are collectively and technically called ‘appropriation’. According to Section 23 “Where there is a contract for the sale of unascertained or future goods by description and goods of that description as well as in deliverable state are unconditionally appropriated to the contract, either by the seller with the consent of the buyer or by the buyer with the consent of the seller, the property in the goods shall be transferred from the seller to the buyer, as soon as such appropriation is made, the consent of the buyer or the seller as the case may be obtained either before or after appropriation.

Thus appropriation of goods is the most important act which permits the transfer of property from the seller to the buyer. Appropriation may be defined as the application of the goods for the purposes of a contract of sale such an act must have the following essentials.

**1. Goods which are appropriated must be of the same description under which they are sold:**

For example where an order was placed for tea sets, jars and glasses made of china clay and where the seller while supplying the goods also placed some other things in the parcel it was held that there was no appropriation because the goods did not exactly answer the description given in the contract.

**2. The goods appropriated to the contract must be in a deliverable state:**

Because unless they are in such a state no transfer of property can take place.

**3. The goods must be unconditionally appropriated to the contract:**

According to section 23 sub-section 2. “Goods are said to be unconditionally appropriated to the contract when the seller gives them to the buyer or a carrier or some other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer. The most common form of appropriation is the delivery of goods to person for the purpose of transporting them to the buyer and as soon as this is done, generally speaking, the property shall be transferred to the buyer if the seller has not reserved the right of disposal as defined by section 25.

**4. Basis of appropriation:**

Appropriation of goods is done on the basis of consent of either the buyer or the seller. Such a consent may be obtained either before or after appropriation.

**C. By the buyer with the consent of the seller:**

Where the buyer is holding the goods on behalf of the seller as an agent, the buyer can appropriate the goods for the purpose of the contract, inform the seller regarding the same, obtain his consent only them the property shall be transferred to the buyer.

**D. By the seller with the consent of the buyer**

**Illustration:**

A agrees to purchase 10 tons of petrol from B and already sends the steel tins to B for packing the petrol. As soon as B will fill the petrol in the steel tins sent to him by the buyer, the property shall be transferred from B to A because the consent of the buyer to the appropriation made by the seller shall be taken to have been given by the buyer himself supplying the steel tins (consent of buyer before appropriation).

**5. Method of Appropriation**:

Appropriation of goods for the purpose of the contract may be made:

(a) By packing the goods in suitable containers.

(b) By separating the goods from a larger quantity.

(c) By the delivery of the goods to a common carrier or bailee for the purpose of transmission to the buyer without reserving the right of disposal which has been defined by Section 25 of the Sale of Goods Act as follows:

1. Where there is a contract for the sale of specific goods or unascertained goods which are unconditionally appropriated to the contract, the seller may under the terms of the contract or appropriation lay down certain conditions to be fulfilled by the buyer. In such a case although goods may be delivered to the common carrier or other bailee for the purpose of transmission to the buyer the property shall not be transferred to the buyer.

2. Where the seller sends the goods and takes a bill of lading or railway receipt, deliverable to himself or his order it is presumed that the seller has reserved the right of disposal over the goods.

**Transfer of property in transaction of sale or return:**

According to section 24 where the goods are sent to the buyer "on approval or on sale or return" or similar other terms the property in them shall pass to the buyer:

(a) When the buyer expresses his approval or acceptance to the buyer or does any other act adopting the transaction:

**Illustration :**

A gives a diamond to B on sale or return. B gives the same to C on similar terms and C delivers the same to D on sale or return. The diamond was lost from the custody of D. As B cannot return the diamond to A, his act in giving the diamond to C shall tantamount to adopting the transaction. Similarly if the buyer on sale or return pledges the goods to a third party the act of pledge shall be taken to be an act adopting the transaction.

**Reservation of Right of Disposal:**

Under Section 25, reservation of the right of disposal is defined as any action made by the seller, where it is expressed that an intention on his part not to part with control over the goods until certain condition are fulfilled. Then, the property will be passed subject to fulfillment of these conditions.

**Example:** 'A' supplies 100 bags of Rice to 'B' by a trunk, where no reservation of the right of disposal was there. In this case, the rice will pass to B immediately after goods are handed over to the carrier.

**Transfer of title:**

In the performance of a contract of sale of goods by a seller there are three stages, namely, the transfer of property in the goods, the transfer of possession of the goods, i.e. delivery of the

goods and the passing of the risk. The main object of a contract of sale of goods is the transfer of property in goods from the seller to the buyer. The term ‘property in goods’ is different from the term ‘possession of goods’: ‘property in goods’ means the ownership of the goods whereas ‘possession of goods’ means custody or control of goods.

## 15.3 QUESTIONS

1. What are the consequences of Transfer of Property?
2. How Property can be transferred in various situations?
3. Short Notes:-
   a. Transfer of Property in the transaction of sale or return.

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# 16

# UNPAID SELLER

**Unit Structure**



## 16.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of Unpaid Seller.
- Explaint the Rights of Unpaid Seller.

## 16.1 MEANING AND DEFINITION

### 16.1.1 Definition:

(1) The seller of goods is deemed to be an ***unpaid seller*** within the meaning of this Part-

(a) When the whole of the price has not been paid or tendered;

(b) When a bill of exchange or other negotiable instrument has been received as conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

### 16.1.2 Meaning:

According to (section 45) the term seller includes ‘any person who is in the position of a seller, as, for instance, an agent of the seller to whom the bill of lading ( BOL is a document issued by a carrier which details a shipment of merchandise and gives title of that shipment to a specified party.) had been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price.

The seller of goods is deemed to be an ‘unpaid seller’

- When the whole of the price has not been paid or tendered; or
- Where a bill of exchange or other negotiable instrument has been received as a conditional payment, i.e., subject to the realization thereof, and the same has been dishonoured.

### 16.1.3 Characteristics of An 'Unpaid Seller'.

According to above the following are the characteristics of an 'unpaid seller'.

1. He must sell goods on cash terms and not on credit, and he must be unpaid.
2. He must be unpaid either fully or partly. Even if only a portion of the price, however small, remains unpaid, he is deemed to be an unpaid seller.
3. Where the price is paid through a bill of exchange or other negotiable instrument, the same must be dishonoured.
4. He must not refuse to accept payment when tendered. If the buyer has tendered the price but the seller wrongfully refuses to take the same, he ceases to be an unpaid seller.

## 16.2 RIGHTS OF UNPAID SELLER

An unpaid seller has two-fold rights, viz.,;

I. Rights of unpaid seller against the goods, and

II. Rights of unpaid seller against the buyer personally. We shall now examine these rights in detail.

### A. Rights of Unpaid Seller against the Goods:

An unpaid seller has the following rights against the goods notwithstanding the fact that the property in the goods has passed to the buyer:

1. Right of lien;
2. Right of stoppage of goods in transit;
3. Right of resale [Sec. 46 (1)].

### 1. Right of lien (Sec. 47)

'Lien' is the right to retain possession of goods and refuse to deliver them to the buyer until the price due in respect of them is paid or tendered. An unpaid seller in possession of goods sold is entitled to exercise his lien on the goods in the following cases:

- Where the goods have been sold without any stipulation as to credit;
- Where the goods have been sold on credit, but the term of credit has expired:
- Where the buyer becomes insolvent, even though the period of credit may not have yet expired.

In other words The seller can exercise his rights of lien on the following two conditions:

- He must be in possession of the goods.
- He is an unpaid seller.

**2. Right of Stoppage of Goods in Transit:Sections 50-52**

The right of stoppage in transit means the right of stopping the goods while they are in transit, to regain possession and to retain them till the full price is paid.

The essential feature of stoppage in transit is that the goods should be in the possession of a middleman or some other person intervening between the vendor who has parted with and the purchaser who has not received them.

- **Conditions under which Right of Stoppage in Transit can be Exercised [Section 50]:**

The unpaid seller can exercise the right of stoppage in transit only if the following conditions are satisfied:

**a.** The seller must have parted with the possession of goods, i.e., the goods must not be in the possession of seller

**b.** The goods must be in the course of transit.

**c.** The buyer must have become insolvent.

**3. Right of Resale:**

The right of resale is an important right given to an unpaid seller. In the absenteesim of this right, the unpaid seller's other rights against the goods, namely, 'lien' and 'stoppage in transit,' would not have been of much benefited because these rights only entitle the unpaid seller to retain the goods until paid by the buyer. If the buyer continues to remain in default, then should the seller be expected to retain the goods I for a indefinite period, especially when the goods are perishable. Certain limited rights has given to the unpaid seller under section 54, in the following cases:

- Where the goods are of a perishable nature; or
- Where such a right is expressly reserved in the contract in case the buyer makes a default in making payment.

## 16.3 QUESTIONS

1. Who is Unpaid Seller?
2. What are the rights and duties of an unpaid seller?
3. Short Notes:- a. Right to stoppage in Transit.

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# 17

## MODULE-IV
# THE NEGOTIABLE INSTRUMENTS ACT, 1881

**Unit Structure**



## 17.0 OBJECTIVES

After studying the unit the students will be able to**:**

- Understand the meaning, definition and Classification of Negotiable Instruments.
- Understand the meaning and essential of Promissory Note.
- Know the meaning and essentials of Bill of Exchange.
- Explain the meaning and types and parties of the Cheque.
- Understand the meaning and types of Crossing of Cheque
- Know the meaning of Dishonour of Cheque.
- Understand the meaning and essentials of the Holder of a negotiable instrument and the Holder in due course.Understand the meaning and modes of Negotiation
- Know the meaning, essentials and kinds of Endorsement.
- Understand the meaning of Noting and protesting
- Explain the meaning and types of Hundi.

# 17.1 NEGOTIABLE INSTRUMENTS

### 17.1.1 Meaning:

The term ***"negotiable instrument"*** means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A .negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer. [Section 13(1)]

The objectives of the Negotiable Instruments Act, is to legalise the system by which the instrument pass from one hand to other through negotiation.

As the commercial activities and trading increases at alarming rate the growing demand for money was not possible to met with the current supply of coins in the time of british rule in India. To cope up with the scarcity of the coins the instruments of credit took the function of money.

Negotiable instruments are those documents which are generally use in commercial transaction and dealing of money.

### 17.1.2 Features:

Essential Features of Negotiable Instruments are given below:

**1. Writing and Signature:**

Negotiable Instruments must be written and signed by the parties according to the rules relating to Promissory Notes, Bills of Exchange and Cheques. Demand Drafts are also construel as Negotiable Instruments in the limiting case as they have the same property as N.I. Instrumes.

**2. Money:**

Negotiable instruments are payable by legal tender money of India.The liabilities of the parties of Negotiable Instruments are fixed and determined in terms of legal tender money.

**3.Negotiability:**

Negotiable Instruments can be transferred from one person to another by a simple process. In the case of bearer instruments, delivery to the transferee is sufficient. In the case of order instruments two things are required for a valid transfer: endorsement (i.e., signature of the holder) and delivery. Any

instrument may be made non-transferable by using suitable words, e.g., “pay to X only.”

**4.Title:**

The transferee of a negotiable instrument, when he fulfils certain conditions, is called the holder in due course. The holder in due course gets a good title to the instrument even in cases where the title of the transferor is defective.

**5. Notice:**

It is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay. The transferee can sue in his own name.

**6. Presumptions:**

Certain presumptions apply to all negotiable instruments. Example: It is presumed that there is consideration. It is not necessary to write in a promissory note the words “for value received” or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

**7. Popularity:**

Negotiable instruments are popular in commercial transactions because of their easy negotiability and quick remedies.

**8. Evidence:**

A document which fails to qualify as a negotiable instrument may nevertheless be used as evidence of the fact of indebtedness.

**17.1.3 Presumptions as to Negotiable Instruments: (Sec-118 And 119):**

There are number of presumptions which are applied to a negotiable instrument unless the contrary is proved. As such these presumptions would not arise if the contrary is proved. Sections 118 and 119 deal with the following presumptions:

**1. Consideration:**

It is presumed that every negotiable instrument was made or drawn, accepted, endorsed, negotiated or transferred for consideration. As such the holder need not prove consideration.

However, this presumption would not arise if it is proved that the instrument was obtained from its owner by any offence

**2. Date:**

Every negotiable instrument is presumed to have been made on the date which it bears.

**3. Time of acceptance:**

It is presumed that every accepted bill was accepted within a reasonable time and before its maturity.

**4. Time of transfer:**

It is presumed that every transfer was made before maturity.

**5. Order of endorsements:**

The endorsements are presumed to have been made in the same order in which they appear.

**6. Stamp:**

In case an instrument is lost, it is presumed that it was duly stamped and the stamp was duly cancelled.

**7. Every holder is a holder in due course:**

Every holder is presumed to be a holder in due course.

**8. Dishonour of instrument:**

In case a suit is filed for dishonour of an instruments the Court, on the proof of protest presumes that the instrument was dishonoured.

It should be noted that where the promisor denies the execution of the promissory note taking the plea that he signed on a blank paper, then the burden is on the plaintiff to prove execution. (Sri Khetramohan Ray Udaya narayan Panda & Another).

It should be noted further that presumption, as consideration, is not conclusive. If execution of promissory note is proved, then burden to prove lack of consideration is on the defendant. (Marimuthm Rounder v/s Radha Krishn and Others

### 17.1.4 Classification of Negotiable Instruments

The negotiable instruments may be broadly classified under the following six heads:

**1.Inland Instrument:Section 12**

The term 'inland instrument' is defined in Section 11 of the Negotiable Instrument Act, Which reads as under:

**"A promissory note, bill of exchange or cheque drawn or made in Pakistan, and made payable in, or drawn upon any person resident inPakistan, shall be deemed to be inland instrument".**

The brief of this section provides that, in any of the following cases an instrument is an inland instrument:

- An instrument which is drawn in Pakistan and also payable in Pakistan.
- An instrument which is drawn in Pakistan on any person resident in Pakistan whether payable in Pakistan or outside Pakistan.

It will be interesting to know that the nature of an inland instrument is not changed by the fact of its being circulation in a foreign country. Thus, an inland instrument remains inland even if it has been endorsed in Japan, they will remain inland bills.

**2. Foreign Instruments:-Section 12**

The term 'foreign instrument' is defined in Section 12 of the Negotiable Instruments Act, which provides that a foreign instrument is one which is not an Inland instrument.

**3. Bearer Instruments:Section 13**

The term 'bearer' instrument may be defined as negotiable instrument the payment of which can be taken by a person who has the Instrument inpossession.

- Where the instrument is payable to bearer.
- Where the only endorsement or the last endorsement on the instrument is an endorsement in blank.

**4. Order Instruments:Section 13**

The term 'order instrument' may be defined as the Instrument the payment of which can be taken by a specific person to whom it is made payable or if it is made payable or if it is made payable to the order of that specific person

Section 13(1) of the Negotiable Instruments Act, reads as under:

***"A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable, or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable".***

The structure of this section provides that a negotiable instrument is payable to order in any of the following circumstances.

a) Where the instrument is to be payable to order.
b) Where the instrument is to be payable to a particular person and which does not contain any words restricting its further transfer.

**5. Instruments Payable On Demand: Sections19-21**

The 'instrument payable on demand' is defined in Section 19 of the Negotiable Instrument Act. In this connection first part of section 21 of the Act is also relevant. Both these sections respectively read as under:

**"In a promissory note or bill of exchange the expression 'at sight' and 'on presentment' means on demand."**

The analysis of these sections reveals that, the following instruments are payable on demand:

a. A promissory note or a bill of exchange in which no time for payment is specified.
b. A promissory or a bill of exchange which is expressed to be payable 'on demand', or 'at sight', or 'on presentment'.
c. A cheque. As a matter of fact, the cheques are always payable 'on demand'.

**6. Time Instrument:**

The term 'time instrument' may be defined as the instrument payable in future.

Following are the examples of time instruments:

a. A promissory note or a bill of exchange which is payable after a fixed period e.g. 60 days after sight.
b. A promissory note or a bill of exchange which is payable on a specified day e.g. on 28th August,20015.
c. A promissory note or a bill of exchange which is payable on the happening of an event which is certain
e.g. on the death of a person.

## 17.2 PROMISSORY NOTE: SECTION 4

### 17.2.1 MEANING:

A promissory note has been defined by Sec. 4 of the Act as follows:
A "promissory note" is an instrument

- in writing
- containing an unconditional undertaking
- signed by the maker
- to pay a certain sum of money only to, or
- to the order of, a certain person or
- to the bearer of the instrument.
- The person making the promise to pay is called the "maker"
- The person to whom the payment is to be made is called the "payee".

**In other words**,It is an unconditional written promise by one person to another in which the maker (Payer) promises to pay on demand on any future date, a stated sum of money to the specified person or to the bearer of the instrument.

A 'promissory note' is an instrument in writing containing an ***unconditional undertaking***,signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

**Illustrations:**

Y signs instruments in the following terms:

1. "I promise to pay Z or order Rs. 1800."
2. "I acknowledge myself to be indebted to Z in Rs. 1800 to be paid on demand, for value received,"
3. "I promise to pay Z Rs, 1800, and all other sums which shall be due to him."
4. "I promise to pay Y Rs. 1800 seven days after my marriage with C."
5. "I promise to pay Y Rs. 1800 on D's death, provided D leaves me enough to pay that sum."
6. "I promise to pay Y Rs. 1800 and to deliver to him my black horse on 1 st January next."
7. "Mr. B. I.O.U, Rs.1,800".
8. "I promise to pay Y Rs. 1800, first deducting there out any money which he may owe me,"

The instruments respectively marked (1)and (2) are promissory notes. The instruments respectively marked (3), (4), (5), (6). (7) and (8) are not promissory notes."

**SPECIMENS OR PROMISSORY NOTE**

I, Shri---------- S/o.---------- promise to pay

Shri ----------S/o----------or order,

the sum of Rs.----------(Rupees---------- only)

Place:

Date: Signature

**PROMISSORY NOTE UNDER SEC.4, NEGOTIABLE INSTRUMENTS ACT. I881**
**MADE BY JOINT PROMISORS**

We, Shri---------- S/o.----------and

Shri ----------S/o----------
acknowledge ourselves to be indebted to Sri,----------

S/o.---------- in Rs. ---------(Rupees---------- only) to be paid on demand for value received.

Place: (Signed)

Date: (Signed)

### 17.2.2 v Essentials Characteristics of a Promissory Note

**1. Writing:**

Promissory note must be in writing. Writing includes print and typewriting. Oral promise cannotconstitute a valid promissory note. Generally consideration, Place and date of making is not essential requirement of the promissory note.

**2.Promise to pay:**

- A Promissory note must contain an undertaking/Promise to pay.
- Mere acknowledgment of debt is not sufficient.

- Use of word “promise’’ is not mandatory, but the maker should bind himself to pay.

**Example:** “I have received a sum of Rs. 5,000 from Sohan. This amount will be repaid on demand’’.

**3. Unconditional promise:-**

- The undertaking/ promise to pay should be unconditional and definite.
- Unconditional event means an event which is certain to happen but the time of its occurrence is uncertain.

**Examples:-** “I promise to pay B Rs. 500, seven days after my marriage with C’’ cannot constitute a promissory note because a condition as to marriage is attached. A writes – “I promise to payC Rs. 25,000, 7days after the death of B’’. This is a valid promissory note and is not conditional, since only the time of death of B is uncertain, but is sure to happen.

**4.Signed by the maker:**

Promissory note should be signed by the maker himself. Where it is written and the name of the maker appears in the instrument, but is not signed, it shall not treated a valid promissory note.

**5. Payee to be a certain person**:

Promissory note should specify the payee in clear terms i.e. by name, son of, and resident of, etc. The payment can also be identified by description.

**6.Payment of Money only**:-

There must be a promise to pay only money and not other consideration, e.g. “I promise to pay B a sum of Rs. 50,000 and deliver him my Scorpio Car’’ is not valid.

**7. Certain some of money:**

The amount to be paid must be certain; otherwise the instrument will be invalid.

**Example: A** promises to pay **B** Rs. 800 and all other sums which become due. This is not a valid promissory note because the sum is not certain as no one knows what other sums will become due.

However, a promise to pay money with interest is valid. If the rate of interest is not given, it will not be valid.

**For example**, A's promise to pay B Rs.5500 with interest accrued, is not valid.

**8. Other formalities:**

Promissory note must be stamped according to the Indian Stamp Act, otherwise it will be inadmissible in evidence. However, other formalities like place of making the instrument, date or the words, "value received" are not necessary.

**9. Form of Promissory Note:**

The law has not given any specific from of a promissory note. As such it may be in any form but it must satisfy all the essential conditions mentioned above. Sum payable must be certain.

**Examples: -** "I promise to pay Ketan , Rs. 12,000, and all other sums which shall be due'' is not valid since the sum is not certain.

**10. Duly stamped and dated:**

Stamps of requisite amount and description must be affixed on the instrument and duly cancelled either before or at the time of its execution. If the promissory note is not dated, it is presumed to have been made on the date of its delivery.

## 17.3 BILL OF EXCHANGE – SECTION 5:

### 17.3.1 MEANING:

**Section 5** defines a bill of exchange as

- 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 order of, a certain person or
- to the bearer of the instrument.

There are three parties to a bill of exchange,

- Drawer : The maker of the bill
- Drawee : The person who is ordered to pay

- Payee : The person to whom or to whose order the money is directed to be paid

### 17.3.2 Essentials of a bill of exchange:

1. It must be in writing.
2. It must contain an express order to pay.
3. It must be signed by the drawer
4 It must contain an unconditional order to pay.
5. There must be three parties to the instrument.
6. The parties must be certain.
7. The order must be to pay a certain sum of money.
8. The instrument must contain an order to pay money and money only.
9. It must be stamped.

**Specimen of Bills of Exchange**

| | |
|---|---|
| Shrikant | Mumbai |
| Rs, 1,00,000/- | April 01, 2015 |
| Three months after date pay to me or my order, the sum of Rupee? One Lakhs, for value received. | |
| **Accepted** | (Signed) |
| (signed) | Shrikant |
| Gayatri | Swaroop.56/286 |
| 1.04.2015 | Bhulabhai Lane |
| Powai Vihar65/569 | Mumbai 72 |
| Mumbai- 400 068. | |
| | To |
| | Gayatri Devi. |
| | Mumbai 400068 |

## 17.4 CHEQUE- SECTION -6

### 17.4.1 MEANING:

Cheque is an important negotiable instrument through which payment can be made.It is a written order issued by a depositor to

a particular bank directing it to pay a certain sum of money to a certain person or to the bearer of the cheque.It is the most widely used tool for drawing money from the bank. A cheque must have all the characteristics of a bill of exchange.

**SEPCIMEN OF A CHEQUE**

Date:

Pay

---

----------(Name of **Payee)** order /OR Bearer

Rupees ----------

---------- Rs.

A/C No.

Drawee. **Bank**

Signature oftheDrawer
(ACCOUNT HOLDER)

### 17.4.2 Characteristics of Cheque.

**1. An unconditional order:**

The drawer or the depositor should not lay down any condition in the cheque.

**2.Drawn upon a Specified Banker**

The drawer issues cheque directing to a particular bank having deposit in it to pay the amount of cheque.

**3. Signed by the maker.**

The cheque should be signed by the account holder.

**4. Amount in words and figures.**

The amount of cheque should be mentioned in words and figures.

**5. Payable on demand.**

The amount of cheque must be paid by the bank as soon as it is presented at its counter.

**6. It must contain an express order to pay.**

**7. The sum contained in the order must be certain.**

**17.4.3 Crossing of Cheque:Section. 123,**

When a cheque bears across its face two parallel transverse lines, or of two parallel transverse lines simply (either with or without the word, not negotiable) that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally.

Thus a cheque can either be an open cheque, and the same can beencashed at the the counter of the bank, or a crossed cheque that is a cheque with a special direction to at the paying banker to make payment only through a particular banker and not to pay it at the counter. Crossing of a cheque in general does not stop its negotiability but if words like '**Not Negotiable' 'or A/c. Payee only'** are used then it cannot be negotiated freely.

**17.4.4 Parties to a cheque**

1. **Drawer :**The person who draws the cheque.
2. **Drawee** : The banker on whom the cheque has been drawn, the payee, holder, Indorser, and Indorsee are the same as in a bill.

**17.4.5 Types of Cheque**

**1. Open Cheques / Bearer Cheques:**

An open or bearer is a cheque which is payable at the counter of the drawee bank on presentation of the cheque. When the cheque is lost or stolen, it is not possible easily to trace the person who has received the payment.

**2. Crossed Cheque:**

A crossed cheque is a cheque which is payable only through a specified banker and not directly at the counter of the bank. Crossing ensures security to the holder of the cheque as only the particular banker credits the funds to the account of the payee of the cheque.When two parallel transverse lines, with or without any words, are drawn generally, on the left hand top corner of the cheque.

- A crossed cheque does not affect the negotiability of the instrument.
- It can be negotiated the same way as any other negotiable instrument.

Hence Crossed cheque is a cheque which is not paid on the counter of a bank. The amount is credited by the bank to the account of payee. The significance of different types of crossed cheques is different in style.

## 17.5 CROSSING OF CHEQUES

### 17.5.1 Types of Crossing of the Cheque:

Following are the types of crossing of the cheque:

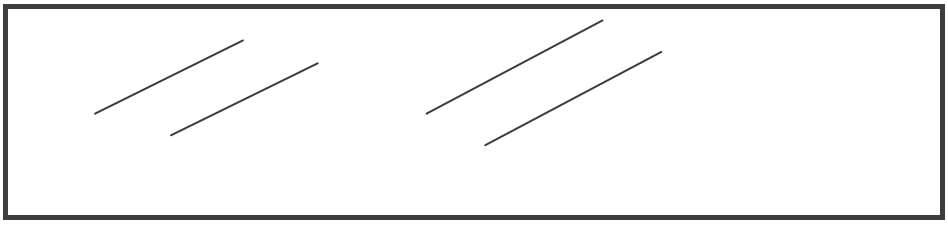
**1. General Crossing: Section 123**

A cheque is said to be crossed generally when it bears across its face any of the following:

a. Two transverse parallel lines.
b. Two transverse parallel lines with the word “And Company” or “And Co”.
c. Two transverse parallel lines with any abbreviation of the word “& Company”.
d. Two transverse parallel lines with the words “Not Negotiable”.
e. Two transverse parallel lines with the words “Account Payee Only”.

The cheque crossed generally does not ceases to be negotiable further. The collecting banker can collect the proceeds of the cheque in the account of that person mentioned on the cheque. A crossed cheque can be made **bearer cheque** by cancelling the crossing and writing that the crossing is cancelled and affixing the full signature of drawer.

**SPECIAL CROSING/RESTRICTIVE CROSSINGOF CHEQUE**



- **Significance of General Crossing:**

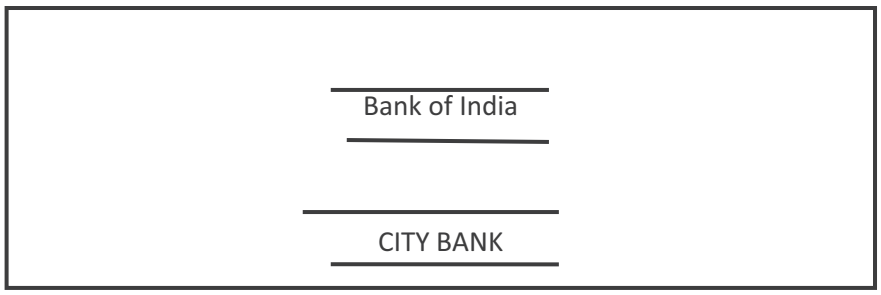
a. The effect of general crossing is that it gives a direction to the paying banker.

b. The direction is that, the paying banker should not pay the cheque at the counter.

C. It must be presented to the paying banker through any other bank and not the payee himself at the counter.

**2. Special Crossing:Section 124:**

It is a cheque in which the name of the bank is appears between the two parallel lines and hence it can be paid to that specific banker only. Insertion of the name of a banker is an essential in special crossing. Special Crossing can not be converted to General Crossing.




- **Essentials of special crossing:**

**a.** Two parallel transverse lines are not at all essential for a special crossing.

**b.** The name of banker must be necessary specified across the face of the cheque may suffice the purpose.

**c.** It must appear on the left-hand side preferably on the corner. It should not be destroy the printed number of the cheque.

**d.** The **two parallel transverse lines** and the words **Not negotiable** may be added to a special crossing.

**1. Restrictive crossing:**

Besides the above two types of statutory crossing in recent years the practice of crossing cheques with the words Account payee only has sprung up. Such a crossing is termed as restrictive crossing.

- **Essentials of restrictive crossing:**

**a.** The two transverse parallel lines across the face of the cheque.

**b.** It must be presented in order to treat any cheque as a crossed cheque.

**c.** The cheque will not be taken as a crossed cheque if this has not been done.

- **Significance of restrictive crossing:**

**a.** It is only a direction to the collecting banker that the proceeds are to be only to the account of payee named in the cheque.

**b.** If the collecting banker allows the proceeds to be credited to some other account, it may be held liable for wrongful conversion of funds.

**c.** It is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

**2. Double crossing**:

When a cheque bears two separate special crossing, it is said to have been doubly crossed. Thus a paying bank shall pay a cheque doubly crossed only when the second banker is acting only the agent of the first collecting banker and this has been made clear on the instrument.

### 17.5.2 Section 125:Crossing of cheques after Issue

Following are the guidelines under the said section.

- The holder may cross the cheque generally or specially.If a cheque has not been crossed,
- If it's crossed generally, holder may cross it specially.
- Holder may add the words "not negotiable".If it's crossed generally or specially,
- If a cheque is crossed specially, banker to whom it's crossed, may again cross it especially to another banker, his agent, for collection.

### 17.5.3 Payment of cheque crossed generally or specially: Sections. 126 & 127:

- If cheque is crossed generally, the banker on whom it's drawn shall not pay otherwise than to a banker.
- If a cheque is crossed specially, it should be paid to the banker on whom it's crossed.
- When a cheque is crossed especially to more than one banker except when it's crossed to an agent for purpose of collection, the banker on whom its drawn shall refuse payment thereof.

### 17.5.4 Payment in due course of crossed cheque: Section 128

- When a banker on whom a crossed cheque is drawn, pays it in due course, it's to be presumed that he has made payment to

the owner of the cheque, though in fact, amount may not reach the owner.

- In this way, banker making payment in due course is protected.

### 17.5.5 Payment out of due course Sec. 129:

Any banker paying the crossed cheque otherwise than in accordance with the provisions of sec. 126 shall be liable to the true owner of the cheque for any loss he may have sustained.

## 17.6 DISHONOUR OF CHEQUE:SECTIONS 137 -138

### 17.6.1 MEANING:

Prior to the introduction of this chapter, the drawer of a dishonoured cheque could be criminally prosecuted under S.420 of the Indian Penal Code. However, even today prosecution under the general for the offence of 'cheating' is maintainable. The offence under S.138 of the Act and S.420 of the Indian Penal Code are different in nature, therefore conviction of offence under one provision does not bar prosecution under the other.

There was no effective legal provision before the year 1888 to restrict people from issuing cheques without having sufficient amount in their account or any harsh provision to punish them in the event of such cheque not being honoured by their bankers and returned unpaid. Dishonour of cheques is a civil liability accrued.

The processes to seek civil justice becomes a time consuming or a process of unusual length, and recovery by way of a civil matters takes a long time. To ensure immediate remedy against defaulters and to ensure credibility of the holders of the negotiable instrument a criminal remedy of penalty was introduced in Negotiable Instruments Act, 1881 in form of the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988 which were further modified by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002.

Many issues arise under this section such as

- what happens in case of default,
- who will be liable to the holder of the cheque,
- what are the procedures involved to make the case adept in the eyes of the magistrate, etc.

The Negotiable Instruments Act, 1881 was amended in the year 1988 to add – Chapter XVII which pertains to penal provisions

in case of dishonor of cheques for insufficiency of funds in the accounts.

**Section 138** – reads: 'Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall without prejudice to any other provisions of this Act, be punished with imprisonment for ["a term which may extend to two year"], or with fine which may extend to twice the amount of the cheque, or with both:'

Provided that nothing contained in this section shall apply unless-

(a) Within a period of six months from the date on which it is drawn the cheque has been presented to the bank or within the period of its validity, whichever is earlier.

(b) The payee of the cheque, or a person in whose custody the instrument is as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer, of the cheque, with in 30 days of the receipt of information by him from the bank regarding the return of the cheques as unpaid, and

(c) The payment of the said amount of money to the payee by the drawer has not ben made

### 17.6.2 THE BASIC ESSENTIALS OF SECTION138:

1. Cheque Drawn by the person who has a account in the Bank i.e existence of Bank-Customer Relationship.
2. Cheque Drawn in discharge – debt or liability.
3. Discharge may be of full – part liability.
4. Cheque returned unpaid.(returned to Payee/Holder/Person entitled to receive money)
5. Reasons for Return-
   - Insufficiency of Funds
   - Either the balance was insufficient – or it exceeded the amount arranged to be paid for overdraft.
6. Cheque presented in bank within 6 months from date of cheque.

7. Payee gave notice to drawer within 30 days of the refund of the cheque.
8. Drawer must make payment within 15 days from receipt of notice.
9. Cause of Action arises on 16th Day. (S.12(1) Limitation Act – excludes 16th Day)

If the above conditions are fulfilled the offence u/s 138 is made out – the Cognizance of which would then be taken by Metropolitan Magistrate/ Judicial Magistrate 1st Class as per S.142.

### 17.6.3 PUNISHMENT:

- Maximum 2 years (earlier it was 1 year – to make the act more stringent vide 2002 Amendments – to was extended to the present 2 years.
- Up to twice the amount of cheque as FINE.

## 17.7 HOLDER OF NEGOTIABLE INSTRUMENT

### 17.7.1 MEANING:

The holder of a negotiable instrument means any person entitled to the possession of the instrument in his/her own name and to receive or recover the amount due there on from the parties liable.

### 17.7.2 CONDITIONS TO BE FULFILLED

Thus, in order to be called a 'holder' a person must satisfy the following two conditions : (Sec. 8).

1. He must be entitled to the possession of the instrument in his own Name. Actual possession of the instrument is notrequisites. What is required is a **right to possession** under valid title. He should be a 'de jure holder' and not necessarily 'de facto holder'. It means that the person must be named in the instrument as the payee or the indorsee, or he must be the bearer of the same, if the instrument is bearer .

2. If a person is in possession of a negotiable instrument without having a right to possess the same he cannot be called the holder. Thus, a thief, or a finder on the road, or an indorsee under a forged endorsement, although may be having the possession of the instrument, cannot be called its holder because he does not obtained legal title of the same and hence is not entitled in his own to the posses the same.

## 17.8 HOLDER IN DUE COURSE

### 17.8.1 MEANING:

The basic principle relating to negotiable instruments is that a person obtaining a negotiable instrument in good faith and for value obtains a valid title though he takes from one who had nothing. The property in a negotiable instrument is acquired by anyone who takes it bona-fide and for value, notwithstanding any defect of title in the person from whom he took it. Now such a person who takes an instrument "in good faith and for value" becomes the true owner of the instrument and is known as a "***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 he become a owner of or the payee or endorsee thereof, if payable to order, before the amount mentioned in it became payable and without having sufficient reason to believe that any defect appears in the title of the person from whom he obtained this title.

### 17.8.2 Essential Qualifications of a "Holder In Due Course":

The essential qualifications of a "holder in due course" as follows:

- He must be a holder for valuable consideration. All the essentials of consideration should be fulfilled so as to result in a valuable consideration.
- The person who takes a negotiable instrument after maturity does not become a holder in due course. Thus the person became the holder of the instrument before its maturity.
- That the instrument should be complete and regular on the fact of it..
- The last requisits is that the holder should have obtained the instrument in "good faith".

## 17.9 NEGOTIATION SECTION 14

### 17.9.1 Meaning:

Negotiation may be defined as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name. According to section 14 of the Act, '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.' The main purpose and

essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder there of. Negotiation thus requires two conditions to be fulfilled, namely

1. There must be a transfer of the instrument to another person; and
2. The transfer must be made in such a manner as to constitute the transferee the holder of the instrument.

### 17.9.2 Modes of negotiation

Negotiation may be effected in the following two ways:

1. **Negotiation by delivery (Sec. 47):**

Where a promissory note or a bill of exchange r a cheque is payable to a bearer, it may be negotiated by delivery thereof.

**Example:** A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep it for B. The instrument has been negotiated.

2. **Negotiation by endorsement and delivery (Sec. 48):**

A promissory note, a cheque or a bill of exchange payable to order can be negotiated only be endorsement and delivery. Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it

## 17.10 ENDORSEMENT –Section 15 &16

### 17.10.1 Meaning:

The word 'endorsement' in its literal sense means, writing on the back of an instrument. But under the Negotiable Instruments Act it means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus, endorsement is signing a negotiable instrument for the purpose ofnegotiation. The person who effects an endorsement is called an 'endorser', and the person to whom negotiable instrument is transferred by endorsement is called the 'endorsee'.

### 17.10.2 Essentials of a Valid Endorsement:

The following are the essentials of a valid endorsement:

1. It must be on the instrument. The endorsement may be on the back or face of the instrument and if no space is left on the instrument, it may be made on a separate paper attached to it called allonage. It should usually be in ink.
2. It must be made by the maker or holder of the instrument. A stranger cannot endorse it.
3. It must be signed by the endorser. Full name is not essential. Initials may suffice. Thumb-impression should be attested. Signature may be made on any part of the instrument. A rubber stamp is not accepted but the designation of the holder can be done by a rubber stamp

**17.10.3 Kinds of Endorsements- Sections 16,50,52,&56**

**1. Blank or general endorsement (Sections 16 and 54):**

It is an endorsement when the endorser only signs on the instrument without putting the name of the person in whose favour the endorsement is made. Endorsement in blank specifies no endorsee. It simply consists of the signature of the endorser on the endorsement. A negotiable instrument even though payable to order becomes a bearer instrument if endorsed in blank. Then it is transferable by mere delivery. An endorsement in blank may be followed by an endorsement in full.

**Example:** A bill is payable to X. **X** endorses the bill by affixing his signature. This is an endorsement in blank by X. In this case the bill becomes payable to bearer.

**2. Special or full endorsement (Section 16):**

When the endorsement includes not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. Thus, when endorsement is made by writing the words “Pay to A or A’s order,” followed by the signature of the endorser, it is an endorsement in full. In such an endorsement, only the endorsee can transfer the instrument.

**3. Partial endorsement (Section 56)**

A partial endorsement is one whichpretendto transfer to the endorsee a part only of the amount payable on the instrument.

**Example: A** is the holder of a bill for Rs.1000. He endorses it “pay to **B** or order Rs.500.” This is a partial endorsement and invalid for the purpose of negotiation.

**4. Restrictive endorsement (Section 50)**

The endorsement of an instrument as a name suggests may contain terms making it restrictive. Restrictive endorsement is one which either by express words restricts or prohibits the further negotiation of a bill.

“Pay C only ,” “Pay C for my use,” Pay C for the account of B” are instances of restrictive endorsement.The endorsee under a restrictive endorsement acquires all the rights of the endoser except the right of negotiation.

**5. Conditional or qualified endorsement**.

It is open to the endorser to attach some conditions to his owner liability on the endorsement. An endorsement where the endorsee limits his liability by putting some condition in the instrument is called a conditional endorsement.

A condition imposed by the endorser may be a condition precedent or a condition subsequent. An endorsement may be made conditional or qualified in any of the following forms:

**a. ‘Sans recourse’ endorsement:**

An endorser may be expressword exclude his own liability thereon to the endorser. Such an endorsement is called an endorsement sans recourse (without recourse).

Thus ‘Pay to **A** or order sans recourse, ‘pay to **A** or order without recourse to me,’ is instances of this type of endorsement. Here if the instrument is dishonoured, the subsequent holder or the indorsee cannot look to the indorser for payment of the same.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.

**Example:A** is the holder of a negotiable instrument. Excluding personal liability by an endorsement without recourse, he transfers the instrument to **B**, and **B** endorses it to **C**, who endorses it to A. A can recover the amount of the bill from B and C.

**b. Facultative endorsement:**

An endorsement where the endorser extends his liability or desert some right under a negotiable instrument, is called a facultative endorsement. “Pay A or order, Notice of dishonour waived” is an example of facultative endorsement.

**c. 'Sans frais' endorsement**:

Where the endorser does not want the endorsee or any subsequent holder, to incur any expense on his account on the instrument, the endorsement is 'sans frais'.

**6. Negotiation back**

'Negotiation back' is a process under which an endorsee comes again into possession of the instrument in his own right. Where a bill is re-endorsed to a previous endorser, he has no remedy against the intermediate parties to whom he was previously liable though he may further negotiate the bill.

**Example:B**, holder of bill endoreses it to **C**, **C** endorses it to **D**, **D** endorses it again to **B**.

## 17.11 NOTING AND PROTESTING–SECTION [99-104(A)]

When a negotiable instrument is dishonoured the holder may sue his drawer and the indorsers after he has given a notice of dishonour to them. The holder may need an evidence of the fact that a negotiable instrument has been dishonoured. When a cheque is dishonoured generally the bank who denies payment returns back the cheque giving reasons inwriting for the dishonour of the cheque. Sections 99 and 100 provide an appropriate methods of genuineness the fact of dishonour of a bill of exchange and a promissory note byway of 'noting' and 'protest".

### 17.11.1 Noting:

As soon as a bill of exchange or a promissory note is dishonoured, the holder can after giving the parties due notice of dishonour, sue the parties liable thereon. Section 99 provides a mode of genuineness of the fact of the bill having been dishonoured. Such mode is by noting the instrument. Noting is a recorded of minute by a notary public on the dishonoured instrument. When a bill is to be noted, the bill is taken to a notary public who represents it for acceptance.

Noting should specify in the instrument,

- The fact of dishonour,
- The date of dishonour,
- The reasons for such dishonour,
- The notary's charges,
- A reference to the notary's register.

Noting should be made by the notary within a reasonable time after dishonour. Noting and protesting is not mandatory but foreign bills must be protested for dishonour.

### 17.11.2 Protest

Protest is a certificate by the notary public attesting the dishonour of the bill by non-acceptance or by non-payment. After noting, the next step for notary is to draw a certificate of protest, which is abona fide declaration on the bill.

An important advantage of protest is that the court on proof of the protest shall presume the facts of dishonour.

Besides the protest for non-acceptance and for non-payment the holder may protest the bill for better security. When the acceptor of a bill becomes insolvent, may protest the same in order to obtain better security for the amount due. For this purpose the holder may employ a notary public to make the demand on the acceptor and if refused, protest may be made. Notice of protest may be given to prior parties. When promissory notes and bills of exchange are required to be protested, notice of protest must be served instead of notice of dishonour. (Sec. 102)

Inland bills may or may not be protested. But foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn (Sec. 104).

## 17.12 QUESTIONS

1. Explain the various features of Negotiable Instruments?
2. What are the presumptions applicable to all the negotiable instruments under Negotiable Instrument Act 1881?
3. Define Promissory Note and explain is salient features.
4. Define Bill of Exchange and explain its salient features.
5. What is cheque? Mention its features and enumerate the different types of Crossing of Cheques.
6. Explain the cases in which a banker justified or bound to dishonour the cheque.
7. What are the penal provisions under Negotiable Instrument Act 1881, in respect of dishonour of cheques?
8. Distinguish between Holder and Holder in due course.
9. What are the essential qualification of holder in due course.
10. What is Negotiation?
11. What is Endorsement and what are its kinds?

12. Short Notes:-
    a. Noting and Protesting
    b. Negotiation Back.
13. Define the following terms:
    a. Bill of Exchange
    b. Time instrument
    c. Bearer instrument
    d. Inland instrument
    e. Negotiable Instruments
    f. Promissory Note
    g. Crossed Cheque
    h. Bearer Cheque
    i. Double Crossing of the Cheque
    j. RestrictiveCrossing of the Cheque
    k. Noting
    l. Protesting
    m. Endorsement
    n. Partial Endorsement

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# 18

## MODULE-V
# THE COMPANIES ACT, 1956.
## (Registration and Membership Of a Company)

**Unit Structure**



## 18.0 OBJECTIVES

After studying the unit the students will be able to:

- Explain the details about registration of a new company
- Understand the meaning of the member of a Company.
- Explain how to acquire the member ship of the company.
- Discuss about the events of Membership ceases.
- Understand the cases of becoming members.
- Explain about the rights and liabilities of the members.
- Understand the concept Register of the Members.

## 18.1 REGISTRATION OF A COMPANY ( Sec. 11)

### I. Registration of a Company:

According to section 11(2), no company, association or partnership, consisting of more than twenty persons (ten in the case of banking business) shall be formed for the purpose of carrying on any business that has, for its objects, the acquisition of gain for itself, or for its members unless it is registered as a company under the Act. Infact, the Act defines a company as a

company formed and registered under the Act. Section 11 further states that if the association is not registered, it is deemed to be an illegal association.

An association, in absence of registration, becomes illegal only if:

i. The membership of that association is more than ten persons in case of banking business; or more than twenty persons in case of any other business.

The term "person" here does not include an association or body of individuals. It simply means and denotes an individual (Pannaji v. Rapurchand). And, to constitute on "association", there must be a legal relation between these persons giving rise to joint rights and obligations. (Neelamega Sastri v. Appiih Sastri).

ii. The association must be formed for the purpose of carrying on business.

The term business though easy to describe is difficult to define. It includes any trade, profession or occupation. In Smith v. Anderson, Vessel M.R. explained the term thus, "anything which occupies the time, attention and labour of a man for the purpose of profit is business"- Business imports an element of continuity. An association formed for a single adventure is not an association formed for conducting business. So also, all association that makes profit but does not carry on any business need not be registered as a company eg. a school, temple hospital etc.

iii. The business must be conducted for the purpose of acquisition of gain.

S.11 does not apply to an association which is formed for charitable or religious purpose, though gain may accrue incidentally.The association must exist for the purpose of acquisition of gain. The gain may be pecuniary, commercial or any other kind.

(These rules do not apply to a Joint Hindu Family Firm.)

**II. Unregistered Companies:**

Are all unregistered companies, illegal associations? - No. An association, in absence of registration, becomes illegal only when the above three conditions exist. In other words an unregistered or unincorporated company is a valid and legal association of persons provided it satisfies the following conditions:

i) In case of banking business, it does not consist of more than ten persons.

ii) In case of any other business, it does not consist of more than twenty persons.

iii) If the company carries on non-business activities e.g. hospital, school, temple etc.

iv) If the company carries on business but not for the purpose of acquisition of gains e.g. trade association, chamber of commerce etc.

**III.Consequences of noncompliance with s. 11 of the Act**

If an association that has to be incorporated as a company as per the requirements of s. 11.is not incorporated, it becomes an illegal association in the eyes of law. And persons who constitute such an association are liable to punishment. They are also liable for all the liabilities incurred by, such an illegal association.

Such an association gets no recognition at law. It does not get any benefits or protection afforded by the Companies Act. It cannot enter into contracts or rank as a creditor in the insolvency of any person. It cannot be wound up under the Act nor can it sue its members or outsiders. But an unregistered association is liable to income-tax on profits earned by it (Gopalji Co.- v. Commissioner of income-tax, 1931, Lah. 376). And an officer or employee of such an association can be convicted under The Indian Penal Code for misappropriation of its funds.

## 18.2 PROCEDURE FOR REGISTRATION (Sec. 33)

For the registration of a company, an application has to be filed with the Registrar of Companies of the State in which the registered office of the company will be situated. The application must be accompanied by the following documents

**i. Memorandum of Association:-**

The memorandum must be prepared in accordance with the provisions of the Companies Act. It must be signed by at least seven persons in the case of public companies and two persons in the case of private companies. It must be duly witnessed.

**ii. Articles of Association:-**

Undersec. 26 of the Act, articles are compulsory only for unlimited companies, companies limited by guarantee and private companies limited by shares. Where articles are not registered Table A of the Companies Act will apply. Table A does not contain the restrictions which the articles of a private company must

contain. So, if a private company does not register its articles, Table A will automatically apply making it a public company.

**iii.** A letter of approval from the Registrar to the effect that the proposed name of the company has been approved.

**iv.** A declaration stating that all the requirements of the Act relating to registration have been complied with. This declaration must be signed by an advocate of the Supreme Court or of a High Court, or an attorney or a pleader entitled to appear before a High Court, or a chartered accountant practicing in India or a person named in the Articles as a director of the company.

**v.** A duly signed list of persons, who have given their consent to be directors of the company.

**vi.** The consent, (in writing) of the directors must be accompanied with the signed agreement with each director to take the requisite number of qualification shares. These are not required in the case of private companies and companies not having a share capital.

**vii.** A challan to the effect that Registration fees have been paid.

## 18.3 CERTIFICATE OF INCORPORATION

### 18.3.1 Meaning:

On receipt of the above documents, if the Registrar is satisfied that the requirements of the Act relating to registration have been complied with, he will register the company and other documents and place the name of the company in the Register of Companies. A certificate known as the Certificate of Incorporation shall be issued by the Registrar. He will then certify under his hand that the company has been incorporated and in case of a limited company, that the company is a limited company. This certificate proclaims to the world the existence of the company.

### 18.3.2 Effect of Certificate of Incorporation

1) The company is born on the day on which it receives its certificate of incorporation.
2) It is a conclusive evidence that all the requirements of the Act in relation to registration have been complied with. The validity of the certificate cannot be challenged on any ground.

### 18.3.3 Effect of Pre-incorporation contracts:

Often contracts are entered into on behalf of the company even before it is duly incorporated. Such pre-incorporation contracts are not binding on the company after it comes into existence. This is because at the time of making of the contract, the company is a non-entity. A company cannot even ratify these contracts, after it comes into existence for the simple reason that ratification relates back to the date on which the contract was made. So, the person entering into the contract incurs personal liability on such contracts.

### 18.3.4 Advantages of Incorporation:

The advantages of incorporation are

i) The company acquires an independent corporate personality.
ii) It becomes the owner of its capital, assets and other property.
iii) It is capable of perpetual succession.
iv) It can use a common seal.
v) It can sue in its own name.
vi) The liability of the members is limited.
vii) Shares of the company are easily transferable.

(All these points have been discussed while studying the nature of a company.)

### 18.3.5 Disadvantages of Incorporation

**i) Company is not a citizen.**

**ii) Formality and expenses :-**

Incorporation of a company is not only expensive but it also involves a number of formalities. Several requirements hare to be complied with - both as to the formation of a company as well as the administration of its affairs. Whereas, constituting a firm is a relatively easy and inexpensive affair.

**iii) Lifting the veil of Corporation :-**

Personality of a company is a legal myth.It ignores reality. And the reality is that a company is an association of persons who are in fact the beneficial owners of corporate property.So in some cases, the courts ignore the legal personality of the company, pierce the veil of corporation and look at persons behind it.Thus, some of the advantages of incorporation may become illusory.
Following are the circumstances in which the courts may lift the veil of corporation:

**a) When the company assumes an enemy character**

In Daimler Co. Ltd. v. Continental Tyre and Rubber co. (1916)2A C 307, the House of Lords, while determining the character of a company registered in England, held that though the company was registered in England it would assume enemy character if the persons in de facto control of its affairs are residents in an enemy country (Germany).

**b) When the company is formed for evasion of taxes**

Where the company is formed only for the purpose of evasion of taxes, the court has the power to disregard the corporate personality of the company (Re Sir DinshawManeckjee Petit).

**c) Where the company is formed for fraudulent purposes**

The courts can pierce the corporate personality if the company is formed for a fraudulent purpose, or for an unlawful object (Gilford Motor Co. v. Horne)

**d) Where the company is an agent or trustee**

Courts will refuse to uphold the separate and independent existence of a company where it is an agent of its, members or of another company.

**e) Under Statutory Provisions**

The courts will crack the shell of corporate personality where, because of the fall in the number of members below the prescribed legal minimum (seven in case of a public company and two in case of private company) the liability has become unlimited (s. 45).

**f) Any other just case**

The courts may, in the interest of truth and justice, set aside the cloak of corporate personality so as to determine liability.

## 18.4 COMMENCEMENT OF BUSINESS (Sec. 149)

Section 148 permits a private company to commence business from the date of its incorporation. But a public company cannot commence business as soon as it is incorporated. It has to obtain from the Registrar of Companies a Certificate of Commencement of Business. This certificate is granted subject to the following conditions

1. Shares, payable in cash, must have been subscribed and allotted tip to the amount of minimum subscription. Under section 69 (1) and Clause 5 of schedule II, the expression "minimum subscription" means the amount, which, in the estimate of directors, is sufficient to meet the following needs, namely, purchase price of any property to be defrayed party or wholly out of the proceeds of the issue, preliminary expenses and working capital.

2. Every director must have paid, in cash, the application and allotment money in respect of shares, for which he is bound to pay in cash.

3. A declaration signed by any director or secretary of the company to the effect that the above requirements have been complied with, must have been filed with the Registrar of Companies.

4. A company, which has not issued a prospectus, must file a statement in lieu of the prospectus with the Registrar of Companies.

5. Finally, a certificate to the effect that every director has paid his application and allotment money for shares, contracted to be taken by him for cash, must be filed with the Registrar.

The Amendment Act of 1965 introduced certain conditions for commencement of business by a company. It has added two new sub-sections to section 149.

As a result of the amendment of section 13, dealing with the object clause in the Memorandum, a company must state in the object clause the following:

1. The main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.

2. The other objects of the company, not included in the above clause.

Now, if a company wants to start a business included in the "other objects", it shall have to obtain the authority by a special resolution of its shareholders. Similarly if an existing company wishes to commence any new business, which, though included in its objects, is not germane to the business, which it has been carrying on, at the commencement of the Amendment Act, it shall have to obtain the authority by a special resolution.

Where, however, a special resolution has not been passed, but the votes cast in favour of the resolution exceed the votes cast against it, the Central Government may on an application by the board of directors, allow the company to commence such business. [sec. 149 (2-B)].

In both the above cases, a declaration must be filed with the Registrar by the Secretary or a director of the company to the effect that the requirement as to resolution, has been complied with [sec. 149 (2-A)(ii)].

If the Registrar is satisfied that all the above requirements are complied with, he shall issue a certificate which will entitle the company to commence its business. The certificate is conclusive that all the requirements of the Act with regard to commencement of business have been duly fulfilled by the company [s. 149 (3)].

## 18.5 MEMBERSHIP OF COMPANY

### 18.5.1 MEANING OF THE MEMBER OF A COMPANY

The sec 2 (27) states that 'member' in relation to company does not include the bearer of share warrant. The person whose name is entered into the register of members is known as a member of the company. According to Sec 41 of the Companies Act, a member of a company means a person:

i. Who has subscribed his name to the memorandum
ii. Any other person who has agreed in writing, to become a member and whose name is entered in the register of members.
iii. Every person, holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository (Inserted by the Depositories Act, 1976)

On the other hand, a shareholder is one who holds shares in a company. These two expressions are being used interchangeable

Therefore, membership of a company can be obtained in following ways:

i. By subscribing to the Memorandum of Association of a company;
ii. By agreeing in writing to become a member;
iii. Every person holding equity share capital and whose name is entered as beneficial owner in the records of the depository.

The essential factor to constitute membership is that the name of the person in either of the above circumstances must appear in the register of members of the company or as beneficial owner in records of depository.

### 18.5.2 ACQUISITION OF MEMBERSHIP

**1. By subscribing to the memorandum Sec. 41**

The subscribers to the memorandum are deemed to have agreed to become members. Their names must be entered into the Register of member. Thus, if the subscribers later do not subscribe to the shares to which they have agreed, they will still be the 'members' and will be responsible for the payment in respect of the shares which they have agreed to subscribe. Hence neither application nor allotment of shares is necessary.

**2. By undertaking to buy qualification: Sec 266**

When the director agrees to take qualification shares, such director is in same position as if he has signed a memorandum of the company for those shares of that number of value.They too are deemed to have become members on registration of the company and will be liable in respect of those qualification shares.

**3. By allotment:**

A person can become a shareholder if he agrees to take shares in the company by allotment. Allotment means an appropriation of shares out of the previously un-appropriated capital of a company, to a particular person. Re-issue of forfeited shares does not amount to allotment.

**4. By transfer:**

A person who take shares from an existing member by sale, gift or some other transaction, acquires membership, on his name appearing in the register of member. Under Sec 41 of the Act, every person who agrees in writing to become a member of the company and whose name is registered in its register of members, is a member of the company. Thus two ingredients are necessary for membership by transfer of shares:

i. An application in writing to become a member, and
ii. An entry in the register

**5. By Transmission:**

The transmission of shares takes places on the death or insolvency of the shareholder. On the death of a member, his

executor or the person who is entitle under the law to succeed to his estate gets the right to have the shares transmitted to his name in the company's register of members. In case of transmission of shares no instrument of transfer is necessary. Articles of association gives the formalities to be followed with regards to transmission. The shares of the company are freely transferable.

**6. Membership by acquiescence and estoppels:**

A shareholder is not a member unless his name is entered in the register of members of the company. Where a person allows his name to be put on the register of members, or knowing that his name is put on the register, does not take steps to have his name taken off, he shall be stopped from denying that he is a member. Where his name is entered by mistake and he is unaware of it then he does not become a member.

**7. Joint members:**

When two or more persons hold share in a company in their joint names it is called a joint membership. They are to be treated as single member for the purpose of sending notices, dividends, interest etc. and name of person appearing first is to be treated as main member.

### 18.5.3 CEASES OF MEMBERSHIP

Membership ceases in following event:

1. By transfer of shares. In such case even though transferor ceases to be a member, he remains liable to be placed in 'B' list for one year, if the company goes into liquidation.
2. By forfeiture of shares
3. By surrender of shares, where surrendering is permitted
4. By sales of shares by the company after it exercises its right of lien on the shares or in execution of a decree by court or other proper authority
5. By insolvency. Such shares of an insolvent vest in the Official Receiver or Assignee.
6. By death, the name of deceased member continues till the shares are registered in the name of his legal representative
7. By rescission of the contract to take shares on the ground of misrepresentation in the prospectus
8. When the company redeems its redeemable preference shares
9. On issue of share warrants by the company in place of share certificates

10. On winding up of the company. However a member remains liable as a contributor and is also entitled to shares in the surplus assets, if any.

### 18.5.4 Who can be a member?

An individual or body corporate can be a member in a company. A person who is of a sound mind and capable of contracting can be a member. Therefore person should be competent to a contract. Following are the cases:

**1. Minor:**

As a minor is incapable of entering into a valid contract, he cannot become a member. However, it has been held in Diwan Singh V. Minerva Films Ltd. (1958 Com. Cas. 191), that there is nothing in law to prevent a minor from acquiring or holding shares in a joint stock company, if he is properly represented and acts by a lawful guardian. A guardian can therefore hold shares in a company for and on behalf of minor. Minor's name may remain on company's register of members, but during minority he incurs no liability. If the allotment is made to the minor wrongly, the company can repudiate or cancel the allotment but must repay all the money received by such minor.

The minor on attending majority can rescind the contract and get his name removed from the register of members.However if he does not do so, he shall be a member of the company, and incur all the liabilities of a member. The company however cannot be compelled to admit minor as a member. In Balaraman R. V. Buckingham and Carnatic Company Ltd. (1969) 1 Comp. L.J. 81 (CLB), it has been held that the acquisition of fully paid up shares by a minor is valid in law and that the name of the minor represented by the guardian could be entered on the register of members of the company.

Every person who is competent to a contract may become a member. Hence a minor and a person of unsound mind cannot be members of a company. In Palaniappa v/s Pasupati Bank (1942) 1 Mad. L.J. 425, the Madras High Court held that a minor cannot validly be a member of a company. A minor can be admitted to the membership of a company limited by shares, by means of transfer of shares provided the shares are fully paid up. A minor during his minority can enjoy the benefits of membership without being liable as a contributory

**2. Company and subsidiary company Sec 42:**

A company can become a member of another company as a company is a legal person.

However a subsidiary company cannot be a member of a holding. Any allotment or transfer of shares by a holding company to its subsidiary shall be void. It may become a member of another company provided it is not prohibited by its memorandum of association. However a company cannot buy its own shares. (Except in a limited manner permitted by section 77). A subsidiary company can however be a member of the holding company in following cases:

i. Subsidiary Company is concerned as a legal representative of a deceased member of the holding company
ii. When subsidiary company is concerned as a trustee
iii. When subsidiary company is a member of the holding company before the commencement of Act and it continues to be so.
iv. Where subsidiary company was a member of the holding company before becoming the subsidiary of the holding company.

**3. Trust (Sec 153):**

A trustee, who buys shares, will be treated as a member in his individual capacity. It cannot hold share in a company. A trustee can however hold shares in his name for and on behalf of the trust. Any person holding shares in a company as a trustee is required to make a declaration to the public trust within the prescribed time. A copy of such declaration is required to be sent by the trustee to the company concerned within 21 days after the declaration to the public trust. Failure to do so will lead to penalty. However these provisions are not applicable to the following two cases:

a. Where a trust is not created by an instrument in writing
b. Even if the trust is created by an instrument in writing, if the value of the shares, held in trust does not exceed Rs. 1,00,000/- or if it exceeds that amount, it does not exceed Rs. 5,00,000/- or 25% of the paid up share capital of the company, whichever is less.

According to Companies Amendment Act, 1963 it has provided for appointment of Public trustee by the Union Government.

**4. Partnership Firm:**

A firm is not a legal person or a body corporate. It cannot hold shares in the company; however partners in their individual capacity or as nominees of the partnership firm can hold shares in a company. These shares will constitute a part of the Assets of the firm. However a firm can be a member of any association

registered under section 25 of the Act, such as Chamber of Commerce or a Social Club or a Charitable Institution

**5. Society:**

A registered society under the Societies Registration Act, 1860 can acquire shares in the company.

**6. Other:**

An insolvent may be taken as member so long as his name appears in the register of members, notwithstanding the right of official assignee or receiver to be registered as a member.

**7. Non-resident:**

A non-resident cannot become a member of a company without the permission of the Reserve Bank of India under the Foreign Exchange Regulation Act, 1973

**18.5.5 RIGHTS OF MEMBERS:**

Following are rights of the members**:**

1. Right to receive notices of all general meetings
2. A member has a right of priority to have shares offered in case of increase of capital
3. Right to attend and vote at meetings
4. Right to appoint directors and auditors of the company
5. Right to receive copies of annual accounts of the company
6. Right to transfer his shares
7. Right to receive a share certificate
8. Right to inspect the minutes of proceedings of any general meeting
9. Right to inspect the register of members, register of debenture holders and copies of annual returns.
10. If his name is omitted in the register of members, he can apply to court for rectification of the register.
11. In case of statutory meeting, he is entitled to a copy of statutory report.
12. Right to receive dividends in case of preference shares
13. Right to be registered as a shareholder in Company's Book
14. Right of Privilege of immunity from personal liability of company's debts

15. Right to participate in dividend distribution, if ordered in the discretion of directors
16. Right to rescind the contract and claim damages in case of his acquiring shares on account of mis-statement in the prospectus.
17. Right of Priority to have shares offered to him in case of increase of capital by the company.
18. Right to petition to High court for relief in cases of oppression and mismanagement.
19. Right to petition to High court for winding up of the company
20. Right to petition to the Central Government for ordering an investigation into the affairs of the company
21. Right to participate in appointments of directors and auditors in annual general meetings
22. Right to apply to the Central Government for calling an annual general meeting if the board of directors fails to call such a meeting
23. Right to apply to the Court for calling an extra ordinary meeting of the company
24. Right to participate in the distribution of assets in case of liquidation of the company.

    [ Bacha F. Guzdar v. Commissioner of Income Tax AIR 1955 SC 74]
25. Right to bring representative suits and company's cause of action, to remedy mismanagement or unauthorised acts and thereby to compel the company to enforce its rights.

### 18.5.6 LIABILITIES OF A MEMBER:

1. Liability of members depends on the nature of the company. In the case of an unlimited company, the liability of each member is unlimited. Every member of such a company is liable in full for all the debts of the company, contracted during the period of his membership.

   If the company is limited by guarantee, each member is bound to contribute, in the event of winding up, a sum of money specified in the liability clause of its memorandum of association.

   If the company is incorporated with the liability of its members limited by shares, each member is liable to pay only the full nominal value of the shares held by him.
2. He is liable as a contributory in the case of winding up of the company.

3. A shareholder continues to be liable to the company even though he have transferred his shares to another company, until his name is deleted from the register of members and the name of transferee is put in his place.
4. He is liable to abide by the acts of the majority of members unless the majority acts oppressively, malafidelyor fraudulently.
5. A member is liable to accept the share if they are allotted to him within a reasonable time and in compliance with the provisions of the Act.
6. A member is liable to pay for the shares allotted to him either when allotment is made and/or when calls are validly made in accordance with the provisions of the articles. If the full nominal value of the shares has already been paid at the time of application, the liability of the shareholder to pay ceases.
7. A member is liable to have his shares forfeited in event of non-payment of any call. Shares can he forfeited only if all the conditions for a valid forfeiture exist. These conditions are:

a. Forfeiture must be in accordance with the provision of the company's articles.
b. Share can be forfeited only for non-payment of a call due in respect of the shares.
c. A proper notice requiring him to pay the exact amount on or before a specified day (Which must not be earlier than fourteen days from the date of service of the notice) should be given to the shareholder. The slightest defect in the notice invalidates forfeiture.
d. A formal resolution declaring the forfeiture of shares must be passed and a notice of the same served on the defaulting shareholder.
e. The power to forfeit shares should have been exercised in good faith and for the benefit of the company.

## 18.6 REGISTER OF MEMBERS: (Sec. 150 & 164)

### 18.6.1 CONTAINS IN THE REGISTER

Under Sec. 150(1) every company is bound to keep register of members which must contain the following particulars:

1. The name , address and occupation, if any of each member
2. In case of a company having a share capital, the shares held by each member, distinguishing each share by its number, except where such shares are held with a depository, and the

amount paid or agreed to be considered as paid on those shares

3. The date at which each member was entered in the register as a member
4. The date on which any person cease to be a member

Where the company commits a default in maintaining the register in the above manner, the company and every officer of the company who is in default shall be punishable with fine. Sec 150(2)

In Gulabrai Kalidas Naik V. Lakshmidas Lallubhai Patel (1977)47 Comp. Cas. 151 (Guj.), it was held that till the name is entered, it could not be said that a person can enjoy the powers of a member conferred by the Companies Act on the members of a company.

Any alteration in the register of members must be noted within 14 days of the alteration.

The register of member shall be prima facie evidence of any matter directed or authorized to be inserted therein by the Companies Act. If any default is committed in maintaining the register, the company and every officer of the company, who is in default, shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues.

### 18.6.2 INDEX OF MEMBERS (Sec 151):

A company having more than fifty members, shall keep an index of the names of its members. The index can be dispensed with if the register of member is maintained in an index form. The company shall within 14 days after the date, on which any alteration is made in the register of members, make the necessary alteration in the index.

The index shall at all times, be kept at the same place as the register of members. On payment of a fee of Re. 1 for each inspection, any member may make extracts from any register or acquire a copy of any register. The court may also by order compel an immediate inspection.

### 18.6.3 POWER TO CLOSE THE REGISTER OF MEMBERS (Section 154):

After giving notice (of not less than seven days)in the local newspaper circulating in the district in which the registered office of the company is situated, a company may close its register of

members for a period of not more than 45 days in a year and not more than 30 days at a time.

### 18.6.4 PLACE OF KEEPING AND INSPECTION OF REGISTER (Sec 163):

The register of members and the index of members shall be kept at the registered office of the company. They may be kept at any other place within the city, town or village in which the registered office is situated, if such other place has been approved by a special resolution by the company in its general meeting and the registrar has been given in advance a copy of a proposed special resolution.

The central government has prescribed rules under Companies (Preservation and disposal of records) Rules, 1966 for the preservation and for the disposal, whether by destruction or otherwise, of the registers and other records and documents of the company. The register of members being a public document should be opened during the business hours to the inspection of any member without fee. Outsiders can inspect on payment of fee Re.1.

### 18.6.5 RECTIFICATION OF REGISTER OF MEMBERS:

The court may order the rectification of the register of members in the following cases:

1. Where the name of a person has been entered in the register without sufficient cause.
2. Where the name of member has been removed without sufficient cause.
3. Where the company has, without sufficient cause, defaulted or delayed in entering the person’s name in the register.
4. Where a member has ceased to be a member and the company refuses to remove his name from the register.
5. Where the shares have been improperly surrendered to the company.
6. Where the shares have been transferred for the purpose of escaping liability.
7. Where the shares have been improperly issued at a discount.
8. Where the shares have been improperly forfeited.
9. Where the application for shares was conditional but the condition was not fulfilled.

Rectification has retrospective effect. The registrar of the companies must be informed of the rectification within 30 days of the rectification of the register.

### 18.6.6 FOREIGN REGISTERS:

**A** company which has a share capital or which has issued debentures may, if so authorized by its articles, keep in any state or country outside India a branch registers of members or debenture holders resident in that state or country. Such a register is called "**Foreign Registers".**

The company shall file with the registrar notice of the situation of the office where such register is kept within 30days from the date of opening of any foreign register. A foreign register shall be deemed to be a part of the company's register of members.

## 18.7 QUESTIONS

1. Who can be a member of a company? How does a member cease to be a member?
2. Enumerate and explain the various modes of membership of a company.
3. State and discuss the rights and liabilities of a member.
4. Answer in brief-
   a. What are "Register of Members" and "Index of Members"?
   b. When can a company close its register of members?
   c. When can the register of members be rectified?

5. Write Notes on:
   a. Forfeiture of shares
   b. Member and shareholder
   c. Register of members
   d. Membership by acquiescence

6. Define the following terms:
   a. Certificate of Incorporation
   b. Foreign Registers
   c. Member of a company

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# 19

# THE COMPANIES ACT, 1956.
# Types of Companies

**Unit Structure**



## 19.0 OBJECTIVES

After studying the unit the students will be able to;

- Understand the classification of companies.
- Explain the procedure for converting the Private company into Public Company.
- Explain the procedure for converting the public company into Private Company.
- Understand the distinction between Private Company and Public Company.

## 19.1 INTRODUCTION

The reason being the corporate form can take many forms in order to efficiently meet the needs of time. The Company law recognises various classifications of companies, however it cannot be exhaustive.

## 19.2 CLASSIFICATION OF COMPANIES

The conventional classification of companies is as follows:

**A. Classification Based on Modes of Incorporation:**

**1. Chartered Companies**:

These companies come into existence by the Royal Charter, issued by the Head of State. Its powers and obligations are determined by the terms of Charter.

**Examples**: East India Company, Bank of Australia.

**2. Statutory Companies**:

These are formed under the special statue of the State parliament or State legislature. These are generally, public undertaking formed for the purpose of public utilities [like railways, electricity, gas etc.] and not for making profits out of it. Such Companies are mostly vested with some special or compulsory powers unlike the other ordinary companies registered under the Companies Act.

**Examples:** State Bank of India, Reserve Bank Of India, Life Insurance Corporation of India, Unit Trust of India etc.

**3. Registered Companies**:

These are the companies registered and incorporated with the Registrar of Companies under the provisions of the Companies Act. Companies which do not require registration under Sec. 11 are unregistered companies or an incorporated co. These companies can exercise an option to register or not to register. If they do not register they are not illegal associations.

Companies can be further divided as:

**B. On the basis of number**:

**1. One-man Company:**

With the increase use of Information, technology and computers, emergence of service sector, it is time that the entrepreneurial capabilities of the people are given an outlet for participation in economic activity. Such economic activity may take place through the creation of an economic person in the form of a company. It is where one individual or an entity holds majority share. Here there is one member & one director.

**Examples:** Solomon & Co., Wipro.

**2. Private Company:**

Where the minimum number is two & maximum is fifty, and having following characteristics:

- Minimum paid up capital is one lakhs rupees or such higher paid up capital as may be prescribed in articles.
- Prohibits an invitation to public to subscribe for shares or debentures.
- Where two or more persons hold the shares jointly in such a company, they shall be treated as a single member.
- Restricts the rights of its members to transfer its shares, if any.
- Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.
- Limits the number of its members to fifty excluding persons who are or were in the employment of the company.

A private company can be further classified into:

- Companies limited by shares and
- Companies limited by guarantee (If it has a share capital)
- Unlimited companies (If it has a share capital)
- Producer Companies

**3. Public Company:**

Section 3(1)(iv) states that all companies other than private companies are called public companies.

- It is a company which;
- Is not a private Company
- Whose minimum number are seven and maximum is unlimited
- Has minimum paid-up capital of Five lakhs rupees or such higher paid up capital, as may be prescribed
- A private company which is subsidiary of a public company

A public company is further classified into:

- Companies limited by shares
- Companies limited by guarantee and
- Unlimited companies

**C. On the basis of Liability:**

**1. Limited liability Companies**:

The liability of the members is limited to the face value(Fixed nominal value) of the shares. This amount is paid either at the time of application, allotment or when the calls are made. Once the nominal value of shares held by member is paid, his liability ceases, irrespective of company's liability.

**2. Company limited by Guarantee:**

Such types of companies may or may not have a share capital. Each member promises to pay sum of money, specified in the memorandum in the event of liquidation of the company (or winding up) for payment of debts and liabilities of the company. Such promised amount is called guarantee.

A company limited by guarantee must have articles of association, which is to be registered at the time of registration with Registrar. If it has a share Capital then each member is liable to the extent of share value and also to the extent of guarantee.

**3. Unlimited liability Company:**

Such companies may or may not have a share capital. It does not have any limit on the liability of members. The members are liable in the event of winding up, to the full extent of their fortunes to meet the obligations of the company.

On liquidation creditors of such companies can proceed against the personal assets, estate and properties of the members of such a company. Unlimited Company too must file articles of association with the registrar.

**D. On the basis of Control**:

**1. Holding Company:**

Where a company has a control over another company, it is known as holding company. A company is deemed to be a holding of another if:

- Controls in the composition of the directors of another company
- Holds more than half in nominal value of shares of another company.

**2. Subsidiary Company:**

Subsidiary company is a company which is controlled by the holding company. It is deemed to be under control if :

- That other company controls the majority composition of its board of directors,
- The other Company holds more than half in nominal value of its equal share capital
- It is subsidiary of a third company which itself is a subsidiary of the Controlling Company.

**Example:** Company A is the subsidiary of Company B and in turn a subsidiary of Company C. Then company A is a subsidiary of Company C.

**3. Government Companies:**

Sec. 617 defines Government Company to mean any company in which not less 51% of the paid up share capital is held by the following:

- The Central Government or
- One or more state governments or
- Partly the Central Government and partly one or more State Governments hold not less than fifty-one percent of paid up share capital of the company.

And it includes a company, which is subsidiary of a Government company.

The concept of the Government companies is enlarged by the Amendment Act, 1974. Section 619(B) provides that the provision of audit of Government Companies shall apply to companies in which not less than 51 per cent of the paid up share capital is held by one or more of the following or any combination thereof, as if it were a Government Company, namely:

- The Central Government and one or more government companies;
- Any State Government or Governments and one or more Government Companies;
- The Central Government, one or more State Governments and one or more Government Companies;
- The Central Government and one or more Corporations owned or controlled by the Central Government;

- The Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government;
- One or more Corporations owned or controlled by the Central Government or the State Government.
- More than One Government Company

**4. Foreign Companies(Sec 591) :**

Section 591 of the Act defines a foreign company as a company which is incorporated outside India but has a place of business in India. Sections 592 to 608 of the Companies Act apply to foreign companies which:

i. After 1st April 1956, establish a place of business within India;

ii. Before 1st April 1956 have established a place of business within India and continue to have an established place of business within India on 1st April,1956.

If not less than 51 % of the paid up share capital (Whether Equity or preference), of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in aggregate, such company shall comply with such of the provisions of the Act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India (Sec 591)

A foreign company, within thirty days of establishment of business in India, must submit the following documents to the Registrar of the Companies:-

a. A certified copy of the Charter, statues, memorandum and articles of the company or other instrument constituting or defining the constitution of the Foreign Company. If the instrument is not in English language then it must be translated and certified.

b. The full address of the registered office of the company abroad.

c. A list of directors and secretaries of the company, giving name in full, usual residential address, nationality or origin, his business and details of other directorship, held by him in every individual case.

d. The names and addresses of persons, resident in India who are authorised to accept service in India on behalf of the Company.

e. The full address of its principal place of business in India (Sec. 592)

Any alteration that may take place in relation to above particulars must be notified to the registrar (Sec. 593)

Sec. 594 & 595 of the Act impose obligations on Foreign Company regarding accounts and other matters (Stating the name of the company, whether limited, and country of incorporation) respectively. A foreign company must deliver all its documents not only to the Registrar of companies, New Delhi, but also to the registrar of state in which it has its principal place of business in India.(Sec. 597). Failure to comply with the above provision will expose the companies to penalties as prescribed under section 599

**5. Producer Company (sec. 581):**

The registration of a producer company enables incorporation of co-operatives as companies and conversion of existing co-operatives into companies on optional basis. The provision provide for registration of producers companies limited by shares as if it is a private company. Every producer company shall deal primarily with the produce of its active members for carrying out any of the above objects. Active member is a member who fulfils the quantum and period of patronage of the producer company as may be required by the articles. Producer means any person engaged in any activity connected with or relatable to any primary produce. Amember means a person or producer institution(whether incorporated or not) admitted as member of a producer company and who retains the qualification necessary for continuance as such. Producer institution means a producer company or any other institution having only producer or producer companies as its members whether incorporated or not having any of the above objects and which agrees to make use of the services of the producer companies as provided in the article.

Any ten or more individuals, each of them being a producer or any two or more producer institutions or a combination of ten or more individuals and producers institution having prescribed objects may form incorporated company as a Producer company.

If the registrar is satisfied that all the requirements have been complied with in respect of registration and matters precedent and incidental there to, within thirty days of the receipt of documents required for registration, register the memorandum, the articles and the other documents, if any, And issue a certificate of incorporation.

The producer company shall be company limited by shares. On registration, the producer company shall became a body corporate as if it is a private company, without however, any limit to the number of members thereof . The producer company shall not

under any circumstances, whatsoever become or deemed to become a public company.

## 19.3 PROCEDURE FOR CONVERTING A PRIVATE COMPANY INTO A PUBLIC LIMITED COMPANY (Sec. 44)

Following is procedure:

Sec 44 of the companies Act prescribes the following procedure for converting a private limited company into a public limited company:

i. Alter the articles of the Company by special resolution to eliminate restriction of a private company under section 3(1)(iii)
ii. If the number of members is less than seven it must be raised at least to seven
iii. If the number of directors is less than 3, it must be raised at least to 3

On the date of such alterations, private company shall cease to exist. It shall become a public company. It shall within 30 days file with the registrar either a prospectus or a statement in Lieu of prospectusandresolutionalteringthearticles.

*In Hindustan liver Ltd. v. Bombay Soda Factory(AIR 1964 Mys. 173),* it has been heldthat on such conversion, no new company springs into existence. When a private limited company is converted into a public limited company, apart from the change in its name, the constitution and the entity of the company is not affected in any other manner and legal proceedings instituted by its former name can be continued by its new name. *[Solvex Oils and Fertilizers v. Bhandari Cross-fields (P) Ltd. (1978) 48 Comp Cases 260]*

## 19.4 PROCEDURE FOR CONVERTING A PUBLIC CO. INTO PRIVATE CO.

**Following is the procedure:**

i. Pass a special resolution authorising conversion of the company and altering the articles so as to contain the restrictions under section 3(1)(iii) of the Act.
ii. Change the name of the company by a special resolution.
iii. Obtain Central Government approval.
iv. File the altered articles with the Registrar within 30 days of the receipt of the approval from the Central Government.

## 19.5 WHEN A PRIVATE COMPANY BECOMES A PUBLIC COMPANY (SEC 43)

A private company shall become a public company in following cases:

**1. By default:**

When it fails to comply with the essential requirements of a private company under section 3(1)(iii). Default in complying with the said provisions shall disentitle a private company to enjoy certain privileges (Sec 43)

**2. Subsidiary private company:**

A private company which is a subsidiary of another public company shall be deemed to be a public company.

**3. By conversion:**

When the private company converts itself into a public company by altering its Articles in such a manner that they no longer include essential requirements of a private company under Sec 3(1)(iii). On the date of such alterations it shall cease to be a private company. It shall comply with the procedure of converting itself into a public company Sec 44.

Within three months of such a conversion, Registrar of Companies shall be intimated. The Registrar shall delete the words 'Private' before the words 'Limited' in the name of the company and shall also make necessary alterations in the certificate of incorporation.

## 19.6 MINIMUM PAID UP CAPITAL

Companies (Amendment) Act, 2000 provides that every private company shall have a minimum paid up capital of lac rupees. Every private company with a paid up capital of less than one lack rupees, shall within a period of two years from 13/12/2000 enhance its paid-up capital to one lack rupees.

Similarly a public limited company shall have a minimum capital of five lack rupees or within two years from 13/12/2000 enhance its paid up capital to five lack rupees. If a private company or a public company fails to enhance its paid up capital to five lack rupees. If a private company or a public company fails to enhance its paid up capital as aforesaid, such company shall be deemed to

be a defunct company and its name shall be struck off from the register by the Registrar [Sec. 3(3)].

## 19.7 PRIVATE AND PUBLIC COMPANY DISTINCTIONS

In the case of a private company, the minimum number of persons to form a company is two while it is seven in case of private company. In case of the private company, the maximum number must not exceed fifty whereas there is no such restriction on the maximum number of members in case of the public company.

In the private company the right to transfer of shares is restricted whereas in case of the public company shares are freely transferable.

The private company cannot issue a prospectus while the public company may through prospectus invite the general public to subscribe for its shares or debentures.

The private company must have at least two directors whereas the public company must have at least three directors.

The private company can commence a business immediately after receiving the certificate of incorporation while the public company can commence business, only when it receives a certificate to commence business from the Registrar of Companies'.

The private company need not hold a statutory meeting but the public company must hold a statutory meeting and file a statutory report with the Registrar.

The directors of the private company are not required to file with the Registrar written consent to act as a director or sign the memorandum of association or enter into a contract for his qualification shares. But the directors of a public company must file with the Registrar their written consent to act as directors must sign the memorandum and must enter into a contract for their qualification shares.

Two members personally present from the quorum in the private company but in the public company this number is five.

In the private company, there is no restriction on managerial remuneration but in case of the public co. the total managerial remuneration cannot exceeds 11 % of the net profits.

The private company can be registered with a paid-up capital of Rs. 1 lakhs but the public company must have a minimum paid-up of Rs. 5 lakhs

The private company cannot accept deposits from the public. There is no such restriction for a public company.

In addition to the above, a private company enjoys some special privileges. The public company enjoys no such privileges.

## 19.8 SPECIAL PRIVILEGES OF A PRIVATE COMPANY OVER PUBLIC COMPANY

Both private and public companies are regulated by the provisions of the Companies Act, 1956. However, certain provisions of the Act do not apply to a private company. These are the privileges which a private company enjoys over the public company under the Act. They are summarised as below:

1. The minimum number of members in a private company can be two only as again seven in public company.
2. Provision regarding minimum subscription before allotment of shares do not apply to a private company
3. A private company need not file prospectus or a statement in lieu of prospectus with the registrar.
4. Further shares can be issued without passing special resolution or obtaining Central Government's approval and need not be offered to the existing members
5. Private company may issue share capital of such kinds, in such forms and with such voting rights as it may think fit. However its paid up capital shall not be less than Re.1lakh.
6. Private company can commence business immediately on in corporation.
7. Private company need not keep an index of members.
8. Private company need not hold statutory meeting or file statutory report.
9. Provisions as to overall maximum managerial remuneration and remuneration to direct tors do not apply to a private company.
10. Minimum number of director is only two in private company.
11. Provisions as to proportion of directors liable to retire by rotation do not apply to a private company.

12. Director's consent to act as such is not required.
13. Restrictions on appointment of directors as regards their consent and holding qualification shares do not apply to private company.
14. Government approval to appointment or amendment of provisions relating to managing or whole timeor non-rotational directors is not required.
15. Director's contract to take up qualification shares need not be filed with the registrar of the companies.
16. Provisions regarding loans to directors do not apply.
17. Provisions regarding interested directors not to participate or vote in Board's proceedings do not apply.
18. Provisions requiring government approval for increasing remuneration of a director or a managing director do not apply.
19. Provision regarding appointment of a managing director for more than five years at a time does not apply.
20. Restrictions on loans to another company do not apply.
21. Provisions relating to transfer of shares not to be registered except on production of instrument of transfer, transfer by legal representative, application for transfer and power to refuse registration and appeal against refusal do not apply without prejudice to a power of a private company to enforce its restrictions against the right to transfer the shares of such a company.

- **WHEN A PRIVATE COMPANY LOSES ITS PRIVILEGES?**

When it fails to comply with essential requirements of a private company [sec. 3(1) (iii)]. Default in complying with the set provisions shall disentitle a private company from the privileges and exemptions it is entitled to the company's act shall apply to such a company as if it were not a private company (sec.43)

## 19.9 COMPANIES ACT 2013 V/S COMPANIES ACT 1956

The long-awaited Companies Bill 2013 got its assent in the LokSabha on 18 December 2012 and in the RajyaSabha on 8 August 2013. After having obtained the assent of the President of India on 29 August 2013, it has now become the much awaited Companies Act, 2013 (2013 Act). An attempt has been made to reduce the content of the substantive portion of the related law in

the Companies Act, 2013 as compared to the Companies Act.1956 (1956 Act).

The Act of 2013 is more of a rule-based legislation containing only 470 sections, which means that the substantial part of the legislation will be in the form of rules. It is expected that the Act of 2013 will become applicable and the corresponding portion of 1956 Act will be repealed in a phased manner.

The Act of 2013 intends to promote self-regulation and has also introduced some progressive concepts like One-Person Company, Small Company, Dormant Company, E-governance, etc. The concept of Corporate Social Responsibility has also been introduced to encourage a socially, environmentally and ethically responsible behavior by companies.

The Act of 2013 is aimed at building a smooth and *easy* corporate environment along with the new and improved measures of strong investor protection norms and presents a model for other economies with similar characteristics to emulate. Following are the points of comparison.

| **Points of Comparison** | **Companies Act, 2013** | **Companies Act 1956** |
|---|---|---|
| FORMATION OF COMPANY<br><br>Minimum ,No, of persons required to form a company | One Person can form a One Person Company.<br><br>Minimum2 for a private company other than OPC<br><br>Minimum 7 for a public co. | One Person can't form a company.<br><br>Minimum 2 for a private company.<br><br>Minimum 7 for a public co. |
| Maximum number members allowed in private company | 200 (for a private company other than One Person Company) | 50 |

**REGISTERED OFFICE**

| | | |
|---|---|---|
| **From which date, company must have a registered office?** | On and **from the** I5th day ofits incorporation. | From the earlier **of the following two dates:**<br>• The day on which it begins to carry |

| | | |
|---|---|---|
| | | on business.<br>•The thirtieth day after the date of its incorporation. |
| Notice of change of registered office address to ROC-Time Limit | To be given to ROC within 15 days of such change. | To be given to ROC within 30days of such change **inoperative.** |

## MEMORANDUM OF ASSOCIATION (MOA)

| | | |
|---|---|---|
| **Objects clause of Memorandum** | Objects of the Company to be classified and stated in MOA as :<br>(i) the objects for which the company is proposed to be in corporated and<br>(ii) any matter considered necessary infurtherance thereof. | Objects of the Company should be classified and stated in MOA as :<br>(i) the main objects of the company;<br>(ii) Objects incidental or ancillary to the attainment of the main objects and<br>(iii) other objects of the company. |
| **Availability of name** | Section 4(4) and 4(5)(i) of the 2011 Act incorporate the procedural aspects of application for availability of name of proposed company or proposed new name for existing company. | **Pr**ocedural aspects of application for availability of name find no place in the 1956 Act. |

## ALTERATION OF OBJECTS CLAUSE

| | | |
|---|---|---|
| **Purposes for which objects *clause* may be altered** | No requirement in the 2013 Act that alteration of objects clause should he for specified purposes. Provisions of section 17(1) of the 1956 Act have been omitted by the 2013 Act. | Alteration of object clause should be for one of the specified purposes [Se section 17(1) of the 1956 Act], |

## 19.10 QUESTIONS

1. What are the types of Company?
2. What is the procedure for converting public company into private company?
3. What is the procedure for converting private company into public company?
4. What are the special privileges of private company over public company?
5. When a private company loses its privileges?
6. Explain the difference between the Companies Act, 2013 and the Companies Act.1956.
7. Define the following terms:
   a. Chartered Company
   b. Private Company
   c. Public Company
   d. One man Company
   e. Holding Company
   f. Subsidiary Company

*****

# 20

# THE COMPANIES ACT, 1956 (Memorandum of Association And Articles of Association)

**Unit Structure**



## 20.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning and contents of Memorandum of Association.
- Understand the meaning and contents of Articles of Association.
- Explain the distinction between Memorandum of Association. and Articles of Association.
- Understand the effects of Memorandum of Association and Articles of Association.

# 20.1 MEANING AND CONTENTS OF MEMORANDUM OF ASSOCIATION

## 20.1.1 Meaning

The memorandum of association is the most basic document of a company. It sets out the constitution of the Company and limits the scope of the activities of the company. It enables the members, creditors and all those whose who come in contact with the company, to know the purpose for which the company has been established and the permitted scope of its activities.

"Memorandum means memorandum of association of a company originally formed or as altered from time to time in pursuance of any previous company's law or of this Act.

## 20.1.2 CONTENTS

According to section 13 of the Act the memorandum of every company shall state:

1. Name of the company with "Limited" as the last word of the name in case of a public company and "Private Limited" in case of a private company.
2. Registered office of the Company
3. Objects of the Company
4. Liability of the members
5. Details of Share Capital of the Company
6. Subscription or Association Clause.

### 1. Name Clause (Sec. 20):

The name gives a personal existence; therefore every company must have its own name. Company is a legal person possessing a separate identity; it must have a name with which it can be identified. Promoters of the Company have to make an application to the Registrar of Companies for the availability. The company can adopt any name if:

i. There is no other company registered under the same or under an identical name;

ii. The name should not be considered undesirable and prohibited by the Central Government. A name which misrepresents the public is prohibited by the Government under the Emblems & Name (Prevention of Improper Use) Act,1950, for example, Indian National Flag, name and pictorial representation of

Mahatma Gandhi and the Prime minister of India, name and emblems of the U.N.O., and W.H.O., the official seal and Emblems of the Central Government and State Governments.

- **A name which is identical with or too nearly resembles:-**

i. The name by which a company in existence has been previously registered, or

ii. A registered trade mark, or a trade which is subject of an application for registration, of any other person under the Trade Marks Act, 1999 may be deemed to be undesirable by the Central Government. The Central Government, before deeming a name as undesirable, may consult the Registrar of Trade Marks.

Where the name of the company closely resembles the name of the company already registered, the court may direct the change of the name of the company.

iii. Once the name has been approved and the company has been registered, then:

a. The name of the company with registered office shall be affixed on outside of the business premises ;

b. If the liability of the members is limited the words “Limited” or ” Private Limited” as the case may be, shall be added to the name [Sec. 13(1)(a)]

c. The name and address of the registered office shall be mentioned in all letter-heads, business letters, notices and Common Seal of the Company, etc. [Sec. 147]

In Osborn v/s the Bank of U.A.E. (9 Wheat (22 US) 738) it was held that the name of a company is the symbol of its personal existence. The name should be properly and correctly mentioned. The Central Government may by license under section 25 of the Act allow a company to drop the word ‘Limited’

However, the Central Government has the power to grant a license to a company to drop the word “limited” from its name. The license is granted if:

i. The company is formed for the promotion of commerce, art, religion, science, charity or any other useful object, and

ii. The company intends to apply its income, if any, in promoting its objects and prohibits the payment of dividends to its members (Sec. 25)

- **Alteration of Name Clause (Sec. 21-23):**

A company may change its name by:-

i. Passing a special resolution to that effect; and by

ii. Obtaining the approval, in writing, of the Central government (the Company Law Board)

However no approval is required in case of addition or deletion of the word “Private” as a result of the conversion of the public company into a private company or vice versa (Sec. 21) But where a company has been registered with a name which subsequently appears to be undesirable, the name may be altered by an ordinary resolution and with the approval of the Central Government (Sec. 22).

On the alteration of the name of the company, the Registrar must enter the new name of the company in the register and issue a fresh certificate of incorporation. Change of name becomes effective only on the issue of the new certificate

Alteration of name does not, in any way, affect the rights and obligation of the company.

The department of Company Affairs, has held that if the following key words in the name, it must have minimum authorised capital as stated below

| | **Key words** | **Required authorised capital (Rupees)** |
|---|---|---|
| i. | Corporation | 5 crores |
| ii. | International, Globe, Universal, Continental, Inter-Continental. Asia, Asiatic (Being the first name) | 1 crore |
| iii. | If any of the words mentioned in (ii) is used within the name (with or without brackets) | 50 Lakhs |
| iv. | Hindustan, India, Bharat being the first word of the name | 50 Lakhs |
| v. | If any of the words mentioned in (iv) is used within the name (with or without brackets) | 5 Lakhs |
| vi. | Industries/Udyog | 1 Crore |
| vii. | Enterprises, Products, Business, Manufacturing | 10 Lakhs |

**2. Registered Office Clause :Sec 146**:

The memorandum of Association must contain the name of state in which the registered office of the company is to be situated. Every company must have registered office. The company shall from the date on which it commences its business or within thirty days of incorporation, whichever is earlier, have a registered office. Intimation should be given to Registrar within thirty days of incorporation. All communication and notices are to be sent to its registered office. All the important documents and books of the company such as the Registrar of Members, Minutes and book are kept at the registered office.

Where the securities are held in a depository, the records of the beneficial ownerships may be served by such depository on the company by means of electronic mode or by delivery of floppies or disk.

In Daimler Co. Ltd. v. Continental Tyre & Rubber Co. Ltd. (1916) 2 AC. 307, it has been held that the situation of the registered office of a company determines its domicile. On the situation of the registered office of a company depends the Court which will have jurisdiction over it.

- **Alteration of Registered office:**

**a)** Registered office if shifts from one place to another within the same city, town, or village it can be made by passing a resolution by Board of directors.

b) Where registered office shifts from one place to another within the same state and is within the same office of Registrar of Companies it could be done by passing a special resolution at the shareholders meeting. Even if the change is within the state it may fall within the jurisdiction of another Registrar of Companies, in which the change shall not be effective unless approved by Regional Director. Intimation of the change is to be filed with the Registrar within 30 days of the change.

c) But, shifting of registered office from one state to another state involves alteration of memorandum itself.

The alteration of the memorandum for this purpose is subject to the provision of Sec.17 which requires:

a) A special resolution to that effect, and

b) Confirmation by the Company Law board.

The alteration comes into force only when it is registered with the Registrar of Companies of both the States i.e. the State in which the registered office was originally situated and the state to which the office is being situated.

A change in the registered office of the company is permitted from one state to another on the following grounds: Substantive Limits:

i) To enable the company to carry on business more economically or more efficiently

ii) To attain its main purpose by new or improved means (E.g. by new scientific discoveries); or

iii) To enlarge or change the local area of its operations; or

iv) To carry on some business which under the existing circumstances may conveniently or advantageously be combined with the business of the company; or

v) To restrict or abandon any of the objects specified in the memorandum; or

vi) To sell or dispose of the whole, or any part of the undertaking, or of any of the undertakings of the company; or

vii) To amalgamate with any other company or body of persons.

- **Procedural limits:**

i) A special resolution of shareholders, authorising the alteration of the object clause must be passed.

ii) Thereafter, a petition must be made to the Central Government for confirmation of the alteration.

iii) The Central Government must be satisfied that sufficient notice has been given to every debenture holder, every creditor, every shareholder, and every person whose interest will be affected by the alteration, and also to the Registrar and State Government to enable them to state their objection, if any.

iv) If any debenture holder, or shareholder, or creditor has a genuine objection, the central Government may order the company to satisfy the creditor and buy the dissenting shareholder's interest

v) If the alteration is confirmed by the Central Government, a certified copy of the Board's order, together with a printed copy of the Memorandum as altered, must be filed with the Registrar within three months of the date of the order, otherwise the alteration and the entire proceedings of alteration will lapse and become void.

The certificate of the Registrar of Companies is the conclusive evidence of the alteration and its validity (Sec. 18)

**3. Object Clause Sec. 13:**

The third clause in the memorandum states the object which the company, on its incorporation will pursue. This clause defines the object of the company and indicates what a company can do. Companies (Amendment) Act, 1965, requires the object clause to be divided into:

i) Main objects of the company to be pursued by company on its incorporation
ii) Objects incidental or ancillary to the attainment of the main objects; and
iii) Other objects

Company without the approval of Central Government or/and shareholder cannot go beyond the object clause. Objects can never be illegal, immoral, opposed to public policy or the Act.

- **Alteration of Object Clause**:

The procedure for alteration of the Object clause is the same as the alteration of registered office from one state to another.

**4. Liability clause:**

The liability of the members is limited to the extent of the shares subscribed by the members if the company is formed with share capital or to the extent of the guarantee given by the members if the company is formed with guarantee. In the absence of this clause it is deemed that liability of its members is unlimited.

- **Alteration of liability clause:**

The liability of the members cannot be altered so as to increasethe liability of the members,or prejudice their interests. The alteration can be effected onlywiththe consent of themembers in writing, either before or after a particular alteration is made.

**5. Capital Clause:**

In case of a company having share capital unless the company is an unlimited company, memorandum shall also state the amount of share capital with which the company is to be registered and division thereof into shares of a fixed amount.

- **Alteration of Capital Clause:**

The capital can be increased by passing a ordinary resolution in the general body meeting and shall not require to be confirmed by the court. It should be noted that cancellation of shares shall not be deemed to be a reduction of share capital. A notice of alteration of capital must be filed with the registrar within 30 days of such alterations.

**6. Subscription or Association Clause:**

It is a declaration made by the subscribers who have signed the memorandum of their intention to form a company. The signature of the subscribers shall be attested by at least one witness.

## 20.2 DOCTRINE OF ULTRA VIRES

Anything that a company does which is beyond the scope of the object clause is called ultra vires the object clause and is null and void. Since the Act is void it cannot be ratified by the shareholders either. When the company does an act in furtherance of its objects, it is intra vires (intra vires means within; and vires means power) the company. But, where the company does an act which is outside the scope of the object clause, it is ultra vires (outside the powers of) the company. This rule was first time laid down by the House of Lords in Ashbury Railway,Wagon Co. v/s Riche (1875), The objects of the Ashbury Company were:-

a. To manufacture and sell railway carriages etc. and
b. To act as mechanical engineers and general contractors.

The directors of the company entered into a contract with Riche to finance the construction of railway line in Belgium. Subsequently, they repudiate the contract, claiming it to be ultra vires the company. Riche brought an action for damages for breach of contract. The House of Lords held that the contract was ultra vires the company and hence null and void.

## 20.3 EFFECTS OF ULTRA VIRES TRANSACTION

**1. Ultra Vires Contracts:**

A contract that is ultra vires the company isabsolutely null and void. Such a contract cannot become intra vires by reason of estoppels, ratification, acquiescence, delay or lapse of time. The company is not liable on such contract however:

a. If the company has lent money and this lending is ultra vires the company, it can recover the money from the debtors. The debtors would be stopped from contending that the company had no power to lend.
b. If the company has rendered any particular service which is ultra vires, it is entitled to receive the charges for the service rendered.
c. If the property of the company has been delivered to an outsider through an ultra vires act, the company has a right to retrieve its property provided it existin specie or if it can be traced.

**2. Ultra Vires Property:**

If a company's money has been utilized in acquiring some property and such an act is ultra vires the company, the company is entitled to the ownership of that property. This is because; the property through wrongly acquired represents the capital of the company.

**3. Personal Liability of Directors:**

If the director of a companymakes an ultra vires payment, he becomes personally liable, for that amount, to the company. He can be compelled to refund the money.

**4. Breach of Warranty of Authority:**

If the directors induce, however innocently, an outsider to contract with the company in a matter that is ultra vires the company the directors shall be personally liable to the outsider for any loss caused to him, provided he has no knowledge of the fact that the act was ultra vires the company.

**5. A company is liable for any tort, if the following conditions are fulfilled:-**

i) The activity, in the course of which the tort has been committed, falls within the scope of the memorandum of association; and
ii) The servant of the company must have committed the tort within the course of his employment

(A tort is a civil wrong, not arising out of a contract, and the remedy for which is damages)

## 20.4 ARTICLES OF ASSOCIATION

### 20.4.1 Meaning:

Articles of association isa document containing rules and regulation for the administration of the company. The following companies are required to file with the Registrar, their articles along with the memorandum:

a. Unlimited companies

b. Companies limited by guarantee; and

c. Private companies limited by shares (Sec. 26).

In case of public company limited by shares, articles of association may be submitted along with the Memorandum of Association. But in other case namely unlimited company, company limited by guarantee and private company limited by shares, articles of association must be submitted along with the memorandum of association.

Schedule I of the Act sets out several tables containing model forms of articles applicable to different companies. The model set out in Table A applies to a public company limited by shares. Thus, if a company limited by shares does not frame its own articles, the form set out in Table A will automatically apply to it.

### 20.4.2 Contents of Articles of Association:

Articles of a public company limited by shares usually provide for the following rules:

i. Share Capital and alteration thereof
ii. Meetings of company
iii. Rights of shareholders
iv. Accounts & audit
v. Dividends
vi. Indemnity
vii. Winding up
viii. Appointment, remuneration, qualification , powers, etc. of Board of Directors
ix. Share Certificates and warrants
x. Payment, calls, transfer, lien, transmission, forfeiture, etc. of shares
xi. Votes to members
xii. Capitalization of profits

xiii. Seal

xiv. Adoption to preliminary contracts

### 20.4.3 Form of Articles:

If the articles are proposed to be registered they must be:

i. Printed;

ii. Divided into paragraph, each consisting of one regulation;

iii. Each paragraph should be numbered consecutively;

iv. Signed by each subscriber of the memorandum in the presence of at least one attesting witness. The subscribers as well as the witness must also add their addresses and occupations.

### 20.4.4 Alteration of Articles (Sec. 31):

A company can, at any time, alter its articles subject to the following conditions or restrictions:

i. Alterations of Articles can be made only by a Special Resolution of the shareholders of the Company to that effect. Even if, the articles prescribe an ordinary resolution for its alteration or even if the members agree, it must not be followed. (Navanitlal v. Soindia Steam Navigation Co. Ltd.)

ii. No alteration of Articles will be allowed, which will violate the provisions of the Companies Act, or any other provisions of general law which may be applicable

iii. No alteration of Articles will be allowed, which will violate the conditions, contained in the Memorandum of Association of the Company (Hutton v. Scarborough Cliff Hotel Co. Ltd.)

iv. Alteration must not contain anything illegal

v. An alteration cannot require a member, or any class of members, to purchase more shares or increase his/their liability without his/their consent in writing

vi. Alteration of certain provision of Articles, such as provisions relating to the number of directors and their remuneration, etc. requires the previous consent of the Central Government.

vii. An alteration must not constitute a fraud on the minority. In other words, an alteration must not affect the interests of the minority shareholders.

viii. An alteration of Articles which has the effect of converting a public company into a private company shall have effect only if the alteration is approved by the Central Government.

ix. Alteration must be made bonafide in the interest of the company as a whole, even though the private interests of some members may be affected.

x. Lastly, Articles of Associations may be altered with retrospective effect.

## 20.5 DISTINCTION BETWEEN MEMORANDUM AND ARTICLES OF ASSOCIATION

i. The Memorandum is the character of the company which defines its objects and powers. The Articles are bye laws of the company for the internal management of the affairs for achieving the objects set out in the Memorandum

ii. The Memorandum is the supreme document of the company while the Articles are subordinate to the memorandum. In case of inconsistency between the memorandumand articles, the provision ofthe memorandum will override the provisions of the articles.

iii. The Memorandum of Association should not contain any provision contrary to the Companies Act. The Articles must not include any provisions contrary to Companies Act as well as the Memorandum of Association.

iv. Every company must have its own Memorandum. But a public company limited by shares may or may not have its own Articles. It may adopt Table A of Schedule I of the Act.

v. The Memorandum defines the relationship between the company and the outsiders while the Articles defines the relationship between the company and its members and among the members themselves.

vi. A new company must prepare its Memorandum and file it with the registrar before the registration of the company is affected. But the Articles are not required to be filed for the purpose of registration. The company can adopt Table ‘A’ if it does not prepare its own Articles.

vii. Any act of the company which is *ultra vires* the Memorandum is wholly void and cannot be ratified, even by the whole body of shareholders. But any act which is ultra vires the Article but intra vires the Memorandum can be ratified by the shareholders by passing a special resolution.

viii. The Memorandum cannot be altered easily. The procedure laid down in the Act must be followed for altering the various clauses of the Memorandum. In some cases the approval of the Central

Government is required. But the alteration of Articles is not difficult. The Articles can be altered by passing a special resolution and the approval of the Central Government is not necessary.

## 20.6 EFFECT OF MEMORANDUM AND ARTICLES

Sec 36 contains provision regarding the binding force of the Memorandum and the Articles, onthe company and its members. They are:

**i) Binding on members in their relation to the company:**

The members of a company are bound to the company by the provisions of the memorandum and the articles, as if they had entered into a contract with the company. (Borlands Trustee v. Steel Brothers & Co. Ltd.)

**ii) Binding on company in its relation to its members:**

Just as the members of the company are bound to the company by the provision of the memorandum and the articles, the company too is bound to its member for giving effect to the articles.(Wood v. Odessa Waterworks co.

**iii) Not binding in relation to outsiders:**

Memorandum and articles bind the members to the company and vice versa. But, neither the company nor the members are bound to an outsider to give effect to the articles. No article can constitute a contract between the company and a third party. (Browne v. La Trinidad)

**iv) To what extent binding between the members:**

The Articles determine the rights and liabilities of member. But, whether there rights and liabilities can be enforced by one member against another has been one of the most baffling questions in company law. (Lord Herschell, in Welton v. Saffery )

## 20.7 DOCTRINE OF CONSTRUCTIVE NOTICES

Memorandum and articles of association of a company are public documents. These documents are pre-requisite for registration of a company. These documents are available for public inspection either in the office of the company or in the office of the Registrar of Companies on the payment of fee.

Any person who is dealing with a company is presumed to have read and understood the proper meaning of the documents. Ever person, dealing with the company must inspect these documents to ensure whether they are in conformity with the respective provisions. A party cannot take a plea that he was ignorant of what has been stated in memorandum or articles of association.

It comes to the aid of a company vis-à-vis the outsiders. If a person deals with the company, and the transaction is beyond the powers of the company, he cannot enforce it against the company and he shall be personally liable to bear the consequences of such dealings. If a person deals with the company in good faith and the person with whom he is dealing has 'Ostensible authority' to deal on behalf of the company, the company will be held liable.Eg.*DehdradunMussoorie Electric Tramway Co. v/s Jagmandardas.*

The above doctrine is subject to one exception that is, so far as the internal proceedings of the company are concerned the outsiders dealing with the company, can assume that everything has been regularly done. This is known as the "Doctrine of indoor management".

**Doctrine of Indoor Management or Turqu and Rule:**

The principle of constructive notice operates against the person dealing with the company by protecting the latter against the former. Whereas the doctrine of indoor management protects the outsider against the company.

It is the duty of every person to read the memorandum and Articles of the company, but he is not bound to inquire into the internal affairs of the company whether they are being conducted in accordance with the Articles of the Company. He has a right to assume that internal proceedings and affairs of the company are being regularly carried on in accordance with the rules and regulations. The limitation to doctrine of constructive notice is called 'indoor management'

The directors of a company (Royal British Bank), borrowed a sum of money from Turqu and issued a bond to him. The articles of the company provided that the directors might borrow on bonds such sums, as may, from time to time, be expressly authorised by resolutions of shareholders. The shareholders claimed that there had been no such resolution authorising the loan.

The company was held bound by the loan because Turquand, the plaintiff, had the right to assume that the necessary resolution must have been passed.

**Exception to the Rule of Indoor management:**

**The doctrine of indoor management is subject to five exceptions:**

**a) Knowledge of internal irregularities of the company:**

Where the third person dealing with the company has actual or constructive notice regarding the non-compliance and irregularity of the internal procedure prescribed by the articles of association, they cannot claim protection under this rule.

**b) Suspicion of irregularity:**

The doctrine also does not apply when the circumstances are so suspicious that an inquiry is invited by the person dealing with the company.

**c) Acts void ab initio:**

This doctrine does not apply to acts that are void ab initio. Eg.Where the documents is a forged one.(*Ruben v. Great Fingall Consolidated)*

**d) Acts, outside the apparent authority of the company:**

Where the acts of an officer do not fall within the apparent authority of such an officer, the contract is not binding on the company.

**e) No knowledge of articles:**

A person who at the time of entering into a contract with a company, has no knowledge of the company's articles of association, cannot be saved or protected by the doctrine.

## 20.8 QUESTIONS

1. What are articles of association? Compare the relation of the articles to memorandum of association.
2. Answer the following

a. To what extent and how are the articles of association amended.

b. What is the binding force of memorandum and articles of association?

3. Discuss fully the Doctrine of Indoor Management.

4. Critically examine the principle of the Constructive notice.

5. Define the following terms:

a. Memorandum of association

b. Articles of Association

c. Ultra vires

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# 21

# THE COMPANIES ACT, 1956. (Prospectus)

**Unit Structure**



## 21.0 OBJECTIVES

After studying the unit students will be able to:

- Define the various terms like prospectus, statement in lieu of prospectus and Shelf prospectus.
- Explain the contents of Prospectus.
- Discuss about the legal requirements of prospectus.
- Explain the liabilities against misstatement and how to defence against this liability.

## 21.1 INTRODUCTION AND DEFINITION OF PROSPECTUS SEC. 2(36)

"Prospectus means any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate"

Definition of prospectus includes any invitation to the public to subscribe to shares or debentures. A document by which an invitation is issued to the public to take shares or debentures of the company is called a prospectus. Prospectus is thus a document

described or issued as a prospectus. Even inviting offers from the public for subscription to shares or debentures is a prospectus.

An 'abridged prospectus' means a memorandum containing such salient features of a prospectus as may be prescribed [Sec 2(1)].Any written invitation inviting a person to submit request for purchasing or subscribing purchase of shares for cash will be prospectus. It is obligatory to issue a prospectus with prescribed particulars, except:

i. When the shares or debentures are not offered to the public [Sec 56(3)(b)]; or

ii. When shares are offered to the existing shareholders debenture holders as rights issue; [Sec 56(5)(a)]

iii. When the issue relates to shares or debentures which are in all respect uniform with shares or debentures previously issued and quoted in a stock exchange [Sec 56(5)(b)]

iv. Where a person is bonafide invited to enter into an underwriting agreement[Sec 56(3)(a)]

## 21.2 CONTENTS OF THE PROSPECTUS

Sec. 56 lays down that the matters and reports stated in Schedule II to the Act must be included in a prospectus. The format of prospectus is divided into three parts.

**PART I:**

1. **General information :** Under this head information is given about:

I Name and address of registered office of the company.

ii Names of stock exchanges where application for listing is made

iii Declaration about refund of the issue if minimum subscription of 90% is not received within 90 days from closure of the issue.

iv Declaration about the issue of allotment letters/refunds within a period of 10 weeks and interest in case of any delay in refund, at the prescribed rate, under sec 73.

v Date of opening of the issue.

vi Date of closing of the issue.

vii Name and address of auditors and lead managers.

viii Whether rating from CRISIL or any rating agency has been obtained for the proposed debentures or preferences issue. If no rating has been obtained, this should be answered as 'NO'

ix Name and address of the underwriters.

**2. Capital Structure of the Company:** It includes on the following matters:

i. Authorised, issued, subscribed and paid-up capital

ii. Size of the present issue giving separately reservation for preferential allotment to the promoters and others.

**3. Terms of Present issue:** It includes information on the following matters:

i. Terms of payment

ii. How to apply

iii. Any special tax benefits.

**4. Particulars of the issue: It includes information on the following matters:**

i. Objects

ii. Project Cost

iii. Means of financing (Including Contribution of promoters)

**5. Company Management and Project:** It includes information on the following matters:

i. History and main objects and present business of the company.

ii. Promoters and their background.

iii. Location of the project.

iv. Collaborations, if any.

v. Nature of the product(s) export possibilities.

vi. Future prospectus

vii. Stock market data

Certain prescribed particulars with regard to the company and the other listed companies under the same management which made any capital issue during the last three years.

Relating to the financial matters or criminal proceedings against the company or the directors, any outstanding litigations under Schedule XIII.

Management perception of the risk factors

**PART II:**

Requires the company to give detailed information. This part is further sub-divided into three parts viz., General information, Financial Information and Statutory and other information.

**1. General information shall include information on matters like:**

i. Consent of directors, auditors, solicitors, managers to the issue, Registrars to the issue, Bankers to the issue and experts.

ii. Changes, if any, in directors and auditors during the last 3 years and reasons therefore.

iii. Procedure and time schedule for allotment and issue of certificates.

iv. Name and address of Company Secretary, Legal advisor, Lead Managers, Co-managers, Auditors, Bankers to the issue.

v. Authority for the issue and details of resolution passed therefore.

**2. Financial information includes:**

i. Reports of the auditors of the company with respect to its profits and losses and assets and liabilities, and the dividends paid during five financial years immediately preceding the issue of prospectus.

ii. Report by accountants (Who should be named) on the profits or losses for the preceding 5 financial years and on the assets and liabilities on a date which must not me more than 120 days before the date of issue of the prospectus.

**3. Statutory and other information includes information about :**

i. Minimum Subscription

ii. Expenses of the issue

iii. Underwriting commission & brokerage

iv. Previous public & rights issue, if any, giving particulars about date of allotment, refunds, premium/discount, etc.

v. Issue of shares otherwise than for cash.

vi. Commission or brokerage on previous issue.

vii. Particulars about purchase of property

viii. Revaluation of assets

ix. Material contracts and time and place where such documents may be inspected.

x. Debentures & redeemable preference shares or others instruments issued but remaining outstanding on the date of the prospectus and terms of their issue.

**PART III:**

Gives explanations of certain terms and expressions used under Part I & Part II of the schedule.

## 21.3 LEGAL RQUIREMENTS OF PROSPECTUS

### 21.3.1 Legal Requirements

Following are the legal requirements of prospectus:

1. A prospectus is required to be issued only after the incorporation of the company.
2. The prospectus must contain all the particulars, listed in Schedule II to the Companies' Act.
3. The prospectus must be dated.
4. A prospectus must be signed by every person, mentioned therein as a director or a proposed director, or his agent.
5. Every application form for shares, issued by the company, must be accompanied by a copy of the prospectus except (a) application form, issued for bona fide invitation to a person to enter into an underwriting agreement, and (b) application forms, issued to existing members and debenture holders.
6. A statement, relating to the affairs of the company by an expert, may be included in the prospectus.
7. Consent of the expert must be obtained in writing and this fact must be stated in the prospectus.
8. No deposit can be invited without issuing an advertisement in a daily newspaper. The said advertisement must be contain a statement, reflecting the company's financial position issued by the Company and in such a form or in such a manner, as may be prescribed.
9. Before a prospectus is issued, a copy of it must be registered with the registrar of companies.
10. Prospectus shall be issued within 90 days of its registration.

### 21.3.2 Misstatement in the prospectus/misleading:

Every person authorising the issue of prospectus has a primary responsibility to see that the prospectus contains the two state of affairs of the company and does not give any fraudulent picture of the public. People invest in the company on the basis of information published in the prospectus. They have to be safe guarded against all wrong or false statement in prospectus. Prospectus must therefore make full and honest declaration of material facts without concealing or omitting any relevant fact. This is known as the golden rule for framing prospectus as laid down in *New Brunswick etc. Co. V. Muggeridge[(1860) 3 LT. 651: (1860)1 Dr.& Sm363].*The true nature of companies venture should be disclosed. The statement which do not qualify to the particulars mentioned in the prospectus, or any information is intentionally and

wilfully concealed by the director of the company, would be constructed as misstatement. They are in other words, either false or untrue statement in the prospectus or information which ought to have been disclosed is concealed, or omission of any material fact. Statements which produce wrong impression of actual facts would also be constructed as misstatements.

**Misstatements includes:**

i. Untrue statements
ii. Statements which produce wrong impression
iii. Statement which are misleading
iv. Concealment of material fact
v. Omission of facts

The prospectus must make all statements with absolute accuracy and not state the facts which are not strictly correct. A statement may be false not only because of what it states but also because of what it conceals or omits.

A statement included in prospectus shall be deemed to be untrue if:

i. Statement is misleading in the form and context in which it is included
ii. The omission from prospectus of any matter is calculated to mislead

The prospectus which contains misstatements or misleading statements is called “Misleading Prospectus”

**Example:**

1. A statement in the prospectus that share capital has been subscribed when it has only been allotted in fully paid shares to the company’s contractor. It was held that it is a misstatement in prospectus.

### 21.3.3 Liability:

The liability may be civil or criminal.

### I. CIVIL LIABILITY

### 1. Compensation:

The above person shall be liable to pay compensation to every person who subscribes for any shares or debentures for any loss or damage sustained by him by reason of any untrue statement included therein.

**2. Damages for deceit or fraud**:

Any person induced to invest in the company by fraudulent statement in a prospectus can sue the company and person responsible for damages. The shares should be first surrendered to the company before the company is sued for damages. Fraud occurs when any statement is made without belief in the truth or carelessly. A statement made with knowledge that is false, will constitute fraud or deceit.

**3. Rescission of the Contract for misrepresentation**:

It means avoiding the contract.Any person can apply to the court for rescission of the contract if the statement on which he has taken the shares are false or caused by misrepresentation whether innocent or fraudulent. It must be of material fact and not of law. It should be noted that a person cannot claim rescission of contract on misrepresentation, if he had the means of discovering the truth with ordinary diligence.

**4. Liability for noncompliance with sec 56.** :

A director or other person responsible for not setting out matters and reports required to be set out in the prospectus as provided under sec. 56 of the Act, shall be punishable with fine which may extended to Rs. 50,000/-.

**5. Liability under general law**:

Any person responsible for the issue of prospectus may be held liable under the general law or under the Act for misstatements or fraud.

**6. Penalty for contracting Sec 57 or 58**:

If any prospectus is issued in contravention of Sec 57 or Sec 58, the company and every person who is knowingly a party to the issue thereof, shall be punishable with fine which may extend to Rs. 50,000/- [Sec. 59(1)].

**7. Penalty for issuing the prospectus without delivering for registration**:

If a prospectus is issued without a copy thereof being delivered to the Registrar, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extend to Rs. 50,000/- [Sec.60(5)]

## II. CRIMINAL LIABILIY

Every person who authorize the issue of prospectus shall be punishable for untrue statements with imprisonment for a term which may extend to 2 years or with fine which may extend to Rs. 50,000 or with both.

**Fraudulently inducing persons to invest money:**

Any person who either knowingly or recklessly makes any statement, promises or forecasts which is false, deceptive or misleading or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into:

i. Any agreement with a view to acquiring, disposing of, subscribing for, or underwriting shares or debentures; or
ii. Any agreement, the purpose of which is to secure a profit to any of the parties from the yield of shares or debentures, or by reference to fluctuation in the value of shares or debentures;

Shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to One lac rupees or with both.

### 21.3.4 Defences against Civil Liabilities:

Every person made liable to pay compensation for any loss or damages may escape such liability by proving that:

**1. Withdrawal of consent before issue**:

Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus and that it was issued without his authority or consent;

**2. Issued without knowledge**:

The prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

**3. Withdrawal of consent after issue**:

After the issue of prospectus, and before allotment there under, he. On becoming aware of any untrue statement therein withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and the reasons therefore ; or

**4. Reasonable belief** :

As regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or a statement, he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, as the case may be, believe that the statement was true; and

**5. Statement by an expert** :

As regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy or an extract from a report or valuation

**(a)** It was correct and fair representation of the statement ; or

**(b)** A correct copy of, or a correct and fair extract from the report or valuation; and

**(c)** He had reasonable ground to believe and did up to the time of the issue of the prospectus, believe that the person making the statement was competent to make it; and

**(d)** That the person(expert) had given the consent to the issue of prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or before allotment.

**6. Statement by an official person or extract from a public official document :**

As regards every untrue statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from the document.

**21.3.5 Defences against Criminal Liabilities**

Any person made criminally liable can escape the same on proving that-

(1) The statement was immaterial; or

(2) He had reasonable ground to believe and did up to the time of the issue of the prospectus believe that the statement was true.

**21.3.6 Defences to an expert and any person authorizing issue of prospectus:**

An expert giving his consent to the issue of a prospectus can escape his liability by proving that-

1. Having given his consent, he withdraw it in writing before delivery of a copy of the prospectus for registration;

2. After delivery of copy of the prospectus for registration and before allotment there under, he on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reason therefore; or
3. He was competent to make the statement and that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures believe that the statement was true.

### 21.3.7 Personation for acquisition,etc. of shares(Sec 68 A):

Any person who :

a. Makes in a fictitious name an application to a company for acquiring or subscribing for any shares therein, or
b. Otherwise induces a company to allot, or register any transfer of share therein to him or any other person in a fictitious name

Shall be punishable with imprisonment for a term which may extend upto 5 years. This provision shall be prominently reproduced in every prospectus issued by a company and in every form of application for shares which is issued by the company to any person.

## 21.4 STATEMENT IN LIEU OF PROSPECTUS

A public limited company

(i) Which has not issued prospectus or
(ii) Which has issued prospectus but has not proceeded to allot any of the shares, offered to public to public for subscription, is required to deliver to the registrar a “Statement in lieu of Prospectus” for registration , at least three days before the allotment of shares or debentures.

A such a statement is required to be signed by every person , who is named therein as a director or a proposed director, of the company, or by his agent authorised in writing

A public company or a private company converting itself into public company may issue a statement in lieu of the prospectus. This statement must contain Schedule II details or Schedule IV details depending on the nature of the company. Contravention of rules may invoke fine upto Rs. 10,000.

## 21.5 MINIMUM SUBSCRIPTION

While discussing the contents of prospectus we have observed that the prospectus shall mention the minimum subscription which in the opinion of the board of directors must be raised by the issue of share capital before the allotment is made to the public. No allotment shall be made of any share capital of the company offered to the public for subscription unless the minimum amount is raised. The minimum amount which shall be raised,is called, 'Minimum Subscription.' The minimum subscription is fixed by the board of directors after taking into account the matters specified in clause 5 of Part I to Schedule II of the Act i.e.

**i.** The purchase price of any property purchased or to be purchased;

**ii.** Any preliminary expenses payable

**iii.** Any commission payable towards subscription of any shares

**iv.** The repayment of any money borrowed by the company for the above matters

**v.** Working capital

**vi.** Any other expenditure

Sufficient application must be received to caber the minimum subscription amount. The sum payable on application for the amount so stated has been paid to and received by the company whether in cash or cheque .The amount payable on application on each share shall not be less than 5% of the nominal amount of shares. In respect of subsequent allotments this condition is not applicable. Only after the minimum-subscription is raised, shares can be offered to the public for subscription. All moneys received from applicants for shares shall be deposited and kept deposited in Schedule Bank:-

a. Until the certificate to commence business is obtained and

b. Until the entire amount payable on applications for shares in respect of the minimum subscription has been received by the company.

If the above condition are not complied with on the expiry of 120 days after the first issue of the prospectus, all moneys received from applicants for shares shall be forth with repaid to them without interest. If such money is not repaid within 130 days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest @ 6% p.a. from the expiry of $130^{th}$ day.

In the event of any contravention, every promoter, director, or other person who is knowingly responsible for such

contravention shall be punishable with fine which may extend to Rs.50,000/-.

## 21.6 SHELF PROSPECTUS (SEC 60A)

Any public, financial institution, public sector, bank or schedule bank whose main object is financing shall file a Shelf Prospectus. Shelf Prospectus means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus. “Financing “means making loans to or subscribing in the capital of a private industrial enterprise engaged in infrastructural financing or such other company as the central government may notify in this behalf.

A company filing a Shelf Prospectus with the registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such Shelf prospectus A company filing a Shelf Prospectus shall be required to file an information memorandum on all materials, facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities. Previous offer of securities and succeeding offer of securities within such time as may be prescribed by the central government, prior to the making of a prior or subsequent offer of securities under the Shelf Prospectus.

An information memorandum shall be issued to the public along with the shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for the period of one year from the date of opening of the first issue of securities under that prospectus. However, where an update of information and memorandum is filed every time an offer of securities is made, such memorandum together with the Shelf prospectus that constitutes the prospectus.

## 21.7 QUESTIONS

1. What is prospectus? Must every company issue it.
2. What are the contents of a prospectus?
3. What are the remedies available to a shareholder for misrepresentation or omissions in a prospectus?
4. What are the provisions of the companies act relating to registration and issue of prospectus?
5. Who are liable for misstatement in the prospectus?
6. What are the nature of liability for misstatement?
7. What are the defences available for misstatement?

8. Write short notes on:
   a. Minimum Subscription
   b. Statement of lieu of prospectus
   c. Liability of an expert for his statement in the prospectus
   d. Civil liability for misstatement in prospectus
   e. Criminal Liabilities of directors and other persons responsible for issue of prospectus

9. Define the following terms:
   a. Shelf Prospectus
   b. Prospectus
   c. Statement in lieu of prospectus

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# 22

## MODULE-VI

# CORPORATE LAW AND INTELLECTUAL PROPERTY RIGHTSSECURITIES &EXCHANGE BOARD OF INDIA (SEBI)

**Unit Structure**



## 22.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning and legal provisions about compromise and arrangement.
- Know the meaning and legal provisions about amalgamation and reconstructions.
- Explain about National Company Law Tribunal.
- Discuss about the Intellectual Properties Act.
- Discuss and understand the working and functions of SEBI

# 22.1 COMPROMISE AND ARRANGEMENT

### 22.1.1 Meaning of Compromise:

‘Compromise’ means an amicable or cordial agreement between parties to a controversy orsettletheir differences by making mutual concessions, as distinguished from adjudication on the basis of an exact ascertainment of the opposing rights. In a compromise, "the parties agree to try to settle it between themselves by a give-and-take arrangement". For the purpose of a compromise, it has been held that it is but essential that each party thereto should be empowered to make the necessary concessions.

### 22.1.2 Meaning of Arrangement.

Section 390(b) provides meaning of 'arrangement’ it includes a reorganization of the share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods. It has a wider term then that of Compromise. It is an arrangement may also involve debenture orders being given an extension of time for payment, releasing their security in whole or in part or exchanging their debentures for the claims and the balance in shares or debentures of the company; preference shareholders giving up their rights to arrears of dividends, further agreeing to accept a reduced rate of dividend in the future, etc.

The Act empowers a company to make compromise or arrangement with its creditors or members and make suitable provisions under section391 to 393 of Companies Act.

Section 391 makes the following provisions: Arrangement or Compromise can take place

(a) between a company and its creditors or any class of them: or
(b) between a company and its members or any class of them; the court may, on the application of the company or any creditor or member or liquidator order that a meeting of the creditors or members (or any class of them) be called and held in the manner directed by the court.

# 22.2 AMALGAMATION AND RECONSTRUCTION

### 22.2.1 Meaning and Features of Amalgamation:

When two or more companies engaging in similar business go into liquidation and a new company is formed to take over their business, it is called amalgamation. In other words, amalgamation

means to the formation of a new company by taking over the business of two or more existing companies doing similar type of business. In amalgamation, two or more companies are liquidated and a new company is formed to take over the business of liquidating companies. The companies which go into liquidation are called **vendor or Amalgamating** companies where as the new company which is formed to take over the business of liquidating companies is called purchasing or amalgamated or transferee company. The main aim of amalgamation is to minimize the possibility of cut-throat competition and to secure the advantages of large scale production.

Under Amalgamation the shareholders of the previous companies also become the shareholders of the new company which is formed under the scheme.

Following are the features of amalgamation.

- Liquidating **companies are called vendor companies and the new company is called purchasing company.**
- Two or more existing companies are liquidated.
- Any company is formed to takeover the business of liquidating companies. The nature of business of existing companies is similar.

### 22.2.2 Meaning of Reconstruction:

A reconstruction is commonly said to have taken place when a company resolves to wind up its business and it is proposed to form a new company, with only the old shareholders as its members to take over its undertakings the rights of shareholderin the old company being satisfied by their being allotted hares n the new company. In that case, the old company ceases to exist in point of aw, and its assets are transferred to the new company.

There are two types of reconstruction or reorganization that is external reconstruction and internal **reconstruction.**

### 1. External Reconstruction:

When a company is suffering losses for the past several years and facing financial crisis, the company can sell its business to another newly formed company. Generally, the new company [s formed to take over the assets and liabilities of the old company. This process is called external reconstruction. In external reconstruction, one company is liquidated and another new company is formed. The liquidated company is called "Vendor Company" and the new company is called "Purchasing Company".

Shareholders of Vendor Company become the shareholders of purchasing company.

**2. Internal Reconstruction**

Internal reconstruction refers to the internal re-organization of the financial structure of a company. It is also termed as re-organization which permits the existing company to be continued. In general sense, share capital is reduced to write off the past accumulated losses of the company.

### 22.2.3 Effects of Reconstruction:

Reconstruction may be carried out:

(a) By sale of the company under the powers contained in its Memorandum of Association:

b) By a scheme of arrangement under section 391;

**(c) By acquiring all or a majority of the shares in another company under section 395;**

(d) By a compulsory amalgamation of companies in the public interest by an order of the Central Government under section 396;

(e) By a scheme of arrangement with creditors only; under section 517 (voluntary windingupboth by members and creditors, a special resolution and consent of three-fourths in value of creditors are necessary.

## 22.3 COMPANY LAW ADMINISTRATION

### 22.3.1 Need for National Company Law Tribunal: (NCLT)

Before passing of Companies (Second Amendment) Act, 2002, Corporate were required to apply to High Courts for proceedings such as amalgamation/ merger, reduction of capital and winding up of companies. But the High Court's being over burdened with other matters, used to take very long time in deal with the issues and as a result of which the society was not able toderive the intended benefits out of such decision. Even the Winding Up petitions before the various High Courts have been pending for a very long lime. Similarly various matters before the Company Law Board (CLB), Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR) have been pending fora very long period.

### 22.3.2 Establishment of National Company Law Tribunal: (NCLT)

The Central Government shall by notification with effect from a specified date constitute a National Company Law Tribunal. The Companies (Second amendment) Act, 2002 provides for the setting up of a National Company Law Tribunal and Appellate Tribunal to replace the existing Company Law Board and board for Industrial and Financial Reconstruction. It also provides for dealing with various matters, which fall presently under the jurisdiction of High pursuant to various provisions companies in the Companies Act, 1956.

### 22.3.4 QUALIFICATION *OF* PRESIDENT AND MEMBERS

The President shall be a person who is eligible to be as a judge of the High Court or has been a Judge of a high Court**.**

**1. Judicial Member:**

A judicial member shall be person, who

**a.** **is or has** been a judge **of a High Court; or**

**b.** **is or has been a District** Judge **for at** least five years; or

**c.** has for at least ten years as an advocate of a court or held a judicial office or as member of a tribunal.

**2. Technical Member:**

A Technical member shall be a person who:

**a.** has for at least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Service out of which at least three years as Joint Secretary or above; or

**b.** is or has been in practice **as a chartered accountant** for at least fifteen **years; or**

**c.** is or has been in practice as a cost accountant for at least fifteen years; or

**d.** is or has been in practice as a company secretary for at least fifteen years; or

**e.** is a person of proven ability integrity and standing having special knowledge and experience, of not less than fifteen years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related to management conduct of affairs, revival, rehabilitation and winding up of companies; or

**f.** is or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the industrial Disputes Act 1947.

### 22.3.5 SELECTION OF MEMBERS

The Selection committee shall comprise of the Chief Justice of India or his nominee as Chairman of the committee and Secretaries of the Ministry of Finance and Company Affairs, Labour Laws and Justice as members of the committee.

### 22.3.6 TERMS OF OFFICE (SFCTION 413):

The President and every other Member of the Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office, but shall be eligible for re-appointment for another term of five years.
A Member of the Tribunal shall hold office as such until he attains,—

**a.** in the case of the President, the age of sixty-seven years;

**b.** in the case of any other Member, the age of sixty-five years:

The President of the Tribunal and the chairperson and Judicial Members of the Appellate Tribunal shall be appointed after consultation with the Chief Justice of India.

The Members of the Tribunal and the Technical Members of the Appellate Tribunal shall be appointed on the recommendation of a Selection Committee consisting of—

**a.** Chief Justice of India or his nominee — Chairperson;

**b.** a senior Judge of the Supreme Court or a Chief Justice of High Court — Member;

**c.** Secretary in the Ministry of Corporate Affairs — Member;

**d.** Secretary in the Ministry of Law and Justice — Member; and

**e.** Secretary in the Department of Financial Services in the Ministry of Finance — Member.

The Secretary Ministry of Corporate Affairs shall be the Convener of the Selection Committee. .A person who has not completed fifty years of age shall not be eligible for appointment as Member. The Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

The chairperson or a Member of the Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office, but shall be eligible for re-appointment for another term of five year.

A Member of the Appellate Tribunal -shall hold office as such until he attains,—

(a) In the case of the Chairperson, the age of seventy years;

(b) In the case of any other Member, the age of sixty-seven years:

A person who has not completed fifty years of age shall not be eligible for appointment asMember. The Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

### 22.3.7 Power and Function of National Company Law Tribunal. (Companies Act, 2013)

**BENCHES OF TRIBUNAL**

**a.** The Central Government may notification decide the number of Benches of the Tribunal

**b.** The Principal Bench of the Tribunal shall be at New Delhi and shall be presided over by the President.

**ORDERS OF TRIBUNAL:**

**a.** The Tribunal may after giving reasonable opportunity to the parties to the proceeding, pass any order as it thinks fit.

**b.** The Tribunal may, at any lime within two years from the date of the order may rectify any mistake, if the mistake brought to its notice.

**c.** No rectification shall be made in an order against which an appeal has been preferred.

**d.** Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.

**e.** No appeal shall lie to the Appellate Tribunal from a consent order.

**f.** It has Power to review its order.

**g.** The Tribunal has the same powers as those exercised by the Civil Court.

**Other Powers:**

**a.** The powers of the Tribunal may be exercised *by* Benches, constituted by the President of the Tribunal, out of which one shall be a Judicial Member and another shall be aTechnical Member.

**b.** The Tribunal may, after giving the parties to any proceeding before it, an opportunity of being heard, pass such orders thereon as it thinks fit.

**c.** The Tribunal shall have power to review its *own* orders..Any person aggrieved by an order or decision of the Tribunal may prefer an appeal to the Appellate Tribunal.

**d.** The Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down in the Code of Civil Procedure. 1908, but shall be guided by the principles of natural justice. Subject to the other provisions of this Act and of any rules made by the Central Government, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.

The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging its functions under this Act the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the Following matters

**a.** Summoning and enforcing the attendance of any person and examining him on oath;

**b.** Requiring the discovery and production of documents;

**c.** Receiving evidence on affidavits;

**d.** Subject to the provisions of the Indian evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office;

**e.** Issuing commissions for the examination of witnesses or documents;

**f.** Reviewing its decisions:

**g.** Dismissing a representation for default or deciding it ex parte;

**h.** Any order made by the Tribunal or the Appellate Tribunal may be enforced by that Tribunal in the same manner as if it were a decree made by a court in a suit pending therein.

### 22.3.8 Removal of the President or Member

The Central Government in consultation with the Chief Justice of India may remove President or Member from the office who:

**a.** Has convicted for an offence involving moral turpitude; or

**b.** Has involved in financial or other wasted interest as is likely to affect adversely on the functions as such president or member of the tribunal, or

**c.** Has been adjudged insolvent: or

**d.** Has become mentally or physically not capable for acting as such President or member of the Tribunal; or

## 22.4 CONSTITUTION OF APPELLATE TRIBUNAL (SEC. 410)

The Central Government shall by notification, constitute an National Company Law Appellate Tribunal, constituting of *a* Chairperson and not exceeding eleven members for hearing appeals against the orders of the Tribunal.

### 22.4.1 Qualifications for the Chairperson in the NCLAT:

The chairperson shall be a person who is or has been a Judge of the Supreme Court or the Chief Justice of a High Court.

### 22.4.2 Qualifications for the Members in the NCLAT:

A Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years.

A Technical Member shall be a person of ability, integrity and standing having special knowledge and experience, of not less than twenty-five years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related to management conduct of affairs, revival, rehabilitation and winding up of companies.

### 22.4.3 Selection Committee:

The Selection **Committee shall** comprise **of the** following **persons:**

| | | |
|---|---|---|
| **Chairperson** | : | Justice **of India** or **his** nominee. |
| **Member** | : | Secretary in the ministry of Finance and Company Affairs |
| **Member** | : | Secretary in Ministry of Law and Justice |
| **Member** | **:** | Secretary in Ministry of finance and **Company** Affairs. |

## 22.5 INTELLECTUAL PROPERTY ACT

### 22.5.1 Introduction:

Intellect leads to creativity. Creativity is always personal and abstract and therefore it is intellectual property .Law recognizes innovations through creativity and originality and embosses the same in the form of patents, Copyrights , Trade Marks, Designs etc. Patent are granted to inventions of new manufacture. Any sign or

mark distinguishing goods or services constitute trade mark. Protection to man's literary, dramatic, or musical works, films, artistic work and sound recording is governed by Copyright Act 1957.Protection of original design act is governed by Design Act 2000.

**22.5.2 PATENTS:**

The concept of patent was originated in great Britain.The first patent Act was enacted in 1856 granting exclusive patent for 14 years, to inventors of new manufacture. After many amendments and committee report headed by Justice N R Ayyangar the Patent Act 1970 was enacted and rules thereto were published in 1971. The Act came into force from 20 April 1972. The act was required to be amended again as India signed WTO agreement including Agreement onTrade Related Aspects of Intellectual Property Rights.

**22.5.3 OBJECT**:

It is important for State in the interest of its development to encourage inventors and provide them protection by way of examining their new inventions, creation and improvements .

Invention must relate to a machine, article or substance produce by manufacture or must relate to the process of manufacture of an article, or an improvement of an article or of a process of manufacture.

The protection is granted to the inventor for a limited period through Monopoly right by way of grant of patent for inventing a new and useful article or a new process which has an industrial application. The inventor who is granted a patent is called the patentee. The patentee during the period of patent holds exclusive monopoly rights to manufacture the new article invented or to manufacture an article according to the invented process. Such article is called patented article.

The patentee can prevent any other person from using the patented invention. After the expiry of the patented period, anybody can then make use of the invention. There is an obligation cast on the patentee to work the invention on a commercial scale either by himself or through licencees. The owner can sell the whole or part of his patent right or grant licences to others to use it. Though invention to be patented is not compulsory, it is in the interest of the inventor to get the invention patented.

### 22.5.4 Meaning:

Patent means a patent for any invention granted under the Act. By grant of patent, protection by way of a monopoly is extended to the inventor for a limited period for

**a.** inventing a new product; or

**b.** inventing a new process; and

**c.** new invented product or process is capable of industrial application.

When a patent is granted and is in force in respect of either the article or the process it is called patented article and patented process respectively. The person in whose favour the patent is granted and who is entered in the register of the patent is called patentee. Patentee includes an exclusive license. Exclusive licensee means a licence from a patentee which confers on the licensee any right in respect of the patented invention.

### 22.5.5 FEATURES OF A PATENT:

**a.** The patent must be in respect of invention and not a discovery

**b.** Patent may be in respect of a substance or in respect of a process.

**c.** It is not possible to bifurcate a patent and state one relates to substance and other relates to process

**d.** In order to have a complete patent, the specification and the claim must be clearly and distinctly mentioned.

**e.** It is the claims and claims alone which constitute patent

### 22.5.6 GENERAL CONSIDERATION APPLICABLE FOR GRANTING PATENTS:

**a.** That patents are granted to encourage inventions and to secure that the inventions are worked in India on a commercial scale

**b.** That they are not granted merely to enable patentee to enjoy a monopoly for the importation of the patented article.

**c.** That the protection and enforcement of patent right contribute to the promotion of technological innovation and to the transfer and dissemination of technology to the mutual advantage of producer and users of technological knowledge.

**d.** That the patent granted do not impede protection of public health and nutrition and should act as instrument to promote public welfare.

**e.** That the patent right is not abused by the patentee or person deriving title or interest on patent from patentee.

**f.** That patent is granted to make the benefit of the patented invention available at reasonably affordable prices to the public.

### 22.5.7 TRUE AND FIRST INVENTOR:

True and first inventor is a person who first made the invention and applied for the patent .If two persons have independently made the same invention and neither have disclosed it to the world, the one who applies first for the patent will be considered in law the true and first inventor, although the other might have made it earlier in point of time.

The patentee during the period of patent holds exclusive monopoly rights to manufacture an article according to the invented process. The patentee can prevent any other person from using the patented invention. After the expiry of the patented period, anybody can make use of invention.

There is an obligation cast on patentee to work the invention on the commercial scale either by himself or through licensees.

### 22.5.8 WHICH INVENTIONS ARE NOT PATENTABLE?:

1) An inventions which are frivolous or which claims anything contrary to established natural law.
2) An invention whose intended use or commercial exploitation may cause serious prejudice to human, animal, or plant life or health or to the environment.
3) Method of agriculture or horticulture.
4) Any process for the medicinal, surgical, diagnostic, the rapeutic or other treatment of human being or any process for a similar treatment of animals.
5) A mere scheme or rule or method of performing mental act or method of playing game.
6) A presentation of information.
7) A literary, dramatic, musical or artistic work, or any other aesthetic creation whatever including cinematographic work and television production.
8) Topography of integrated circuits.
9) An invention which, in effect, is traditional knowledge or which is aggregation or duplication of known properties of traditionally known component or components.
10) A substance obtained by a mere mixture resulting only in the aggregation of properties of the components thereof or process for producing such substance,

11) An invention relating to atomic energy falling within sub section (1) of section 20of the Atomic Energy Act.

### 22.5.9 REVOCATION OF PATENTS:

On a petition of any person interested, or the Central Government by the Appellate Board or on a counter claim in a suit for infringement of the patent by High Court the patent may be revoked on any of the ground:

1) Invention earlier Claimed
2) Patentee not entitled to apply
3) Patent wrongfully obtained.
4) Subject claim not an invention.
5) Claims not new.
6) Invention is obvious and no inventive step.
7) Invention not useful.
8) Invention is not sufficiently and fairly described.
9) Claim not clearly defined.
10) Controller was misled into granting patent by false suggestion.
11) Invention secretly used before priority date of claim.
12) Failure to disclose information.
13) Requirement of public not satisfied,
14) Patent has expired.

## 22.6 COMPULSORY LICENCES AND WORKING OF PATENT: (Sec 84 to 94)

### 22.6.1 Ground of application:

At any time after the expiration of 3 years, from the date of grant of patent

“any person interested” may make an application to the controller for a grant of compulsory licence on patent on any of the following ground:

1) That the reasonable requirement of the public with respect to the patented invention have not been satisfied. Or
2) That the patented invention is not available to the public at a reasonable affordable price , or
3) That the patented invention is not worked in the territory of India.

A person interested must be a person who has direct, present, and tangible commercial interest or public interest which was affected by the continuance of the patent on the register.

### 22.6.2 PROCEDURE FOR GRANT OF COMPULSORY LICENCE:

In considering application, the controller shall take in to account following matters :

**1)** The nature of the intention, the same which has elapsed since the sealing of the patent and the measures already taken by the patentee to make full use of the invention.

**2)** The ability of the applicant to work the invention to the public advantage.

**3)** The capacity of the applicant to undertake the risk in providing capital and working the invention, if application were granted.

**4)** As to whether the applicant has made efforts to obtain a licence from the patentee on reasonable terms and conditions and such efforts have not been successful within a reasonable period not exceeding.

**5)** As to whether the applicant has made efforts to obtain a licence from the patentee on reasonable terms and conditions and such efforts have not been successful within a reasonable period not ordinarily exceeding a period of 6 months as the controller may deem fit.

## 22.7 COPYRIGHT (THE COPYRIGHT ACT 1957)

### 22.7.1 Introduction:

To meet the public consciousness of the right and obligation of the authors, new and advanced means of communication like broadcasting , litho photography etc. and for fulfilment of intellectual obligations, Copyright Act ,1957 was enacted , repealing the earlier Copyright Act 1911.

### 22.7.2 Meaning ( Sec 14 & 16):

Copyright means the exclusive right to do or authorise the doing of any of the following acts in respect of a work or any substantial part thereof, namely:

**A.** In case of a literary, dramatic or musical work, not being computer programme

i To reproduce the work in any material form including the storing of it in any medium electronic means;

ii To issue copies of the work to the public not being copies already in circulation;

iii To perform the work in public, or communicate to the public ;

iv To make any cinematograph film or sound recording in respect of the work

v To make any translation of the work;

vi To make any adaptation of the work;

In relation to a literary work or an artistic work, adaptation shall mean the conversion of workinto a dramatic work by way of performance in public or otherwise. In relation to dramatic work, adaptation shall mean any abridgement of the work or any version of the work in which the story 0r action is conveyed wholly or mainly by means of pictures in a form suitable for reproduction in a book or in a newspaper, magazine or similar periodicals. In relation to a musical work, adaptation shall mean any arrangement or transcription of work.

**B.** In the case of a computer programme –

i. To do any of the acts specified in clause (a) above;

ii. To sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme

**C.** In case of an artistic work –

i. To reproduce the work in any material form including the storing of it in any electronic media.

ii. To communicate the work to the public;

iii. To issue copy of the work to the public not being copies already in circulation

iv. To include the work in any cinematograph films;

v. To make any adaptation of work.

**D.** In case of cinematograph films—

i. To make copy of the film including a photograph of any image forming part there of or storing of it in any medium by electronic or other means,

ii. To sell or give on commercial rental or offer for sale or for such rental, any copy of the film.

iii. To sill or give on hire or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions.

iv. To communicate film to the public,

**E.** In the case of sound recording---

i. To make any other sound recording embodying it, including storing of it in any medium by electronic or other means,

ii. To sell or give on commercial rental or offer for sale or for such rental any copy of sound recording,

iii. To communicate the sound recording to the public

## 22.7.3 OWNERSHIP OF COPYRIGHT: (Sec 17)

### a) In the case of literary, dramatic or artistic work:

If these work made by the author in the course of his employment by the proprietor of a newspaper, magazine, or similar periodical under a contract of service or apprenticeship for the purpose of publication in the newspaper, magazine or similar periodical, the said proprietor shall be the first owner of the copyright . This is however in the absence of any agreement to the contrary between the author and his employer.

### b) In case of photograph, painting or portraitetc.:

In the case of a photograph taken, or a painting or a portrait drawn, or an engraving or a cinematograph made, for valuable consideration, at the instance of any person, such person shall , in the absence of any agreement to the contrary , be the first owner of the copyright

### c) In case of any address or speech delivered in public:

the person who has delivered such address or speech or if such person has delivered such address or speech on behalf of another person, such other person shall be the first owner of the copyright therein even if the person who delivers or on whose behalf such address or speech is delivered, is employed by any other person who arranges such address or speech or on whose behalf such address or speech is delivered.

### d) Government work:

Government shall, in the absence of any agreement to the contrary, the first owner of the copyright therein.

### e) Work of international organisation:

The international organisation concerned shall be the first owner of the copyright therein.

**f) Work made under direction and control of any public undertaking:**

Such public undertaking shall in the absence of any agreement to the contrary, be the first owner of the copyright therein. Public undertaking means an undertaking owned or controlled by the Government, or Government Company, or a body corporate established under any Central Provincial or State Act.

## 22.8 TRADE MARKS (THE TRADE MARKS ACT, 1999)

### 22.8.1 Introduction:

To promote the interest of consumers and safeguard reputation and goodwill of the proprietors of certain works done on the goods, the Trade and Merchandise Marks Act, 1958 was enacted.

With the development in trade and commerce, globalisation of trade and industry and need to encourage investment and transfer of technology and for simplification and harmonization of trade mark management system, Trade Mark Act, 1999 was enacted repealing Trade and Merchandise Marks Act, 1958.

### 22.8.2 Meaning: (Sec 2 ZB)

Trade Mark means a “mark “ capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours.

A “mark” includes a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or combination of colours or any combination thereof.

A mark capable of distinguishing the goods or services in connection with which it is used in the course of trade which are certified by the proprietor of the mark in respect of origin, material, mode of manufacture of goods or performance of services, quality , accuracy or other characteristics from goods or services, is the “certification trade mark”.

“Goods” means anything which is the subject of trade or manufacture [sec.2(1)(j)].”Service” means service of any description which is made available to potential users and includes the provisions of services in connection with business of any industrial or commercial matters such as banking, communication, education financing, insurance, chit funds, real estate, transport, storage, material treatment, processing ,supply of electrical or other

energy, boarding lodging, entertainment, amusement, Construction, repair, conveying of news or information and advertising [sec.2(1)(z)]. “Goods and Services” are associated with each other if it is likely that those goods and those services might be provided with the same business with description of goods and services, [ Sec.2(3)].”Package” includes any case, box, container, converting, folder, receptacle, vessel, casket, bottle, wrapper, label, band, ticket, reel, frame, capsule, cap, lid, stopper and cork.[Sec.2(1)(q)]

### 22.8.3 PERMITTED USE [Sec.2(1)(r)]

A person entered in the register of trademarks as proprietor of the trademark is the” Registered proprietor “of the trademark. A person who is for the time being, on joint application to the registrar by registered proprietor and proposed registered user, registered as such in respect of goods or services is a “registered user”.

### 22.8.4 REGISRTATION OF TRADEMARK [SEC 6,7,18 TO 13]

Any person claiming to be the proprietor of a trademark used or proposed to be used by him shall apply in writing to registrar to register a trademark for a specification of goods or services included in any one class or for different classes of goods or to register a trademark for a specification of goods or services included in any one class from a convention country. The registrar shall classify goods and services in accordance with the international classification of goods and services for the purposes of registration of trademark.

The registrar, after service of notice on the applicant, after considering evidence , objections and after hearing the parties may refuse the application or may accept it absolutely or subject to such amendments, modification, condition or limitation, if any, as he may think fit. In case of refusal or conditional acceptance of an application, the registrar shall record in writing the grounds for such refusal or conditional acceptance and materials used by him in arriving at the decision. Where an application for a registration for trademark has been accepted, the registrar shall register the set trademark within 18 months of the filing of the application. The trade mark when registered shall be registered as of the date of the making of the said application and that date shall be deemed to be the date of registration. The registrar shall, under the seal of trademarks registry issue a certificate of registration to the applicant.

### 22.8.5 EFFECT OF REGISTRATION [Sec. 27,28& 31]

The registration of a valid trademark gives the registered proprietor of the trademark, the exclusive

Right to the use of trademark in relation to the goods or service in respect of which the trademark is registered and to obtain relief in respect of infringement of trademark as provided in the act.

## 22.9 DESIGN[THE DESIGN ACT, 2000]

### 22.9.1 INTRODUCTION:

The progress in the field of science and technology requires protection of registered industrial designs, promotion of design activity and to promote the design element in an article of production. In view of extensive amendments required, Designs act,1911 was repealed and Designs act, 2000 was enacted to balance the interests, achieve the objects, to create required incentive to design activity and to remove the impediments to the free use of the available designs .

### 22.9.2 MEANING OF DESIGN [Sec. 2(b) & 20 ]

Designs means only the features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article whether in two dimensional or three dimensional or in both the forms, by any industrial process or means, whether manual, chemical or mechanical , separate or combined, which in the finished article appeal to and are judged solely by the eye. Design does not include (i) any mode or principle of construction or anything which is in substance a mere mechanical device,(ii) any trade mark or property marks or any artistic work.

### 22.9.3 ORIGINAL DESIGN:

Original design means originating from the author of such design and includes the cases which though old in themselves yet are new in their application.

### 22.9.4 PROPRIETOR OF A NEW OR ORIGINAL DESIGN :

Proprietor of the original design shall mean ---

(i) The person for whom the author of the design, for good consideration , executes the work ;

(ii) Any person who acquires the design or the right to apply the design to any article either exclusively or otherwise;

(iii) In any other case, the author of the design ;

(iv) Where the property in the design or the right to apply in the design has devolved from the original proprietor upon any other person, that other person.

### 22.9.5 REGISTRATION OF DESIGNS

Any person claiming to be the proprietor of any new or original design not previously published in any country and which is not contrary to public order or morality, may apply to the controller for his registration of design. The controller-general of patents, Designs and Trademarks shall be the controller of designs. The controller shall refer the applications for examination to the examiner appointed by the central government for a report as to whether such a design is capable of being registered .After consideration of the report of the examiner; the controller may register the design.

## 22.10 GEOGRAPHICAL INDICATIONS

In India the Geographical Indications of Goods (Registration and Protection) Act, 1999 came in force with effect from September 2003.

- The salient features of the Act are defines Geographical Indication,
- It provides Amechanism for registration of Geographical Indications,
- It elaborates the concept of authorised user and registered proprietor.
- Higher level of protection are provided for notified goods and remedies for infringements.

Most commonly, a Geographical Indications consists of the name of the place of origin of the good, such as "Jamaica Blue Mountain'* or '"Darjeeling*". But non-geographical names, such as "Vinho Verde", "Cava" or "Argan Oil", or symbols commonly associated with a place, can also constitute a Geographical Indication. In essence, whether a sign functions as a GI is a matter of national law and consumer perception. Moreover, in order to work as a Geographical Indication, a sign must identify a product as originating in a given place. At international level Champagne', 'Havana'. Tequila', 'Scotch Whisky', 'Bordeaux', 'Burgogne', Irish Whisky'. 'Porto', 'Cognac', Sherry', Camembert', 'Gouda' and many others are some of the popular examples.

We purchase these products simply for their qualitative properties attributing the same to their geographical origin. From ancient limes every region had its claim to fame for its products for example Arabia for horses, China for its silk, Dhaka for its muslin, Venice for glass, India for its spices. Economic Importance and products sell at premium. Basmati rice exports from India and

Pakistan, Darjeeling tea, a registered Geographical Indication sells at a premium world over.

In addition, the qualities or reputation of the product should be essentially due to the place of origin. Since the qualities depend on the geo-graphical place of production, there is a linkbetween the product and its original place of production.

Geographical indications and trademarks are distinctive signs used to distinguish goods or services n the marketplace. Both convey information about the origin of a good or service, and enable consumers to associate a particular quality with a good or service.

Trademarks inform consumers about the source of a good *or* service. They identify a good or service as originating from *a* particular company. Trademarks help consumers associate *u '* good or service with a specific quality or reputation, based on information about the company responsible for producing it. Geographical indications identity a good as originating from a particular place. Based on Its place of origin, consumers may associate a good with a particular quality, characteristic- or reputation.

Consumers pay increasing attention to the geographical origin of products, and care about specific characteristics present in the products they buy. In some cases, the "place of origin" suggests to consumers that the product will have a particular quality or characteristic that they may value. Often, consumers are prepared to pay more for such products. This has favored the development of specific markets *for* products with certain characteristics linked to their place of origin.

## 22.11 SECURITY & EXCHANGE BOARD OF BOARD OF INDIA

### 22.11.1 Establishment:

Securities Exchange Board of India (SEBI) was set up in 1988 for regulating the functions of securities market. SEBI promotes healthy development in the stock market. In the initial period SEBI was not able to put complete control over the functioning of stock market. In May 1992, SEBI was granted legal status. SEBI is a body corporate having a separate legal existence and perpetual succession as initially it used to observe only the activities and found ineffective in regulating and controlling the stock market transactions.

With the growth in the dealings of stock markets, lot of malpractices also started in stock markets such as price rigging, 'unofficial premium on new issue, and delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements. Due to these malpractices the customers started losing confidence and faith in the stock exchange. So government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI).

### 22.11.2 Purpose and Role of SEBI:

SEBI was set up with the main purpose of keeping a check on malpractices and to curb the same and protect the interest of investors.

It was come into existence to meet the needs of three groups.

- **Issuers:**

It provides a market place for issuers in which they can raise finance fairly and easily.

- **Investors:**

It provides protection to Investors and supply of accurate and correct information.

- **Intermediaries:**

It provides a competitive professional market for intermediaries.

### 22.11.3 Objectives of SEBI:

The overall objectives of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market.

Following are the objectives of the SEBI:

1. To regulate the overall activities of stock exchange.
2. To protect the rights of investors and ensuring safety to their investment.
3. To prevent fraudulent and malpractices.
4. To regulate and develop a code of conduct for intermediaries such as:
   a. brokers,
   b. Underwriters, etc.

### 22.11.4 Functions of SEBI:

The SEBI performs functions to meet its objectives. To meet three objectives SEBI has three important functions. These are:

#### 1. Protective Functions:

These functions are performed by SEBI to protect the interest of investor and provide safety of investment in relation with..

i. **It Checks Price Rigging**: Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

ii. SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

iii. **It Prohibits and Prevents Insider trading**:

SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.Insider is any person associated with the company such as directors, promoters etc. These insiders have sensitive or confidential information which affects the prices of the securities. These information are not available to general public or people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., The promoters of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading.

iv. SEBI promotes fair practices and code of conduct in security market by taking following steps:

v. SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midtem.

#### 2. Developmental Functions:

These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange. Under developmental categories following functions are performed by SEBI:

i. SEBI promotes training of intermediaries of the securities market.

ii. SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way:

a) SEBI has allowed internet trading through registered stock brokers.

b) SEBI has made underwriting optional to lower the cost of issue.

**3. Regulatory Functions:**

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

a) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

b) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

c) SEBI conducts inquiries and audit of stock exchanges

d) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

e) SEBI registers and regulates the working of mutual funds etc.

f) SEBI regulates takeover of the companies.

**22.11.5 The Organizational Structure of SEBI:**

1. The head office of SEBI is in Mumbai and it has branch office in Kolkata, Chennai and Delhi.
2. SEBI is working as a Corporate Sector.
3. Its activities are divided into five departments. Each department is headed by an executive director.
4. SEBI has formed two advisory committees to deal with primary and secondary markets.
5. These committees consist of, investors associations, market players and eminent persons.

**Objectives of the two Committees are:**

1. To advise SEBI to regulate intermediaries.
2. To advise SEBI on issue of securities in primary market.
3. To advise SEBI on disclosure requirements of companies.
4. To advise for changes in legal framework and to make stock exchange more transparent.
5. To advise on matters related to regulation and development of secondary stock exchange.

These committees can only advise SEBI but they cannot force SEBI to take action on their advice.

### 22.11.6 Members of SEBI:

The SEBI is managed by its members, which consists of following:-

1. The chairman who is nominated by Union Government of India.
2. Two members, i.e., Officers from Union Finance Ministry.
3. One member from the Reserve Bank of India.
4. The remaining five members are nominated by Union Government of India; out of them at least three shall be whole-time members.

SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three-member tribunal and is headed by Mr. Justice J P Devadhar, a former judge of the Bombay High Court. A second appeal lies directly to the Supreme Court. SEBI has taken a very proactive role in streamlining disclosure requirements to international

For the discharge of its functions efficiently, SEBI has been vested with the following powers:

a. To approve by−laws of stock exchanges.
b. To require the stock exchange to amend their by−laws.
c. Inspect the books of accounts and call for periodical returns from recognized stock exchanges.
d. Inspect the books of accounts of a financial intermediaries.
e. Compel certain companies to list their shares in one or more stock exchanges.
f. Registration of brokers.

## 22.12 QUESTIONS

1. What are the Provisions of Geographical Indication Act 1999.
2. What are the features of Geographical Indication Act.
3. What is Amalgamation and Reconstruction?
4. State the difference between Internal Reconstruction and External Reconstruction,
5. Explain the effects of Reconstruction.
6. What are the powers and functions of NCLT?

7. Explain fully the establishment of National Company Law Tribunal: (NCLT).
8. Who can be a member of NCLT. What would be his/her qualifications and disqualifications?
9. Write a detailed note on SEBI.

10. Define the following terms:
    a. Trade marks
    b. Copy rights
    c. Design
    d. Compromise
    e. Amalgamation
    f. Reconstruction
    g. Patent

*****

# 23

## MODULE-VII
# PARTNERSHIP ACT

**Unit Structure**



## 23.0 OBJECTIVES

After studying the unit students will be able to:

- Understand the meaning of Partnership and Partnership deed.
- Explain the features of Partnership
- Distinguish between Partnership and co-partnership, HUF and Company.
- Discuss about Dissolution of Partnership Firm.

## 23.1 INTRODUCTION

Partnership form of business organisation have came into existence due to some of the limitations of sole trading concern such as limited capital, managerial ability etc.

Formerly partnership business was regulated by Indian contract act 1872 but subsequently authorities found it necessary to have a separate law for this purpose, as a result of which Indian partnership Act 1932 came into effect. The act was established to define and modify as and when required.

Partnership derived from the word ‘part’ and implies sharing. Persons come together to share profits and properties of the business. The relationship of partnership arises from contract and

not status. The law of partnership extends to whole of India, Except the state of Jammu and Kashmir.

## 23.2 MEANING

### 23.2.1 Definition:

Section 4 of the Act defines Partnership as “the relation between the persons who have agreed to share the profits of business carried on by all or any of them acting for all”. Person who have entered into partnership with one another are called individually partners and collectively a firm. The name under which their business is carried on is called firm name.

### 23.2.2 PARTNERSHIP DEED OR ARTICLES OF PARTNERSHIP

Partnership may be expressed or implied. Express Partnership arises by words spoken or written. Implied Partnership may arise from conduct of the parties. Partnership agreement must satisfy all conditions of valid contract such as offer, acceptance, competency, lawful business etc.

Sometimes minor may be admitted to the benefits of the partnership with the consent of all the partners. As relationship of partners to one another is that of agency, no consideration is required to create partnership. The documents which contains the terms of partnership as agreed among the partner is called partnership deal.

Following are the contents or provisions of the deed:

a) Name of the firm
b) Name and address of all partners
c) Nature and place of business
d) Duration of the partnership.
e) Amount of capital of each partner with profit sharing ratio.
f) Interest on drawings and Interest on capital.
g) Interest on loan advanced by partner.
h) Salary or commission payable t any partner.
i) Method of valuation of goodwill in case of admission, retirement or death of a partner.
j) Settlement of account in case of retirement or death of a partner or dissolution of a firm.

As per section 11 of the Indian Contract Act every Person who is of the age of majority according to the law to which he is subject to and who is of sound mind and not disqualified from

contracting by any law to which he is subject is component to contract and therefore may be a partner.

### 23.2.3 WHO MAY BE A PARTNER:

1. **INDIVIDUAL** – An individual who satisfies all conditions required for a valid contract can become a partner.

2. **MINOR –** A minor cannot become a partner. He may be entered into partnership business with consent of all other partners.

3. **LUNATIC –** A person of unsound mind is not competent to contract and therefore cannot become a partner.

4. **CORPERATE BODY –** A corporate body being an artificial person can become a partner and can enter into partnership agreement.

5. **AFIRM-**A firm cannot be a partner of another firm, though its partner can be in their individual capacity.

### 23.2.4 WHO ARE NOT PARTNERS:

1. The members of Hindu undivided family carrying in family business. However partnership contract inter se between members of family is permissible.
2. Lender of the money receiving a rate of interest from any person engaged in business or about to engage in business.
3. An agent engaged in business receiving commission from principal.
4. Widow or a child of deceased partner receiving a portion of profit as annuity.
5. A previous owner or part owner of the business selling his business along with the good will and receiving a portion of the profit in consideration of sale.
6. Joint or co-owners of property sharing profits arising from the business.

## 23.3 CHARACTERISTICS OR FEATURES OF PARTNERSHIP

Following are the main characteristics of Partnership:

**1. Two Or More Persons:**

Minimum two persons are required to form a partnership. In case of banking business maximum number of partners allowed is ten, while in any other business the numbers cannot exceed 20.

**2. Competency:**

All partners must have attained an age of majority and must be of sound mind to enable him to enter into contracts.

**3. Agreement:**

There has got to be an agreement to form partnership. This agreement may be expressed or implied. Express agreement arises out of words spoken or written. Similarly implied agreement arises out of the conduct and custom of business. Section 5 of the act states “The relation of the partnership arises from contract and not from status.

**4. Lawful business:**

Term business refers any lawful activity, which if successful would result in profits. It include every trade, occupation and profession. It is not necessary that a business be permanent undertaking. A Partnership may exist even for a single venture example: X and Y are partners for producing a film.

**5. Profit Sharing:**

An agreement entered into by all the partners concerned must be for sharing the profit of the business. Profit means net profit arrived at after providing for all expenses. It must be remembered that profit sharing is must irrespective of profit sharing ratio. However it must be noted that near sharing of profits between persons would not necessarily determine the existence of partnership e.g: Joint owner of a shop who shared the rent of the shop will not be called partners

- **IMPORTANT ILLUSTRATIONS**

a. A & B are joint owners of a flat does not constitute partnership.
b. P & Q buy 10 tonnes of rice agreeing to share between them is no partnership.
c. P & Q buy 10 tonnes of rice and agree to sell for their joint account. Hence P & Q are partners.

- **A MUTUAL AGENCY:**

U/s 18 of the Indian partnership act 1932 there must exist mutual agency relationship amongst the partner. It means each partner is both agent and a principal. A partner is an agent of the other partner in the sense that by his act he can mind other

partners. He is principal in the sense that he can be held liable for the acts of the other partners.

- **CONDITIONS OF CONTRACT:**

As partnership is an agreement it must fulfil the conditions of the contract such as capacity, competency lawful business registration etc.

## 23.4 TEST OF PARTNERSHIP

Following three tests must be undertaken to determine whether or not a group of persons doing lawful activity constitute partnership or not.

**1. Agreement to share profits:**

Sharing of profit is a prima facie evidence of existence of partnership. The term profits mean net profit i.e surplus left after deducting all expenses paid or payable. In what ratio profit is to be shared is immaterial.

**2. Mutual agency:**

U/S 18 of the Indian partnership act a partner is both agent and principal. It means each partner is both agent and a principal. A partner is an agent of the other partner in the sense that by his act he can bind other partners. He is principal in the sense that he can be held liable for the acts of the other partners.

**3. Intention of parties:**

The intention of the partners may be gathered from their conduct, course of dealings, circumstances of their entering into business.

## 23.5 DISTINGUISH

**1. Partnership and Co-ownership**

| | Partnership | Co ownership |
|---|---|---|
| 1 | **Business:** To carry on business is an essential element of partnership. | Co ownership may exist without carrying on any business. |
| 2 | **Mutual agency:** There exist mutual agency among the partners of the firm. | No mutual agency exists among co owners. |

| | | |
|---|---|---|
| 3 | **Creation:** Partnership is created by an agreement. | Co ownership is created by an agreement or by law or by virtue of status. |
| 4 | **Profit:** An agreement to share profit is essential element of partnership. | Sharing of profit is not essential as they may not be Interested in doing business. |
| 5 | **Lien:** a partner has a lien on the property of the firm owned in common | Co ownership has no lien on the property owned in common. |
| 6 | **Partition of property:** a partner cannot demand the partition of property of the firm. | A co-owner is entitle to claim partition of property.7 |
| 7 | **Agreement:** Partnership arises from an agreement. | Co ownership may or may not arise from agreement. |
| 8 | **No of partners:** Minimum 2, maximum 10 for banking,20 for other business. | There is no maximum limit of co owners. |

**2. Partnership and Company**

| | Partnership | Company |
|---|---|---|
| 1 | **Meaning:** Partnership is the relationship between the persons who have agreed to share profits of the business carried on by all or any one of them acting for all. | A company means a company formed and registered under company's act or an existing company. |
| 2 | **Legal person:** A firm is not a legal entity. | A company is a legal person created in the eye of a law. |
| 3 | **Liability:** liability of a partner is unlimited. Even personal property of the partner is liable to settle claim of creditor. | In case of company the liability of the member is limited to the extent of unpaid amount on calls. |
| 4 | **Transfer of share:** in a firm a partner cannot his share without the consent all the partners. | In a company shareholder can transfer his shares subject to the provision of A.A. |
| 5 | **Agency :** every partner is an agent of other partner. | Shareholder of the company is not an agent of the company. |
| 6 | **Registration:** registration of | Registration of company is |

| | | |
|---|---|---|
| | firm is not compulsory under partnership act 1932. | compulsory under companies act 1956. |
| 7 | **Management:** management vests in the hands of the partners except in the case of sleeping partner | Management vests in the hands of BOD, elected periodically by the shareholders. |
| 8 | **Creditors:** creditors of the firm are also the creditor of the partners individually as well. | Creditors are only the creditors of the company and not of individual shareholders. |
| 9 | **Accounts:** Accounts of the partnership need not be audited by the auditors | Accounts of the company must be audited by auditor. |
| 10 | **Ownership of property:** the property of the Firm collectively belongs to the partner. | The property of the company, belongs to the company, and not to the shareholders |
| 11 | **Effect of death:** In case of a death or insolvency of a partner firm gets dissolved, unless there is contract to the contrary. | In case of company, death or insolvency of a member of the company does not results in to dissolution of the company. |
| 12 | **Disposal of property:** A partner can dispose the property of the firm | A shareholder cannot dispose of the property of the company. |
| 13 | **No of members:** minimum 2, maximum 10 in case of banking and 20 in case of general business. | In case of private company maximum 50 members and public company can have any number of shareholder. |
| 14 | **Existence:** partnership has no perpetual or continuous life. | Company has long and stale life |
| 15 | **Statutory obligation:** Partnership has less statutory obligation | Company is strictly regulated as per companies act 1956. |

**3. Partnership and HUF**

| | Partnership | Hindu undivided Family |
|---|---|---|
| 1 | **Meaning:** partnership is the relationship between the persons who have agreed to share profits of the business carried on by all or any of the acting for all. | A joint Hindu family which carries on business handed down from its ancestors. |
| 2 | **Agreement:** It can arise only by an agreement of the partner | It arises by the operation of the law. |

| | | |
|---|---|---|
| 3 | **Admission of new member:** A new partner can be admitted in the partnership, only with the consent of all the partners. | A person becomes member only by birth in the family. |
| 4 | **Numbers:** maximum 10 in case banking and 20 in case any general business. | There is no statutory limit on maximum numbers of members. |
| 5 | **Mutual agency:** There exist mutual agency among the partners i.e. all is acting for one and one is acting for all. | There is no such agency relationship between members of the family. The karta i.e. head or manager of the family is the only representative of the family. |
| 6 | **Implied authority:** Every partner has an implied authority to bind the firm by his acts done in the ordinary course of the business. | Only karta has an implied authority to bind the family by his acts. |
| 7 | **Liability:** A partner is personally liable for the business obligation of the firm. The share of each partner in the property and profits along with his private property is liable for the discharge of the debts of the firm. | A member is not personally liable for the business obligation of the family. Only his share of profits and property in the family is liable for discharge the debts of the family. |
| 8 | **Dissolution/partition:** A partner has right to demand for dissolution of firm. | A member has right to demand the partition of the joint family property. |
| 9 | **Death/insolvency:** firm gets dissolved on death or insolvency of any one partner. | It is not dissolved on the death or insolvency of any of the members. |

## 23.6 PROPERTY OF THE FIRM (SECTIONS 14 & 15)

Property of the firm includes all property, rights and interest in the property originally brought in to the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm and includes the good will of the business.

The following shall constitute the property of the firm in the absence of any agreement.

1. Property originally brought in by the firm.
2. Property acquired by or for the firm after the commencement of the partnership.
3. Partners personal property in the firms used.

E.g. Personal Motorbike is been used exclusively for firms purpose becomes the property of the firm and partner becomes creditor for that amount.

4. Conversion of joint properties into separate property

   **Example:** Vehicle bought out of the joint funds of the firm is used by Mr A the partner, for the private use only. The vehicle becomes the property of A and Mr. A becomes Debtor of the firm for the car amount.

5. Goodwill of the business is an advantage the firm has acquired while carrying on its business. In other words it is benefit acquired in terms of reputation connection etc. Goodwill is of two types :

a. **Personal goodwill:** It is associated with individual partners of the firm enjoys reputation in his own name.

b. **Firms goodwill:** It is associated with the premises of the firm. It is the firm's name which enjoys the reputation or goodwill in the market.

Goodwill is an asset of the firm and can be sold either separately or along with the other property of the firm.

## 23.7 TYPES OF PARTNERSHIP

**1. Partnership for a fixed term:**

It is a partnership where at time period is fixed. Such a partnership gets dissolved at the expiry of the time period. Before the fix period it may be dissolved by mutual consent. However if it continues after the fix period it becomes partnership at will

**2. Particular partnership:**(Section 8)

Where two or more persons agree to do business in a particular adventure or undertaking such partnership is called particular partnership.

**E.g.** X & Y enter into partnership for producing advertising film.

**3. SECTIONS 7 & 43:**

**It is a** partnership in which duration is not fixed and can be dissolved by any partner by giving a notice. The firm may be dissolved by any partner by giving 14 days advance notice in writing to all the other partners indicating his intention to dissolve the firm.

## 23.8 DISSOLUTION OF FIRM

### 23.8.1 MEANING OF DISSOLUTION:

Partnership, as we are aware is a result of an agreement. All agreements can be discharged or terminated. This termination of the contractual relationship in case of partnership is called as dissolution. Dissolution under the partnership law can be mean “Dissolution of the firm” as well as “Dissolution of partnership”. Commonly both are taken to mean the same and are used interchangeably. However, legally there is a difference in the two. Dissolution of the firm means complete breakdown of the relations among all partners. Whereas dissolution of the partnership means, the relationship between same partners came to be an end while the firm continues. It would be right for us to say dissolution of the firm necessarily implies dissolution of partnership whereas dissolution of partnership does not necessarily involve dissolution of firm.

### 23.8.2 Example:

1. A, B,C, D. are partners in a firm. A, dies B, C, D decides to close down the firm. This amount to dissolution of the firm.
2. A, B, C, D, and E are partners in a firm. There is an agreement that the firm shall not be dissolved on the death, retirement or expulsion of any partner. C dies, this amounts to dissolution of partnership as the firm continues. Only relationship with C. comes to an end.

### 23.8.3 MODES OF DISSOLUTION

There are modes of dissolution of a firm

1) Voluntary dissolution.
2) Dissolution by operation of law.
3) Dissolution by intervention of court.

**1. Voluntary dissolution**:

It includes dissolution by any of the following manner.

**a) By consent:** All partners may consent for the dissolution of the firm. This can happen whether the firm is for a fixed duration or not.

**b) By agreement:** A firm may be dissolved in accordance with a contract. For example partnership formed for a specific period or for a particular venture.

c) **By notice :**Whenever a partnership is at will any partner can give 14 days' clear notice in advance indicating his intention to disassociate from the firm.

**2. Dissolution by operation of law:**

It includes dissolution in any of the following manner.

a) **Compulsory dissolution:** In this case firm is compulsorily dissolved due to insolvency or some new law makes the business of the firm unlawful

b) Some event making the business unlawful, if carried on in partnership, due to change in its number, example a firm carrying in banking business by more than 10 person

c) On happening of certain contingencies such as expiry of fixed period or particular venture for which it was formed, on death of a partner and on insolvency of a partner.

**3. Dissolution by intervention of court**:

It arises on the following ground:

**a) Insanity of a partner**:

When a partner becomes of unsound mind. The other partner can institute case against such partner to dissolve the firm.

**b) Permanent incapacity:**

In case a partner becomes permanently incapable in discharging his duties, the court may order dissolution of the firm.

**c) Misconduct of a partner:**

When a partner is guilty of misconduct which adversely affects the business of the firm then court may order dissolution of the firm provided other partner take legal action.

**d) Wilful or persistent breaches of agreement:**

Sometimes, a partner wilfully or persistently commits a breach of agreement relating to the management of the affairs of the firm or conducts the business in such a way that the other partners find it difficult to carry on business with him. In such a cases any partner other than the guilty partner may approach the court for dissolution.

**e) Transfer of interest:**

Sometimes a partner may transfer the whole of his interest or share to a third party or the share may be charged or the share

has been sold for the recovery of arrears of land revenue in which cases the other partner or partners may seek for dissolution of the firm

**f) Losses in business :**

Where the business of the firm cannot be carried on except at a loss the court can order for dissolution.

**g) Any other just an equitable ground:**

Where the court is satisfied that is just an equitable to dissolve the firm.

**NOTE :** The right of a partner to file a suit or dissolution of any of the above seven grounds cannot be excluded by any agreement to the contrary. (Hardit Singh v. Mukha Singh (Air 1973 J&K 46)

### 23.8.4 RIGHTS OF A PARTNER ON DISSOLUTION OF A FIRM

1. Rights to have the business wound up.
2. Right to repayment of premium on premature dissolution.
3. Where the firm was dissolved on account of fraud or misrepresentation by a partner, the innocent partner can rescind the contract and also have right to retain surplus if any for the capital and sum paid to be indemnified for all debts paid with regard to the firm.
4. Right to restrain partners from the use of the firm name or firm property.

### 23.8.5 LIABILITY OF A PARTNER ON DISSOLUTION OF A FIRM

1. Every partner continues to be liable to the third parties for the acts of the Firm even after dissolution until public notice is given.
2. The partner would even liable for any transaction began but remain unfinished at the time of dissolution.
3. Sometimes, a firm is dissolved on account of the death of a partner, and before the affairs are wound up the surviving partners continue to carry on business. Any profit made in such a case needs to be accounted for.

## 23.9 QUESTIONS

1. Define partnership. Explain its features
2. Explain Test of partnership

3. What do you mean by the property of the firm under section 14 & 15?
4. Explain kinds of partnership
5. What do you mean by dissolution of the partnership firms? How dissolution takes place by operation of law?
6. Explain dissolution by intervention of court.
7. Distinguish between partnership & co-ownership
8. Distinguish between partnership & company
9. Distinguish between partnership & Hindu undivided family.
10. Define the following terms:
    a. Partnership
    b. Partnership Deed
    c. Particular Partnership
    d. Dissolution of Partnership

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# 24

## MODULE-VIII
# THE CONSUMER PROTECTION ACT 1986

**Unit Structure**



## 24.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand how to apply the Consumers Protection Act and define the related terms in the Act.
- Discuss bout the Consumers Protection Council.
- Explain the procedure of redressal of the Consumers Disputes.

## 24.1 INTRODUCTION

The Consumer Protection Act, 1986 seeks to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consumer's disputes and for matters connected therewith. The interests of consumers were also protected even earlier under the provisions of several legislations but these legislations failed to protect the ultimate consumer from defective goods or deficient services, overcharging of prices and unscrupulous exploitation. Further, there is ignorance of the consumer of his rights. The consumers have not yet organised themselves into a powerful movement. The consumer needed better protection which led to the enactment of the Consumer Protection Act of 1986. The Act is a very important socio-economic legislation with its main thrust on giving speedy redressal and compensation to the consumer.

## 24.2 APPLICATION OF THE ACT AND DEFINITIONS OF THE RELATED TERMS

### 24.2.1 Application of the Act:

The Act applies to all goods and services. The Central Government has the power to issue notification exempting any goods or services from the application of the Act. But, no such notification has been issued so far. Thus, the Act applies to all goods and services whether in private, public or co-operative sector. Now a consumer can initiate an action under this Act against defective goods supplied or deficient services rendered even by public sector or government undertakings such as Railways, Telephones, Electricity Boards, Postal authorities etc.
The Act is a beneficial statute specially enacted to confer additional consumer rights and to preserve and guard the existing one under the law.

The Act gives the consumer an additional remedy besides those which may be available under the existing laws. However, the, Forums under the Act have not taken over the jurisdiction of civil courts. If the dispute between the parties is pending in civil court, no consumer forum will adjudicate the dispute. Similarly, if evidence to be laid by the parties to the dispute is voluminous or complicated, the parties will be referred to the appropriate civil court.

### 24.2.2 Definitions:

**1. Consumer of Goods**[Sec.2(1)(d)]

Under Sub-Clause (i) of Section 2(1)(d), a consumer for the purpose of goods means any person, who :

(a) Buys any goods for consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment.
(b) Includes any user of such goods other than the person who buys them, when such use is made with the approval of the buyer.

The person claiming himself as ‘consumer’ should satisfy that

(i) There must be a sale transaction between the seller and the buyer,
(ii) The sale must be of goods,
(iii) The buying of goods must be for consideration,

(iv) The consideration has been paid or promised or partly paid and partly. Promised or under any system of deferred payment,

(v) The user of the goods may also be a consumer when such use is made with the approval of the buyer.

**Who is not a consumer?**

A person is not a consumer if he obtains goods for resale or for any commercial purpose. Commercial purpose does not include use by a consumer of goods bought by and used by him exclusively for the purpose of earning his livelihood, by means of self-employment for e.g. buying a car to run it as a taxi or a widow purchasing a sewing machine for her lively hood etc.

When the manufacturer sells the goods to the wholesaler, who in turn sells the goods to a retailer, the wholesaler will be excluded from the definition of the word consumer as he has brought the goods for 'resale' or for 'commercial purpose'. A person buying the goods for resale or for commercial purpose, even if for consideration, is not a consumer. Commercial purpose is commerce, mercantile, having profit as the main aim. It includes all business activities. A purchase of a car by a company for use by its business, by director and employees is purchased for commercial purpose. (V. M. Agarwal J. By ford Leasing Ltd. 1992 CPJ 29 Del).

**2. Person [Sec. (i) (m)] Person includes :**

(i) a firm whether registered or not

(ii) a Hindu undivided family

(iii) a co-operatives society

(iv) every other association of persons whether registered under the Societies Registration Act, 1860 or not.

A person has to be a consumer within the definition of the word consumer under the Consumer Protection Act to get remedy.

**3. Good:**

The meaning of the word 'Goods' under the Consumer Protection Act is the -same as defined in the Sale of Goods Act of 1930.

**4. Service [Sec.2(o)]:**

"Service" means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport,

processing, supply of electrical or other energy, board or lodging or both, (housing construction) entertainment, amusement or the purveying of news or other information but does not include the rendering of any service free of charge or under a contract of personal service.

Contact of personal service is excluded from the definition. A service offered by an Advocate to his client or service rendered by a private tutor is therefore not included in the definition.

**5. Consumer Dispute**[Sec. 2(1)(e)]

"Consumer Dispute" means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

**6. Complainant [Sec.2(1)(b)]**

"Complainant" means

(i) a consumer or

(ii) any voluntary consumer association registered under the Companies Act, 1956 or under any other law for the time being in force. or

(iii) the Central Government or any State Government, who or which makes a complaint, or

(iv) one or more consumers, where there are numerous consumers having the same interest.

A person seeking redressal of his complaint, must come within any of the above mentioned categories, otherwise he has no **Locus Standi** to proceed with the case before the consumer Redressal Forum.

**7. Complaint [Sec. 2 (1)(c)]**

Complaint means any allegation in writing made by a complainant in regard to one or more of the following :

(i) an unfair trade practices or a restrictive trade practice has been adopted by any trader.

(ii) the goods bought by him or agreed to be bought by him, eager suffer from one or more defects.

(iii) the service hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect.

(iv) a trader has charged for the goods mentioned in the complaint a price in excess of the price fixed by or under any law for the

time being in force or displayed on the goods or any package containing such goods.

(v) goods which will be hazardous to life and safety when used, are being offered for sale to the public in contravention of the provision of any law for the time being in force requiring traders to display information in regard to the contents, manner and effect of use of such goods.

In order to obtain any relief under this Act the complaint must be made in writing specifying the name and address of the complainant and the opposite party. It must state the facts and also must specify the relief which the complainant is seeking.

**8. Trader [**Sec. 2(1)(q)]

(1) A person who sells or distributes any goods for sale and includes

(2) the manufacturer of goods and

(3) packer - where such goods are sold or distributed in package form.

**9. Manufacturer [**Sec.2(1) (j)]

"Manufacturer" means a person who

(1) makes or manufactures any goods or part of it or

(2) assembles parts of any goods which are made or manufactured by others and claims the end product to be goods manufactured by himself or

(3) puts his own mark on any goods made or manufactured by any other manufacturer and claims such goods to be goods made or manufactured by himself.

Where a manufacture dispatches any goods or parts thereof to any branch office maintained by him, such branch office is not the manufacturer, even though the parts dispatched are assembled at such branch office and are sold or distributed from such branch office.

**10. Defects: Sec. 2(1)(f)**

"Defect" means any fault, imperfection or shortcoming in the quality, potency purity or standard which is required to be maintained by or under any law for the time being in force under any contract, express or implied or as is claimed by the trader in relation to any goods.

**11. Deficiency: Sec.2(1)(g)**

Deficiency means any fault, imperfection or shortcoming or inadequacy in the quality, nature and manner of performance which

is required to be maintained or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

### 24.2.3 Cases:

1. Abhoya Kumar Panda V. Bajaj Auto Ltd.
(1992)/Comp. L.J. 180 (NCDRC)

The complainant purchased a Bajai Auto Trailer manufactured by the respondent. The vehicle suffered from a major structural manufacturing defect. The National Commission held that the manufacturer should not have sold initially a product which suffered from a major manufacturing defect.

2. Deficiency in telephone service.
Overbilling – In Union of India V. Nilesh Agarwal.
(1991) 1 CPR 23 (Raj CDRC)

A complaint was made averring that there were excess charges in the telephone bill. The Rajasthan State Commission held that the complainant who is a subscriber is a 'consumer' and the telephone service provided by the Telecom Department is a 'service' for which he pays rent and over billing of telephone is "deficiency in service" within the meaning of the section.

## 24.3 CONSUMER PROTECTION COUNCILS (Section4 to 8)

### A. Central Council

### 24.3.1Constitution of the Central Council

According to section 4(2) of this Act the Central Council shall consist of the following 150 members namely:

(a) The Minister in-charge of consumer affairs who shall be the Chairman of the Central Council.

(b) The Minister of State (where he is not holding independent charge) or Deputy Minister in the Department who shall be the Vice-Chairman of the Central Council.

(c) The Minister of Food and Civil Supplies or Minister in charge of Consumer Affairs in states.

(d) Eight Members of Parliament - five from the LokSabha and three from the Rajya Sabha.

(e) The Commissioner for Scheduled Castes and Scheduled Tribes.

(f) Representatives of the Central Government Departments and autonomous organizations concerned with consumer interests - not exceeding twenty.

(g) Representatives of the Consumer Organisations or Consumers - not less than thirty-five.

(h) Representatives of women - not less than ten.

(i) Representatives of farmers, trade and industries - not exceeding twenty.

(i) Persons capable of representing consumer interest not specified above not exceeding fifteen.

(k) The Secretary in the Department of Civil Supplies shall be the member secretary of the central council.

According to the notification issued by the Central Government on 10th April 1988 the total strength of the Central Council shall be 126 members representing the concerned ministries, departments, consumer organisations. The Chairman of the Central Council shall be the Minister-in-charge of consumer affairs in the Central Government.

**24.3.2 Term of the Central Council:**

The term of the central council shall be three years. But it is very difficult task to reconstitute the whole council after every three years. It is therefore suggested that it should be the term of the members other than ex-official members of the council which shall be three years and not the term of the council. Thus, the members may keep on changing on the expiry of their terms but the council will always remain to protect the interest of the consumers.

**24.3.3 Procedure for meetings of the Central Council (Sec.5)**

Sub-section (1) of Sec. 5 makes it obligatory that the Central Council must hold at least one meeting in a year. This is the minimum requirement but the Council is entitled to hold as many meetings as it deem necessary.

Following is the Procedure for meetings:

**1. Proper Authority:**

The proper authority to call the meeting of the Central Council is the Chairman of the Council.

**2. Notice:**

A proper notice of the meeting should be given to the members. The notice should be in writing and must be given at

least ten days before the date of the meeting of the council. Notice should also specify the place and the day and hour of the meeting and shall contain statement of business to be transacted in the meeting.

**3. Presiding Officer:**

It shall be presided over by the Chairman of the council. In the absence of Chairman, the Vice Chairman shall preside over the meeting.

**4. Resolution:**

The resolution shall be passed by simple majority of the members present and voting. The resolution passed by the council shall be recommendatory in nature.

**5. Defect in the Constitution of Council:**

The proceedings of the central council shall not be invalid merely by reason of existence of any vacancy in or any defect in the constitution of the council.

**6. T.A. AND D.A. to Members:**

The non-official members are entitled to first class railway fare to and from and a daily allowance of one hundred rupees per day, for attending the meetings of the Central Council or any working group. Members of Parliament are entitled to travelling and daily allowances at such rates as are admissible to such members.

**24.3.4 Objects of the Central Council (See 6):**

The object of the Central Council shall be to promote and protect the rights of the consumer such as :

(a) The right to be protected against marketing of goods and services which are hazardous to life and property.

(b) The right to be informed about the quality and quantity potency, purity standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices.

(c) The right to be assured, whenever possible, access to a variety of goods and services at competitive prices.

(d) The right to be beard and to be assured that consumers interests will receive due consideration at appropriate forums.

(e) The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers and

(f) The right to consumer education.

### B. THE-STATE CONSUMER PROTECTION COUNCILS (Sec.7)

#### 24.3.5 Constitution of the State Council

The State Council shall consist of the following members, namely :

(a) The Minister in charge of consumer affairs in the State Government who shall be it's chairman.

(b) Such number of other official or non-official members representing such interests as may be prescribed by the State Government.

The State Councils have to play a vital role in creating consumer awareness and in the development of consumer movement in their states as well as in the country. The amendment Act, 1993 has made it obligatory under section 7(3) that the State Council must hold at least two meetings in a year. The State Government has to prescribe the procedure for the conduct of the meetings of the State Council.

#### 24.3.6 Objects of the State Council (Sec.8):

The object of the council shall be to promote and protect within the state the rights of the consumers laid down in clauses (a) to (f) of section 6.

## 24.4 CONSUMER DISPUTE REDRESSAL AGENCIES (SEC. 9 TO 15)

### 24.4.1 REDRESSAL OF CONSUMER DISPUTES

To provide simple, speedy and inexpensive redressal of consumer grievances, the Act envisages Three-tier quasi-judicial machinery at the district, state and national level. At the district level there will be "District Forum" to entertain consumer complaints where the value of goods or services and compensation does not exceed rupees five lakhs, and at the state level there will be 'State Commission' to deal with the complaints where the claim exceeds rupees five lakhs but does not exceed rupees twenty lakhs. At the national level there is a 'National Commission' for complaints exceeding rupees twenty lakhs.

**1. District Forum –(Sec. 9)**

Each district of the state shall have a Consumer Dispute Redressal Forum known as 'District Forum' it is to be established by the State Government by notification to be published in official Gazette. With the 1993 amendment, the constitution and setting up of the District Forum is now under the exclusive domain of the State Government. The State Government, if it deems fit, establish more than one District Forum in a district.

- **Composition of the District Forum (Sec.10):**

Each District Forum shall consist of

(a) a person who is or has been or is qualified to be a District judge, who shall be it's President.

(b) two other members, who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

Every appointment shall be made by the State Government on the recommendation of a selection committee consisting of the following:

(i) The President of the State Commission - Chairman.

(ii) Secretary, Law Department of the State - Member.

(iii) Secretary in-charge of the Department dealing with consumer affairs in the State - Member.

Every consumer of the District Forum shall hold office for a term of five years or up to the age of 65 years whichever is earlier and shall not be eligible for re-appointment.

A member may resign his office in writing under his hand addressed to the State Government. His office shall become vacant on his resignation being accepted by the State Government. Any vacancy so caused may be filled by appointment of a person possessing the required qualifications. The salary or honorarium and other allowances payable to, and the other terms and conditions of service of the members of the District Forum shall be as may be prescribed by the State Government.

- **Jurisdiction of the District Form (Sec. 11)**

Subject to the other provisions of this Act, the District Forum shall have jurisdiction to entertain complaints where the value of the

goods or services and the compensation, if any claimed does not exceed rupees five lakhs.

The provisions of Sec. 11 are intended to bring justice as near as possible to the consumers and at the same time the defendant should not be put to under inconvenience of travelling long distance.

- **Pecuniary Jurisdiction**

The complaint involving claims exceeding rupees five lakhs cannot be entertained by the District Forum. 'The pecuniary Jurisdiction depends upon the amount of relief claimed and not upon the value of the subject matter, nor upon the relief allowed by the forum.

- **Territorial Jurisdiction**

Section 11 sub sec. (2) provides that a complaint shall be instituted in a District Forum within the local limits of whose jurisdiction.

**a.** The opposite party or each of the opposite parties at the time of institution of the, complaint (i) actually and voluntarily resides or (ii) carries on business or (iii) has a branch office or (iv) personally works for gain.

**b.** Where there are more than one opposite parties, any of the opposite parties at the time of the institution of the complaint - (i) actually and voluntarily resides or (ii) carries on business or (iii) has a branch office or (iv) personally works for gain. Provided that in such case either the permission of the District Forum is given or the opposite party who do not reside or carry on business etc., consents in such institution.

**c.** The cause of action, wholly or in part arises.

**Who can make the complaint(Sec.12):**

Under sec. 12 a complaint may be filed by:

**a.** the consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.

**b.** any recognised consumer association whether the consumer to whom the goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided is a member of such association or not.

**c.** one or more consumers, where there are numerous consumers having the same interest, with the permission of the District

Forum, on behalf of or for the benefit of, all consumers so interested.

**d.** the central or the State Government.

Thus the complaint may be filed by the affected consumer himself or by any recognised consumer association. It meant any voluntary consumer association registered under the Companies Act, 1956 or any other law for the time being in force.

- **Procedure on receipt of complaint (Sec. 13):**

The provisions of sec. 13 lay down the procedure which is to be followed by the District Forum on the receipt of a complaint under the Act, where a complaint does not require analysis or testing of the goods, it should be decided as far as possible within a period of 90 days from the date of the notice received by the opposite party and within 150 days if it requires analysis or testing of goods.

- **Procedure applicable to State Commission and National Commission**

This procedure specified in Sec. 13 for disposal of complaints is also applicable to the disposal of complaints by the State Commission under sec. 18 and by the National Commission under sec. 22.

- **Remedies available to consumers (Sec. 14):**

Sec. 14 of the Act enumerates the relief that can be granted to a complainant by the District Forum. The provisions of this section are also applicable to the State Commission under sec.18 and to the National Commission under rule 14(5) of the Consumer Protection Rules, 1987.

According to section 14(1) if, after the proceeding conducted under sec. 13, the District Forum is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in complaint about the services are proved, it may grant relief by directing the opposite party to do one or more of the following things :-

(a) to remove the defect pointed out by the appropriate laboratory.

(b) to replace the goods with new goods of similar description,

(c) to return the price or charges paid by the complainant,

(d) to pay compensation for loss or injury suffered by the consumer due to the negligence of the opposite party.

(e) to remove the defects or deficiencies in the services in question.

(f) to discontinue the unfair trade practice or the restrictive trade practice or not to repeat it,

(g) not to offer the hazardous goods for sale,

(h) to withdraw the hazardous goods from being offered for sale,

(i) to provide for adequate costs to parties.

The satisfaction of the District Forum must be based upon the judicial approach and after complying with the procedure laid down in Sec. 13 of the Act.

- **Cases**

1. In Patel Ramabhai Shankerlal vs. Indian Airlines Corporation. (1991) CPR 422 (Guj. CDRC) Gujarat State Commission has held that power to re-schedule the flight is a rare power and if the Indian Airlines Corporation exceeds that power, the corporation should be considered to be negligent and hence it should be held liable to bear damages.

2. In Secretary Karnataka Electricity Board vs. Secretary Bellary Citizen's Forum. (1991) 1 CPR 475 (Kant CDRC).

The complainants alleged that due to sudden high voltage surge, the electric equipment and fitting got damaged and claimed compensation for the same. The Karnataka State Commission held that mere fluctuation in the electricity voltage will not by itself give cause of action to the consumers for claiming damages. The complainants have to prove negligence of the officials of the Electricity Board.

- **Appeal (Sec. 15)**

Any person aggrieved by an order made by the District Forum may prefer an appeal against such order to the state commission within a period of thirty days from the date of the order, in such form and manner as may be prescribed.

Provided that the state commission may entertain an appeal after the expiry of the said period of thirty days if it is satisfied that there was sufficient cause for not filing it within that period.

When the appeal is presented after the expiry of the period of limitation as specified in the Act, the memorandum of appeal shall be accompanied by an application supported by an affidavit setting forth the fact on which the appellant relies to satisfy the

state commission that he has sufficient cause for not preferring the appeal within the period of limitation.

**2. State Commission**

**Composition of the State Commission (Sec.16):**

Each state commission shall consist of:

**a.** a person who is or has been a judge of a High Court, appointed by the State Government, who shall be its President provided that no appointment under this clause shall be made except after consultation with the Chief Justice of the High Court.

**b.** two other members, who shall be persons of ability integrity and standing and hate adequate knowledge or experience of, or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administrations, one of whom shall be a woman.

Provided that;

**a.** every appointment made under this clause shall be made by the State Government on the recommendation of a selection committee consisting of the following namely :

(i) President of the State Commission - Chairman.

(ii) Secretary of the Law Department of the State - Member

(ill) Secretary and in-charge of Department dealing with consumer affairs in the state - Member.

**b.** The salary or honorarium and other allowances payable to, and the other terms and conditions of service of the members of the state commission shall he such as may be prescribed by the State Government.

**c.** Every member of the State Commission shall hold office for a term of five years or up to the age of sixty-seven years, whichever is earlier and shall not be eligible for re-appointment.

**d.** Notwithstanding anything contained in sub-section (3), a person appointed as a President or a member before the commencement of the consumer protection (Amendment) Act, 1993, shall continue to hold such office as President or member as the case may be, till the completion of his term.

- **Vacancies in office**

A vacancy in the office of the President or a member may occur, after the expiry of the term, or by resignation, or by removal. According to the Consumer Protection Rules framed by the States,

the President or a member may resign his office at any time by writing under his hand and addressed to the State Government; Every vacancy so caused shall be filled up by fresh appointment. No act or proceeding of the District Forum, the State Commission or the National Commission shall be invalid by reason only of the existence of any vacancy amongst its members or any defect in the constitution thereof.

- **Removal of the President or Member**

The State Government may remove from office, the President or member of the State Commission who -

(a) has been adjudged an insolvent or

(b) has been convicted of an offence which, in the opinion of the State Government, involves moral turpitude or

(c) has become physically or mentally incapable of acting as such president or

(d) has acquired such financial or other interest as is or a member, as the case may be or

(e) has so abused his position as to render his continuance in office prejudicial to public interest.

However the President or a member shall not be removed from his office on the ground specified in clause (d) and (e) above, except on an inquiry held by the State Government.

- **Jurisdiction of the State Commission(Sec.17)**

The State Commission shall have jurisdiction

a. to entertain:

(i) Complaints where the value of the goods or services and compensation, if any claimed exceeds rupees five lakhs but does not exceed rupees twenty lakhs and

(ii) Appeals against the orders of any District Forum within the State and

b. to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State where it appears to the state commission that such District Forum has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of it's jurisdiction illegally or with material irregularity.

Thus the State Commission has been vested with three types of jurisdiction namely.

(i) Original jurisdiction
(ii) Appellate Jurisdiction and
(iii) Revisional jurisdiction

- **Appeals (Sec. 19):**

Any person aggrieved by an order made by the State Commission in exercise of its powers conferred by sub-clause (i) of clause (a) of section 17 may prefer an appeal against such order to the National Commission within a period of thirty days from the date of the order in such form and manner as may be prescribed.

## 3. NATIONAL COMMISSION

### Composition of National Commission(Sec. 20):

The National Commission shall consist of :

a. a person who is or has been a judge of the Supreme Court, to be appointed by the Central Government who shall be it's President, provided that no appointment under this clause shall be made except after consultation with the Chief Justice of India.

b. four members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of, or have shown capacity in dealing with, problems relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

Provided that:

1) every appointment made under the clause shall be made by the Central Government on the recommendation of a selection committee consisting of the following, namely :
   - i A person who is a Judge of the Supreme Court, to be nominated by the Chief Justice of India - Chairman.
   - ii The Secretary in the Department of Legal Affairs in the Government of India - Member.
   - iii Secretary of the Department dealing with consumer affairs in the Government of India - Member.

2) The salary or honorarium and other allowances payable to and the other terms an d conditions of service of the members of the National Commission shall be such as may be prescribed by the Central Government.

3) Every member of the National Commission shall hold office for a term of five years or upto the age of seventy years, whichever is earlier and shall not be eligible for re-appointment.

Notwithstanding anything contained in sub-section (3) a person appointed as a President or a member before the commencement of the Consumer Protection (Amendment) Act 1993 shall continue to hold such office as President or member, as the case may be, till the completion of the term.

- **Terms and conditions of service of the President and members of the National Commission (Rule 12) :**

Before appointment, the president and a member of the National Commission shall have to take an undertaking that he does not and will not have any such financial or other interest as is likely to affect pre judicially his functions as a member.

The terms and conditions of service of the President and the members shall not be varied to their disadvantage during their tenure of office.

- **Vacancies in office**

A vacancy in the office of the President or a member, may occur by the expiry of the term, or by death, resignation, or by removal. A vacancy so caused shall be filled up by fresh appointment by the central government.

- **Removal of the President or Member (Rule 13):**

Rule 13 of the Consumer Protection Rule, 1981 provides that the Central Government may remove from office the President or member of the National Commission on the same grounds as earlier mentioned for the removal of the president or member of the State Commission.
(See Removal of President or Member of the State Commission).

- **Jurisdiction of the National Commission (See. 21):**

The jurisdiction of the National Commission may be classified into three categories namely.

**(1) Original Jurisdiction -** to entertain complaints where the value of the goods or services and compensation, if any, claimed exceeds rupees twenty lakhs.

**(2) Appellate Jurisdiction -** to entertain appeals against the order of any State Commission.

**(3) Revisional Jurisdiction -** This is limited to consumer disputes where in a state commission

(i) has exercised a jurisdiction not vested in it by law or

(ii) has failed to exercise jurisdiction so vested or

(iii) has acted in the exercise of its jurisdiction illegally or with material irregularity. The National Commission can exercise its power in revision only under these situations.

- **Appeals**

From the order of the State Commission, an appeal shall lie to the National Commission and from the order of the National Commission an appeal shall lie to the Supreme Court, an appeal shall be filed within a period of thirty days. The delay may be condoned on the aggrieved party showing a sufficient cause.
Every order passed by the District Forum, State Commission or National Commission, unless appeal, shall be final. Every order may be enforced as a decree or order of the court.

**Note:** As amended by The Consumer Protection (Amendment) Act 1993.

## 24.5 QUESTIONS

1. "Every person is not a consumer under the Consumer Protection Act". Explain with special reference.
2. What is a consumer dispute? Who can file a complaint and under what circumstances?
3. What is the meaning of "defects" in goods and "deficiency" in service?
4. Discuss the three tier system of redressal to consumer disputes under the Consumer Protection Act.
5. Lay down the constitution and powers of the District Forum with the extent to which it can exercise jurisdiction.
6. What are powers of the State Commission ?
7. Lay down the composition of the National Commission and the term and conditions of service of the President and its members.
8. Write Short notes on:
   a. Central Consumer Protection Council
   b. State & Consumer Protection Council
9. Define the following terms;
   a. Consumer b. Complaint
   c. Complainant d. Manufacturer
   e. Trader f. Defects g. Deficiencies

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# 25

# LAW OF COMPETITION: (THE COMPETITION ACT 2002)

**Unit Structure**



## 25.0 OBJECTIVES

After studying the unit the students will be able to:

- Know about Competitive Advocacy.
- Explain the meaning of Anti-competitive Agreement
- Know the meaning and abuse of dominant position
- Understand about the establishment of Competitive Commission of India and its duties, scope of inquiries, and orders by the commission.

## 25.1 INTRODUCTION

The Monopoly and Practices Act 1969 has become obstacle in certain respect mainly due to globalisation and liberalisation. There is need to shift our focus from curbing monopolies to promoting competition.

The competition Act 2002 provides for establishment of quasi-judicial body to be called as Competition Commission of India (CCI) which shall not only ensure fair competition but also undertake competition advocacy for creating awareness and imparting training on competition issues. The act also provides for investigation by the Director General for the commission. The director General would be able to act only if so directed by the commission but will not have any suomotu power for initiating investigations. The Act confers power upon CCI to levy penalty for

contravention of its orders, failure to comply with its direction, making of false statement or omission to furnish material information, etc. It can also order division of dominant enterprises and has power to demerger and amalgamations that adversely affects competition.

## 25.2 COMPETITION ADVOCACY (Sec.49)

The Central Government and State Government may in formulating policy on competition or on any other matter ,make a reference to the commission for its or its opinion on the possible effect of such policy on competition .The opinion given by the commission shall not be binding upon the Central government or State government The commission shall take suitable measure for the promotion of competition advocacy, creating awareness and imparting training about competition issues.

The MRTP Act, 1969 is repealed. The MRTP Commission established under MRTP ACT, stands dissolved. The MRTP may however, continue to exercise jurisdiction and power under the repealed Act for a period of two years from the date of commencement of the Competition Act in respect of all cases or proceedings filed before the commencement of competition Act, as if MRTP Act had not been repealed.

All cases pertaining to monopolistic trade practices or restrictive practices including cases of unfair trade practiced, pending before the MRTPC shall, after the expiry of aforesaid two years period stand transferred to the Appellate Tribunal and shall be adjudicated by the Appellate Tribunal in accordance with the provision of the repealed act.

All the investigation or proceedings, other than those relating to unfair trade practices pending before the Director General of Investigation and Registration , on or before the commencement stand transferred to the Competition Commission of India (CCI) may conduct or order for conduct or order for such conduct of such investigation or proceeding in the manner as it deem fit.

## 25.3 ANTI-COMPETITIVE AGREEMENT (Sec 3(1) (2) and 54)

### 25.3.1 Anti-competitive Agreement:

No enterprise or association of enterprises or persons or association of persons shall enter into any agreements in respect of production, supply, distribution, storage, acquisition, or control of goods or provisions of services, which causes or is likely to cause

an adverse effect on competition within India. Any agreement which causes an adverse effect on competition shall be void. The Act has no retrospective effect. An anti-competitive agreement entered into before the enforcement of the act will not be invalid. However, if the anti-competitive agreement continues after the enforcement of the act, the same shall rendered invalid.

The Central Government may exempt–

a) Any class of enterprise if such exemption is necessary in the interest security of the state or public interest.
b) Any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with other country or countries.
c) Any enterprise which performs a sovereign function on behalf of the central government or a state government.

### 25.3.2 Which type of an agreement cause an adverse effect on competition [Sec 3 (3) (4)]

1. Any agreement entered into between enterprises or association of enterprises or persons or association of persons or between any person and enterprise or practice carried on or decision taken by any association of enterprise or associations of persons, including cartels, engaged in identical or similar trade of goods or provisions of services, which—

a) Directly or indirectly determines purchase or sale price.
b) Limits or controls the production ,supply , markets, technical development, investment or provision of services;
c) Shares the market or source of production or provision of services, by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;
d) Directly or indirectly results in bid rigging or collusive bidding.

2. Any agreement amongst the enterprises or persons at different stages or level of the production chain in different markets, in respect of production, supply, distribution , storage sale or price of or trade in goods or provision of services including ---

a) Tie in arrangements;
b) Exclusive supply agreement;
c) Exclusive distribution agreement;
d) Refusal to deal;
e) Resale price maintenance.

### 25.3.3 Agreements which do not cause adverse effect on competition: [Sec 3 (5)]

The following agreements are excluded from the impact of adverse effect on competition:

1. The right of any person to restrain any infringement of or to impose reasonable conditions as may be necessary for protecting any of his rights which have been conferred upon him under---
   a) The Copyright Act 1957
   b) The Patents Act 1970
   c) The Trade and Merchandise Marks Act 1958
   d) The design Act 2000.
   e) The semi-conductor Integrated circuit Layout-Design Act 2000.

2. The right of any person to export goods from India to the extent to which agreement relates exclusively to the production, supply, distribution, or control of goods or provision of services for such exports.

3. Any agreement entered in to by way of joint ventures, if such agreement increases efficiency in production, supply, distribution, storage , acquisition or control of goods or provision of services.

## 25.4 DOMINANT POSITION

### 25.4.1 Meaning:

Dominant position means a position of strength, enjoyed by an enterprise , in the relevant market , in India, which enable it to

1) Operate independently of competitive forces prevailing in the relevant market; or
2) Effect its competitors or consumers or the relevant market in its favour.

Relevant market means the market which may be determined by the commission with reference to the relevant product market or the relevant geographical market or with reference to both the markets.

Relevant product market mandates demand sustainability as revealed by consumer preferences.

Relevant geographic market means a market comprising the area in which the conditions of competition for supply of goods or

provision of services or demand of goods or services are distinctly homogeneous and can be distinguished from the conditions prevailing in the neighbouring area.

Relevant product market means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer , by reason of characteristics of the product or services , their prices and intended use.

## 25.5 COMMISSION

### 25.5.1 Establishment:

Competitive Commission of India is established under the Act. The commission shall be a body corporate having perpetual succession and a common seal with power to acquire, hold, and dispose of the property, both movable and immovable. It shall have power to contract and to sue and be sued. Commission shall have head office and other offices. It shall consist of chairperson and less than two and not more than six other members to be appointed by the Central Government. The chairperson and every other member shall hold office for a term of five years and be eligible for reappointment. The chairperson and other members shall not hold office if he has attained the age of 65 years. The Chairperson shall have the power of general superintendence, direction and control in respect of all administrative matters of the Commission.

### 25.5.2 Appointment of Director General: (Sec 16, 17, & 41)

The Central government may appoint a direct general for the purpose of assisting the Commission in conducting inquiry into contravention of any provision of the act. The director general shall have power to appoint the number of other Additional , joint, Deputy or Assistant Director or such other officers or employees who have experience in investigation and knowledge of accountancy, management, business, public administration, international trade, law, or economics and such other qualification as may be prescribed.( Sec 16).

The Commission may engage in accordance with the procedure specified by regulation such number of experts and professionals of integrity and outstanding ability who have special knowledge and experience in required areas.

### 25.5.3 Meetings of Commission: (Sec 22)

The Commission shall meet at such times and such places and shall observe such rules of procedure in regard to the transaction of business as its meetings as may be provided by

regulations. The Chairperson if for any reason, is unable to attend a meeting of the commission, the senior most Member present at the meeting, shall preside at the meeting. All matters that comes up before any meeting of the commission shall be decided by majority of members present and in the event of equality of votes, the Chairperson or in his absence, the Member presiding shall have a second or casting vote. The quorum for such meeting shall be 3 members.

**25.5.4 Power of Commission:**

The Commission shall have power to regulate its own procedures with respect to following matters—

(a) Summoning and enforcing the attendance of any person and examining him on oath.
(b) Requiring the discovery and production of documents,
(c) Receiving evidence on affidavit,
(d) Issuing commission for the examination of witnesses or documents,
(e) Requisitioning any public record or document or copy of such record or document from any office.

The Commission may direct any person:

**1.** To produce before the Director General or the Secretary or an officer authorised by it, such books or other documents in the custody or under the control of such persons so directed, being documents relating to any trade the examination of which may be required for the purpose of the said act.

**2.** To furnish to the Director General or the Secretary or any other officer authorised by it, such other information as may be in his possession in relation to the trade carried on by such person , as may be required for the purpose of the act.

**25.5.5 Duties of the Commission**: (Sec 18)

It shall be the duty of the commission to

**1.** Eliminate practices having adverse effect on competition ,
**2.** Protecting the interest of the consumer s and ensure freedom of trade carried on by other participants in market in India.
**3.** Promoting and sustaining competition in the market.
**4.** Commission may in order to perform its duty enter into any memorandum or arrangement with the prior approval of Central Government, with any agency or any foreign country.

**25.5.6 Inquiries :**(U/s 19)

The Commission may inquire into any alleged contravention relating to anti-competitive agreements or relating to abuse of dominant position, either on its motion, or on –
a) Receipt of any information from any person, consumer or their association or trade association or

b) A reference made to it by the Central Government or a State Government or statutory authority.

**1. Inquiry into Anti-Competitive Agreements: [Sec 19(3)]**

The Commission shall, while determining whether an agreement has an adverse effect on competition, have due regard to all or any of the following factors namely:

a) Creation of barriers to new entrants in the market ;
b) Driving out existing competitors from the market;
c) Foreclosure of competition by hindering entry into the market ;
d) Accrual of benefits to consumers;
e) Improvements in the production or distribution of goods or services;

**2. Inquiry into Abuse Dominant Position: [Sec 19(4) to (7)]**

The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not have due regard to all or any of the following factors namely---

a) Market share of the enterprise ;
b Size and resources of the enterprise;
c) Size and importance of the competitors;
d) Economic power of the enterprise;
e) Vertical integration of the enterprises or sale or service network of the enterprises;
f) Dependence of consumer s on the enterprise;
g) Monopoly or dominant position whether acquired as a result of any statue or by virtue of being a government company or a public sector undertaking or otherwise.
h) Market structure and size of market
i) Social obligation and social cost,
j) Relative advantage, by way of the contribution to the economic development, by the enterprise enjoying dominant position having or likely to have adverse effect on competition.
k) Any other factor which the commission may consider relevant for inquiry.

**3. Inquiry into Combination (Sec 20):**

The Commission may, upon its own knowledge or information relating to acquisition or acquisition of control or merger or amalgamation, inquire into whether such combination has caused or is likely to cause an adverse effect on competition in India.

No such inquiry shall be initiated after the expiry of one year from the date on which combination has taken effect. Whether combination would have adverse effect on competition in the relevant market, the commission shall have due regards to all or any of the following factors namely---

a) Actual and potential level of competition through imports in the market.
b) Extent of barriers to entry to the market.
c) Level of competition in the market.
d) Extent of effective competition likely to sustain in the market.
e) Extent of substitutes available or likely to be available in the market.
f) Nature and extent of vertical integration in the market.
g) Degree of countervailing power in the market.
h) Likelihood that the combination would result in the removal of a vigorous and effective competitor in the market.
i) Nature and extent of innovation.
j) Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition.

**3. Inquiry into Acts taking place outside India but having an effect on Competition In India.( Sec 32):**

The Commission shall have power inquire into anti-competitive agreement or abuse of dominant position or combination if it is likely to have appreciable adverse effect on competition in the relevant market n India even though----

a) An anti-competitive agreement has been entered into outside India

**or**

b) Any party to such agreement is outside India or
c) Any enterprise abusing the dominant position outside India or
d) A combination has taken place outside India or
e) Any party to combination is outside India.

## 25.5.7 ORDERS BY COMMISSION.

### 1. On anti-competitive agreement or abuse of dominant position (Sec 27):

Where after inquiry, the Commission finds that any agreement is an anti-competitive agreement or the action of the enterprise is in abuse of dominant position, it may pass any of the following orders.

a) Direct any enterprise or association of enterprise to discontinue and not to re-enter such agreement or discontinue such dominant position.
b) Impose such penalty, as it may deem fit, which shall not be more than 10% of the average of the turnover for the last three years.
c) Direct the enterprise concerned to abide by such other orders as the Commission may pass and comply with the directions,

### 1. Division of enterprise enjoying dominant position: (Sec 28)

The Commission may by order in writing, direct division of an enterprise enjoying dominant position to ensure that such enterprise does not abuse dominant position. The order may provide any of the following matters:

a) The transfer or vesting of property, rights, liabilities or obligation.
b) The adjustment of contact either by discharge or by reduction of any liability or obligation or otherwise,
c) The creation, allotment, or surrender of any shares, stocks or securities;
d) The formation or winding up of an enterprise or the amendment of the memorandum of association or articles of association or any other instrument regulating the business of the enterprise.
e) Any other matter which may be necessary to give effect to the division of the enterprise.

### 2. On certain combination (Sec 31):

Where the Commission is of the opinion that the combination has or is likely to have an appreciable adverse effect on competition, it shall direct that the combination shall not take effect.

Where the Commission is of the opinion that the combination has, or is likely to have an appreciable adverse effect on competition but such adverse effect can be eliminated by suitable modification to the combination, it may propose to the party such combination, appropriate modification to the combination. Once

such modifications are accepted by the parties to the combination, it must be implemented within specified time limit, if, parties fails to do so the combination shall be deemed to have an appreciable adverse effect on competition, and Commission shall deal with such combination in accordance with provision of the Act.

**3. To issue interim orders (Sec 33):**

Where during an inquiry, the Commission is satisfied that the following acts are committed....

a) Anti-competitive agreement is entered into or
b) There is abuse of dominant position or
c) That a combination is causing appreciable adverse effect on combination or
d) That the import of goods is likely to affect the above, the Commission may without giving notice to opposite party, by order temporarily restrain any party on such act until the conclusion of such inquiry or until further orders.

### 25.5.8 Rectification of order of commission (Sec 38) :

With a view to rectifying any mistake apparent from the record, the commission may amend any order passed by it under the provision of the Act. Commission may make –

a) An amendment of his own motion.
b) An amendment for rectifying any such mistake which has been brought to its notice by any party to the order.

### 25.5.9 Execution of order of Commission: (Sec 39):

If a person fails to pay any monetary penalty imposed on him under the Act, the Commissioner shall proceed to recover such penalty, in such a manner as may be specified by the regulation. In case where the Commission is of the opinion that it would be expedient to recover the penalty imposed under the act in accordance with the provision of the Income tax Act, it may make reference to that effect to concerned Income tax authority for recovery of the penalty as tax due under the act.

## 25.6 APPEALS (Sec 53A to 53U)

**Competition Appellate Tribunal:**

The Central Government has established Competition Appellate Tribunal which shall consist of Chairperson and not more than two other members to be appointed by the Central Government.

The Chairperson shall be judge of Supreme Court or the Chief Justice of High Court. A Member of the Appellate Tribunal shall be a person of ability, integrity and having knowledge and experience of not less than 25 years in competition matters.

The Central government or the State Government or a local authority or enterprise or any person aggrieved by any direction, decision or order, may prefer an appeal to the Appellate tribunal, to hear and dispose of appeal from following matters.

1) Order passed by the Commission closing the matter under section 26(2), after being of opinion that there exists no prima facie case;
2) Order passed by the Commission closing the matter under section 26(2), after agreeing with the recommendation of Director General;
3) Order passed by the Commission under section 27, after inquiry into agreement or abuse of dominant position;
4) Order passed by the Commission under section 28 , directing the division of enterprise enjoying dominant position;
5) Order passed by the Commission under section 31 on certain combination;
6) Interim order passed by the Commission under section 33;
7) Rectification of order passed by the Commission u/s 38;
8) Execution of order of Commission u/s 39 to recover the penalty.
9) Order passed by the Commission u/s 45 imposing penalty for offence in relation to furnishing of information;
10) Order passed by the commission u/s 44imposing penalty for making false statement or omission to furnish material information etc.

## 25.7 QUESTIONS

1. Answer the following:-

a. What are the functions of Appellate Tribunal

b. Explain the agreement which causes an adverse effect on competition.

c. What are the various authorities under Law of Competition? Explain their functions and duties.

d Short Notes:-

a. Anti-competitive Agreement b. Dominant Position

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