

Business LAW

BUSINESS

Satish B Mathur

The McGraw-Hill Companies

Business Law

About the Author

Dr. Satish B. Mathur, Ph.D. (Business Management), C.A.I.I.B., has recently retired as a Professor of Finance and Accounting at the Indian Institute of Management (IIM), Lucknow. He is currently running a consultancy firm: Mathur Management Consultants, and is organising tailor-made company-specific In-Company Management Development Programmes (MDPs) in the areas of finance and accounting, organisation behaviour and business law. Before joining IIM Lucknow, he was a Senior Member of Faculty at the Administrative Staff College of India (ASCI), Hyderabad (1988–95). Earlier, he was with the State Bank of India for over 27 years (1961–88), wherein he had held several senior executive positions in the areas of policy and planning, training and administration. By virtue of having such a vast and varied executive and teaching experience with the senior executives of the banks and industries, he has developed credible knowledge and expertise in the area of Business Law, with deep understanding and insight into the various practical legal aspects pertaining to the various Acts, dealt with in the book. Besides, with his long, vast and varied on-the-job experience, while working with the State Bank of India, as also by virtue of directing several Management Development Programmes (MDPs) in the area of corporate finance and management accounting at the Administrative Staff College of India, Hyderabad, he has developed a pragmatic and realistic understanding and proficiency in the area of corporate finance and management accounting.

He has published several articles/papers in the national and international journals of repute, some of which have been used by the UNICEF in their International Management Development Programmes. His books titled, *Sickness in Small Scale Sector: Causes and Cures* (Concept Publishing Company, 1999, New Delhi), *Working Capital Management and Control* (New Age International Private Limited Publishers, 2002, New Delhi), *Understanding Balance Sheets* and a textbook on *Financial Management* (Macmillan India Ltd., New Delhi, 2005 and 2009, New Delhi) have been received very well by the academicians and students, as also by the practising executives, in the banks and industries. His other three books in the organisation behaviour area titled, *The A to Z of Managerial Excellence* (Global Business Press, 1995, Delhi), *The A to Z of Management Mantras* (Jaico Publishing House, 2002, Mumbai), and *The A to Z of Strategic Sutras* (Rupa & Co., 2006, New Delhi), have gained immense popularity over the years. The Hindi transcription of his book *The A to Z of Managerial Excellence* (Global Business Press, 1995, Delhi), has been published by Hind Pocket Books Private Limited, 2009, New Delhi), under the title *Uttam Prabandhan Ke Saar,* and has gained great popularity soon after its publication. His other textbook on 'Management Accounting' (again by Tata McGraw Hill) is expected very soon.

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To
my Students
for their inspiration
and
my Wife, Meera Mathur,
and my Daughters,
Archana Mathur
and
Kartika Mathur
for their sustained support

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FOREWORD

On a quick scanning of the book titled 'Business Law', I noticed that it has been written in a lucid and convincing style, containing chapters pertaining to almost all topics of Mercantile Law in a special style, which will be of utmost use to the students of Business Administration, Law and Commerce as well as bank executives.

The summary, question–answers, and practical problems attached to each chapter are very helpful to the users. The appendices containing the case laws, are an asset to the reader to understand the extent and implementation of various laws. In fact, this aspect of the book makes it really useful because of the richness of its contents.

The efforts taken by the author, Sri Satish B. Mathur, in making such a comprehensive compendium of business laws is really commendable and praiseworthy. I am sure that this publication will be welcomed by the judiciary as well as the students and lawyers. I felicitate the author on his erudition and industry, which has illumined this dimension of jurisprudence.

The book has been divided into eight parts and some of the parts of the book deserve particular mention.

Professor S. B. Mathur is a profound author and the Part One of the book titled 'Law of Contracts' is sure to be an excellent addition to the legal literature on the subject of contract. A quick glance at the topics reveals the comprehensiveness and thoroughness of the book. Every aspect of Contract Law, every principle underlying the Indian Contract Act, finds appropriate places in the pages of this part. The topics which deal with pledges, hypothecation, mortgage and agency have been considered in some detail by the author. Beyond all these Prof. Mathur gives practical illustrative examples and live legal problems with actual solutions. Small wonder then that Prof. Mathur has enriched the law of contracts by his excellent new publication; it covers the alpha to omega of the Indian Contract Act. This textbook, I am sure, will find a place in every law library, every collection of books in the courts from the lowest to the highest level, as a reference book of authority.

Professor Satish B. Mathur ranks high as an academic of excellence in the field of commercial law. He has written several books which are best sellers and has papers published in Indian and international journals. Part Two on Law of Negotiable Instruments is as high in the standard of its contents.

The chapters deal with every dimension of the law of negotiable instruments. The case-law covered in this part is an asset. Miscellaneous branches of the law of negotiable instruments add to the value of this part. I need hardly say that Prof. Mathur is a creative jurist whose pen is so popularly educative and

legally erudite that the commercial community will benefit in its understanding of the law by keeping a copy of the book for ready reference in its library. I congratulate Prof. Mathur on his learned work, useful for the law and the lawyer, and feel confident that, coming as it does from the author of established reputation, the book will reach every law school and every lawyer concerned with commercial law. I may as well say, there is a patriotic dimension in such a publication, because the rule of the law in commercial India sustains itself on authoritative and standard works which are lucid and luminous, oriented on the practical issues and respected by the Bench and the Bar.

The laws governing the sale, transfer and contract of sale of goods are available in several legislations making access difficult for the laity, the legal professionals and the judiciary. The efforts taken by Sri. Satish B. Mathur in collecting them and presenting them in a comprehensive book form is a really commendable and I shall regard it a socially beneficial service. While in administrative justice the judiciary has more freedom to interpret the law, in business jurisprudence such flexibility is not available. However, British Indian justice has left behind a sound system of sale of goods law.

It is worth mentioning here that in the present book an endeavour has been made by the author to deal with the topics in an analytical manner with the aid of the rulings of our courts inter alia introducing some related matters also at the right context. I hope that the present book, including the law of sale of goods, will be found worthwhile by the members of the Bar and the Bench as well as all other interested readers.

Dr. Satish B. Mathur in his masterly work on the law of partnership has done us invaluable service by a comprehensive coverage of the laws bearing on partnership deeds.

Since the contents are scholarly, it will be very useful for the law and MBA students, who seek to acquire academic knowledge of the subject. The division of the topics into separate chapters, with summaries of each chapter and covering questions together with practical problems with solutions, makes the book worthy of erudite addition both as a reference book as well as a text book for the students. The appendices containing the case laws add to the utility of the publication.

I am sure that the present publication on business law will be welcomed by the students, the Bar and the Bench.

13 March, 2009

V. R. KRISHNA IYER
(*Padmavibhushan*)

Preface

The dictum 'Ignorance of law is no excuse' (*Ignorantia juris non excusat*), by implication, suggests that every person is presumed to be knowing the law, and also that, if he or she does not know it, he or she had better known it. It is, therefore, imperative and essential for all the business executives, too, to have the basic knowledge of at least the main provisions of the respective laws, which mostly and frequently pertain to their areas of operation. Such legal provisions, in consolidated term, are usually referred to as 'Business Law' (or 'Mercantile Law'). It comprises a set of laws concerning the business world—trade, commerce and industry—which usually includes Acts like the Indian Contract Act, Negotiable Instruments Act, Sale of Goods Act, Indian Partnership Act, Payment of Bonus Act, Payment of Gratuity Act, Minimum Wages Act, Consumer Protection Act, Indian Companies Act, Industrial Disputes Act, and so on. That is why, the subject of Business Law has been included in the curriculum of all the IIMs as also of other business schools, commerce, chartered accountancy.

Keeping in view the non-legal background of most of the students of the MBA, Commerce, Chartered Accountancy, and so on, as also of the practising executives in the business and banking areas, I have kept the language very simple and lucid, and have given ample examples to illustrate the concepts, to help the readers in understanding the subject-matter with greater ease and sustained interest. At the end of each chapter, a summary of the main points has been given to facilitate recapitulation of the subject matter at the time of the examinations. Each chapter also contains a set of possible questions and problems (with complete solutions) that may possibly be asked in the examinations.

It is my fond hope that the book will meet the desired requirements and expectations of the students. At the same time, as there is no room on earth bigger than the room for improvement, I will feel grateful to receive some constructive suggestions from the readers, for any further improvement of the book in its next edition. You may contact met at my mobile number or email given below.

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Acknowledgements

In the very first place, I will like to record my sincere gratitude to Padmavibhushan Shri V R Krishna Iyer, former judge of the Supreme Court of India, for his encouragement, inspiration, and appreciation of my work on Business Law, and his parental blessings for its success. I am especially grateful to him for the fact that, despite his failing health, he obliged me by writing the Foreword to the book.

The very next name that instantaneously comes to my mind is that of Dr. Prasanna Chandra, former Professor of Finance at the IIM, Bangalore, for his precious suggestion and inspiration to write a book on Business Law with practical and pragmatic approach, by bringing in my vast and varied practical experience as an executive and academician in the area, without which the book would not have seen the light of the day.

I will be failing in my duty, if I do not acknowledge the encouraging and inspiring words of my wife, Meera Mathur, especially for her constructive suggestions, perennial inspiration and patience, in allowing me time for the work, whereby I could complete the book in lesser time than was otherwise expected.

I profusely thank my daughters Archana Mathur and Kartika Mathur, for their novel and creative views and valuable suggestions in making the book even more reader friendly.

My sincere thanks are amply due to Mr. Biju Kumar, Mr. Tapas Maji, Mr. Hemant K Jha, Ms. Shalini Negi, Ms. Anubha Srivastava, Mr. Manohar Lal, Mr. Atul Gupta, and the entire team of the professionals at Tata McGraw Hill, for their taking keen interest and initiative for an excellent work done, and the innovative professional and valuable suggestions made for the project, and more importantly, for their taking up the project on a top priority basis, and publishing the book in a record short span of time of just three months, from the date of the receipt of the typescript of the book.

SATISH B. MATHUR

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Chapter One

Business Law: An Overview

"*There is but one law for all, namely that law which governs all law, the law of our Creator, the law of humanity, justice, equity—the law of nature and of nations.*
Edmund Burke

Laws are subordinate to customs
Tutus M Plautus

Laws, like houses, lean on each other
Edmund Burke"

1.1 Definition and Scope of Business Law

'Business Law', also referred to as 'Mercantile Law', comprises a set of laws concerning the business world—trade, commerce, and industry. It generally includes the laws pertaining to contracts, sale of goods, partnership, companies, negotiable instruments, insurance, consumer protection, payment of bonus, payment of gratuity, minimum wages, carriage of goods, insolvency, and arbitration. But, with the fast development and globalisation, and the ever-increasing complexities of the business world therewith, the scope of Business Law is also widening, to cope with the ever-changing circumstances.

The dictum 'Ignorance of law is no excuse' *(Ignorantia juris non excusat)*, by implication, suggests that every person is presumed to know the law. It is, therefore, imperative and essential for all the business executives to have the basic knowledge of at least the main provisions of the respective laws concerning their areas of operation.

1.2 A Historical Perspective

To meet the felt need for the provision of a uniform law, to regulate the contracts entered into among the

parties, involved in the business transactions, the Indian Contract Act 1872 was enacted. Thereafter, various other Acts have also been enacted like the Negotiable Instruments Act, 1881, the Sale of Goods Act 1930, the Indian Partnership Act 1932, the Insurance Act 1938, the Companies Act 1956, and so on.

1.3 Sources of Business Law

(i) The English Mercantile Law

The Indian Business Law is largely based on the English Mercantile Law, so much so that even today our courts continue to refer to the provisions, practice, and precedence of the English Mercantile Law in the cases of ambiguity and lack of expressly clear provisions in our Acts.

(ii) The Statute Law

When a bill is passed by both the houses of the Parliament (*Lok Sabha and Rajya Sabha*) and is signed by the President of India, it becomes an Act or a Statute. Most of the Indian business laws are in the form of Acts or Statutes, like the Indian Contract Act, Negotiable Instruments Act, Sale of Goods Act, Indian Partnership Act, Insurance Act, Companies Act, and so on.

(iii) Case Laws or Judicial Decisions

The judgements pronounced by the Supreme Court of India and the various High Courts, in the specific cases, are usually quoted as precedents in the subsequent cases. Such judicial decisions are also referred to as Case Laws. The Case Laws assume special significance and importance in that all the judicial decisions pronounced by the Supreme Court of India become binding on all the High Courts and the lower courts. The judgements pronounced by a High Court, however, may not necessarily be binding on any other High Court, or even in the same High Court, in the subsequent cases under their consideration. But then, these may definitely be given due consideration and value by the respective judges, while deciding the cases, and in most of the cases the judgements are likely to be on similar lines. Thus, we may say that the judicial decisions are, in effect, binding on all the Courts having a jurisdiction lower than the Court, which had pronounced such judgements. Further, these are generally followed even by the Courts of equal jurisdiction, especially while deciding on similar points of law. However, in the cases where the specific Act is silent or ambiguous on a point, the judges concerned may decide the case in accordance with the principles of equity, natural justice, and good conscience.

(iv) Customs and Usages

The widely known, reasonable, established, and certain customs and usages, generally observed in a particular trade, are also given due consideration and weightage by the respective judges, while deciding the cases. Such customs and usages, however, should not be contrary to any provision of the law. In some cases, even an Act may specifically provide that the provisions of law contained therein are subject to the well-recognised customs and usages of the respective trade, and that the same may prevail and over-ride the Statute Law.

Law of Contracts

(The Indian Contract Act, 1872)*

Chapter Two

Nature and Classification of Contracts

> *Society is indeed a contract.*
> **Edmund Burke**
>
> *I think it is an immutable law in business that words are words, explanations are explanations, promises are promises—but only performance is reality.*
> **Harold S Geneen**

The provisions of the Indian Contract Act, 1872, provide the firm foundation upon which the entire edifice of the modern business is built. In our daily life, we enter into a series of contracts, sans realisation, that is, even without realising it. For example, when we enter into a public transport (bus or auto), we enter into a contract. How? Let us explain it with the help of some illustrative examples.

The public transport (bus or auto), plying on the road, and displaying a specific route number and/or details, is in the nature of an open offer to the members of the general public to reach the person, entering into the bus or auto, to his or her desired destination, falling on the specified route, on payment of the amount of the pre-fixed fare for the required distance. Further, the very act of the person entering into the bus or auto constitutes an acceptance of the (open) offer. Thus, the two-way process of offer (by the transport company, being the first party) and its acceptance (by the person entering into the public transport, being the other party), completes the required process of the agreement, and the contract is said to have been completed.

Let us take some other example. When one enters into a restaurant, and takes some snacks, lunch or dinner, an agreement gets entered into to the effect that the person (being the first party) will make the payment to the hotel management (being the other party), for the items consumed, at the price specified in the menu-card or the price list displayed, plus taxes, if any.

2.1 What is a Contract?

Contract is an agreement, enforceable by law [Section 2(h)]

Further, "every promise and every set of promises forming consideration for each other" is an agreement [Section 2(e)].

"When the person, to whom the proposal is made, signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise." [Section 2(b)].

Alternatively speaking, an accepted proposal constitutes an agreement. Thus, we find that there are two specific essential elements involved in an agreement. These are:

(i) A proposal or an offer, and
(ii) An acceptance of that proposal or offer.

2.2 Essential Ingredients of a Valid Contract

But then, we should not be under the impression that all the agreements (i.e. the proposals when accepted) would necessarily become a contract. No. Instead, only such **agreements**, which are **enforceable in law**, and are also **intended to be so**, constitute contracts.

Here again, there are two specific elements involved. These are:

(i) The agreement should be **enforceable in law,** and
(ii) At the same time, the parties involved must have had (at the material time) **such intention**, that is, to make it enforceable in law.

Thus, in case even one of these two conditions would be missing, the agreement would not constitute a valid contract.

Let us now take some specific illustrative examples to examine as to which type of agreements may constitute a contract, and which other ones would not.

Examples

1. Ramesh invites Ranjana for dinner at his residence. Ranjana fails to turn up at the appointed place, date and time. In this case, Ramesh does not have a legal course of action against Ranjana. Why? Because, none of the two parties, involved in the instant case, had any intention to make it enforceable in law.
   Similar would be the case if Ranjana had come to Ramesh's house on the appointed date and time, and, to her utter surprise and disgust, would have found that Ramesh's house was locked.
   It is so because, these are in the nature of just social agreements entered into, but without any intention of creating any legal contractual obligation on the part of either of the two parties involved.
2. Let us take yet another example, this time involving the clear intention of creating a legal contractual obligation, on the part of both the parties concerned.

   Krishna agrees to sell his car (Maruti 800) to Kavita for Rs 1 lakh. This agreement obviously involves the intention, on the part of both the parties concerned, of creating legal contractual obligation against each other, in the event of any breach of agreement, and non-fulfilment of the contractual obligation.

Under the aforementioned agreement, there is a legal obligation on the part of Krishna to deliver the car to Kavita, and on the part of Kavita to pay Rs 1 lakh to Krishna. Therefore, in case either of the two parties would fail to fulfil the aforementioned conditions of the agreement, the other party has the legal right to proceed against the defaulting party. That is, if Krishna fails to deliver the car to Kavita, she has the legal right to proceed against Krishna. In a similar manner, if Kavita fails to pay to Krishna the agreed sum of Rs 1 lakh against the delivery of the car, Krishna can file a civil suit against Kavita for the breach of the contract, inasmuch as it had created a legal obligation on both the parties, and it was so intended, too.

Thus, we may say that while all contracts are agreements, all agreements are not necessarily contracts. This is so because; social agreements do not constitute a contract in the eye of law. In other words, only such agreements would constitute contracts which have been entered into with the clear intention of creating a legal obligation on the part of the two parties concerned, to perform accordingly.

But again, we must remember that all contracts are not necessarily enforceable in law, either. There are some contracts, which have been specifically declared as void, *ab initio* (i.e. right from the very beginning), and hence, these are not enforceable in law.

For example:

(i) An agreement in restraint of trade (Section 27);
(ii) An agreement to bet, better known as 'wagering contract' (Section 30);
(iii) An agreement to do an impossible act (Section 56).

We may, thus, conclude that an agreement to do any unlawful, immoral, illegal, or impossible act is void *ab initio* (i.e. right from the very beginning). Hence, all such agreements are non-enforceable in law.

For example: The trade of printing fake currency notes, or smuggling drugs, gold, etc., or an agreement to murder a specific person for a price, or fixing of cricket matches, and so on.

In addition to the aforementioned two basic essential elements in a contract, [viz. (i) an agreement and (ii) the intended legal obligation], there are several other essential ingredients, too, necessarily required to constitute a valid contract. These have been enlisted in Section 10 of the Act, reading as under:

"All agreements are contracts if they are made by free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void."

On a careful and minute study of the aforementioned conditions, read with the provisions of Section 10 above (along with some other provisions in the Act, discussed later), the following essential elements, involved in a valid contract may emerge:

2.2.1 Essential Elements of a Valid Contract

(a) Agreement
(b) Intention to create legal relationship
(c) Free and genuine consent
(d) Parties being competent to contract
(e) Lawful consideration
(f) Lawful object
(g) Agreements not declared void or illegal
(h) Certainty of meaning
(i) Possibility of performance
(j) Necessary legal formalities

We would now proceed to provide brief explanations and descriptions of the aforementioned essential elements, one after the other.

(a) Agreement

An agreement includes two basic elements, viz. (i) offer and (ii) acceptance. Thus, by implication, it involves two persons or parties, inasmuch as one single person cannot enter into an agreement with oneself. The first person or party, who makes the offer, is referred to as the **offeror**, and the second person or party, who accepts the offer so made, is referred to as the **offeree.**

It has been further provided that each of the two parties must be thinking of the same thing, and in the same sense, and at the same time. That is to say that there must be *'consensus-ad-idem'*.

Let us now understand the principle of *'consensus-ad-idem'* with the help of an illustrative example.

Example

Rahul had two cars, referred to hereafter as car A and car B. He had offered his car B for sale to Kriskna for Rs 50,000. Krishna had accepted the offer. Thus, the required two-way process, of offer and acceptance, was got completed. Accordingly, the agreement may be said to have been entered into. But then, at a later date, it

got revealed that Krishna was under the impression that Rahul had only one car A, and so he was all through under the impression that he had purchased that very car A. As against this, Rahul had, in fact, made the offer for the sale of his car B, instead, and not his car A. Thus, it is apparent that the two parties, while entering into the agreement, had not thought of the same thing, in the same sense, and at the same time. In other words, there had not been the required *'consensus-ad-idem'*. Accordingly, in its absence, the aforementioned agreement would not constitute a valid agreement, enforceable in law.

(b) Intention to create legal relationship

As already aforementioned, the two parties entering into a contract must necessarily have the intention to bind the other party with the involved legal obligations. Conversely speaking, the agreements involving just some domestic or social obligations cannot constitute a contract.

Let us take some illustrative examples to clarify the point.

Example

A husband had failed to pay the promised amount to his wife every month, during the period of his stay abroad. The wife had lost the case for the recovery of the amount from her husband as it was held to be in the nature of a domestic agreement, sans intention to create any legal obligation. **[Balfour vs Balfour (1919) 2, K. B. 571].**

It may be pertinent to mention here that there is a usual presumption that all business agreements are entered into with the intention of creating legal consequences, and that all the domestic and social agreements are generally entered into without the intention of creating a legal relationship, unless expressly stated or established otherwise, with reference to the facts the case. Let us clarify the point with the help of some illustrative examples.

Examples

1. One of the clauses in the agreement document had a provision to the effect that "This arrangement is not …..a formal or legal agreement and shall not be subject to legal jurisdiction in law courts". **[Rose and Frank Co. vs J. R. Compton and Bros. Ltd. (1925) A. C. 445].**
2. In yet another case, one of the clauses in the agreement document had provided that it "shall not give rise to any legal relationships, or be legally enforceable, but binding in honour only". **[Jones vs Vernon's Pools Ltd. (1938) 2 All E. R . 626].**

   In both these cases, it was held in the court of law that in the absence of the intention to create any legal relationships, these did not constitute legally binding contracts.
3. Let us take an example of another category of agreement, where it was held that there existed the intention to create legal obligations on the part of the parties, and hence, the young couple was entitled to recover the damages from the old couple.

The fact of the case **[Parker vs Clark (1960) I W.L.R. 286]** is given hereunder:

An old couple (Mr and Mrs Clark) had promised to her niece and her husband (Mrs and Mr Parker), through correspondence, that if the latter would sell their cottage and start living with the former, and share their household and other expenses, the former would leave a portion of his estate in his will. Mrs and Mr Parker, in compliance of the request, sold their property and started living with them. But, after some time, the two couples quarrelled and the old couple repudiated the agreement and asked the young couple to leave the house and stay somewhere else. The young couple won the case for the breach of promise by the old couple, and could claim damages from the old couple, as aforementioned.

(c) Free and genuine consent

It is necessary that the two parties must give their free and genuine consent to the terms of the agreement. In other words, such consent should **not** be obtained in any one or more of the following manners (which, in itself, would render the contract, in question, invalid and void):

(i) By coercion
(ii) By undue influence
(iii) By fraud
(iv) By misrepresentation
(v) By mistake.

Alternatively speaking, if the consent would be proved to have been obtained in one or more of the aforementioned manners, such contract would be automatically declared as voidable (not void), but at the option of that party only, whose consent was so obtained. A detailed discussion on the aforementioned five manners of obtaining consent, which may render the contract so obtained as voidable, appear in Chapter 5 on 'Free Consent'.

(d) Parties being competent to contract.

According to Section 11, every person is considered competent to contract if he is

(i) of the age of majority,
(ii) of sound mind, and
(iii) is not disqualified from contracting by any law to which he is subject.

Alternatively speaking, the following parties are considered to be incompetent to enter into a contract:

(i) Minors
(ii) Lunatics (or persons of unsound mind) [There are, however, certain exceptions, too, in such cases, which have been discussed, in detail, in Chapter 4.
(iii) Idiots
(iv) Drunkards, and so on.

(e) Lawful Consideration

What is a consideration? Consideration is the price for which the promise or undertaking is sought and, in turn, given (by and to), the respective two parties involved. That is, the consideration must be on the part of both the parties concerned. Accordingly, an agreement without consideration would be just a mere promise (*nudum pactum*), and hence, not enforceable in law.

[There are, however, certain exceptions, too, as provided in Section 25 (and some other sections, too), which have been discussed, in detail, in Chapter 6].

More importantly, the consideration of giving something, and receiving something in return (not necessarily in monetary terms), must be lawful and real. In other words, any contract, entered into with an unlawful and unreal consideration, would be void.

(f) Lawful Object

Besides there being lawful and real consideration, the object of such consideration, too, should be lawful and not illegal.

(g) Agreements not declared void or illegal

Besides, the agreement should be such which have not been expressly declared as illegal or void by any law

of the land. Such agreement would, naturally be not enforceable by law just for this single reason (all other required conditions of a valid contract being fulfilled in all respects, notwithstanding).

(h) Certainty of meaning

The contract, to be valid and enforceable in law, must have certainty in its meaning, or else it must be capable of being made certain. That is, it should be without any ambiguity, whatsoever. Otherwise, such contract would be considered as void and unenforceable in law. Let us take some illustrative examples.

Examples

1. Suresh agrees to sell 100 table fans to Suman. In the instant case, the specifications of such fans, like the brand name, type, size, etc., have not been clearly stated. Hence, the agreement is not enforceable in law for want of certainty of meaning.
2. It would have, however, been enforceable in law only if the aforementioned distinguishing particulars would have been clearly specified to avoid any element of uncertainty in the meaning of the agreement.

It may be pertinent to mention here that an 'agreement just to agree' cannot be said to be a concluded contract. **[Punit Beriwala vs Suva Sanyal, AIR 1998 Cal. 44].**

(i) Possibility of performance

An agreement to be eligible for being enforceable in law must contain only such terms and conditions, which may actually be capable of being performed. Alternatively speaking, an agreement having certain conditions, which cannot be actually and possibly performed (e.g., an agreement to actually shift the Taj Mahal from Agra, and relocate it in Delhi, by magic), would not come within the purview of a contract, enforceable in law.

(j) Necessary legal formalities

An agreement, to be enforceable in law, need not be necessarily in writing, unless specifically so required by certain provisions of law. That is to say that an agreement, to be enforceable in law, could be even verbal, provided such agreement is not necessarily and specifically required to be in writing. For example, in the case of an agreement to sell a landed property, it is specifically required (according to the Transfer of Property Act) that the terms and conditions, specifications, and other required particulars must be in writing, written or typed on judicial stamp papers worth the required amount, and that the same must be registered, too, with the Registrar of Association. It is then and then alone that it would be held valid and enforceable in law.

2.3 Classification of Contracts

Contracts may be classified on the basis of the following three distinct criteria:

(i) In terms of their validity or enforceability in law,
(ii) In terms of their mode of formation, and
(iii) In terms of their performance.

Let us now discuss these classifications, in some details, one after the other.

2.3.1 Classification in Terms of Their Validity or Enforceability in Law

Under this category, the contracts may be classified under the following heads:

(i) Valid agreements or contracts
(ii) Voidable agreements or contracts
(iii) Void agreements or contracts

(iv) Illegal agreements or contracts, and
(v) Unenforceable agreements or contracts.

Let us now discuss these classifications, in some details, one after the other.

(i) Valid agreements or contracts

A valid agreement or contract is one, which comprises all the aforementioned essential elements, required for the purpose. That is, even if one or more of these necessary elements would be wanting, such an agreement or contract would not be valid but would fall under one or more of the remaining four categories enlisted above, viz. voidable, void, illegal, and unenforceable.

(ii) Voidable agreements or contracts

A voidable contract is one, which could be repudiated but at the option and will only of one of the parties involved. Thus, such contract would be deemed to be valid and binding, unless it is specifically repudiated by the party, entitled to do so. [Section 2(i)]. A voidable contract is one, which is affected by one or more of the flaws, like simple misrepresentation, fraud, coercion, and undue influence. In such cases, only the party so aggrieved can exercise the option to repudiate the contract, if he or she so desires. But the other party does not have such option, and is, therefore, bound to meet the obligations under the contract, till the other party duly repudiates it.

(iii) Void agreements or contracts

As against a voidable contract, which could be set aside by only one of the parties (i.e. the aggrieved one), in the case of a void contract, it cannot be enforced even by either of the two parties involved, inasmuch as such agreements are invalid and void *ab initio* (right from the very beginning), and, thus, is unenforceable in law. [Section 2(i)]. According to Section 11, a contract with a minor is void.

Some other categories of void agreements, too, are enlisted hereunder:

(a) An agreement entered into through a mutual mistake of fact between the parties (Section 20)
(b) An agreement, a part of the consideration or object whereof is unlawful (Section 21)
(c) An agreement, the consideration or object whereof is unlawful (Section 23)
(d) An agreement made without consideration (Section 25)
(e) An agreement in restraint of marriage (Section 26)
(f) An agreement in restraint of trade (Section 27)
(g) An agreement in restraint of legal proceedings (Section 28)
(h) An agreement, which is uncertain (Section 29)
(i) An agreement to bet, better known as 'wagering contract' (Section 30)
(j) An agreement to do an impossible act (Section 56), and
(k) An agreement to enter into an agreement in the future.

Further, a contract, which ceases to be enforceable by law, becomes void when it ceases to be enforceable [Section 2 (j)].

For example, the contract of marriage becomes void when one of the parties to the contract goes mad before the time fixed for marriage. Similarly, the contract of shipment of some items to a port in a foreign country becomes void after the transporting country (i.e. the country of origin) declares war against the destination country.

In the above two cases, we find that the contracts were valid at the time these were entered into, but then these became void at a later date due to the turn of some events. While in the first example, the agreement became void due to the **subsequent impossibility**, in the second case; it is due to the element of **subsequent illegality**.

(iv) Illegal agreements or contracts

What constitutes an illegal agreement or contract? An agreement or contract is considered illegal wherein the consideration or object is either

(a) Forbidden by law, or
(b) Defeats the provisions of any law, or
(c) It is fraudulent, or
(d) It involves or implies injury to the person or property of the another, or
(e) The court regards it as immoral or opposed to public policy.

Let us take some illustrative examples to clarify the points.

Examples

1. An agreement among persons to divide the gains, obtained by fraudulent means.
2. An agreement to arrange a job for a person on payment of a bribe of say, Rs 50, 000

(v) Unenforceable agreements or contracts

An unenforceable agreement or contract is neither void nor voidable. It, in fact, just cannot be enforced in the court of law, but for want of some item of evidence, like

(1) Not being in writing, or
(2) Not having been registered, with the competent authority, authorised on this behalf, as required by law, or
(3) Not having been duly stamped, as required by law.

Let us take some illustrative examples to clarify the points.

(1) Examples of Contracts, which must necessarily be in writing:

(i) A negotiable instrument, like a promissory note, bill of exchange, cheque, bank draft (as per the Negotiable Instrument Act, 1881).
(ii) A sale deed, mortgage deed, lease, or gift, of immovable property (as per the Transfer of Property Act, 1882).
(iii) A promise to pay a time-bared debt (as per Section 25 of the Indian Contract Act, 1872).
(iv) A memorandum and articles of association of a company, an application for the purchase or transfer of shares of a company (as per the Companies Act, 1956).

(2) Examples of Contracts, which, in addition to necessarily being in writing, must also be duly stamped with appropriate amount, as exible thereon

(i) Demand and time (usance) promissory notes, time (or usance) bill of exchange, sale and mortgage deed, transfer deed for transfer of shares, held in physical (and not dematerialised) form, agreement, affidavit, creating charge by way of pledge or hypothecation, and so on (as per the Indian Stamp Act or the respective State Stamp Acts). [However, some case of flaws, like under-stamping or non-stamping on the respective instruments/documents can be rectified, but only in some special cases, and that, too, on payment of some stipulated fine or penalty].

(3) Examples of Contracts, which must necessarily be in writing, and are also required to be duly registered with the appropriate authoritiers.

(i) Transfer of immovable property (as per the Transfer of Property Act, 1882)
(ii) Memorandum and articles of association of a company, charges created by companies by way of equitable mortgage and hypothecation (as per the Companies Act, 1956).
(iii) Documents coming within the purview of Section 17 of the Registration Act, 1908.
(iv) Contracts without consideration, but made due to natural love and affection, between the parties, being of near relations to each other (as per Section 25 of the Indian Contract Act, 1872).

2.3.2 Classification of Contracts in Terms of Their Mode of Formation

There may be different modes of formation of contracts, like

(a) **Express Contracts,** which are stated in words (written or verbal), and

(b) **Implied Contracts,** which are not stated in words (written or verbal), but are inferred from the conduct of the parties involved, or else from the circumstances of the particular case. (Section 9)

Let us take some illustrative examples of 'Implied Contracts' to clarify the points.

Examples

(i) As stated at the very beginning of the chapter, if a person enters into a public transport (bus or auto-rickshaw), a contract gets completed, by just the act of the passenger entering into the bus or auto, by way of accepting the **open offer** of the public transport company to reach the person at the desired destination, falling on the displaced route, on payment of the stipulated amount of fare.

(ii) A trader, by mistake, forgets to pick up some of his goods at the house of Karishma. Karishma consumes these goods, as if these were her own. Karishma is, therefore, bound to pay for such goods to the trader.

In the above case (ii), a contract is implied by law, under which, the person who has availed of the benefit therefrom is under a legal obligation to reimburse the other party. Such obligations are known as 'quasi-contracts'. These have been described as "certain relations resembling those created by law" (Sections 68 to 72). Quasi-contracts have been discussed, in detail, in Chapter 9.

2.3.3 Classification in Terms of Their Performance

In terms of the extent or stage of the execution/completion of the agreed performance, the contracts may be classified under the following heads:

(a) (i) Executed contract, and (ii) Executory contract,

(b) (i) Unilateral contract, and (ii) Bilateral contract.

(a) (i) An Executed contract is the one, which has been fully completed, and nothing further remains to be done , as per the terms of the contract.

Example

Ramesh agrees to buy a second hand car from Rakesh against payment in cash. Rakesh delivers the car to Ramesh, and Ramesh, in turn, pays the agreed amount to Rakesh in cash. Thus, the entire required terms and conditions of the contract have been completed in all respects, and nothing remains to be done now any further, on the part of either of the two parties to the contract.

(a) (ii) An Executory contract , as against the executed contract, is one where either all or some of the requirements, as per the terms and conditions of the contract, still remain to be completed by both or any one of the parties involved in the contract. That is to say that something further still remains to be done.

Example

On the 1st November 2008, Ramesh agrees to buy a second-hand car, from Rakesh against payment in cash on the 30th November 2008. Thus, as on the 1st November 2008, through the 30th November 2008, the contract remains just an **executory contract**, as none of the terms of the agreements have yet been performed by either of the parties.

But then, the monument both the parties would perform their required action, the contract would become an executed one immediately thereafter. That is, if Rakesh delivers the car to Ramesh on the 30th November 2008, and Ramesh, too, in turn, pays the agreed amount to Rakesh in cash the same day, the entire required terms and conditions of the contract have been completed in all respects, and nothing remains to be done now any further, on the part of either of the two parties to the contract. Thus, the executory contract has now become an executed one, instead.

But then, if on the 30th November 2008, Rakesh delivers the car to Ramesh, but Ramesh does not pay the agreed amount to Rakesh in cash the same day, the contract would still remain an the executory contract only. Now let us take yet another example.

Example

On the 1st November 2008, Ramesh agrees to buy a second-hand car from Rakesh. But then, while the car is required to be delivered by Rakesh to Ramesh on 30th November 2008, Ramesh would make the cash payment to Rakesh only on the 1st December 2008. Thus, though on the 30th November 2008, Rakesh has delivered the car to Ramesh, the payment is yet to be made by Ramesh (at a later date, i.e. only on the 1st December 2008). The contract, thus, still remains an **executory contract** only, inasmuch as something more (i.e. payment of cash by Ramesh) is yet to be performed. Further, when Ramesh would make the cash payment to Rakesh on the 1st December 2008, the contract would become an executed one, as all the required performances have, by now, got executed by both the parties in full.

(b) (i) A Unilateral contract is such where, while one of the involved parties has already performed his obligation, right at the time of entering into the contract itself, it is only the other party who now remains to fulfil the obligation on his part, as per the terms of the agreement.

Example

Somya has already made the payment of the amount of the bus fare for travelling from Lucknow to Dehradun. Thus, Somya has already performed the obligation on her part. Now, only the transport company remains to perform its part of obligation (i.e. to take Somya from Lucknow to Dehradun in its bus), as per the terms of the contract.

(b) (ii) A Bilateral contract, as against the unilateral contract, is one where both the involved parties remain to perform the obligation on their respective parts. Such obligation could be either to perform a particular thing, or even to refrain from doing that particular thing. This way, it may as well be said that a bilateral contract is in the nature of an executory contract.

In the foregoing circumstances, we may say that a contract becomes a contract, right from the time it is made, and not from the time the performance of the obligation by the parties involved, is due. Thus, the required performance of the obligation could be made right at the time of entering into the contract, or else it could even be postponed to be performed at a later date.

Let us Recapitulate

In our daily life, we enter into a series of contracts, even without realising it. For example, when we enter into a public transport (bus or auto), a restaurant, etc., we enter into a contract.

Contract is an agreement, enforceable by law [Section 2(h)]

But, "every promise and every set of promises forming consideration for each other" is an agreement [Section 2(e)].

"When the person, to whom the proposal is made, signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise." [Section 2(b)].

Only such **agreements**, which are

(i) **enforceable in law**, and are also
(ii) **intended to be so**, constitute contracts.

Thus, while all contracts are agreements, all agreements are not necessarily contracts. For example: (a) Social agreements, as these are not intended to be enforceable in law, and (b) Contracts, specifically declared as void, *ab initio*.

These are:

(i) An agreement in restraint of trade (Section 27);
(i) An agreement to bet, or 'wagering contract' (Section 30); and
(ii) An agreement to do an impossible act (Section 56).

Thus, an agreement to do any unlawful, immoral, illegal, or impossible act is void *ab initio*

Further, "All agreements are contracts if they are made by free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void." (Section 10)

In summary, the following 10 essential elements are, involved in a valid contract:

1. Agreement. [Including (i) offer and acceptance (ii) offeror and offeree and (iii) *'consensus-ad-idem.'*]
2. Intention to create legal relationship. [That is, not being just some domestic or social obligations.]
3. Free and genuine consent. [Such consent should not be obtained by misrepresentation, fraud, undue influence, coercion, or mistake.]
4. Parties being competent to contract. [That is, he being a major, of sound mind, and not disqualified from contracting by any law to which he is subject.]
5. Lawful consideration. [That is, the price for which the promise or undertaking is sought and, in turn, given, by the two parties, must not be unlawful.]
6. Lawful Object. [This, too, should be lawful and not illegal.]
7. Agreements not declared void or illegal. [By any law of the land.]
8. Certainty of meaning. [That is, it should be without any ambiguity.]
9. Possibility of performance. [That is, not having any conditions, which cannot be actually and possibly performed.]
10. Necessary legal formalities. [That is, it should be in writing, duly stamped, and /or registered, as required by law.]

Classification of Contracts

1. Classification in terms of their validity or enforceability in law

(i) Valid agreements or contracts, [That is not being voidable, void, illegal or unenforceable in law.]

(ii) Voidable agreements or contracts, [That is, which could be repudiated but at the option and will only of one of the two parties involved.] [Section 2(i)].

(iii) Void agreements or contracts, [These cannot be enforced by any of the two parties, as it is invalid, *ab initio;* and, accordingly, it is unenforceable in law, Section 2(i).]

According to Section 11, a contract with a minor is void.

For some more categories of void agreements please refer to sub-section 2.3.1 (iii) of this Chapter.

(iv) Illegal agreements or contracts [That is, wherein the consideration or object is
- (a) Forbidden by law, or
- (b) Defeats the provisions of any law, or
- (c) It is fraudulent, or
- (d) It involves or implies injury to the person or property of the another, or
- (e) The court regards it as immoral or opposed to public policy.

(v) Unenforceable agreements or contracts. [That is, when it is notin writing, duly stamped, and/or registered, as it should be, as required by law.]

2. Classification in terms of their mode of formation

(a) Express Contracts, which are stated in words (written or verbal), and

(b) Implied Contracts, which are not stated in words (written or verbal), but are inferred from the conduct of the parties involved, or else from the circumstances of the particular case. (Section 9).

3. Classification in terms of their performance.

(a) (i) Executed contract,[which is fully completed, nothing further remaining to be done.] and

(ii) Executory contract, [where either all or some of the terms of the contract, still remain to be completed by both or any one of the parties.]

(b) (i) Unilateral contract, [where, while one of the parties has already performed his obligation, the other party remains to fulfil his obligation.] and
(ii) Bilateral contract [where both the parties remain to perform their obligations.]

Questions for Reflection

1. (a) What is a contract?
   (b) What constitutes an agreement?
2. "Only such agreements, which are (i) enforceable in law, and are also (ii) intended to be so, constitute contracts." Discuss, by citing suitable illustrative examples.
3. "While all contracts are agreements, all agreements are not necessarily contracts." Do you agree? Give reasons for your answer, by citing suitable illustrative examples.
4. "All agreements are contracts if they are made by free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void." Discuss the various elements of a valid contract, inherent in this sentence. Illustrate your points with some illustrative examples in each case.
5. What are the various essential elements, involved in a valid contract? Discuss each of them, with the help of one example in each case.
6. Distinguish between (i) valid (ii) void and (iii) voidable contracts, by giving suitable illustrative examples, to amplify your point.
7. What types of contracts would fall under the category of void agreements? Give illustrative examples in each case.
8. What types of contracts would fall under the category of illegal agreements or contracts?
9. Distinguish between the following pairs of terms, by citing suitable illustrative examples in each case:
   (a) Express Contracts and Implied Contracts
   (b) Executed Contract and Executory Contract
   (c) Unilateral contract and Bilateral Contract

Problems for Practice (With Suggested Solutions)

Problem 1

Joseph had invited Keynes to take lunch with him at the Hotel Taj Mahal, Mumbai, at 1.30 p.m.. on the 12th June 2009, to which Keynes had readily agreed. But, due to some other pressing engagements, he failed to turn up at the appointed place, date, and time for lunch, as was agreed upon. He had even forgotten to inform Joseph that he might not join him for lunch that day. In the process, Joseph had to pay for the lunch for two persons to the hotel as he had booked the lunch in advance. Accordingly, he filed a suit in the Court of law against Keynes, claiming damages for the loss of money and time. What are the possibilities of Joseph winning the case? Give specific reasons for your answer.

Solution

In this case, Joseph will surely lose the case because he does not have a legal course of action against Keynes. This is so because, none of the two parties, involved in the instant case of the agreement, had any intention to make it enforceable in law. It is true that Section 2 (h) provides that a contract is an agreement, enforceable by law. But then, it is not sufficient that the agreement must just be enforceable in law. In fact, and more importantly, the parties involved in the agreement must have had an intention, at the material time, to make it enforceable in law, too. Alternatively speaking, only such agreements, which are enforceable in law, and are also intended to be so, constitute contracts. Thus, as in the instant case, one of these two vital conditions (i.e. the intention to make it enforceable in law) is conspicuously missing (because inviting a person for lunch is simply in the

nature of a social and friendly gesture, having no legal intentions and implications); the agreement would not constitute a valid contract.

Problem 2

In Problem 1, would the legal position be any different, if Keynes would have reached the hotel in time for lunch at the appointed date and place and, to his utter surprise and disappointment, would have, instead, found Joseph being missing there?

Solution

The legal position would be the same in this case also; in that, Keynes would not have had any legal course of action against Joseph. This would be so because the agreement in question is in the nature of just social agreements and without any intention of creating any legal contractual obligation on the part of either of the two parties involved.

Problem 3

Abhinav had agreed to sell his house to Bachchan for Rs 10 lakh. What would be the legal position in the following two different situations?

(a) If Abhinav would have failed to hand over the possession of the house to Bachchan, even after having received the agreed amount of Rs 10 lakh from him (Bachchan), because he had received another offer of Rs 12 lakh for the same house from some other party.

(b) If Bachchan would have failed to make the payment of the agreed amount of Rs 10 lakh to Abhinav, because he was offered yet another house of a better construction and in a better locality, and that too, for just Rs 7 lakh.

Solution

We observe that in the instant case both the conditions stipulated for a valid contract have been fulfilled, viz.

(i) The agreement is enforceable by law, and

(ii) The agreement obviously involves the intention, on the part of both the parties concerned, to create legal contractual obligation against each other. That is to say that, in the event of any breach of agreement, and non-fulfilment of the respective contractual obligation on the part of any of the two parties, each party has the intention of proceeding legally against the other party.

Thus, in the agreement in question, there is a clear legal obligation on the part of Abhinav to hand over the possession of the house to Bachchan, and similarly, on the part of Bachchan to pay a sum of Rs 10 lakh to Abhinav, as per the agreement. We may also say that from the facts and nature of the case, it is obvious and clear that both the parties to the contract had legal intentions in mind at the time of entering into the contract and were keen on the performance of the respective contractual part by the party concerned. We say so because the agreement pertains to some business deal and involves financial transactions.

Therefore, in the event of the failure on the part of any one of the two involved parties to perform their respective parts of the contract, the other party has the legal right to proceed against the defaulting party. That is, if Abhinav would fail to hand over an undisputed possession of the house to Bachchan, he (Bachchan) has the legal right to proceed against Abhinav. In a similar manner, if Bachchan fails to pay to Abhinav the agreed sum of Rs 10 lakh, against the handing over of the undisputed possession of the house to him (Bachchan), Abhinav can file a civil suit against Bachchan for the breach of the contract.

Problem 4

Rohit had promised to his wife, Roshni, that he would pay her a sum of Rs 10, 000 every month during the entire period of his posting outside the country. He continued to remit the promised amount to his wife for around a year, and thereafter he refused to keep his promise. Roshni filed a case against Rohit for recovery of the amount from him. Do you think that Roshni would win the case/? Give reasons for your own legal opinion in the case.

Solution

Roshni will, for sure, lose the case for the recovery of the amount from Rohit inasmuch as the promise in question was in the nature of a domestic agreement, without any intention involved therein to create any legal obligation. And, the agreements involving just some domestic or social obligations cannot constitute a contract. This view is based on the decided legal case of **Balfour vs Balfour [(1919) 2, K. B. 571].**

Problem 5

Harish and Bharadwaj had entered into a business agreement, which was executed in writing under the joint signatures of both the parties to the contract. In the contract document, one of the clauses read as under:

'This arrangement is not a formal or legal agreement and shall not be subject to legal jurisdiction in the Courts of law.'

After some time, a dispute arose between Harish and Bharadwaj. Harish filed a suit in the court of law against Bharadwaj on the contention that usually all business agreements are presumed to have been entered into with the intention of creating legal obligations and consequences. Do you think that the contention of Harish is valid in the instant case? Give reasons for your answer.

Solution

It is true that there is a usual presumption that all business agreements are entered into with the intention of creating legal obligations and consequences. But Harish seems to have overlooked a very important legal point to the effect that such presumption would be operative and valid only in the cases where the agreements or legal documents concerned do not expressly state otherwise, i.e. to the effect that it has not been created with any legal intention, and that, accordingly, it will not have any legal jurisdiction in the Courts of law.

We, however, observe that in the agreement document executed by Harish and Bharadwaj, it is expressly stated in one of the clauses to the agreement document that it is not a formal or legal agreement and that it shall not be subject to legal jurisdiction in the Courts of law. Accordingly, the contention of Harish is not at all valid in the instant case. His legal point of view is rather misconceived and misunderstood in that he has overlooked the remaining part of the general presumption, i.e. regarding the specific provision in the agreement document to the contrary.

Such observations are based on the decisions given by the learned judges in legal cases of similar nature titled **Rose and Frank Co. vs J. R. Compton and Bros. Ltd. [(1925) A. C. 445] and Jones vs Vernon's Pools Ltd. [(1938) 2 All E. R . 626].** In both these cases, it was held that in the absence of the intention to create any legal relationships, these did not constitute legally binding contracts.

Problem 6

Vidya agrees to sell 1000 pieces of colour TV to Yasmin. Do you think that this agreement is enforceable in law? Give specific reasons for your answer, quoting the relevant Section and the inherent legal provisions in this context.

Solution

In the instant case, the details of the specifications like the brand name, type, size, etc. of the colour TV, have not been clearly stated. Hence, the agreement is not enforceable in law for want of certainty of meaning. It would have, however, been enforceable in law only if the aforementioned distinguishing particulars would have been clearly specified to avoid any element of uncertainty in the meaning of the agreement.

Section 29 of the Act provides that 'Agreements, the meaning of which is not certain, or capable of being made certain, are void.' In other words, the contract, to be valid and enforceable in law, must have certainty in its meaning, or, alternatively, it must be capable of being made certain. That is, it should be without any ambiguity, whatsoever. Otherwise, such contract would be considered as void and unenforceable in law. Accordingly, the agreement in question would be considered to be void and unenforceable in law.

Problem 7

Gagan, a renowned magician, makes an offer to Yashwant, a multi-millionaire, that he would actually shift the Qutub Minar from Delhi by magic, and would relocate it in Lucknow, if he would be paid a sum of Rs 10 lakh by Yashwant. Yashwant accepts the offer and deposits a sum of Rs 10 lakh in the State Bank of India, New

Delhi branch, for the purpose, to show his seriousness about his having accepted Gagan's aforementioned offer. Does this agreement amount to a valid contract, enforceable in law?

Solution

No; it would not come within the purview of a contract, enforceable in law. This view is based on the legal provision to the effect that an agreement to be eligible for being enforceable in law must contain only such terms and conditions, which are capable of being actually performed. Alternatively speaking, an agreement having such conditions, which cannot be actually and possibly performed (like actually shifting the Qutub Minar from Delhi, and relocating it in Lucknow, by magic, as has been provided in the aforementioned agreement), would not amount to a valid contract, enforceable in law.

Problem 8

Anurag and Anuradha, both being majors, agree to marry each other. But, unfortunately, after some time, well before the date fixed for marriage, Anurag is declared as being of unsound mind (mad). Will the contract of marriage be still valid or else it will become void, instead? Give specific reasons for your answer, quoting the relevant Section and the inherent legal provisions in this context.

Solution

The contract of marriage between Anurag and Anuradha in question will no longer remain valid. It will become void, instead, because as per the provisions of the Act, the contract of marriage becomes void when one of the parties to such contract goes mad before the date fixed for marriage. Thus, as Anurag has gone mad before the date fixed for marriage, this contract of marriage becomes void.

This contention is based on the provisions of Section 2 (j) of the Act, which stipulates that 'a contract which ceases to be enforceable by law, becomes void when it ceases to be enforceable'.

Problem 9

Raghuraj enters into a contract with Yasin to ship his consignment of woollen carpets from Varanasi to Karachi in Pakistan. Subsequently, India declares war against Pakistan. Will the contract be still valid or else it will become void, instead? Give specific reasons for your answer, quoting the relevant Section and the inherent legal provisions in this context.

Solution

The contract in question will no longer remain valid. It will become void, instead, because as per the provisions of the Act, the contract of shipment of some items to a port in a foreign country becomes void after the transporting country (i.e. the country of origin) declares war against the destination county. Thus, in the instant case, as India, being the transporting country (the country of origin) has declared war against the destination county (viz. Pakistan), the contract in question will no longer remain valid. It will become void, instead. This contention is based on the provisions of Section 2 (j) of the Act, which stipulates that 'a contract which ceases to be enforceable by law, becomes void when it ceases to be enforceable'.

A significant observation to be taken careful note of:

It may, however, be noted with interest that in the cases of both the Problems 8 and 9 above, the contracts were valid at the time these were entered into. But then, it was only at a later date that these became void due to the turn of some events.

It may also be observed that in Problem 8, the agreement later became void due to the subsequent impossibility, i.e. when Anurag had subsequently gone mad.

As against this, in Problem 9, the agreement had later become void due to the element of subsequent illegality, i.e. when India had declared war against Pakistan.

Problem 10

Lalit, the proprietor of Lalit Traders & Company, had visited the house of Rangan, to sell some of his goods to him. While leaving the house of Rangan, he had, by mistake, forgotten to pick up some of his goods thereat. Rangan, however, had consumed these goods, taking all these to be his own. Under the circumstances, is Rangan, from the legal point of view, required to pay for such goods to the trader? Give specific reasons for your answer, quoting the relevant Section and the inherent legal provisions in this context.

Solution

This is a clear case of a contract implied by law, under which, the person who has availed of the benefit therefrom is legally bound to reimburse the other party. The aforementioned contention is based on the provisions of Section 70 of the Act, which, inter alia, provides that if a person delivers something to another person, not intending to do so gratuitously, and the other person enjoys the benefit thereof, he is bound to make compensation to the former person in respect thereof.

In the instant case, we find that Rangan had consumed these goods, taking all these to be his own. We further observe that Lalit had not left the goods gratuitously at all. We say so because our contention is supported by the facts stated in the case to the effect that he had, instead, just forgotten to collect them by mistake.

All considered, Rangan is bound to pay for such goods to Lalit, as is required under Section 70 of the Act.

Chapter Three

Offer and Acceptance

"*There is no greater impediment to the advancement of knowledge than the ambiguity of words.*
Thomas Reid

Four basic premises of writing: clarity, brevity, simplicity, and humanity.
William Zinsser

Bad laws are the worst form of tyranny
Edmund Burke"

3.1 Offer or Proposal

What is an offer or proposal? According to Section 2 (a), a proposal is the one "when one person signifies to another his willingness **to do** or to **abstain from doing** anything, with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal".[Here we may mention that an offer and proposal are one and the same thing and, that these two different terms are used interchangeably]. It, thus, implies that an offer may involve a positive action or a negative action (i.e. passive abstinence from doing a thing).

Examples

(i) Ashok offers to sell his computer to Akash. Here, Ashok is making an offer to do something, that is, to sell his computer to Akash. Here, it is a positive act on the part of Ashok (the offeror or the proposer).

(ii) A banker offers not to file a civil suit against Vivek, if he would repay the amount of Rs 10,000 outstanding on his loan account. Thus, it is a negative act on the part of the banker (the offeror or the proposer), to abstain from filing a civil suit against Vivek.

3.1.1 How is an Offer Made?

An offer can be made in two distinct ways. These are:

(a) By any act, or
(b) By any omission, on the part of the party proposing, by which he intends to communicate such proposal, or which has the effect of communicating such proposal to the other (Section 3).

Further, an offer by an act, too, can be made in two distinct ways, viz. (a) by words or (b) by conduct (i.e. by implication)

(a) Offer by Words

An offer by words could be made either **in writing**, by way of a letter, telegram, fax, email, or advertisement, and so on, or else even **orally**, and that, too, again either in person (face-to-face) or over the telephone, and the like. Such offers are known as **express offers**.

Examples

(i) Anuradha proposes to Amitabh, by way of a letter, to sell her house to him at a certain price. It is an offer by act, and in writing, and hence an express offer, too.
(ii) Anuradha proposes to Amitabh, by way of a telephone call, to sell her house to him at a certain price. It is an offer by act, but orally (and not in writing), but this too is an express offer.

(b) Offer by Conduct (i.e. by Implication)

An offer can as well be made by positive acts, or even by signs, such that the person acting or making the signs means to say or covey something to the other party. But then, it must be clearly understood that mere silence on the part of the party can in no case be construed as an offer by conduct. An offer, which could be implied from the conduct of the parties, or the circumstances of the case, is referred to as an **implied offer**.

Example

Tarun plies his Tata Safari as a taxi from Lucknow to Kanpur. The currently stipulated and specified charge is Rs 200 per person. Thus, the very fact that his taxi is in the queue at the taxi stand goes to imply his offer to take persons in his taxi from Lucknow to Kanpur, for Rs 200 per person. He need not shout to attract persons, as his act itself implies his aforementioned offer. This is an apt example of an implied offer.

(c) Offer by Omission or Abstinence (from Doing Something)

An offer can also be made by a party, by omission to do, or by abstaining from doing, something.

Example

A banker offers not to file a civil suit against Salim, if he would repay the amount of Rs 20,000 outstanding on his loan account.

3.1.2 Specific and General Offer

An offer can be made in two different ways. These are:

(a) To a specific person, or to a particular group of persons, which is referred to as a **specific offer**.
(b) To the members of the general public at large, which is referred to as a **general offer**.

A specific offer can, therefore, be accepted only by that very specific person, or by a particular group of persons, to whom it has been made, and not by any other person, whatsoever.

Example

Anuradha proposes to Amitabh to sell her house to him at a certain price. It is a specific offer, which could be accepted by Amitabh and Amitabh alone, and by no one else. **[Boulton vs Jones (1857) 2H. and N. 564]**

But, as against the specific offer, a general offer can be accepted by any of the persons by complying with its terms and conditions.

Example

Carbolic Smoke Ball Company had advertised that it would reward a sum of 100-pound sterling to any person who would contact influenza, even after using its smoke balls, as per the direction printed thereon, and for a given period of time. Mrs Carlill bought the company's smoke balls, but she contacted influenza despite having used it, as per the direction printed thereon, and for the given period of time. Accordingly, she claimed the reward from the company. The company, however, refused to pay the amount on the plea that the offer was not made specifically to her, and that she had not conveyed her acceptance of the offer to the company, either. She then preferred to file a civil suit against the company.

It was held that she could claim the reward from the company because; she had accepted the offer just by complying with the terms of the offer. This is so because, as such an offer is in the nature of a general (and not specific) offer, it automatically gets accepted by any member of the public, just by complying with the terms of the offer, and also that the fact of its acceptance is not required to be necessarily conveyed to the offeror company, either. **[Carlill vs Carbolic Smoke Ball Company (1813) 1 Q. B. 256]**

3.1.3 Essential Requisites of a Valid Offer

The essential requirements for constituting a valid offer are:

(A) **The offer must be made with an intention of getting its acceptance.**

(B) **The offer must be made with the intention of creating a legal obligation, too.**

(C) **The terms of the offer must be definite, unambiguous and certain or capable of being made certain** (Section 29). Alternatively speaking, the terms of the offer must not be indefinite, ambiguous or vague.

Examples

(i) Sarita offers to sell 20 kg. of dry fruits to Vimla at the rate of Rs 400 per kg. But then, here, in the instant case, it is not quite clear as to what type of dry fruits is intended to be sold off. This offer, thus, cannot be accepted for want of the required clarity.

(ii) Sarita, well-known for dealing in cashew nuts only, offers to sell 20 kg. of dry fruits to Vimla at the rate of Rs 400 per kg. Here, as Sarita is well-known to be trading only in the specific variety of the dry fruits (that is, cashew nuts), it is a valid offer, inasmuch as the meaning of the term 'dry fruits' here is clear and specific, under the aforementioned circumstances of the case, and there is no ambiguity attached to the word.

(D) The offer must not be just a declaration of the intention to offer, or merely an invitation to offer.

Let us now proceed to bring out clearly the distinguishing features of an 'offer', as compared to

(i) Just a 'declaration of the intention to offer', and
(ii) An 'invitation to offer'.

(i) Distinction between an 'offer' and a 'declaration of the intention to offer'

It is quite possible that a person may just make some announcement, without any intention of making a legally binding obligation, or a valid offer. It may, thus, amount to a mere 'declaration of the intention to offer', which may not necessarily amount to a valid 'offer'.

Examples

(a) Lickerson, an auctioneer, issued an advertisement to the effect that a sale of office furniture would take place at a particular place. Harris reached the place, after travelling around 100 km., but to his utter surprise, he found that the sale of the office furniture was withdrawn. Harris filed a suit against the auctioneer for his loss of time and expenses. It was held that the auctioneer was not liable, inasmuch as

the advertisement amounted only to a 'declaration of the intention to offer' and not a valid 'offer' as such. **[Harris vs Lickerson (1875) L.R. SQ. B 286].**

(b) A man wrote to his would-be son-in-law that his daughter would have a share in his property after his death. The person (son-in-law of the deceased) claimed his share in the property left by the deceased person. It was held that the claim of the son-in-law of the deceased was not tenable in law, inasmuch as there was no offer as such from the father-in-law, creating a legally binding obligation on his part, and that the letter under reference was just a 'declaration of the intention to offer', and not a valid 'offer'. **[Re Ficus (1900) 1. Ch.331].**

(ii) Distinction between an 'offer' and an 'invitation to offer'

The prospectus issued by a company issuing its shares, a prospectus issued by a university, college or management institute, for admission to the various courses offered by them, a price list of its publications issued by a publishing house, and the like, do not constitute an offer. These, instead, amount to only an invitation to offer. And, on such invitation to offer, if a person fills in the application form for the issuance of the shares of the company, or for seeking admission in the educational institutions, or fills in the order form for the purchase of a specific book, it is only then that an offer is actually made by the person concerned, and not earlier. Similarly, the price tags attached to the items in the display windows of a shop, or the auctioneer, while auctioning the goods, inviting offers from the prospective bidders, are in the nature of invitation to an offer, and not an offer as such.

The case **'Harvey vs Facie'** amply clarifies the inherent distinctions between an 'invitation to an offer', and an 'offer'. The main facts of the case are narrated hereafter.

Harvey (the plaintiff), sent a telegram to Facie (the defendant), reading somewhat as under:

1. "Will you sell us the property named 'Bumper Hall Pen'? Telegraph lowest cash price." Facie (the defendant), sent a telegram in reply, reading somewhat as under:
2. "Lowest price for Bumper Hall Pen 900 pound-sterling." Harvey (the plaintiff), immediately replied back by the telegram (this being their last telegram) reading somewhat as under:
3. "We agree to buy Bumper Hall Pen for 900 pound-sterling asked by you."
4. Facie (the defendant), refused to sell the plot of land (viz. Bumper Hall Pen) for 900 pound-sterling.

The various points of law involved in the instant case are summarised hereunder:

The telegram at No. 1 above is in the nature of an enquiry on two distinct points, viz.

(i) 'Will you sell us the property named 'Bumper Hall Pen', and
(ii) 'Telegraph lowest cash price'.

The telegram at No. 2 above is in response thereto, but only on the second point of the enquiry, advising the lowest cash price for Bumper Hall Pen at 900 pound-sterling. This telegram is conspicuously silent on the point number (i), i.e. about the intention to sell the property.

Thus, in the absence of an intention to create a legal obligation, this telegram cannot be construed as a valid offer. Accordingly, in the absence of an offer, in the very first place, the question of its acceptance does not arise at all. The judicial committee had rejected the contention of Harvey that 'by quoting the lowest price of the property, Facie had made an offer to sell'. Thus, the telegram at No. 3 above (to agree to buy) is just uncalled for, and does not have any legal significance, as there is no offer, as such, which could be accepted and agreed upon. This can, at best be treated as an offer to buy, which offer was declined by Facie, as he had every legal right to accept or reject the offer, and he chose to reject it.

(E) The offer must be communicated by the offeror to the offeree

The offer (both specific and general offers) must be communicated to the offeree, before it could be accepted.

Example

Gauri Dutt had sent his servant, Lalman Shukla, in search of his missing nephew. Shukla, left the place to search his missing nephew. Thereafter, Dutt had announced an award to anyone who would inform him about his missing nephew. Shukla was able to trace the boy and informed Dutt accordingly, of course, without

knowing at that time that an award was subsequently announced for the purpose. But later, when he came to know of the award, he claimed the same from Dutt. But Dutt refused to pay him the award amount. Shukla, therefore, filed a suit to recover the amount from Dutt. It was held that, Shukla was not entitled to the award in view of the established fact that he was not aware of the aforementioned award at the material time, and that one could not accept the offer unless he had its knowledge. He could not claim it, inasmuch as the offer was not intimated to him, nor was he aware of the announced award. Thus, one of the essential requirements of a valid offer, that 'it must be communicated' was lacking in the instant case, and accordingly, the question of its acceptance and completion of the legally enforceable contract did not arise. The case was, accordingly, dismissed. **[Lalman Shukla vs Gauri Dutt, II, A.L.J. 489]**

(F) The offer should not contain a term to the effect that the non-compliance of such term may amount to the assumption that it has been accepted

That is, the offeror cannot stipulate that if the offeree does not specifically accept the offer, within a week, it would be deemed to have been accepted by the offeree.

Example

Ramesh tells Rakesh: "I offer to sell my Fiat car (1975 model), to you for Rs 5,000. If I do not hear from you within five days from now, I would presume that you have accepted the offer." This cannot be said to be a valid offer inasmuch as the essential ingredient, stated at (F) above, has not been fulfilled in this case.

(G) A tender, when submitted, in response to a notice or advertisement, inviting such a tender, is an offer, inasmuch as it has been submitted in response to such notice or advertisement, which, in turn, amounts to an invitation to an offer. A tender could be submitted for making some supplies (like the supply of some items of stationery, or for performing some work (like construction of a hostel building). The tender may generally be of two types, viz.

(i) A **specific or definite tender**, that is, for the supply of a certain quantity of the items of stationery, just once.

(ii) A **standing tender**, that is, for the supply of a certain quantity of the items of stationery periodically, say, every month, or else to replenish the stocks, depending upon such requirements arising from time to time.

Examples

(i) A company invites tenders for the supply of office furniture of the given specifications. (This is a case of invitation to offer). Five different parties submit their respective tenders. (This is a case of making the offers) The lowest tender of the party XYZ has been accepted by the company. (This is a case of accepting this very offer alone, and not the remaining four). Thus, the contract is complete, immediately when one of the valid offers has been accepted. This is so, only in the case of a specific or definite tender.

(ii) As against this, in the case of a standing tender, the offeror gives an open offer to supply the goods and services as and when required by the offeree. Thus, each time the order is placed, it becomes a separate invitation to offer, and each time when the price is quoted, it becomes a separate offer, and each time when the quoted price is accepted, it becomes a separate contract.

(H) Special Terms of an Offer

Special terms, if any, forming part of the offer, must be duly brought to the notice of the offeree at the time the offer is made. But, if such special terms, forming part of the offer, have not been duly brought to the notice of the offeree, at the time the offer is made, the offeree is not bound by such special terms. Such special terms could be brought to the notice of the offeree in one of the following two ways:

(i) By specifically drawing the attention of the offeree to such conditions, or

(ii) By inferring that a man of ordinary prudence could be able to find them by exercising ordinary intelligence.

In the first case, if it were stated on the receipt of a dry cleaner shop, or luggage booking office, like "For conditions, please see the reverse" or "PTO for conditions", it would be construed as specifically drawing the attention of the offeree to such conditions. And, if the offeree even fails to read the conditions, stated on the back of such receipt, the offeror would not be held liable beyond the stated conditions.

Examples

(i) Parker Parker, a passenger, deposited his baggage in the cloakroom at the railway station. On the face of the acknowledgement receipt was written: "See back". One of the conditions, written on the reverse of the receipt, stipulated that the claim, from the railways for the loss of any luggage, would not exceed 10 pound-sterling. Parker's baggage was lost. He claimed 24 pound-sterling and 10 pence, the value of his lost baggage, on the plea that he had not read the conditions printed on the reverse of the receipt.

It was held that his claim couldn't exceed the stated amount of 10 pound-sterling, inasmuch as he was bound by the conditions printed on the reverse of the receipt. It was further held that the company, by printing the words "See back" on the face of the acknowledgement receipt, had given sufficient notice to the depositors, regarding the conditions printed on the reverse of the receipt. **[Parker vs South Eastern Railway Company (1877) 2 C.P.D. 416].**

(ii) Thompson bought a railway ticket on the face whereof was printed the words:

"For conditions see back". One of the conditions printed on the reverse of the ticket excluded the liability, on the part of the Railways, for any injury to the passengers, howsoever caused. Thompson got injured during the railway journey. She pleaded that she was an illiterate person and, therefore, she could not read the conditions printed on the reverse of the ticket, and accordingly, claimed damaged from the railways for the injury, sustained by her during the journey.

It was held that the conditions, printed on the reverse of the ticket, would apply whether she had read them or not, or even whether she was able to read them or not (being illiterate), in view of the fact that the company, by printing the words "For conditions see back" on the face of the ticket, had given sufficient notice to the passengers, regarding the conditions printed on the reverse of the ticket. **[Thompson vs L.M. and L. Rly (1930) 1 KB 417].**

(iii) Even in the case of a person, who does not know the language in which such specific terms and conditions are written, the same rule will apply, as has been discussed in the example (ii) above, pertaining to the plea of the person being illiterate. This is so because, such persons are expected to call for the translation of the conditions, or else to request for being explained such specific terms and conditions in the language known to him or her. And, if the person does not take care to do so, the conditions would apply on the ground that he or she would be presumed to have a constructive notice of the terms and conditions, if his or her attention has been drawn to them in a reasonable manner, like printing on the face of the receipt or ticket the words to the effect that "For conditions, see the back" or the like. **[Mackillingan vs Campagine de Massangeres Maritimes (1897) 6 Cal.227J].**

Conversely speaking, in case the terms and conditions, limiting or defining the rights of the acceptor are not brought to the notice of such acceptors, in a reasonable manner (as aforementioned), such terms and conditions would not form a part of the offer and, accordingly, these would not be binding on the acceptors.

Example

(iv) A person was travelling with his luggage by ship from Dublin to Whitehaven. He bought a ticket. One of the conditions printed on the reverse of the ticket excluded the liability, on the part of the shipping company, due to the loss of any luggage. He lost his luggage during the journey, and sued the company for the damages on the grounds that:

(a) He did not read the conditions printed on the back of the ticket.
(b) Nothing was written on the face of the ticket to draw his attention to the conditions written on the reverse of the ticket.

It was held that, in view of the fact that nothing was printed or written on the face of the ticket to draw his attention to the conditions written on the reverse of the ticket, he was entitled to the damages inasmuch as he was not bound by the conditions, which were not communicated to him. That is, the shipping company had not given him sufficient notice regarding the conditions printed on the reverse of the ticket. **[Henderson vs Stevenson (1875) 2 H.L.S.C. 470].**

(I) Cross Offers

A Cross Offer is one where the two parties, being ignorant of each other's offer, make identical offers to each other. In such cases, only offers may be said to have been made by the parties concerned, and there is no element of acceptance involved in either of the cases. Accordingly, there is no contract made, either, as the element of acceptance is absent.

Example

Hoffman & Co. had written to Tinn, making an offer **to sell** to him 800 tonnes of iron at the rate of 69 shillings per tonne. The same day, Tinn had also posted a letter to Hoffman & Co. offering **to buy** from them 800 tonnes of iron at the rate of 69 shillings per, tonne. Their letters crossed each other in transit in the post.

Tinn's contention was that there was a good contract, because the elements of buying and selling the same quantity of iron, and at the same price, were involved in the case. It was, however, held that there was no contract, inasmuch as only cross offers were involved, as also because, at the material time, Tinn was not aware of the offer letter of Hoffman & Co., regarding the sale by them. **[Tinn vs Hoffman & Co. (1873) 29 L.T. Exa. 271].**

Summary

We may now summarise, at one place, the various essential requirements of a valid offer hereunder:

(A) The offer must be made with an intention of getting its acceptance.
(B) The offer must be made with the intention of creating a legal obligation, too.
(C) The terms of the offer must be definite, unambiguous and certain or capable of being made certain (**Section 29**).
(D) The offer must not be just a declaration of the intention to offer, or merely an invitation to offer.
(E) The offer must be communicated by the offeror to the offeree.
(F) The offer should not contain a term to the effect that the non-compliance of such term may amount to the assumption that it has been accepted.
(G) A tender, when submitted, in response to a notice or advertisement, inviting such a tender, is an offer.
(H) Special terms of an offer must be duly brought to the notice of the offeree, at the time of making such offer.
(I) Two identical cross offers do not constitute a contract.

3.1.4 Termination or Lapse of an Offer

An offer is made with an intention of getting its acceptance. And, the moment it is accepted by the offeree, it becomes a contract. But then, well before its acceptance, it may even lapse, or may even be revoked by the offeror. In both such cases, the offer will expire. Now let us examine as to under what specific circumstances, an offer may expire, or may be revoked.

(i) An offer may expire or lapse after a stipulated time, or even after a reasonable time

As provided in Section 6(2), the offeree must accept an offer within the time, as stipulated in the offer. Further, in case no such specific time limit has been stated, it must be accepted within a reasonable time. Thus, such offer automatically expires, if it has not been accepted within that time limit, or within a reasonable time. But what should be regarded as the reasonable time, would, of course, depend on the circumstances of each case.

Example

In the case **[Ramsgate Victoria Hotel Co. vs Montefiore (1860) L. R. I. Ex 109],** Montefiore had offered to Ramsgate Victoria Hotel Co., by means of a letter, written on 8th June, to purchase its shares. The company had allotted the shares to him as late as on 23rd November. Montefiore refused to purchase the shares. It was held that the offer had lapsed, inasmuch as it was not accepted within a reasonable time.

(ii) An offer lapses with the death or insanity either of the offeror or the offeree, before acceptance

As provided in Section 69 (4), an offer automatically gets revoked with the death or insanity of the offeror before its acceptance, provided that the offeree was in the know of the fact of the death or insanity of the offeror, before accepting the said offer. Alternatively speaking, if the offeree was not in the knowledge of the fact of the death or insanity of the offeror, at the time of his accepting the said offer, it would amount to a valid contract.

Further, in the case of the death or insanity of the offeree, before accepting the said offer, the offer automatically gets terminated inasmuch as a dead person cannot accept an offer, and, at the same time, even an insane person is not considered to be competent enough to accept an offer, and thereby enter into a valid contract.

(iii) An offer gets terminated when the offeree rejects it

(iv) An offer gets terminated when it is revoked by the offeror himself, well before its acceptance

(v) An offer gets terminated when it is not accepted in the mode specifically prescribed for the purpose, or else (in the absence of any specifically prescribed mode) when it is not accepted in some usual and reasonable manner

(vi) A conditional offer, however, gets terminated when its condition is not accepted by the offeree

Example

Ramesh offers to sell his car to Lakshman for Rs 50,000, provided he would rent out his house to him at the rental of Rs 10,000 per month. Lakshman declined to rent out his house to him at the rental of Rs 10,000 per month. Thus, the offer gets automatically terminated.

(vii) An offer also gets terminated when the offeree makes a 'Counter Offer'

When, instead of accepting the terms and conditions of the offer, as they are, the offeree prefers to accept such offer, but subject to certain conditions and qualifications, it gets automatically terminated, and the offeree is considered to have made a counter offer. Some examples of such counter offers are given hereunder:

Example

Anurag offers to buy a house from Anjum with the condition that the possession of the house would be given on 30th November, 2008. Anjum accepts the offer with the condition that the possession of the house will be given on 31st December 2008, instead. This does not amount to the acceptance of the offer, but it will be construed as a counter offer, instead. Thus, the former offer of Anurag lapses and the counter offer now made by Anjum would be taken as a fresh offer, which, only if and when accepted by Anurag, would amount to its acceptance, and not otherwise. A case on this point is **Routledge vs Grant [(1828) 130 E.R. 920].**

Summary

To sum up, an offer may terminate, expire or lapse, under the following conditions:

(i) After expiry of a stipulated time, or even after a reasonable time.
(ii) With the death or insanity either of the offeror or the offeree, before acceptance.
(iii) When it is rejected by the offeree.
(iv) When it is revoked by the offeror himself, well before its acceptance.
(v) When it is not accepted in the mode specifically prescribed for the purpose, or else when not accepted in some usual and reasonable manner.
(vi) When the condition of a conditional offer, is not accepted by the offeree.
(vii) When the offeree makes a 'Counter Offer'.

3.2 Acceptance of an Offer or Proposal

What does amount to an acceptance of an offer or proposal? According to Section 2(b), "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted". In other words, acceptance is giving one's consent to an offer. And, when the offeree accepts the offer, it becomes a contract. Now let us examine the various ways in which an offer may be accepted.

3.2.1 Modes of Acceptance

The offeree may give his assent to a proposal (that is, he may accept a proposal), either by expressing his assent thereto verbally or in writing. This is simple enough. But then, the offeree may give his assent to a proposal even by implication (which may signify his assent), like by performing some specified act. The case of **Carlill vs Carbolic Smoke Ball Company,[(1813) 1 Q. B. 256],** quoted earlier in this chapter at sub-section 3.1.2 , is an apt example. Let us take some other illustrative examples of acceptance, implied by a particular act or performance.

Examples

(i) Gopal's son is missing. He announces an award of Rs 1,00,000 to anyone who would bring his missing son back to him. Raghunath came to know of the offer, and was later able to trace the boy, whom he brought to Gopal. This is a case of a general offer and each individual person is not required to convey his acceptance of the offer to Gopal. In this case, Raghunath's very act of finding and restoring the boy to Gopal implies his acceptance of Gopal's offer, by doing the act (of restoring Gopal's son to him). Thus, a contract gets entered into, and Raghunath is entitled to receive the award.

Here, it may be pertinent to bring out a contrasting distinction between the instant case (where Raghunath was in the know of the announced award, and the case cited earlier viz. **Lalman Shukla vs Gauri Dutt, [II, A.L.J. 489]**, where Lalman Shukla was not aware of the announced award at the material time. He had come to know of it only later, after having found the missing boy, and bringing him back to Gauri Dutt.

(ii) Macmillan India Limited, New Delhi, receives an order from the IIM, Lucknow, for supply of some books. The company sends the required books. The order sent by the IIM, Lucknow, is the offer, which has been accepted by the company, impliedly, by its act of despatching the books. In this case, the offer has been accepted (not expressly, written or verbal), but by the act, conduct, or performance, on the part of the company, that is, by the despatch of the books ordered for.

(iii) Avinash's car develops some trouble on his way back home. Saurabh, a passer-by, offers to correct the faults, and opens the bonnet. Avinash does not object, and rather allows him to go ahead. In view of the nature of the aforementioned circumstances, Avinash may be said to have accepted the offer made by Saurabh, to correct his car.

(iv) The case, **Parker vs Clark [(1960) I W.L.R. 286]** cited at earlier at page 8 in Chapter 2, is also an illustrative case in point.

(v) Rahul enters into a bus to reach his school, and takes his seat. His act of entering into the bus itself, under the circumstances, amounts to the acceptance of the open offer of the bus company.

3.2.2 Who can Accept an Offer?

A specific offer (that is, an offer made to a specific person), can be accepted only by that very person to whom it has been specifically made, and by no one else (unless the offeror expressly allows such other person to do so).

In the aforementioned example, if the IIM, Lucknow, had placed an order to Macmillan India Limited, New Delhi, for the supply of some books, and some other publishing house had sent the required books to the IIM, Lucknow, the latter can very well refuse to accept the books, on the ground that the offer was in the

nature of a specific order, made specifically to Macmillan India limited, New Delhi, and, therefore, no one else can be deemed to have accepted it (by performance, or whatever).

The case of **Boulton vs Jones** is a live illustrative example. The brief facts of the case are cited hereunder:

Boulton, who was serving with the ABC Company as its Manager, had purchased the business of the company. The ABC Company owed some debt to Jones. With a view to getting the debt settled, Jones had placed an order with ABC Company for supply of certain goods. The goods were, however, supplied by Boulton, instead, though the specific order was not placed with him, but with ABC Company. Jones refused to pay Boulton for the supply of the goods, on the ground that the offer was not made to him but to ABC Company, which alone could accept it by way of the performance, that is, by supplying the goods. Furthermore, in this case, the intention was two-fold, that is, not only to get the supply of the goods, but also to get the amount of the debt, outstanding with ABC Company, cleared to that extent. It was held that, as the offer was made to the ABC Company, it was not within the powers of Boulton to have accepted it.

As against the specific offer, in the case of a general offer, any person would be entitled to accept it, by complying with the terms of the offer. The case of **Carlill vs Carbolic Smoke Ball Company, [(1813) 1 Q. B. 256],** quoted earlier in this chapter at sub-section 3.1.2 , well illustrates the point .

3.2.3 Essential Ingredients of a Valid Acceptance

An acceptance, to be effective in law, must comply with certain legal rules, so as to become a valid contract. These essential ingredients of a valid acceptance have been discussed hereafter.

(i) The acceptance must be absolute and unqualified

As provided in Section 7, an acceptance of an offer, to be valid in law, must be in absolute and unqualified terms. That is to say that, all the terms and conditions of the offer must be accepted absolutely, and in exactly the same manner, as stated in the offer, without stipulating any condition or change (howsoever minor or slight it may be), because, otherwise, it may be construed, not as an acceptance, but just as a counter offer, instead. And, the original offeror has the option to accept or reject such counter offer.

Examples

1. Kailash offers to sell his house to Vasantraj for Rs 1,00,000. Vasantraj responds by saying that he would purchase the house for Rs 90,000, instead. It amounts to rejection of the offer of Kailash by Vasantraj, inasmuch as the acceptance is not in absolute terms. Instead, Vasantraj has made a counter offer to Kailash.

   Vasantraj, however, subsequently reconsiders, and agrees to purchase the house for Rs 1,00,000, as was originally quoted by Kailash to him earlier. This again would be treated as a counter offer, which Kailash may accept or may not accept. This goes to indicate that once an offer is not accepted, in absolute terms, and, thus, gets rejected, the same offer cannot be accepted any more. A fresh offer or proposal would be required in such cases. **[Union Bank of India vs Babulal, A.I.R. (1968) Bombay, 294].**
2. Merrett made an offer to Neale to sell his land to him for 280 pound-sterling. Neale accepted the offer, but sent 80 pound-sterling only, adding that the balance amount of 200 pound-sterling would be definitely paid by him in equal monthly instalments of 500 pound-sterling each. It was held that in view of the fact that the offer has not been accepted in absolute terms, it would not amount to its acceptance, but rather its rejection, instead (by way of making a counter offer, that is) **[Neale vs Merrett (1930) W. N. 189].**
3. Joseph offers to sell his car to Philip for Rs 50,000. Philip accepts the offer provided Joseph would purchase his motorcycle for Rs 20,000. This, too, is a case of non-acceptance of the offer, for the same reason as aforementioned.

Here, it may be pertinent to specifically clarify certain points of law involved, so far as the condition of the acceptance being in absolute terms is concerned.

1. First, a mere variation in the language, not amounting to any material alteration or difference in the substance of the terms of the offer concerned, would not go to make the acceptance thereof as ineffective in law. **[Heyworth vs Knight (1864) 144 E.R. 120, 142 R.R. 855]**
2. Second, in case certain conditions are implied in the offer as a part of the contract, and the offeree accepts such an offer, subject to such conditions, such acceptance would amount to a valid acceptance, and culmination of a legal contract.

   Example

   Joseph offers to sell his house to Philip for Rs 50,000. Philip accepts the offer, subject to its title being approved by his lawyer. Such an acceptance would be treated as an absolute, unqualified, and unconditional one, inasmuch as it is presumed that Joseph has a valid title to the house he has proposed to sell to Philip, and that it was not considered necessary for Joseph to have made a mention in his offer about the validity of his title to the property.
3. Third, an offeree may accept an offer, 'subject to a contract', or 'subject to a formal contract', or even 'subject to a contract to be approved by his lawyer'. In such a case, the parties intend not to be bound (and, are accordingly not bound) by the contract, unless and until a formal contract is drafted and signed by both the parties concerned. Further, in such a case, the acceptor may agree to all the conditions of the offer in absolute terms, but then, he may yet prefer to decline to be bound thereby, until a formal agreement is drafted and signed by both the parties involved.

Examples

(i) Esche offers to sell his nursery to Chillingworth for 4,000 pound-sterling. Chillingworth accepts the offer, provided a proper contract is prepares by the lawyers of Esche, the vendor. The lawyers of Esche prepared the contract document, which was, in turn, duly approved by the lawyers of Chillingworth, too. But Chillingworth, in the mean time, changed his mind and declined to sign the contract document. It was held that, in view of the fact that the agreement was only conditional, and the other party had not signed the contract, there was no binding contract between the two parties. **[Chillingworth vs Esche (1924) 1 Ch. 97].**

(ii) Eccles had purchased the house of Bryant 'subject to a contract'. The terms and conditions of the formal contract document were prepared, and were even signed by both the parties. But, while Eccles had posted his part of the contract, Bryant, in the mean time, changed his mind, and did not post his part of the contract. It was held that there was no binding contract between the two parties, in view of the fact that, though the other party had signed the contract, he had not posted it, and thus, there was no exchange of contract, and accordingly, there was no binding contract between them. **[Eccles vs Bryant (1948) Ch. 93].**

(ii) The acceptance must be communicated to the offeror

The acceptance must be necessarily communicated to the offeror, failing which there would be no valid acceptance of the offer, and accordingly, no binding contract between the two parties, either. That is, only an acceptance in mind, sans communication, is no acceptance at all. But then, an acceptance may be either **express or implied**.

Example

William sends a draft agreement for sale of sugar to another trader, Victor. Victor finds the terms and conditions favourable to him, and accordingly, immediately writes the word 'Approved' on the draft agreement itself, and keeps it in the first drawer of his table, to send it to his lawyer for drafting a final contract document for execution, the very next day. But, due to some other pressing preoccupation, he forgets to do so. It was held that there was no contract, inasmuch as the acceptance of the offer was not communicated to the offeror.

It must also be borne in mind that the acceptance of an offer cannot be implied just by mere silence on the part of the offeree, nor due to his failure to respond thereto.

Example

Felthouse wrote to Bindley, his nephew, to buy his horse for 30 pound-sterling, and also added: "If I hear no more about it, I shall consider the horse is mine at 30 pound-sterling." Bindley did not respond. He, however, told the auctioneer concerned, who was selling his horse, not to sell that particular horse to any one else, as the same was already sold out to his uncle. But, by mistake, the auctioneer sold out that very horse to someone else. Felthouse sued the auctioneer for conversion. It was held that, as there was no communication by Bindley in regard to the acceptance of the offer to Felthouse, no binding contract was created, in view of the fact that the acceptance of an offer cannot be implied just by mere silence on the part of the offeree, nor due to his failure to respond thereto. **[Felthouse vs Bindley (1862) 11 C.B. (N. S.) 869].**

However, in this context, it may be pertinent to clarify that if, the offeree, by his earlier conduct, had indicated that the silence on his part would automatically imply his acceptance of the offer, then, in that case, his silence would imply his acceptance of the offer.

It may be further stressed here, as has already been clarified earlier, that, in the case on a general offer, a specific communication of the acceptance of the offer is not necessary, inasmuch as the performance, as per the terms of the general offer, in itself would be considered sufficient for the purpose (of acceptance). In this context, please refer to the case: **Carlill vs Carbolic Smoke Ball Company, [(1813) 1 Q. B. 256],** explained in earlier pages in this chapter at sub-section 3.1.2 , which is an apt example.

(iii) The acceptance must be in accordance with the prescribed mode

As provided in Section 7, where the offeror has already specifically prescribed a particular mode of acceptance of the offer, it has to be done in strict conformity therewith, and thus, any deviation therefrom would not be treated as a valid acceptance, and therefore, there would not be a valid enforceable contract, either.

Example

Rahman makes an offer to Ramakrishna by means of a letter, but asks that the offer must be accepted by fax. Ramakrishna should accept the offer by fax only.

However, in case the offeror has not specifically prescribed a particular mode of acceptance, it may be accepted by some usual or reasonable mode.

Example

Rahman makes an offer to Ramakrishna by means of a letter. He, however, does not stipulate any specific mode of acceptance of the offer. Ramakrishna accepts the offer, by posting a letter to him, within a reasonable time. It would amount to a valid acceptance, as no particular mode of acceptance of the offer had been prescribed, and the acceptance by post is considered to be a 'usual and reasonable manner' of acceptance in law. Further, it was accepted within a reasonable time, too.

But, let us now take some different circumstances of a case, where, too, the offeror has already specifically prescribed a particular mode of acceptance of the offer. But then, the offeree has not accepted it in strict conformity therewith. However, such acceptance has been duly communicated to the offeror by the offeree. Under such circumstances, the offeror is required to insist and inform the offeree, and that too, within a reasonable time, to send the acceptance over again, in the prescribed format, as required. And, if the offeror fails to do so (that is, insist and inform the offeree, within a reasonable time, to send the acceptance over again, in the stipulated manner), the acceptance would be held valid, and accordingly, a valid enforceable contract would be deemed to have been completed (it being not in strict conformity with the prescribed mode, notwithstanding).

Example

Rahman makes an offer to Ramakrishna by means of a letter, but asks that the offer must be accepted by fax. Ramakrishna should accept the offer by fax. But, instead, he accepts the offer, by posting a letter to him, of course, within a reasonable time. In such a case, Rahman should insist that Ramakrishna must accept the offer over again, this time by fax only. And, if he fails to insist, as aforementioned, the acceptance would become legally binding on him.

(iv) The acceptance must be given within the specified time, or else within a reasonable time

It is further required that the acceptance must be given within the specified time, as stipulated in the offer. If, however, no time limit has been prescribed in the offer, it must be accepted within a 'reasonable time'. But, what would constitute a 'reasonable time' would, naturally, depend on the facts and circumstances of each case.

Example

The case of **Ramsgate Victoria Hotel Co. vs Montefiore [(1860) L. R. I. Ex 109],** cited earlier in this chapter at sub-section 3.1.4, well illustrates the point.

(v) The acceptance must be given in response to an offer

It goes without saying that the acceptance can invariably be given in response to an offer. Alternatively speaking, if there is no offer made, the question of accepting any non-existent offer does not arise at all. That is, the acceptance can only follow an offer, and can, under no circumstances, precede it.

Example

A company comes with a public issue of its shares. If Ramadin does not apply for the shares, the company cannot allot any share to him on its own, as there is no offer to that effect from Ramadin, as has specifically been stipulated in section 41 of the Companies Act, 1956.

(vi) The acceptance must be made before the offer lapses or it gets terminated, revoked or withdrawn by the offeror

Thus, in the event of any of the aforementioned things happening (that is, if the offer lapses or it gets terminated, revoked or withdrawn by the offeror), it becomes extinct and non-existent. Hence, the question of its acceptance thereafter does not arise at all.

(vii) The acceptance can be given only by the specific person to whom it is made

That is to say that if Suman has made the offer to Sukhdev, Sukhdev and Sukhdev alone can accept it, and no other person can accept it, whomsoever he or she may be. However, in the case of a general offer, it could be accepted by any one.

Essentials of a valid acceptance has been summarised hereunder:

(i) It must be absolute and unqualified
(ii) It must be communicated to the offeror
(iii) It must be in accordance with the prescribed mode
(iv) It must be given within the specified time, or within a reasonable time
(v) It must be given in response to an offer
(vi) It must be made before the offer lapses or it gets terminated, revoked or withdrawn by the offeror
(vii) It can be given only by the specific person to whom it is made.

3.2.4 Agreement to Agree in the Future

As we have seen earlier, the terms of an agreement must be certain, or else, it must be capable of being made certain, without involving any further agreement between the parties. Accordingly, an agreement to agree in the future is not permitted by law, inasmuch as it is not certain, nor it is capable of being made certain, as of now.

Example

The terms of the agreement with an actress provided that if the party went to London, she would be engaged at a 'salary to be mutually arranged between us'. It was held that there was no binding contract, in view of the fact that the terms of the agreement were neither definite, nor were capable of being made definite, without involving any further agreement between the two parties. **[Lofus vs Roberts (1902) 18 T.L.R. 532].**

3.2.5 Communication of Offer and Acceptance

As already discussed earlier, an offer, as also its acceptance, to be held valid, must be communicated to the respective parties, that is, the offer to the offeree, and the acceptance to the offeror. Similar is the case as regards their revocation, too. That is, the revocation of the offer must be communicated by the offeror to the offeree, and the revocation of the acceptance thereof must be communicated by the offeree to the offeror.

Further, according to Section 4, the communication of an offer is complete when it comes to the knowledge of the specific person to whom it has been made.

Example

Om (offeror) writes to Anurag (acceptor) to sell his car to him for Rs 45,000. This offer is said to be complete the moment Anurag receives the offer letter. But not earlier than that.

But, the completion of the communication of an acceptance involves two aspects. These are:

(a) As against the offeror (or the proposer) and
(b) As against the acceptor (or the offeree).

(a) The communication of an acceptance is said to be complete as against the offeror (or proposer), when it has been put in the course of transmission, so as to be out of the power of the acceptor. But not earlier than that.

Example

Om (offeror) writes to Anurag (acceptor) to sell his car to him for Rs 45,000. Anurag accepts this offer by means of a letter, sent by post. The communication of acceptance is complete as against Om (the offeror) the moment Anurag (the acceptor) posts the letter of acceptance (but not earlier).

(b) But, it is said to be complete as against Anurag, the accerptor (offeree), when it comes to the knowledge of Om, the offeror or the proposer. But, not earlier than that.

That is, in the above example, the communication of acceptance is complete as against Anurag, the moment Om receives the letter of acceptance (but not earlier).

3.2.6 Communication of Revocation of Offer and Acceptance

Now, let us examine as to how and when the communication is said to be complete in respect of the revocation of both the offer and acceptance, as against the respective parties.

The completion of the communication of revocation of an offer, as also of the acceptance, involves two aspects. These are:

(a) As against the offeror (or proposer) and
(b) As against the acceptor (or offeree).

(a) The communication of the revocation of an offer or an acceptance is said to be complete, as against the person who makes it (i.e. who makes the offer or acceptance), when it has been put in the course of transmission, so as to be out of the power of the person who makes it (i.e. who makes the offer or acceptance). But not earlier than that.

(b) But, it is said to be complete as against the person to whom it is made, when it comes to the knowledge of the person to whom it is made. But, not earlier than that.

Let us elucidate the legal points involved, with the help of some illustrative examples.

Examples

Oscar (offeror) offers to sell his car for Rs 1,00,000 to Arnold (accepter), by means of a letter, sent by post. Arnold (accepter), too, accepts the offer by means of a letter, sent by post.

Now, let us examine as to by when the revocations of the proposal and acceptance would be deemed to be complete as against these two parties, respectively, under the various circumstances discussed hereunder:

Situation (a) Oscar (offeror) revokes his offer by fax
The revocation is complete,

(i) As against Oscar (offeror), the moment the fax is sent. But, it would be deemed to be complete
(ii) As against Arnold (accepter), only when he receives the fax.

Situation (b) Arnold (accepter) revokes his acceptance by fax
Now, let us examine as to when the revocation of the acceptance would be deemed to be complete as against the respective two parties.
The revocation is complete,

(iii) As against Arnold (accepter), the moment the fax is sent. But, it would be deemed to be complete
(iv) As against Oscar (offeror), only when he receives the fax.

3.2.7 Time Limit for Revocation of Offer and Acceptance

According to Section 5, an offer may be revoked at any time, but only before the communication of its acceptance is complete, as against the offeror. Accordingly, once the communication of acceptance of the offer is complete, as against the offeror, as aforesaid, the offer cannot be revoked thereafter

In a similar manner, an acceptance, too, may be revoked at any time, but only before the communication of its acceptance is complete, as against the acceptor. Accordingly, once the communication of acceptance of the offer is complete, as against the acceptor, as aforesaid, it cannot be revoked thereafter.

Let us elucidate the legal points involved here, even further, with the help of the aforementioned illustrative example itself.

Example
Oscar (offeror) offers to sell his car for Rs 1, 00,000 to Arnold (accepter), by means of a letter, sent by post. Arnold (accepter), too, accepts the offer by means of a letter, sent by post.

Now, let us examine as to, upto what latest stage or time, the two respective parties, under the various circumstances, discussed hereunder, could revoke the proposal and acceptance:

(i) Oscar (offeror) may revoke his offer at any time, but before or at the very moment Arnold (accepter) posts his letter of acceptance, but not thereafter.
(ii) Similarly, Arnold (accepter) may revoke his acceptance at any time, but before or at the very moment his letter, communicating the acceptance of the offer reaches Oscar (offeror), but not thereafter.

This is so because, in India, the post office is deemed, under the law, to be the common agent of both the offeror and the acceptor. Thus, once the letter is just posted in the post office, or dropped in the letterbox, by the parties concerned, it has the effect of completion of the communication, by the one party to the other (the principals), through their respective common agent (post office) on their behalf, as appointed and authorised by law.

As against this, under the English Law, the post office is deemed to be the agent of the offeror and offeror alone. Thus, the post office is deemed to be performing the twin tasks on behalf of the offeror, viz. (i) to take the offer to the offeree, and (ii) to bring back the acceptance (or rejection) thereof. Under the circumstances, the acceptance cannot be revoked at any stage, under the English Law. This fact has been very succinctly summarised by Sir William Anson in his observation: "Acceptance to an offer is what a lighted match is to a train of gun-powder. It produces something which cannot be recalled or undone."

Let us Recapitulate

According to Section 2 (a), 'When one person signifies to another his willingness **to do** or to **abstain from doing** anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make

a proposal". Thus, an offer may involve a positive action or a negative action (i.e. passive abstinence from doing a thing).

Thus, an offer can be made in two distinct ways, viz.:

1. By any act, which could be in the nature of either

(i) Express Offer (i.e. in writing, like by letter, telegram, fax, email, or advertisement, or else even orally, either in person or over the telephone. or

(ii) Implied Offer (i.e. by conduct, or by implication)

2. By any omission, or abstinence (from doing something) by the offeror. (Section 3)

Specific Offer, which is made to a specific person, or to a particular group of persons, which, therefore, could be accepted only by the specific person or the specific group.

General Offer, which is made to the members of the general public at large, which, therefore, could be accepted by any one.

The essential requirements for constituting a valid offer are:

(A) It must be made with an intention of getting its acceptance.

(B) It must be made with the intention of creating a legal obligation, too.

(C) Its terms must be definite, unambiguous and certain or capable of being made certain, i.e. it must not be indefinite, ambiguous or vague. (Section 29).

(D) It must not be

(i) Just a declaration of the intention to offer, or

(ii) Merely an invitation to offer.

(E) It must be communicated by the offeror to the offeree.

(F) It should not contain a term to the effect that the non-compliance of such term may amount to the assumption that it has been accepted.

(G) A tender, when submitted, in response to a notice or advertisement, inviting such a tender, is an offer. The tender may generally be of two types, viz.

(i) A specific or definite tender, and

(ii) A standing tender,

(H) Special Terms of an Offer must be duly brought to the notice of the offeree at the time the offer is made.

(I) It should not amount to a Cross Offer, that is, where the two parties, being ignorant of each other's offer, make identical offers to each other.

An offer may expire or lapse:

(i) After a stipulated time, or even after a reasonable time. Section 6(2).

(ii) With the death or insanity either of the offeror or the offeree, before acceptance. Section 69 (4).

(iii) When the offeree rejects it.

(iv) When it is revoked by the offeror himself, well before its acceptance.

(v) When it is not accepted in the mode specifically prescribed for the purpose, or else, in some usual and reasonable manner.

(vi) A conditional offer, however, gets terminated when the offeree does not accept its condition.

(vii) When the offeree makes a 'Counter Offer'.

An offer may be accepted, either expressly (i.e. verbally or in writing) or even by implication (which may signify his assent), like by performing some specified act. Further, a specific offer can be accepted only by that very person to whom it has been specifically made, and by no one else (unless the offeror expressly allows such other person to do so). A general offer, however, can be accepted by any person, by complying with the terms of the offer.

The essential ingredients of a valid acceptance are:

(i) The acceptance must be absolute and unqualified (Section 7)

But, a mere variation in the language, not amounting to any material alteration or difference in the substance of the terms of the offer, would not make the acceptance ineffective in law.

Further, if certain conditions are implied in the offer as a part of the contract, and the offeree accepts such an offer, subject to such conditions, such acceptance would amount to a valid acceptance.

Moreover, an offeree may accept an offer, 'subject to a contract', or 'subject to a formal contract', or even 'subject to a contract to be approved by his lawyer'.

(ii) The acceptance must be communicated to the offeror, either expressly or even impliedly, and not just by being accepted in mind. Moreover, the acceptance of an offer cannot be implied just by mere silence on the part of the offeree, nor due to his failure to respond thereto. But then, if, the offeree, by his earlier conduct, had indicated that his silence would automatically imply his acceptance of the offer, then, in that case, his silence would imply his acceptance of the offer.

Further, in the case of a general offer, a specific communication of the acceptance of the offer is not necessary, inasmuch as the performance, as per the terms of the general offer, in itself would be considered sufficient for the purpose (of acceptance).

(iii) The acceptance must be in accordance with the already specifically prescribed mode, otherwise it may be accepted by some usual or reasonable mode. (Section 7). But then, if the offer is accepted and communicated (though not in the prescribed mode), and the offeror does not insist for it to be in the prescribed mode, nor communicates it to the acceptor, it would be a valid acceptance.

(iv) The acceptance must be given within the specified time, or else within a reasonable time.

(v) The acceptance must be given in response to an offer. If no offer is made, there is nothing to accept. That is, the acceptance can only follow an offer, and cannot precede it.

(vi) The acceptance must be made before the offer lapses or it gets terminated, revoked or withdrawn by the offeror.

(vii) The acceptance can be given only by the specific person to whom it is made

An agreement to agree in the future is not permitted by law, inasmuch as it is not certain, nor it is capable of being made certain, as of now.

An offer, as also its acceptance, to be held valid, must be communicated to the respective parties, that is, the offer to the offeree, and the acceptance to the offeror. Similar is the case as regards their revocation, too.

Further, the communication of an offer is complete when it comes to the knowledge of the specific person to whom it has been made. (Section 4).

But, the completion of the communication of an acceptance involves two aspects, viz.

(a) As against the offeror (or the proposer) and
(b) As against the acceptor (or the offeree).

(a) The communication of an acceptance is said to be complete as against the offeror (or the proposer), when it has been put in the course of transmission, so as to be out of the power of the acceptor.

(b) But, it is said to be complete as against the accerptor (offeree), when it comes to the knowledge of the offeror or the proposer.

The completion of the communication of revocation of an offer, as also of an acceptance, involves two aspects. These are:

(a) As against the offeror (or the proposer) and
(b) As against the acceptor (or the offeree).

(a) The communication of revocation of an offer or acceptance is complete, as against the person who makes it, when it is transmitted, so as to be out of his power.

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

According to Section 5, an offer may be revoked at any time, but only before the communication of its acceptance is complete, as against the offeror.

Similarly, an acceptance, too, may be revoked at any time, but only before the communication of its acceptance is complete, as against the acceptor.

This is so because, in India, the post office is deemed to be the common agent of both the offeror and the acceptor. As against this, under the English Law, the post office is deemed to be the agent of the offeror and offeror alone. Thus, the post office is deemed to be performing the twin tasks on behalf of the offeror, viz. (i) to take the offer to the offeree, and (ii) to bring back the acceptance (or rejection) thereof. Under the circumstances, the acceptance cannot be revoked at any stage, under the English Law.

Questions for Reflection

1. (a) What is an offer?
   (b) "An offer may involve either a positive action or a negative action (i.e. some omission." Do you agree with this view? Explain, with the help of some illustrative examples in each case.
2. Distinguish between the following pairs of words, by citing some illustrative examples in each case:
   (a) Express offer, and Implied offer
   (b) Oral offer, and Written offer
   (c) Offer by positive action, and Offer by omission or abstinence (from doing something)
   (d) Specific offer, and General offer
   (e) 'Offer', and a 'Declaration of the intention to offer'
   (f) 'Offer', and an 'Invitation to offer'
   (g) Specific or definite tender, and Standing tender
3. What are the essential elements of a valid offer? Explain, each of them, with the help of some illustrative examples in each case.
4. "Special terms, if any, forming part of the offer, must be duly brought to the notice of the offeree at the time the offer is made. But, if such special terms, forming part of the offer, have not been duly brought to the notice of the offeree, at the time the offer is made, the offeree is not bound by such special terms." Elucidate with the help of some illustrative examples, by citing various possible situations.
5. (a) What do you understand by the term 'Cross Offer'?
   (b) Under what especial circumstances can a 'Cross Offer' be accepted to make a valid contract? Clarify, by citing illustrative examples.
6. Under what different circumstances or situations can an offer be said to have lapsed or terminated? Illustrate your points, with the help of suitable examples in each case
7. (a) What are the various modes of acceptance of (i) a 'Specific Offer' and (ii) a 'General Offer'?
   (b) Who all can accept such offers?
   Explain with the help of illustrative examples in each case.
8. Discuss the various essential ingredients of a valid acceptance, by citing some illustrative examples in each case.
9. Can an 'agreement to agree in the future' constitute a valid and enforceable contract? Give reasons for your specific answer.
10. Explain the different ways in which the communication may be deemed to be complete, as against the respective parties, in the following specific cases:
    (a) When an offer is made.
    (b) When an offer is accepted.
    (c) When an offer is revoked.
    (d) When an acceptance is revoked.
11. "An offer, as also an acceptance, can be revoked by the parties concerned, any time, at their own sweet will and convenience." Do you agree with this view? Give reasons for your answer.

12. "In India, the post office is deemed, under the law, to be the common agent of both the offeror and the acceptor. As against this, under the English Law, the post office is deemed to be the agent of the offeror and offeror alone."

    Are there any significant legal implications of such subtle differences, especially in regard to the revocation of an offer, or an acceptance thereof?

Problems for Practice (With Suggested Solutions)

Problem 1

Jagdish, a leading auctioneer, had advertised in the leading local newspapers that a sale of precious stones by auction would take place at 45, Park Street, Kolkata, on the 6th June 2009 from 10:00 am to 5:00 pm. Based on such advertisement, Reshma arrived at the appointed place at the appointed time, fully tired, after driving a rather long distance of around 240 km. But then, to her great dismay and disappointment, she found that the sale of the precious stones by auction was withdrawn. Disgusted on such irresponsible act on the part of Jagdish, the auctioneer, she filed a suit against him, claiming compensation for her loss of time and expenses. What are the possibilities of her winning the case? Also specify the basis of your contention.

Solution

Reshma just cannot win her case simply because the advertisement, inserted in the leading local newspapers, just amounted to a 'declaration of the intention to offer' and not a valid 'offer' as such.

This contention is based on the decision given by the learned judges in the case titled **Harris vs Lickerson, [(1875) L.R. SQ. B 286],** wherein it was held that the auctioneer was not liable to pay the compensation for the reasons, as aforementioned.

Problem 2

The texts of a chain of e-mails are quoted hereunder:

1. Harish had sent an e-mail to Phalguni, reading as under:
   'Will you sell your house named 'Shantiniketan' located at 5/108 Vikas Khand, Gomti Nagar, Lucknow? E-mail lowest cash price.'
2. Phalguni responded by an e-mail, reading as under:
   'Lowest price for the house named 'Shantiniketan' is Rs 11 lakh.'
3. Harish jumped at the offer and immediately shot back an email, reading as under:
   'I agree to buy the house named 'Shantiniketan' for Rs 11 lakh asked by you.'
   Incidentally, this third e-mail happened to be the last one in the series of emails.

However, Phalguni refused to sell her house named 'Shantiniketan' for Rs 11 lakh. Accordingly, Harish filed a case against Phalguni on the ground that by quoting the lowest price for her house property named 'Shantiniketan', she had made an offer to sell, which he had readily accepted. Accordingly, a valid and lawful contract was entered into, which Phalguni was bound to perform as per the law.

(i) Do you agree with the aforementioned contention of Harish? Give reasons for your answer.
(ii) Identify and state the various points of law involved in the instant case, clearly stating which ones of the three telegrams amount to 'invitation to an offer', and which other ones amount to an 'offer'.

Solution

We do not agree with the aforementioned contention of Harish. Our legal stand is based on the following points, established on the analysis of the contents of each of the three e-mails in question:

(a) The e-mail no. 1 above is not in the nature of an offer. Instead, it is only in the nature of an enquiry, and that too, on two distinct points, viz.
    (i) 'Will you sell us the house named 'Shantiniketan'? and
    (ii) 'E-mail lowest cash price'.

(b) The e-mail at no. 2 above is in response thereto, but only on the second point of the enquiry, advising the lowest cash price for the house named 'Shantiniketan'; it being Rs 11 lakh. Accordingly, this email does not amount to an offer as such. It has, instead, been sent only by way of a response to the enquiry made. More importantly, it may be observed that this telegram is conspicuously silent on the point number (i), i.e. about the intention to sell the property, i.e. the house named 'Shantiniketan'. Thus, in the absence of an intention to create a legal obligation, this e-mail cannot be deemed to be a valid offer. Accordingly, in the absence of an offer, in the very first place, the question of its acceptance does not arise at all. Under the circumstances, the contention of Harish that by quoting the lowest price of the property, Phalguni had made an offer to sell the house named 'Shantiniketan', is not tenable in law.

(c) Accordingly, the e-mail at no. 3 above (to agree to buy) is just uncalled for, and does not have any legal significance, as there is no offer, as such, which could be accepted and agreed upon. This can, at best, be treated as an offer to buy, which offer was declined by Phalguni, as she had every legal right to accept or reject the offer, and she chose to reject it.

Our foregoing contentions and stands are based on the decided legal case titled **'Harvey vs Facie'** which amply clarifies the inherent distinctions between an 'invitation to an offer', and an 'offer' as such. Incidentally, it may be mentioned here that the judicial committee had also rejected the contention of Harvey, in the case.

Problem 3

Shahjahan had instructed his servant Sevak Ram to search his missing son Shaukat. After Sevak Ram had left the place in search of Shaukat, Shahjahan had announced an award to anyone who would inform him about Shaukat. Sevak Ram, however, was lucky enough to trace Shaukat in a couple of days after leaving the place. Accordingly, he happily informed Shahjahan that he was successful in tracing Shaukat. But at the material time he was not aware of the fact that Shahjahan had announced an award to the members of the general public to the effect that whosoever would trace Shaukat and inform him about his whereabouts, would be given the award. And it was only after he had come back along with Shaukat that he came to know of the award. Immediately thereafter, he claimed the same from Shahjahan. But Shahjahan flatly refused to pay him the amount of the award. Sevak Ram, therefore, filed a suit to recover the amount from Shahjahan. Do you think that Sevak Ram will win the case? Give specific reasons for your answer.

Solution

Sevak Ram will not be able to win the case. This is so because, as he was not aware of the aforementioned award at the material time, i.e. when he had traced Shaukat, he will not be entitled to receive it, either. This is based on the legal principle that the offer (both specific and general offers) must be communicated to the offeree, before it could be accepted. Alternatively speaking, one cannot accept an offer unless he has its knowledge, that is, unless it has been communicated to him. Accordingly, Sevak Ram would not be able to claim the award, inasmuch as the offer was not intimated to him, nor was he aware of the award announced to the members of the general public, either. Thus, one of the essential requirements of a valid offer, that 'it must be communicated' was lacking in the instant case, and accordingly, the question of its acceptance and completion of the legally enforceable contract did not arise. This contention and stand is based on the decided legal case titled **Lalman Shukla vs Gauri Dutt (II, A.L.J. 489),** wherein the servant had lost his case.

Problem 4

Pradeep had written a letter to Prakash offering him to sell his Priya scooter to him for Rs 3,000. He had further added in the letter that in case he would not hear anything from him within seven days from the date of the letter, he would presume that he (Prakash) had accepted the offer. Prakash had ignored the letter and did not care to write back to Pradeep saying that he did not accept the offer. After expiry of seven days from the date of the letter, Pradeep insisted that Prakash must purchase his scooter and pay him the offer amount of Rs 3,000, as he had not refused the offer within the stipulated seven days. Do you think that Pradeep is legally entitled to press Prakash to pay him Rs 3,000 and take delivery of the scooter, in terms of his offer to him, as aforementioned?

Solution

No; Pradeep is not legally entitled at all to press Prakash to pay him Rs 3, 000 and take delivery of the scooter, because in the instant case, the letter of Pradeep to Prakash cannot be termed as a valid offer. This is so because, as per law, the offer should not contain a term to the effect that the non-compliance of such term may amount to the presumption that it has been accepted. In other words, the offeror cannot stipulate that if the offeree does not specifically refuse or reject the offer, within a stipuated period, it would be deemed to have been accepted by the offeree.

Problem 5

Farooqui was travelling in the AC First Class by Lucknow Mail from Lucknow to New Delhi. At the New Delhi railway station, he deposited his baggage in the cloakroom. An acknowledgement receipt was given to him on the face whereof was written: 'For conditions see back'. And one of the conditions, written on the reverse of the receipt, stipulated that the claim, if any, from the Indian Railways for the loss of any luggage, would not exceed a sum of Rs 10,000. His baggage was unfortunately lost. He claimed a sum of Rs 25,000 from the Indian Railways on the ground that the value of his lost baggage was even more than the amount claimed by him. When the railway authorities tried to draw his attention to the conditions printed on the reverse of the receipt, he pleaded that he had not read the conditions printed on the reverse of the receipt. Do you think that his claim is valid and enforceable in law? Give reasons for your answer.

Solution

Farooqui's claim is not valid and enforceable in law. In fact, he is not entitled to claim any amount in excess of Rs 10,000, as he is bound by the conditions printed on the reverse of the receipt to this effect, whether he reads these conditions or not. This is so because the Indian Railways, by virtue of printing the words: 'For conditions see back', on the face of the acknowledgement receipt, had given sufficient notice to the depositors, regarding the conditions printed on the reverse of the receipt. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Parker vs South Eastern Railway Company, [(1877) 2 C.P.D. 416].**

Problem 6

Will the legal position be any different if, in the Problem number 5 above, Farooqui were illiterate, and thus, was not able to read the conditions printed on the reverse of the receipt?

Solution

No; the legal position will not be any different; it would remain unchanged. This is so because, as per law, the conditions will apply whether Farooqui had read them or not, or even whether he was able to read them or not (being illiterate). This is so because the Indian Railways, by printing the words 'For conditions see back' on the face of the receipt, had given sufficient notice to the passengers, regarding the conditions printed on the reverse thereof. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Thompson vs L.M. and L. Rly, [(1930) 1 KB 417].**

Problem 7

Will the legal position be any different if, in the Problem 5 above, the receipt was printed in Hindi, and Farooqui did not know the language, and thus, was not able to read the conditions printed on the reverse of the receipt?

Solution

No; the legal position will not be any different; it would remain unchanged even under such circumstances. This is so because, as per law, the person, who does not know the language in which such specific terms and conditions are written, is expected to call for the translation of the conditions, or else he could make a request to the effect that the terms and conditions may be explained to him in the language known to him. And, if the person does not take care to do so, the conditions would apply on the ground that he or she would be presumed to have a constructive notice of the terms and conditions, if his or her attention has been drawn to them in a reasonable, manner, like printing on the face of the receipt or the ticket the words like 'For conditions,

see the back', or the like. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Mackillingan vs Campagine de Massangeres Maritimes [(1897) 6 Cal.227J].**

Problem 8

Will the legal position be any different if, in the Problem 5 above, all the conditions were meticulously printed on the back of the receipt, but the words 'For conditions see back' were erroneously left to be printed on the face of the receipt?

Solution

Yes; the legal position will completely change in the instant case because; Farooqui can take a valid legal stand, pleading as under:

(a) That he did not read the conditions printed on the back of the ticket. And, more importantly
(b) That nothing was written on the face of the receipt to draw his attention to the conditions written on the reverse of the ticket.

And, as stipulated in law, in case the terms and conditions, limiting or defining the rights of the acceptor are not brought to the notice of such acceptor, in a reasonable manner (like by printing the words 'For conditions see reverse' or 'Conditions apply' and so on), such terms and conditions would not form a part of the offer and, accordingly, these would not be binding on the acceptor.

Thus, in the instant case, in view of the fact that nothing was printed or written on the face of the receipt to draw his attention to the conditions written on the reverse of the receipt, he will be legally entitled to the damages even beyond Rs 10,000, i.e. to the tune of Rs 25,000, as claimed by him, inasmuch as he was not bound by the conditions, which were not communicated to him, or were not given sufficient notice of. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Henderson vs Stevenson, [(1875) 2 H.L.S.C. 470].**

Problem 9

Ashok had sent a letter dated the 9th May 2009 to Virendra, which he had posted the same day, proposing that he would sell his sofa to him for Rs 5,000. On the same day, i.e. on the 9th May 2009 itself, but without having the knowledge about the letter written to him by Ashok, Virendra had also sent a letter to Ashok, making an offer to buy his sofa from him for Rs 5,000. These two letters had crossed each other in transit.

However, when Virendra received the letter of Ashok dated the 9th May 2009, proposing that he would sell his sofa to him for Rs 5,000, he thought that there was a good contract, because the elements of buying and selling the same sofa was involved, and that too at the same price. Do you think that the aforementioned contention of Virendra is legally valid? Give reasons for your answer.

Solution

No; the contention of Virendra in the instant case is not valid from the legal point of view, because the two letters are in the nature of cross offers, and none of these may be deemed to be an offer, as such. This is so because both the parties were ignorant of each other's offer. Thus, they had, in fact, made independent offers (though identical offers) to each other. Therefore, we find that, in the instant case, the parties concerned have made only offers, and there is no element of acceptance involved on the part of either of the two parties involved. Accordingly, as the most essential element of acceptance is absent on the part of both the parties involved, no contract may be said to have been made in the instant case. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Tinn vs Hoffman & Co., [(1873) 29 L.T. Exa. 271].**

Problem 10

Dinesh had sent a letter dated the 5th June 2009 to Gaurav, offering to purchase his motorcycle for Rs 15,000. He had also taken care to specify in his aforementioned letter of offer that the motorcycle should be delivered to him on or before the 15th June 2009. However, when Gaurav received the letter of Dinesh, he promptly accepted the offer and wrote back saying that he would definitely sell his motorcycle to him for Rs 15,000, but mentioned in the letter of acceptance that the delivery of the motorcycle will be made on the 30th June 2009, instead. Do you think that a valid contract has been made in the instant case? Give reasons for your answer.

Solution

No. A valid contract has not been made in the instant case. This is so because, the letter of Gaurav will not be deemed to be the acceptance of the offer of Dinesh. It will, instead, be construed as a counter offer. This is so because, instead of accepting the terms and conditions of Dinesh's offer, as they were, Gaurav had preferred to accept it, but subject to certain conditions and qualifications.

Thus, the former offer of Dinesh automatically gets terminated and the counter offer now made by Gaurav would be taken as a fresh offer. And now, only if and when Dinesh would accept the counter offer of Gaurav, it would amount to its acceptance, and a valid contract will be deemed to have been made, and not otherwise. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Routledge vs Grant, [(1828) 130 E.R. 920].**

Problem 11

Ashwini had gone with his family to *Kumbh Mela* in Allahabad on 14th January 2009. This being a very auspicious occasion (*Makar Sankranti*), a huge crowd had converged there for taking bath in the *sangam.* While returning home, he found that his son, Arvind, was missing. He became very anxious and immediately announced an award of Rs 50,000 to anyone who would bring his missing son, Arvind, back to him. Krishna came to know of the offer. He made strenuous efforts to trace Arvind, and succeeded in finding him. Soon thereafter he reached the residence of Ashwini along with Arvind. Ashwini was very happy to find Arvind back. But when Krishna demanded the payment of the announced award from Ashwini, he (Ashwini) flatly refused saying that he had not made the offer to him (Krishna), nor had he (Krishna) communicated to him his acceptance of the offer. Do you think that the stand taken by Ashwini is legally sound and valid? Give reasons for your answer.

Solution

No; the stand taken by Ashwini is not at all legally sound and valid. This is so because the instant case is in the nature of a general offer, wherein each individual person is not required to convey his acceptance of the offer to Ashwini. In this case, Krishna's very act of finding and restoring Arvind to Ashwini implies his acceptance of Ashwini's offer, by doing the act (of restoring Ashwini's son, Arvind, to him). Thus, a contract gets entered into, and Krishna is entitled to receive the award.

It may be noted with sufficient interest that there is a contrasting distinction between the instant case (where Krishna was in the know of the announced award), and the case cited earlier at the Problem 3 of this chapter, wherein Sevak Ram was not aware of the award at the material time, i.e. when he had traced Shaukat, whereby he was not entitled to receive it.

Problem 12

Amitabh offers to sell his car to Dinkar for Rs 1, 00,000. Dinkar responds by saying that he would purchase the car for Rs 95,000, instead. Dinkar, however, subsequently reconsiders, and agrees to purchase the car for Rs 1, 00,000, as was originally quoted by Amitabh to him earlier. Do you think that the contract has been finally entered into between Amitabh and Dinkar? Give reasons for your answer.

Solution

No; the contract has not been finally entered into between Amitabh and Dinkar. Dinkar's response to Amitabh by saying that he would purchase the car for Rs 95,000, in fact, amounts to rejection of the offer of Amitabh by Dinkar, inasmuch as the acceptance is not in absolute terms. Instead, Dinkar has made a counter offer to Amitabh.

Further, Dinkar's act of subsequently agreeing to purchase the car for Rs 1, 00,000, as was originally quoted by Amitabh to him earlier, does not constitute a valid acceptance of the offer of Amitabh. It, instead, amounts to a counter offer again, which Amitabh is free to accept or reject. In fact, as per law, once an offer is not accepted in absolute terms, it amount to its rejection, and, accordingly, the same rejected offer cannot be accepted any more. A fresh offer will have to be made in such cases. Section 7 clearly provides that an acceptance of an offer, to be valid in law, must be in absolute and unqualified terms. Otherwise, it may be construed, not as an acceptance, but just as a counter offer, instead. And, the original offeror has the option to accept or reject such counter offer at his own sweet will. This contention is based on the judgement delivered by the honourable Court in the legal case titled **Union Bank of India vs Babulal, [A.I.R. (1968) Bombay, 294].**

Chapter Four

Competence to Contract

"*The law is reason, free from passion.*
Aristotle

Man cannot live by incompetence alone.
Laurence J. Peter

Obscurity and competence:
That is the life that is worth living.
Mark Twain"

As already discussed in the earlier chapter, one of the essential elements of a valid agreement is that the parties to the contract must be competent to enter into a legally binding contract (Section 10).

4.1 Who are Competent to Contract?

According to Section 11, "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."

Conversely speaking, the following categories of persons are deemed disqualified or incompetent to enter into a valid agreement and contract:

(a) Minors,
(b) Mentally incompetent persons, and
(c) Persons who are declared incompetent through their status (political, corporate, legal, etc.).

We would now proceed to discuss the aforementioned aspects of competence or otherwise, one after the other.

4.1.1 Minors

As defined in Section 3 of the Indian Majority Act, 1875, a minor is a person who has not completed 18 years of age. But then, in the following two specific cases, a minor is said to attain the majority on the completion of his 21 years of age, instead:

(a) Where a guardian of minor's person or property has been appointed under the Guardians and Wards Act, 1890, or
(b) Where a Court of Wards assumes the superintendence of the minor's property.

4.1.2 Position of the Contract by a Minor

The position of the contract by a minor has been discussed hereafter.

1. A Contact with or by a Minor is Void, *ab initio*, and Not Just Voidable

Under the English Law, a contract by a minor is not void, but only voidable, at the option of the minor only, though only under certain exceptional circumstances. As against this, under the Indian Law, a contact with or by a minor is void, and not just voidable. Accordingly, a minor cannot bind himself by a contact, inasmuch as a minor is not competent to contract. This position of law, in the Indian context, has been made amply clear by the Privy Council in the oft-quoted case of **Mohiri Bibi vs Dharmodas Ghose [190, 30 Ca. 539].**

The main points of the case have been discussed hereafter.

Dharmodas Ghose, a minor at the material time, had entered into a contract to borrow a sum of Rs 20,000, whereas the lender had lent him only a sum of Rs 8,000, instead, against the security of mortgage of his property in favour of the lender concerned. Later, the minor filed a suit for setting the mortgage aside.

While ascertaining the validity of the mortgage, created by the minor, the Privy Council found that, under Section 7 of the Transfer of Property Act, every person competent to enter into a valid contract was competent to create a valid mortgage, too. The Privy Council further observed that under Sections 10 and 11 (of the Indian Contract Act), the contract by a minor is not just voidable but void. Thus, the mortgage created by the minor was invalid, too. Accordingly, the mortgage was set aside.

The lender, thereafter, prayed at least for the recovery of the sum of Rs 8,000, lent by him to the minor. It was further held that, inasmuch as the contract entered into by a minor is void, *ab initio,* the lender could not recover the loan amount, either.

2. If a Minor has Happened to Receive some Benefits under a Void Contract, he Cannot be Asked to Return or Refund such Benefits

This principle is the natural and logical inference, derived from the judgement, pronounced in the case law of **Mohiri Bibi vs Dharmodas Ghose**, discussed in the earlier paragraphs.

3. A Minor can be a Promisee or a Beneficiary

It is true that during the period of his minority, a minor cannot bind himself by a contract. But then, there is nothing specified in the Indian Contract Act, which could prevent him from making the other party to the contract to be bound to him (minor). Alternatively speaking, a minor may not create a valid mortgage, to execute an enforceable promissory note, but then he is not incapable of being a motgagee of a property, or a payee or endorsee of a promissory note. That is to say that the minor is entitled to all the benefits available to him, under the contract.

4. The Minor, even on his Attaining the Majority, cannot Ratify his Old Agreement

This is so for the simple reason that a contract by and with the minor is void *ab initio*. Thus, as the original contract itself is void, right from the very beginning, it is deemed to be non-existent in the eye of the law. Thus, the question of ratification of a non-existent thing just cannot arise.

Example

Mohan, a minor, executes a Demand Promissory Note (D P Note), in favour of Lakhan. After attaining the age of majority, he executes a fresh D P Note, in lieu of the old one. It was held that both the original as also the fresh D P Notes were invalid and unenforceable in law. **[Indran Ramaswamy vs Anthiappa Chettiar (1906) 16 M. L. J. 422]**

5. A Minor can Always take the Plea of being a Minor

The facts of the case **'Leslie vs Shiell' [(1914) 3 K.B. 607]**, discussed hereafter, amply clarifies the points of law involved.

Example

Shiell, though being a minor at the material time, fraudulently misrepresented himself as a major, and borrowed a sum of 400-pound sterling from Leslie. He spent the whole amount, but failed to repay the loan. Leslie filed a suit against him on the following two distinct points:

(i) For recovery of the loan amount, and also
(ii) For the damages for fraudulent misrepresentation (i.e. for the tort of deceit).

It was held that Leslie, the moneylender, could not recover the amount of the loan from Shiell, on the ground that, Shiell was a minor at the material time. Moreover, he (Leslie) even could not claim the damages under the Law of Tort, for the same reason (i.e. because Shiell was a minor at the material time). This is so because, a minor could not be bound by the contract to borrow money, or even for some other purposes, despite his fraudulent misrepresentation of being of age at the material time. Accordingly, in case the Court would have granted the relief, it would have indirectly amounted to enforcing a void contract, which is unenforceable in law.

It was further observed that, as the minor had already spent the amount, he could not be asked to refund it, even on the ground of equity. That is to say that, if the loan amount would not have been spent by the person, he (even being a minor at the material time) would have been asked to refund it to the lender, under Sections 30 and 33 of the Specific Relief Act, 1963. It is so because; even a minor cannot be allowed the liberty to cheat anyone.

Example

A minor had fraudulently misrepresented himself as a major, and thereby he had borrowed some money by mortgaging some of his property, which he had later even fraudulently sold to some other person. Thereafter, the minor had cancelled these agreements. It was held that both the lender and the buyer were entitled to the award of the compensation, on the ground that these two parties were not aware of the fact that the person had fraudulently misrepresented himself as a major, though he was, in fact, a minor at the material time.

6. A Minor cannot become a Partner in any Partnership Firm

However, as provided under Section 30 of the Partnership Act, 1932, he may be admitted to the benefits of an already existing partnership firm (and to its benefits alone, and not to any losses or any liabilities, etc.), but only with the consent of all the partners, and that too, only for the time being.

7. The estate of a minor is liable to a person who supplies necessaries of life to him
8. The guardians and parents of a minor are not liable to the creditor(s) of a minor, for any breach of contract by a minor, even for the supply of the necessaries, or otherwise
9. A minor can, however, act as an agent

Thus, in such cases, he can bind the principal (even if he be his parents or guardian), by acting as his agent, but without incurring any liability on his personal behalf.

The legal position of the contracts, entered into with or by a minor, have been summarised at one place, as under:

1. A contact with or by a minor is void, *ab initio,* and not just voidable.
2. If a minor has happened to receive some benefits under a void contract, he cannot be asked to return or refund such benefits.
3. A minor can be a promisee or a beneficiary.
4. The minor, even on his attaining the majority, cannot ratify his old agreement.
5. A minor can always take the plea of being a minor.
6. A minor cannot become a partner in any partnership firm. However, he may be admitted to the benefits of an already existing partnership firm.
7. The estate of a minor is liable to a person who supplies the necessaries of life to him.
8. The guardians and parents of a minor are not liable to the creditor(s) of a minor, for any breach of contract by a minor, even for the supply of the necessaries, or otherwise.
9. A minor can act as an agent, and bind the principal, but not himself.

4.1.3 Contracts by the Persons of Mental Incompetence

Sections 10 and 11 have provided that a person, to be competent to contract, must, *inter alia*, be of sound mind. And, as provided under Section 12, "A person is said to be of unsound mind, for the purpose of making a contract, if at the time he makes it, he is incapable of understanding it, and of forming a rational judgement as to its effect upon his interest."

The Section further clarifies that "A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind."

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

We may, thus, observe that the soundness of mind of a person depends on the following two factors:

(a) His capacity to understand the terms of a contract, and
(b) His ability to form a rational judgement as to its effect upon his interest.

Let us take some illustrative examples to clarify these legal points a little further.

Examples

(i) A lunatic, in an asylum, may usually be of an unsound mind. But then, at some intervals, he may possibly happen to be of sound mind, though only for a short while.

Thus, during such time, when he happens to be of sound mind, he can be said to be competent to enter into a valid contract, during such moments, when he happens to be of sound mind.

(ii) As against this, even a sane person, who is usually of a sound mind, may sometimes happen to be of unsound mind, though only for a short while, like while being in a drunken state, or in delirium under the influence of high fever. Thus, during such time, when he happens to be of an unsound mind, as aforementioned (i.e. in a drunken state, or in delirium under the influence of high fever) he cannot be said to be competent to enter into a valid contract, during such moments, and only till then, when he happens to be of an unsound mind.

However, whether a person was of a sound mind or of an unsound mind, at the material time, when he happened to enter into a contract, would decidedly depend upon the judgement of the court, depending upon the specific facts and circumstances of each case separately.

An idiot, however, is the person who is considered to be of an unsound mind, permanently, that is, at all times. Alternatively speaking, he does not have any interval of being of sound mind at any time, during his entire lifetime. Accordingly, a contract by an idiot is void, *ab initio*, as is the case with the contract by a minor, as discussed earlier.

Further, as regards the liability for supplying the necessaries of life to a person of unsound mind (i.e. to a lunatic, to a drunk person or to a person in delirium as also to an idiot), it is the same as is the position in the case of a minor (Section 68). Furthermore, like in the case of a minor, he can always be a beneficiary, i.e. entitled to the benefits, if any, under the contract.

Incidentally, as against the Indian Law, under the English Law, a contract made by a person of an unsound mind is not considered as void, but only viodable, at the option of such person of an unsound mind.

4.1.4 Incompetence Through Status

The incompetence to contract may arise under different situations, like:

(i) From political status,
(ii) From corporate status,
(iii) From legal status,
(iv) From marital status, etc.

Examples

(i) Pertaining to Political Status

(a) An **alien enemy** (that is, a foreigner, who is the citizen of a country, which is at war with India), cannot enter into a contract with an Indian during the period of such war. But, as regards the contract entered into before the break out of the war, it may either stand dissolved, or may remain just suspended, to be revived after the war is over. That is, such contracts, which happen to be against the public policy, or which would benefit the enemy country, would stand dissolved. Other contracts, would, however, remain just suspended, and would get revived after the war is over, provided, of course, that, in the mean time, these have not been rendered time-barred under the Indian Limitation Act.

(b) As against the case of an enemy, an **alien friend** (that is, a citizen of a foreign country, which is not at war, but at peace, with India), is as competent to enter into a valid contract as an Indian citizen can do (subject to their being competent to contract, otherwise).

(ii) Pertaining to Corporate Status

Under the Companies Act, 1956, a company cannot enter into a contract, which is *ultra vires* (that is, against the stipulated provisions of) its Memorandum of Association.

(iii) Pertaining to Legal Status

Persons, who have been declared insolvents, are not considered competent to enter into a contract, till such time they are able to get a certificate of discharge (from insolvency).

(iv) Pertaining to Marital Status

A married woman has full ability and competence to enter into a valid contract. She can sue, and even be sued against, in her own name.

Let us Recapitulate

Who are 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." (Section 11).

Who is a Minor?

- A minor is a person who has not completed 18 years of age, or else, 21 years of age (i) Where a guardian of minor's person or property has been appointed under the Guardians and Wards Act, 1890, or (ii) Where a Court of Wards assumes the superintendence of the minor's property.

Position of contract with or by a minor

- A contact with or by a minor is void, *ab initio,* and not just voidable, though under the English law, a contract by a minor is not void, but only voidable, at the option of the minor only, though only under certain exceptional circumstances.
- If a minor has happened to receive some benefits under a void contract, he cannot be asked to return or refund such benefits.
- A minor can be a promisee or a beneficiary.
- The minor, even on his attaining the majority, cannot ratify his old agreement.
- A minor can always take the plea of being a minor.
- A minor cannot become a partner in any partnership firm. However, he may be admitted to the benefits of an already existing partnership firm.
- The estate of a minor is liable to a person who supplies the necessaries of life to him.
- The guardians and parents of a minor are not liable to the creditor(s) of a minor, for any breach of contract by a minor, even for the supply of the necessaries, or otherwise.
- A minor can act as an agent, and bind the principal, but not himself.

Position of contracts by the persons of mental incompetence

- A person, to be competent to contract, must, inter alia, be of sound mind (Sections 10 and 11). Further, "A person is said to be of unsound mind, for the purpose of making a contract, if at the time he makes it, he is incapable of understanding it, and of forming a rational judgement as to its effect upon his interest." (Section 12).
- The Section further clarifies that "A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind."
- Conversely speaking "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, the soundness of mind of a person depends on:

(a) His capacity to understand the terms of a contract, and
(b) His ability to form a rational judgement as to its effect upon his interest.

An idiot, however, is the person who is considered to be of an unsound mind, permanently, that is, at all times. Accordingly, a contract by an idiot is void, *ab initio* (like the contract by a minor).

Incompetence Through Status

The incompetence to contract may arise under different situations, viz.

(a) From political status, like alien enemies (and not alien friends)
(b) From corporate status, i.e. a company cannot enter into a contract, which is *ultra vires* its Memorandum of Association.

Questions for Reflection

1. (i) Who are the persons who are considered to be competent to contract?
   (ii) Who are the persons who are deemed to be incompetent to enter into a valid contract?
2. (i) Who are considered as minors?
   (ii) When can a person be said to have attained the age of majority under different circumstances?
3. (i) What is the position of a contract with or by a minor?
   (ii) Is there any difference in this regard under the Indian and the English Laws?
4. If a minor happens to receive some benefits under a void contract, can he be asked to return or refund such benefits? Give reasons for your answer.
5. Do you agree or disagree with the following statements? Give reasons for your specific answer in each case.
   (i) A minor can be a promisee or a beneficiary.
   (ii) The minor, on his attaining the majority, can ratify his old agreement.
   (iii) A minor can always take the plea of being a minor.
   (iv) A minor can become a partner in any partnership firm, but, on the condition that he will be admitted only to the benefits.
   (v) The estate of a minor is liable to a person who supplies necessaries of life to him.
   (vi) The guardians and parents of a minor are liable to the creditor(s) of a minor, for any breach of contract by a minor, as also for the supply of the necessaries.
   (vii) A minor cannot act as an agent, and, thus, cannot bind his principal.
6. What are the essential elements, which must be present to consider that the person is of an unsound mind?
7. Can the persons of the following categories enter into a valid contract at any time in their lifetime? Give reasons for your answer in each case.
   (i) A lunatic
   (ii) A person in the state of drunkenness
   (iii) A person in delirium under the influence of high fever
   (iv) An idiot
8. (i) Distinguish between an alien enemy and an alien friend**.**
   (ii) What is the position of the contact entered into by each of these two categories of persons? Give reasons for your answer in each case.
9. (i) Can a company enter into a contract, which is *ultra vires* its Memorandum of Association? Give reasons for your answer.
   (ii) The persons, who have been declared insolvent even once, are not considered competent to contract during their entire lifetime. Do you agree? Give reasons for your answer.
   (iii) 'A married woman is not considered to be competent to enter into a valid contract. Accordingly, she can neither sue, nor be sued against, in her own name.' Do you agree? Give reasons for your answer.

Problems for Practice (With Suggested Solutions)

Problem 1

Shrikant was a minor at the material time. Despite being a minor, he had fraudulently misrepresented himself as a major, and had borrowed a sum of Rs 1 lakh from Shekhar. He, however, had spent the entire amount of Rs 1 lakh, and failed to repay the loan. Therefore, Shekhar filed a suit against him on the following two distinct points:

(i) For recovery of the loan amount, and
(ii) For the damages for fraudulent misrepresentation (i.e. for the tort of deceit).

Do you think that both the aforementioned claims of Shekhar, or at least one of these two, are tenable in the court of law?

Solution

No; none of the two claims of Shekhar are tenable in the Court of law. First, Shekhar cannot recover the amount of the loan from Shrikant, inasmuch as Shrikant was a minor at the material time. Second, Shekhar cannot even claim the damages under the Law of Tort, for the same reason (i.e. because Shrikant was a minor at the material time). This is so because, a minor cannot be bound by the contract to borrow money, or even for some other purposes, despite his fraudulent misrepresentation of being a major at the material time. This is so because, had the Court granted the relief, it would have indirectly amounted to enforcing a void contract, which was not enforceable in law.

It may be further observed in the instant case that, as the minor had already spent the entire amount, he could not be asked to refund it, even on the ground of equity. But then, if Shrikant had not spent the entire loan amount, he (even being a minor at the material time) would have been asked by the Court to refund the balance amount to Shekhar, under Sections 30 and 33 of the Specific Relief Act, 1963. It is so because; even a minor cannot be allowed the liberty to cheat anyone.

Problem 2

Ahmad is admitted in an asylum, because he usually happens to be of an unsound mind. But then, at some intervals, he was found to be of sound mind too, though only for a short period of time. And during such period, when he was found to be of sound mind, he had entered into a contract with Asif. Do you think that this contract entered into between Ahmad and Asif would be held valid in the Court of law?

Solution

Yes; this contract, entered into between Ahmad and Asif, would be held valid in the Court of law. This is so because he had entered into the contract in question during such time, when he happened to be of sound mind, and accordingly, he was competent to enter into a valid contract, during such moments, when he happened to be of sound mind.

But then, whether Ahmad was of a sound mind at the material time, when he had entered into a contract with Asif, would be entirely dependent upon the judgement of the Court, relying on the specific facts and circumstances of the instant case.

Problem 3

Shyam was usually a sane person. But then, though usually found to be of a sound mind, he was sometimes found to be of unsound mind, though only for a short period of time, like when he was heavily drunk. And when he was heavily drunk, he had entered into a contract with Ram. Do you think that this contract entered into between Shyam and Ram would be held valid in the Court of law?

Solution

No; this contract entered into between Shyam and Ram would not be held valid in the Court of law. This is so because he had entered into the contract in question during such time, when he happened to be of unsound mind, by virtue of being heavily drunk. Accordingly, he was incompetent to enter into a valid contract, during such moments, when he happened to be heavily drunk, and therefore, of an unsound mind.

But then, whether Shyam was actually heavily drunk, and therefore, was of an unsound mind, at the material time, when he had entered into a contract with Ram, would entirely be dependent upon the judgement of the Court, relying on the specific facts and circumstances of the instant case.

Problem 4

Rahman, a citizen of Pakistan, had entered into a contract with Krishna, an Indian, during the period of war between India and Pakistan.

(a) In your considered opinion, is this contract, entered into between Rahman and Krishna, valid in the eyes of law? Give reasons for your answer.
(b) Will the position be any different if this contract was already entered into between Rahman and Krishna, before the war had broken out?

Solution

(a) No; this contract, entered into between Rahman and Krishna, is not valid in the eyes of law. This is so because, as per the Act, a foreigner, who is the citizen of a country, which is at war with India, cannot enter into a contract with an Indian during the period of such war.
(b) As regards the contract in the situation (b), in view of the fact that Rahman and Krishna had already entered into the contract before the break out of the war between India and Pakistan, it may either stand dissolved, or it may just remain suspended, and may again be revived after the war is over. But then, either of the two aforementioned courses of action will be resorted to, depending upon the nature and circumstances of the case in question.

That is, as per the Act, if the contract in question will be found to be against the public policy, or else it would benefit the enemy country in some way or the other, it would automatically stand dissolved. As against this, if the contracts would be found to be not falling within the purview of the aforementioned categories (i.e. if it is not found to be against the public policy, nor to benefit the enemy country in any manner), it would just remain suspended during the continuance of the war, and would get revived over again immediately after the war would be over. However, one further vital condition must be borne in mind that, in the mean time, the subject matter of the contract should not have been rendered time-barred under the Indian Limitation Act.

Problem 5

(a) Gaurav had been declared an insolvent on the 15th May 2009. However, he was later able to obtain a certificate of discharge from insolvency on the 19th June 2009. On the 1st July 2009, he had entered into a contract with Harish. Do you think that the contract entered into between Gaurav and Harish on the 1st July 2009 would be held valid in the Court of law? Give reasons for your answer.
(b) Will the position be any different, if Gaurav would have entered into a contract with Harish on the 9th June 2009, instead?

Solution

(a) Yes; the contract entered into between Gaurav and Harish on the 1st July 2009 will be held valid in the Court of law, because it has been entered into after the date Gaurav had been issued the certificate of discharge from insolvency, i.e. the 19th June 2009. Thus, he was no longer deemed to be an insolvent person, and therefore, he was well-considered to be competent enough to enter into a valid contract. The Act also provides that an insolvent person is considered to be incompetent to enter into a contract only till such time he gets a certificate of discharge from insolvency.
(b) Regarding the contract in the situation (b), in view of the fact that in this case Gaurav had entered into a contract with Harish on the 9th June 2009, which falls well before the date Gaurav had been issued the certificate of discharge from insolvency, i.e. on the 19th June 2009, it will not be held as a valid contract. This is so because Gaurav was still considered to be an insolvent person, pending the issuance of the certificate of discharge from insolvency, which was issued only later, i.e. on the 19th June 2009. And, as per the Act, the person, who has been declared insolvent, is not considered to be competent to enter into a valid contract, till such time he is able to get a certificate of discharge from insolvency.

Chapter Five

Free Consent

"*Better a friendly refusal than an unwilling consent.*
Spanish Proverb

Nobody can make you feel inferior without your consent.
Eleanor Roosevelt

Rather fail with honour than succeed by fraud.
Sophocles

Manners are of more importance than law.
Edmund Burke"

5.1 What Constitutes a Free Consent?

One of the essential ingredients of a valid agreement is that there must be a free consent between the two parties. This statement, thus, involves two distinct elements:

1. **First**, there must be a **consent**, which means that the two or more parties involved, must agree to the same thing in the same sense, and at the same time (Section 13); that is, there must be *'consensus-ad-idem'*.

Examples

(i) Suresh offers to Narain to sell his Maruti 800 to him for Rs 1 lakh. Narain agrees. This amounts to a valid contract inasmuch as the two parties have agreed to the same thing in the same sense, and at the same time, that is, there is a *'consensus-ad-idem'*.

(ii) Let us take another slightly different example.

Suresh had two cars, referred to hereafter as car A and car B. He had offered his car B for sale to Narain, for Rs 50,000. Narain had accepted the offer. Thus, the required two-way process, of offer and

acceptance, had apparently got completed. Accordingly, the agreement may be said to have been entered into in this case, too. But then, at a later date, it got revealed that Narain was under the impression that Suresh had only one car A, and so he was all through under the impression that he had purchased that very car A. As against this, Suresh had, in fact, made the offer for sale of his other car B, instead, and not his car A. Thus, it is obvious that the two parties, while entering into the agreement, had not thought of the same thing, in the same sense, and at the same time. In other words, there had not been the required *'consensus-ad-idem'*. Accordingly, in its absence, the aforementioned agreement would not constitute a valid agreement, enforceable in law.

2. Second, the consent to the terms of the agreement must be **free**, too (Section 14). That is, such consent should **not** be obtained in any one or more of the following manners (which, in itself, would render the contract, in question, voidable; though not void):

(i) By coercion,
(ii) By undue influence,
(iii) By fraud,
(iv) By misrepresentation, and/or
(v) By mistake.

Alternatively speaking, if the consent would be proved to have been obtained in one or more of the aforementioned manners, such contract would be automatically declared as voidable (not void), but at the option of that party only, whose consent was so obtained.

Let us now explain these five different manners, one after another, in which the consent must not be obtained, so as to qualify as a free consent.

5.1.1 Coercion (Sections 15, 19, and 72)

What amounts to 'Coercion'? Coercion comprises:

(i) Committing, or threatening to commit, any act, forbidden by the Indian Penal Code, or
(ii) Unlawfully 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.

Examples

(i) Raghunath is compelled to marry his daughter to Dharam Singh, failing which the latter threatens to kill the son of the former. Such marriage would be treated as voidable at the option of Raghunath, because it was sought by coercion.
(ii) Kishna threatens to kill Lalu if the latter does not sell his house to him at a throw-away price. Such sale would be voidable at the option of Lalu, because it was induced by coercion.
(iii) Anurag, an agent, threatens not to handover the books of accounts to his principal unless the latter agrees to exonerate him of all the irregularities committed by him in the earlier transactions. Such release, got under coercion, was not valid, but voidable. **[Muthia vs Karuppan, 50 Mad. 780]**.
(iv) Aditya threatens Anurag to kidnap his son if he would not pay him a sum of Rs 10,000. Anurag gets frightened and pays him the amount. In such a case, Aditya will have to repay the amount to Anurag, as the same was obtained under coercion.
(v) Ashok threatens Shrikant to kill his daughter if he would not deliver the gold ornaments to him. Shrikant acts as required. Thus, Ashok will have to return those ornaments to Shrikant, as these were delivered to him under coercion, and not at his free will.

As may be observed from the examples at (iv) and (v) above, the person, to whom the money has been paid, or something has been delivered, under coercion, is required to repay the amount or return the things so obtained. (Section 72)

It may, however, be clarified here that it is not necessary that the promisor himself must have been threatened. It could be directed against any one. This inference may well be drawn from the words used in the Section 14, i.e. "to the prejudice of any person, whatsoever".

Example

Shaligram threatens to kill Jaggoo's son, Laddoo, if he (Jaggoo) fails to sell his Fiat car to Ghanshyam, for Rs 5,000. Such sale, having been obtained under coercion, is voidable, despite the fact that the coercer, in this case, is a stranger to the entire transaction.

It may be pertinent to clarify here even further that it is not necessary that the Indian Penal Code (IPC) should necessarily be in force at the place where the coercion had been induced. *[Explanation to Section 15]*.

Example

Johnson and Joseph are travelling in a French ship on the high seas, where the provisions of the Indian Penal Code (IPC) are not applicable. Availing of this opportunity, Johnson criminally intimidates Joseph to enter into an agreement. Joseph later backs out. Johnson later files a suit against Joseph for the breach of contract in the Court in Delhi.

The contract is not enforceable in law inasmuch as it was induced under criminal intimidation, which is a criminal offence under the IPC. It, however, is not relevant in this context, whether such coercion was obtained at the high seas in the French ship, where the provisions of the IPC are not applicable, under the International Law. The only material legal point that will be applicable here, due the aforementioned fact and circumstances of the case, would be that the person (Johnson) would not be prosecuted under the IPC for the cognisable offence of criminal intimidation. But, the contract would be voidable, all the same.

Whether the threat to commit suicide would amount to coercion?

With a view to coming to a definite conclusion on this point, we will have to first examine whether suicide, in itself, is a crime or not, punishable under the IPC. Here, it goes without saying that a 'successful' suicide (excuse me for using the word in this sad context!) is not punishable under the IPC because, you just cannot punish a person who is already dead, and, thus, gone out of the reach even of the long hands of the law. But, an 'unsuccessful' attempt to commit suicide is punishable, all the same. That is to say that, in the case of an attempt to commit suicide, the success is not punishable, but a failure is. [Strange! But let us leave this controversy at this stage only, as it is beside the point for our discussion in point.] Thus, we come to the definite conclusion that in view of the fact that even 'threatening to commit any act forbidden under the IPC' amounts to coercion, and that an attempt to commit suicide is a crime, such threat, too, would amount to a criminal offence under the IPC, and, accordingly, such coercion would also render that agreement so obtained as voidable.

In the case of **Ammiraju vs Seshamma [(1917), 41 Mad. 33]**, wherein a release deed was obtained by the person, from his wife and son, under the threat of committing suicide, the transaction was declared not enforceable in law, on the ground that it was obtained through coercion.

Thus, we find that, any contract obtained under coercion, is treated as voidable (not void), but at the option of the aggrieved party alone (Section 19). That is, only the aggrieved party (and not the other party), has the following two options available to him, to choose any one of them, whichever he may find to be beneficial to him:

(a) He can prefer to have the contract set aside, or else.
(b) He can choose to insist on the performance of the contract by the other party.

Coercion vs Duress

The near equivalent of the term 'coercion' in the English Law is 'duress'. I have used the term 'near equivalent', because the term 'duress' has several limitations and restrictions in it's meaning and scope, as compared to the much wider scope of the term 'coercion'. These are:

(i) Duress can be employed only against the other party, involved in the contract, or to his family members, and not against any other person, whatsoever, as is the case with coercion.
(ii) Duress can be employed only by the promisee (that is the other party involved in the contract), or by his agent, but coercion can be employed, not necessarily by the other party to the contract, but by any other person, too, whosoever he may be.
(iii) Duress includes only the bodily violence and imprisonment of persons, and not the unlawful detention of goods. But, the unlawful detention of goods, too, is included in the case of coercion.

5.1.2 Undue Influence (Sections 16 and 19A)

As provided under Section 16, in a situation where the relations between the two parties are such that one of the parties is in such a position whereby he can dominate the mind and will of the other, and when he uses such position to obtain an unfair advantage over the other party, the respective contract so obtained is said to have been induced by 'Undue Influence'. Thus, as per Section 16 (3), an undue influence may be presumed in the cases of the following relationships:

(a) Doctor and patient,
(b) Parent and child,
(c) Guardian and ward,
(d) Lawyer and client,
(e) Spiritual Guru and disciple,
(f) Trustee and beneficiary, and similar other relationships.

Examples

(i) A surgeon leaves a patient on the operation table, with his stomach cut and unstitched, and comes out to say so to his wife, and asks her to immediately pay him an unreasonable amount by way an extra fee, and also that he will stitch up and close the patient's stomach only thereafter. The surgeon would be said to have employed an undue influence.
(ii) A spiritual guru asks his disciple, a Hindu devotee of an advanced age, to pay him a sum of Rs 1 lakh so that he can ensure peace and benefit to his departed soul, after his natural death, in the other world. In this case, too, the exercise of an undue influence would be presumed.

The presumption of exercising the undue influence can, however, be successfully refuted, if it could be proved that the person, said to have been induced by the alleged undue influence, had an independent legal advice of someone, who had the full knowledge of the relevant facts. **[Inche Nora vs Shaik Allie bin Omar (1929) A.C. 127].**

But then, it may be pertinent to point out here that the presumption of exercising undue influence has not been accepted in the following relationships:

(i) Husband and wife **[Howes vs Bishop (1909) 2 K.B. 390]**
(ii) Master and servant **[Daulat vs Gulab Rao (1925) Nag. 369]**
(iii) Landlord and tenant **[Lakshmi Chand vs Pt. Niader Mal, AIR (1961) All. 295]** and
(iv) Creditor and debtor.

Onus (burden) of Proof [Section 16 (3)]

Thus, inasmuch as in such relationships, the exercise of undue influence cannot be presumed, the onus of proof (of undue influence) will lie on the party who is alleging that undue influence was exercised.

However, if it is proved that the party concerned was in a position to dominate the will of the other party, and the transaction *prima faci* (on the face of it), or as per the evidences available, appears to have been induced by exercising undue influence, the burden to prove that no undue influence was induced will lie on the party who was in a position to dominate the will of the other party.

Further, like the contract, induced by coercion, the contract, induced by undue influence, too, is voidable (and not void) [Section 19A]. That is, only the aggrieved party (and not the other party), has the following two options available to him, to choose any one of them, whichever he may find to be beneficial to him:

(a) He can prefer to have the contract set aside, or else,
(b) He can choose to insist on the performance of the contract by the other party.

It may, however, be clarified here that such contract could be set aside, either in full, or else only in part, at the discretion of the Court. That is, it could be set aside only in part, if the aggrieved party, who was entitled to avoid the contract, had received some benefits thereunder. But it would be granted in part, only on such terms and conditions as the Court may deem fit.

Example

Mani Ram, a moneylender, advances a sum of Rs 2,000 to Virendra Singh, a villager, and by exercising undue influence, forces him to execute a Demand Promissory Note (DPN) for Rs 5,000, instead. He also stipulates an exorbitantly high rate of interest at 5 per cent per month. Virendra Singh, having no choice, executes the document, as forced.

The Court may set this agreement aside, and may ask Virendra Singh, to pay the actually borrowed sum of Rs 2,000 only, plus the amount of interest accrued on this sum of Rs 2,000 only, computed at a reasonable rate of interest, and not as stipulated in the DP Note. This is an example where the Court has set aside the contract, but only partially, as aforesaid, and not in absolute term.

It may, however, be carefully noted here that the mere fact of charging a higher rate of interest, in itself, may not be sufficient enough to establish that it has been induced by undue influence.

Example

Virendra applies to a bank for a loan. The bank grants him the loan, but on the condition that it would charge him an interest at a rate unusually higher than the usual rate of interest, on the ground that some stringent situation was prevailing in the money market, at the material time. Virendra agrees to such higher rate of interest, as he was in a disparate need of the money urgently.

Under the aforementioned circumstances, the condition of charging a higher rate of interest would be deemed to be a transaction, in the ordinary course of business. Accordingly, the contract would not be presumed to have been made under undue influence. *[Illustration (a) to Section 16]*.

Here, it may be pertinent to note that a mere urgent and disparate need of money, on the part of the borrower, in itself, would not be sufficient enough to imply and establish that the moneylender was in a position to dominate the will of the borrower, and that he had actually taken advantage of his such position. Here, the onus of proof, that the moneylender was in a position to dominate the will of the borrower, and also that he had actually taken advantage of his such a position, squarely lies on the borrower himself.

[As observed by the judicial committee in the case of Aziz Khan vs Duli Chand]

As against this, if, in the opinion of the Court, the rate of interest so charged is unreasonably and exorbitantly high, the Court may fix a reasonably lower rate of interest. And, in such cases, the onus of proof that no undue influence was induced, would lie, not on the borrower, but on the creditor concerned. This amounts to saying that the undue influence would be presumed in such cases.

Examples

(i) In the case of **Ruknisa vs Mohib Ali Khan [(1931), I. A. 938]**, wherein the creditor had charged the interest at the compound rate of 25 per cent per annum, from an old and illiterate person, the Court had found such interest rate as unconscionable (i.e. unreasonable or excessive), and accordingly, had allowed the interest to be payable at the rate of 12 per cent per annum, instead, and that too, as a simple interest, and not a compounded one.

(ii) Similarly, a poor Hindu widow, wanting to file a suit for her maintenance, had borrowed a sum of Rs 1,500, with the interest payable at the rate of 100 per cent per annum. The Court had found such interest rate as unconscionable (i.e. unreasonable or excessive), and accordingly, had allowed the interest to be payable at the rate of 24 per cent per annum, instead. **[Annapurani vs Swaminathan (1910) 34 Mad. 7]**

Contract with a *Pardanashin* Lady

More than ordinary care and caution need to be exercised while entering into a contract with a *pardanashin* lady. This is so because; the Courts in India regard such women of being quite susceptible to undue influence. Accordingly, if an illiterate *pardanashin* lady executes the documents for the sale of some property, the burden of proof, that no undue influence was used, lies on the party in whose favour such sale deed was executed. Thus, the demand of the law is that such beneficiaries must take more than ordinary care to see to it that there may be sufficient affirmative and conclusive evidence to establish, even at a later date, that the contents of the deed were duly read and explained to her, and also that she had confirmed having understood them.

But, to take the plea of being a *pardanashin* lady, the person will have to prove complete seclusion, inasmuch as only some degree of seclusion is not considered sufficient enough to make her eligible for getting the special protection of a *pardanashin* lady.

5.1.3 Fraud (Sections 17 and 18)

Any of the following acts, committed by a party to the contract (or with his connivance, or by his agent), with the intention of deceiving the other party to the contract, or his agent; or to induce him to enter into the contract, amounts to fraud:

(i) The suggestion, as a fact, of that which is not true, by one who himself does not believe it to be true;
(ii) The active concealment of a fact by one having knowledge or belief of the fact;
(iii) A promise made without any intention of performing it;
(iv) Any other act fitted to deceive; and
(v) Any such act or omission as the law specially declares to be fraudulent.

We would now proceed to discuss and explain the various essential ingredients of a fraud, inherent in the aforementioned provisions.

(i) The Assertion (or Representation) must be Made, and it must be False, and it must be Made Knowingly, Too

(a) There must be an assertion by the person. That is, a mere silence on the part of such person, on some of the facts, which may even be likely to affect the willingness of the other party, would not amount to fraud.
(b) Such assertion must pertain to something, which is not true, but false.
(c) Such (false) assertion, made by the party, must be known to the party (making it), to be not true, but false. Conversely speaking, if the party does not know that his assertion is false, and believes it to be true, his such assertion would not amount to fraud.

Examples

(i) Hobbs sold some pigs to Ward. The pigs were suffering from some fever, the fact which Hobbs knew for sure. But then, the pigs were sold 'with all faults'. Hobbs, however, did not disclose this fact to Ward, though he knew it. He rather preferred to keep silent on this point.

It was held that there was no fraud in this case. **[Ward vs Hobbs (1878) A.C. 13].**

(ii) Saleem sold an unsound dog, by auction, to Rahman. Saleem knew that the dog was unsound. But then, he kept silent on this point, and did not tell anything to Rahman about the unsoundness of the dog. In this case, too, there is no fraud committed by Saleem.

In both these cases, there is no fraud involved, on the ground that a mere silence on the part of such person, on some of the facts, which may even be likely to affect the willingness of the other party, would not amount to fraud.

But then, this does not mean that silence would not amount to fraud under all circumstances.

(i) In fact, it would definitely amount to a fraud, where the relationship between the two parties to the contract is of a fiduciary nature (like the relationship between father and son or daughter, between guardian and ward, and so on) In such cases, it is expected that the person should not hide, but must, instead, speak out the relevant point; that he is not expected to deliberately keep silent on that point, either, inasmuch as the fiduciary relationship demands it likewise. Let us take the example of a father, entering into a contract with his daughter. In such a case, the daughter does not expect from her father that he would act in a fraudulent manner, and would hide some known fact from her. That is, if a father would be selling an unsound dog, by auction, to her daughter, it would be the duty of her father to specifically tell her of the unsoundness of the dog (instead of just keeping quiet), by virtue of the very fiduciary relationship existing between the two.

Similarly, such duty to speak exists even in the cases of the contracts, which require utmost good faith *(uberimae fidei)*, like the contract of insurance.

(ii) Further, 'silence is fraudulent', where the circumstances are such that "silence is, in itself, equivalent to speech". *[Explanation to Section 17].*

Example

Harrison tells Blanchard: "In case you don't deny it, I shall presume that the dog is sound". Blanchard keeps silent. In this case, the silence, on the part of Blanchard, would amount to speech, as if saying that the dog is sound, and not unsound.

(iii) Besides, the suppression of some relevant truth also amounts to fraud.

Example

A company had issued a prospectus, which did not refer to the existence of a document disclosing its liabilities. Thus, naturally, a wrong impression was created, in the minds of the prospective investors, that the company did not have any liability, and that it, accordingly, was a prosperous one, which was far from being true.

It was held that the suppression of truth in this case amounted to fraud. **[Peek vs Gurney (1873) 6 H. L. 377].**

(ii) The Assertion (or Representation) must Pertain to a Fact

The assertion (or representation), which is alleged to be false, must be of fact, and not just an exaggerated description. That is, an exaggerated description alone would not amount to fraud.

Example

Ahmed is selling his horse. He says that the horse is the 'Black Princess', a 'pride possession', and is worth Rs 45,000. The expressions like 'pride possession', and 'Black Princess', are just expressions of his opinion, and, therefore, cannot be considered to be fraudulent as such. But then, if he had actually bought the horse for Rs 25,000 only, the expression that it is 'worth Rs 45, 000', would amount to a misstatement of a fact, and thus, it would be considered to be fraudulent.

(iii) The Assertion (Representation or Statement) must be made with the Knowledge of it being Not True, or Without the Belief that it is True, or even when Made Recklessly

To put it rather differently, we may say that a person may be held liable for fraud in all the following three circumstances, under which the false statement has been made:

(i) Knowingly (i.e. with the knowledge of it being false);
(ii) Without belief in its truth; and
(iii) Recklessly, that is without taking due care to verify the truth and facts contained in the statement, which could be either true or false.

Example

The points have been well explained in the case of **'Reese River Silver Mining Company vs Smith' [(1869) L. R. 4 H. L. 64].** In this case, the company had given some false information in its prospectus, regarding its unencumbered (unbounded) wealth of Nevada. A share broker had taken some shares of the company on the faith that the statements made in the prospectus were true. Finding the aforementioned fact to be untrue, he wanted to avoid the contract. It was held that he could do so, inasmuch as the untrue presentation of the information in the prospectus amounted to fraud.

But, in the cases, involving some reckless misinformation, the position may not appear to be as simple and easy as it is in the cases, involving some false representation of facts, made either knowingly or even without one's belief in its truth. This is so because, it may be rather difficult to say, for sure, whether the person, making the false statement, himself believed that such statement was false, whereby it could amount to fraud. But then, when we would prefer to have a closer look at the circumstances of even such cases, we would come to the conclusion that this as well may amount to fraud. This is so because, even though the person might not have been in the full knowledge about the veracity of his statement, he had preferred to give an impression to the members of the public at large to the effect, as if he was in the full knowledge of the facts and truth of the statement.

But then, it may be pertinent to clarify here that if the person, being alleged for having acted fraudulently, could prove that he honestly believed that the statement(s), made by him were true, he would not be deemed to have acted fraudulently. The judgement in the case of **'Derry vs Peek [(1889) 14 A. C. 337],** discussed hereafter, may be read with great benefit and interest on this ticklish and tricky point.

Example

The prospectus, issued by the Directors of a Tramway Company, stated that they had the right to run the tramcars on steam power, instead of with horses, as hitherto. But, in fact, the relevant Act had provided that the steam power could be used with the approval of the Board of Trade. But the Board of Trade had, in fact, refused to grant the required permission. Accordingly, the company had to be wound up. Peek, one of the shareholders of the company, had filed a suit against the Directors of the company for damages for fraud. The Privy Council had held in the case that the Directors were not liable for fraud, inasmuch as they had honestly believed that whatever they had stated in the prospectus were true.

(iv) The Assertion (Representation or Statement) must have been made with the Intention of Inducing the other Party to act Thereupon

Thus, it is clear that there must be an intention on the part of the person, making the false statement, to induce the other party to act upon such false statement. Conversely speaking, if it could be established that there was no such intention, the false statement, sans intention, would not amount to fraud.

(v) The Assertion (Representation or Statement) must Actually Deceive

It is well said that the deceit, which does not deceive, does not amount to fraud. In other words, if the (intended) fraud or misstatement, practised on a person, or to whom such misrepresentation was made, in

itself, does not induce that person to enter into the contract, it would not amount to fraud. Accordingly, such contract would be held valid, and not voidable.

Example

John had purchased the cannon of William. William knew that the cannon had certain defects, which had rendered it worthless. He had, however, put a metal plug to hide the defect. But, John had purchased the cannon without caring to examine it. And, when he used it, it got burst. It was held that no fraud was involved in this case, on the ground that, in view of the aforementioned circumstances, he (John) would have purchased the cannon, even if the deceptive plug were not there. This is so because; he had taken no care to examine it, before going for it. Thus, in fact, he had not been deceived or defrauded because of the deceptive plug, as such. **[Horsefall vs Thomas (1862) 158 E. R. 813].**

(vi) Some Loss must have been Suffered by the Party, Who was Subjected to such Fraud

There is a common rule of law to the effect that 'there is no fraud without damages'. Accordingly, in case no damage has been caused to the person involved in the misstatement or the like, the same will not amount to fraud or deceit.

We may now summarise the various essential elements, involved in fraud, at one place.

(i) The assertion (or representation) must be made, and it must be false, and it must be made knowingly, too.
(ii) The assertion (or representation) must pertain to a fact.
(iii) The assertion (representation or statement) must be made with the knowledge of it being not true, or without the belief that it is true, or even when made recklessly.
(iv) The assertion (representation or statement) must have been made with the intention of inducing the other party to act thereupon.
(v) The assertion (representation or statement) must actually deceive.
(vi) Some loss must have been suffered by the party, who was subjected to such fraud.

Remedies Available to the Defrauded (Deceived) Party

The following remedies are available to the party, who has been defrauded:

(i) He can avoid the performance of the contract, so made;
(ii) He can insist that the contract should be performed, but with some required suitable changes so made that he would be in the same position that he would have been, had the false statement made were true; or
(iii) He can file a suit for damages.

Example

Rohan has mortgaged his estate to a bank. But, he tells Showmik that the estate in question was free from any encumbrances. Showmik, therefore, purchases the property.

Here, Showmik has the following choices open to him to choose any one from:

(a) He may avoid the contract, or
(b) He may prefer that the contract must be performed, and the mortgage deed must be got released from the bank (obviously after payment of the dues there-against), or else
(c) He can file a suit against Rohan, for damages.

Some Exceptions

But then, there are certain exceptional circumstances under which the contract may not be considered as voidable. These are:

(a) When the party, whose consent was obtained through misrepresentation or fraud, had the means to verify and discover the truth, or otherwise, of such statement, with ordinary diligence *(Exception to Section 19)*, and

(b) When the party, even after becoming aware of the misrepresentation or fraud, had taken some benefit under the contract, or else, he had affirmed the contract in some way or the other.

5.1.4 Misrepresentation (Sections 18 and 19)

Misrepresentation, too, like fraud, comprises incorrect or false statement, but with a subtle but significant difference, in that such inaccuracy or falsity does not involve any intention, on the part of the party making such misrepresentation, to deceive or defraud the other party. In other words, such misrepresentation happens to be innocent, and honest; in that, the party concerned believed it to be true.

Under Section 18 of the Act, the cases of misrepresentation have been classified into the following three distinct categories:

(a) The Positive Assertion, in a Manner not Warranted by the Information of the Person making it, of that which is not True, Though he Believes it to be True

Example

Raghuvir tells Krishna that Chowksy was going to join the recently promoted ABC Company as its Managing Director, and induces him to purchase the shares of the company. On the basis of this piece of information, Krishna purchases the shares of the company. Chowksy, however, did not join the company. And, it transpires that Raghuvir had not got the information from Chowksy direct, but it was based on some hearsay, instead. Under such circumstances, it amounts to misrepresentation by Raghuvir, though he had believed that the information was true, and also that there was no intention on his part to deceive Krishna, either.

(b) Any Breach of Duty, which, without an Intention to Deceive, gives an Advantage to the Person Committing it (or any one Claiming under Him), by Misleading another to His Prejudice, or to the Prejudice of anyone Claiming under Him

(c) Causing, however, Innocently, a party to an Agreement to make a Mistake as to the Substance of a thing, which is the Subject Matter of the Agreement

Example

Johnson agrees to purchase some hops (dried flowers of this climbing plant, used for giving a bitter flavour to beer) from Blanchard, on the condition that no sulphur must have been used for growing them. Blanchard tells him that no sulphur had been used for their growth. But, as a matter of fact, sulphur had been used, though only on the five out of the 300 acres. But, Blanchard had evidently forgotten this fact while telling him that no sulphur had been used for their growth. It was held that, the stipulation that 'no sulphur had been used for their growth', was of a primary nature, and in a sense a basic condition, without which the contract would not have been entered into. In view of this fact, the contract could be avoided, it being non-fraudulent, notwithstanding. **[Bonnerman vs White (1861) 142 E. R. 658].**

Remedies Available to the Party Subjected to Misrepresentation (Section 19)

The aggrieved party, subjected to misrepresentation, has the following two options to choose one from:

(i) He can avoid the performance of the contract, so made; or else

(ii) He can insist that the contract should be performed, but with some required suitable changes so made that he would be in the same position that he would have been, had the representation made were true.

Example

Let me reiterate and reinforce the same example here as well, as has been cited under the previous portion on 'Fraud', of course, with some required changes.

Rohan's estate was mortgaged to a bank. However, he tells Showmik that the estate in question was free from any encumbrances. Showmik, therefore, purchases the property. But, in fact, Rohan did not know this fact.

Here, Showmik has the following alternatives open to him to choose any one from:

(a) He may avoid the contract, or
(b) He may prefer that the contract must be performed, and the mortgage deed must be got released from the bank (obviously after payment of the dues there-against).

It may, however, be carefully noted here that, unlike the cases of fraud, the remedy of claiming damages is, **generally**, not available in the cases involving misrepresentation. Thus, Showmik cannot file a suit against Rohan, for damages in this case.

Some Exceptions

The word 'generally' has been used in this context, quite deliberately, in view of the fact that even the remedy of damages may be available in some exceptional cases of misrepresentation, too. These exceptional cases are:

(i) In the cases of breach of warranty of authority of an agent

That is, in case an agent believes that he has the authority to represent his principal, though, in fact, such authority had not been given to him, the agent is liable for damages, despite the fact that he was honestly under the impression that he had such authority (that is, despite the fact that he has committed only an innocent misrepresentation). **[Collen vs Wright (1857) E. & B. 647]**

(ii) In the cases of Negligent Representation

A negligent representation may arise only in such cases where the relationship of a confidential nature may exist between the two parties involved, e.g., between the lawyer and the client.

It may, however, be noted here that if the party, whose consent was obtained even by misrepresentation, had the means of finding out the truth, with ordinary diligence and effort, he would not have any remedy, whatsoever.

Distinguishing Features of 'Fraud' and 'Misrepresentation'

Some main distinguishing features of 'Fraud' and 'Misrepresentation' have been discussed hereunder:

(i) In both the cases (i.e. of 'Fraud' and 'Misrepresentation'), the contracts so obtained are voidable (not void), but only at the option of the wronged party. But then, there is a slight, but significant, difference in respect of the remedies available to the wronged party to the respective contract. That is, in the case of the contract obtained by fraud, the wronged party has an additional remedy by way of claiming damages, too (in addition to the other two remedies, discussed in the foregoing paragraphs). In other words, the additional remedy, of claiming damages from the other party, is generally not available in the case of the contract, obtained through misrepresentation. This additional remedy, however, is available only in some exceptional cases, like:
   (a) In the cases of 'breach of warranty of authority of an agent' and,
   (b) In the cases of 'negligent representation'.

   This point has already been discussed, in greater details, in the preceding paragraphs, under the sub-heading: 'Some Exceptions'.

(ii) The second distinguishing feature between these two, pertains to (the presence or absence) of the element of the 'intention to deceive' the other party. That is, the false and untrue representation made may amount to fraud, if and only when it has been made with the intention to deceive the other party to enter into the contract, or to gain some advantage. As against this, if the false and untrue representation has been made innocently (i.e. without the intention to deceive the other party to enter into the contract, or to gain some advantage), it would amount to misrepresentation.

(iii) Third, only in the case of misrepresentation, the contract cannot be avoided, if the party, whose consent was so obtained, had the means of finding out the truth by ordinary diligence. This,

however, is not so in the case of fraud. That is, the contract, obtained by fraud, can be avoided in all such cases.

5.1.5 Mistake (Section 20)

Mistake pertains to an erroneous belief concerning something. It may be of two types, viz.:

(i) Mistake of Fact, and
(ii) Mistake of Law.

(i) Mistake of Fact

Mistake of Fact, too, may be of two types, viz.

(a) Bilateral, and
(b) Unilateral.

(i) (a) Bilateral Mistake of Fact A 'Bilateral Mistake of Fact' takes place when both the parties to the agreement are under a mistake of fact, which is essential to the agreement. The agreement so reached is void, and not just voidable.

As stated above, the bilateral mistake of fact involves two elements, viz.

(i) The mistake must pertain to some matter, essential to the contract, and
(ii) Both the parties to the contract must commit the mistake.

Such mistakes may occur under different circumstances, which have been discussed hereafter:

(1) Mistake Pertaining to the Existence of the Subject Matter

Under such cases, the very matter (the articles or goods, etc.) which itself comprises the subject matter of the agreement, was non-existent at the time the contract was entered into.

Examples

(i) Barkha offers to sell her cow to Banwari. Banwari agrees to buy that cow. But later it transpires that, well before the agreement was made, that cow had already expired. Both the parties, however, were not aware of this fact at the time of entering into the agreement. This agreement is, thus, void, on the ground of mistake of fact. This is so because the cow sold and bought itself was non-existent (dead) at the time the agreement was reached.

(ii) Some commodities are on the high sea on their way from America to Kolkata. Keshav offers to sell these commodities to Kabir, while on the high sea. Kabir agrees, and the agreement gets completed. But, later the parties come to know that the ship had sunk in the sea, well before the agreement was made. None of the parties, however, were aware of this fact at the time of entering into the agreement. Thus, the agreement is void, on the ground of mistake of fact. This is so because the commodities on the high sea sold and bought themselves were non-existent (sunk in the sea) at the time the agreement was reached.

(iii) Siddharth agrees to assign the insurance policy, taken on the life of Bhagirath to Shankar. But then, Bhagirath had already died before the agreement was made. This fact was not known to any one of the two parties at the time of the agreement. This agreement would be void; as the person insured himself was non-existent (dead) at the time the agreement was reached, and accordingly, there was no contract, at all. **[Scott vs Coulson (1903) 2 C.H. 249]**.

(2) Mistake Pertaining to the Identity of the Subject Matter

Mistake, regarding the identify of the subject matter, occurs when the two parties to the agreement agree upon two distinctly different things all together. That is, while one of the parties has one thing in his mind, the other party is thinking of quite a different one. Such agreement is void, due to the mistake of identify of the subject matter.

Example

Let us repeat the same example, cited at the very beginning of this chapter, by way of reinforcement, too.

Suresh had two cars, referred to hereafter as car A and car B. He had offered his car B for sale to Narain, for Rs 50,000. Narain had accepted the offer. But then, at a later date, it got revealed that Narain was under the impression that Suresh had only one car A, and so he was all through under the impression that he had purchased that very car A. As against this, Suresh had, in fact, made the offer for sale of his car B, instead, and not his car A. Thus, it is obvious that the two parties, while entering into the agreement, had not thought of the same thing, in the same sense. In other words, there had been the mistake, regarding identify of the subject matter. Accordingly, the aforementioned agreement would be void for this very reason (i.e. mistake of identify of the subject matter).

(3) Mistake Pertaining to the Title to the Subject Matter

Mistake, pertaining to the title to the subject matter, occurs when the buyer of the article, property, etc., is under the impression that the seller has a valid title thereto. But, in fact, the seller does not have any. This, thus, amounts to the mistake, pertaining to the title to the subject matter. Accordingly, the aforementioned agreement would be void for this very reason. (i.e. mistake pertaining to the title to the subject matter).

Example

Daniel sells his piece of land to Robert. Further, at the time of the agreement, both the parties were under the impression that Daniel had a valid title to the plot. But later, it transpired that Daniel did not have a valid title to the property at the material time, i.e. when the contract was entered into. This contract would be, thus, void due to the mistake, pertaining to the title to the subject matter. The case of **'Cooper vs Phibbs [(1867) 159 E. R. 375]** is an apt example, somewhat on similar points.

(4) Mistake Pertaining to the Quantity of the Subject Matter

Mistake, pertaining to the quantity of the subject matter, occurs when there is a difference of understanding between the buyer and the seller, in regard to the quantity of the article actually ordered, and the quantity actually supplied.

Example

In the case **'Henkel vs Pape' [(1870) 6 Ex. 7],** Pape had sent a letter to Henkel enquiring about the price of the rifles, and, at the same time, he had suggested that he may buy 50 such rifles. Henkel supplied the required information to Pape. Thereafter, Pape sent a telegram to Henkel reading as:"Send three rifles." But, due to the mistake, on the part of the telegraph department, the message was wrongly transmitted reading as: "Send the rifles." On receipt of such telegram, Henkel despatched fifty rifles (as was indicated in the letter, sent by Pape to Henkel earlier).

It was held that there was no contract, due to the mistake pertaining to the quantity of the subject matter (i.e. the number of pieces of the rifles to be actually supplied). However, in this case, Pape could be held liable for paying for the three rifles supplied, on the ground of the implied contract.

(5) Mistake Pertaining to the Price of the Subject Matter

Mistake, pertaining to the price of the subject matter, occurs when there is a misunderstanding between the two parties to the contract, as to the exact price of the thing under the deal.

Example

Amit had given his house on rent to Sunil at a monthly rental of Rs 6,000. But, in the relative agreement document the rental was, by mistake, typed as Rs 5,000 per month, instead. Such agreement would be held as void, on the ground of the mistake, pertaining to the price of the subject matter of the agreement.

But then, it must be carefully noted in this context that, if there were some wrong estimate in the mind of the prospective buyer, regarding the value of the commodity to be purchased, it would not amount to a mistake pertaining to the price of the subject matter of the agreement. Accordingly, such contract would be deemed as valid, and not void. *[Explanation to Section 20].*

Example

Satyanarayanan goes with his wife to purchase some ornaments. He selects one gold chain, and thinks that it must be costing around Rs 10,000. But, when he asked the shopkeeper about its price, it was quoted at Rs, 6,000 only. This, in itself, would not amount to the mistake regarding the price of the article under the deal. The contract, therefore, will not become void just for this reason. It would be held valid, instead.

To sum up, we may say that a 'Bilateral Mistake of Fact' takes place when both the parties to the agreement are under some mistake of fact, which is essential to the agreement. Such mistakes may be regarding its:

1. Existence; i.e. say, the cow under the deal was already dead.
2. Identity; i.e. the car under sale was different and the one thought to have been bought was different.
3. Title; i.e. both the parties think that the seller party has valid title, but actually he does not have it.
4. Quantity; i.e. quantity ordered, and thought (by the buyer) to have been ordered differ.
5. Price; i.e. the two parties have two different notions about the price of the commodity under the deal. But a wrong estimate about the actual price does not amount to a mistake regarding the price.

(i) (b) Unilateral Mistake Unilateral mistake is said to have occurred, when there is some mistake on the part of only one of the parties to the contract, and not so with regard to the other party. Contract, due to such unilateral mistake, is neither voidable nor void, but it is valid, instead, and so it is enforceable in law. As Section 22 reads: "A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact." But then, there are some exceptions, too, to this provision, which have been dealt with hereafter.

Exceptions

(1) Where the unilateral mistake is regarding the Nature of the Contract (and not its terms)

The unilateral mistake, regarding the 'Nature of the Contract', occurs when one of the parties thereto does not have an intention to enter into it, but then, due the fault of some other person, and without any fault on his own part, enters into it. Under such situation, he is said to have made a mistake pertaining to the nature of the contract. And, such contract is not valid, but void.

Example

In the case of **Foster vs McKinnon [(1869) L.R. 4 C. P. 704]**, an old illiterate man was made to understand by another person, by way of a false representation, that the document, he was required to sign, was a guarantee, whereas, in fact, it was a bill of exchange, instead. The old man had signed the document thinking it to be a guarantee, and not a bill of exchange. That is, in this case, there was no mistake, on his part, about the nature of the contract. The contract, accordingly, was held as void.

It may, however, be carefully noted in this context that, for claiming the plea of such mistake, it must pertain to the nature of the contract, and not regarding the terms of the contract. **[Bay vs Polla and Morris (1930) 1 K. B. 628].**

(2) Where the unilateral mistake is regarding the Quality of the Contract

Hindley was selling, through an auction, some lots of hemp, and some other lots of tow. While the lot of tow was being auctioned, Scriven was under the impression that the lot of hemp was under the auction, and accordingly, he bid the amount for the same (which was the lot of toe, and not hemp). But, the bid amount was a fair price only for hemp, and an unreasonably high price for tow. It was held that the contract could well be avoided; it being void due to the mistake of the quality of the promise. **[Scriven vs Hindley (1913) 3 K. B. 564].**

(3) Where the unilateral mistake is regarding the Identity of the Person, with whom the contract is being made

The unilateral mistake, regarding the identity of the person, takes place, when a person enters into an agreement with another person, mistaking him to be someone else, than he actually is. That is, when Ram intends to enter into an agreement with Ghanshyam, but by mistake actually enters into an agreement with Shyam, instead, mistaking him to be Ghanshyam, it would amount to a unilateral mistake, regarding the identity of the person.

Examples

(i) A person, named Blenkarn, knew that Blenkiron & Co. were one of the valued customers of Lindsay & Co. He, therefore, placed some orders with Lindsay & Co. for supply of certain goods, by forging the signature of Blenkiron & Co. He, in turn, sold these goods to Cundy, who innocently purchased the same. Lindsay & Co. filed a suit against Cundy, for the return of these goods on the ground that the company never intended to enter into an agreement with Blenkarn, and that they were under the impression that they had entered into the contract with Blenkiron & Co., instead.

It was, therefore, held that, as Lindsay & Co. never intended to enter into any contract with Blenkarn, no valid contract was entered into, and Cundy, therefore, did not get a valid title to the goods. Thus, this contract was void. Accordingly, Cundy was asked by the Court to return these goods to Lindsay & Co, or else to pay the price of these goods to them. **[Cundy vs Lindsay & Co. (1878) 3 App. Cas. 459].**

(ii) Likewise, in another case of **Lake vs Simmons, [(1927) A. C. 487],** one lady (Anne) had falsely impersonated herself as the wife of a baron (Blanchard), and had thereby induced Clark to deliver two pearl necklaces to her so as to show them to her husband for his approval. Clark had delivered those two pearl necklaces to her, in good faith, taking her to be the wife of the baron (Blanchard), though actually she was not.

It was held that Clark had the intention of entering into the contract only with the wife of the baron (Blanchard), and not with Anne herself. Thus, Anne did not have a good title, and so, she could not pass any valid title even to any innocent and bonafide buyer. The contract was, therefore, declared as void.

(iii) But, the position was materially different in another case **[Philips vs Brooks (1919) 2 K. B. 243]**. In this case, one person, named Nitin, entered into a jeweller's shop, just as a casual customer, and purchased some jewels, and gave a cheque in payment there-against. But then, he had signed the cheque as Gopal, instead, who was a well-known creditworthy person in the area. The shopkeeper, therefore, accepted the cheque and delivered the jewellery to Nitin, the casual customer. Nitin then pledged these jewels to Bhaskar, who took them in good faith.

It was held that, in this case, Bhaskar, the pledgee, had a good title to the jewels, inasmuch as the contract between Nitin and the jeweller cannot be treated as void on the ground of mistake of identity, as Nitin himself was present in the shop, in person, as a casual customer, and had entered into a contract as a casual customer, and not as Gopal, though he had (fraudulently) signed the cheque in a false name as Gopal. This contract, however, was declared as only voidable (and not void), on the ground of fraud.

(ii) Mistake of Law (Section 21)

The 'Mistake of Law' may be of two types, viz.

(a) The 'Mistake of Law' of the land (i.e. of one's own country), and
(b) The 'Mistake of Law' of a foreign country.

(a) The 'Mistake of Law' of the Land The dictum: 'Ignorance of law is no excuse' (*Ignorantia juris non excusat)*, is applicable only in the cases of the law of the land. That is why; Section 21 provides that "A contract is not voidable because it was caused by a mistake as to any law in force in India". That is, if the two parties agree on the basis of an erroneous belief that a particular debt is already time-barred, when actually it is not time-barred, as per the provisions of the Indian Limitation Act, the contract would not become voidable. That is to say that, this rule is not applicable in the cases where the law of any foreign country applies.

(b) The 'Mistake of Foreign Law' The dictum: 'Ignorance of law is no excuse' (*Ignorantia juris non excusat)*, though applicable in the cases of the law of the land, it is not applicable in the cases of the foreign law. Thus, the mistake of the foreign law is treated as a mistake of fact, and not as a mistake of law. This is so because, Section 21 provides that "A mistake as to a law not in force in India has the same effect as a mistake of fact'.

Remedies available in the cases of 'Mistake'

An agreement entered into with the element of mistake is void. The remedies available in such cases of agreement, however, are of two different types, applicable under two different situations. These are:

(a) The complaining person may repudiate the contract, which is yet to be executed by him (the aggrieved person or party). In other words, he need not perform it.
(b) But then, if the contract has already been performed, the party, who has received some benefit arising thereby, must restore the same to the aggrieved party, or else, he must compensate the aggrieved party, the moment the contract has been found to be void.

Let us Recapitulate

In a valid agreement, there must be a free consent between the two parties. That is,

(i) There must be two parties;
(ii) There must be consent between them, that is, they must agree to the same thing in the same sense, and at the same time.(i.e. there must be *'consensus-ad-idem;* and
(iii) The consent must be free.

That is, such consent should **not** be obtained in any one or more of the following manners:

(i) By coercion,
(ii) By undue influence,
(iii) By fraud,
(iv) By misrepresentation, and/or
(v) By mistake.

Otherwise, such contract would be automatically declared as voidable (not void), but at the option of that party only, whose consent was so obtained.

Coercion comprises:

(a) Committing, or threatening to commit, any act, forbidden by the Indian Penal Code, or
(b) Unlawful by detaining, or threatening to detain, any property, to the prejudice of any person whatsoever, with the intention of causing any person to enter into an agreement.

Coercion vs Duress

(i) Duress can be employed only against the other party, involved in the contract, or to his family members, and not against any other person, whatsoever, as is the case with coercion.
(ii) Duress can be employed only by the promisee (that is the other party involved in the contract), or by his agent, but coercion can be employed, not necessarily by the other party to the contract, but by any other person, too, whosoever he may be.

(iii) Duress includes only the bodily violence and imprisonment of persons, and not the unlawful detention of goods. But, the unlawful detention of goods, too, is included in the case of coercion.

Undue Influence may be exercised where the relations between the two parties are such that one can dominate the mind and will of the other, and when he uses such position to obtain an unfair advantage over the other party.

Such relationships are:

(a) Doctor and patient,
(b) Parent and child,
(c) Guardian and ward,
(d) Lawyer and client,
(e) Spiritual Guru and disciple,
(f) Trustee and beneficiary, and similar other relationships.

But, if it could be proved that the person, said to have been induced by the alleged undue influence, had an independent legal advice of someone, who had the full knowledge of the relevant facts, the plea of undue influence could be refuted.

Fraud

Any of the following acts, committed by a party to the contract (or with his connivance, or by his agent), with the intention of deceiving the other party to the contract, or his agent; or to induce him to enter into the contract amounts to fraud:

(i) The representation must be made, and it must be false, and it must be made knowingly, too.

(ii) The representation must pertain to a fact.

That is, it should not be just an exaggerated description, like 'Beauty' or 'Pride Possession', etc. But giving an exaggerated statement about the value of the thing will amount to fraud.

(iii) The false statement must have been made:

- Knowingly (i.e. with the knowledge of it being false);
- Without belief in its truth; and
- Recklessly, that is, without taking due care to verify the truth and facts contained in the statement, which could be either true or false.

(iv) There must be an intention of inducing the other party to act thereupon.

Thus, the false statement, sans fraudulent intention, would not amount to fraud.

(v) The statement must actually deceive.

If the (intended) fraud or misstatement does not induce that person to enter into the contract, it would not amount to fraud.

(vi) Some loss must be suffered by the party, who was subjected to such fraud.

If no damage is caused to the person involved in the misstatement or the like, it will not amount to fraud.

Remedies Available to the Defrauded (Deceived) Party

(i) He can avoid the performance of the contract, so made; or
(ii) He can insist that the contract should be performed, but with some required suitable changes so made that he would be in the same position that he would have been, had the false statement made were true; or
(iii) He can claim damages for the fraud.

Misrepresentation

As against fraud, in the case of misrepresentation, though comprising incorrect or false statement, the element of fraudulent intention to deceive is not involved. That is, the misrepresentation happens to be innocent and honest, in that the party concerned believed it to be true.

Mistake pertains to an erroneous belief concerning something. It may be

(i) Mistake of Fact (Bilateral and Unilateral), and
(ii) Mistake of Law.

(i) (a) Bilateral Mistake of Fact

A 'Bilateral Mistake of Fact' takes place when both the parties to the agreement are under a mistake of fact, which is essential to the agreement. The agreement so reached is void, and not just voidable. Such mistakes may be regarding its:

1. Existence
2. Identity
3. Title
4. Quantity
5. Price

(i) (b) Unilateral Mistake occurs, when only one of the parties to the contract commits some mistake. Contracts so made are valid.

Exceptions

But the contracts so made are void where the unilateral mistake pertains to the:

- Nature of the Contract (and not its terms)
- Quality of the Contract
- Identity of the Person, with whom the contract is being made

(ii) Mistake of Law (of own country, or of some foreign country)

The dictum: 'Ignorance of law is no excuse' is applicable only in the cases of the law of the land. Accordingly, the contract, caused by a mistake as to any law in force in India, is not voidable, but valid. But then, as this dictum is not applicable in the case of the law of some foreign country, the contract, so caused, is treated only as a mistake of fact, and not as the mistake of law.

Questions for Reflection

1. (a) What are the various elements which are considered necessary to constitute a 'Free Consent'?
   (b) Under what circumstances the consent so obtained may not be said to be free? Explain with the help of illustrative examples, in each case.
2. (a) Distinguish between the terms 'void' and 'voidable'. Bring out the inherent distinctions clearly by citing suitable examples in each case.
   (b) If the consent were obtained in any one or more of the following manners, the contract, in question, would be declared as void or voidable? Are there any exceptions in any of the cases?
      (i) By coercion,
      (ii) By undue influence,
      (iii) By fraud,
      (iv) By misrepresentation,
      (v) By mistake.

   Explain the inherent features of the above-noted terms, with the help of some illustrative examples in each case.
3. 'It is necessary that the Indian Penal Code (IPC) should be in force at the place, where the coercion had been induced'. Do you agree with this contention? Give reasons for your answer by citing some illustrative examples on the point.
4. Whether the threat to commit suicide would amount to coercion? Give reasons for your answer by citing some illustrative examples.
5. (a) Bring out the main distinguishing features between 'misrepresentation' and 'fraud', with the help of illustrative examples in each case.
   (b) What are the various optional remedies available to the wronged party, in each of these two cases? Bring out the subtle differences between these two, if any.

6. Distinguish between the terms 'Coercion' and 'Duress', by citing suitable illustrative examples in each case.
7. (a) Define the term 'Undue Influence', with the help of some illustrative examples.
   (b) Can an undue influence be presumed in the cases of the following relationships?
      (i) Doctor and patient,
      (ii) Master and servant,
      (iii) Parent and child,
      (iv) Husband and wife,
      (v) Guardian and ward,
      (vi) Lawyer and client,
      (vii) Landlord and tenant,
      (viii) Spiritual Guru and disciple,
      (ix) Trustee and beneficiary,
      (x) Creditor and debtor.
8. (a) On which of the two parties would the onus of proof lie in the following cases?
      (i) In the relationships wherein the exercise of undue influence cannot be presumed,
      (ii) In the relationships wherein the exercise of undue influence is presumed,
      (iii) In the relationships wherein it is proved that the party concerned was in a position to dominate the will of the other party, and the transaction *prima faci*, or as per the evidences available, appears to have been induced by exercising undue influence,
   (b) The contract, induced by undue influence, will be void or voidable?
   (c) What are the remedies available to the respective two parties to the contract?
   (d) Can such contract be set aside by the Court always in full, or sometimes in part, too? Give your opinion by citing some specific situations where it may be possible.
   (e) Is the fact of charging a higher rate of interest, from the borrower, who is in an urgent and disparate need of money, be sufficient enough to establish that it has been induced by undue influence? Would the position be any different if such rate of interest happens to be unreasonably high?

Give your definite opinion with the help of some specific situations where it may be possible. Also specify as to on which of the two parties would the onus of proof of undue influence lie.

9. (a) Do you agree that more than ordinary care and caution needs to be exercised while entering into a contract with an illiterate *pardanashin* lady? Give reasons for your answer.
   (b) What special precautions, you would suggest, should be taken, and why?
!0. (a) What are the various essential ingredients of a fraud, inherent in the provisions, made in the Indian Contract Act? Explain each of them with suitable illustrative examples in each case.
   (b) What are the various remedies available to the defrauded party?
   (c) Under what exceptional circumstances, the contract, where though the consent was obtained through misrepresentation or fraud, may not be considered as voidable? Explain with examples.
11. (a) What are the main similarities and the distinguishing features inherent in 'Misrepresentation' and 'Fraud'?
   (b) What are the three distinct categories of misrepresentation, as classified in the Indian Contract Act? Explain with examples.
   (c) What are the exceptional cases of misrepresentation, where even the additional remedy by way of damages may be available? Discuss, by citing suitable illustrative examples in each case.
12. (a) What constitutes a mistake?
   (b) Distinguish between
      (i) 'Mistake of Fact' and 'Mistake of Law'.
      (ii) 'Bilateral Mistake of Fact' and 'Unilateral Mistake of Fact'

13. 'Bilateral Mistake of Fact' may take place, when both the parties to the agreement are under some mistake of fact, essential to the agreement, in regard to its:
    (a) Existence
    (b) Identity
    (c) Title
    (d) Quantity
    (e) Price

    Explain each of these with the help of some illustrative examples, in each case.
14. (a) When is a 'Unilateral Mistake of Fact' said to have occurred?
    (b) Is the contract, so entered into, void, voidable or valid?
    (c) Are there any exception(s) to (b) above? Explain with examples.
15. (a) Distinguish between the 'Mistake of Law' of the land, and the 'Mistake of Law' of a foreign country.
    (b) Whether the contracts so obtained are void, voidable, or valid? Give reasons for your answer.
    (c) What are the specific remedial options available in the aforementioned cases?

Problems for Practice (With Suggested Solutions)

Problem 1

Aditya had two digital cameras, say, camera P and camera Q. He had offered his camera P for sale to Basant for Rs 10,000. Basant had readily accepted the offer. However, at a later date, it was revealed that Basant was under the impression that Aditya had only one camera Q, and so he had thought that he had purchased that very camera Q from Aditya. As against this, Aditya had offered for sale his camera P, instead, and not his camera Q. Do you think that the aforementioned agreement would constitute a valid agreement, enforceable in law? Give reasons for your answer.

Solution

No; the aforementioned agreement between Aditya and Basant would not constitute a valid agreement, enforceable in law. This is so because the two parties, Aditya and Basant, while entering into the agreement, had not thought of the same thing, in the same sense, and at the same time. In other words, there had not been the much-required *'consensus-ad-idem'*. Accordingly, in the absence of one of the most essential vital requirements to constitute a valid contract, viz., *'consensus-ad-idem'*, the aforementioned agreement between Aditya and Basant would not constitute a valid agreement, enforceable in law.

Problem 2

Shaukat Ali had threatened Karamatullah that he will kill his wife Abida Begum if he does not pay him a sum of Rs 5, 00,000. Karamatullah had got scared and so had readily agreed to pay the amount of Rs 5,00,000 to Shaukat Ali, as was demanded by him, and finally had paid the amount, as per his promise.

(i) Do you think that a valid agreement had been entered into between Shaukat Ali and Karamatullah in the instant case? Give reasons for your answer.

(ii) Can Shaukat Ali be asked to refund the amount to Karamatullah under any provision of law contained in the Act? If so, quote the relevant Section of the Act to substantiate your point of view.

Solution

(i) No, a valid agreement had not been entered into between Shaukat Ali and Karamatullah, because one of the vital elements, viz. free consent, as required under the provisions of Section 14, was conspicuously lacking in the instant case. This is so because the manner in which the consent was obtained did not constitute a free consent. In fact, it was obtained under coercion, instead. Accordingly, such contract would be automatically declared as voidable (though not void), and at the option of that party only, whose consent was so obtained, i.e. at the option of Karamatullah in the instant case. This contention is based on the provisions of Section 19 of the Act.

(ii) Further, Shaukat Ali will have to refund the amount of Rs 5,00,000 to Karamatullah, as the same was obtained under coercion. This is so because, as has been specifically provided under Section 72 of the Act, the person, to whom the money has been paid, or something has been delivered, under coercion, is required to repay the amount or return the things so obtained.

Problem 3

Ram Lakhan was desperately in need of a sum of Rs 10,000 to perform the marriage of his daughter. He approached Shridhar, a village moneylender, to borrow the required amount from him. Shridhar had agreed to lend a sum of Rs 10,000 to him. But taking undue advantage of the emergent need of Ram Lakhan, he had unduly prevailed upon him to execute a Demand Promissory Note (DPN), not for only Rs 10,000, actually lent by him, but for Rs 25,000, instead. Not only that. He had also stipulated an exorbitantly high rate of interest at 75 per cent per annum. Left with no alternative, Ram Lakhan agreed and put his signature on the DP Note, as he was forcibly required by Shridhar to do. After the marriage of his daughter was successfully solemnised, he filed a suit against Shridhar, stating the full facts of the case as aforementioned, and sough remedies from the Court. In your considered opinion, what remedies the Court is likely to grant to Ram Lakhan? Give convincing reasons for your suggestion referring to the relevant provisions in the Act, as also quoting the applicable Section(s).

Solution

Section 16 provided that, in a situation where the relations between the two parties are such that one of the parties is in such a position whereby he can dominate the mind and will of the other, and when he uses such position to obtain an unfair advantage over the other party, the respective contract so obtained is said to have been induced by 'Undue Influence'. Further, as per the nature of some illustrative examples, given in Section 16 (3), an undue influence may be presumed in the instant case as well, by relying on the words 'similar other relationships', stated in the aforesaid Section, i.e. Section 16 (3). Accordingly, like the contract, induced by coercion, even the contract, induced by undue influence, is considered voidable (and not void), as per the provisions of Section 19A.

Thus, the Court may set this agreement aside, as it had been obtained by exercising undue influence on Ram Lakhan by Shridhar, taking undue advantage of the desperate conditions and circumstance in which he (Ram Lakhan) was placed, in the given situation. Besides, the Court may also ask Ram Lakhan, to pay only the actually borrowed sum of Rs 10,000, and not Rs 25,000 as was stated in the D P Note. Further, Shridhar will also be paid the amount of interest accrued on this sum of Rs 10,000 only, and that too, computed at a reasonable rate of interest, instead, and not at the exorbitantly high rate of interest of 75 per cent per annum, as is said to have been stipulated in the relative DP Note. We may, thus, observe that, under certain situations, like the one in the instant case, the Court may most likely set aside the contract, but only partially, and not necessarily, in absolute terms. We say so because the Court, may most likely allow Shridhar to receive at least the principal amount of Rs 10,000 lent by him to Ram Lakhan, together with the amount of accrued interest, though only at a reasonable rate, and not force Shridhar to forego the entire amount of the principal and interest lent by him to Ram Lakhan. This remedy seems to be most reasonable to meet the ends of justice. We may say so because, as provided by the Act, the contract may be set-aside only in part, if the aggrieved party, in the case of a voidable contract, - who was entitled to avoid the contract (viz. Ram Lakhan in the instant case) - had received some benefits thereunder.

Problem 4

As against the facts of the case stated in Problem 3 above, would the legal position be any different if Ram Lakhan would have, instead, approached a bank for the loan of Rs 10,000, and the bank concerned would have granted him the loan, but on the condition that it would charge him an interest at a rate abnormally higher than the normal rate of interest, on the ground that some stringent situation was prevailing in the money market at the material time, and Ram Lakhan would have agreed to such higher rate of interest, as he was in a disparate need of the money urgently for the marriage of his daughter? Give reasons for your answer.

Solution

Yes, the legal position, under the circumstances cited in the case in question, would have definitely been different. This is so because, as per the provisions contained in the Act, just because a higher rate of interest has been charged, in itself, may not be considered sufficient enough to establish that it has been induced by undue influence.

And, under the circumstances mentioned in the instant case, the condition of charging a higher rate of interest by the bank, on the ground that the money market conditions were quite stringent and tight at the material time, whereby the bank itself could have been able to raise funds at a much higher rate of interest for its own purposes - like for lending money or the like - its act of charging a higher rate of interest than usual from its borrowers, would be deemed to be in the nature of a business transaction, in the ordinary course of business. Accordingly, the contract would not be presumed to have been made under undue influence. This contention is based on the Illustration (a) given at Section 16 of the Act.

Problem 5

Rahman had sold some chickens to Quraishi. The chickens, however, were suffering from some fever. And, Rahman also had full knowledge of the fact that the chickens were suffering from some fever. But then, the chickens were sold by Rahman on the 'as is, where is' situation, i.e. 'with all faults'. Rahman, however, deliberately did not disclose the fact to Quraishi that the chickens were suffering from the aforementioned disease, despite his full knowledge of it, for sure. He, instead, kept silent on this pertinent point. Do you think that such act on the part of Rahman (i.e. deliberately keeping silent on the point of disease the chickens were suffering from) would amount to fraud and hence the contract would be declared as voidable at the option of Quraishi? Give reasons in justification of your answer.

Solution

No, the silence on the part of Rahman, in itself, would not amount to fraud, and hence, the contract would not be declared as voidable at the option of Quraishi. Instead, the contract will be held to be valid in the eyes of law for the following two reasons:

(a) As per the provisions of the Act, a fraud may not necessarily be said to have been involved merely on the ground of maintaining silence regarding some of the facts (like the disease of the chickens in the instant case), on the part of such person, which may even be likely to affect the willingness of the other party.

(b) Furthermore, as the chickens were sold by Rahman on the 'as is, where is' situation, i.e. 'with all faults' (if any), it was the duty of Quraishi to have examined whether the chickens were suffering from some disease or were having some other defects and lacuna, etc. This contention of ours is based on the principle of *'caveat emptor'* which, in the English language, means 'caution buyer' or 'buyer, beware', as contained in the Sale of Goods Act, 1930.

Our foregoing conslusion and stand is based on the observations of the learned judges made in their judgement delivered in the case titled **Ward vs Hobbs, [(1878) A.C. 13]**

Problem 6

Sarvesh had clearly told Hemant that in case he (Hemant) did not deny it, he (Sarvesh) would presume that the horse, being sold by Hemant, was sound. But Hemant had deliberately preferred to maintain perfect silence on this point. Do you think that in this case the silence on the part of Hemant would amount to fraud? Give reasons for your stand, quoting the relative reference from the Act.

Solution

In this case, the silence, on the part of Hemant, would amount to speech, as if saying that the horse was sound, and not unsound. This is so because Sarvesh had clearly told Hemant that in case he (Hemant) did not deny it, he (Sarvesh) would presume that the horse, being sold by Hemant, was sound. But Hemant had kept silent. Thus, in this case, the silence, on the part of Hemant, would amount to speech, as if saying that the horse was sound, and not unsound. This goes to indicate that it is not necessary that

silence will not amount to fraud under all circumstances (as has been the case in the Problem 5 above). In fact, in the illustrative example marked (c) given in Section 17, it has been categorically stated that silence is fraudulent where the circumstances are such that 'silence is equivalent to speech'.

Problem 7

Hemant agrees to purchase some vegetables from Shailendra, but on the strict condition that no urea must have been used for their growth. Shailendra categorically confirms to him with all the confidence at his command, that no urea had been used for their growth. But, as a matter of fact, urea had been used, though only on a very small portion of his farm. It may be further clarified that Shailendra had honestly forgotten that urea had been used, though only on a very small portion of his farm, at the material time, while emphatically confirming to Hemant that no urea had been used for their growth. Do you think that this agreement will be declared as voidable on the ground of misrepresentation? Give reasons for your answer.

Solution

In the instant case, it may be observed that the stipulation that 'no urea had been used for their growth', was of a primary nature, and in a sense a basic condition, without which the contract would not have been entered into. In view of this fact, the contract would be treated as voidable, at the option of Hemant, as it will be deemed to be involving misrepresentation. We say so because Section 18 (3) specifically provides that misrepresentation means and includes 'causing, however, innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the contract'. This stand of ours is based on the observations of the learned judges made in their judgement delivered in the case titled **Bonnerman vs White, [(1861) 142 E. R. 658].**

Problem 8

Shikha had made an offer to Sulekha to sell her scooter to her for Rs 2,500. Sulekha, in turn, had agreed to buy her scooter for Rs 2,500. Both Shikha and Sulekha were very happy at the conclusion of a valid contract to their mutual satisfaction. However, they had come to know only later that, well before the agreement was entered into between the two parties, Shikha's scooter had already been burnt in the course of a communal riot, and it had turned into ashes. It was, thus, a total loss. But then, while entering into the agreement, none of the two parties to the contract were having any knowledge of this fact. Do you think that Shikha's contention that this agreement was enforceable in law as it was entered into in good faith, and without the knowledge of the total burn out of the scooter in question at the time the agreement was actually entered into? Give reasons for your answer.

Solution

No. Shikha's contention that this agreement was enforceable in law, as it was entered into in good faith, and without the knowledge on the part of both the parties to the agreement, regarding the total burn out of the scooter in question at the time the agreement was actually entered into, will not be tenable in the Court of law. On the contrary, the Court, in all likelihood, will declare this agreement as void (and not even voidable) on the ground of mistake of fact. This is so because the scooter, the very subject matter of the agreement, in itself, was non-existent (totally burnt out) at the time the agreement was reached. Thus, it is a clear case of 'Bilateral Mistake of Fact', inasmuch as both the parties to the agreement were under the mistake of fact, which fact was essential to the agreement. Moreover, the aforesaid mistake pertained to the very matter (i.e. Shikha's scooter in the instant case), which was an essential subject matter of the agreement. Accordingly, the agreement so reached will be considered as void, and not just voidable.

Problem 9

Ruqnuddin had sent a letter to Raunaq Singh asking about the price of the plasma TV of a specific brand, and had also indicated to him in the same letter that he may buy 10 pieces of the same. Raunaq Singh had promptly furnished the required information to Ruqnuddin by return mail. Immediately on receipt of the letter, Ruqnuddin had sent a telegram to Raunaq Singh, reading as under: 'Send three plasma TVs'.

But, due to the mistake, on the part of the telegraph department, the message was wrongly transmitted to Raunaq Singh reading as 'Send the plasma TVs'.

On receipt of the telegram, Raunaq Singh immediately despatched 10 pieces of the plasma TVs to Ruqnuddin (relying on the earlier letter that was sent by Ruqnuddin to Raunaq Singh, as aforementioned). But Ruqnuddin refused to pay for 10 pieces of the plasma TV to Raunaq Singh, on the plea that he had ordered for only three pieces of the plasma TV, as per the telegram, and not 10 pieces, as Raunaq Singh had wrongly billed him for. As against this, Raunaq Singh was insisting that Ruqnuddin will have to pay for the full consignment of 10 pieces of the plasma TV, emphatically and forcefully quoting the text of the telegram, read with the earlier letter of Ruqnuddin to him, wherein he (Ruqnuddin) had indicated that he (Ruqnuddin) may buy 10 plasma TVs Getting annoyed, Ruqnuddin refused to pay even for the three pieces of plasma TV and insisted that Raunaq Singh must take back the entire consignment of 10 pieces of the plasma TVs supplied to him by Raunaq Singh. Thereupon Raunaq Singh had filed a suit in the Court of law and prayed in his petition that Ruqnuddin may be made to pay to him the cost of all the ten pieces of the plasma TV, supplied to him as per his order by telegram. What are the chances of Raunaq Singh winning the case? Give convincing reasons for your answer.

Solution

In the instant case, the Court may most likely hold that there was no contract, due to the mistake pertaining to the quantity of the subject matter (i.e. the number of pieces of the plasma TVs required to be actually supplied by Raunaq Singh to Ruqnuddin). Therefore, the prayer of Raunaq Singh for payment of 10 pieces of the plasma TVs will not be allowed by the Court. But then, the Court may ask Ruqnuddin to pay for the three pieces of the plasma TVs to Raunaq Singh, on the ground of the implied contract. This contention is based on the judgement delivered by the learned judges in somewhat similar case titled **Henkel vs Pape, [(1870) 6 Ex. 7].**

Problem 10

Sudhakar had agreed to rent his house to Gaurav on a monthly rental of Rs 21,000. But, in the relative agreement document the rental was, by mistake, typed as Rs 12,000 per month, instead. In your expert opinion, will this agreement be held valid, voidable or void? Give reasons for your answer.

Solution

The agreement in the given case will neither be held valid nor voidable, but will definitely be declared as void, on the ground of the mistake, pertaining to the price of the subject matter of the agreement, i.e. the amount of the rent in the instant case.

Chapter Six

Lawful Consideration

"*The world is ruled only by consideration of advantages.*
Johann Fried rich Von Schiller

A lean compromise is better than a fat lawsuit.
George Herbert
"

6.1 Definition of Consideration

The term, 'Consideration', has been defined in Section 2 (d) as under:

"When, at the desire of the promissor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or promises to abstain from doing something, such act or abstinence or promise is called consideration for the promise." This 'something' may pertain to 'some benefit, right, interest or profit (accruing to one party), and, correspondingly, it may pertain to some forbearance, responsibility, detriment, or loss, suffered or undertaken (by the other party)'. **[Lush J, in Currie vs Misa (1875) L. R. 10 Ex. 162].**

Thus, a consideration pertains to both the (positive) act and the (negative) abstinence, which again may pertain to the past (i.e. already done or abstained from doing), the present (i.e. being done or being abstained from doing), and the future (i.e. yet to be done or yet to be abstained from doing).

To quote Sir Frederick Pollock, consideration is "an act or forbearance of one party or the promise thereof is the price for which the promise of the other is bought and the promise, thus, given for value is enforceable." To put it in a simpler language, the consideration is what the promisor demands, in return, as the price for his promise.

Thus, we may say that 'consideration' is based on the principle of '*quid pro quo*', which means, 'something in return' (for the promise made by one of the parties). That is, while one party promises to give or do something, the other party must also reciprocally promise to give or do something, in return. Alternatively speaking, if the process of giving or doing something is only one-sided, it would mean that the most vital and

essential element (i.e. consideration) is missing in such a promise. Hence, this would not amount to an agreement, on the ground of it being without any consideration, which is the most important and essential element of any agreement, enforceable in law.

6.2 Importance of Consideration

The importance of 'Consideration' has been categorically and clearly emphasised in Section 25, which provides that "An agreement made without consideration is void". Thus, the basic rule: 'No Consideration, No Contract', amply signifies the utmost importance of the presence of the element of consideration to make a contract valid and enforceable in law. Conversely speaking, in the absence of any consideration, the contract is generally declared as void.

[But then, Section 25, and some other Sections, also specifically lay down some exceptional cases, where alone an agreement without consideration (referred to as gratuitous) may as well be treated as valid and enforceable in law. These, however, have been discussed a little later in this chapter.]

Examples

(i) Prakash agrees to sell his car to Dwarka for Rs 50,000. In this case:
   (a) Prakash's promise to sell his car is the consideration for Dwarka's promise to pay Rs 50,000. In a similar and corresponding manner,
   (b) Dwarka's promise to pay Rs 50,000 is the consideration for Prakash's promise to sell his car.

(ii) Let us take another example. Vikas promises to donate a sum Rs 5, 50,000 to a cancer hospital. In this case, while applying the principle of '*quid pro quo*' ('something in return'), we find that the hospital has not promised to give or to do anything in return of the promise of Vikas to donate the amount to the hospital. Thus, it is clear that there is no element of consideration involved in this case. Hence, this promise is void, *ab initio*.

(iii) Similar is the position in the case of **Abdul Aziz vs Mazum Ali [(1914) 36 All. 268].** Here, a person had verbally promised to the Secretary of the Mosque Committee to donate a sum of Rs 500 for the rebuilding of a mosque. But, subsequently, he backed out from his promise, and refused to pay the promised amount. It was held that there was no element of consideration (by way of a reciprocal promise in return to the promise of the first party) in this case. Hence, the agreement was void, and not enforceable in law.

(iv) But the position is slightly different in the case of **Kedarnath vs Gori Mohamed [(1886) 14 Cal. 64].** The relevant facts of the case are given hereunder:

The defendant had agreed to subscribe a sum of Rs 100 for the building of a Town Hall at Howrah. On the basis of his faith in the promise, the Secretary of the Town Hall had called for the plans of the proposed Town Hall, and had also entrusted the construction work to the contractors, and had assured them regarding the payment, too.

In this case, the agreement was held to be enforceable on the ground that there was consideration, on the part of the promisee, in the form of his detriment, inasmuch as he had undertaken the liability for payment to the contractors, based on the aforementioned promise, made by the defendant. Conversely speaking, if the promisee had not undertaken any liability for the payment to the contractors (and the like), based on the aforementioned promise, the agreement would have been void, for lack of consideration.

In this connection, it may be pertinent to note that, in such a situation, the liability of the promisor would be limited to the amount of his promise, or the amount of expenditure actually incurred, on the basis of such promise, whichever is lesser of these two amounts. That is to say that, if the actual expenditure were Rs 500, he would be liable to pay only Rs 100, as promised by him. And, in case such expenditure was Rs 75, he would be required to pay Rs 75 only, and not the promised amount of Rs 100. This would be the effect of the clause reading as 'whichever is lesser of these two amounts.'

6.3 Essential Ingredients of Consideration

As is inherent in the definition of consideration, [as given in Section 2 (d) above], there are the following main necessary elements of consideration, which have been discussed hereafter, one after the other.

6.3.1 Consideration Should be at the Desire of the Promisor

The consideration should be at the desire of the promisor. In other words, the act, done at the desire of any third party, would not constitute the required consideration.

Example

The case of **Durga Prasad vs Baldeo [(1880) 3 All. 221],** discussed hereafter, brings out the involved legal points quite clearly.

The Collector of the area had asked Durga Prasad, a rich person, to construct the market in the town. Durga Prasad had finally constructed the market, and Baldeo had occupied one of the shops therein. Later on, Baldeo had promised to pay to Durga Prasad a certain commission, based on his sales in the shop, as he (Durga Prasad) had built the shops. Afterwards, Baldeo backed out of his aforementioned promise.

It was held that, in view of the fact that the act, of constructing the market, was done by **Durga Prasad**, not at the desire of Baldeo, the promissor (as is required to constitute a valid consideration) but at the desire of the Collector, instead, there was no valid consideration in this case. Accordingly, in the absence of the essential element of a valid consideration, the promise so made by Baldeo was not binding on him.

It may be pertinent to mention here that neither the benefit derived by the promissor, nor the detriment or loss suffered by the promisee, is of any consequence in this case, inasmuch as here, the very basic element of consideration, to be necessarily made by the promissor himself, is lacking. It is thus, here alone that lies the subtle point of distinction between this case and the case of **Kedarnath vs Gori Mohamed [(1886) I.L.R. 14 Cal. 64],** discussed earlier.

6.3.2 Consideration Could Come from the Promisee, or Any other Person

While it is necessary that the (initial) consideration should come at the desire of the promisor himself alone, and of none else, in the case of the reciprocal consideration, it could come from the promisee (usually), or even by any third party, stranger to the agreement. This is so because, when we have a very careful and analytical look at the wordings of Section 2 (d), [which reads as: 'at the desire of the promissor, the promisee or any other person', we find that the phrase 'or any other person' has been used only after the word 'promisee', inasmuch as the coma used after the word 'prommisor' intends to separate the clause 'or any other person' from it (i.e. promissor).

Example

Chinnaya vs Ramayya [(1882) 4 Mad.137], discussed hereafter, is a leading case on this point. An old lady (say Amma), by a deed of gift, had transferred a portion of her landed property in the name of her daughter Ramayya, in return of a commitment from her (Ramayya) to the effect that she would give an annual payment regularly to her aunt (Amma's sister), named Chinnaya**,** as the maintenance allowance, as she (Amma) herself had so far been doing. Ramayya executed the relative written agreement to this effect, in favour of her aunt Chinnaya, the same day. However, Ramayya did not make the promised payment, on the plea that there was no corresponding promise (amounting to consideration) made by her aunt, Chinnaya. Her such plea was rejected on the same ground, as has been discussed in the earlier paragraph (viz. that the 'consideration could come from the promisee' (in this case, Chinnaya) or 'any other person' (in this case, Amma). But under the English Law, the consideration of a stranger (third party) is not considered valid.

'Stranger to the Consideration' vs 'Stranger to the Contract'

We would now try to distinguish between the legal implications of the two terms, viz. 'Stranger to the Consideration ' and 'Stranger to the Contract' itself.

While the elements of 'Stranger to the Consideration' has already been clarified with the help of the aforementioned example of 'Chinnaya vs Ramayya' case**,** those of 'Stranger to the Contract' can be clearly understood with the help of the following examples:

Examples

(a) X has taken some loan from Y. X sells his property to Z. Thus, Z is not a party in the transaction pertaining to the loan given by Y to X. Z, however, promises to X to repay the loan of X taken from Y. Now, in case Z fails to repay the aforementioned loan amount to Y, Y does not have a legal right to file a suit against Z, inasmuch as Z is a stranger to the contract between X and Y.

(b) The father and father-in-law of Anurag entered into a contract between themselves that each of them would pay a certain amount of money to Anurag, after his marriage. His father had paid the money as per his promise. But his father-in-law had failed to do so. It was held that Anurag cannot sue his father-in law to recover the amount from him, on the ground that Anurag was a stranger to the aforementioned contract entered into between his father and his father-in law. **[Tweddle vs Atkinson (1861) 1 B. & S. 393]**

Thus, the rule is that while the stranger to the consideration may sue, the stranger to the contract may not. That is to say that an outsider does not have a *locus standi* (right to appear in the Court) to file a suit in the case of a contract. The rule that a stranger to the contract may not sue is based on the doctrine of **'Privity to Contract'**, which means, being party to the contract. This way, even the beneficiary to the contract, [being the third party (an outsider), other than the two parties to the contract], cannot file a suit, as a general rule. But then, there are certain exceptional cases, wherein even a stranger to the contract concerned, may do so. A detailed discussion on the exceptions to the doctrine of 'Privity of Contract' appears at Appendix 6.1.

6.3.3 Consideration may Pertain to the 'Past', 'Present', or 'Future'

As has already been discussed earlier, as per the wordings of Section 2(d), the consideration, besides referring to both the (positive) act and the (negative) abstinence, may also pertain to the past (i.e. already done or abstained from doing), the present (i.e. being done or being abstained from doing), and the future (i.e. yet to be done or yet to be abstained from doing). Let us now discuss these three considerations, viz. the 'Past', 'Present', or 'Future', in some greater details, one after the other.

(a) Past Consideration

Past Consideration pertains to a situation, where a person has already done something in the past, at the desire of another person, but he has not got any promise from the other person, in return of his such work done, at that very time, but does get the promise only at a later date.

Example

A patient 'P' comes to his doctor friend 'D' for treatment of his ailment. The doctor D treats him, accordingly. But P goes away without making any payment to D towards his professional fee. D does not ask for the payment of his professional fee, either. But later, P offers to pay to D a sum of Rs 1,000, and D agrees to receive such payment. This constitutes a promise from P to D.

Here, we may observe that D had not done anything at the time of P's promise, nor had he promised to do something even at a future date. In fact, he had already done something (treated P) in the past, at the desire of P. Thus, the act of treatment done in the past by D, at the desire of P, constitutes the consideration for P's subsequent promise to pay him the sum of Rs 1,000. This is referred to as the 'past consideration'.

We would, at this stage, prefer to discuss the legal implications of somewhat different situations, by introducing some small but significant variations in the above case.

(a) Let us presume the situation where P might not have made any promise to pay, even at any later date. This situation pertains to the provision that the beneficiary of a non-gratuitous act may have to pay even without an agreement to this effect. This matter has been discussed in detail in the Chapter 9, titled 'Quasi Contracts'.

(b) Let us presume another situation where D might have treated P without his such request. In this case, if P had promised later (i.e. after the treatment) to pay, it would amount to a promise without consideration. But then, this situation would be covered under the exception (to the doctrine of consideration) provided under Section 25 (2), whereby P will be held liable to pay under his promise for the voluntary services of D, by way of the treating P, even without his request to this effect.

(c) Let us presume yet another situation where D might have treated P without his such request, and also where P, even at a later date, might not have promised to pay to D. In this case D would not be able to claim the payment from P, if he happened to be a major, due to the lack of consideration. But then, in case P would have been a minor, and D must have known that P was a minor, D would be able to claim the payment from P, on the ground of the rule of 'minor's liability to necessaries', discussed earlier in Chapter 4.

(b) Present Consideration

As against the past consideration, the present consideration refers to the case where the consideration, in response to the promise, is provided immediately at the very time of entering into the contract, and not at a later date. This is also referred to as the 'executed consideration'.

A reference to the discussion on the 'executed contract' in Chapter 2 may amply clarify the point. An executed contract has been referred to as the one, which has been fully completed, and nothing further remains to be done, as per the terms of the contract.

Example

Ramesh agrees to buy a second-hand car, from Rakesh against payment in cash. Rakesh delivers the car to Ramesh, and Ramesh, in turn, pays the agreed amount to Rakesh in cash. Thus, the entire required terms and conditions of the contract have been completed in all respects, and nothing remains to be done now any further, on the part of either of the two parties to the contract.

In this case the consideration, too, is in the nature of a present consideration.

(c) Future Consideration

As against the present consideration, the future consideration refers to the case where the consideration, in response to the promise, still remains to be provided at a later date.

A reference to the discussion on the 'executory contract' in Chapter 2 may amply clarify the point. An executory contract**,** as against the executed contract, is one where either all or some of the requirements, as per the terms and conditions of the contract, still remain to be completed by both or any one of the parties involved in the contract. That is to say that something further still remains to be done. Let us repeat the same example here, too.

Example

On the 1st November 2008, Ramesh agrees to buy a second-hand car, from Rakesh against payment in cash on the 30th November 2008. Thus, as on the 1st November 2008, through the 30th November 2008, the contract remains just an **executory contract**, as none of the terms of the agreements have yet been performed by either of the parties. Thus, in this situation, the consideration, too, is in the nature of a future consideration.

6.3.4 Consideration must be 'Something of Value'

This means that whatever is thought to be given, as consideration for the promise, must be something of value

or significance, in the eye of law. That is, the interpretation of the word 'something', appearing in Section 2 (d), entirely depends upon the interpretation, contained in the various decisions of the Court. Accordingly, with a view to getting sufficiently elaborate and clear idea about the various connotations, inherent in the key words 'something of value', we must refer to the main points contained in some of the relevant court decisions: the case laws.

1. Consideration Need not be Adequate

The principle that, the consideration need not be adequate, has been derived from the observation of the Court, in the case of **Bolton vs Maden, [L.R. 9 Q.B. 55]**, which reads as under:

"Adequacy of consideration is for the parties to consider at the time of making the agreement, not for the Court when it is sought to be enforced." Conversely speaking, even an apparently inadequate consideration would be held valid, if it has been obtained by free will, and not otherwise. A reference to Section 25 (Explanation 2) clarifies the legal point beyond doubt, as it reads as under:

"An agreement to which the consent of the promissor is freely given is not void merely because the consideration is inadequate; but the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promissor was freely given."

Example

Ganga Ram sells his car worth Rs 2 lakh to Sohan for just Rs 10,000, instead. Here, the inadequacy of the price in itself would not render the contract as void. But then, if Ganga Ram pleads that he had not given his consent for the transaction with his free will, but, say, under undue influence, coercion, or fraud, the Court, in such case, would definitely take into account the inadequacy of the price, while deciding whether the consent was given with free will or otherwise.

2. Consideration must be Real, and Not Worthless or Illusory

A agrees to sell is horse worth Rs 1,000 for Rs 10 only. The consideration is valid, though inadequate, as there is something of value to be given by the buyer. It is real, and not worthless, nor illusory**.** As against this, the consideration, like the promise to turn an iron rod into gold by some chemical process, is not valid inasmuch as it is an impossible, unreal and illusory act.

3. Consideration must Not be a Pre-existing Duty

If a person is already bound to perform some duty under law, or as per his service rules, or under some contract, and if he promises to do the same thing on some payment for doing it, it would not form a valid consideration.

Example

(i) The Court has issued summons to a person to appear before it, to give the evidence in a case. And, if some other person (say, one of the parties in the case), with a view to ensuring his appearance in the Court on the appointed date and time, promises to pay him some extra money (other than his actual travel expenses), it would be void, for want of consideration. This is so, because the person was doing only what he was already required to do under the law. Hence, no payment need be given to him, as he was not doing anything more than his normal legal duty, which he is already bound to perform, anyway, as per the law **[Collins vs Godfrey (1831) 100 E. R. 1040]**

(ii) Supposing that a person has engaged a lawyer to plead his case on the usual fee. But later, the client promises to pay to the lawyer some extra amount, if he would plead his case in the best possible manner, such that he wins the case. Finally, he wins the case. Here, the client is not bound to pay the extra amount promised by him, inasmuch as it was the bounden duty of the lawyer to plead the case in the best possible manner. **[Ramchandra Chintaman vs Kalu Raju (1877) 2 Bom. 362]**

(iii) Let us take yet another example, which is slightly different, but has great legal implications. A team of policemen is entrusted with the job of finishing a dacoit, and, an award, too, has been announced on his head. The team succeeds in killing the dacoit. Here, though it was the bounden duty of the policemen to do the job entrusted to them, the announcement of the award had motivated them to work even harder, and therefore, the extra risks taken and the extra efforts made, would constitute the consideration for that extra work, well beyond the usual duty. Accordingly, it was held that the team could claim the award on the ground of that extra 'something', as aforementioned (i.e. the extra risk and efforts, beyond their normal official duty). **[England vs Davidson (1840) 19 L. J. Q. B. 287]**.

However, more than ordinary care needs to be taken to guard against any misuse (by the public servants), of such observations made in the English case, cited above.

4. Consideration may be Either an Act or even Abstinence

As already mentioned earlier, the consideration pertains to both the (positive) act and the (negative) abstinence. In other words, it may pertain to an action, which is a positive feature of consideration. Such positive feature of considerations appears in most of the examples given above. But then, it may as well have a negative feature in the form of agreeing not to do something; that is, to abstain from doing something, in exchange of something. Let us now consider such examples hereafter.

Examples

(a) To abstain from filing a suit

That is, the abstinence or forbearance to file a suit means abstaining from exercising the legal right to file a suit. And, such abstinence would constitute a valid consideration, forming a valid contract.

Examples

(i) A wife had a right to file a suit against her husband to claim maintenance allowance from him. The husband offered to pay her a certain amount per month towards her maintenance allowance, provided she did not sue him in the Court. The wife agreed to abstain from filing the case. It is an example of a valid consideration by way of abstinence (i.e. a negative action or inaction, as you may choose to call it). The elements of valid considerations are on the part of both the parties:

  (a) On the part of the husband, by way of a positive promise by him to pay the monthly maintenance allowance to his wife, and

  (b) On the part of the wife, by way of a negative abstinence from filing the suit, that is, her promise not to file the suit, to which she was rightfully entitled. **[Debi Radha Rani vs Ram Das ((1941) AiRpat 282].**

(ii) In the case of **Kastoori Devi vs Chiranjilal [(1960) A.I.R. All. 446],** it was held that even a promise to withdraw a case would amount to a valid consideration (by way of withdrawing, and thus, abstaining from perusing the case).

(iii) As against the aforementioned examples, a "forbearance in respect of a non-existing claim would be no forbearance at all". **[Krishna Chander vs Hemja Sankar Nandi (1917) 22 Cal. W.N. 463].** In other words, the claim itself, which forms the very basis of the intended suit, must be a bona fide one. That is, a promise to abstain from doing something, which, in itself, is illegal or impossible, would not amount to consideration. For example, to promise not to kidnap one's son, or else to run one km. in less than a minute (being illegal and impossible, respectively) would not constitute a consideration.

6.3.5 Consideration must be Lawful

More importantly, the consideration of giving something, and receiving something in return (not necessarily in terms of money alone) must be lawful and real. Conversely speaking, any unlawful and unreal consideration would render such contract as void.

As provided under Section 10, an agreement can be a valid contract only if it is made for both a lawful consideration as also a lawful object. Alternatively speaking, if either the consideration or object of an agreement is unlawful, or both its consideration and object are unlawful, the contract so entered into would be invalid and void.

Further, according to Section 23, the consideration and the object of an agreement are considered unlawful in the following cases:

1. If either is forbidden by law,
2. If either is of such a nature that if permitted, it would defeat the provisions of any law,
3. If either is fraudulent,
4. If either involves or implies injury to the person or property of another, and
5. If the Court regards either as immoral or opposed to public policy.

In view of the fact that the aforementioned points, pertaining to the illegality of the consideration, are equally applicable to the illegality of the object of an agreement, too, we propose to discuss them all simultaneously, in the next Chapter 7 on 'Lawful Object'.

6.4 Exceptions to the Rule: "No Consideration, No Contract"

The general rule of law, as provided under Section 25, is that an agreement without consideration is void. That is why, Lord Loughborough has so succinctly asserted: "A bargain without consideration is a contradiction in terms and cannot exist." But then, Section 25 itself also specifically provides certain exceptions to this rule, in which cases an agreement, even without consideration (referred to as gratuitous agreement), may be considered valid and enforceable in law. Some exceptions have been provided in the other Sections, too (in addition to Section 25), which have been discussed hereafter.

Exception 1. Promise made out of natural love and affection [Section 25 (1)]

As provided in Section 25 (1), an agreement without consideration is valid if "it is expressed in writing, and registered under the law for the time being in force for the registration of documents, and is made on account of natural love and affection between parties standing in a near relation to each other".

We may, thus, observe that Section 25 (1) stipulates that the aforementioned four essential conditions must necessarily be fulfilled to avail of the benefits of this exception; that is, to make such an agreement (even without consideration), valid and enforceable in law. These are:

(a) It must necessarily be in writing. To put it differently, a verbal agreement would not be valid.
(b) Further, it must be registered, too, as per the requirements of the law.
(c) Third, it must be entered into out of natural love and affection between the parties. It may, however, be noted here that the closeness of relationship, in itself, would not necessarily mean natural love and affection.
(d) Last but not the least, the two parties must be in near relationships. It may be clarified here that the near relationship should normally be in the nature of blood relationship, or by marriage. Thus, two very fast and close friends would not be held to be the persons in near relationship.

Examples

(i) A person promised, in writing, to pay the debts of his younger brother on account his natural love and affection, and got it duly registered, as required by law. It was held that the agreement was valid, as per the exception contained in Section 25 (1). **[Venkatswamy vs Rangaswamy (1903) 13 MLJ 428].**
(ii) A Mohammedan, through a written and registered document, promised to pay his earnings to his wife. It was held that this agreement, despite being without any consideration, would be valid as it satisfies the conditions stipulated in Section 25 (1). **Poonoo Bibi vs Fyaz Buksh (1874) Bom LR 57].**
(iii) A couple used to always quarrel. One day husband (H) promised to pay to wife (W) a certain amount every month towards her maintenance, as also a separate residence, without any consideration. H had

made such promise in writing, wherein it was also mentioned that there had been quarrels and disagreements between his wife and himself. The document got duly registered, too, as per the legal requirements for the purpose. Afterwards, H refused to keep his promise. W filed a suit against H. The court did not allow W any relief, whatsoever, on the ground that, as there was no natural love left any more between them (signified by the quarrels and disagreements between them). Accordingly, the provisions of this exception did not apply in this case. W, however, could file another case to claim her maintenance allowance, but under some other law, instead. **[Rajlakhi Debi vs Bhootnath Mukerjee ((1900) 4 Cal WN 488].**

(iv) But in another case of **Bhiwa vs Shivaram [(1899) 1 Bom LR 495]**, the Court had held quite a different view. The relevant facts of the case are given hereunder:

The two brothers, X and Y, were having some litigation regarding some property. Finally, X had lost the case. Subsequently Y, through a written and duly registered agreement, promised to give half of his property to X. But, later Y backed out of the promise. Thereupon, X filed a suit against Y for the enforcement of the agreement. The Court observed that, notwithstanding the fact that the two brothers had litigation against each other in the past, the very fact that Y had later preferred to make the aforementioned promise subsequently, this act in itself, was a sign of this having been made out of the natural love and affection for the brother, the blood relation. The Court had, accordingly, held that the exception applied in this case, and that Y was liable to comply with his promise.

Exception 2. Promise to Compensate for Past Voluntary Services [Section 25 (2)]

One of the essential ingredients of a valid consideration is that it should have been provided at the desire of the promissor himself. Thus, if one party has rendered a service to the other party, that is voluntarily, without the desire of the other party, whether it would amount to a valid consideration, for the promise of the other party given in return thereto (in the absence of his such express will, at the material time, when the service was rendered voluntarily)? Let us explain the situation with the help of an **Illustrative Example.**

Raghunath loses a packet, containing some of his share certificates, on his way to the share broker's office. Saurabh finds these share certificates lying on the roadside, and with some sincere efforts, succeeds in tracing the house of V Raghunath, and returns these share certificates to him. Raghunath promises to pay to Saurabh a certain sum of money for the aforementioned service rendered by him, though voluntarily. And, Saurabh agrees. Now, we have to take a view, as to whether such promise, made by the promisor, without the required will of the finder, is enforceable in the absence of the consideration.

To form a firm opinion on this legal point, we must refer to the exceptional situation specified under Section 25 (2), which stipulates as under:

An agreement without consideration is valid if "it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do".

Thus, we find that the situation, referred to in the aforementioned example, satisfies all the requirements of the exception provided in Section 25 (2). Accordingly, the promise made by the owner of the packet to its finder would be enforceable in law.

Exception 3. Promise to Pay a Time-Barred Debt [Section 25 (3)]

As provided under Sub-Section 25 (3), an agreement to pay a time-barred debt would be valid, even without consideration, provided some other conditions are satisfied.

Sub-Section 25 (3) reads as under:

An agreement without consideration shall be valid, if "it is a promise, made in writing and signed by the person to be charged therewith or by his agent generally or specially authorised in that behalf, to pay wholly or in part debt of which the creditor might have enforced payment but for the law for the limitation of suits".

The Limitation Act, 1963, provides the law pertaining to limitations in India. This Act has provided different time limits for exercising the right to sue the other party, under different circumstances. An ordinary debt, however, becomes time-barred after expiry of three years. Therefore, the lawsuit must be filed (i.e. the legal

action must be initiated), well before the expiry of three years; otherwise the right to sue would lapse and become time-barred. Thus, if a debt has become time-barred, a promise to pay the time-barred debt (amounting to being without consideration), would normally be void. But then, the Sub-Section 25 (3) provides that if some other conditions are also satisfied, such promise, even without consideration, would be held valid and binding upon the promisor, and the time-barred debt would become payable. The other specified conditions, required to be fulfilled, are discussed hereunder:

(a) There must be a clear and existing debt, of a certain amount, which would have been otherwise actually enforceable in law, but for it's having, by now, become time-barred. Thus, a contingent liability (which, in fact, does not constitute a debt), would not be covered under this exception. Moreover, the debt must be of a certain amount. Thus, a promise to pay whatever amount is due, after taking the accounts, would not be covered under this provision. **[Chowksi vs Chowksi, 8 Bom. 194].**

(b) There must be an expressed promise (to pay the debt), and not just an implied promise. For example, the statement from the debtor that he owes to the creditor a debt of Rs 10, 000, in itself, would not amount to a promise to pay.

(c) Further, such an expressed promise should be to pay the time-barred debt, and not just an acknowledgement thereof. That is, if the debtor just says that he owes a sum of Rs 10,000 to the other party, it would not amount to a promise to pay the debt, and accordingly, this exemption would not apply in such a situation. But then, an acknowledgement of a debt may extend the period of limitation by another three years, provided it has been given before the debt has already become time-barred.*

(d) The promise to pay the time-barred debt must come from that very person who was originally liable under the debt. In other words, the provisions of the Sub-Section 25 (3) do not apply in the case where the third party (i.e. the person other than the original debtor) makes such a promise to pay the debt owed by the original debtor. **[Pestonji vs Meherbai, 30, Bom. LR 1407].**

(e) The promise so made must be in writing, and must be duly signed by the original borrower himself. Such written promise could be prepared by way of a separate document, specifically prepared for the purpose, or else it may be given even by way of a simple letter.

Exception 4. Completed Gift [Section 25 (Explanation 1)]

A promise to give a gift would be void for want of consideration. But then, if the gift so promised, has not just been promised, but has actually been given, would be valid, and accordingly, it cannot be undone or invalidated on the ground of lack of consideration. Thus, the recipient of the gift becomes its rightful owner. This is so because, Section 25 (Explanation 1) dealing with the matter of completed gift reads as under:

"Nothing in this section shall affect the validity, as between the donor and donee, of any gift actually made."

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* Incidentally, it may be mentioned here that an acknowledgement of a debt can be given in different ways, so as to get the limitation period extended, from time to time. Such various legal means are**:**

(a) A letter from the borrower, duly signed by him, acknowledging the debt, before it has already become time-barred, extends the limitation period by three years, from the date of such letter. (Section 18 of the Limitation Act, 1963). That is to say that a mere acknowledgement of the debt can extend its limitation period, only if given before the debt has already become time-barred, but not thereafter. But a time-bared debt cannot be revived by mere acknowledgement, In other words, an acknowledgement can only revive an existing (i.e. 'living' and not time-barred) debt, and it cannot revive an expired ('dead' or time-barred) debt. This can be done only under the exception provided in Section 25 (3) `of the Indian Contract Act..

(b) A letter, signed by the borrower, even if denying the debt, has the effect of extending the limitation period. Therefore, the creditor (like a banker) must also carefully preserve such letter.

(c) Any transaction/operation (deposit or withdrawal) on the account also extends the limitation periods. Further, a deposit by the borrower, or by his authorised agent, has the effect of extending the limitation period. And remember that the person/employee of the borrower who frequently visits the branch of the bank, to transact business, on behalf of the borrower, can be treated in law, as the authorised agent.

(d) By getting the confirmation of the debit balance on the account outstanding on a particular date, duly signed by the borrower, and thus, the debt's limitation period gets extended for three years from the date of such letter/ confirmation.

Exception 5. Remission of Promise (Section 63)
A person, being the promisee, may have some contractual rights against the other party. But then, if he agrees to give some one-sided concession, in regard to the performance of the contract by the other party (referred to as 'remission', in the legal parlance); such remission would be valid even if given without consideration. That is, it shall be binding on the person allowing such remission (Section 63).

Exception 6. Contract of Agency (Section 185)
Section 185 specifically provides that no consideration is necessary to create an agency (i.e. the relationship of agency). That is, if a person has agreed to act as an agent of another person, even without any remuneration for the work done, the valid relationship of agency between the two parties would get created even without consideration. But then, such agreement as such, would be void for lack of consideration, if it has not been actually executed (i.e. the gratuitous agent has not already started acting as the agent). In other words, if such a gratuitous agent wants to back out, he can do so, but only till he has not started acting as an agent. And, the moment he actually starts working as an agent under the agreement, such agreement would be deemed executed. Thus, the agent would be entitled to act as an agent of the other party, and bind the principal (the other party).

Exception 7. Creation of Bailment
Consideration is not necessary for effecting a bailment (Section 148).

Let us Recapitulate

(a) The consideration is what the promisor demands, in return, as the price for his promise. Thus, it is based on the principle of '*quid pro quo*', which means, 'something in return'. The consideration pertains to both the (positive) act and the (negative) abstinence, which again may pertain to the past (i.e. already done or abstained from doing), the present (i.e. being done or being abstained from doing), and the future (i.e. yet to be done or yet to be abstained from doing).

(b) Section 25, provides that "An agreement made without consideration is void". Thus, the basic rule: 'No Consideration, No Contract', amply signifies the utmost importance of the element of consideration to make a contract valid.

(c) Essential Ingredients of Consideration

(i) The consideration should be at the desire of the promisor, and not that of any third party. While the (initial) consideration should come at the desire of the promisor himself, the reciprocal consideration could come from the promisee (usually), or even by any third party, stranger to the agreement. Further, the rule is that while the stranger to the consideration may sue, the stranger to the contract may not. That is, an outsider does not have a *locus standi* (right to appear in court) to file a suit in the case of a contract. It is based on the doctrine of 'Privity to Contract', which means, being party to the contract. But then, there are some exceptions to the rule (vide Appendix 6.1).

(ii) Consideration, besides referring to both the (positive) act and the (negative) abstinence, may also pertain to the past (i.e. already done or abstained from doing), the present (i.e. being done or being abstained from doing), and the future (i.e. yet to be done or yet to be abstained from doing).

(iii) Consideration must be real, and not worthless or illusory. It, however, need not be adequate.

(iv) Consideration must not be a pre-existing duty

(v) Consideration may be either an act, or even abstinence

(vi) More importantly, the consideration of giving something, and receiving something in return, must be lawful and real.

According to Section 23, the consideration and the object of an agreement are unlawful in the following cases:

(i) If either is forbidden by law,

(ii) If either is of such a nature that if permitted, it would defeat the provisions of any law,
(iii) If either is fraudulent,
(iv) If either involves or implies injury to the person or property of another,
(v) If the Court regards either as immoral or opposed to public policy.

(d) Exceptions to the Rule: "No Consideration, No Contract"

Exception 1. Promise made out of natural love and affection, between parties standing in a near relation to each other (out of blood relation or by marriage), provided it is expressed in writing, and is duly registered as required by law. [Section 25 (1)]

Exception 2. Promise to compensate for past voluntary services [Section 25 (2)]

Exception 3. Promise to Pay a Time-Barred Debt [Section 25 (3)], provided that

(i) There is a clear and existing debt, of a certain amount, which would have been otherwise actually enforceable in law, but for it's having become time-barred.
(ii) There must be an expressed promise (to pay the debt), and not just an implied promise.
(iii) Further, such an expressed promise should be to pay the time-barred debt, and not just an acknowledgement thereof.
(iv) The promise must come from that very person who was originally indebted, and not by any outsider (third party).
(v) The promise so made must be in writing, and must be duly signed by the original borrower himself. It could be prepared as a separate document, or by a simple letter.

Exception 4. In the case of a Completed Gift [Section 25 (Explanation 1)]

Exception 5. In the case of Remission of Promise (Section 63).

Exception 6. In the case of Contract of Agency (Section 185).

Exception 7. In the case of effecting a bailment (Section 148).

Questions for Reflection

1. "The consideration pertains to both the (positive) act and the (negative) abstinence, which again may pertain to the past, the present, and the future." Elucidate, by citing suitable examples in each case.
2. (a) "An agreement made without consideration is void". Explain, with the help of suitable illustrative examples.
   (b) The basic rule: 'No Consideration, No Contract', has some exceptions, too. Do you agree? If so, explain the exceptional cases, where an agreement, even without consideration, may be treated as valid and enforceable in law. Illustrate your points, by citing suitable examples.
3. Specify the other additional necessary legal requirements, if any, in the following cases, where an agreement, even without consideration, may be treated as valid and enforceable in law:
   (i) Promise made out of natural love and affection.
   (ii) Promise to pay a time-barred debt.

   Explain, with the help of some illustrative examples in each case.
4. Bring out the various necessary elements of 'consideration', with the help of illustrative examples in each case.
5. Explain the following, by citing suitable illustrative examples in each case:
   - Consideration may pertain to the 'Past', 'Present', or 'Future'.
   - Consideration may pertain to some 'action' or even to some 'abstinence'.
   - Consideration must be 'Something of Value', but need not necessarily be 'Adequate', too.
   - Consideration must not be a 'pre-existing duty'.
   - Consideration must be 'Lawful'.

6. Distinguish between 'Stranger to the Consideration' and. 'Stranger to the Contract'
7. Discuss the doctrine of 'Privity of Contract', as also the various exceptions thereto, with the help of illustrative examples in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

Sandeep had sold his house to Bachchan for Rs 10 lakh. It was only later that he came to know that it was even conservatively estimated to be worth at least Rs 25 lakh. Immediately thereafter, he preferred to back out and refused to perform the contract by giving an undisputed possession of his house to Bachchan, on the plea that the sale price was too inadequate, and that he (Bachchan) must pay him Rs 15 lakh more, when alone he will sell his house to him. Thereupon, Bachchan filed a suit against Sandeep to perform the valid contract entered into between them. What are the chances of Bachchan winning the case? Give reasons for your answer.

Solution

Bachchan will, for sure, win the case, on the legal ground that even an apparent inadequacy of the price in itself does not render the contract as void. This is so because a valid contract must have consideration, all right. But then, the adequacy or inadequacy of the consideration money is to be decided between the parties to the contract themselves at the time of entering into the contract, and the Court of law need not interfere in the question of its adequacy or otherwise. Such contention is based on the lines of the observations made by the learned judge in the case titled **Bolton vs Maden, [L.R. 9 Q.B. *55*]**. Moreover, Section 25 (Explanation 2) of the Act clarifies the instant legal point beyond doubt, by stipulating that 'An agreement to which the consent of the promissor is freely given is not void merely because the consideration is inadequate….'

Problem 2

Had the position in Problem 1 above been any different if Sandeep would have pleaded, instead, that he had sold the house to Bachchan at a throwaway price because he was forced to do so by Bachchan under threat to his life? Give reasons for your answer.

Solution

It is true that even an apparent inadequacy of the price in itself does not render the contract as void. Even Section 25 (Explanation 2) of the Act stipulates that 'An agreement to which the consent of the promissor is freely given is not void merely because the consideration is inadequate….' In the first part of the sentence, it has been clearly stated that the agreement will be valid provided the consent has been given freely by the promissor. And the second part of the same sentence further amplifies and clarifies the legal point when it asserts that '… the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promissor was freely given.' Therefore, if Sandeep will plead that his free will was conspicuously absent in the instant case, the Court will definitely examine his such plea, because the sufficiently lower sale price gives a significant doubt that the element of free consent might probably be lacking in the instant case. But then, it needs to be emphasised here that it will be only after Sandeep will be successful in proving that he was coerced to sell his house under some threat to his life by Bachchan, that the contract will be treated as void for want of free consent, but not otherwise. Thus, it may be observed here that as per law, the substantially lower consideration price only gives substantial ground just to presume that the element of free consent might be missing, as it might have been obtained under coercion or by exercising undue influence and the like. But the insufficient consideration in itself will not go to declare the contract as void. On the contrary, the person who pleads that the element of free will was lacking, will have to first establish that his aforementioned contention is true and proved beyond doubt.

Problem 3

Karan had engaged Lalwani, an eminent lawyer, to plead his case in the Supreme Court on the usual fee of Rs 2 lakh. After a month, as the case was progressing, Karan promised to Lalwani that he would pay him an

additional sum of Rs 1 lakh, if he would plead his case in the best possible and professional manner, such that he finally wins the case. Lalwani most willingly accepted this offer of Karan. Incidentally, Karan happened to win the case. Thereupon Lalwani asked Karan to pay him the extra Rs 1 lakh, as was promised by him (Karan). But Karan refused to make such payment to Lalwani. Thereupon Lalwani filed a suit in the Court to claim the promised money from Karan. Do you think that Lalwani will win the case? Give reasons for your answer.

Solution

No. Lalwani will, for sure, lose the case, because, as has been provided in the Act, the client is not bound to pay the extra amount promised by him, inasmuch as it was the bounden duty of the lawyer to plead the case in the best possible manner. The Act clearly provides that if a person is already bound to perform some duty under law, or as per his service rules, or under some contract, and if he promises to do the same thing on some extra payment for doing it, it would not form a valid consideration. Thus, Lalwani is not entitled to receive the payment of the additional Rs 1 lakh, though Karan had promised it.

This contention is based on the decided case titled **Ramchandra Chintaman vs Kalu Raju, [(1877) 2 Bom. 362].**

Problem 4

Hasan and Wafa, husband and wife respectively, had somehow developed somewhat strained marital relationship between them just within a couple of months of their marriage. They were mostly found fighting with each other. One day Hasan, while he was in a happy mood, promised to pay to Wafa a sum of Rs 10,000 per month towards her maintenance, and also to provide a separate residence, there being no consideration, whatsoever, notwihstanding. Hasan had made the aforementioned promise in writing. The document was also got duly registered, as per law. Besides, in the legal document, it was also specifically stated that there had been frequent quarrels and disagreements between the two (viz. Hasan and Wafa). But soon thereafter, Hasan refused to keep his promise any more. Consequently, Wafa filed a suit against Hasan. Hasan pleaded in the Court of law that as the agreement was made without consideration, whatsoever, it should be declared as void, on the legal principle that 'No consideration; no contract'. This legal principle, in itself, is made on the basis of the specific provision made under Section 25, to the effect that 'an agreement made without consideration is void'.

(a) Do you think that the contention of Hasan will be held valid in the eye of law?
(b) What are the chances of Wafa winning the case? Give specific reasons for your specific stands on both the aforementioned points.

Solution

(a) As regards part (a) of the question, pertaining to the contention of Hasan that the agreement was made without consideration, we will prefer to first discuss, in detail, the various legal points involved in the case, before coming to a sound legal decision in the matter. As we all know, Section 25 of the Act provides that an agreement made without consideration is void. But then, it (Section 25) also stipulates certain exceptions to the aforementioned rule. And one of the exceptions, found relevant in the instant case, has been stipulated in Section 25 (1), which categorically provides that an agreement without consideration is valid if 'it is expressed in writing, and registered under the law for the time being in force for the registration of documents, and is made on account of natural love and affection between parties standing in a near relation to each other'.

We, thus, observe that Section 25 (1) stipulates the following four specific essential conditions, which must necessarily be fulfilled to avail of the benefits of this exception, under which even an agreement made without consideration may be held valid and enforceable in law. These four essential conditions are:

(i) It must necessarily be in writing. To put it differently, a verbal agreement would not be valid.
(ii) Further, it must be registered, too, as per the requirements of the law.
(iii) Third, it must be entered into out of natural love and affection between the parties. It may, however, be emphasised here that the closeness of relationship, in itself, would not necessarily mean natural love and affection.

(iv) Last, the two parties must be in near relationships. And the near relationship should normally be in the nature of blood relationship, or by marriage (i.e. between husband and wife, as in the instant case).

On the first, fast and somewhat superfluous reading, we may observe that all the four conditions, stipulated under exceptions made under Section 25 (1), seem to have been fulfilled, and therefore, we may hasten to conclude that the contention of Hasan is not valid. But on a closer examination and scrutiny of all the four conditions, deeply and separately, we find that only the conditions stipulated under exceptions 'a', 'b', and 'd' above [viz. pertaining to the agreement being in writing, it being duly registered, and that the agreement must be between close relations, by blood or in marriage (i.e. between husband and wife, in the instant case)], seem to have been fulfilled. But as regards the condition mentioned under item 'c' above, we find that the following two specific elements must be present in this category of the exception to make an agreement, even without consideration, as valid. These two conditions are the following:

(i) The agreement must be entered into out of natural love and affection between the parties to the contract, and that

(ii) The closeness of relationship, in itself, would not necessarily mean natural love and affection. And this second provision is of utmost importance and relevance in the instant case.

Hasan should, therefore, be well-advised to specifically argue in the Court of law that, though the agreement was entered into in writing, and that it was registered too, plus that it was entered into between close relations (i.e. between husband and wife), the fourth essential element attached to Section 25 (1), viz. that the agreement must be entered into out of natural love and affection between the parties to the contract is conspicuously absent in the instant case.

This is so because the closeness of relationship, in itself, cannot necessarily mean the existence of natural love and affection between the two parties. And, in the instant case, the very fact (as also specifically mentioned in the written and registered legal agreement document) to the effect that there had been frequent quarrels and disagreements between the two (viz. Hasan and Wafa), it will definitely go to incontrovertibly prove in the Court of law that the essential element of love and affection was conspicuously and irrefutably absent between Hasan and Wafa at the time the agreement was entered into between them. Accordingly, the agreement will not come within the purview of the aforementioned exception. And, therefore, the general rule of 'No consideration, no contract' will apply in the instant case, and not the exception provided under Section 25 (1). Therefore the agreement will be held void for want of consideration.

(b) Regarding part (b) of the question, Wafa is most likely to lose the case because, as already explained in detail at item (a) above, the contract will be treated as void as one of the essential elements, viz. consideration, is conspicuously missing in the instant case. This is substantiated by the fact that the couple were mostly found fighting and differing with other. Under the circumstances, as one of the essential elements, viz. love and affection is conspicuously found missing, the exception provided under Section 25 (1), which makes a contract valid even without consideration, will not apply in the instant case. Accordingly, the contract will be deemed as void, and the case of Wafa will be dismissed on the aforementioned ground.

This contention is based on the already decided case titled **Rajlakhi Debi vs Bhootnath Mukerjee, [(1900) 4 Cal WN 488]**, wherein the court had not allowed Wafa any relief, whatsoever, on the ground that there was no natural love left any more between them (signified by the quarrels and disagreements between them). Accordingly, the provisions of this exception did not apply in this case, and Wafa had lost the case.

But then, as was observed by the learned judge in the above-cited case itself, Wafa could file another case to claim her maintenance allowance from her husband, Hasan, but under some other law, instead.

Problem *5*

Ram had made a written promise to Rahim, his fast friend right from his early childhood, to the effect that he will pay his (Rahim's) debts, not for any consideration, whatsoever, but by virtue of his natural love and affection for him, arising out of their long and fast friendship for years. Further, Ram had got this agreement document even duly registered, as required by law. Later, some differences developed between them so

much so that Ram refused to keep his aforementioned promise. Thereafter, Rahim filed a suit against Ram for the performance of the contract, claiming that the agreement entered into between him and Ram were covered under the exception to the rule viz. 'No consideration, no agreement', as stipulated under Section 25 (1) of the Act. What are the chances of Rahim winning the case? Give reasons for your answer.

Solution

Rahim has no chance of winning the case. In fact, he is most likely to lose the case for the following reasons:

We may observe that though some of the conditions stipulated under Section 25 (1), like the agreement had been entered into in writing, and that the same was got registered as well, have been satisfied in the case in question, it does not satisfy the condition to the effect that the agreement must be entered into on account of natural love and affection between the parties, standing in a near relation to each other. Here the clause 'standing in a near relation to each other' is of prime essence. And, it may be clarified here that the near relationship should normally be in the nature of blood relationship (like brothers and sisters), or by marriage (viz. husband and wife). Alternatively speaking, two very fast and close friends would not be considered to be the persons in near relationship. Accordingly, the contention of Rahim that the agreement was made by Ram out of love and affection does not seem to be valid enough, even though it has been so mentioned in the agreement document, because the law stipulates that natural love and affection will be presumed only in the cases of blood relationship and out of marriage, and not otherwise, e.g., between fast friends, as is the position in the case in point. Therefore, the provisions of Section 25 (1) will not be applicable in the instant case. Accordingly, the Court is most likely to declare the agreement between Ram and Rahim as void, on the ground of it having been made without any consideration.

Problem 6

Subhash promises to pay the time-barred debt of Rs 5 lakh obtained by his friend Rameshwar from the Punjab National Bank, Gomti Nagar branch in Lucknow. He sends a letter duly signed by him to this effect to the branch manager concerned. The branch manager happily keeps the aforementioned letter of Subhash, thinking that the loan of Rs 5 lakh, granted to Rameshwar, and which had by then become time-barred, had since been revived by virtue of the aforementioned letter of Subhash, whereby an agreement to pay a time-barred debt would be valid, even without consideration, as per the provisions of the Sub-section 25 (3) of the Act. Do you think that the contention of the bank manager is legally valid? Give reasons for your answer.

Solution

No. The contention of the bank manager is not legally valid, because one of the conditions stipulated under Section 25 (3) clearly states that the letter to agree to repay the time-barred debt must come from that very person alone who was originally liable to repay the debt. In other words, the provisions of the Sub-section 25 (3) do not apply in the case where the third party (i.e. the person other than the original debtor) makes such a promise to pay the debt owed by the original debtor. Thus, the letter of Subhash (he being the third party, and not the original debtor) will not be deemed to revive a time-barred debt. In fact, the bank manager must have tried to obtain such letter duly signed by Rameshwar, instead, so as to get the time-barred debt revived, as per the provisions of Section 25 (3) of the Act.

Appendix 6.1

1. Some Exceptions to the Doctrine of 'Privity of Contract'

The doctrine of **'Privity of Contract'** (which means, being party to the contract), stipulates the rule that a stranger to the contract may not sue the party to the contract. This doctrine has, by and large, been considered valid in the Indian context, too, in several cases. But then, the Courts may prefer even to make some reasoned exceptions to this general rule, wherever the ends of justice may demand so, depending upon the merit of each specific situation separately. In other words, the Courts may allow the exception in such cases where the strict observance of the doctrine of privity of contract may amount to serious injustice. Some such especial cases, situations and circumstances, have been discussed hereafter:

1. (a) Beneficiaries of a Trust

The person for whose benefit the trust has been created is referred to as its beneficiary. And, in the case of trusts, the beneficiary may enforce the contract, even without being a party thereto.

Example

Philip has formed a trust, and has appointed T as its trustee, with the arrangement that the income arising from the trust property would be handed over by him to B. In this case, B is the beneficiary. Thus, in the event of non-compliance of the aforementioned arrangement on the part of T, even B (a stranger to the contract) by virtue of his being the beneficiary, can file a suit to recover such amount from him (T). **[Rana Uma Nath Baksh Singh vs Jang Bahadur (1938) AIR PC 245]**.

1 (b) Beneficiaries of an Implied Trust

It may be pertinent to mention here that such trust need not be an actual and proper trust as such; it may even be an implied (or constructive) trust, wherein such exception could be made available.

Example

A person sends a registered and insured parcel, through a post office to the addressee named thereon. The parcel is not delivered to the addressee. In this case, the addressee happens to be the beneficiary of the implied trust (created between the sender and the postal authorities), and he can file a case to claim the compensation from the postal authorities. **[Chaudhry Amir Ullah vs Central Government (1959), All IJ 271].**

2. In the case of a Family Settlement

(**a**) At the time of the partition of the property of a joint Hindu family, the male members may agree to set aside a certain portion of the property, say, to meet the expenses of education and marriage of a female child, or for the benefit of some aged person, and so on. In this situation, such persons (by virtue of being the beneficiaries of the arrangement), can avail of the right to file a suit to claim their respective shares. **[Sundararaja vs Lakshmi Ammal (1914) 38 Mad 788].**

(**b**) Similarly, if the daughter had agreed with her father to maintain her mother, provided the father's property was assigned to her; the mother, under such circumstances, can file a suit, as and when required. **[Veeramma vs Appaya (1957) AIR AP 965].**

(**c**) Again, if the wife leaves her husband's house, due to some ill treatment, and the husband agrees with his father-in-law to treat her well henceforth, failing which he would provide her with monthly

maintenance allowance and a separate house to live in, the wife is entitled to sue her husband, if needed. **[Daropti vs Jaspat Rai (1905) PR 171].**

3. In the case of a Contract of Marriage

The father of a minor girl had agreed to marry off his daughter to a person. That person, however, had later broken the contract. In this case, the girl, on attaining her age of majority, can file a suit against the person, though she was not a party to the contract concerned. **[Rose Fernandez vs Joseph Gonsalves (1924) ILR 48 Bom 673].**

4. In the Case of Assignment of Rights

Where a person assigns (or transfers) his rights to some other (third) person or party, such third person, by virtue of being the assignee, can enforce such rights in his own name, even though he is not a party to the contract. For example, if the insured person assigns his life insurance policy to the bank, say, for raising some loan there-against, the bank, despite being a party outside the contract (between the person insured and the insurance company concerned) can enforce the rights of the insured person, by virtue of being the assignee. Similar will be the position in the case of the official assignee of an insolvent person, too.

Chapter Seven

Lawful Object

"*Nothing can have value without being an object of utility.*
Karl Marx

Management by objective works — if you know the objectives. Ninety percent of the time you don't.
Peter F Drucker

The object of living is work, experience, and happiness. There is joy in work.
Henry Ford

Can there be a love, which does not make demands on its object?
Confucius

The object of love is to serve, not to win.
Woodrow Wilson"

We have already seen in the preceding Chapter 6 that the consideration of an agreement (of giving something, and receiving something, in return) must be lawful. Likewise, the objective of an agreement also must be lawful. In other words, any unlawful object (like any unlawful consideration) would render such contract as void (Section 10).

7.1 Distinction between 'Consideration' and 'Object'

In an agreement, while the 'consideration' pertains to the content (of the agreement), involving giving something, and receiving something in return, the 'object' refers to the 'purpose', or the intended 'end-result' thereof. Let us take some illustrative examples to bring home the subtle distinction between the two.

Examples

(i) Ramulu agrees to rent his house to Rohan for residential purposes, at a monthly renal of Rs 5,000. Here the consideration of giving the house on rent, in exchange of the rental of Rs 5,000 per month is legal, and so is the object, too, i.e. of using the house for residential purposes. But then, if the purpose of renting the house would be to run a gambling den, instead, the object in this case would be illegal, and hence, the contract will be void and unenforceable in law.

(ii) Let us take another example. Tom hires Dick for Rs 1 lakh to murder Harry. In this case, both the consideration and object are unlawful, rendering the contract as void and unenforceable in law.

7.2 Unlawful Consideration and the Object

According to Section 23, the consideration and the object of an agreement are deemed unlawful in the following cases:

(a) If either is forbidden by law
(b) If either is of such a nature that if permitted, it would defeat the provisions of any law
(c) If either is fraudulent
(d) If either involves or implies injury to the person or property of another
(e) If the Court regards either as immoral, and
(f) If the Court regards either as opposed to public policy.

The aforementioned points, pertaining to the illegality of both the consideration and object, are discussed simultaneously, in this Chapter, one after the other.

(a) If Either is Forbidden by Law

If the object and/or consideration of an agreement involve some action, which is forbidden by law, such agreement would be considered as void. And, an act or undertaking is treated as unlawful, when it is punishable under the criminal law of the country, or else when it is prohibited by some other special legislation passed by the legislature (vide Pollock and Mulla, Indian Contract Act, p.138).

Examples

(i) A loan given to the father or guardian of a minor, for celebrating the marriage of the minor, which is, obviously, in contravention of the Child Marriage Restraint Act, would be deemed as illegal, and therefore, not valid and enforceable in law. That is the amount of such loan cannot be recovered through the intervention of the Court. **[Srinivas vs Raja Ram Mohan (1951) 2 MLJ 264].**

(ii) An agreement to drop a case filed by X against Y, for committing a robbery, on the condition that Y will restore to X the value of the things, taken away by him, is invalid and void, inasmuch as the object (i.e. of dropping the case for robbery, punishable under the Indian Penal Code) is unlawful. **[Illustration (h) to Section 23].**

(b) If Either is Likely to Defeat the Provisions of any Law

In the case, where either the consideration or the object of the agreement is such that, though not specifically prohibited under any laid-down law, it may, in effect, defeat the provision of any law, the agreement so obtained will be void.

Examples

(i) The estate of A has been sold to recover the arrears of revenue, as per the laid-down law. Further, under the law, the defaulter concerned (viz. A) is prohibited to purchase his estate so sold. A, with a view to circumvent such legal provisions, enters into an agreement with B, such that the estate may initially be

purchase by B, and later it may be transferred back to A for the actual amount earlier paid by B, in this regard. This agreement is void, in that the aforesaid transfer of property by B to A, in effect, amounts to purchase by A himself, which is prohibited under law. **[Illustration (i) to Section 23]**

(ii) An accused person A, requesting for the grant of bail, was required to furnish a surety for the amount of Rs 5,000 for his good conduct during the period of the bail. But, no one was coming forward for the purpose. Accordingly, A requested a person S to stand as a surety to him on the condition that he (A) would pay the proposed surety S the sum of Rs 5,000 for his doing so, such that he (S) may not stand to lose the money in case A did not maintain good conduct. A, however, did maintain good conduct during the period of the bail, whereby S did not have to suffer any pecuniary loss, whatsoever. Accordingly, A filed a suit against S for the recovery of Rs 5,000 paid to him earlier. The case was naturally dismissed on the plea that that the agreement was void, on the ground that it had defeated the provision of the law to the effect that the surety is supposed to incur personal risk, for giving the guarantee for the accused to be released on bail. **[Fateh Singh vs Sanwal Singh (1878) 1 All 751].**

(iii) An agreement entered into between a debtor and a creditor (e.g., the borrower and the bank, respectively) to the effect that the debtor will not take the plea of limitation, even when the debt may become time-barred, will be void, inasmuch as it would, in effect, defeat the provisions of the Limitation Act. **[Ramamurthy vs Gopayya (1917) 40 Mad 701].**

Similarly, an agreement, even in writing, to reduce the period of limitation, from the usual three years to say, three months, six months, one year, and so on (i.e. well within three years), will as well be considered as void, inasmuch as it would also, in effect, defeat the provisions of the Limitation Act. For a detailed discussion on this point, please refer to the portion dealing with Section 28 in Chapter 7.

(iv) Further, an agreement to give a child in adoption in consideration of money, too, is illegal, and hence void. **[Narayan vs Gopalrao (1922) 24 Bom IR 414,** as also **Sitaram vs Harihar (1910) 35 Bom 1696].**

In this connection, it will be pertinent to quote and consider the facts of the case, **Andhara Bank vs Vattikuti Sreemannarayana and others, AIR 2005 Andhra Pradesh 108**.

The borrowers had taken a loan of Rs 69,000 from the Andhra Bank for running the *'abkari'* (liquor manufacturing/selling) business. Later, they had taken the plea that, as the *'abkari'* business in itself was against the public policy, as also against the statutory provisions of the law of the land, the contract concerned was void *ab initio*, under Section 23 of the Contract Act. Therefore, they had refused to repay the loan amount with interest aggregating Rs 1.14,274, and had even further pleaded that the charge of equitable mortgage, created by them in favour of the bank, by the deposit of the title deed, was void, too. The lower Court had accepted their points of contention, and had, accordingly, rejected the claim of the bank.

The bank had thereafter preferred an appeal in the Andhra Pradesh High Court, and had argued that, according to the provisions of Section 65 of the Contract Act, even if the contract were void, the bank was entitled to the restoration of the benefit received by the borrowers. The High Court had taken into account the provisions of Section 23, read with Section 65 of the Contract Act, and had, accordingly, reversed the decision of the lower Court, and had allowed the claim of the bank.

(c) If either is Fraudulent

An agreement to play some fraud against a third person will be void.

Example

An investor A entered into an agreement with a share-broker B to purchase the shares of a company at a premium, with a view to giving the impression to the general public that such shares were worthy of investment, for earning some quick profit. Later, it transpired that the share–broker B had sold his own shares, instead of making any fresh purchases from the secondary market, as instructed by A. Accordingly, A applied to the Court for rescission. But no relief was granted to him on the plea that the agreement was intended by A to cheat and defraud the public. **[Scott vs Brown (1891) All ER Rep 654].**

(d) If Either Involves or Implies Injury to the Person or Property of Another

An agreement, involving attempt to cause harm to a person or to his property or reputation (even falling outside the injury through criminality, already covered under the first part of the Section 23), will be regarded as unlawful.

Example

(i) Abdul took a loan of Rs 100 from Mathews and, in return, executed a bond to serve for him for two years without any payment. It was held that it amounted to slavery, and was, therefore, injurious to the person of the promisor (Abdul). Accordingly, the agreement was declared unlawful and void. **[Ram Saroop vs Bansi Mandar (1915) 42 Cal 742].**

(ii) Similarly, in the case of **Brown Jenkinson vs Perry Dalton (1957) 2 QB 621**, the agreement to compensate a person for loss, to be suffered by him, for publishing a libellous or defamatory material against a third person was also held to be void, inasmuch as it aimed at causing injury to the reputation of the third person concerned.

(e) If the Court Regards Either as Immoral

All agreements, involving any act, which is considered to be immoral in the opinion of the Court, are considered to be void. The element of morality or otherwise is decided by the Court, taking into account the tradition of the respective community involved in each case, prevailing and practised at the material time.

Examples

(i) M enters into an agreement with L that he (M) will pay her (L) some agreed amount, to enable her to seek a divorce from her husband, and thereafter she will marry him (M). M was not allowed by the Court to recover the amount from L, on the ground that the agreement in question aimed at encouraging extra-marital relationship, which is considered to be immoral. **[Baivijli vs Nansa Nagar (1885) 10 Bom 152]**.

(ii) Similarly, the promotion of prostitution, too, is considered to be an immoral act in all the societies, from time immemorial. For example, if A knowingly gives his car on hire to P (a prostitute) to enable her to go to her customer's place, the agreement, being for immoral act and purpose, will be held void. **[Pearce vs Brooks (1886), LR 1 Ex 213].**

(f) If the Court Regards Either as Opposed to Public Policy

The term 'public policy' has a very wide and sweeping connotation, which gives the Court a very wide and far-reaching discretionary power and authority to determine what is opposed to public policy, or otherwise. The 'doctrine of public policy' means that the Courts must discourage all such acts which involve public mischief, or which may harm the public welfare, and the interest of the State. But some authorities have opined that this doctrine is a 'vague and unsatisfactory term' and, therefore, may be compared to an 'unruly horse'. But then, over a period of time, the position has somewhat stabilised in the sense that some definite categorisation of the acts, considered to be opposed to the public policy, have since crystallised under different heads. The Supreme Court of India has also provided some very sound guidelines in this regard, and has also counselled that the Courts, should not invent new heads, as far as possible. Some such heads have been discussed hereafter.

7.3 Some Heads of Agreements Opposed to Public Policy

The following heads of agreements have already been declared by the Courts in India, in the past, as being opposed to public policy.

(a) Trading with Alien (foreign) Enemy

All the citizens of that country (living anywhere in the world), as also the residents of that country, which is at war with India, are regarded as the alien (foreign) enemies. And, all contracts, involving any economic or business transactions with such alien (foreign) enemies, will be considered as void, on the ground that these are against public policy. This is so because any such transaction may tend to help the enemy country, in some way or the other. This point has already been discussed in detail earlier in Chapter 4, Sub-section 4.1.4 (i) (a).

(b) Trafficking (sale) in Public Offices and Titles

The term 'trafficking', in the present context, stands for sale, trade or business. And the term 'public office' stands for a position of the State Authority. The public office is expected to promote public and national interests, and refrain from becoming instrumental in making some private gains. Accordingly, any agreement, involving any such attempt, will be considered as void. .

Thus, an agreement, whereby a public office is sold for some financial gains, in disregard of the merit and the laid-down rules and regulations in this respect, would be declared void, inasmuch as this way some undesirable elements may also enter into the public offices, which may go against the interest of the public services. **[Puttu Lal vs Raj Narain, 29 ALJ 397].**

Examples

(i) A agrees to secure a job for B in some public service on payment by B of some agreed amount to A for the purpose. This will be a void agreement by virtue of its being against public policy.

(ii) Similarly, if A agrees to secure a seat for B in some medical or engineering institution on payment by B of some agreed amount to A for the purpose, it will be a void agreement for the same reason, that is, because of it being against public policy. **[N V P Pandian vs M M Roy (1979) AIR Mad 42].**

(iii) If A would agree to pay to B an agreed sum of money, provided B would retire from his job so that A may get the same, this would again be considered as against public policy, and hence, void. **[Saminatha vs Muthusami (1907) ILR 30 Mad 530].**

(iv) The Secretary of the College of Ambulance Limited had promised to one Parkinson that he would arrange for the award of the title of the knighthood to him provided he would donate a substantial amount to the college. It was held that the agreement was void; it being against public policy **[Parkinson vs College of Ambulance Limited (1925) 2 KB 1].**

(c) Interference with the Course of Justice

Any interference with the course of justice, like in the functioning of the Courts, may prove prejudicial to meeting the free and fair ends of justice, and, therefore, it will be deemed to be against public policy.

Examples

Accordingly, any agreement to give money for procuring some false evidences **[Ko Pa Tu vs Azimulla (1940) AIR Rang 73]**, or an agreement to delay the execution of a decree, **[Nand Kishore vs Kunj Behari Lal (1933) AIR All 303]**, or even an agreement to perform some *'puja'* (worship) with a view to securing judgement in favour of a person in some legal suits **[Sati Bhagwan Das Shastri vs Raja Ram (1927) AIR All 406],** all these agreements would be declared as void.

(d) Stifling Criminal Prosecution

Any agreement, which stifles or suppresses the prosecution and punishment of a criminal, or even reduces the chances of the prosecution being carried to its logical end, would be deemed illegal and void, on the ground of it being against public policy. Similarly, an agreement to withdraw a criminal suit against payment of some agreed amount would be against public policy, and hence void.

In the case **[Williams vs Bayley (1866) LR 1 HL 200],** the learned judge had observed: "You shall not make trade of felony (a serious crime). If you are aware that a crime has been committed, you shall not convert that crime into a source of profit or benefit to yourself." Similarly, an agreement between a person (father) and a banker, to save his son from being proceeded against in a criminal case of forgery, would be void, too. In the same way, an agreement to pay some money to a person, who happens to be an eye witness to some criminal offence, on the condition that he would not give his evidence in the Court, will also be unlawful and, thus, void.

(e) Maintenance and Champerty

The term, 'maintenance' pertains to an arrangement whereby a person agrees to assist another person financially (by giving grants or loans) or even by giving some professional advice, to pursue or defend the litigation against a third person. The term, 'champerty' (pronounced as 'shamperty'), however, refers to giving a similar kind of help, but against some bargain, like in consideration of an agreed share in the award granted in the judgement. That is, if A gives a loan of Rs 10,000 to B to pursue the legal suit for recovery of a sum of Rs 1 lakh, from C, and A agrees to get back only the loan amount with interest, if any, it would be a case of 'maintenance'. But then, if A wants to get say, 30 per cent of the awarded amount of Rs 1 lakh, received by B from C, on B's winning the case against C, it would be treated as a case of 'champerty', instead.

We may, thus, observe that, as the suppression of a justified punishment is deemed as being against public policy, so is the encouragement or incitement to frivolous litigation, too, inasmuch as this may amount to promoting avoidable litigation in the society. But in India, all the cases of maintenance and champerty are not necessarily treated as illegal. Instead, as opined by the Courts, only in the following two types of situations would such agreements be automatically declared as illegal in India, [and not in all the cases (except under especially justifiable circumstances], as is the prevalent situation in England). Thus, in India, all the agreements involving the elements of maintenance and champerty are deemed to be valid, except in the following two types of situations and cases only:

(i) Where the Terms are Unfair and Unjust to the Person so Helped

In regard to this point, all the maintenance agreements will be considered valid in all the cases. But, in the case of 'champerty' agreements, only such agreements will be held valid where the terms of the agreement (viz. the proportion of the share of the awarded money received by the person so helped in the case) are considered, in the opinion of the Court, to be reasonable. Thus, there have been several cases where the percentage of such share, agreed at 12.5%, 20%, 25%, or even to the extent of 50%, has been held by the Courts to be reasonable and hence valid and binding. But at the same time, even the 6.5 per cent share of the awarded amount was considered by the Court to be unreasonable, because the amount of the award itself was large enough. Hence, this 'champerty' agreement was declared to be void, being against public policy. **[Ratan Chand Hira Chand vs Askar Nawaz Jung (1976) AIR AP112].**

(ii) Where the Motive is Mala Fide

In the cases, where the motive is found by the Court to be mala fide, and not bona fide, such agreements (both maintenance and champerty agreements) will be considered as void. Thus, an agreement by a financer, with another person, to implicate a third person in some false cases out of enmity against him (third person), the agreement would be illegal.

Again, if the financer will indulge in such activity with the purpose of making some quick money by way of speculation and gambling in the litigation, such agreements, too, will be void**. [Ram Coomar vs Chunder Canto Mukherjee (1876) LR 4 IA 23].**

Even an agreement with the lawyer, to the effect that the quantum of his professional fees will depend upon the result of the case, would be considered as being against public policy, and hence void. **[Kothi Jairam vs Vishwanath (1925) AIR Bom 470]**.

(f) Marriage Brokerage Agreements

When one of the parties to the marriage, or their parents, or even some of the third parties, agree to receive some amount of money in consideration of a marriage, it does tantamount to earning brokerage and commission for the marriage. Such agreement is considered to be against public policy, and hence, void. This is so because, marriage has been regarded as a solemn understanding and relationship between the two persons and the two families involved. This, therefore, cannot be allowed to be made a subject matter of trade and financial gains.

Examples

(i) An agreement with the parents of a minor girl to agree to give her in the marriage, in consideration of some payment in this regard, is considered as void. **[Wazarimal vs Rallia (1889) Punj 128].**

(ii) And the sale of a girl has rightly been held as void. **[Girdhari Singh vs Neeladhar Singh (1912 10 All LJ 159].**

(iii) An agreement to procure a wife for a person in consideration of some payment is also held as being against public policy, and hence, void. **[Pitamber vs Jagjiwan ((1884) 13 Bom 131; Vaithyanathan vs Gungarazu (1893) 17 Mad 9].**

(iv) As regards the agreement, involving demand for, and payment of, dowry, in consideration of marriage is unlawful and void; it being against public policy, as also under the Dowry Prohibition Act 1961.

The marriage so performed, however, is held valid. It means that if the dowry amount has not been paid, it cannot be recovered in the Court of law. Similarly, if the amount has already been paid, it cannot be claimed back, either.

It may, however, be pertinent to mention here that the business of marriage bureau does not come within the purview of being against public policy, inasmuch as it only serves as an information centre, providing the information (bio-data, family particulars, etc.) about the availability of the boys and girls, desirous of marriage, and it charges only the professional fee for providing such services. It does not arrange or guarantee any marriage to take place. The marriage, however, is finalised by the persons involved, or by their family members.

(g) Creating an Interest Against Duty

If a person, instead of performing his duty honestly, enters into an agreement, which conflicts with his assigned duty, it shall be deemed as being against public policy, and hence void. **For example**, if a forest officer, entrusted with the duty to check poaching and preserve the forest, enters into an agreement with some timber merchant to supply him the timber, it would be deemed as against public policy and hence, void. Similarly, if an agent enters into some agreement to make some personal profit, out of his agency work, this too, would be void; it being against public policy.

(h) Interfering with the Parental and Marital Rights

Parents have the legal right to keep the custody of their children. Accordingly, any agreement to sell away this right will be held as void. Similarly, the husband and wife enjoy the right to live together. Thus, any agreement to the effect that after the marriage the girl will live with her father, whether her husband lives with his father-in-law or not, will be void. Further, if a man makes a promise to a woman that he will marry her after the death of his wife, such agreement is also held as being against public policy and, therefore, void**. [Roshan vs Muhammad (1887) Punj Rec 46]**

(i) Restrictions on Personal Liberty

An agreement with a person that he will work as a slave or as a bonded labour for some payment (consideration), or even restricting his personal freedom in an unreasonable manner, shall be deemed as being against public policy, and hence void.

Example

A person had borrowed some money and had given an undertaking to the lender that he will not leave his job, or borrow any further money from any one else, or sell his property, or change his residence, without obtaining a written permission from the lender. This agreement was held to be void, as it had unreasonably restricted the personal liberty of the borrower, which is against public policy. **[Harwood vs Miller's Timber Trading Company (1917) 1 Kb 305].**

(j) Creating Monopolies

Any agreement, which may tend to create monopoly in the market, will obviously be against the interest of the general public. It is, therefore, deemed to be against public policy and hence void.

(k) Alienation of Land by Depressed Classes

A plot of land was allotted to a member of the depressed class, under the condition that it will not be sold. But it was sold under an agreement. Such agreement was held to be against public policy and hence void. **[Papaih vs State of Karnataka (1997) AIR SC 2676]**.

Let us Recapitulate

While the 'consideration' pertains to the content (of the agreement), involving giving something, and receiving something in return, the 'object' refers to the 'purpose', or the intended 'end-result' thereof.

According to Section 23, the consideration and the object of an agreement are deemed to be unlawful in the following cases:

1. If either is forbidden by law,
2. If either is of such a nature that if permitted, it would defeat the provisions of any law,
3. If either is fraudulent,
4. If either involves or implies injury to the person or property of another,
5. If the Court regards either as immoral, and
6. If the Court regards either as opposed to public policy.

Some Heads of Agreements Opposed to Public Policy

(a) Trading with alien (foreign) enemy, that is, with the citizens of that country (living anywhere in the world), as also the residents of that country, which is at war with India, inasmuch as such transaction may tend to help the enemy country.

(b) Trafficking (sale) in public offices and titles, inasmuch as this way some undesirable elements may also enter into the public offices, or may be awarded some titles.

(c) Interference with the course of justice (like in the functioning of the Courts), as such agreement will prove to be prejudicial to meeting the free and fair ends of justice.

(d) Stifling criminal prosecution, that is, suppressing the prosecution and punishment of a criminal, or even reducing the chances of the prosecution being carried to its logical end. .

(e) Maintenance and champerty, as these may tend to encourage frivolous and avoidable litigation in the society. But in India, all the agreements involving the elements of maintenance and champerty are deemed to be valid, except in the following two types of situations and cases only:

(i) Where the terms are unfair and unjust to the person so helped, and
(ii) Where the motive is mala fide.

(f) Marriage brokerage agreements, where marriages are arranged in consideration of some money, which amounts to brokerage. However, the business of marriage bureau does not fall under this category, as it serves only as an information centre.
(g) Creating an interest against duty, that is where a person, instead of performing his duty honestly, enters into some agreement, which conflicts with his assigned duty.
(h) Interfering with the parental and marital rights, that is, to sell away one's legal right to keep the custody of the sons and daughters, or insisting that after the marriage the girl will live with her father, whether her husband lives with his father-in-law or not, or even a promise to marry a woman after the death of his wife.
(i) Restrictions on personal liberty, like an agreement with a person that he will work as a slave or as a bonded labour for some payment (consideration).
(j) Creating monopolies.
(k) Alienation of land by depressed classes.

All the aforementioned agreements are held to be against public policy and hence, void.

Questions for Reflection

1. Bring out the distinguishing factors/features of 'Consideration' and 'Object', with the help of some illustrative examples.
2. Under what different circumstances and cases are the consideration and object of an agreement deemed to be unlawful? Explain, with the help of some illustrative examples in each case.
3. Discuss each of the following circumstances and cases, wherein the consideration and object of an agreement are deemed to be unlawful. Elucidate your answer with the help of some illustrative examples in each case.
   (i) When either is forbidden by law,
   (ii) When either is of such a nature that if permitted, it would defeat the provisions of any law,
   (iii) When either is fraudulent,
   (iv) When either involves or implies injury to the person or property of another,
   (v) When the Court regards either as immoral, and
   (vi) When the Court regards either as opposed to public policy.
4. Some authorities have opined that the 'doctrine of public policy' is a 'vague and unsatisfactory term', which may well be compared to an 'unruly horse'. Do you agree? Give reasons for your answer.
5. (a) What are the various heads of agreements opposed to public policy? Write short notes on each of them with the help of some illustrative examples in each case.
   (b) The Supreme Court of India has provided some guidelines in regard to the 'doctrine of public policy'. Has it also given some considered counsels to the Courts in India with a view to averting the risk and fear of its misuse? If so, what are the specific points of such legal counselling?
6. Write short notes on the following heads of agreements opposed to public policy, by citing illustrative examples in each case, to amplify the legal points involved:
   (i) Trading with alien (foreign) enemy,
   (ii) Trafficking (sale) in public offices and titles,
   (iii) Interference with the course of justice,
   (iv) Stifling criminal prosecution,

(v) Maintenance and champerty,
(vi) Marriage brokerage agreements,
(vii) Creating an interest against duty,
(viii) Interfering with the parental and marital rights,
(ix) Restrictions on personal liberty,
(x) Creating monopolies,
(xi) Alienation of land by depressed classes.

7. What are the specific connotations of the following terms, used in the context of the heads of agreements opposed to public policy?
   (a) Alien enemy,
   (b) Public offices and titles,
   (c) Trafficking in regard to (b) above,
   (d) Maintenance
   (e) Champerty
8. (i) In India, all the agreements, involving the elements of maintenance and champerty, are deemed to be valid, except in some specified situations and cases. Do you agree? And, if so, what are these situations? Explain with the help of some illustrative examples.
   (ii) Is the legal position any different in England? Explain.
9. Does the business of marriage bureau fall under the category of 'marriage brokerage agreements', one of the heads of agreements opposed to public policy? Give reasons for your specific answer.

Problems for Practice (With Suggested Solutions)

Problem 1

Raghunath was desperately in need of money to celebrate the marriage of his daughter Rukmini, aged 15 years, who had already attained the age of puberty. Sudhakar had come to his rescue in time and had lent him a sum of Rs 10,000, on the condition that Raghunath must return the amount to him as soon as he (Raghunath) is able to sell the stocks of wheat after harvesting his field. But even after selling the harvested wheat, Raghunath failed to repay the loan to Sudhakar. Thereupon, Sudakar had filed a suit against him (Raghunath) for recovery of the amount lent by him to Raghunath. What are the chances of Sudhakar winning the case? Give reasons for your answer.

Solution

There is no chance of Sudhakar winning the case because he had lent the amount to Raghunath for the purpose and object of celebrating the marriage of his daughter, who was a minor at the material time. Thus, the marriage in question, being obviously in contravention of the Child Marriage Restraint Act, would be deemed as illegal - it being forbidden by law. Thus, the consideration and the object of the agreement in question will be deemed to be unlawful, under Section 23 of the Act. Therefore, the agreement entered into between Sudhakar and Raghunath, in itself, would not be held as valid and enforceable in law. Accordingly, the amount of such loan cannot be recovered through the intervention of the Court. This contention is based on the decided case titled **Srinivas vs Raja Ram Mohan, [(1951) 2 MLJ 264].**

Problem 2

Robert had committed robbery in the house of Shrikant, whereafter Shrikant had filed a criminal case against Robert. Later on, they had entered into an agreement to the effect that Shrikant will drop the case against Robert if he (Robert) will return to Shrikant the value of the things, taken away by him. Do you think that this agreement will be held valid in the eye of law? Give reasons for your answer.

Solution

No. This agreement will not be held valid in the eye of law. Instead, it will be held as void. This is so because, robbery is a crime punishable under the provisions of the Indian Penal Code (IPC). Thus, an agreement to drop a case pertaining to committing a robbery is invalid and void, inasmuch as the object (i.e. of dropping the case for robbery, punishable under the Indian Penal Code) is deemed unlawful. This stand is based on the illustration (h) given to Section 23 of the Act.

Problem 3

Ahmed's bungalow was sold to recover the arrears of revenue, as per the laid-down law. It may be pertinent to point out here that, as provided under the law, the defaulter concerned (viz. Ahmed in the instant case) was prohibited to purchase back his bungalow so sold. But then Ahmed, with a view to circumvent such legal provisions, had entered into an agreement with Bhasin, to the effect that the estate may initially be purchase by Bhasin, and later it may be transferred back to Ahmed against payment of the actual amount earlier paid by Bhasin in this regard. Do you think that this agreement entered into between Ahmed and Bhasin will be deemed to be valid, or void in the Court of law? Give reasons for your answer.

Solution

This agreement will be declared as void in the Court of law because the transfer of Ahmed's bungalow by Bhasin to Ahmed, in effect, will amount to the repurchase of the bungalow by Ahmed himself, which is prohibited under law. This is so because Section 23 provides that where either the consideration or the object of the agreement is such that, though not specifically prohibited under any laid-down law, it may, in effect, defeat the provision of any law, the agreement so obtained will be void. Therefore, as has been further elucidated in the illustration (i) given to Section 23 of the Act, this agreement will be declared as void.

Problem 4

HDFC Bank advances a sum of Rs 5 lakh to Vish**a**kha against execution of a Demand Promissory Note (DP Note). By way of an abundant precaution, it also gets an additional agreement document signed by Vishakha to the effect that she (Vishakha) will not take the plea of limitation, even when the debt may become time-barred. The agreement document also specifically states that the document has been signed by her (Vishakha) with her free will, and that no undue influence was exercised on her by the bank. However, through an oversight on the part of the bank manager, the D P Note becomes time barred after expiry of three years from the date of its execution. Can the bank take the plea that the D P Note will be still held valid (and not time-barred) on the strength of the additional agreement document signed by Vishakha to the effect that she (Vishakha) will not take the plea of limitation, even when the debt may become time-barred? Give reasons for your answer.

Solution

No. The contention of the bank manager will not be held valid because the additional agreement document signed by Vishakha [to the effect that she (Vishkha) will not take the plea of limitation, even when the debt may become time-barred] will, in itself, be considered as void, inasmuch as it would, in effect, defeat the provisions of the Limitation Act. This is so because Section 23 specifically provides that the consideration and the object of an agreement will be deemed to be unlawful if either is of such a nature that, if permitted, it would defeat the provisions of any law. Accordingly, the agreement so obtained will be void. Therefore, the additional agreement document signed by Vishakha, will be declared as void. This stand is based on the legal case titled **Ramamurthy vs Gopayya, [(1917) 40 Mad 701]**.

It may be further pertinent to mention here that even the plea – that the document was executed by Vishakha out of her free will and without any undue influence exercised on her – will not be of any significance in the instant case, either, because the agreement, in itself, has already been considered as void on some other valid legal ground, as aforementioned.

Problem 5

Rahim had taken a loan of Rs 25,000 from Shahim, which he had promised to repay to him on or before the 25th June 2009. Rahim, however, failed to repay the loan amount to Shahim on the due date. Thereafter,

Shahim proposed to him that he would excuse the entire loan amount of Rs 25,000, if Rahim would execute a bond to the effect that he (Rahim) would serve for him (Shahim) for three years without any payment. Rahim executed the bond as was desired by Shahim. Do you think that the document in question will be held valid, voidable or void? Give reasons for your answer.

Solution

The bond executed by Rahim will be declared as void (and not valid nor voidable) because it had amounted to slavery, and was, therefore, injurious to the person of the promisor (Rahim, in the instant case). Besides, it was unlawful, too. Accordingly, the agreement will be declared as unlawful and, therefore, void. This is so because Section 23 provides that 'every agreement of which the object or consideration is unlawful is void'. This contention is also supported by the decided case titled **Ram Sarup vs Bansi Mandar, [(1915) 42 Cal 742].**

Problem 6

Adam had fallen in love with a married woman named Candida, so much so that he wanted to marry her. He, therefore, entered into an agreement with Candida to the effect that he will pay her a sum of Rs 10 lakh on the condition that she would seek a divorce from her present husband named David, and thereafter, she will marry him (Adam). Candida readily agreed, and Adam paid her the agreed amount, too. But later on, Candida backed out and refused to seek divorce from David. Thereupon, Adam became furious and filed a suit against her for the recovery of the amount of Rs 10 lakh he had paid her for the aforementioned purpose. What are the chances of Adam winning the case? Give reasons for your answer.

Solution

No. Adam has no chance of winning the case to recover the amount of Rs 10 lakh from Candida, because the agreement in question was aimed at encouraging extra-marital relationship, which is most likely to be regarded as immoral, and accordingly unlawful, in the opinion of the Court. Further, as Section 23 provides that 'every agreement of which the object or consideration is unlawful is void', the instant agreement entered into between Adam and Candida will as well be declared as void, and unenforceable in law. Thus, Adam will not be able to get the amount of Rs 10 lakh back from Candida. This contention is also supported by the decided case titled **[Baivijli vs Nansa Nagar (1885) 10 Bom 152]**.

Problem 7

Arun was not able to get admission in any of the medical colleges, as he had failed to score the desired marks in the test. When he had gone to meet the Director of one of the reputed medical colleges with a request for his admission in his college, he (Director) flatly refused to oblige him. Thoroughly shattered and disappointed, he met Rohan on his way back home. Rohan agreed to secure a seat for him (Arun) in the same medical college provided he paid him a sum of Rs 5 lakh for the purpose. Arun gladly agreed to the proposal. Do you think that a valid contract had been entered into between Arun and Rohan? Give reasons for your answer.

Solution

No. The contract entered into between Arun and Rohan will not be considered as valid, but void, because it is most likely to be considered by the Court as being against the public policy and hence unlawful. Further, as Section 23 provides that 'every agreement of which the object or consideration is unlawful is void', the instant agreement entered into between Arun and Rohan will also be declared as void, and unenforceable in law. This contention is based on the legal points decided in the case titled **N V P Pandian vs M M Roy, [(1979) AIR Mad 42].**

Chapter Eight

Agreements Expressly Declared as Void; Contingent Contract; and Quasi-Contract

"

The good of the people is the greatest law.
Marcus T Cicero

When we come into contact with the other person, our thoughts and actions should express our mind of compassion, even if that person says and does things that are not easy to accept. We practice in this way until we see clearly that our love is not contingent upon the other person being lovable.
Thich Nhat Hanh

Laws are not invented. They grow out of circumstances.
Azarias

Commerce flourishes by circumstances, precarious, transitory, contingent, almost as the winds and waves that bring it to our shores.
Charles Caleb Colton

Sales are contingent upon the attitude of the salesman — not the attitude of the prospect.
Alice Mary Hilton

A person's worth is contingent upon who he is, not upon what he does, or how much he has. The worth of a person, or a thing, or an idea, is in being, not in doing, not in having.
Alice Mary Hilton

Newsmen believe that news is a tacitly acknowledged fourth branch of the federal system.
P J O'Rourke

Life is not a series of gig lamps symmetrically arranged; life is a luminous halo, a semi-transparent envelope surrounding us from the beginning of consciousness to the end.
Virginia Woolf

If anything goes bad, I did it. If anything goes semi-good, then we did it. If anything goes real good, then you did it. That's all it takes to get people to win football games.
Bear Bryant

A void agreement is one, which is deemed as if not having been made at all. It is void *ab initio* (i.e. right from the very beginning). We have already examined in the earlier chapters as to under what different situations and circumstances can an agreement be considered as void, viz. when entered into by incompetent parties, when it has been made without consideration, or with an unlawful consideration and/or object, when it is against public policy, and so on. However, **Section 10** has also stipulated that an agreement to be a valid contract should not have been expressly declared as void. And, we find that **Sections 26 to 30, 36, and 56** of the Act are such Sections, which have expressly declared certain agreements as void, by virtue of their very nature itself. We would now proceed to discuss these void agreements hereafter one after the other.

8.1 Agreements in Restraint of Marriage (Section 26)

As provided under **Section 26**, 'Every agreement in restraint of the marriage of any person, other than a minor, is void.'

In this context, the term 'restraint' stands for restrictions. Thus, all agreements, which impose any restriction on the freedom of the adult persons to get married, or to select a marriage partner of their own choice, have been expressly declared as void, inasmuch as it encroaches upon their legal rights to make their own decision in regard to their own marriage, of course, within the legal limits of the marriage laws. Thus, under **Section 26**, all types of restraint to marriage, whether complete or even partial, would render the agreement as void. In other words, a promise not to marry at all, or even not to marry for a few years, or not to marry a particular person or a class of person, will be treated as void.

But then, an agreement that an employee will not marry till a certain age, or up to a certain period, during the period of his or her service, will not be held void but valid, inasmuch as it does not put any restraint on the marriage itself, but only stipulates that in that event the person, while being free to get married, will have to leave the job, prior to his or her marriage.

Let us take another example. A promises to B that he would marry B. This will be a valid contract inasmuch as it is in the nature of a marriage contract, and may finally result in marriage (of A with B), and it does not put any restriction on the marriage as such taking place, though it may imply that A would marry B, and no one else. But then, if A would simply and expressly promise that, if and when he would marry, he would marry B only and none else, such agreement would be void, because it does not amount to a marriage contract (as is the position in the preceding example). It, instead, imposes a restriction on the marriage itself; in that, it is only a promise that if and when he would marry, he would do so with B and B alone. Thus, the terms **'if and when'** go to suggest that, provided he decides to marry at all, meaning thereby that he may or even may not marry at all. Accordingly, it would be like imposing a restriction on marriage itself, and hence, void.

Thus, we may observe that the spirit of the provisions under **Section 26** is that, in the case of an agreement amounting to restraint of marriage, any non-compliance on the part of the defaulting party would not amount to any breach of contract. Further, the restrictions imposed by **Section 26** in regard to the minor's freedom to marry, would be restored to the minor on his or her attaining the age of majority.

8.2 Agreement in Restraint of Trade (Section 27)

As provided under **Section 27,** 'Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.'

8.3 Agreement in Restraint of Legal Proceedings (Section 28)

As stipulated under **Section 28,** all agreements in restraint of legal proceedings are considered as void.

As we have seen in Chapter 7, the consideration and object of an agreement are deemed unlawful if either is of such a nature that if permitted, it would defeat the provisions of any law (**Section 23**). Thus, an agreement entered into between a debtor and a creditor (e.g., borrower and bank respectively) to the effect that the debtor will not take the plea of limitation, even when the debt may become time-barred, will be void, inasmuch as it would, in effect, defeat the provisions of the Limitation Act. **[Ramamurthy vs Gopayya (1917) 40 Mad 701].**

Similarly, an agreement, even in writing, to reduce the period of limitation, from the usual three years to say, three months, six months, one year, and so on (i.e. well within three years), will as well be considered as void, inasmuch as it would also, in effect, defeat the provisions of the Limitation Act. This fact has been further reconfirmed by the provisions in **Section 28** [inserted later by the Indian Contract Amendment Act, 1996 (w.e.f. 8.1.1997)], which stipulates that 'An agreement which provides for forfeiture of any rights arising from a contract, if suit is not brought within a specified period, without regard to the time allowed by the Limitation Act', would be held as void.

It may be pertinent to mention here that, prior to such amendment, the banks were usually taking special care to include a clause in the bank guarantees, issued by them, to the effect that the bank guarantee will be valid for say, six months only from the date of issuance thereof. Such specific date of validity, so calculated, was also usually specified in the guarantee document itself, so as to avoid any confusion in this regard at a later date. But now, since the **amendment of the Section 28**, the beneficiaries of the bank guarantees may no longer be required to invoke the bank guarantee well within such specific date and, instead, they will continue to enjoy the legal right to claim the benefits under the guarantee, as per the Limitation Act [i.e. for three years in the case of private parties, and for thirty years in the case of the Government Departments and Government (Public) Undertakings]. That is, the stipulation in the bank guarantee, reducing the limitation period will be held void.

Exception

But then, an exception has been made in this regard by the Courts, in respect of a clause, which is usually incorporated in the insurance policies, which stipulates that the company shall not be liable if no legal suit is filed within twelve month from the date of the occurrence of the loss. Such clause has been held to be valid (and outside the provision of Section 28) by the Court on the ground that with the passing of unreasonably long time, after the loss has actually occurred, the evidence gradually starts fading out, and thus, it may become increasingly difficult to estimate and accurately compute the actual loss suffered under the policy, and pass the claim accordingly. **[Ghosh vs Reliance Insurance, 11 rang 475; and others].**

[The banks, too, may, therefore, prefer to take the same plea, and continue with the earlier practice (of stipulating a reduced period of limitation, like six months, etc., in their bank guarantees), for whatever worth it may be. They may be well-advised to consult their legal experts on this specific point.]

8.4 Agreements Void for Uncertainty (Section 29)

As stipulated under **Section 29**, 'Agreements, the meaning of which is not certain, or capable of being made certain, are void'.

Examples

(i) S agrees to sell to B 'a hundred tonnes of oil'. In this case, which kind of oil is intended to be sold, has not been specified. Accordingly, this agreement is void for uncertainty.

(ii) But then, let us take another case, where S agrees to sell to B 'a hundred tonnes of coconut oil'. In this case, which kind of oil is intended to be sold has been specified. Accordingly, this agreement will be held as valid, and not void for uncertainty. This is so because, there is no uncertainty regarding the specific oil that is intended to be sold.

(iii) Similarly, in the example (i) above, if S was dealing only and exclusively in coconut oil, the agreement would be held as valid, and not void.

8.5 Agreement by Way of Wager (Section 30)

As provided under **Section 30,** all agreements by way of wager are void.

8.6 Agreements Contingent on Impossible Event (Section 36)

A detailed discussion on this point appears in this chapter, dealing with **Section 36**. item (f).

8.7 Agreements to do Impossible Act (Section 56)

For a detailed discussion on this point, please refer to Chapter 10, item (C), dealing with **Section 56**.

Contingent Contract

8.8 Contingent Contract (Sections 31 to 36)

A contingent contract is such contract where a person agrees to do something, or not to do something, on the stipulated condition of some event, collateral to such contract, taking place or not taking place (**Section 31**).

Example

R enters into a contract with K that he (R) will pay to K a sum of Rs 50,000 in the event of the car of K getting stolen.

This contract is in the nature of a contingent contract in that here R will be required to pay the agreed amount to K only in the event of the car of K getting stolen. That is, till the car of R gets stolen, R need not pay to K any amount under the contract. Similarly, the moment the car of K gets stolen, R is bound to pay the amount to K, as per the contract.

8.9 What are the Essential Elements of a Contingent Contract?

A contingent contract comprises the following essential elements:

(i) The performance of a contingent contract is made dependent upon some event or incident taking place or not taking place (but not otherwise).

(ii) Further, such event or incident, on the happening or not happening whereof the performance of the contract has been made dependent upon, is collateral to the contract. That is, it does not form a part of

the reciprocal promises that are usually made between the two parties involved in a contract. Let us take some illustrative examples in which cases the contract may not be said to be a contingent contract.

Examples

(a) S agrees to sell his second-hand motorcycle to P for Rs 20, 000, and P agrees to buy it, but to make the payment in five equal monthly instalments of Rs 4,000 each. In this case, the contract is in the nature of a conditional contract, and not a contingent contract. This is so, simply because the event on which the obligation of the purchaser P has been made dependent upon is a part of the mutual promise itself between the two parties involved in the contract, instead of it being a contingent or collateral event, unrelated to the promise.

(b) Similarly, if F agrees to pay to G a sum of Rs 2 lakh, if G agrees to marry his daughter D, is also not a contingent contract, on the same aforementioned ground.

(c) Finally, the contingent event should not just be merely a desire of the promissor. Thus, a promise by X to pay Rs 50,000 to Y, if he (X) so desires or chooses to do, is not a contingent contract. In fact, it does not constitute a contact at all, any way.

But then, where the event is within the will (desire) of the promissor, but it does not happen to be merely his will, it may constitute a contingent contract.

Example

M promises to pay to D a sum of Rs 25,000, if D leaves Kolkata for Delhi. It constitutes a contingent contract inasmuch as, though the going to Delhi is undoubtedly an event within D's will, it is not merely his will alone that matters here, as it did in the earlier example, in which case there is 'a promise by X to pay Rs 50,000 to Y, if he (X) so desires or chooses to do'. That is, it is, instead, dependent on D's leaving Kolkata for Delhi, and not just on M's sweet will. That is, the moment D leaves for Delhi, M has no alternative but is obliged under the law to pay the agreed amount to D.

8.10 Rules Pertaining to the Enforcement of Contingent Contracts (Sections 32 to 36)

We will now discuss the various rules pertaining to the enforcement of contingent contracts.

(i) The contracts, which are contingent to, or are dependent upon, the happening of some uncertain event in the future, cannot be enforced under the law unless and until that event actually takes place. Accordingly, if and when the happening of such future event somehow becomes impossible to take place, the contract in question becomes void **(Section 32).**

Examples

(a) S makes an offer to P to sell his car to him at a certain price. (Please take note of the fact that at this stage it is a case of making only an offer by S to P, and the contract will be complete between S and P only after the offer is accepted by P). Thereafter, S enters into a contract with A (as against just making an offer to A) to sell his car to him at a certain price, but only in the event of P refusing the offer made to him earlier for purchasing the car. This contract, however, cannot be enforced until and unless P refuses the offer made to him earlier for buying the car. Similarly, the moment the refusal of the offer comes from P, S will be obliged under the law to sell the car to A.

(b) P enters into a contract with S to buy the motorcycle of S, if P survives X, that is, if X dies during the lifetime of P. This contract can be enforced only if and after X dies (and not until and unless X dies), and that too, in the lifetime of P. Conversely speaking, in the event of the death of P (before the death of X) the contract cannot be enforced any way.

(c) F enters into a contract with G to pay him a sum of Rs 5 lakh, if and when G will marry his daughter D. Unfortunately, the daughter D herself dies before her marriage with G could take place. The contract thus, becomes void.

(ii) As against the condition of an uncertain event taking place in the future, in the cases where the contingent contract is, instead, made contingent and dependent upon the non-happening of a certain event in the future, it will become enforceable only after the happening of such an event becomes impossible of taking place, and not earlier thereto **(Section 33).**

Example

X promises to pay to Y a sum of Rs 50,000 if a particular truck does not come back. The particular truck meets with an accident and gets totally burnt and damaged on its return journey. Now the compliance of the happening of the stipulated condition (of the return of the particular truck) has become an impossibility. Thus, the contract has now become enforceable immediately after the truck had been destroyed in the accident.

(iii) There may be some cases where a contract may be contingent upon the manner in which a certain person will act at an uncertain and unspecified future point in time. In such case, the specific event will be deemed to have become impossible when the specific person does something, which has the effect of making it impossible that he would be able to so act (i.e. act in the desired manner) within a definite timeframe, or otherwise than under some further contingencies **(Section 34).** This point may be further clarified with the help of an illustrative example.

Example

F agrees to pay to G a sum of Rs 5 lakh if G marries his daughter D. G, however, marries X, instead. In the circumstances, now the marriage of D to G must be considered as impossible. It is so despite the fact that in the event of the death of X (which may possibly take place), and the possibility of G marrying D in that event is equally possible.

(iv) Similarly, if a contract is contingent to (or dependent upon) the happening of some specific but uncertain event within a fixed stipulated time in the future, such contract will become void, if the stipulated fixed time has already expired, and the specific event has not taken place, or else even when, before the expiry of such fixed time, the happening of that specific event becomes impossible **(Section 35, paragraph 1).**

Example

X promises to pay to Y a certain sum of money if a particular ship comes back within one year from the specific date. In this case, the contract will become enforceable if the ship comes back within one year, as stipulated. The contract will, however, become void, if the ship were to sink within one year, whereby its return within the stipulated time would become impossible, now that the ship has sunk already.

(v) There may be cases where the contract may be contingent (dependent) upon the non-happening of a specific but uncertain event (and not on its happening) within a specified (fixed) time. In such cases, the contract may be enforced in law when the time so fixed has expired and the specified event has not taken place till then. Alternatively, it may also be enforced even if the time so fixed has not expired; but then, it has become certain and clear that such event can now never take place (**Section 35, paragraph 2).**

Example

X promises to pay to Y a certain sum of money if a particular ship does not come back within one year from the specific date. In this case, the contract will become enforceable if the ship does not come back within one year, as stipulated. The contract will also become enforceable if the ship were to sink or get burnt within one year, whereby its return within the stipulated time would become certainly impossible, now that the ship has sunk or got burnt already.

(f) But a contingent agreement pertaining to doing something or even pertaining not to do anything, in the case of an impossible event happening, is considered void, irrespective of the fact whether such impossibility of the event taking place in the future was known to the parties involved in the contract, or even not known to them, at the time when the contract was being made **(Section 36).**

Examples

(a) A agrees to pay to B a sum of Rs 10 lakh, if the sun rises in the west. This agreement is void inasmuch as it may never happen that the sun may rise in the west.

(b) A agrees to pay to B a sum of Rs 10 lakh if B will marry D, the daughter of A. But, as a matter of fact, D was already dead, at the time the agreement was made, though neither of the two parties to the contract, viz. A and B, were in the know of this fact.

In the circumstances, the contract will be deemed as void inasmuch as the taking place of the marriage of B with D has become an impossibility, now that she is already dead, the two parties to the contract (A and B) not knowing the fact at the material time of making the agreement to this effect, notwithstanding.

QUASI-CONTRACT

8.11 Quasi-Contract (Sections 68 to 72)

Quasi-Contracts, which literally means semi-contracts, are named as such because, though the obligations involved in such agreements and transactions could neither be referred to as contractual nor tortuous (i.e. relating to torts), the terms of such agreements or transactions are enforceable in the Court of Law, like a true contract, all the same. As so succinctly put by Dr. Jenks, a quasi-contract is 'a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract, express or implied, has, in fact, been entered into by them'.

Example

S supplies certain goods to his customer C, who receives the goods and also consumes them. In the circumstances, C will have to make the payment to S towards the price of the goods so supplied, inasmuch as the acceptance of the goods by C constitutes an implied agreement on the part of C to pay for the price of the goods to S. Such types of contracts are referred to as tacit contracts.

In the above example itself, if the goods, meant for D were delivered by the servant of S to C, mistaking him to be D, C will be bound to compensate S for the price of the goods. This as well is a quasi-contract, implied contract or a tacit contract – all these terms signifying one and the same thing.

The rationale behind the quasi-contract is that no one will be allowed to enrich himself in an unjust manner at the cost of the other. It may be further pointed out here that the claim arising out of a quasi-contract is generally for money.

Let us now discuss the various cases, one after the other, which are deemed to be quasi-contracts.

(i) Claims for Necessaries Supplied to a Person who is Incompetent to Enter into a Contract on his Own

Let us take the example of a person who is not considered to be competent to enter into a contract (e.g., a lunatic person). Section 68 provides that if a person is incompetent to enter into a contract, and he is supplied by another person the necessaries of life, commensurate with his condition in life, the other person who makes such supplies is entitled to be reimbursed from the property of such incompetent (incapable) person. The same Section also provides that in the cases where the supplies of necessaries are made to such persons, who are supposed to be supported by the incapable person (e.g., the wife and children of the lunatic), the other person who makes such supplies to them (e.g., to the wife and children of the lunatic) suited to their condition in life, is entitled in such cases also, to be reimbursed from the property of such incompetent (incapable) person.

Examples

(a) S supplies to L, a lunatic, the necessaries suitable to his condition in life. In this case, S is entitled to be reimbursed from the property of L, the lunatic.
(b) S supplies to the wife and minor children of L, a lunatic, the necessaries suitable to their condition in life. In this case also, S is entitled to be reimbursed from the property of L, the lunatic.

Thus, we observe that this Section covers the cases of:

(a) The supply of necessaries,
(b) To a person who is incompetent to enter into a contract (e.g., minor, lunatic, etc.), and

(c) To the persons who are bound to be supported by the incapable person (e.g., his wife and minor children).
(d) The compensation will be payable out of the property of the incapable person.

On a careful study of the above points, the following legal ramifications emerge:

1. The goods so supplied must constitute the necessaries of life only, and nothing else. Conversely speaking, in case something else, other than the necessaries of life, have also been supplied, the compensation will be payable only for the supply of necessaries and not for anything else. However, what will constitute the necessaries of life will, of course, depend upon the social status of the person(s) involved. That is to say that it may vary from case to case, from person to person. (A detailed discussion on the point of contracts with minors appears in Chapter 4 on 'Competence to Contract').
2. Second, it must be carefully noted that it is only the property of the incapable person which will be held liable for the payment of the compensation in such context. Conversely speaking, the incapable person will incur no personal liability in such cases. We may elaborate the point still further and say that in case the incapable person does not own any property, out of which such compensation could be paid, the other person, who has supplied the necessaries, will not be paid anything at all.

(ii) Reimbursement of the Person, who has Paid the Amount Payable by Another Person Under Law, and where such Payment is Made to Protect His Own Self-interest (Section 69)

A person who, in his self-interest, makes the payment of some amount of money, which is payable by another person under the law, is entitled to be reimbursed by the other person with the amount so paid.

Example

Z, a landlord in Varanasi, has given a piece of his land to L on lease. Z, however, has defaulted in paying the amount of government revenues, which have, by now, become long overdue, so much so that the government authorities have advertised for the sale of the piece of land of Z (which, happens to be the one leased to L), The sale proceeds of the land so realised, will be adjusted towards the realisation (recovery) of the government dues. Incidentally, under the revenue law, the effect of such sale by the government authorities will be that the lease granted by Z to L will automatically get annulled (cancelled). Therefore, with a view to avoiding the sale of the land and thereby safeguarding his lease interest therein, L prefers to clear the government dues outstanding in the name of Z, from his own account. In such a case, Z will be bound by law to make good to L the amount so paid by L .Alternatively speaking, L will be entitled to receive or recover the amount from Z.

Here, it must be clarified that, the provisions of Section 69 can be applied only when the following conditions will be satisfied:

(a) The person who makes the payment is interested in the payment of the money. In other words, the payment was so made by the person in order to protect his own *bona fide* interest thereby.
(b) The payment so made should not have been made voluntarily, but under some unavoidable compelling circumstances, like legal compulsions or such other coercive process involved thereto.
(c) The payment so made, must be made to another person (other than the person who will be bound to reimburse the amount to such person, who has paid the amount).
(d) The payment so made should involve such payment which the other party was bound to pay under the law.

(iii) Obligation of a Person Enjoying Benefits of Non-gratuitous Act (Section 70)

In the cases where a person does something legally for another person, or delivers something to him, and he (the former person) does not do so with any gratuitous intentions, and where the other person enjoys the benefits of such action or delivery (by the former person), the other person is legally bound to make due compensation to the former person in respect of the act done or the delivery made by the former person, or else, the other person must restore or return the act done or the goods delivered by the former person.

Examples

(a) S saves the property of P from fire. If S has done so, out of gratuitous intentions, if so evidenced by the circumstances, he will not be entitled to the compensation from P. But then, if he would have acted not out of any gratuitous intentions, he will, of course, be entitled to the compensation from P.

(b) M, a merchant, has delivered certain goods at the residence of W, by mistake. If W has consumed these goods, he is legally bound to make due compensation (i.e. to pay the price of the goods) to M. Alternatively, he should not have consumed the goods and must have, instead, returned them to M to avoid payment of the price of the goods to M.

It may, thus, be observed that the provisions of Section 70 can be applied only when the following conditions are satisfied:

(a) The things must have been done lawfully,
(b) The thing must have been done without any gratuitous intentions, and
(c) The person for whose benefit the act was done, must have enjoyed the benefit of such act.

(iv) Responsibility of Finder of Goods

Ordinarily, if a person sees some goods or articles lying on the road, park, or such other public places, left accidentally or inadvertently by the owner thereof, he is not bound by law to take care of such goods or article belonging to some other person, provided he does not take them into his personal custody. But if he does so (i.e. take them into his personal custody), an agreement is implied by law; that is, an agreement impliedly takes place then and there. Despite the fact that there is no formal contract entered into between the owner and the finder of the goods, for certain purposes the finder may be deemed to be a bailee under the law, and accordingly, will be required to take as much care of the goods as a man of ordinary prudence would take in the case of his own goods of similar value and volume, as is the legal duty of a bailee. This is so because, as provided under Section 71, 'A person, who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee'. Such obligation is imposed on the basis of a quasi-contract.

(v) Liability of a Person to Whom Money is Paid, or Thing Delivered by Mistake or Under Coercion

As provided under Section 72, the person, to whom a certain sum of money is paid, or something is delivered by mistake or under coercion, is required to repay the money so received, or return such goods.

Examples

(a) Ram and Shyam have jointly borrowed a sum of Rs 5,000 from Mohan. Ram alone pays the amount in full to Mohan. Not knowing this fact, Shyam also over again repays the amount in full to Mohan. In this case, Mohan will have to refund the amount of Rs 5,000 to Shyam, being the amount received by him in excess.

(b) A transport company refuses to deliver the goods to the rightful consignee unless some extra (illegal) charges are also paid along with the reasonable charges. Under such compelling circumstances, the consignee makes payment of the unreasonable (excess) charges also to the transport company, so that the goods could be taken delivery of. In this case, the transport company will have to refund to the consignee the amount so received in excess of the reasonable charges.

Here, it may be pertinent to clarify that the term 'mistake', used in Section 72, applies not only in relation to the mistake of fact, but also to the mistake of law. It may be further clarified here that there is no conflict or contradiction between the provisions of Section 72 on the one-side, and the provisions of Sections 21 and 22 on the other. In fact, the basic principle and rationale is that in case one of the parties, by mistake of fact, or by mistake of law, pays certain amount to the other party, which amount is not due and payable under the

contract or even otherwise, that excess (overcharged) amount must be refunded **[Sales Tax Officer, Benares, vs Kanhaiyalal Makandlal Saraf (1959), SCJ 53]**.

8.12 Quantum Meruit

The term 'Quantum Meruit' means 'as much as is merited' or 'as much as is earned'. By way of a general rule of law, unless a person has performed his obligation under the contract in full, he cannot claim the performance of the contract by the other party **[Cutter vs Powell (1795), TT, 320].**

But then there could be cases where one of the parties to the contract might have performed some work under the contract, but the other party might have repudiated the contract, or else some event might have taken place whereby the remaining portion of the performance of the contract might have since become impossible. In such cases, the party, who has performed some work under the contract, can claim remuneration from the other party for the work he has already performed.

Here, it may be clarified that the right to claim 'quantum meruit' does not arise in the contract, as it does in the case of the right to damage. In fact, it is a claim based on the quasi-contractual obligation, which constitutes an implied legal obligation, that is, impliedly and implicitly only (as indicated by the circumstances obtaining at the material time), and not directly or expressly. [**Patel Engineering Company Limited vs Indian Oil Corporation Limited, AIR (1975) Pat. 212**].

The claim in regard to 'quantum meruit' arises in the following circumstances:

(i) Where a Contract is Subsequently Discovered to be Unenforceable (Section 65)

There may be cases where the contract might have been subsequently discovered to have been void, or it might have become void. In such cases, any person, who might have received any advantage or benefits under such agreement or contract, is legally obliged to restore such advantage so received, or else to make compensation for the same to the person from whom he might have obtained or received the advantage.

Examples

(a) F, the father of D, has paid a sum of Rs 5 lakh to B in consideration of B promising to marry D. But, at the material time, when the contract was being entered into, D had already died, which fact, however, was not known to F and B. The contract as such will be void. But then, B must refund to F the sum of Rs 5 lakh, received by him from F.

(b) S has agreed to deliver 55,000 bales of cotton to B on or before 31st October 2008. S, however, is able to deliver only 30,000 bales of cotton to B by the stipulated date, i.e. 31st October 2008, and does not make any further delivery thereafter. B, on his part, has retained the 30,000 bales of cotton even after 31st October 2008, being the delivery only in part, as against the delivery of 55,000 bales of cotton, as per the terms of the contract. In such a case, B will be obliged to make the payment for the 30,000 bales of cotton delivered to him, though S has not performed the contract, pertaining to the delivery of 55,000 bales of cotton, in its entirety.

(c) R, the owner of a restaurant in Lucknow, engages G, a noted *ghazal* singer, to sing in his restaurant in the evening on every Sunday, for the next six months, on payment of Rs 1,000 per performance. G has sung in the restaurant for 10 Sundays. But on the eleventh Sunday, G wilfully fails to turn up for his perforce. This irritates R, and consequently, R rescinds his contract with G. In the instant case, R will have to pay to G, the *ghazal* singer, for 10 performances as per the agreed terms of the payment at the rate of Rs 1,000 per performance, i.e. Rs 10,000 in the aggregate.

(ii) When One of the Parties Abandons or Refuses to Perform the Contract

There may be cases where one of the parties to the contract might have committed the breach of contract, by

way of abandoning or refusing to perform the contract. In such a case, the aggrieved party will be entitled to claim reasonable compensation from the other party, who has committed the breach of contract, for what he (the aggrieved party) might have already done under the contract.

Example

M, the Managing Director of a publishing company, enters into a contract with a reputed writer W, to write short stories for his magazine, being published every fortnight. After a few short stories were published in the magazine, the magazine was abandoned. It was held in the case of **Planche vs Colburn (1831), 8 Bing. 14,** that W can claim payment, based on the principle of 'quantum meruit', for the number of his short stories already published in the magazine.

(iii) When a Contract is Divisible

In the cases where the contract is divisible, and the party, who is not a defaulter, has enjoyed the benefits of the part performance of the contract, the defaulting party has the legal right to sue the non-defaulting party on the basis of the principle of 'quantum meruit'.

(iv) When a Non-divisible Contract is Completely Performed but Badly

There may be cases where a non-divisible contract (like the denting and painting work on a car), is completely performed by the other party, but the job has been done in a faulty manner, involving sub-standard workmanship, which might involve an expenditure of a further sum of money. In such cases, the person, whose work has been done in an unsatisfactory manner, will be entitled to deduct the extra amount so spent by him for getting the defects removed, while making the payment to the other party, who has performed the job completely, but unsatisfactorily.

Example

A contract is entered into between the owner of the car C, and the car painter P, for a thorough denting and painting of the car, for a lump sum amount of Rs 6,000. P has performed the contract completely. But C finds that the work has not been done to his satisfaction, involving sub-standard workmanship. Therefore, C had to get the defects in the work removed by spending another sum of Rs 2,000. In this case, C will be legally required to make a payment of Rs 4,000 only to P, i.e. after making a deduction of Rs 2,000 that he had to incur to get the defect removed **[Hoening vs Isaacs (1952) AIR 11 ER 176].**

Let us Recapitulate

A void agreement is one, which is deemed as if not having been made at all. It is void *ab initio* (that is, right from the very beginning). We have already examined in the earlier chapters as to under what different situations and circumstances can an agreement be considered as void, viz. when entered into by incompetent parties, when it has been made without consideration, or with an unlawful consideration and/or object, when it is aginst public policy, and so on. However, **Section 10** has also stipulated that an agreement to be a valid contract should not have been expressly declared as void. Further **Sections 26 to 30, 36, and 56** of the Act are such, which have expressly declared certain agreements as void, by virtue of their very nature itself. Such void agreements are:

1. Agreements in restraint of marriage (Section 26)
2. Agreement in restraint of trade (Section 27)
3. Agreement in restraint of legal proceedings (Section 28)
4. Agreements void for uncertainty (Section 29)
5. Agreement by way of wager (Section 30)
6. Agreements contingent on impossible event (Section 36)
7. Agreements to do impossible act (Section 56)

What is a Contingent Contract?

A contingent contract is such contract where a person agrees to do something, or not to do something, on the stipulated condition of some event, collateral to such contract, taking place or not taking place (**Section 31**).

Essential elements of a contingent contract

(i) The performance of a contingent contract is made dependent upon some event or incident taking place or not taking place (but not otherwise).

(ii) Further, such event or incident, is collateral to the contract, in that it does not form a part of the reciprocal promises that are usually made between the two parties

(iii) Finally, the contingent event should not just be merely a desire of the promissor. But then, where the event is within the will (desire) of the promissor, but it does not happen to be merely his will; it may constitute a contingent contract.

In 'Quasi-Contracts' (or semi-contracts), though the obligations involved could neither be referred to as contractual nor tortuous (i.e. relating to torts), expressly or impliedly, the terms of such agreements or transactions are enforceable in the Court of Law, like a true contract, by virtue of its being a tacit contract.

The rationale behind the quasi-contract is that no one will be allowed to enrich himself in an unjust manner at the cost of the other. It may be further pointed out here that the claim arising out of a quasi-contract is generally for money.

Cases, which are deemed to be quasi-contracts:

(i) Claims for necessaries supplied to a person who is incompetent to enter into a contract on his own, e.g., a lunatic person.

(ii) Reimbursement of the person, who has paid the amount payable by another person under law, and where such payment is made to protect his own self-interest (Section 69)

The Section 69 can be applied only when:

(a) The person who makes the payment has his *bona fide* interest in the payment of the money.

(b) The payment so made should not have been made voluntarily, but under some unavoidable compelling circumstances, like legal compulsions or such other coercive process involved thereto.

(c) The payment so made, must be made to another person (other than the person who will be bound to reimburse the amount to such person, who has paid the amount).

(d) The payment so made should involve such payment, which the other party was bound to pay under the law.

(iii) Obligation of a person enjoying benefits of non-gratuitous act (Section 70)

In the cases where a person does something legally for another person, or delivers something to him, and he (the former person) does not do so with any gratuitous intentions, and where the other person enjoys the benefits of such action or delivery (by the former person), the other person is legally bound to make due compensation to the former person in respect of the act done or the delivery made by the former person, or else the other person must restore or return the act done or the goods delivered by the former person.

Section 70 can be applied only when:

(a) The things have been done lawfully,

(b) The thing have been done without any gratuitous intentions, and

(c) The person for whose benefit the act was done, must have enjoyed the benefit of such act.

(iv) Responsibility of finder of goods

If a person sees some goods or articles lying on the road, park, or such other public places, left accidentally or inadvertently by the owner, he is not bound by law to take care of such goods or article, unless he takes them into his personal custody. But if he were to take them into his personal custody, an agreement impliedly takes place then and there. Further, for certain purposes the finder may be deemed to be a

bailee under the law, and accordingly will be required to take as much care of the goods as a man of ordinary prudence would take in the case of his own goods of similar value and volume, as is the legal duty of a bailee. (**Section 71**).

(v) **Liability of a person to whom money is paid, or thing delivered by mistake or under coercion (Section 72)**

The person is required to repay the money so received, or return such goods

Here, the term 'mistake', applies both in relations to the 'mistake of fact', and to the 'mistake of law'.

Quantum Meruit

The term 'Quantum Meruit' means 'as much as merited' or 'as much as earned'. By way of a general rule of law, unless a person has performed his obligation under the contract in full, he cannot claim the performance of the contract by the other party. But then, there could be cases where one of the parties to the contract might have performed some work under the contract, but the other party might have repudiated the contract, or else some event might have taken place whereby the remaining portion of the performance of the contract might have since become impossible. In such cases, the party, who has performed some work under the contract, can claim remuneration from the other party for the work he has already performed.

The claim in regard to 'quantum meruit' arises in the following circumstances:

(i) Where a contract is subsequently discovered to be unenforceable, i.e. it might be void, or it might have become void. (Section 65).

In such cases, any person who might have received any advantage or benefits under such agreement or contract, is legally obliged to restore such advantage so received, or else to make compensation for the same to the person from whom he might have obtained or received the advantage.

(ii) When one of the parties abandons or refuses to perform the contract

In such a case, the aggrieved party will be entitled to claim reasonable compensation from the other party, who has committed the breach of contract, for what he (the aggrieved party) might have already done under the contract.

(iii) When a contract is divisible

In such cases, the party, who is not a defaulter, and has enjoyed the benefits of the part performance of the contract, the defaulting party has the legal right to sue the non-defaulting party on the basis of the principle of. 'quantum meruit'.

(iv)When a non-divisible contract is completely performed but badly

In such cases, the person, whose work has been done in an unsatisfactory manner, will be entitled to deduct the extra amount so spent by him for getting the defects removed, while making the payment to the other party, who has performed the job completely, but unsatisfactorily.

Questions for Reflection

1. Discuss, by citing suitable illustrative examples in each case, the following agreements which have been expressly declared as void, by virtue of their very nature itself:
   (a) Agreements in restraint of marriage;
   (b) Agreement in restraint of trade;
   (c) Agreement in restraint of legal proceedings; and
   (d) Agreements void for uncertainty.
2. Define a contingent contract. Give suitable illustrative examples to clarify the points.
3. Bring out the various essential elements of a contingent contract, with the help of suitable illustrative examples to clarify each point.
4. Explain the various rules pertaining to the enforcement of contingent contracts. Cite suitable illustrative examples in each case.

5. (i) What do you understand by the term 'Quasi-Contracts'?
   (ii) What is the rationale behind the quasi-contract? Explain with the help of some illustrative examples on each point.
6. What are the various cases, which are deemed to be quasi-contracts? Explain each circumstance by citing suitable examples to illustrate each of such points separately.
7. Explain the various legal implications and ramifications involved in each of the following circumstances of 'Quasi-Contracts': Elucidate your points by citing suitable examples.
   (i) Claims for necessaries supplied to a person who is incompetent to enter into a contract on his own.
   (ii) Reimbursement of the person, who has paid the amount payable by another person under law, and where such payment is made to protect his own self-interest.
   (iii) Obligation of a person enjoying benefits of non-gratuitous act.
   (iv) Responsibility of the finder of goods.
   (v) Liability of a person to whom money is paid, or thing delivered by mistake or under coercion.
8. (i) What do you understand by the term 'Quantum Meruit'? Explain by citing examples.
   (ii) What are the various circumstances under which the claim in regard to 'quantum meruit' arises? Give suitable examples in each case.
9. Discuss the following circumstances under which the claims in regard to 'quantum meruit' may arise. Give suitable examples in each case.
   (i) Where a contract is subsequently discovered to be unenforceable due to it being void, or it might have become void;
   (ii) When one of the parties abandons or refuses to perform the contract;
   (iii) When a contract is divisible and the party, who is not a defaulter, has enjoyed the benefits of the part performance of the contract;
   (iv) When a non-divisible contract is completely performed but badly, whereby the aggrieved party has to incur extra expenditure to get the defects removed.

Problems for Practice (With Suggested Solutions)

Problem 1

Akash Airlines has entered into an agreement with Veena, an airhostess, to the effect that she will not marry till a certain age, or upto a certain period, during the period of her service. Do you think that such contract will be valid or void? Give reasons for your answer.

Solution

This contract will be held valid, and not void, because it does not put any restraint on the marriage itself, but only stipulates that, in that event, the person, while being free to get married, will have to leave the job, prior to her marriage.

Problem 2

Anurag expressly promises that if and when he would marry, he would marry Barkha only and none else. Do you think that such agreement would be considered as valid or void? Give reasons for your answer.

Solution

This agreement would be considered as void, because it does not amount to a marriage contract. It, instead, imposes a restriction on the marriage itself; in that, it is only a promise that if and when he (Anurag) would marry, he would do so with Barkha and Barkha alone. Thus, the terms **'if and when'** go to suggest that, provided he decides to marry at all, meaning thereby that he may or even may not marry at all. Accordingly, it would be like imposing a restriction on marriage itself, and hence void.

Problem 3

Saurabh agrees to sell 100 kg of rice to Basant. Do you think that this contract will be held as valid or void? Give reasons for your answer.

Solution

This contract will not be deemed to be a valid contract but a void contract, instead, for uncertainty, because the particular variety of rice has not been specified in the instant case.

Problem 4

Saurabh agrees to sell 100 kg of Dehradun *Basmati* rice to Basant. Do you think that this contract will be held as valid or void? Give reasons for your answer.

Solution

This contract will be deemed to be a valid contract (and not a void contract, for uncertainty), because, in the instant case, the particular variety of rice has been specified.

Problem 5

Saurabh, who deals only and exclusively in Dehradun *Basmati* rice, agrees to sell 100 kg of rice to Basant. Do you think that this contract will be held as valid or void? Give reasons for your answer.

Solution

This contract will be deemed to be a valid contract (and not a void contract, for uncertainty), because, though the particular variety of rice has not been specifically mentioned in the agreement, the very fact that Saurabh was dealing only and exclusively in Dehradun *Basmati* rice, the variety of rice, intended to be sold in the instant case, will be deemed to be only and exclusively Dehradun *Basmati* rice, and nothing else.

Problem 6

Shekhar had offered to Prakash to sell his house to him at a certain price. Later, Shekhar had entered into a contract with Akash to sell his house to him at a certain price, but only in the event of Prakash refusing such offer made to him earlier. After some time, Prakash had refused the offer made by him to Shekhar earlier for buying the house. Under such circumstances, is Shekhar legally obliged to sell his house to Akash? Give reasons for your answer.

Solution

Yes, Shekhar will be legally obliged to sell his house to Akash, immediately on the receipt of the notice of refusal from Prakash in regard to his offer, made to him earlier. This is so because, as provided under Section 32 of the Act, the contract, which is contingent to, or is dependent upon, the happening of some uncertain event in the future, cannot be enforced under the law unless and until that event actually takes place. Conversely speaking (in a positive manner, instead of the negative manner of the statement incorporated in Section 32 of the Act), the contract can be enforced in law when the required event actually takes place. And, in this case, because the event of refusal of the offer by Prakash (as was stipulated as a condition in the contract), had actually taken place, Shekhar will now be legally bound to sell his house to Akash, immediately on the receipt of the notice of refusal from Prakash.

Problem 7

Priti had promised to pay to Jaggoo a sum of Rs 2 lakh if a particular ship does not come back safely. The particular ship had, unfortunately, sunk in the high sea on its return journey. Is Priti legally bound to pay to Jaggoo a sum of Rs 2 lakh, as was promised by her to him? Give reasons for your answer.

Solution

Yes. Priti is legally bound to pay to Jaggoo a sum of Rs 2 lakh, as was promised by her to him. This is so because, as provided under Section 33 of the Act, in the cases where the contingent contract is made contingent and dependent upon the non-happening of a certain event in the future, it will become enforceable only after the happening of such an event becomes impossible of taking place and not earlier thereto. And, in the instant case, now that the safe arrival of the ship had become impossible, after it had already sunk in the high sea, this contract will now become enforceable in law.

Problem 8

On 30th April 2008, Abdul had promised to pay to Balan a sum of Rs 5 lakh, if a particular ship comes back to Mumbai port safely, within one year, with effect from 30th April 2008. But, unfortunately, on 12th March 2009, the ship sunk in the high sea. Is Balan entitled to receive the amount of Rs 5 lakh from Abdul? Give reasons for your answer.

Solution

In the instant case, the contract would have become enforceable only if the ship would have come back to Mumbai port safely within one year from 30th April 2008, as was stipulated in the contract. But now that the ship had already sunk in the deep sea, well within a period of one year from 30th April 2008, i.e. on 12th March 2009, its return to Mumbai port within the stipulated time, i.e. latest by 29th April 2009, had become impossible. Thus, the contract had become void. This is so because, as provided under Section 35, paragraph 1, of the Act, if a contracts is contingent to (or dependent upon) the happening of some specific but uncertain event within a fixed stipulated time in the future, such contract will become void when, before the expiry of such fixed time, the happening of that specific event becomes impossible. Accordingly, Balan will not be entitled to receive the amount of Rs 5 lakh from Abdul. Conversely speaking, Abdul will no longer be required to pay to Balan the amount of Rs 5 lakh as the contract in question had already become void and, thus, not enforceable in law.

Problem 9

Will the legal position be any different if, in Problem 8 above, the ship would have reached safely at the Mumbai port on 15th May 2009**?** Give reasons for your answer.

Solution

No. The legal position, even in that event, will not be any different either, if, in Problem 8 above, the ship would have reached safely at the Mumbai port on 15th May 2009. This is so because, one of the two conditions stipulated in the contract had still remained to be fulfilled. That is, while the ship had reached Mumbai port safely, it had failed to reach there within the stipulated time, i.e. within one year from 30th April 2008, i.e. latest by 29th April 2009. The ship had, in fact, arrived after 29th April 2009, i.e. on 15th May 2009. Thus, in that event also, the contract in question would have been declared as void. This is so because, as provided under Section 35, paragraph 1, of the Act, if a contract is contingent to (or dependent upon) the happening of some specific but uncertain event within a fixed stipulated time in the future, such contract will become void, if the stipulated fixed time has already expired, and the specific event has not taken place (till that time). Accordingly, Balan will not be entitled to receive the amount of Rs 5 lakh from Abdul, even in this case. Conversely speaking, Abdul will no longer be required to pay to Balan the amount of Rs 5 lakh, as the contract in question had already become void and, thus, not enforceable in law, even in this case..

Problem 10

On 30th April 2008, Abdul had promised to pay to Balan a sum of Rs 5 lakh, if a particular ship does not come back to Mumbai port safely, within one year, with effect from 30th April 2008. But, unfortunately, on 12th March 2009, the ship got sunk in the high sea. Is Balan entitled to receive the amount of Rs 5 lakh from Abdul? Give reasons for your answer.

Solution

Yes. In this case, Balan will be entitled to receive the amount of Rs 5 lakh from Abdul because, now that the particular ship had already sunk in the deep sea on 12th March 2009, it's not coming to Mumbai port latest by 29th April 2009 had become certain. Thus, the payment of the agreed amount of Rs 5 lakh by Abdul to Balan, in the event of the non-arrival of the particular ship within one year from 30th April 2008, had also become certain and, accordingly, legally binding on Abdul, as per the terms of the agreement between Abdul and Balan. This is so because, Section 35, paragraph 2, of the Act provides that the contract may be enforced in law even if the time so fixed has not expired; but then, it has become certain and clear that such event can now never take place. And, in the instant case, the event of the arrival of the particular ship, after its having

been sunk in the deep sea, can never take place. Thus, the contract has become enforceable in law, and making Balan entitled to receive the amount of Rs 5 lakh from Abdul.

[Here, it may be noted with great interest and care that while in the Problem 8 above, the payment was made dependent on the safe arrival of the particular ship, in Problem 10 above, the payment has been made dependent on the non-arrival of the particular ship.]

Problem 11

Will the legal position be any different if, in Problem 10 above, the ship would have reached safely at the Mumbai port on 15th May 2009**?** Give reasons for your answer.

Solution

No. The legal position, even in that event, will not be any different either, if, in Problem 10 above, the ship would have reached safely at the Mumbai port on 15th May 2009. This is so because, though the ship had reached Mumbai port safely, it had not reached there within the stipulated time, i.e. within one year from 30th April 2008, i.e. latest by 29th April 2009. The ship had, in fact, arrived after 29th April 2009, i.e. on 15th May 2009. Thus, in that event also, the contract in question would have been declared valid and enforceable in law, because the subject matter of the contract, in the instant case, was not the arrival, but the non-arrival of the particular ship latest by 29th April 2009, and that condition had been amply fulfilled. This is so because, as provided under Section 35, paragraph 2, of the Act, in the cases where the contract may be contingent (dependent) upon the non-happening of a specific but uncertain event (and not on its happening) within a specified (fixed) time, the contract may be enforced in law when the time so fixed has expired and the specified event has not taken place till then. And, in the instant case, the event of the arrival of the particular ship had not taken place till 29th April 2009. Thus, the contract, based on the non-arrival of the ship within the stipulated period, had become enforceable in law, and, thereby making Balan entitled to receive the amount of Rs 5 lakh from Abdul.

[Here also it may be noted with great interest and care that, while in the Problem 9 above, the payment was made dependent on the safe arrival of the particular ship, in Problem 11 above, the payment has been made dependent on the non-arrival of the particular ship.]

Problem 12

Prakash had telephoned to Bhaskar, the shopkeeper, to supply him one litre of mustard oil. But Bhaskar had erroneously supplied him one litre of coconut oil, instead. Prakash, however, had consumed the coconut oil that was erroneously supplied to him by Bhaskar. But when Bhaskar came to his house the next day and asked for payment, Prakash refused to make any payment to him on the ground that he had not supplied him the mustard oil, as was actually ordered by him. Thereupon, Bhaskar preferred to file a civil suit against Prakash for recovery of the price of the coconut oil, which was already consumed by Prakash. What are the chances of Prakash losing the case? Give reasons for your answer.

Solution

Yes. Prakash will definitely lose the case and will have to make the payment to Bhaskar towards the price of the coconut oil, though it was erroneously supplied to him instead of the mustard oil. This is so because, Prakash's act, of accepting and consuming the coconut oil so supplied, will go to constitute an implied contract (which is also referred to as a quasi-contract, or a tacit contract) Accordingly, Prakash will have to make payment to Bhaskar for the price of the coconut oil so supplied and accepted by Prakash. The rationale behind the quasi-contract is that no one will be allowed to enrich himself in an unjust manner at the cost of the other.

Problem 13

Raghu had telephoned to Shankar, the shopkeeper, to supply him one kilogram of sugar at his house located at 2/108 Vinay Khand, Gomti Nagar, Lucknow. But the servant of Shankar had got somewhat confused and thus, he had erroneously supplied the one kilogram of sugar to Varun instead, at his house located at 2/108 Vijay Khand, Gomti Nagar, Lucknow. Varun, however, had consumed the one kilogram of sugar that was

erroneously supplied to him by the servant of Shankar. But when Shankar came to know of the mistake committed by his servant, he came to the house of Varun the next day and asked for payment. Varun refused to make any payment to him on the ground that he had not ordered for any supplies to him. Thereupon, Shankar filed a civil suit against Varun for recovery of the price of the one kilogram of sugar that was supplied to him and which was already consumed by Varun. What are the chances of Shankar losing the case? Give reasons for your answer.

Solution

No. Shankar will not lose the case. He will, instead, win the case, and Varun will have to make the payment to Shankar towards the price of the sugar that had erroneously got supplied to him, instead of to Raghu. This is so because, Varun's act of accepting the sugar so supplied to him, though erroneously, and also consuming it, will go to constitute a quasi-contract (also referred to an implied contract or a tacit contract). Accordingly, Varun will have to make payment to Shankar for the price of the sugar so supplied and accepted and consumed by Varun. This stand is based on the legal principle that no one should be allowed to enrich himself in an unjust manner at the cost of the other.

Problem 14

Will the legal position be any different in the above Problems 12 and 13, if Prakash and Varun respectively would not have consumed the goods, which were wrongly supplied to them by Bhaskar and Shankar, the respective shopkeepers?

Solution

Yes, the position would have been definitely different under the changed circumstances stated in the Problem 14. The significant and material difference in the instant case is that both the persons, to whom the wrong goods were supplied, or the goods were wrongly supplied, had not consumed them, and thus, had not accepted such goods. In fact, in Problems 12 and 13 above, the act of consuming the goods by the persons concerned – though wrongly supplied and against no such orders by any of them – had amounted to their accepting the goods, and thus, a quasi-contract had got entered into between each of them and the respective shopkeepers. As against this, in the instant case, in view of the fact that none of them had consumed the goods wrongly supplied to them, there was no acceptance on their part for the goods so supplied to them, and accordingly, even quasi-contract was not got entered into between the respective two parties concerned. Thus, instead of making payment to the respective shopkeepers, for the goods so supplied to them, they may rightfully ask the respective shopkeepers to take back the goods so supplied, instead of making payments for the same, on the ground that they were not ordered for by them.

Problem 15

Gaurav had voluntarily supplied to Lalloo, a lunatic, as also to his wife and minor children, the necessaries suitable to their condition in life, though none of them had asked him to do so. Do you think that under the aforementioned circumstances, Gaurav would be entitled to be reimbursed from the property of Lalloo, the lunatic, for such supplies made only for Lalloo , or else for his wife and minor children also, who are not lunatic but of sound mind ? Give reasons for your answer.

Solution

Yes. Gaurav will be entitled to be reimbursed from the property of Lalloo, the lunatic, for such supplies made not only for Lalloo, but also for his wife and minor children, who are deemed to be dependent upon him. This is so because of the following two specific and separate provisions made under Section 68 of the Act:

(i) First, Section 68 provides that if a person is incompetent to enter into a contract (Lalloo, the lunatic, in the instant case), and he is supplied by another person the necessaries of life, commensurate with his condition in life, the other person who makes such supplies is entitled to be reimbursed from the property of such incompetent (incapable) person, i.e. Lallo, in the instant case.

(ii) Second, under the same Section 68, it has also been stipulated that in the cases where the supplies of necessaries are made to such persons, who are supposed to be supported by the incapable person (e.g.,

the wife and children of the lunatic, in the instant case), the other person, who makes such supplies to them (i.e. to the wife and children of the lunatic), suited to their condition in life, is entitled in such cases also, to be reimbursed from the property of such incompetent (incapable) person.

Problem 16

Zahir had leased a piece of his land to Lalji. But Zahir had not paid the amount of government revenues for a long time, which had, by then, become so much overdue that the government authorities had preferred to insert an advertisement in the local newspapers for the sale of the piece of land of Zahir, so as to realise the government dues from the sale proceeds of the same. Incidentally, the specific piece of land for sale happened to be the one, which Zahir had leased to Lalji. It may as well be noted in this context that, under the revenue law, the effect of such sale by the government authorities will be that even the lease granted by Zahir to Lalji will automatically get cancelled. Therefore, with a view to avoiding the sale of the land, and thereby safeguarding his lease interest therein, Lalji preferred to himself clear the entire government dues that were outstanding in the name of Zahir, thinking that he will be able to recover the amount so paid by him from Zahir at a later date. But, to Lalji's utter surprise and dismay, Zahir had refused to pay back to Lalji the money that was paid by Lalji towards payment of the government dues on his (Zhir's) behalf, on the ground that he (Zahir) had not asked him to do so. Accordingly, Lalji filed a suit against Zahir for recovery of the amount so paid by him on his (Zahir's) behalf. What are the chances of Lalji winning the case? Give reasons for your answer.

Solution

Yes. Lalji will surely win the case and, as per law, Zahir will have to make good to Lalji the amount so paid by him (Lalji). This is so because, as provided under Section 69 of the Act, a person who, in his self-interest, makes the payment of some amount of money, which is payable by another person under the law, is entitled to be reimbursed by the other person with the amount so paid by him. It may be further asserted in this context that all the conditions required in such cases, to make the provisions of Section 69 applicable, have been fully satisfied in the instant case. These are the following:

(a) The person who makes the payment is interested in the payment of the money. In other words, the payment is so made by the person in order to protect his own *bona fide* interest thereby. And, in this case Lalji's interest in the lease is involved.

(b) The payment so made should not have been made voluntarily, but under some unavoidable compelling circumstances, like legal compulsions or such other coercive process involved thereto. In this case, the threat of the sale of the leased land by the government authorities is the unavoidable compelling circumstances.

(c) The payment so made, must be made to another person (other than the person who will be bound to reimburse the amount to such person, who has paid the amount). Here the payment has been made to the government authorities, and not to Zahir, who will be bound to reimburse the amount to Lalji, who has paid the amount on behalf of Zahir.

(d) The payment so made should involve such payment, which the other party was bound to pay under the law. In this case the payment has been made which Zahir was legally bound to pay to the government authorities by way of land revenue.

Problem 17

Prasanna had observed that the shop of Mohsin, his friend, was on fire. He had made strenuous efforts and had been finally able to save the property of Mohsin from destruction by fire. When Mohsin had come back to his shop and had come to know of the aforementioned facts, he had gone to the shop of Prasanna and profusely thanked him for his prompt and friendly action. While most humbly accepting the gratitude expressed to him by Mohsin, Prasanna had not forgotten to say that it was his moral duty to help his friend in his times of need, and he had finally added that 'a friend in need, is a friend indeed'. Do you think that Prasanna would be entitled to receive some compensation from Mohsin for his having saved the shop of Mohsin from fire? Give reasons for your answer.

Solution

No. Prasanna will not be entitled to receive any compensation from Mohsin for his having saved the shop of Mohsin from fire, because he had done so with a gratuitous intention. This (the gratuitous intention) can well be inferred from the facts of the case narrating the manner in which Mohsin had expressed his sincere gratitude to Prasanna, and Prasanna, in turn, had categorically stated that he had done so by way of his duty as a friend in times of his need. When we look into the provisions of Section 70 of the Act, we find that it specifically provides that in such cases, where a person does something legally for another person, not with any gratuitous intentions, and where the other person enjoys the benefits of such action, the other person is legally bound to make due compensation to the former person in respect of the act done. Conversely speaking, we may infer that in the cases where non-gratuitous act is not involved, i.e. which involves gratuitous act instead, such compensation will not be payable by the person who derives the benefit from such gratuitous act.

Problem 18

Prakash had observed that the house of Madan was on fire. He had made strenuous efforts and had been finally able to save the house of Madan from destruction by fire. And soon after Madan had come back to his house, Prakash had gone to him and had demanded that Madan must duly compensate him in terms of money, for his having made strenuous efforts to save his house from fire. Madan had, however, refused to pay him any money for his aforementioned act. Thereupon, Prakash had filed a suit against Madan for recovery of the amount of compensation that he was entitled to. Do you think that Prakash will win the case? Give reasons for your answer.

Solution

Prakash will definitely win the case because Section 70 of the Act specifically provides that in the cases where a person does something legally for another person, and he (the former person) does not do so with any gratuitous intentions, and where the other person enjoys the benefits of such action (by the former person), the other person is legally bound to make due compensation to the former person in respect of the act done. And the very fact that immediately after Madan had come back to his house, Prakash had gone to him and had demanded that Madan must duly compensate him in terms of money for his act in question, goes to establish beyond doubt that the act was done by Prakash not with any gratuitous manner, but without any such (gratuitous) intentions, whatsoever. Accordingly, Madan will be legally bound to duly compensate Praksh for his non-gratuitous act, as he had enjoyed the benefit arising from it, in that his house could be saved from destruction by fire.

Problem 19

Lalit has lent a sum of Rs 20,000 to Abraham and Hasan jointly, to be repaid by them on or before the 30th June 2009. On the 30th June 2009 Abraham had repaid the loan amount in full by paying Rs 20,000 to Lalit. But, being unaware of this fact, Hasan had also over again paid the amount of the loan in full to Lalit the same day. Do you think that Lalit will be legally bound to refund the amount of Rs 20,000 to Hasan, as this amount has been received by him (Lalit) in excess?

Solution

Yes. Lalit is legally bound to refund the amount of Rs 20,000 received by him in excess of the loan amount. This is so because Section 72 of the Act provides that if a person is paid a certain sum of money, by mistake, he is required to repay the money so received.

Problem 20

Vikas, living in Bangalore, had received a consignment of ripe mangoes of the top variety, sent to him by his father, living in Lucknow. Knowing this, the transport company had refused to deliver the goods to Vikas, the rightful consignee, unless some extra (illegal) charges were also paid along with the reasonable charges. Under such compelling circumstances, fearing that the mangoes, so affectionately sent to him by his father, may get over-ripe with any further passage of time, Vikas had paid the excess charges also to the transport company, so that the mangoes could be taken delivery of.

After some time, Vikas had gone to the office of the transport company and had demanded the refund of the excess amount that had been charged from him by them illegally. Do you think that Vikas will be legally entitled to get back the money from the transport company, once he had already paid the money to the transport company?

Solution

Yes. In the instant case, the transport company will have to refund to Vikas the amount so received by them in excess of the reasonable charges. This is so because, as has been provided under Section 72, the person, to whom a certain sum of money has been paid under coercion, is required to repay the money so received.

Problem 21

Fazal was in search of a suitable match for her daughter, Dimple, for quite some time. At last, he could find the most suited match in Bashir, an MBA from IIM, Lucknow. Bashir had agreed to marry Dimple but on the condition that he must be paid a sum of Rs 10 lakh to enable him to go to the USA for higher studies. Fazal had agreed to this proposal of Bashir, and had immediately paid him a sum of Rs 10 lakh by means of a cheque, which Bashir had promptly encashed and credited to his bank account. But, as bad luck had it, Dimple had already expired at the time when the agreement was being entered into between Fazal and Bashir. But while entering into the aforementioned agreement, neither Fazal nor Bashir was aware of the fact that Dimple had already died. After some time, when Fazal had been able to adjust to the unfortunate and sad demise of his daughter, he asked Bashir for refund of the sum of Rs 10 lakh that he had paid to Bashir, as aforementioned. But Bashir declined to refund the amount to Fazal on the ground that the contract had already been entered into, as none of the parties were aware of the death of Dimple. Do you think that the contention of Bashir will be held valid from the legal point of view? Give reasons for your answer.

Solution

No. The contention of Bashir will not be held valid from the legal point of view. In fact, the agreement entered into between Fazal and Bashir will not be deemed to be valid but void, because of it being unenforceable, inasmuch as due to the death of Dimple –despite this fact being unknown to both the parties involved – the performance of the contract had become absolutely impossible. Further, Bashir will have to refund the amount of Rs 10 lakh to Fazal. This is so because, as provided under Section 65 of the Act, in the cases where the contract might have been subsequently discovered to be void, or it might have become void, any person, who might have received any advantage or benefits under such agreement or contract, is legally obliged to restore such advantage so received, or else to make compensation for the same to the person from whom he might have obtained or received the advantage. The aforementioned legal remedy is based on the principle of '*quantum meruit*', which means 'as much as is merited' or 'as much as is earned'.

Chapter Nine

Performance of Contracts

"

Let your performance do the thinking.
H. Jackson Brown Jr.

An acre of performance is worth a whole world of promise.
William Dean Howell

Be slow to resolve, but quick in performance.
John Dryden

Promises may fit the friends, but non-performance will turn them into enemies.
Benjamin Franklin

The person who is slowest in making a promise is most faithful in its performance.
J. J. Rousseau

All promise outruns performance.
Ralph Waldo Emerson

Better a lean agreement than a fat suit.
Proverb

"

9.1 What is Meant by the Term 'Performance of a Contract'?

A contract is making an undertaking by the two parties to undertake and fulfil certain obligations arising from it. Accordingly, the performance of a contract means the carrying out of the respective obligations undertaken by each of the two parties, who have entered into an agreement to fulfil such obligations. As required by Section 37, the parties to a contract must either perform or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of the Contract Act, or of any other law.

9.2 Offer to Perform or Tender of Performance

What is meant by the term 'tender' or an 'attempted performance'? In the cases where the promissor offers to perform his obligation, agreed under the contract, at the proper time and place, but the promisee, on his part, refuses to accept the performance, it is referred to as the 'tender' or an attempted performance'. Section 38 provides that, if a valid tender is made and it is not accepted by the promisee, the promissor will not be held responsible for the non-performance, nor shall he lose his right under the contract.

When is the Offer to Perform or Tender of Performance deemed valid?

A tender or an offer of performance, to be considered as valid, must satisfy the following conditions:

(i) It must be Unconditional

An offer to perform must be unconditional. Conversely speaking, a conditional offer to perform will not be treated as valid, and accordingly, the promissor concerned will not thereby get relieved or absolved of his obligations under the contract. Further, a tender is considered as being conditional in the cases where it is not in accordance with the terms, stipulated in the contract.

Examples

(a) A has borrowed a certain sum of money from B, payable with interest at the stipulated rate. A, however, offers to pay to B only the amount of the principal (and not the amount of the accrued interest). In this case, it will not amount to a valid tender, inasmuch as, according to the terms of the agreement, the entire amount of the principal and interest was payable, whereas only the amount of the principal has been offered, with the exclusion of the amount of the accrued interest, and not the entire amount, as required under the contract.

(b) A has borrowed a certain sum of money from B, payable after certain time in full. A, however, offers to pay to B the borrowed amount in instalments, instead, and has also paid the amount of the first instalment to B. This again is not a valid tender as the payment in instalments is in contravention of the terms of the agreement to repay the amount in full, and not in instalments **[Behari Lal vs Ram Ghulam, 24 All. 461].**

(ii) It must be Made at a Proper Time and Place

The other condition whereby a tender may be considered to be valid is that it must be made at a proper time and place. Further, it must be made under such circumstances that the person to whom it is made may have a reasonable opportunity so as to ascertain that the person making such an offer is able and willing to perform his entire obligation as a whole, stipulated under the terms of the contract, and that too, then and there itself.

Examples

(a) A sends a letter to B to the effect that he will pay the amount that he owes to him. This is not a valid tender inasmuch as A has just sent a letter, which goes to suggest that A is not available at the place where B is present at the moment, and thereby he may not be able to pay the amount to B then and there.

(b) A offers to deliver the contracted quality and quantity of the goods to B at 2:00 a.m. at the dead of night. It will not be deemed to be a valid tender, as the time apparently is too odd and unreasonable. This, however, may be treated as a valid tender if it has been so agreed upon between the two parties.

Now, a question may arise as to what should be considered as a proper time and place. It, of course, depends upon the intention of the parties to the contract and as per the provisions of Sections 46 to 50, and Section 55, which has been discussed a little later in this chapter.

(iii) Promisee to have Opportunity to Verify the Goods being Delivered

As we have already seen, a tender is an offer by the promissor to deliver to the promisee the goods agreed upon. Accordingly, the promisee must be given a reasonable time and opportunity to verify the quality and quantity of the goods being so tendered, to enable him to satisfy himself that they are in conformity with the terms and conditions of the respective agreement.

Example

A has entered into a contract with B to deliver 100 quintals of certain quality of sugar to B at his (B's) warehouse on 31st December 2008. Accordingly, A must bring 100 quintals of the agreed quality of sugar to B at his (B's) warehouse on the appointed date (i.e. on 31st December 2008), and also under such circumstances that B may have a reasonable opportunity to satisfy himself that the sugar being so delivered by A is the sugar of the same quality as has been contracted for, as also that the total quantity weighs 100 quintals.

Here, it may be further pointed out that an offer to one of the several joints promisees (i.e. the parties to the contract on the other side) has the same legal effect as if the offer has been made to all of the joint promisees.

9.3 Who Must Perform?

The following persons can perform the promise made under the contract:

(i) The promisor himself;
(ii) The agent of the promisor, and
(iii) The legal representative(s) of the promisor.

We will now discuss the circumstances under which each one of these three parties may perform the contract.

(i) The Promisor Himself (Section 40)

In the cases where it appears from the contents of the contract that the party to the contact intends that the contract should be performed by the promisor himself, such contract must be performed by the promisor himself, and not by any other person. Let us take some illustrative examples.

Examples

(a) M. F. Husain has contracted with A to draw a painting for him. Here, the intention of A is that M. F. Hussain himself must perform the job, and no one else.
(b) Dr. Trehan has agreed with A to perform the by-pass surgery on him. Here again the intention of A is that Dr. Trehan himself must perform the operation and none else.

(ii) The Agent of the Promisor

In the cases other than the ones cited above (where it is clear that the performance of the contract is intended to be accomplished by the promisor himself), the agent of the promisor, employed for the purpose, could as well perform the contract. But such person (agent) must be competent enough to perform the job.

Example

A has promised to pay a sum of Rs 50,000 to B. In this case, either A may pay the amount to B personally or he may even arrange for the payment of the amount to B by some one else.

(iii) Legal Representative(s)

In the event of the death of the promissor, his legal representative(s) must perform the contract, unless some intention, to the contrary, may appear to be there from the contents of the contract.

Example

A has promised to B that he will deliver 100 bales of cotton of a certain quality to B on 31st December 2008, against payment of a sum of Rs 55,000. But A dies before that specified date, i.e. 31st December 2008. In this case, the legal representative(s) of A is/are bound to deliver 100 bales of cotton of the agreed quality to B on 31st December 2008, and B, on his part, is also equally bound to pay a sum of Rs 55,000 to the legal representative(s) of A.

Here, it may be pertinent to clarify that in the cases where the contract involves the personal skill of the promisor, or else where it is founded on normal considerations, it comes to an end, in the event of the death of the promisor.

Example

A, a painter, promises to paint a picture for B, by 31st October 2008. But A dies before that date. In this case, the contract cannot be performed either by the representative of A, nor by B.

9.4 Contracts, Which Need Not Be Performed

A contract need not be performed in the following cases:

(i) In the cases where the parties mutually agree to change the terms and conditions of the original contract by a fresh (new) one, or else they mutually agree to rescind or alter it **(Section 62).**

Example

A has borrowed a certain sum of money from B under a contract. However, a new contract has now been entered into among A, B, and C, whereby it has been agreed that henceforth B will accept C as his debtor instead of A. Thus, the old debt of A to B (under the old contract) will come to an end, and need not be performed now. Instead, a new contract between B and C will be in force henceforth, whereby C has agreed to pay the amount of the debt to B.

(ii) In the cases where the promisee dispenses with, or remits, wholly or even in part, the performance of the promise made to him, or extends the time for such performance, or accepts any satisfaction for it **(Section 63).**

Example

(a) P promises to paint a picture for R. Later on, R prohibits him to do so. Now, P is not bound to perform the promise.

(b) B has borrowed a sum of Rs 60,000 from C. B pays a sum of Rs 20,000 to C, and C accepts the amount in satisfaction of his entire dues from B. This payment will be treated as a full settlement of the entire loan amount.

(c) The recent strategy adopted by the banks to settle the long overdue loans (with a view to reducing the level of their Non-Performing Assets, popularly known as NPAs), where, by way of a one-time settlement, the entire long outstanding debts are fully settled, out of court, for a substantially lesser amount, is also an apt illustrative example in point.

(iii) In the case where the person, at whose option a contract is voidable, rescinds the contract **(Section 64).**

(iv) In the case where the promisee neglects or refuses to allow the promissor reasonable facilities to enable him to perform his promise **(Section 67).**

Example

C enters into a contract with H to repair the house of H. But H either neglects or refuses to show the places where the house requires the repairs. In such a situation, C need not perform his contract.

9.5 Performance of a Joint Promise

(i) Devolution of Joint Liability

In the cases where two or more persons make a joint promise, the promisee may, in the absence of an express contract to the contrary, ask any (one or more) of such joint promissors to perform the whole of the promise **(Section 43).**

Example

P, Q, and R jointly promise to pay to S a sum of Rs 50,000. S can compel any one of these three persons (viz. P or Q, or R) or any two of these three persons, to pay him the promised sum of Rs 50,000. In other words, it is not necessary for S to ask for the payment of the promised amount from the entire three persons, jointly, and at the same time.

It means that in such a case, the liability of all the joint promissors is both joint and several.

Release of Joint Promisors

Section 44 provides that in a situation where two or more persons have made a joint promise, the release of one of such joint promissors by the promisee does not discharge the other joint promisor or promisors. Further, such a situation does not even free such released person from his responsibility to the other joint promisor or promisors.

Example

A person had filed a suit against some partners of a firm for damages. But then, he had settled his claim against one of the partners and had accordingly agreed to withdraw his claim and his suit against that person. It was held that the suit could go on against the other partners named in the case, with the exclusion of one of the partners as a plaintiff in the case **[Kirtee Chunder vs Struthers (1878), 4 Cal 336]**.

But then, as against such provisions of law in India, under the English Law, the liability of the joint promisors is only joint, and not several. Thus, by way of a corollary and natural inference to such provisions under the English Law, if the promisee were to release or discharge any one or more of the joint promisors, it will have the effect of releasing or discharging all the joint promisors, including the remaining (unreleased or undischarged) ones too. That is to say that the promisee will have to file a suit against all the joint promisors jointly, and should not withdraw the case against any one of them.

Right of Contribution

In the cases where one of the joint promisors has been compelled to perform the promise in full by himself, he, in turn, has the right to compel each one of the other joint promisors to contribute equally with himself towards the performance of the promise so made jointly. That is, he has the right to recover the amount, so paid in excess by him, from the remaining promisors in equal proportions. But this provision will apply only in the cases where there is no intention to the contrary, as per the contents of the contract. Further, if one or more of the joint promisors were to default in making such contributions, the remaining joint promissors will have to bear the resultant loss, arising from such default, and that too, in equal proportions.

Examples

Let us presume a situation where A, B, and C have jointly promised to pay a sum of Rs 30,000 to D. We will now examine the quantum of contribution to be made by B and C, in the different situations, where in each such cases, A alone has been compelled by D to pay to him the entire amount of Rs 30,000.

(a) First, A can, and will be able to recover, a sum of Rs 10,000 each from B and C, in a normal situation where none of the two have defaulted.

(b) But let us take another case where B is insolvent and his assets are sufficient enough to meet only half of his obligation, i.e. Rs 5,000 only, instead of Rs 10,000. Here, the remaining two joint promisors will have to share the balance amount amongst themselves in equal proportion. That is, C will be required to pay Rs 12,500 only to A, and A will have to bear the loss of another Rs 2,500 (that is, 50 per cent of

the amount of Rs 5,000, defaulted by B). Thus, on a final analysis, the amount paid by A, B, and C comes to Rs 12,500, Rs 5,000, and Rs 12,500 respectively.

(c) However, in case B is not able to pay any amount, C would be required to pay Rs 15, 000 to A, and A will have to bear the loss of another Rs 5,000.

(ii) Devolution of Joint Rights (Section 45)

In the cases where a person has made a promise to two or more persons jointly, the right to claim the performance belongs to all the joint promisees. Further, after the death of any of them, it belongs to the representatives of such deceased promisee(s), jointly with the survivor or survivors [of the promisee(s)]. Furthermore, even after the death of the survivors, the right to claim performance rests with the representatives of all the promisees jointly. Such legal provisions, however, hold valid only in the absence of a contradictory intention appearing from the contract.

On a careful study and analysis of the provisions, as contained in Sections 44 and 45, we may observe that, as against the liability of the joint promisors being both joint and several, the right of the joint promisees, is only and exclusively joint, and not several. In other words, any one of the promisees or the representative(s) of one or more of the deceased promisee(s) cannot ask for the performance of the promise. As a corollary to this statement, all the joint promisees or the representatives of the deceased promise(s), as the case may be, will have to claim the performance jointly, i.e. together and jointly, and not separately. Such legal positions, however, will hold valid only in the absence of a contradictory intention appearing from the contract.

Example

A has borrowed a sum of Rs 50,000 from B and C jointly, and has promised to repay to B and C jointly, the loan amount together with the amount of interest at the agreed rate, on or before a specified date. B dies in the mean while. Now, the right to claim the performance will rest with C and the representative of B jointly (i.e. during the life time of C). Further, in the event of the death of even C, the right to claim the performance will rest with the representatives of both B and C jointly.

9.6 Time, Place, and Manner of Performance (Sections 46 to 50, and 55)

The legal provisions pertaining to the time, place, and manner of performance have been summarised in the following paragraphs:

(i) In the cases where the time of the performance of the contract has been specified, and the promisor has agreed to perform the contract without application (or demand) by the promisee, the promisor must perform the contract on such specified day/date. Such performance, however, should take place during the usual business hours of the promisee and at the place at which it is required to be performed.

Example

S has promised to deliver the goods to W on 24th October 2008, at his (W's) warehouse. Accordingly, S offers for the delivery of the goods to W on 24th October 2008, at his (W's) warehouse, but after the close of the usual working hours of the warehouse (when the warehouse was already closed). The performance is not valid, inasmuch as it has not been done during the working hours as was agreed to be the time of the required performance.

(ii) In the cases where a particular time of performance has not been specified, and the promissor has agreed to perform without a demand being made by the promisee in this regard, such performance must be made within a reasonable time. The reasonable time, however, will depend upon the merit and facts of each case, and thus, may vary from case to case.

(iii) In the cases where the day and date of the performance of the contract has been specified, but the promisor has not agreed to perform the contract without application (or demand) by the promisee, the

promisee is required to apply for (or demand) the performance at a proper (reasonable) place and within the usual business hours. The proper (reasonable) time and place, however, will depend upon the merit and facts of each case, and thus, may vary from case to case.

(iv) In the cases where the promisor has agreed to perform without a demand being made by the promisee in this regard, but no place has been fixed for such performance, the promisor is required to approach and request the promisee to specify a reasonable place for the performance of the promise, and he (promisor) is required to perform the promise at the place so specified by the promisee.

Example

S has undertaken to deliver 100 bales of cotton to P on 21st July 2008. As the place of such delivery has not been specified in the contract, S is required to approach P to appoint (specify) a reasonable place where he (P) will like to take delivery of the cotton bales, and S, on his part, must, now deliver the cotton bales to P at such appointed place.

(v) The performance of any promise may be made in any manner, or at any time, which the promisee stipulates or specifies.

Examples

(a) B has borrowed a sum of Rs 5 lakh from C. Later, C asks B to pay the dues to him by credit of the amount into his (C's) account maintained with the Bank of Lucknow. Incidentally, B also maintains his account with the same bank, viz. Bank of Lucknow. B instructs his banker (Bank of Lucknow) to debit his account with a sum of Rs 5 lakh and transfer the amount to the credit of the account of C, maintained with the same bank. The Bank of Lucknow, on its part, complies with the aforementioned instructions of B. But afterwards, before C could come to know of the aforementioned banking transaction, the Bank of Lucknow fails. In such a case, the payment made by B will be deemed to be a good payment. Accordingly, B will be deemed to have performed his promise, though the bank had failed after the transactions were completed.

(b) B has borrowed a sum of Rs 55,000 from C. C asks B to deliver to him certain goods, and deduct the amount from the amount due to him. Thus, the delivery of such goods by B will constitute a part payment of the loan.

(c) A owes a sum of Rs 1,000 to B. B asks A to send the currency notes worth Rs 1,000 to him by post. A sends the currency notes by post under cover of a letter, addressed to B, as desired. The promise is performed, and the debt is discharged the moment A posts the currency notes and the letter to the postal address of B.

9.7 Performance of Reciprocal Promises (Sections 51 to 54, and 57)

A reciprocal promise is a promise in return of a promise. That is, where the contract comprises a promise by one party (to do or not to do something in the future) in consideration of a similar promise by the other party, it will constitute a case of a reciprocal promise.

Reciprocal promises may be classified under the following three categories:

(i) Mutual and Dependent,
(ii) Mutual and Independent, and
(iii) Mutual and Concurrent.

(i) Mutual and Dependent

Mutual and dependent (reciprocal) promises occur in the cases where the performance on the part of one party depends upon the prior performance by the other party. Thus, if the party, who is supposed and required to perform before the other party, fails to perform, he cannot claim the performance of the reciprocal promise

by the other party. Instead, he will have to compensate the other party to the contract for any loss sustained by him (other party) due to his non-performance.

Examples

(a) H and T enter into a (reciprocal) contract to the effect that H will construct the house at a certain price, and T will supply the timber and iron materials required for the job. T, however, refuses to supply the timber and iron materials, as a result whereof the work could not be executed. In this case, H need not execute the work. At the same time, T will have to compensate the other party H for any loss sustained by him (other party) due to the non-performance by T.

(b) S promises to sell to P 100 bales of cotton the very next day, and P promises to make the payment after a month. S, however, does not supply the goods. Thus, P need not make any payment to S, as no supply has been made. At the same time, S will have to compensate P for non-supply of the goods, as promised.

(ii) Mutual and Independent

In the case of a mutual and independent promise, the respective performances by the two parties are not dependent upon the performance of the other party. In such a case, each party is required to perform his part of the promise without waiting for the performance, or readiness to perform, on the part of the other party.

Example

S promises to deliver the goods to P on 24th September 2008. P, in turn, promises to pay the price of the goods so supplied by S on 19th September 2008. In this case, the payment of the price of the goods, and the supply of the goods are independent of each other. Thus, even if, on 19th September 2008, P does not pay to S the price of the goods, S on his part, is required to supply the goods on the stipulated date, i.e. on 24th September 2008. He can, however, claim compensation from P for non-payment of the price on 19th September 2008.

(iii) Mutual and Concurrent

In the cases of mutual and concurrent (reciprocal) promises, the promises are required to be performed by both the parties (i.e. mutually), as also simultaneously (i.e. concurrently, or at the same time). Further, as provided under **Section 51**, where a contract comprises reciprocal promises to be performed simultaneously by both the parties, the promissor is not required to perform his part of the promise, unless and until the promisee is ready as also willing to perform his part of the (reciprocal) promise.

Examples

(a) A and B have entered into a contract to the effect that A will supply certain goods to B, on the condition that B will make the payment in certain instalments, but the first such instalment will be paid by B at the time the goods are actually delivered to B. In this case, A need not deliver the goods unless B is ready and willing to pay the first instalment on delivery. Similarly, B need not pay the first instalment unless and until A is ready and willing to deliver the goods to B, on payment of the first instalment.

(b) A and B have entered into a contract to the effect that A will supply certain goods to B, on the condition that B will make the full payment of the price of the goods to A at the time the goods are actually delivered to B. In this case, A need not deliver the goods to B unless B is ready and willing to make the full payment of the price of the goods to A on delivery. Similarly, B need not make the full payment of the price of the goods to A unless and until A is ready and willing to deliver the goods to B, on payment in full.

Reciprocal promise to do some things which are legal and some others which are illegal (Section 57)

Section 57 stipulates that in the cases where the two parties reciprocally agree, to do certain things which are legal, but at the same time, reciprocally agree to do some other things (under some specified circumstances),

which happen to be illegal, the first set of the promise(s) constitutes a contract, but the second set of the promise(s) will be treated as a void agreement.

Examples

S and B enter into two separate sets of contracts to the effect that S will sell his house to B for Rs 20 lakh, if B uses it for residential purposes; but he will sell the same house to B for Rs 55 lakh, if B uses the house as a gambling den. In this case, while the first set of the agreement for the sale of the house for Rs 20 lakh is concerned, it will constitute a valid and enforceable contract. But, so far as the second part of the agreement is concerned (i.e. to sell the house for Rs 55 lakh with the unlawful objective of using it as a gambling den), it will be treated as void, inasmuch as all agreements with unlawful objects are void *ab initio*.

9.8 Assignments of Contracts

The term, 'Assignments of Contracts' means the transference of the rights, under the contract. Thus, where the party to a contract transfers his rights, titles, or interest, in a contract, to some other person or persons, he is said to have assigned the contract. Here, it may be noted with care that only the rights (and not the obligations or liabilities), under the contract can be assigned.

The assignment of a contract can usually take place in one of the following two ways:

(i) By operation of law, and
(ii) By an act of the parties.

(i) Assignment by Operation of Law

The assignment of a contract by operation of law may take place by way of assignment of interest in the event of insolvency or death of the party to the contract. Further, in the case of the insolvency of the party to the contract, the 'Official Receiver' or the 'assignee' acquires the interest in the contract, as per the law. As against this, in the case of the death of the party to the contract, the legal representative(s) of the deceased party acquire(s) the interest in the contract, as per the law.

(ii) Assignment by an Act of the Parties

In such cases, the parties to the contract themselves assign the contract to some other party or parties.

Let us now discuss and summarise the rules regarding the assignment of the contracts.

9.9 Rules of Assignment

(i) Only the rights covered under the contract can be assigned, and not the obligations or liabilities pertaining thereto.

Example

Suppose that A owes a sum of Rs 5,000 to B. Here, A cannot transfer to C his obligation to repay the loan to B, and thereby to force B to collect the amount from C, instead. But then, in case the promisee (i.e. B in this case) agrees to such an arrangement of assignment, he will be bound thereby. However, in such a case, a new contract gets substituted in place of the previous one. Such contract is referred to as 'novation'. Therefore, in the above example, if B were to accept payment from C, instead of A, the assignment will be held valid, and accordingly, A will be deemed to have been absolved of his obligation (liability) to pay the amount to B.

(ii) Rights and benefits under a contract can be assigned.

Let us explain the point with the help of the above illustrative example itself, with slight modification in the situation.

Example

As we have seen in the above example, where A owes a sum of Rs 5,000 to B, A cannot transfer to C his obligation to repay the loan to B, and thereby to force B to collect the amount from C, instead. But, even in this case, B can assign his right to C, inasmuch as the assignment of right is permissible. But even in such cases, the right or benefit cannot be assigned to another person if such right or benefit involves the personal skill, ability, or such other personal qualifications or merits. For example, a contract to marry cannot be assigned.

(iii) There may be cases where the rights of a party to the contract may amount to 'actionable claim' or chose-in-action. Now let us first see as to what constitutes an actionable claim.

As per Section 3 of the Transfer of Property Act, an actionable claim 'is a claim to any debt (except a secured debt) or to any beneficial interest …. whether such claim or beneficial interest be existent, accruing, conditional or contingent'.

Examples of actionable claims are the following:

(a) A debt pertaining to repayment of some amount of money;
(b) The interest of the buyer in the goods in a contract for forward delivery, and so on.

It has been further provided under Section 130 of the Transfer of Property Act, that actionable claims can be assigned by a document in writing. Moreover, notice of such assignment must also be given to the debtor to make the assignment valid.

Appropriation of Payment (Sections 59 to 61)

There may be cases where one person might have taken more than one loan from one and the same person or organisation like a bank. In such a case, where the borrower makes some repayment by specifically stating as to on which one of his loan accounts it must be deposited or appropriated, there will be no problem, and the creditor will compulsorily have to credit the amount so received to the loan account clearly and categorically specified by the borrower. But then, a problematic situation may arise when the borrower, at the time of making some repayment towards the repayment of the loan amounts, does not specify as to on which one of his loan accounts it must be deposited or appropriated. Under the English Law, this problem is to be settled on the principles laid down in the famous **'Clayton's Case' [(1816) 1 Mer. 572, 610].** In India, however, the position is different, and the procedure and pattern of the required appropriation of the amount received in repayment of different loan accounts has been clearly stated under **Sections 59 to 61,** which, too, in fact, have been largely based on the principles and rules laid down in the **'Clayton's Case',** of course, with some modifications. These provisions (rules of appropriation) have been discussed hereafter.

Rule No. 1: Appropriation by the Debtor

As already stated in the preceding paragraph, when the borrower makes some repayment by specifically stating as to on which one of his loan accounts it must be deposited or appropriated, the creditor will compulsorily have to credit the amount, so received and accepted, to the loan account categorically specified by the borrower. (**Section 59**)

Section 59 also specifies that, even in the cases where no such specification has been categorically made by the borrower, but the circumstances of the case so imply and indicate that the amount is intended by the borrower to be appropriated on some specific loan account, though not specified as such by the borrower, the amount, when received and accepted, must be appropriated to that very loan account. Let us clarify the position with the help of some illustrative examples.

Examples

(a) B had borrowed several loans from the creditor C. Out of these several loan accounts; a sum of Rs 5,000 was outstanding on one of B's accounts, as on 31st October 2008. Further, B had raised this loan against the execution of a Demand Promissory Note (D P Note) expiring on 31st October 2008 itself. Moreover, there was no other loan account of B with the creditor C with the outstanding amount of exactly Rs 5,000. On 31st October 2008, the borrower had deposited a sum of exactly Rs 5,000, but

without specifying as to which of his loan accounts it must be appropriated to. In such circumstances, the amount so received and accepted will be deposited in the appropriation of the loan account with the outstanding (dues) to the extent of the exact amount of Rs 5,000 so deposited, and thereby the D P Note will also get discharged. This is so because the very fact that the amount of exactly a sum of Rs 5,000 had been deposited by the borrower, and there was no other account of B with C, with the outstanding of the same amount, his intention, as per the circumstances of the case, clearly indicated that the amount was to be appropriated towards the full repayment and liquidation of the loan account with the exact outstanding of the amount of Rs 5,000 on date.

(b) B has borrowed several loans from the creditor C. Out of these several loan accounts, B owes a sum of Rs 555 on one and only one of his loan accounts with C. B receives a letter from C, asking him for the payment of a sum of Rs 555. Accordingly, B sends a cheque for a sum of Rs 555, as asked for. In this case, it is clear from the aforementioned circumstances that the cheque for Rs 555 has been intended by the borrower to be appropriated towards the liquidation of the entire loan amount of Rs 555 on that specific account with such exact outstanding.

Rule No. 2: Appropriation by the Creditor

There may be some other types of cases where neither the borrower specifies as to on which one of his multiple loan accounts he intends the amount, so deposited, is to be appropriated, nor do the circumstances of the case indicate towards any specific intention of the borrower to be inferred from. In such cases, the creditor has the sole discretion to apply the amount to any of the several loan accounts of the borrower, provided such loan is a lawful debt, and that it is actually due for payment, and is actually payable to him by the debtor. Here, it may be further pointedly reiterated that in such cases the creditor will be within his legal rights to appropriate such unspecified payment even towards the repayment of a time-barred debt. However, it must be noted here with care that under such unspecified circumstances, the creditor cannot apply the amount so deposited by the borrower towards the repayment of any disputed debt. **(Section 60).**

Example

B has borrowed the amounts of Rs 5 lakh and Rs 15 lakh from the creditor C on two different accounts. Out of these two loans, the loan for a sum of Rs 15 lakh has been collaterally (additionally) secured by way of a third party guarantee by G, as also an equitable mortgage of the house property of B. B sends a cheque for a sum of Rs 3 lakh to C but without specifying as on which of these two accounts the amount so sent is to be applied against. In such a case, the creditor prefers to apply it towards the part payment of the loan account with the outstanding of Rs 5 lakh, which is not having any collateral security by way of a third party guarantee or an equitable mortgage of any landed property. C does so because the loan for Rs 15 lakh has some substantial collateral security too, in addition to some other primary security. In such a case, the creditor C is legally justified in his action regarding the application of the amount deposited by the borrower B. C's such action cannot be disputed by either B or G.

Rule No. 3: Where neither of the two parties appropriates (Section 61)

In the cases where neither the borrower specifies nor the creditors applies his discretion in regard to the manner of the appropriation of the amount deposited by the borrower, the amount will be appropriated in the discharge (or part payment) of the debt in order of time. That is to say that the loan, which has been raised first (or on the earliest date) will be appropriated against first, followed by the next earliest debt, and so on. Here, it may be further clarified that in such cases, even the time-barred debts could be appropriated, if it happens to be the earliest one. It may be further clarified that under the circumstances where two or more loans had an equal standing (i.e. where more than one loan had been raised on the same day), the payment will need to be applied proportionately among all such accounts. These provisions, made in Section 61, are largely based on the rules laid down in the aforementioned Clayton's Case.

The aforementioned appropriation procedure will be applicable in the cases of non-running accounts like the demand loan or the term loan accounts; that is, in regard to such accounts which are not in the nature of

running accounts. The term 'non-running' account suggests that while the amount of loan could be disbursed in phases and in instalments, the amount, of money once deposited therein cannot be withdrawn again till the account remains live and active. Let us now apply the Rule No. 3 in the cases of running accounts, like the cash credit account or the overdraft account (the terms generally used by the banks). In the case of a running account, the money can be deposited any time, and it can again be withdrawn any number of times without any restrictions. Thus, the amount once deposited can again be withdrawn (as against in the case of a non-running account where the amount once deposited cannot be withdrawn).

Let us demonstrate the position of a running account, like the overdraft account or the cash credit account, as the various debit and credit entries will appear in the party ledger account with the bank or in the statement of the bank account sent to the borrower every month.

Bank's Statement of Cash Credit Account of B for the month of October 2008

Limit Rs 50,000

Date	Particulars	Debit	Credit	Balance (Rs)
1	Cheque paid	15, 000		15, 000 (debit)
7	Cash deposited		10, 000	5, 000 (debit)
15	Cheque paid	25, 000		30, 000 (debit)
27	Cheque paid	12, 000		42, 000 (debit)
30	Cash deposited		14, 000	28, 000 (debit)
		52, 000	24, 000	

We thus, observe from the above statement of account that the various credit entries made in the borrower's ledger account are being (automatically) applied to decrease the earlier debit balance outstanding in the account. In such a case, the various debits and credits made into the account will be appropriated against one another, in the order of the dates of the respective transactions, and thereby leaving only the final balance, which remains due as on that date, and which remains to be recovered by the creditor from the debtor. Such position of the account, as also the amount of the resultant final debit balance to be recovered from the borrower by the bank, keeps on changing from time to time, in the case of running accounts. And this system and mechanism of the appropriation of the amount so deposited on the account, keeps on.

Case of Hallett's Estate, by way of an exception to Rule No. 3

It will be pertinent to mention here the rule laid down in the case of Hallett's Estate, which is an exception to the rule No. 3 above. This rule applies in the cases where the trustee happens to mix-up the funds of the trust with his own funds. In such cases, where the trustee happens to misappropriate any sum of money belonging to the trust, the first amount so withdrawn by the trustee would be first debited to the own money of the trustee, and only thereafter to the funds of the trust. This is the laid down procedure in regard to the wrongful withdrawal of the trust money by the trustee. As against the withdrawals, in the case of any deposit made by the trustee, such amount will be first credited to the account of the trust and only the balance amount, if any, would be credited to his own personal account. These various procedures will be invariably followed in such cases, irrespective of the order of the dates of such withdrawals or deposits.

Example

The trustee T deposits a sum of Rs 2 lakh, being the trust money, in the bank account. Thereafter, at a later date, he also deposits a sum of Rs 5 lakh in the same bank account, which, however, is his own money. Subsequently, he withdraws a sum of Rs 1 lakh from the trust account, and misappropriates it. This withdrawal of a sum of Rs 1 lakh will not be appropriated against the trust amount of Rs 2 lakh, but only and exclusively against his own deposit of Rs 5 lakh, despite the fact that this deposit of Rs 5 lakh was made in the bank account at a later date than the first deposit of Rs 2 lakh. This way the trust fund has remained intact and protected. In fact, the rationale behind the rule established in the case of Hallett's Estate is to safeguard the interest of the trust against the acts of misappropriation of funds, and the like, by some unscrupulous trustees.

Let us Recapitulate

The performance of a contract means the carrying out of the respective obligations undertaken by each of the two parties to the contract. They must either perform or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of the Contract Act, or of any other law.

Offer to Perform or Tender of Performance

Where the promisor offers to perform his obligation, at the proper time and place, but the promisee refuses to accept the performance, it is referred to as the 'tender' or an 'attempted performance'. Section 38 provides that, if a valid tender is made and it is not accepted by the promisee, the promissor will not be held responsible for the non-performance, nor shall he lose the right under the contract.

Conditions to consider the tender or an offer of performance, to be valid

(i) It must be unconditional
(ii) It must be made at a proper time and place
(iii) Promisee to have a reasonable time and opportunity to verify the quality and quantity of goods being delivered

Who Must Perform?

The following persons can perform the promise made under the contract:

(a) The promisor himself;
(b) The agent of the promisor, and
(c) The legal representative(s) of the promisor.

Performance of a Joint Promise

(a) Devolution of Joint Liability

Where two or more persons make a joint promise, the primisee may, in the absence of an express contract to the contrary, ask any (one or more) of such joint promisors to perform the whole of the promise **(Section 43).**

(b) Release of Joint Promisors (Section 44)

Where two or more persons have made a joint promise, the release of one of such joint promisors by the promisee does not discharge the other joint promissor or promissors. Further, such a situation does not free such released person from his responsibility to the other joint promisor or promisors. Under the English Law, however, the liability of the joint promissors is only joint, and not several.

(c) Right of Contribution

Where one of the joint promissors has been compelled to perform the promise in full by himself, he has the right to compel each one of the other joint promisors to contribute equally with himself towards the performance of the promise so made jointly. That is, he has the right to recover the amount, so paid in excess by him, from the remaining promisors in equal proportions. But this provision will apply only in the cases where there is no intention to the contrary, as per the contents of the contract. Further, if one or more of the joint promissors were to default in making such contributions, the remaining joint promissors will have to bear the resultant loss, arising from such default, and that too, in equal proportions.

(d) Devolution of Joint Rights (Section 45)

Where a person has made a promise to two or more persons jointly, the right to claim the performance belongs to all the joint promisees. Further, after the death of any of them, it belongs to the legal representatives of such deceased promisee(s), jointly with the survivor or survivors [of the promisee(s)]. Furthermore, even after the death of the survivors, the right to claim performance rests with the representatives of all the promisees jointly. Such legal provisions, however, hold valid only in the absence of a contradictory intention appearing from the contract. Thus, we find that, as against the liability of the joint promisors being both joint and several, the right of the joint promisees, is only and exclusively joint, and not several.

Time, Place, and Manner of Performance (Sections 46 to 50, and 55)

(i) Where the time of the performance of the contract has been specified, and the promissor has agreed to perform the contract without application (or demand) by the promisee, the promissor must perform the contract on such specified day/date. Such performance, however, should take place during the usual business hours of the promisee and at the place at which it is required to be performed.

(ii) Where a particular time of performance has not been specified, and the promissor has agreed to perform without a demand being made by the promisee, such performance must be made within a reasonable time. The reasonable time, however, will depend upon the merit and facts of each case, and thus, may vary from case to case.

(iii) Where the day and date of the performance of the contract has been specified, but the promissor has not agreed to perform the contract without application (or demand) by the promisee, the promisee is required to apply for (or demand) the performance at a proper (reasonable) place and within the usual business hours. The proper (reasonable) time and place, however, will depend upon the merit and facts of each case, and thus, may vary from case to case.

(iv) In the cases where the promissor has agreed to perform without a demand being made by the promisee, but no place has been fixed for such performance, the promisor is required to approach and request the promisee to specify a reasonable place for the performance of the promise, and he (promissor) is required to perform the promise at the place so specified by the promisee.

(v) The performance of any promise may be made in any manner, or at any time, which the promisee stipulates or specifies.

Performance of Reciprocal Promises (Sections 51 to 54, and 57)

Where the contract comprises a promise by one party (to do or not to do something in the future) in consideration of a similar promise by the other party, it will constitute a case of a reciprocal promise.

Reciprocal promises may be classified under the following three categories:

(a) Mutual and Dependent,
(b) Mutual and Independent, and
(c) Mutual and Concurrent.

Assignments of Contracts

The term 'Assignments of Contracts' means the transference of the rights under the contract. Thus, where the party to a contract transfers his rights, titles or interest, in a contract, to some other person or persons, he is said to have assigned the contract. Here, it may be noted with care that only the rights (and not the obligations or liabilities) under the contract can be assigned.

The assignment of a contract can usually take place in one of the following two ways:

(a) By operation of law, and
(b) By an act of the parties.

Rules of Assignment

(i) Only the rights covered under the contract can be assigned, and not the obligations or liabilities pertaining thereto.

(ii) Rights and benefits under a contract can be assigned.

(iii) There may be cases where the rights of a party to the contract may amount to 'actionable claim' or chose-in-action. As per Section 3 of the Transfer of Property Act, an actionable claim 'is a claim to any debt (except a secured debt) or to any beneficial interest …. whether such claim or beneficial interest be existent, accruing, conditional or contingent'.

Examples of actionable claims are the following:

(i) A debt pertaining to repayment of some amount of money;
(ii) The interest of the buyer in the goods in a contract for forward delivery, and so on.

It has been further provided under Section 130 of the Transfer of Property Act, that actionable claims can be assigned by a document in writing. Moreover, notice of such assignment must also be given to the debtor to make the assignment valid.

Appropriation of Payment (Sections 59 to 61)

Where one person has taken more than one loans from one and the same person or organisation like a bank, and the borrower makes some repayment by specifically stating as to on which one of his loan accounts it must be deposited or appropriated, the creditor will compulsorily have to credit the amount so received to the loan account clearly and categorically specified by the borrower. But when the borrower, does not specify as to on which one of his loan accounts it must be deposited or appropriated, such problem, under the English Law, is to be settled on the principles laid down in the famous **'Clayton's Case' [(1816) 1 Mer. 572, 610].** In India, however, the position is different, and the procedure and pattern has been clearly stated under **Sections 59 to 61,** largely based on the principles and rules laid down in the **'Clayton's Case',** with some modifications.

Questions for Reflection

1. (a) What is meant by the term 'Performance of a Contract'?
   (b) What is meant by the term 'tender' or an 'attempted performance'?
   Explain, with the help of illustrative examples in each case.
2. What are the various conditions, which must be satisfied whereafter an offer to perform or tender of performance, is deemed to be valid?
3. What are the different circumstances under which each one of the following three parties may perform the contract?
   (a) The promisor himself;
   (b) The agent of the promisor; and
   (c) The legal representative(s) of the promisor.
   Give suitable examples to clarify the points.
4. Under what circumstances a contract need not be performed?
5. 'In the cases where two or more persons make a joint promise, the promisee may, in the absence of an express contract to the contrary, ask any (one or more) of such joint promissors to perform the whole of the promise.' Explain this statement with the help of illustrative examples.
6. (a) 'In a situation where two or more persons have made a joint promise, the release of one of such joint promissors by the promisee does not discharge the other joint promisor or promisors. Further, such a situation does not even free such released person from his responsibility to the other joint promisor or promisors.' Discuss with the help of illustrative examples.
   (b) Are the provisions any different under the English Law, and if so, in what ways?
7. 'In the cases where one of the joint promisors has been compelled to perform the promise in full by himself, he, in turn, has the right to compel each one of the other joint promisors to contribute equally with himself towards the performance of the promise so made jointly.' Explain this statement with the help of illustrative examples.
8. 'As against the liability of the joint promisors being both joint and several, the right of the joint promisees, is only and exclusively joint, and not several'. Discuss, with the help of illustrative examples to clarify the legal points involved.
9. Discuss the various legal provisions pertaining to the time, place and manner of performance of a contact with the help of illustrative examples in each case.
10. What are the salient and distinguishing features of the following three categories of reciprocal promises?
    (a) Mutual and Dependent,
    (b) Mutual and Independent, and
    (c) Mutual and Concurrent.

11. Explain the legal position that may obtain in the cases where the two parties reciprocally agree, to do certain things which are legal, but at the same time, reciprocally agree to do some other things (under some specified circumstances) which happen to be illegal. Citing of illustrative examples is a must in each case.
12. (a) What does the term 'Assignments of Contracts' mean?
    (b) Discuss the assignments taking place by way of
    (i) The operation of law, and
    (ii) By an act of the parties.
    (c) Will it be in order to state that only the rights (and not the obligations or liabilities) can be assigned? Explain.
13. Discuss the various rules of appropriation of amount deposited by the borrower towards the repayment of the multiple debts raised by him from the same creditor.
14. Explain the main legal points involved in the rules laid down in the case of Hallett's Estate, by citing suitable illustrations to clarify the points.

Problems for Practice (With Suggested Solutions)

Problem 1

Satya Prakash had entered into a contract with Ustad Bismillah Khan to the effect that the latter himself must personally play the Shahnai in the marriage of his daughter, Shikha. But unfortunately, well before the date of the marriage of Shikha, Ustad Bismillah Khan had expired. Do you think that the legal heirs of Ustad Bismillah Khan—all of them being competent *shanai* players in their own right—can legally insist on performing the contract in question, under such an eventuality? Give reasons for your answer.

Solution

No. The legal heirs of Ustad Bismillah Khan cannot legally insist on performing the contract in question, even under such an eventuality, and in spite of the fact that all of them were also competent *shanai* players in their own right. This is so because the intention of Satya Prakash had been—as is evident from the contents of the agreement in question—that Ustad Bismillah Khan and Ustad Bismillah Khan alone must perform, and none else, as per the contract. This stand is based on the provisions under Section 40 of the Act, to the effect that in the cases where it appears from the contents of the contract that the party to the contact intends that the contract should be performed by the promisor himself, such contract must be performed by the promisor himself, and not by any other person. And, as the contract in question had involved the personal skill of the promisor, it had naturally come to an end after the death of the promisor, viz. Ustad Bismillah Khan in the instant case.

Problem 2

Adarsh and Bhaskar had entered into an agreement to the effect that Adarsh will supply to Bhaskar 500 bags of Birla white cement on 31st May 2009, against payment of a sum of Rs 4 lakh. But unfortunately Adarsh died on 24th April 2009.

(i) Are the legal representatives of Adarsh bound to deliver 500 bags of Birla white cement to Bhaskar on 31st May 2009? Give reasons for your answer.
(ii) Is Bhaskar equally legally bound to pay a sum of Rs 4 lakh to the legal representatives of Adarsh?

Solution

(i) Yes. The legal representatives of Adarsh are legally bound to deliver 500 bags of Birla white cement to Bhaskar on 31st May 2009. This is so because, the supply of cement of the specific brand did not involve any personal skill on the part of the promissor, which otherwise would have required the performance of the contract by him personally, as had been the case in Problem 1 above. And, under such cases, the legal representatives of the promissor are required under law to perform the act of the promissor.

(ii) Further, in turn, Bhaskar will also be equally legally bound to pay a sum of Rs 4 lakh to the legal representatives of Adarsh, being the amount of the agreed price of the required brand and quantity of cement supplied by the legal representatives of Adarsh.

Problem 3

Blake had borrowed a sum of Rs 2 lakh from Carlyle. Later, Carlyle had asked Blake to repay the amount to him by credit to his (Carlyle's) current account maintained with the Rajasthan Cooperative Bank, Jaipur. Blake also happened to maintain his account with the same bank, viz Rajasthan Cooperative Bank, Jaipur. Accordingly, Blake had issued the necessary instructions to his banker (Rajasthan Cooperative Bank, Jaipur) to debit his current account with a sum of Rs 2 lakh and transfer the amount to the credit of the account of Carlyle, maintained with the same bank. The Rajasthan Cooperative Bank, Jaipur, on its part, complied with the aforementioned instructions of Blake instantaneously, the same day. But before Carlyle could come to know of the aforementioned banking transaction, the Rajasthan Cooperative Bank, Jaipur, had failed. And, when Carlyle demanded the repayment of the loan amount of Rs 2 lakh from Blake, he (Blake) argued that, in the aforementioned circumstances, the payment made by him (Blake) should be deemed to be a good payment. Accordingly, Blake should be deemed to have performed his promise of repaying the loan amount to Carlyle, on the ground that the transaction in question had already been completed well before the bank had failed. Carlyle did not agree and held that the contention of Blake was not legally valid. In your expert opinion, whose contentions are likely to be held valid in the Court of law? Give reasons for your answer.

Solution

Keeping in view the circumstances of the instant case, the payment made by Blake will be deemed to be a good payment. Accordingly, in view of the Court, Blake will be deemed to have performed his promise, of repaying the loan amount to Carlyle, because the bank had failed after the transactions were completed.

Problem 4

Sujata and Basanti had entered into two separate sets of contracts to the effect that Sujata will sell her residential quarter to Basanti for Rs 1 lakh, if Basanti uses it for residential purposes, but she will sell the same quarter to her (Basanti) for Rs 5 lakh, if she (Basanti) uses the quarter as a gambling den, instead. Do you think that only one of the two sets of the aforementioned agreements, or both of them, would be declared as void? Give specific answers in respect of each of the two agreements separately, quoting the relevant Section(s) in support of your contention.

Solution

Section 57 stipulates that in the cases where the two parties reciprocally agree, to do certain things which are legal, but at the same time, reciprocally agree to do some other things (under some specified circumstances) which happen to be illegal, the first set of the promise constitutes a contract, but the second set of the promise will be treated as a void agreement.

Accordingly, in the instant case, while the first set of the agreement, for the sale of the residential quarter for Rs 1 lakh (to be used for residential purposes) is concerned, it will constitute a valid and enforceable contract. But, so far as the second part of the agreement is concerned (i.e. to sell the residential quarter for Rs 5 lakh with the unlawful objective of using it as a gambling den), it will be treated as void, inasmuch as all agreements with unlawful objects are void *ab initio*.

Problem 5

Arun had borrowed a sum of Rs 20,000 from Banwari and Kunal jointly, and had promised to repay the loan amount, along with the amount of accrued interest at the agreed rate, to Banwari and Kunal jointly, on or before 30th June 2009. But unfortunately, Banwari had died on 30th May 2009.

(i) In the foregoing circumstances, with whom will the right to claim the performance rest?
(ii) Will the position be any different, if Kunal would also have died on 10th June 2009?

Solution

(i) In situation stated in (i) above, the right to claim the performance will rest with Kunal and the representative of Banwari jointly (i.e. during the lifetime of Kunal).

(ii) As against this, under the situation stated in (ii) above (i.e. in the event of the death of even Kunal), the right to claim the performance will rest with the representatives of both Banwari and Kunal jointly.

Problem 6

Shamim had promised to deliver 100 bags of sugar to Wasim on 18th May 2009, at his (Wasim's) warehouse, during the working hours. Accordingly, on 18th May 2009, at around 10 p.m., Shamim had gone to the warehouse of Wasim to deliver 100 bags of sugar to Wasim at his (Wasims's) warehouse. But by that time, the warehouse of Wasim was already closed, as it usually functioned between 10 a.m. to 6 p.m. Do you think that the contention of Shamim, that he had already performed the contract, would be held valid in the Court of law? Give reasons for your answer.

Solution

No. The contention of Shamim, to the effect that he had already performed the contract, would not be held valid in the Court of law, on the ground that it had not been done during the working hours of Wasim's warehouse, as was agreed to be the time of the required performance.

Problem 7

Zahid had taken several loans from the Bank of Agra. And, amongst the different loans, a sum of Rs 12,000 only was outstanding on one of these accounts, as on 31st May 2009. On 31st May 2009, Zahid had deposited a sum of Rs 12,000 only with the bank, but he had forgotten to specifically mention in his letter to the bank as to in which one of his loan accounts the amount must be credited. Taking due advantage of such a situation, the Bank of Agra had deposited this amount in one of the loan accounts of Zahid with an outstanding balance of Rs 21,000 as on 31st May 2009, on the logical ground that this particular loan account was shortly going to become time-barred, and in this way, this particular loan account will be saved from becoming time-barred. Do you think that such an action of the bank was legally valid and justifiable on the aforementioned ground, as contemplated by the bank? Give reasons for your answer.

Solution

No. The action of the bank, in the instant case, was not legally valid. We come to this conclusion, on a closer and careful examination of the following facts of the case:

(i) First, that the amount of exactly a sum of Rs 12,000 had been deposited by Zahid (the borrower) with the bank on 31st May 2009, and

(ii) Second, that there was no other loan account of Zahid with the bank, having an outstanding of exactly the same amount, i.e. Rs 12,000, on that day, i.e. on 31st May 2009.

Thus, the aforementioned two facts of the case, when read and analysed together, indisputably go to indicate that he (Zahid) had clearly and unambiguously intended that the amount of Rs 12,000, so deposited by him with the bank on 31st May 2009, must be appropriated towards the full repayment and liquidation of his that very loan account which was having an outstanding of the exact amount of Rs 12,000 on that day, i.e. on 31st May 2009. Therefore, his having forgotten to mention his aforementioned intention specifically in his letter to the bank will not in the least alter the situation in the instant case. Accordingly, the bank will be well-advised to reverse the entries and appropriate the amount of Rs 12, 000, so deposited by Zahid, in full and final settlement and liquidation of that very loan account of Zahid, which was having an outstanding of exactly the same amount, i.e. Rs 12,000, on that day, i.e. on 31st May 2009.

This is so because, Section 59 of the Act, *inter alia*, specifies that, in the cases where no such specification has been categorically made by the borrower, but the circumstances of the case so imply and indicate that the amount is intended by the borrower to be appropriated on some specific loan account, though not specified as such by the borrower, the amount, when received and accepted, must be appropriated to that very loan account.

Problem 8

Would the position be any different in Problem 7 above, had Zahid sent a cheque to the bank for Rs 10,000, instead of for Rs 12,000—other conditions and facts of the case remaining the same? Give reasons for your answer.

Solution

Yes. In that eventuality, the bank's action would have been held legally valid, and Zahid, the borrower, would not have been in a position to raise any objection, either. This is so because, in those changed circumstances, the case would have fallen into quite a different category of cases where neither the borrower had specified as to on which one of his multiple loan accounts he intended the amount so deposited by him was to be appropriated, nor did the circumstances of the case indicated towards any specific intention of the borrower to be inferred from (as was the case in Problem 7 above). Thus, in such cases, as per the provisions of Section 60 of the Act, the creditor, i.e. the Bank of Agra in the instant case, had the sole discretion to apply the amount to any of the several loan accounts of the borrower, provided such loan was a lawful debt, and that it was actually due for payment, and was actually payable to the bank by the debtor. Here, it may be further pointed out that in such cases the creditor will be within his legal rights to appropriate such unspecified payment even towards the repayment of a time-barred debt, as has specifically been so provided under Section 60 of the Act.

Problem 9

Avinash had borrowed a sum of Rs 90,000 from Kailash, which amount he (Avinash) was not repaying to Kailash despite repeated reminders. With great persuasion by Kailash, Avinash had finally agreed to pay to Kailash a sum of Rs 50,000 only, as against the loan amount of Rs 90,000, but in full and final settlement of the entire loan amount of Rs 90,000. Kailash had agreed to this offer of Avinash, thinking that he would be able to recover the balance amount in the Court of law against the Demand Promissory Note (D P Note) that was executed by Avinash for Rs 90,000, the exact amount advanced by Kailash to him. Thus, when Avinash had paid him a sum of Rs 50, 000, he (Kailash) had readily accepted the amount. Later on, Kailash had preferred to file a suit against Avinash for recovery of the balance amount of Rs 40,000 from him. What are the chances of Kailash winning the case? Give reasons for your answer.

Solution

No. Kailash has no chance of winning the case, because, under the fresh agreement between Avinash and Kailash, the payment of a sum of Rs 50,000 by Kailash will be treated as a full settlement of the entire loan amount of Rs 90,000. This is so because, as per the provisions of Section 63 of the Act, every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may accept instead of it any satisfaction which he deems fit. This point has been further clarified beyond doubt by way of the illustration (b) given at Section 62 of the Act.

Chapter Ten

Discharge of Contracts

> *Too great a hurry to discharge an obligation is a kind of ingratitude.*
> **Francois De La Rochefoucauld**
>
> *The only way to get rid of responsibilities is to discharge them.*
> **Walter S. Robertson**

10.1 Manners of Discharge of Contracts

A contract may be discharged in the following manner:

(i) (a) By performance or
(b) By tender,
(ii) By mutual consent,
(iii) By subsequent impossibility,
(iv) By operation of law, and
(v) By breach of contract.

Let us now discuss these different ways of discharging a contract one after the other.

(i) (a) By Performance

The most expected and natural manner of discharging a contract is by way of performing the contract itself; that is, by both the parties to the contract performing or doing whatever they were expected to perform or do, as per the terms of the contract. Thus, the contract gets accomplished and comes to an end.

Example

S promises to sell his second-hand sofa set to B for a sum of Rs 5,500. S delivers the sofa set to B, and B also, on his part, pays a sum of Rs 5,500 to S immediately. Thus, the contract is said to have been performed by performance.

This point has already been discussed, in detail, in the preceding Chapter 9 on 'Performance of Contracts'.

(i) (b) By Tender

Further, the offer of performance, referred to as tender (for performance), also has the same effect as the performance itself. That is, if the promisor tenders performance of his part of the promise, but the other party refuses to accept it, the promisor automatically gets discharged of his obligations (duty to perform) the contract. [For a detailed discussion on this point, please refer to the relevant portions of the preceding Chapter 9 on 'Performance of Contracts'.]

(ii) By Mutual Consent (Section 62)

Where both the parties to a contract mutually agree to substitute the old contract with a new one in its place, or to rescind it, or to alter its terms and conditions, the original contract thereby gets discharged.

A contract may get terminated or discharged by mutual consent in any one of the following manners:

(a) By Novation

By Novation, i.e. by the substitution of an original (old) contract by a new one. Such novation could take place between the same old parties, or even between different parties.

Examples

(a) B has borrowed a sum of Rs 1 lakh from C. B, however, offers that he will create an equitable mortgage of one of his landed properties in favour of C, but for a sum of Rs 75,000 only. C accepts this offer, and the mortgage is created accordingly. Thus, this contract so made substitutes the original (old) contract, and the old one thereby gets automatically terminated.

(b) B has borrowed a sum of Rs 50,000 from C. Later, it is agreed upon between B, C, and N (a new party) that C will, hereafter accept N as his debtor instead of B. Thus, the old agreement between B and C comes to an end, and now B is no longer required to pay his debt amount of Rs 50, 000 to C. Now, a new debt has been contracted between C and N, the new and different party.

In this context, it must be clearly understood that the new contract, which goes to substitute the old one, must be valid and enforceable in law. Alternatively speaking, in case such substituted agreement for some reason, like being unstamped or under-stamped, and accordingly, cannot be sued upon, the respective novation does not become effective, and the old parties and the old contract will be enforceable and liable, instead.

(b) By Rescission (or Cancellation of All or some Portions of the Contract)

There may be cases where all or only some of the portions of the terms of the contract are rescinded or cancelled. In the cases where all or even only some of the portions of the terms of the contract are rescinded or cancelled by mutual consent of both the parties to the agreement, the obligations of the parties under the old (original) contract comes to an end.

(c) By Alteration

In case both the old (original) parties to the contract mutually agree to alter some of the terms of the contract, the original (old) contract automatically terminates. In such cases, however, the two parties to the contract remain the same old ones.

(d) By Remission (Section 63)

A contract may get terminated or discharged by mutual consent even by way of remission, i.e. by accepting a lesser amount than what was originally agreed upon, or settling for a lesser fulfilment of the promise made originally.

Examples

(i) A has borrowed a sum of Rs 55, 000 from a bank, which remains unpaid since long. The bank calls the party for a discussion and settlement of the dues. After some discussions, it is mutually agreed upon between the bank and the borrower that the borrower may pay a sum of Rs 40,000 only at the branch of the bank within two days. The borrower makes the payment of Rs 40,000 within two days, which amount the bank accepts in full satisfaction of the loan of Rs 55,000. Thus, the entire loan of Rs 55, 000 gets fully discharged.

(ii) B has borrowed a sum of Rs 20,000 from C. B pays a sum of Rs 15,000 to C, and C accepts the amount in full settlement of his claim of Rs 20,000 on B. Thus, the entire loan amount on the account of B to the tune of Rs 20, 000 gets settled and liquidated.

We may, thus, observe that the act of remitting or giving up a part of his claim, and the promise to do so, is binding on him even without any consideration, whatsoever. This is the legal situation in India, though under the English Law, such remission needs to be supported by fresh considerations.

(e) By Waiver

The term waiver means relinquishment or abandonment of a right. Thus, in the cases where a party waives his rights under a contract, the other party automatically gets released of his obligations, and, accordingly, is no longer required to perform his promise.

Example

P, a painter, has promised to X that he will paint his (X's) picture. Later, X asks P not to paint his picture. P, in such a case, is no longer bound to perform his promise (of painting the picture of X, as was promised by him earlier).

(f) By Merger

In the cases where an inferior right of a person coincides with a superior right of the same person, the contract is said to have been discharged by way of merger.

Example

Lokmanya is holding a right of lease on a house owned by Onkar. After some time, Lokmanya purchases the house from Onkar, and thereby he becomes the owner thereof. In this case, the lease rights of Lokmanya vanishes, and in its place comes his rights as an owner of the house, which right is superior to his earlier inferior right as a lease holder. That is, his inferior rights of a lease holder now have got merged with his superior rights of an owner, which he has acquired now.

(iii) By Subsequent Impossibility (Section 56)

A contract may get terminated or discharged when its performance subsequently becomes impossible. Such impossibility in a contract could be either inherent in the transaction itself or may be induced subsequently by the change of certain circumstances, which may be material to the contract. Let us first take some examples of impossibilities, which might have been inherent in the contract.

Examples of Inherent Impossibilities

(a) M agrees with N to discover a treasure by magic. In this case, the element of impossibility (of finding a treasure by magic) is inherent in the transaction itself. The agreement is, therefore, void *ab initio.*

(b) S agrees to pay to H a sum of Rs 10 lakh if he (H) could give birth to a child. Here also, the element of impossibility (of a man giving birth to a child) is inherent in the transaction itself. This agreement is also void *ab initio.*

Examples of Subsequent (or Supervening) Impossibilities

As against the cases of inherent impossibilities, there may be cases where the performance of a contract would have been very much a possibility originally, that is, at the time the transaction was taking place. But due to certain changes in the circumstances, its performance would have become an impossibility, but only subsequently. Such contract also becomes void nonetheless, but not *ab initio*, but only subsequently.

[Under the English Law, however, the 'Subsequent Impossibility' is referred to as the 'Doctrine of Frustration'.]

We will now discuss the various circumstances under which a contract may be deemed to have become impossible of performance and hence void.

(i) By destruction of the Subject-matter of the Contract

In the cases, where the subject-matter of the contract itself gets destroyed, and that too without any act or fault on the part of the promisor, such contract is said to have been rendered void by way of subsequent impossibility.

Example

G has agreed to rent out his guest house to H from 9th to 12th June 2009. But, unfortunately, the guest house gets destroyed by fire before the aforementioned dates. Under the circumstances, the owner of the guest house will be absolved of his responsibility of renting out his guest house to H. **Taylor vs Caldwell (1863) 122 ER 299** is an illustrative example on the point.

(ii) By Death or Disablement of the Parties

In the cases where the contract is required to be performed by the promisor himself personally, such contract will be rendered void by way of subsequent impossibility, in the event of his death or any physical disability caused to him (like cutting of the arms of the promisor, who had promised to paint a picture for the promisee). Thus, the promisor will no longer be required to perform the contract by painting the picture of the promisee.

Examples

(a) G had agreed to marry B on a certain date. G dies before the date fixed for the marriage. The contract, thus, becomes void by way of subsequent impossibility.

(b) Zakir Husaain had agreed to give his *Tabla* recital at Bangalore on a particular night. But his flight from Delhi could not land at Bangalorec due to bad weather. This contract will be rendered void by way of subsequent impossibility.

(c) Amitabh Bachchan had agreed with the *Star Plus TV Channel* to give his live performances for 52 days on Saturdays and Sundays in the serial *'Kaun Banega Karorepati'*. But during the period, he had fallen seriously ill on a couple of such fixed days, and was, thus, not able to perform on those days. In the circumstances, the contract to perform on those days is rendered void by way of subsequent impossibility.

(iii) By Subsequent Illegality

In the cases where the performance of a contract becomes illegal by the enactment of some legislation subsequently (that is, after the contract has already been entered into), and, thus, being prohibited under the law, such contact becomes void by way of subsequent illegality, whereby none of the parties to the contract will be required to perform their part, that was required under such contact.

Example

Wasim had agreed on 2nd April 2009 to supply 1,000 bottles of a specific brand of foreign liquor to Qayoom at Ahmedabad on or before 3rd May 2009. But during the month of April itself, a law was passed by the state government of Gujarat, declaring the whole state of Gujarat as a dry state whereby the possession and sale of liquor in the whole of Gujarat, including Ahmedabad, was legally prohibited. Such contract has, thus, become void by way of subsequent illegality, and accordingly, not required to be performed by either of the parties to the contract.

(iv) By Declaration of War

In the cases, where a war has subsequently been declared between the two countries (i.e. between the countries of the promisor and the promisee), such contact also becomes void by way of subsequent declaration of war, whereby none of the parties to the contract will be required to perform their part, that was required under such contact.

Example

S, a shipping company, had agreed with M, a carpet merchant at Varanasi, that S will ship M's consignment of carpets to the port town of Germany, for delivery to an importer in Berlin. But subsequent to such contract, if a war were declared between India and Germany, the contract would become void immediately on the declaration of the war, and hence both the parties to the contract will be exenorated from the performance of their parts of the contract.

(v) By Non-existence or Non- occurrence of a Particular State of Things

There may be cases where certain things, which are necessary for the performance of the contract (i.e. the things are so essential and vital that in their absence it would become impossible to perform the contract), such contract will become void, on the ground of impossibility, if such things would cease to exist.

Examples

(a) G and B enter into a contract to marry each other on a fixed date and time. But subsequently, before the stipulated fixed date and time of the marriage, B goes mad. This contract will become void on B becoming mad and, therefore, it will not be required to be performed.

(b) The facts of the case **Krell vs Henry (1903) 2 KB 740** may well-illustrate the legal points involved. A person had entered into a contract with another person to hire his (other person's) flat for the purpose of viewing the coronation procession of the king. But the programme of the procession was cancelled as the king was suddenly taken ill. The other person filed a suit for recovery of the amount of the rent. It was held that the performance of the contract had become impossible, inasmuch as the very purpose for which the flat was intended to be hired, i.e. for viewing the coronation procession itself had become non-existent. Thus, as the performance of the contract had become an impossibility, the rent was not payable in this case.

Exceptions

We have so far discussed the five specific circumstances under which a contract need not be performed on the ground that the performance of the contract had subsequently become **absolutely impossible**, for no fault on the part of the promisor. That means that there may even be cases where the performance of the contract may not have become **absolutely impossible**, but only difficult to perform, or its performance might result into a financially losing proposition, caused by certain subsequent factors. Accordingly, we will now proceed to discuss the other five such circumstances under which the performance of the contract may still be required to be performed, on the ground that though its performance might have subsequently become rather impossible, it might not have become absolutely impossible, but only difficult or a financially losing proposition.

(i) Difficulty in performance

There may be cases where the performance of the contract could be possible, no doubt, but the hitch might be that, in the event of the performance of the contract, one of the parties to the contract may not earn as much as was anticipated. Under such circumstances, that party will have to perform, and he cannot take the plea of subsequent impossibility, inasmuch as it is not impossible but only more expensive and hence, a difficult business decision.

Example

S, a shipping company had agreed to ship the consignment of carpets from Varanasi to Germany. But, subsequently, a war had broken out, with the result that the shortest route via the Suez Canal was blocked.

Thus, the ship had to take a much longer route, and thereby the shipping company had to incur much more expenses, resulting in the reduction of its margin of profit. In this case, the shipping company will have to perform the contract, as it cannot be exonerated from the responsibility of shipping the consignment to Germany, just because it means a lesser margin of profit now.

(ii) Commercial impossibility

As against the circumstances involving 'difficulty in performance', where the margin of profit may get reduced (as against incurring any losses), in the case of a 'commercial impossibility', on the other hand, the fact of incurring of some loss may be involved, in case the contract is performed by one of the parties. This situation is generally referred to as the 'commercial impossibility' to perform, and it cannot discharge the contract. That is to say that such contract will have to be performed by the party despite its involving some financial losses.

Example

In the case **M/s. Alopi Pd. vs Union of India, [(1960) SC 589],** it was held that the contract to lay gas mains was not discharged because the price of the necessary materials had gone up due to the outbreak of the war.

But the Madras High Court had held an opposite view in the case **Easun Engineering Co. Ltd vs The Fertilisers and Chemicals Travancore Ltd and Another, [AIR (1991) Mad. 158].** The court had held that an abnormal increase in the price of the transformer oil by 400 per cent due to the war conditions was an untoward happening, or a change in the circumstances, which had 'totally upset the very foundation upon which the parties rested their bargain'. Accordingly, the contract for the supply of transformers, due to the aforementioned steep rise in the price of the transformer oil, was held to be an impossibility of performance, and therefore, the supplier was not held liable for the breach of contract.

(iii) Non-performance by the third person or party

In a case where a third party, on whose work the promisor had relied, fails to perform, the promisor does not get discharged from his liability on this account.

Example

A wholesale dealer had agreed to supply the required material to a local merchant by a specific date, on the presumption that the manufacturer will be able to produce and supply the material by that date. But the manufacturer had failed to supply the material by that date and, thus, the dealer had failed to perform his promise. In the circumstances, the contract entered into by the wholesale dealer does not get discharged.

(iv) Strikes, lockouts, or civil disturbances

The events like the strikes; lockouts, or civil disturbances do not have the effect of terminating the contract, unless there is a specific clause to this effect in the contract document.

Example

A company had agreed to supply certain articles to his customer on a specific date in the agreed quantity. But thereafter the labourers of the company had gone on an indefinite strike and, therefore, the company had declared a lockout in the factory. Finally, the company could not perform the contract. Under the circumstances, the company cannot plead the non-supply of the goods due to the strike and lockout. The company, in this case, will be held liable for the breach of contract.

(v) Failure of one of the several objects

There may be cases where a contract might have been entered into with more than one object in mind. In such cases, the failure of one of the objects does not have the effect of terminating the contract.

Example

R had agreed to rent a boat to H for two specific purposes, viz. (a) for viewing the naval review of the coronation, and (b) to cruise round the fleet. But as the king had fallen ill, the naval review of the coronation was cancelled. However, the fleet was assembled and thus, the boat could have been used for cruise round the fleet. It was held in the case **Herne Bay Steamboat vs Hutton KB, 740** that that the contract was not terminated**.** Accordingly, **H** will be required to pay the amount of rent to R.

It will be interesting to compare and contrast the court decisions in the above case, where there were more than one objectives involved in the contract, and the case **Krell vs Henry**, discussed in the previous paragraphs, where one single objective was involved. We will, thus, find that in the case of a single objective being involved in the contract, it (contract) terminates when that objective becomes impossible of performance. As against this, in the case where more than one objectives are involved in the contract, even after one of such objectives becomes impossible of performance, but if it remains possible to perform the other objectives, such objectives are required to be performed.

Effects of supervening (or subsequent) impossibility

(i) As provided under **Section 56, paragraph 2**, in the cases where, after a contract has been entered into, the very act to do something, as required under the contract, becomes impossible to perform, or it becomes impossible of performance due to some subsequent event taking place, for no fault of the promisor, or when it subsequently becomes unlawful, such contract becomes void, when the act itself becomes impossible or unlawful.

(ii) **Section 56, paragraph 3** provides that in the cases where the person, at the time of entering into the contract, had promised to do something, which he already knew to be impossible of performance, or even if he might have, with due diligence, known that it was impossible of performance, or it being unlawful, but, at the same time, provided the promisee did not know such involved act to be impossible or unlawful, such promisor will be required to duly compensate such promisee for any loss that such promisee might have sustained through the non-performance of the promise.

(iii) Further, **Section 65** provides that, in the cases where a contract becomes void, any person, who has received any advantage under such contract, is bound to restore it to the other person from whom he might have received it.

Examples

(a) P, a painter, has agreed to paint a picture for X, in consideration of X paying him a sum of Rs 10,000. Further, X pays him a sum of Rs 5,000 by way of an advance. But, unfortunately, P meets with a serious road accident and fractures both his arms, whereby he is not in a position to perform the promise of painting the picture for X. Under such circumstances, P is legally bound to refund the advance money of Rs 5,000 to X.

(b) Jagjit Singh, the renowned *ghazal* singer, had agreed to give his performance at Lucknow on the specified date against payment of Rs 50,000. Further, a sum of Rs 20,000 had already been paid to him by the organisers by way of an advance. However, the programme had to be cancelled as Jagjit Singh had fallen seriously ill on the appointed date, and accordingly, could not perform the promise. In such a case, Jagjit Singh will be legally bound to refund the advance money to the organisers of the programme.

(c) F has paid a sum of Rs 11 lakh to G in consideration of his promise to marry his daughter D. However, subsequently, D dies before the marriage could take place. In this case, G must refund to F the amount of Rs 11 lakh received by him from F.

(iv) By Operation of Law

The discharge of contract by operation of law may take place under the following circumstances:

(a) By Death

The contract, where the personal skills, craftsmanship or ability of the promisor himself are required for the performance of the agreed act, such contract comes to an end with the demise of the promisor.

(b) By Insolvency

The Insolvency Act stipulates certain circumstances under which the contract may get discharged. Accordingly,

in the cases where the order of discharge is passed by an Insolvency Court, the insolvent person consequently gets discharged of his entire liabilities of all his debts incurred by him prior to his adjudication.

(c) By Merger

In the cases where a new contract is entered into, between the same parties, and in this fresh contract, the security of a higher degree, value, worth or kind is taken, as compared to the original (old) contract (the security of) the earlier contract is said to have merged with (the security of) the new one.

Example

B has borrowed a sum of Rs 50,000 from a bank against his personal security. Incidentally, such loan is treated as an unsecured (clean) loan by the banks. Later, B creates a registered mortgage of his landed property in favour of the bank, to secure his aforementioned loan.

This way the right of action of the bank against the borrower B on his earlier unsecured loan will now get merged with the right of the bank to file a suit against the same borrower for the recovery of the same loan amount, but now on the higher and more valuable security of the mortgage.

(d) By Unauthorised Alteration of Terms of a Written Document

In the cases where any of the parties to the contract alters any of the terms and conditions of the written agreement document, without seeking and obtaining the consent of the other party involved therein, the contract will get automatically terminated due to such unauthorised alteration.

(v) By Breach of Contract

A breach of contract also has the effect of terminating the contract. A breach of contract may take place in two ways. These are:

(a) Anticipatory breach, and
(b) Actual breach.

(a) Anticipatory Breach of Contract

An anticipatory breach of contract takes place when the party repudiates it before arrival of the time, that has been fixed for the performance of the promise, or else where the party by his own act disables himself from performing the contract.

Examples

(i) M has promised to marry a girl G on a certain date. But before the arrival of that date, he marries another girl B. In this case, G has the right to sue M for the breach of contract.
(ii) M has promised to marry a girl G soon after the death of his (M's) father. But, even during the life time of his father, M categorically declines to marry G. In this case, though the time for the performance (i.e. the death of M's father) had not arrived, M was held liable to be proceeded against by G for the breach of the promise. **[Frost vs Knight, LR 7 Ex. 111].**
(iii) A wholesale dealer (W) had agreed to supply the required material to a local merchant (M) on 30th June 2009. On 15th May 2009 itself, W informs M that he will not be able to supply the agreed materials to him. In this case, M is entitled to file a suit against W for the breach of the contract.

Consequences of Anticipatory Breach of Contract

In the cases where a party to the contract refuses to perform his part of the contract, before the arrival of the actual time stipulated for his performance, the promisee has the following two alternatives available to him to choose from:

(i) He may either rescind the contract and treat the contract as terminated, and immediately sue the promisor for damages, or else

(ii) He may prefer not to rescind the contract, but instead, treat the contract to be still operative and wait for the arrival of the actual time of the performance agreed upon, and only thereafter hold the promisor liable for non-performance of his part of the contract, and face the consequences for the same. In such a case, the party who had refused to perform his part of the contract, still has a chance of performing his part of the contract even now, if he can.

We, thus, find that the 'anticipatory breach of contract' does not, by itself, discharge the contract. The contract, instead, gets discharged only if and when the aggrieved party accepts the repudiation made by the other party. In other words, the contract gets discharged only if and when the aggrieved party chooses to rescind the contract and file a suit for claiming the damages from the other party. Conversely speaking, if the aggrieved party does not accept the repudiation made by the other party, and prefers to wait for the arrival of the actual time of the performance, the contract could be performed if the other party chooses to do so, and is able to do so. But then the latter choice has an inherent risk attached therewith. That is, in case the repudiation of the contract, made earlier than the arrival of the actual time of performance of the contract, is not accepted by the aggrieved party, but thereafter and before the arrival of the actual time of performance of the contract some event takes place whereby the contract gets legally discharged, the aggrieved party will consequently lose his right of suing the other party for claiming the damages.

Example

The case **Avery vs Bowen (1856) 6 E & B, 965** illustrates the point well. A had agreed to load cargo of wheat on B's ship at Odessa by a particular date. But when the ship arrived, A refused to load the cargo. B, however, did not accept the refusal and, instead, continued to demand the cargo. But before the expiry of the last date for the loading, the Crimean war had broken out, whereby the performance of the contract had become illegal. It was held in the case that the contract was discharged and therefore B could not sue A for damages.

(b) Actual Breach of Contract

Actual breach of contract may take place in two different points in time. That is:

(a) At the time when the performance is due, or

(b) During the course of the performance of the contract.

(i) Actual Breach of Contract at the Time when the Performance is Due In case a person does not perform his part of the contract at the pre-stipulated time, he will be held liable for the (actual) breach of contract

Example

The seller S of a property offers to execute the sale deed, but only if the buyer pays him an amount which is higher than the amount that was originally payable under the contract of the sale. Thus, by offering a higher amount, the seller S has refused to execute the sale deed on payment of the amount that was originally agreed upon. Under the circumstances, the seller will be held liable for the breach of contract. **[Jaggo Bai vs Hari Har Prasad Singh, AIR 1947, PC 173].**

Element of Time being the Essence of Contract

There may be cases where the promisor may offer to perform his part of the promise subsequently, i.e. after the expiry of the stipulated date. Here the question may arise as to whether such offer of the promisor should be accepted by the promisee, or else, whether the promisee can refuse such offer and hold the promisor liable for the breach of the contract. In such cases, the answer will depend upon whether the element of time was considered by the parties to the contract to be of essence (of the contract) or not. In this connection, **Section *55*** categorically stipulates that 'When a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before a specified times, and fails to do any such thing at or before the specified

time, the contract, or so much of it as has not been performed, becomes voidable at the option of the promisee if the intention of the parties was that time should be of essence of the contract.'

There may be cases where the parties involved in the contract do not intend that time should be of essence of the contract. In such cases, the contract will not become voidable if the promisor fails to do the required thing at or before the stipulated time. But the promisor will, in any case, be liable to compensate the promisee for any loss sustained by him (promisee) on account of such failure on the part of the promisor. Further, in the cases where the contract becomes voidable at the option of the promisee, due to the failure on the part of the promisor to perform at or before the stipulated time, and the promisee accepts the request of the promisor to perform at some other subsequent agreed time, the promisee cannot claim compensation from the promisor for the loss sustained by him for the failure on the part of the promisor to act at the originally stipulated time. But then if, at the time of accepting the request of the promisor to perform at a subsequent agreed time, the promisee, would have given a notice to the promisor that he will claim compensation from him for not acting at the originally agreed time, the promisee will be entitled to claim the compensation in such cases too.

Thus, in order to retain the right to claim compensation from the promissor for his non-performance at or before the stipulated time, the promisee, at the time of accepting the request of the promisor to perform at a later date and time, must give notice to the promisor advising him of his intention to claim compensation from him for his aforementioned failure. Thus, in case the promisee does not give the required notice to the promisor, it will be presumed in law that he had waived and given up his right to claim compensation, and accordingly, he will be prohibited in law to claim any compensation from the promisor. As against such provision (of giving the notice), as per the Indian law, the position under the English law is different in that the promisee retains the right to claim compensation from the promisor even if he does not give him the notice of his intention to do so (i.e. claim compensation from him).

(ii) Actual Breach of Contract During the Performance of the Contract Actual breach of contract may take place during the course of the performance of the contract, when one of the parties to the contract, during the course of his performing the contract, fails to perform, or refuses to perform, his part of the obligation under the contract.

Example

The case **Cort vs Ambergate, etc., Railway Co. (1851) 17 QB 1271** is an illustrative example on the point. In this case, A had entered into a contract with the Railway Company to supply a specific quantity of railway chairs at certain price, and in instalments. After A had supplied some instalments, and some were yet to be supplied, the Railway Company asked A not to make any further supply. It was held in the case that A could file a suit against the Railway Company for the breach of contract during the course of the performance of the contract.

Let us Recapitulate

A contract may be discharged in the following manners:

(i) (a) By performance, or
(b) By tender,
(ii) By mutual consent,
(iii) By subsequent impossibility,
(iv) By operation of law, and
(v) By breach of contract.

(i) (a) By Performance

It is the most expected and natural manner of discharging a contract, where both the parties perform or do as was required from them under the contract.

(i) (b) By Tender
Here, the promisor tenders performance of his part of the promise, but the other party refuses to accept it.

(ii) By Mutual Consent (Section 62)
Where both the parties mutually agree to substitute the old contract with a new one, or to rescind it, or to alter its terms and conditions, whereby the original contract gets discharged.

This may be done in any one of the following manners:

(a) By Novation, i.e. substitution of an original (old) contract by a new one. Such novation could take place between the same old parties, or even between different parties.

But such substituted one must be valid and enforceable in law.

(b) By Rescission (or cancellation of all or some portions of the contract) by mutual consent of both the parties to the original contract, it comes to an end.

(c) By Alteration, with the mutual consent of both the parties, the original contract comes to an end

(d) By Remission, i.e. by mutually agreeing to accept a lesser amount than what was originally agreed upon, or settling for a lesser fulfilment of the promise originally made.

(e) By Waiver, i.e. by relinquishing or abandoning a right by one party and thereby automatically releasing the other party of his obligations.

(f) By Merger, where an inferior right of a person coincides with a superior right of the same person.

(iii) By Subsequent Impossibility, which may be either inherent in the transaction (like involving going to moon on a cycle, or a man getting pregnant, or finding a treasure by magic), or it may be induced subsequently by the change of circumstances. (**Section 56**).

While the agreements involving inherent impossibilities are void *ab initio*, those due to change of circumstances become void not *ab initio*, but only subsequently.

[Under the English Law, however, the 'Subsequent Impossibility' is referred to as the 'Doctrine of Frustration'.]

Subsequent Impossibility, making the contract void, may occur in the following manners:

(i) **By destruction of the subject-matter of the contract,** but without any act or fault on the part of the promisor.

(ii) **By death or disablement of the parties,** where the contract is required to be performed by the promisor himself personally,

. (iii) **By subsequent illegality,** with the enactment of some legislation after the contract is entered into, prohibiting the performance of the promise.

(iv) **By declaration of war,** between the two countries (of the promisor and the promisee).

(v) **By non-existence or non-occurrence of a particular state of things,** like the person agreeing to marry another person becoming insane.

Exceptions, i.e. where the performance of the contract may not have become **absolutely** impossible, but only difficult to perform, or it becoming a financially losing proposition, caused by certain subsequent factors.

(i) Difficulty in performance
That is, where one of the parties to the contract may not earn as much as was anticipated. Here, that party will have to perform, despite a difficult business decision.

(ii) Commercial impossibility, where incurring of some loss may be involved, if the contract is performed by one of the parties. But here the performance is a must, it involving some loss notwithstanding.

(iii) Non-performance by the third person or party does not discharge the promisor from his liability.

(iv) Strikes, lockouts, or civil disturbances do not terminate the contract, unless there is a specific clause to this effect in the contract document.

(v) Failure of one of the several objects does not terminate the contract

Effects of supervening (or subsequent) impossibility

Where the promisor already knew, or could have come to know if he had tried, that the performace of the contract was already impossible or unlawful, and the promisee was not in the know of such things, such promisor must duly compensate such promisee for any loss that such promisee might have sustained through the non-performance of the promise. (**Section 56, paragraph 3**).

Further, where a contract becomes void, any person, who has received any advantage under such contract, must restore it to the other person. (**Section 65**).

(iv) By Operation of Law

The discharge of contract by operation of law may take place under the following circumstances:

(**a**) **By Death** of the promisor**,** where his personal skills, craftsmanship, or ability were required for the performance.

(**b**) **By Insolvency,** i.e. where the order of discharge is passed by an Insolvency Court, the insolvent person consequently gets discharged of his entire liabilities of all his debts incurred by him prior to his adjudication.

(**c**) **By Merger,** where a new contract is entered into, between the same parties, wherein the security of a higher degree, value, worth, or kind is taken, as compared to the original (old) contract.

(**d**) **By unauthorised alteration of terms of a written document** without seeking and obtaining the consent of the other party.

(**v**) **By Breach of Contract,** by way of

(a) Anticipatory breach, and
(b) Actual breach.

(**a**) **Anticipatory Breach of Contract**, where the party repudiates it before the arrival of the time, that has been fixed for the performance of the promise, or else where the party by his own act disables himself from performing the contract.

Consequences of Anticipatory Breach of Contract

The following two alternatives are available to the promisee:

(i) To rescind the contract and treat the contract as terminated, and immediately sue the promisor for damages, or else
(ii) Not to rescind the contract, but instead, treat the contract to be still operative and wait for the arrival of the actual time of the performance agreed upon, and only thereafter hold the promisor liable for non-performance of his part of the contract, and face the consequences for the same. In such a case, the party who had refused to perform his part of the contract still has a chance of performing his part of the contract even now, if he can. But then, if in the mean time, some event takes place, whereby the contract gets legally discharged, the aggrieved party will consequently lose his right of suing the other party for claiming the damages.

(**b**) **Actual Breach of Contract**

(**i**) **Actual Breach of Contract,** where the performance is not done till the time its performance was due. Such contract becomes voidable at the option of the promisee, if the intention of the parties was that the element of time should be of essence of the contract.

But if it was not the intention of the parties that the element of time should be of essence to the contract, it will not become voidable if the promisor fails to do the required thing at or before the stipulated time. But the promisor will, in any case, be liable to compensate the promisee for any loss sustained by him (promisee) on account of such failure on the part of the promisor.

But if the promisee agrees to postpone the performance at a later date, the promisee cannot claim compensation from the promisor for the loss sustained by him for the failure on the part of the promisor to act at the originally stipulated time, unless the promisee would have given a notice to the promisor that he will claim compensation from him for not acting at the originally agreed time.

Under the English Law, however, the promisee retains the right to claim compensation from the promisor even if he does not give him the notice of his intention to do so.

(ii) Actual breach of contract during the performance of the contract, i.e. when one of the parties to the contract, during the course of his performing the contract, fails to perform, or refuses to perform, his part of the obligation under the contract.

Questions for Reflection

1. Discuss each of the following manners in which a contract may be discharged:
   (i) (a) By performance or
   (b) By tender,
   (ii) By mutual consent,
   (iii) By subsequent impossibility,
   (iv) By operation of law, and
   (v) By breach of contract.

Illustrate your points with the help of appropriate illustrative examples.

2. Discuss each of the following manners in which a contract may be terminated by way of Mutual Consent:
   (a) By Novation,
   (b) By Rescission (or cancellation of all or some portions of the contract)
   (c) By Alteration
   (d) By Remission
   (e) By Waiver
   (f) By Merger
3. Discuss the following circumstances under which a contract may be deemed to have become impossible of performance:
   (i) By destruction of the subject-matter of the contract
   (ii) By death or disablement of the parties
   (iii) By subsequent illegality
   (iv) By declaration of war
   (v) By non-existence or non-occurrence of a particular state of things.
4. Discuss the following circumstances under which a contract may not have become absolutely impossible of performance, and therefore, will be required to be performed:
   (i) Difficulty in performance
   (ii) Commercial impossibility
   (iii) Non-performance by the third person or party
   (iv) Strikes, lockouts, or civil disturbances
   (v) Failure of one of the several objects.
5. Discuss the discharge of contract that may take place by operation of law under the following circumstances:
   (a) By Death
   (b) By Insolvency
   (c) By Merger
   (d) By unauthorised alteration of terms of a written document.
6. (a) What are the two alternatives available to the promisee, in the case of anticipatory breach of contract?
   (b) What are the inherent risks, if any, involved in these cases?
   Give suitable examples in each case to clarify your points.

7. Bring out the main distinguishing features between the connotations of the following terms:
   (i) Discharge of a contract by Performance and by Tender
   (ii) Termination of a contract due to (a) Inherent Impossibility, and (b) Subsequent Impossibility
   (iii) Termination of a contract due to the destruction of the subject-matter of the contract itself but
      (a) Without any act or fault on the part of the promisor, and
      (b) Due to the act or fault on the part of the promisor
   (iv) Compulsion of performance of a contract involving
      (a) Difficulty in performance, and
      (b) Commercial impossibility
   (v) Status of the contract in the event of the failure of
      (a) The sole single objective of the contract, and
      (b) One of the several objects of the contract
   (vi) Status of the contract in the event of the death of the promisor, in the following cases:
      (a) Where the personal skills, craftsmanship and/or ability of the promisor himself are required for the performance of the agreed act, and
      (b) Where the personal skills, craftsmanship and/or ability of the promisor himself are not required for the performance of the agreed act.
   (vii) (a) Anticipatory breach, and (b) Actual breach.
   (viii) Actual breach of contract taking place,
      (a) At the time when the performance is due, and
      (b) During the course of the performance of the contract.
   (ix) Status of the contract in the following cases:
      (a) Where the parties intended that time should be of essence of the contract, and.
      (b) Where the parties did not intend that time should be of essence of the contract.

Problems for Practice (With Suggested Solutions)

Problem 1

Nikhil had borrowed a sum of Rs 5 lakh from the Bank of Bangalore, which had remained unpaid for a long time, so much so that it was shortly going to become even time-barred. Accordingly, the bank had called Nikhil for a detailed discussion and fast settlement of the dues. But, after some long discussions, it was mutually agreed upon between the bank and Nikhil, the borrower, that he (Nikhil) will pay a sum of Rs 4 lakh only into his loan account with the bank within a week's time in full settlement of the loan amount of Rs 5 lakh. Finally, Nikhil had made the payment of Rs 4 lakh within a week, as per his promise. And the bank had also apparently accepted the amount in full satisfaction of the loan of Rs 5 lakh. But later on, the Bank of Bangalore had filed a suit in the Court of law for recovery of the balance amount of Rs 1 lakh from Nikhil. What are the chances of the bank winning or losing the case? Give reasons for your answer.

Solution

No. The bank will definitely lose the case. This is so because, under Section 63 of the Act, a contract gets discharged by mutual consent even by way of remission, i.e. by accepting a lesser amount than what was originally agreed upon. Accordingly, the entire loan of Rs 5 lakh will be deemed to have been fully discharged, settled, and liquidated, by way of Nikhil's depositing a lesser amount of Rs 4 lakh, as against 5 lakh, as was finally and subsequently agreed upon between the bank and Nikhil, the borrower.

Problem 2

Qayoom had agreed with Naushad that he would turn a piece of coal into diamond by virtue of his magical power, if Naushad gives him a sum of Rs 10 lakh.. But, despite display of his gimmicks for hours together,

Qayoom had failed to do so. Thereupon, Naushad had preferred to file a suit against Qayoom for the breach of contract. Do you think that Naushad will be finally able to win or lose the case? Give reasons for your answer.

Solution

No. Naushad is bound to lose his case, on the ground that the contract in question was *ab initio* void, because it involved the element of inherent impossibility (viz. turning of a piece of coal into diamond by magic). This is so because, Section 56 of the Act provides that a contract may get terminated or discharged when its performance subsequently becomes impossible. The Section further clarifies that such impossibility in a contract could be either inherent in the transaction itself or it may be induced subsequently by the change of certain circumstances, which may be material to the contract. And we find that, in the instant case, the element of impossibility (of turning a piece of coal into diamond by magic) is inherent in the transaction itself. The agreement is, therefore, void *ab initio, a*nd, accordingly, not enforceable in law. Therefore, Naushad is sure to lose the case.

Problem 3

Harish had agreed to rent out his mare (a female horse) to Ganesh in connection with the marriage of his son, Mahesh, on 21st June 2009. But, unfortunately, the mare had died on 20th June 2009. Subsequently, as Harish had failed to perform his promise on 21st June 2009, Ganesh had filed a suit against Harish for the breach of contract. Which way the Court is likely to decide the instant case? Give reasons for your answer.

Solution

The Court is most likely to dismiss the case because, under the circumstances of the case, Harish, the owner of the mare, will be absolved of his responsibility of renting out his mare on the appointed date, on the ground that the mare had already died before the date he was expected to perform his contract entered into with Ganesh. This is so because, as provided under Section 56 of the Act, a contract may get terminated or discharged when its performance becomes impossible due to a subsequent change of certain circumstances, which may be material to the contract. And we see that, in the instant case, the death of the mare of Harish had been the subsequent change of the circumstance, which was material to the contract, by virtue of the death of the mare, which herself was the subject matter of the contract. Therefore, the contract will be held as void, based on the principle of 'Subsequent Impossibility', as stipulated in Section 56.

Problem 4

Sitara Devi, the reputed danseuse, had agreed to give her dance performance at the *Lucknow Mahotsav* on the night of 15th May 2009. But, on her way to the venue of the function, scheduled on 15th May 2009, the car in which she was travelling, had met with an accident. Sitara Devi was luckily saved, but she had fractured one of her legs in the accident, and was accordingly admitted in a hospital for treatment. The organisers of the show had, however, got immensely annoyed at her and had, accordingly, filed a case against her (Sitara Devi) for breach of contract. Do you think that they will win the case? Give reasons for your answer.

Solution

No. The organisers of the show will not win the case, because the contract will be rendered void by way of subsequent impossibility. This is so because, as provided under Section 56 of the Act, in the cases where the contract is required to be performed by the promisor himself or herself personally, such contract will be rendered void by way of subsequent impossibility, in the event of physical disability caused to him or her. And, in the instant case, the fracture caused to Sitara Devi in one of her legs had rendered it impossible for her to give her dance performance on that night. Further, as the performance was necessarily to be given by her personally, she (the promisor) will no longer be required to perform the contract, as the contract will be held as void, based on the principle of 'Subsequent Impossibility', as stipulated in Section 56.

Problem 5

On 23rd April 2009, Joseph had agreed with George to supply 5,000 bags of Dehradun *Basmati* rice to him at his godown in Jaipur, on or before 14th June 2009. But during the month of May itself, a law was passed by the

State Government of Uttarakhand, banning export of all varieties of rice from the State. Accordingly, Joseph could not perform his promise with George. Do you think that George can successfully claim damages from Joseph for the breach of contract? Give reasons for your answer.

Solution

No. George cannot be allowed by the Court of law to claim damages from Joseph for breach of contract, because, in the instant case, the contract had become void by way of subsequent illegality, and accordingly, it was not required to be performed by Joseph. This is so because, as per the provisions of Section 56 of the Act, in the cases where the performance of a contract becomes illegal by the enactment of some legislation subsequently (that is, after the contract has already been entered into), and, thus, being prohibited under the law, such contact becomes void by way of subsequent illegality, whereby none of the parties to the contract will be required to perform their part, that was required under such contact.

Problem 6

On 3rd April 2009, Ehsan, an Indian, had entered into a contract with Irfan, a Pakistani, that he (Ehsan) will export to him (Irfan) 1,000 quintals of onion, from his farm in Surat, and deliver it at his godown in Karachi, in Pakistan, on or before 15th June 2009. But, on 5th June 2009 itself, a war was declared between India and Pakistan. Under such circumstances, Ehsan feared that Irfan would file a suit against him in the Court of law, and would claim damages from him for breach of contract. Taking you to be an expert in legal matters, he has approached you to give him sound and convincing advice in the matter. What would be your expert opinion and advice to Ehsan in the instant case? You must also cite the relevant Section of the Act to him so as to convince him on the legal point to his entire satisfaction and relief from anxiety.

Solution

Ehsan will be well-advised by us to the effect that he need not worry at all because the contract entered into between him and Irfan had already become void, immediately on the subsequent declaration of war between the two countries of the importer and the exporter. This is so because, as per the provisions of Section 56 of the Act, in the cases where a war has subsequently been declared between the two countries (i.e. between the countries of the promisor and the promisee), such contact becomes void by way of subsequent declaration of war, whereby none of the parties to the contract will be required to perform their part, that was required under such contact.

Problem 7

Pravin and Priya had entered into a contract on 12th April 2009 that they will marry each other on 14th May 2009 at 10.10 a.m. at the local temple. But unfortunately, on 6th May 2009 Priya died in a road accident. What will be legal position of this agreement? Give reasons for your answer.

Solution

This contract will become void on the death of Priya, and, therefore, it will not be required to be performed. This is so because, under Section 56 of the Act, in the cases where certain things, which are necessary for the performance of the contract – that is, the things are so essential and vital that in their absence it would become impossible to perform the contract – such contract will become void, on the ground of impossibility, if such things would cease to exist. Thus, in the instant case, after the death of Priya, the marriage in question had consequently become impossible to take place. Thus, this contract will become void on the death of Priya.

Problem 8

Vinod was transferred from Lucknow to Hyderabad. Tarun, a truck owner, had entered into a contract with Vinod to transport his household effects from Lucknow to Hyderabad on 3rd June 2009. But as the link bridge on the shortest route to Hyderabad had been damaged, heavy vehicles were not allowed to pass over the bridge. Thus, Tarun was required to take the truck from a longer route, which would have meant higher expenses on the fuel, and hence, this would have proved to be far more expensive and thus, would have substantially reduced the quantum of profit of Tarun. Accordingly, being a shrewd businessman, he (Tarun)

had refused to perform the contract. Upon this, Vinod had filed a case against Tarun for breach of contract, and claiming compensation from Tarun for his non-performance of the contract. What are the chances of Vinod winning the case? Give reasons for your answer.

Solution

Vinod has a sure chance of winning the case. This is so because, in the instant case, the performance of the contract had not become absolutely impossible, but only difficult to perform; in that, its performance might have resulted in some financial loss to Tarun, caused by certain subsequent factors. In other words, in the case under reference, the performance of the contract is quite possible, no doubt, but the only hitch is that, in the event of the performance of the contract, one of the parties to the contract, viz. Tarun in the instant case, may not earn as much as he was anticipating. Under such circumstances, Tarun was legally bound to perform the contract, and he cannot take the plea of subsequent impossibility, inasmuch as it was not impossible but only more expensive and hence, a difficult business decision. Therefore, Tarun may be required to compensate Vinod for his non-performance of a valid contract, performance of which was quite possible but only a difficult business proposition.

Problem 9

On 9th May 2009, Pranav had entered into a contract with Dinesh, a local dealer, to supply him 100 pieces of a specific brand of computers, on 12th June 2009, for distribution to the students in his (Pranav's) management institute. Dinesh had agreed to make the required supply by the specified date as he had thought that the regional distributor concerned would be able to supply to him the required numbers of the specific brand of computer by that time. But the regional distributor had failed to supply the same by that date, and, thus, Dinesh had failed to perform his promise. Thereupon, Dinesh had pleaded that the contract must be treated as performed and discharged, as the supply was not made by the regional distributor concerned. Therefore, he himself was not at all at fault. Accordingly, he cannot be charged of non-performance of the contract in question. Do you think that the contention of Dinesh is legally sound? Give reasons for your answer.

Solution

No. The contention of Dinesh is not at all legally sound. This is so because, under Section 56 of the Act, in the cases where a third party, on whose work the promisor had relied, had failed to perform, the promisor does not get discharged from his liability on this account. Thus, in the circumstances, in the instant case, the contract entered into by Dinesh, the local dealer, cannot be deemed to have got discharged.

Problem 10

On 15th May 2009, David had entered into a contract with Computronix, the manufacturers of a specific brand of computers, to supply him 60 pieces of a specific make of the company's brand of computers, on 19th July 2009, for distribution to the students in his (David's) management institute. The company had agreed to make the required supply by the specified date, as no difficulty was foreseen in the matter. But soon thereafter, the labourers of the company had gone on an indefinite strike and therefore, the company had declared a lockout in the factory. Finally, the company could not perform its contract. Under the circumstances, the company had pleaded that the non-supply of the computers had taken place due to the strike and lockout, for which the company can, in no way, be held responsible. Therefore, keeping the extraordinary circumstances of the case in question, the company cannot be held liable for the breach of contract. Do you agree with such contention of the company? Give reasons for your answer.

Solution

No. The contention of the company is not tenable in the eyes of law. This is so because, under Section 56 of the Act, the company cannot plead the non-supply of the goods due to the strike and lockout. In fact, as per the legal provisions, the events like the strikes, lockouts, do not have the effect of terminating the contract, unless there is a specific clause to this effect in the contract document. And, as there was no mention of such clause in the contract document, we may safely conclude that it was not there, especially because, in that event, the company would have taken that very valid plea, instead. Accordingly, the company, in this case, will be held liable for the breach of contract.

Problem 11

On 24th March 2009, Mithun had promised to Lavanya that he would marry her on 21st June 2009. But on 27th April 2009 itself, Mithun had already married another girl named Lalita. Do you think that, in this case, Lavanya has the legal right to sue Mithun for the breach of contract? Give reasons for your answer.

Solution

Yes. In the instant case, Lavanya is well within her legal rights to sue Mithun for the breach of contract. This is so because, it had amounted to an anticipatory breach of contract, as it had taken place when Mithun had repudiated it before the arrival of the time, that had been fixed for the performance of his promise, and by his own act, he had disabled himself from performing the contract, as he will not be allowed to marry a second time, after having been already married to Lalita, in the instant case.

Problem 12

Sunil had entered into a contract with Amit to the effect that he (Sunil) will supply to Amit 1,000 pieces of executive tables at the rate of Rs 5,000 per piece in 10 instalments of 100 pieces each. But Sunil had supplied only 400 pieces of the executive tables to Amit, in four instalments of 100 pieces each. Thus, 600 pieces of executive tables were yet to be supplied to Amit in six further instalments of 100 pieces each, as per the terms of the agreement, Amit had asked Sunil to stop the supply at that very stage, and not to make any further supplies thereafter. Upon this, Sunil had preferred to file a suit against Amit in the Court of law, for the breach of contract. What are the chances of Sunil winning the Court case? Give reasons for your answer.

Solution

Yes. Sunil will surely win the Court case, as the instant case is a clear-cut case of an actual breach of contract by Amit, during the course of the performance of the contract by Sunil. This is so because, one of the parties to the contract, viz. Amit in the instant case, during the course of the performance of the contract, had failed to perform, or had refused to perform, his part of the obligation under the contract, i.e. acceptance of the full supply of 1,000 pieces of the executive tables, as per the terms of the agreement. Therefore, Amit will be definitely held liable for the breach of contract during the course of the performance of the contract.

Chapter Eleven

Remedies for Breach of Contract

"*The prompter the refusal, the less the disappointment.*
Publilius Syrus

Some persons make promises for the pleasure of breaking them.
William Hazlitt"

11.1 What are the Remedies for Breach of Contract?

The moment either of the two parties to a contract commit a breach of contract, in some way or the other, any of the following relieves and remedies become available to the other party:

(i) Recession of the contract,
(ii) Claim damages for the losses sustained or suffered thereby,
(iii) Obtaining a decree for the specific performance,
(iv) Getting an injunction order, or
(v) Filing a suit on quantum meruit.

We will now discuss these remedies one after the other.

(i) Recession of the Contract

In the event of one of the parties to the contract committing a breach of contract, the other party becomes entitled to file a suit in the Court of Law to treat the contract as rescinded. Under such circumstances, the aggrieved party gets freed from all his obligations under the contract.

Example

S and P have entered into a contract to the effect that S will supply to P 1000 pieces of ceiling fans at a certain price on a certain date, and P will make the payment immediately on receipt of the fans. But S fails to supply the fans to P on the mutually agreed date. Under the circumstances; P need not make any payment to S.

Entitlement to compensation

Further, Section 75 provides that where a person rightfully rescinds the contract due to breach of contract by the other party, he is entitled to claim compensation from the other party for any loss or damage sustained by him due to such non-performance of the promise by the other party.

Example

G, an eminent *ghazal* singer had entered into a contract with R, the owner of a restaurant, to sing at his restaurant for two hours regularly on each Sunday evening for six months on payment of Rs 1,000 per show. G sings for 10 Sunday nights, but on the eleventh night G wilfully absents himself and does not perform at the restaurant. Consequently, R rescinds the contract. In this case, R is also entitled to claim compensation from G for the damages sustained by him (R) caused by the non-performance by G.

Here, it may be of some interest to us to compare this case of **wilful** default on the part of the promisor, where he (promisor) is held liable to compensate the promisee for the damages and losses suffered and sustained by him due to his non-performance, with the illustrative case cited in the preceding Chapter 10, where due to non-performance of the contract, but **not wilfully but due to subsequent impossibility without any fault** on the part of the defaulting promisor, the contract, instead, becomes void.

Thus, in the above cited illustrative example, if the *ghazal* singer G, instead of wilfully defaulting, would not have been able to perform on the eleventh night in the event of his falling sick, or for having met with some accident, or due to his wife's serious illness, and so on, where the default would have taken place due to the impossibility of the performance for no fault on the part of the promissor, the contract would have become void, and nothing else would have been involved in that case.

(ii) Claim Damages for the Losses Sustained or Suffered Thereby

Damages, as such, may be classified under the following four different categories:

(a) Ordinary damages,
(b) Special damages,
(c) Vindictive or punitive damages, or exemplary damages, and
(d) Nominal damages.

Let us now discuss these four types of damages one after the other.

(a) Ordinary Damages (Section 73)

The damage, that naturally arises in the usual course of things (business), due to such breach, is referred to as an ordinary damage. The quantum of such (ordinary) damage is assessed on the basis of the difference obtaining between the contract price and the market price, prevailing at the time of such breach of contract. In such cases, if the seller retains the goods with himself (i.e. if he does not deliver the goods), after the breach, he cannot recover any further loss from the buyer if the price of such goods in the market were to fall further down, nor can the quantum of the damages be reduced in the event of the price of the goods involved in the contract going further up.

Examples

(i) S had contracted with B to deliver to him 100 bales of cotton at the rate of Rs 1,000 per bale, on an appointed future date. But on such pre-settled date, S refuses to deliver the cotton bales. Now, let us presume that on such due date the price prevailing in market was Rs 1,200 per bale of cotton. Thus, S will have to compensate B for the amount of the difference between the market price and the contract price as on the date of the breach of the contract, which comes to Rs 20,000 [computed as (Rs 1,200 less Rs 1,000) × (100 bags)].

(ii) B had promised to buy C's car for Rs 1 lakh. But later, he had refused to buy the car. In this case, B will have to compensate C for an amount computed as the difference between the contract amount of Rs 1

lakh and the amount that the car might now fetch at the time of the breach of contract. That is, if C can now get Rs 75,000 only from the sale of the car, B will have to compensate C for Rs 25,000 (i.e. 1, 00, 000 less Rs 75,000).

It may be noted in this context that the ordinary damages would be available only for such losses or damages, which may arise naturally in the usual course of things (business), and not for any indirect or remotely connected loss or damage arising out of such breach.

Example

A person was asked to get down from the train at a place other than the railway station. Thereafter, the person caught cold, and fell sick. He filed a suit against the railway company claiming damages for his catching cold and falling sick due to his being asked to get down at a place other than the railway station. It was held that the person's such claim for the damages was not tenable because it was not directly but only indirectly or remotely connected with his having been asked to get down at a place other than the railway station. He, however, can be compensated for the personal inconvenience caused to him, which was directly connected with his having been compelled to get down at a place other than the railway station.

(b) Special Damages (Section 73)

In the cases where there are certain special or extraordinary circumstances present or involved, and their involvement or existence is communicated to the promisor, the non-performance of the contract by the promisor entitles the promisee not only to claim the ordinary damages, but also the damages that may result from such special or extraordinary circumstances, in addition to the ordinary damages. Here, it may be mentioned that special damages are claimed in the cases of loss of profit, and the like.

Examples

(i) C, a building contractor, has entered into a contract with L, the landlord, to construct and finish the house, and finally hand it over to L latest by 1st October 2008. Further, L has also communicated to C that he (L) has, in turn, entered into a contract with T, the prospective tenant, to let the house out to him and to give its possession to him from 1st October 2008. But, the quality of the construction of the house by C was so poor that before 1st October 2008 the house had fallen down and, therefore, it had to be reconstructed over again by L. In the process, and as a direct consequence thereof, L loses the amount of rent that he would have received from T from 1st October 2008, besides being required to compensate T for the breach of contract by him (L). In this case, C will be required to compensate L, not only with the cost of reconstructing the house, but in addition thereto, with the amount of monthly rent so lost to L, as also for the amount of compensation that L will have to now pay to T for breach of contract.

(ii) F engages a truck from a public transport company T for an immediate and urgent delivery of a machine at his factory premises, informing T of the fact that the production work at the factory was held up for want of that machine. T, however, unduly delays the delivery of the machine at the factory premises, with the result that the factory had to lose heavily due to the loss of production caused by such delayed delivery of the machine. Not only that, F had also lost a profitable contract from a valuable party due to the non-start of the production caused by the delayed delivery of the machine. In the instant case, F will be entitled to receive compensation from T to the extent of the average amount of income lost to F, which he would have otherwise earned if the production had resumed by the delivery of the machine without an undue delay. Alternatively speaking, F will have to be compensated by T for the amount of loss sustained by F due to non-production during the additional period counted from the date the machine should have ordinarily been delivered, and the actual subsequent date when it was actually delivered at the factory premises. But then, it must be noted in this case that the amount of loss sustained by F by way of losing the fresh contract from a valuable party will not be required to be compensated by T, on the ground that this fact was not communicated to T by F. Thus, it must be noted with care and interest that, in such cases, the communication of the presence of the extraordinary and special

circumstances must be necessarily communicated to the promisor by the promisee, failing which the promisee cannot claim any special damages from the promisor. Let us now take some examples where the promisee could not claim any special damage simply on the ground that he had not communicated to the promisor of the existence or presence of any special or extraordinary circumstances attached therewith.

Examples

(i) Let us first take the example of the case of **Hadley vs Baxendale.** The facts of the case are as follows. The mill of M was shut down due to the breakdown of a shaft. He had delivered the shaft to T, a public transport company, to deliver it to the manufacturers concerned to copy it and manufacture a new one. But M had not taken care to communicate to T to the effect that any delay in the transportation of the shaft to the manufacturers would cause a loss in production, and the resultant profit that goes therewith. However, due to some negligence and carelessness on the part of T, the delivery of the shaft to the manufacturers got unduly delayed in transit beyond a reasonable time. As a result of such undue delay, the mill remained closed for a longer time than it would have otherwise remained, if the shaft were delivered to the manufacturers within a reasonable time. In this case, it was held that T was not liable for the loss of profit caused to M during the period of such delay in the delivery of the shaft by T, on the ground that the circumstances of the case did not evidence that M had communicated to T that a delay in the delivery of the shaft would involve loss of profit to the mill.

(ii) S had agreed to supply a certain quantity of beads to E, an exporter, on or before 31st October 2008. E had stipulated this dead line keeping in view the fact the these are to be used for manufacturing certain special and funny designs of caps and dresses, which are to be exported to Europe and America well before the Xmas and New Year celebrations begin, because thereafter there will be no demand for such goods. But he had not taken due care to communicate these facts to S. S, however, did not deliver the beads, even after the stipulated date, i.e. 31st October 2008. These were finally delivered, but by that time, it had become too late for the products to be exported and to catch with the aforementioned celebrations. Thus, E could now use these beads only during the next year, at the earliest. This way E had suffered heavy losses of the anticipated profit for not being able to catch up with the celebrations this year due to the delayed supply by S. In this case, S will be held liable to pay to E only the ordinary damages by way of compensation, i.e. only the amount that represents the difference between the contract price and the price obtaining at the time of the delivery of the beads. But the amount of the expected profit now lost, that E could have otherwise earned, had the beads been supplied to him by S by the appointed date, will not be taken into account, nor will be the expenses that E would have incurred in connection with the tying up of the various inter-connected arrangement for production and export of the caps and dresses.

(c) Vindictive or Punitive Damages, or Exemplary Damages

The basic idea behind claiming and granting vindictive (or punitive damages, or exemplary damages), as the name itself suggests, is not just granting the damages to the promisee (plaintiff), but also to inflict due punishment to the promisor (defendant) so as to meet the ends of justice, as may be demanded by the circumstances and the facts of the specific case.

Examples

Such punitive damages had been awarded in the following cases:

(i) In the cases of breach of promise to marry. In this case, the measure and quantum of the punitive damages will depend upon the severity of the shock and pain that the other party (promisee) might have suffered due to such breach of promise by the promisor.

(ii) In the case where the banker wrongfully dishonours the cheque of his customer under the objection 'refer to drawer' (signifying shortage of funds in the drawer's account), despite the fact that there were

sufficient funds in the drawer's account to honour the cheque. Here, the principle for fixing the quantum of damages is based on the underlying principle: 'Smaller the amount of the cheque wrongfully dishonoured, higher would be the quantum of the punitive damages awarded'.

It may be interesting to examine the rationale lying behind the aforementioned principle, viz. 'lower the amount, higher the penalty'. This is so because, in all the cases where the cheque is (even wrongfully) dishonoured, the payee does not know that the cheque has been wrongfully dishonoured. He will usually get the impression that the drawer did not have sufficient funds in the account to get the cheque honoured. Thus, if a cheque for Rs 5 lakh has been dishonoured, the payee, and even others, will get the impression that the drawer must be having enough funds in his bank account, but the same would have been somewhat short by the (respectable) amount of the cheque, i.e. Rs 5 lakh. But, as against this, let us visualise the situation where the banker has wrongfully dishonoured a cheque for Rs 5 only. In such a case, the payee of the cheque, and even others, will get and form such a poor impression about the financial position and credibility of the drawer of the cheque that he was not worth even a petty sum of as small as Rs 5. I have, however, taken very extreme cases just to amply illustrate the point.

(d) Nominal Damages

Nominal damages are awarded for the breach of contract in the cases, where there is only a technical violation of the legal rights, but where there is no substantial loss caused to the aggrieved party thereby. The damages awarded in such cases are referred to as minimal in view of the fact that these happen to be very small (just nominal or token) like a rupee or two.

It will be pertinent to stress a legal point that in such cases, the responsibility of containing or minimising the possible loss due to such breach of contract squarely lies on the aggrieved party (promisee). Alternatively speaking, he (aggrieved party) is not entitled to claim any damages or compensation from the defaulting party for the losses, which are not caused by the breach of contract, but owing to his own negligence in not caring to minimise his losses after the breach of contract had taken place. This point has been clarified in the case of **British Westinghouse & Co. vs Underground Electric etc. Co. [(1915) AC 673].**

Liquidated Damages and Penalty

There may be cases where the parties to the contract, at the time of entering into the contract itself, may decide and agree about the particular sum of money that will be payable by the defaulting party to the aggrieved party, in case any one of them were to commit the breach of contract. Such pre-settled amount of money may be payable either by way of 'liquidated damages' or else by way of 'penalty'.

Distinction between 'Liquidated Damages' and 'Penalty'

Liquidated Damages

In the case of the liquidated damages, the amount of money, which is agreed to be payable by the defaulting party, in the event of the breach of contract, is estimated by the involved parties themselves, and such calculation is again based on a conscientiously calculated, reasonable, genuine, and realistic pre-estimated quantum of the loss, if any, that the aggrieved party may be expected to sustain. That is to say that such pre-agreed sum of damages will be regarded as the liquidated damages only if the parties to the contract have computed the quantum of such damages in accordance with the aforementioned conditions.

Penalty

In the cases where the amount of money, pre-agreed to be payable to the aggrieved party by the defaulting party, in the event of the breach of contract, is pre-settled between the parties to the contract but only arbitrarily, and not based on the conscientiously calculated, reasonable, genuine, and realistic pre-estimated quantum of the loss (if any), such amount will be referred to as the penalty, as against the liquidated damages. Thus, the amount of penalty so pre-settled will naturally be far in excess of the amount that would have been arrived at by way of the liquidated damages. Such procedure and strategy is usually adopted by the party, who is far

more interested in the performance of the contract (than in its breach), so as to force and compel the other party to perform the contract rather than preferring to default, because, in the latter case, the amount of penalty so pre-settled may happen to be in excess of the loss, if any, that the promisor might possibly suffer in the case of his default (i.e. his breaching of the promise). That is why the term used in such context is 'penalty', which has the element of the punitive action by way of fine and the like, inherent in it.

Under Section 74, the aggrieved party is entitled to receive the amount of compensation from the defaulting party, for the breach of contract in both the cases; that is where the amount of the liquidated damages is duly fixed and pre-settled, as also where the amount of the penalty has been arbitrarily fixed, which comes to far above the quantum of liquidated damages that could have been duly arrived at. But there is a provision made in Section 74 to the effect that the defaulting party will, of course, have to pay the amount by way of compensation in the case of penalty also, but only to a reasonable extent, and not in full. Further, the Court will decide the amount of such reasonable amount of compensation, and that such amount will be within the amount of the pre-settled amount of penalty. Thus, we may observe that, while the amount of liquidated damages will be payable in full, the amount of penalty will not be payable in full. In the case of penalty, only a reasonable amount will be payable as a compensation. That is, the amount of penalty agreed upon serves only as a ceiling, which even the amount of a reasonable compensation stipulated by the Court cannot exceed. [Under the English Law, however, while the amount of liquidated damages is enforceable in law, the amount of penalty is not].

Examples

(i) B has borrowed a sum of Rs 5,000 from C, to be repaid on a particular date, failing which B will have to pay to C a sum of Rs 10,000, instead. B does not pay back the amount on the particular date. In this case, C will be entitled to recover only a reasonable sum of amount, as may be decided by the Court of Law. This amount, however, can in no case exceed the amount of Rs 10,000 (i.e. the amount pre-settled between the parties to the contract, by way of penalty).

(ii) D has borrowed a sum of Rs 1 lakh from C, on execution of a Demand Promissory Note (DP Note), repayable after one year with interest at the rate of 15 per cent per annum. It has been further agreed between them that in case D fails to repay the loan by the stipulated date (i.e. in one year time), D will have to pay the interest at a penal rate of 50 per cent per annum, from the date of such default, i.e. after one year. This stipulation of payment of the interest at a penal rate of 50 per cent per annum is by way of penalty. Thus, in this case, the Court will decide the quantum of reasonable compensation that C will be entitled to receive from D. Such compensation, though to be fixed by the Court, however, will have to be within the amount that could be arrived at, on computation of the amount of interest at the rate of 50 per cent per annum from the date of default till the date on which the loan is actually repaid by D. Such amount of compensation, of course, will be in addition to the amount of the principal and the amount of interest payable for the entire period at the agreed rate of 15 per cent per annum.

Payment of Interest

Let us now consider the circumstances and conditions under which the stipulation of the interest at a higher rate could be considered to be in the nature of a penalty. These are:

(i) In the case where the interest to be payable from the date of the default is stipulated at an abnormally and unreasonably higher rate, it will be deemed to be in the nature of a penalty.
The example, cited at no. (ii) above, illustrates the point.

(ii) However, where the interest is stipulated to be payable at a higher rate, right from the date of the loan, and not just from the date of the default, it will be invariably deemed to be in the nature of a penalty in all such cases, irrespective of the fact whether it could be termed as being abnormally and unreasonably high or otherwise.

Compound rate of interest

Let us now try to understand whether the stipulation of interest at a compound rate of interest (instead of a

simple rate of interest), in itself may amount to a penalty as such, or not. Here, it must be clarified that the stipulation of a compound rate of interest in itself will not amount to a penalty, and accordingly, the Court will allow it, provided, of course, the parties to the contract had expressly agreed to such provisions of compound rate of interest.

Here, it may be mentioned that the banks generally stipulate and charge interest at a compound rate of interest, compounded quarterly. The legal language generally used in the agreement document by the banks is that the interest will be charged at a particular rate per annum, with quarterly rests, which means that the interest will be applied on the loan, account at quarterly intervals.

Example

Thus, the interest, when charged at quarterly intervals, will be computed as has been demonstrated below:

Let us presume that a loan of Rs 10,000 has been taken on 1st January 2009 at the rate of interest of 12 per cent, to be charged at quarterly rests. Thus, after the expiry of the first quarter, i.e. on 31st March 2009, the amount of interest will come to Rs 300. On 1st April 2009, this amount of interest of Rs 300 will be added to the amount of the loan i.e. Rs 10,000. Thus, for the second quarter, i.e. on 30th June 2009, the interest will be charged on the total amount of Rs 10,300, which comes to Rs 309 (instead of Rs 300 only that was charged at the end of the first quarter, as aforementioned). Thus, this process will continue during the currency of the loan account. This is referred to as charging interest at a compound rate of interest.

Compound rate of interest at a higher rate from the date of the loan

But then, the stipulation by way of a clause in the contract document to the effect that the compound rate of interest will be charged at a higher rate from the date of the default will fall under the category of a penalty. As the Privy Council had held in the case of **Sunder Koer vs Rai Sham Krishan [(1907) 34 Cal. 150],** 'compound interest at a rate exceeding the rate of interest on the principal money being in excess of the ordinary and usual stipulation, may well be regarded as being in the nature of a penalty'.

Reduced rate of interest

There may be cases where a clause in the agreement document may stipulate that the interest will be charged at a lower (reduced) rate in the case of repayment of the loan or the loan instalment, timely on the due date. Such provisions, naturally, will not be deemed to be in the nature of a penalty.

Here, it may be mentioned that most of the banks and other financing companies, especially while granting a housing loan, make such stipulations in the agreement document.

Example

A clause in the agreement document for the housing loan by the State Bank of India stipulates that the interest will be charged at a lower (reduced) rate at 7.5 per cent p.a. (reduced from the usual rate of 9 per cent p.a.), in case the periodical instalments of the loan are paid into the loan account on the due date, as and when these may fall due for payment. Such provisions, naturally, will not be deemed to be in the nature of a penalty.

(iii) Obtaining a Decree for the Specific Performance

There may be cases where the payment of some amount by way of damages may not be considered to be an adequate, right, and just remedy for non-performance of the contract. Thus, in such cases, only the performance of the contract itself could be considered to be the appropriate and adequate remedy and nothing short of it. Accordingly, the Court may direct the defaulting party to perform his part of the promise in accordance with the terms of the contract. This is referred to as the specific performance of the contract.

Examples

(a) The contract for the sale of a particular house is an illustrative example of the contract where the Court may direct the defaulting party to perform his part of the promise in accordance with the terms of the contract. The Court may hold accordingly on the ground that the aggrieved party may not be in a position to immediately get yet another party who may purchase the house and at the same price.

(b) Similarly, the other such examples may be of some rare articles or any other thing, where it may not be possible to get exactly a substitute buyer in the market immediately and with the same terms and conditions of the contract.

It may, however, be carefully noted in this context that in the following cases the specific performance will not be granted by the Court:

(a) Where monetary compensation is considered to be an adequate relief;
(b) Where the contract happens to be of a personal nature, e.g., a contract to marry.
(c) Where it may not be possible for the Court to supervise the performance of the contract, e.g., a building contract; and
(d) Where a contract has been entered into by a Company, which falls beyond the scope and objective stipulated in its Memorandum of Association.

(iv) Getting an Injunction

The term 'injunction' refers to an order passed by the Court of Law. There may be cases where one of the parties to the contract may commit a breach of a negative term of the contract (i.e. where he does something, which he had promised not to do), under the terms of the contract. In such cases, the Court may pass an injunction order prohibiting such party to the contract from doing so.

Examples

(a) In the **Metropolitan Electricity Supply Company vs Ginder**, Ginder had agreed with the Metropolitan Electricity Supply Company that he would buy the entire requirement of the electricity for his house from that very company. He was, however, found to be purchasing the electricity for his house from some other company. The Metropolitan Electricity Supply Company had filed a suit against Ginder, and prayed for the issuance of an injunction order by the Court. Accordingly, the Court issued an injunction order prohibiting Ginder from purchasing the electricity from any other company or person.
(b) In another case, N, a film actress, had agreed to act exclusively for a particular producer for a period of one year. But, during that very year, N had entered into a contract to act for some other producer. Accordingly, the Court had passed an injunction order in the case, restraining her from acting for any other producer during the period of one year.
(c) As we know, many of the film stars and cricket heroes are being signed by various companies like Coca-Cola and Pepsi, Lux and Pears, and so on, with some restrictive clauses incorporated in the contract documents. In these cases, if any of the persons would violate the terms and conditions and jump the restrictions, the other party may approach the Court and may be granted an injunction order prohibiting the models to refrain from doing anything prohibited under the contract.

(v) Filing a suit on Quantum Meruit

As we have seen in Chapter 8 on 'Quasi-Contract', the term 'Quantum Meruit' means as much 'as is merited' or 'as much as is earned'. Further, by way of a general rule of law, unless a person has performed his obligation under the contract in full, he cannot claim the performance of the contract by the other party [**Cutter vs Powell (1795), TT, 320**]. But then, there are certain exceptions to such rules based on the principle of 'Quantum Meruit'. But the right to sue may arise on the basis of the principle of 'Quantum Meruit' where a contract, though only partly performed by one of the parties, has itself become discharged by virtue of the breach of the contract by the other party. The points, pertinent for discussion even in the present context, have already been discussed in Chapter 8 on 'Quasi-Contract', which may be referred back to.

Let us Recapitulate

Any of the following relieves and remedies become available to the party, when the other party to a contract commit a breach of contract:

(i) Recession of the contract, whereby the aggrieved party gets freed from all his obligations under the contract. He is also entitled to claim compensation from the other party for any loss or damage sustained.

(ii) Claim damages for the losses sustained or suffered thereby, by way of

(i) Ordinary damages, being the difference obtaining between the contract price and the market price, prevailing at the time of such breach of contract.

(ii) Special damages, where there are certain special or extraordinary circumstances present or involved, and their involvement or existence is communicated to the promisor.

(iii) Vindictive or punitive damages, or exemplary damages, which involve not just granting the damages to the promisee (plaintiff), but also to inflict due punishment to the promisor (defendant) so as to meet the ends of justice.

(iv) Nominal damages, which are awarded where there is only a technical violation of the legal rights, and where there is no substantial loss caused to the aggrieved party thereby.

Liquidated Damages and Penalty

In liquidated damages, the amount of money is estimated by the involved parties themselves, based on a conscientiously calculated, reasonable, genuine and realistic pre-estimated quantum of the loss,

In the cases of penalty, the amount of money is pre-agreed to be payable to the aggrieved party but only arbitrarily, and not on any genuine and realistic basis, whereby it will naturally be far in excess of the amount that would have been arrived at by way of the liquidated damages.

Payment of Interest

Where the interest to be payable from the date of the default is stipulated at an abnormally and unreasonably higher rate, it will be treated as a penalty.

But the stipulation of a compound rate of interest in itself will not amount to a penalty, provided the parties to the contract had expressly agreed thereto.

However, where the compound rate of interest will be made chargable at a higher rate from the date of the default, it will fall under the category of a penalty.

Further, where the interest is chargeable at a lower (reduced) rate, like in the case of repayment of the loan or the loan instalment, timely on the due date, such provisions, will not be deemed to be in the nature of a penalty.

(iii) Obtaining a decree for the specific performance, where mere payment of some amount by way of damages may not be considered to be an adequate, right and just remedy for non-performance of the contract. Accordingly, the Court may direct the defaulting party to perform his part of the promise in accordance with the terms of the contract.

(iv) Getting an injunction, where one of the parties to the contract may commit a breach of a negative term of the contract (i.e. where he does something, which he had promised not to do), under the terms of the contract. In such cases, the Court may pass an injunction order, prohibiting such party to the contract from doing so.

(v) Quantum Meruit

Questions for Reflection

1. Discuss each of the following relieves and remedies that may become available to the other party in the case of the breach of contract. Explain and clarify your points with the help of illustrative examples in each case.

(a) Recession of the contract,
(b) Claim damages for the losses sustained or suffered thereby,
(c) Obtaining a decree for the specific performance,
(d) Getting an injunction order, or
(e) Filing a suit on quantum meruit.

2. Explain the following categories of damages, and bring out the distinguishing features involved in each case. You must explain and clarify your points with the help of illustrative examples in each case.
   (a) Ordinary damages,
   (b) Special damages,
   (c) Vindictive or punitive damages, or exemplary damages, and
   (d) Nominal damages.
3. The promisee becomes entitled to claim special damages only where he has communicated to the promisor the existence of the some special circumstances in the performance of the contract.
   Explain, by citing suitable illustrative examples, where such communication was made to the defaulting party and where it was not, and the legal ramifications thereof under the two different circumstances.
4. (a) What do you understand by the term ' punitive damages'?
   (b) Cite two examples where punitive damages may be awarded.
5. Where the banker wrongfully dishonours the cheque of his customer, the quantum of damages is based on the principle: 'Smaller the amount of the cheque, higher would be the quantum of the punitive damages awarded'. What, in your considered opinion, is the rationale behind such criteria? Explain with the help of some illustrative examples.
6. (a) Under what circumstances are the nominal damages awarded for the breach of contract?
   (b) What, in your considered opinion, is the rationale behind such provisions? Explain with the help of illustrative examples.
7. (a) Distinguish between 'liquidated damages' and 'penalty', and bring out the essential elements involved in each of them with the help of illustrative examples in each case.
   (b) What are the criteria for payment of damages in the cases where the amount of penalty has been pre-fixed?
8. (a) Will it be treated as a penalty, in the cases where the interest payable from the date of the default is stipulated at an abnormally higher rate?
   (b) Will the stipulation of a compound rate of interest in itself amount to a penalty?
   (c) Will it be treated as a penalty where the compound rate of interest is made chargeable at a higher rate from the date of the default?
   (d) Will it be treated as a penalty, where the interest is chargeable at a lower (reduced) rate in the case of repayment of the loan or the loan instalment, timely on the due date?

   Give illustrative examples in each case.
9. (a) Under what circumstances the Court may direct the defaulting party to perform his part of the promise in accordance with the terms of the contract?
   (b) What, in your considered opinion, could be the rationale behind such provisions? Explain with the help of some illustrative examples.
10. (a) What does the term 'injunction' refer to?
    (b) Under what types of breach of contract can the Court pass an injunction order?

    Elucidate your points with the help of suitable examples in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

Akash, a famous singer, had entered into a contract with the Taj Mahal Hotel, to sing at the hotel for one hour regularly on each Saturday night for nine months on payment of Rs 2,500 per show. Akash, after singing for 15 Saturday nights, had wilfully absented himself and did not perform at the restaurant on the sixteenth Saturday night. Consequently, the hotel management had rescinded the contract.

(i) Is the hotel management justified in rescinding the contract with Akash, under the aforementioned circumstances?

(ii) Is any other remedy also available to the hotel management in the instant case?

Give reasons for your answers.

Solution

(i) Yes. The hotel management is fully justified in rescinding the contract with Akash, because, it has been specifically mentioned in the instant case that Akash had **wilfully** absented himself, and had not performed at the restaurant on the sixteenth Saturday night.

(ii) Further, in this case, the hotel management is also entitled to claim compensation from Akash for the damages sustained by the hotel caused by the non-performance by Akash. This contention is based on the provisions of Section 75 of the Act, which specifically provides that where a person rightfully rescinds the contract due to breach of contract by the other party, he is entitled to claim compensation from the other party for any loss or damage sustained by him due to such non-performance of the promise by the other party.

Problem 2

Will the legal position be any different if, in the Problem 1 above, Akash would have failed to perform on the sixteenth Saturday night because he had fallen ill on that night?
Give reasons for your answers.

Solution

Yes. The legal position would have been dramatically different in that case, because of the fact that the non-performance by Akash, in that case, would not be deemed to have been caused by a **wilful** default on the part of Akash. Instead, the default would have been deemed to have taken place due to the subsequent impossibility of the performance, and not for any fault on the part of Akash, inasmuch as he had fallen sick. In the aforementioned circumstances, the contract would have been deemed to have become void and, accordingly, even the question of payment of any compensation to the hotel by Akash for non-performance by him, would not have been involved, either. This is so because, in the instant case, the provisions of Section 56 (pertaining to the subsequent impossibility) will be applicable, instead of the provisions of Section 75 (pertaining to the wilful default), as was the case in Problem 1 above.

Problem 3

On 12th June 2009, Rohan had contracted with Vikas to deliver to him (Vikas) 500 bags of sugar at the rate of Rs 600 per bag. But on 18th July 2009, Rohan had refused to deliver 500 bags of sugar to Vikas at the agreed price, perhaps, because the prevailing rate of sugar, as on the appointed date, was Rs 700 per bag. Accordingly, Vikas had filed a case against Rohan for recovery of damages of Rs 1 lakh from him. What remedies are likely to be granted by the Court to Vikas? Give reasons for your answer.

Solution

The Court is most likely to decide that Rohan will have to compensate Vikas for the amount of the difference between the market price and the contract price as on the date of the breach of the contract, i.e. as on 18th July 2009, which comes to Rs 50,000 [computed as (Rs 700 less Rs 600) x (500 bags)]. This is so because, in the instant case, under the provisions of Section 73 of the Act, only ordinary damages – i.e. which had naturally

arisen in the usual course of business, due to such breach – will be made payable. And, the quantum of such (ordinary) damage is assessed on the basis of the difference obtaining between the contract price and the market price, prevailing at the time of such breach of contract.

Problem 4

Vandana had promised to buy Sudarshna's house for Rs 10 lakh. Later, Vandana had refused to buy Sudarshna's house. By that time the price of house property had fallen and thus, at the material time, the Sudarshna's house would have fetched her Rs 9 lakh only. Accordingly, Sudarshna had filed a suit against Vandana for recovery of damages of Rs 5 lakh from her. What remedies are likely to be granted by the honourable Court to Sudarshna? Give reasons for your answer.

Solution

In the instant case, the Court is most likely to decide that Vandana will have to compensate Sudarshna for an amount computed as the difference between the contract amount of Rs 10 lakh and the amount that Sudarshna's house might now fetch at the time of the breach of contract, i.e. Rs 9 lakh. That is, as Sudarshna will now get Rs 9 lakh only from the sale of her house, Vandana will have to compensate Sudarshna for Rs 1 lakh only, and not for Rs 5 lakh, as was claimed by her (i.e. 10 lakh less Rs 9 lakh, which comes to Rs 1 lakh only). This is so because, in the instant case, under the provisions of Section 73 of the Act, only ordinary damages – i.e. which had naturally arisen in the usual course of business, due to such breach – will be made payable. And, the quantum of such (ordinary) damage is assessed on the basis of the difference obtaining between the contract price and the market price, prevailing at the time of such breach of contract.

Problem 5

On 1st June 2008, Karan had entered into a contract with Lakhan to construct and finish his house, and finally hand it over to Lakhan latest by 30 April 2009. Further, Lakhan had also communicated to Karan that he (Lakhan) had, in turn, entered into a contract with Vandana, the prospective tenant, to let the house out to her and to give its possession to her with effect from 1st May 2009. But, the quality of the construction of the house by Karan was so poor that on 31st March 2009 itself the house had fallen down and, therefore, it had to be reconstructed over again by Lakan. And, in the process, and as a direct consequence thereof, Lakhan had lost the amount of rent that he would have received from Vandana with effect from 1st May 2009, besides being required to compensate Vandana for the breach of contract by him (Lakhan). Consequently, Karan had agreed to compensate Lakhan for the amount spent by him in connection with the reconstruction of the house. But Karan had flatly refused to compensate Lakhan for the loss of rent incurred by him (Lakhan), and the amount of damages that Lakhan was made to pay to Vandana in this case, on the ground that he was not responsible for such losses, as these were not directly connected with his faulty construction work. Lakhan had not agreed to such offer made by Karan, and had, instead, preferred to file a suit against Karan. What remedies are likely to be awarded by the Court in the instant case? Give reasons for your answer.

Solution

In the instant case, the Court is most likely to pronounce the judgement to the effect that Karan will have to compensate Lakhan, not only with the cost of reconstruction of the house, but in addition thereto, with the amount of monthly rent so lost to Lakhan, as also for the amount of compensation that Lakhan will have to now pay to Vandana for the breach of contract. This is so because, the loss of rent incurred by Lakhan and the compensation paid by Lakhan to Vandana, are in the nature of being directly connected with the collapse of the house due to bad construction work of Karan, in the instant case. Moreover, the presence and involvement of the special circumstance – of renting the house to Vandana with effect from 1st May 2009 – had also been specifically communicated by Lakhan to the Karan.

The aforementioned contention is based on the provisions of Section 73 of the Act to the effect that special damages will have to be paid in the cases where there are certain special or extraordinary circumstances present or involved, and their involvement or existence is communicated to the promisor, the non-performance of the contract by the promisor entitles the promisee not only to claim the ordinary damages, but also the damages that may result from such special or extraordinary circumstances, in addition to the ordinary damages.

Problem 6

Would the legal position be any different if, in Problem 5 above, Lakhan would not have specially apprised Karan to the effect that Lakhan had already entered into a contract with Vandana to let the house out to her and to give its possession to her with effect from 1st May 2009?

Solution

Yes. In that case the legal position would have been far different. Because, in that event, Lakhan would have been entitled to the payment of only the ordinary damages, by way of the amount of expenses incurred in connection with the reconstruction of the house. That is to say that, Lakhan would not have been entitled to receive any special damages by way of the amount of loss of rent for the period, as also the amount of damages paid by him to Vandana. This is so because, as has been specifically provided under Section 73 of the Act, the communication of the presence of the extraordinary and special circumstances must be necessarily communicated to the promisor by the promisee, failing which the promisee cannot claim any special damages from the promisor. Alternatively speaking, in that case, only the ordinary damages, and no special damages, would be payable.

Problem 7

Gulshan had promised to Sulbha that he would marry her immediately on his return from his business trip to the USA. But when Gulshan returned home, Sulbha was utterly shocked and pained to find that Gulshan had already married an American lady, whom he had fallen in love with, during his business trip abroad. After recovering from the great pain and shock, Sulbha had filed a case against Gulshan claiming, not only the ordinary damages but also an exemplary damages from Gulshan, for the breach of the contract that was entered into between them. What are the chances of Sulbha winning the case? Give reasons for your answer.

Solution

Sulbha is sure to win the case and would be awarded, not only the ordinary damages, but also exemplary damages from Gulshan, for the breach of the contract by him. Our such contention is based on the fact that the basic idea behind claiming and granting exemplary (vindictive or punitive) damages, is not just granting the damages to the aggrieved party, but also to inflict due punishment to the defaulting party so as to meet the ends of justice, as may be demanded by the circumstances and the facts of the specific case. Thus, while deciding upon the quantum of the exemplary (vindictive or punitive) damages, the Court will take into account the severity of the shock and pain that Sulbha might have suffered due to such breach of contract by Gulshan, in the instant case.

Problem 8

On 15th November 2008, Amit had borrowed a sum of Rs 1 lakh from Virendra, which he had promised to repay to him latest by 5th March 2009. Virendra had further stipulated that in case Amit would fail to repay the loan amount to him on or before 5th March 2009, he (Amit) will have to pay to Virendra a sum of Rs 1. 50 lakh, instead. Amit, however, had failed to pay back the amount on 5th March 2009. Thereupon, Virendra had filed a suit against Amit for the recovery of the amount of Rs 1.50 lakh from him (Amit), as per the terms of the agreement, which were arrived at between the two parties, without involving any element of coercion or lack of free will, whatsoever. Do you think that the Court will ask Amit to pay a sum of Rs 1.50 lakh to Virendra? Give reasons for your answer.

Solution

In the instant case, there is every possibility that the Court may ask Amit to pay to Virendra not a sum of Rs 1.50 lakh , as was prayed by Virendra in his case, but only a reasonable sum of amount, in addition to the amount of the actual loan (i.e. Rs 1 lakh) plus the amount of interest and other charges due thereon, may be decided by the Court of Law. This amount, however, can in no case exceed the amount of Rs 1.50 lakh (i.e. the amount pre-settled between the parties to the contract by way of penalty).

Problem 9

On 11th October 2007, Madan, a film actor, had agreed to act exclusively for the producer, Suresh, for a period of two years. But, on 21st December 2008, he had entered into yet another agreement with the producer, Harish, to act in his films. Accordingly, Suresh had filed a suit against him (Madan), and had prayed for the issuance of an injunction order, restraining Madan from acting in the films of the other producer, Harish, during the currency of the agreement entered into between him and Madan. Do you think that the Court will issue the necessary injunction order, as was prayed for by Suresh? Give reasons for your answer.

Solution

Yes. The Court will definitely pass an injunction order in the instant case, restraining Madan from acting for the other producer, Harish, during the period of the two years, commencing from 11th October 2007 and thus, ending on 10th October 2009. The aforementioned contention is based on the legal provisions to the effect that in the cases where one of the parties to the contract had committed a breach of a negative term of the contract (i.e. where he had done something, which he had promised not to do, under the terms of the contract), the Court may pass an injunction order prohibiting such party to the contract (viz. Madan, in the instant case) from doing so (i.e. acting in the films of the other producer, viz. Harish, in the instant case).

Chapter Twelve

Contracts of Indemnity and Guarantee

"*A stiff apology is a second insult. The injured party does not want to be compensated because he has been wronged; he wants to be healed because he has been hurt.*

G K Chestorton

The word of a gentleman is as good as his bond; and sometimes better.

Charles Dickens

It generally happens that assurance keeps an even pace with ability.

Samuel Johnson

A person who can't pay gets another person who can't pay to guarantee that he can pay. Like a person with two wooden legs getting another person with two wooden legs to guarantee that he has got two natural legs.

Charles Dickens"

12.1 Definition of Indemnity

A contract of indemnity is a contract whereby one party promises to save the other party from the loss caused to him by the conduct of the promisor himself, or by the conduct of any other person (**Section 124**).

12.2 Essential Elements of Indemnity

As per the aforementioned definition of indemnity, the following essential elements of indemnity may emerge:

(a) There must necessarily be some loss sustained by the promisee. In other words, if no loss is sustained by the promisee, the promissor cannot be held liable by the promisee, under the contract of indemnity, on any count.

(b) Further, on a strict interpretation of this Section, the loss, if any, must necessarily be caused by the conduct of the promisor himself or by the conduct of any third person. Accordingly, any loss caused by the conduct of the promisee himself, or by an act of God, may not be covered. But this way, in the event of the death of the insured person (death being the act of God) the claim under the life insurance policy taken in the name of the deceased may not be admissible in law. Similar may be the case at the time of claming compensation under the general insurance policy, for the losses caused by fire, flood, or such other natural calamities. This way, the whole system of insurance itself will collapse. Therefore, the Courts in India follow the provisions of the English Law in this regard, whereby the losses caused by the events or accidents like death, disability, destruction by fire, flood, cyclone, Tsunami, etc., are also covered under the contract of indemnity.

(c) Above all, it may be reiterated here that the contract of indemnity, like the other contracts, must also have all the elements required for a valid contract.

A contract of indemnity may arise under the following circumstances:

(a) By way of an express agreement; or

(b) By operation of any law.

Examples

(i) The principal is bound by law to indemnify his agent for all the consequences, of course, arising only out of the lawful acts performed by him as an agent, authorised by the principal on this behalf.

(ii) Again, in the event of the transfer of shares, the transfee, as per law, undertakes to indemnify the transferor against all future claims, calls, or losses. The transferor company usually gets such indemnity bond from the transferee (the present shareholder) on its prescribed form for the purpose.

(iii) Similarly, the banks also insist on execution of an indemnity bond to issue a duplicate draft in lieu of the original one lost or destroyed. In the case of a draft of small amount, however, such indemnity letter may be obtained on a plain unstamped paper, instead.

12.3 Rights of the Indemnity Holder (Indemnified Party) [Section 125]

The indemnity holder enjoys the legal rights to recover from the promisor in the following cases:

(a) To recover all damages sustained by him by way of payment made by him in any legal suit pertaining to the matter for which the promisor had undertaken to indemnify him against.

(b) To recover all costs of suits which he was required to pay to any third party provided, of course,

  (i) He had filed or had to defend the suit by way of acting under the authority of the indemnifier or else;

  (ii) He did not act in contravention of the order or authority of the indemnifier, and acted in such a way as a man of ordinary prudence would act in his own case, and under similar circumstances.

12.4 Rights of the Indemnifier (Indemnifying Party)

It may be worth noting in this context that under the Act, the indemnifier (indemnifying party) does not enjoy any legal rights. His rights, however, in such cases are similar to those of the surety or guarantor under Section 141, viz. that he gets title to all the benefits of the entire securities already obtained by the creditor from the principal debtor, against the loan granted to him, irrespective of the fact whether he was aware of such securities or not **[Jaswant Singhji vs Section of Sate, 14 Bom 299]**.

12.5 Commencement of the Liabilities of the Indemnifier (Indemnifying Party)

Different Courts of Law have held different views in the matter as to the time from when the liability of the indemnifier actually starts. The High Courts of (i) Lahore (ii) Nagpur, and (iii) Bombay have held the view that the indemnifier's liability does not commence unless and until the indemnified party has actually incurred the loss or damages to be compensated for **[(i) Sham Sunder vs Chandra Lal, 1935 Lah. 974; (ii) Ranganath vs Pachuson 1935 Nag. 147; and (iii) Sanker Nimbaqui vs Laxman Napu 1940 Bom. 161].**

As against this, in some other cases, the High Courts of (i) Calcutta (ii) Allahabad, and (iii) Bombay, have opined that the indemnified party can legally compel the indemnifier to place him (indemnified party) in a position such that he may meet his obligation under the indemnity without waiting for actually suffering the loss by way of actual payment in a legal case **[(i) Kamnannath Bhattacharjee vs Nohokumar (1899) 26 Cal. 241; (ii) Shiam Lal vs Abdul Salal 1931 All. 754; and (iii) Gajnan Moreshwar vs Moreshwar Madan 1942 Bom. 302].**

By now, the latter point of view is quite well-established and settled. That is, it is now no longer necessary that the indemnified party must first make the payment and only thereafter he may claim the repayment and reimbursement from the indemnifier. In essence, the contract of indemnity requires that the indemnified party should never be called upon to make the payment out of his own sources, at any stage.

12.6 Definition of Guarantee (Sections 126 to 141)

A contract of guarantee is 'a contract to perform the promise or to discharge the liability of a third person in case of his default' **[Section 126].** The person who gives the guarantee is known as the 'Surety', the person on whose behalf the guarantee is given is called the 'Principal Debtor', and the person or party to whom the guarantee is given is referred to as the 'Creditor'. Such guarantee could be either in writing or even verbally. The English Law, however, requires it to be necessarily 'evidenced in writing'.

Thus, we may observe that in the case of guarantee there are two distinct sets of agreements, viz.

(a) The principal contract between the principal debtor and the creditor, and
(b) The secondary contract between the creditor and the surety.

Further, in the case of a contract of guarantee, there are three parties, viz. the creditor, the principal debtor, and the surety.

Example

S requests C to grant a loan for Rs 1, 00, 000 to B, and guarantees that B will repay the loan amount in time, and also undertakes that in case B will fail to repay the loan in full and in time, he himself will pay the loan amount to C. Such promise/undertaking is known as the contract of guarantee.

It may be pertinent to emphasise here that the contract of guarantee is an independent contract and is not necessarily collateral (or additional) to the original contract between the principal debtor and the creditor. Alternatively speaking, the contract between the principal debtor and the creditor may be entered into even after the contract of guarantee has already been entered into. This goes to further suggest that both these two separate agreements must take place, though it is immaterial as to which one of these two precedes the other.

12.7 Distinction between 'Contract of Indemnity' and 'Contract of Guarantee'

1. L. C. Mather in his book '*Securities Acceptable to the Lending Banker'* so succinctly brings out the main distinguishing features between these two types of contract by way of the following illustrative examples:

In the case of a contract of indemnity, A tells B "If you lend 20 pound sterling to C, I will see that your money comes back." As against this, an undertaking to the effect that

"If you lend 20 pound sterling to C, and he does not pay you, I will", constitutes a contract of guarantee. We may, thus, observe that while in the case of a contract of indemnity, there are only two parties (indemnifier and indemnified), in the case of a contract of guarantee there are three parties (creditor, surety and principal debtor).

2. In a contract of indemnity, the liability of the promisor is primary and independent. In the case of a contract of guarantee, however, the liability of the surety is only secondary; the primary liability being and remaining that of the principal debtor. In other words, the surety may be held liable only after the principal debtor has refused or has failed to repay the loan.
3. In the case of a contract of guarantee, there must be an already existing debt/obligation, the payment/fulfilment whereof is to be assured (guaranteed) by the surety. As against this, in the case of an indemnity, the indemnifier undertakes to compensate (indemnify) the promisee only, and that, too, only if any loss gets caused, and not otherwise.
4. In the case of a contract of guarantee, the guarantor (surety), after paying the debt of the principal debtor, automatically enters into the shoes of the creditor. Accordingly, all the securities obtained by the creditor from the principal debtor, to cover the amount of the debt, get transferred in his name. Thus, he gets entitled to enforce all such securities (obtained by the creditor from the principal debtor), in the settlement and recovery of his dues. Besides, he can proceed against the principal debtor in his own name for recovery of the balance amount, if any. As against this, in the case of an indemnity, the indemnifier cannot file a suit against the third parties in his own name, unless there happens to be an assignment in his favour.

12.8 Varieties of Guarantees

1. As we have already seen earlier, the contracts of guarantee in India may be either in writing or even verbally. It, however, is preferable to enter into a contract of guarantee, not verbally but invariably in writing, so as to avoid any risk or trouble of proving the terms and conditions, and even the very existence of, the verbal guarantee.
2. Further, from the point of view of scope, the contract of guarantee may be either specific or continuing.

(a) Specific Guarantee

A 'specific guarantee' is one, which pertains to a specific debt, and accordingly, once such debt is repaid, the guarantee automatically ends and gets cancelled. But then, it must be noted that a specific guarantee is irrevocable. That is, once it is given, the surety cannot revoke it during his lifetime, and even after his death, his legal successors may have to honour the commitment of the deceased under the guarantee. However, the liability of the successor would, of course, be limited to the extent of the value of the property of the deceased so inherited.

Example

S has guaranteed the repayment of a debt of Rs 5 lakh granted to B by the bank C. Such guarantee is in the nature of a specific guarantee, and thus, once B repays this loan, the guarantee automatically ends, and gets cancelled.

(b) Continuing Guarantee [Section 129]

As the name itself suggests, a 'continuing guarantee' is one, which pertains to a series of transactions, and not to just a specific one alone.

Example

S guarantees payment to C for the supply of electronic goods to B to the extent of Rs 2 lakh from time to time, in case B fails to do so. This is in the nature of a continuing guarantee. But then, if C supplies electronic goods to B for the value of Rs 3 lakh, instead, and B fails to make the payment, S will be liable to pay upto Rs 2 lakh only, as per the contract of guarantee, and not Rs 3 lakh.

Further, if S guarantees payment to C for the supply of electronic goods to B to the extent of Rs 2 lakh to be paid by B within a period of two months from the date of the supply, such guarantee will be in the nature of a specific guarantee, instead, and not a continuing guarantee. Thus, if B fails to pay his dues of Rs 2 lakh in time, S will have to make the payment as per the term of the guarantee, and thereafter this contract of guarantee will end. Alternatively, if B himself pays his dues of Rs 2 lakh in time, then also this contract of guarantee will end. Accordingly, if C makes a second supply to B to the extent of Rs 1.5 lakh, and B fails to pay, S will not be liable to pay as the guarantee, being in the nature of a specific guarantee, has already ended, with the first transaction itself.

Moreover, as against the specific guarantee, which is irrevocable, the continuing guarantee is revocable, but in regard to the future transactions only **[Section 130]**. That is, if a transaction has already taken place in accordance with the continuing guarantee, prior to its revocation, such transaction will be binding on the surety; but after it has been revoked, any future transaction, taking place subsequent to such revocation, will not be binding on him.

Examples

(a) S guarantees all the advances made by C to B to the extent of Rs 1 lakh, during the period of 12 months from now. C advances Rs 60,000 to B after three months. But in the fourth month S revokes his guarantee. C makes a further advance of Rs 40, 000 to B in the fifth month. B fails to repay the loan.

In such a case, S will be held liable to the extent of Rs 60, 000 only, as C had advanced this amount to B prior to the revocation of the guarantee. That is, the revocation cannot be effective in the case of the earlier transactions. But he (S) cannot be held liable for the repayment of Rs 40, 000, as this amount was advanced subsequent to the revocation of the guarantee by S.

(b) S guarantees to X that Y will pay all the time bills drawn on him upto the extent of Rs 50, 000. X draws a time bill for Rs 45,000 on Y, which Y duly accepts for payment on or before the due date. Thereafter, S revokes his guarantee. Y subsequently fails to pay the bill on the due date. S will be held liable as a surety for this transaction, inasmuch as it had already taken place prior to the notice of the revocation.

Further, the death of the surety in itself has the effect of revocation of the continuing guarantee, of course, only in the absence of any other contract to the contrary. But again, such revocation will also be operative only in regard to the transactions taking place subsequent to the death of the surety. In other words, the liability of the surety will continue to be operative in respect of all the transactions entered into prior to his death, and such obligation(s) will have to be satisfied by his legal heirs, to that extent only, out of the inherited property of the deceased surety **[Section 131].**

12.9 Rights and Duties of a Creditor

(a) Under the Contract of Guarantee, the Creditor Enjoys the following Rights under the Act

(i) The creditor has the legal right to demand from the surety the repayment of the loan given to the principal debtor, immediately, in the event of the latter's failure or refusal to make the repayment when due. That is, it is not necessary for the creditor to exhaust all the remedies available to him for the realisation of the dues from the principal debtor, for making such a demand on the surety.

(ii) The creditor, at the same time, also enjoys the legal right of 'general lien' on the securities of the surety in his possession, but only after (and not prior to) the default or refusal on the part of the principal debtor.

(iii) Further, in the event of the surety being declared insolvent, the creditor can also proceed in the insolvency proceedings of the surety, and claim his dividend on a *pro rata* basis.

(b) Under the Contract of Guarantee, the Creditor also has the flowing Duties (Obligations) to Perform under the Act

(i) Not to Change the Term and Conditions of the Contract with the Principal Debtor

The creditor is required, under Section 133 of the Act, not to change any of the terms and conditions of the original contract entered into by him with the principal debtor, without seeking a specific consent of the surety in this regard, preferably in writing. That is to say that, in the event of changing any of the terms and conditions of the original contract entered into with the principal debtor, without the specific consent of the surety in this regard, the surety automatically gets discharged of all his obligations under the contract of guarantee, of course, in regard to the transactions that have taken place only after (and not prior to) such variation(s) made in the conditions of the contract.

Example

State Bank of India (SBI) enters into an agreement with a borrower to advance him a sum of Rs 60,000 on 1st July 2009. S has guaranteed the repayment of this loan. The bank, however, disburses the loan to the borrower on 1st June 2009 itself, without caring to obtain the consent of S in this regard. In such a case, S is discharged of all his liabilities under the contract of guarantee, inasmuch as there has been a variation in the conditions of the original agreement entered into between the bank and the borrower. The bank, however, can recover the loan amount from the borrower, but not from the surety, as the guarantee were to be effective only from 1st July 2009, and not earlier.

(ii) Not to Release or Discharge the Principal Debtor

Under Section 134 of the Act, the creditor is required, not to release or discharge the principal debtor. That is, if the creditor happens to enter into a contract with the principal debtor to release him, or if any act or omission on his part has the legal effect of discharging him (principal debtor), it has the effect of discharging the surety of all his obligations under the respective contract of guarantee.

Example

Corporation Bank enters into an agreement with a borrower to advance him a sum of Rs 50,000. S has guaranteed the repayment of this loan. The borrower, however, enters into a contract with the bank to assign his property in the name of the bank in consideration of the banker releasing him (principal borrower) from his demands. In such a case, S is discharged of all his liabilities under the contract of guarantee, inasmuch as the principal borrower has been released of his liability to repay the debt to the bank.

(iii) Not to Compound with, or give Time to, or Agree Not to Sue the Principal Debtor

Under Section 135 of the Act, the surety gets discharged of all his liabilities under the contract of guarantee, in case a contract is entered into between the creditor and the principal debtor, whereby the creditor makes a composition with, or promises to give time to, or not to sue him (principal debtor), without any specific consent of the surety in this regard, preferably in writing.

The creditor is refrained from giving any extension in time to the principal debtor for repaying the loan, on the ground that it is quite possible that the principal debtor, during such extended period, may die, or become insane or insolvent, or his financial position may worsen in the mean time. This way, the chances of

recovery of the amount of the loan by the surety from the principal debtor may get impaired, in the event of his (principal debtor's) default in repayment.

Exceptions

However, there are certain exceptions made in this regard, which have been discussed hereafter.

(a) Under **Section 136**, the surety is not discharged of his liabilities, even if his specific consent has not been taken, in the case where the creditor enters into an agreement with any third party (and not the principal debtor) to give some extension of time to the principal debtor

Example

State Financial Corporation (SFC) has disbursed a term loan of Rs 25 lakh to Deoria Industries Limited for the purchase of plant and machinery. State Bank of India (SBI) has also disbursed a working capital loan to the company to the extent of Rs 5 lakh. S has guaranteed the loan granted by the SBI. The company has failed to repay three consecutive instalments on the term loan to the SFC. Accordingly, the SFC has served a legal notice to the company that it will lock up its factory premises and file a suit for the recovery of the loan. SBI contracts with SFC to give some extension of time to the company. SFC grants the desired extension of time. The guarantor S will not be discharged of his liabilities, even if his specific consent has not been taken, in the case. This is so because the SBI (whose loan has been guaranteed by S) has not given the extension but a third party (SFC) has done so, though on the basis of the contract with the SBI.

(b) Under **Section 137**, mere forbearance on the part of the creditor to sue the principal debtor, or to enforce any other remedy against him, for realisation of the dues, does not discharge the surety, in the absence of any provision to the contrary.

Example

State Bank of India has given a loan of Rs 50,000 to a company. S has guaranteed the loan. SBI does not file a suit against the company even after the loan has already fallen due for payment. S is not discharged of his liability as a guarantor on this ground.

(c) When more than one person guarantee a loan, these persons are known as co-sureties. Under **Section 138**, if the creditor releases one of the co-sureties, the remaining co-surety or co-sureties do not get discharged thereby. Further, the co-surety, so released by the creditor, is not released from his liability to the remaining co-surety or co-sureties, either.

(iv) Not to do Any act Inconsistent with the Rights of the Surety, and which may Impair the Surety's Eventual Remedy [Section 139]

Under Section 139, the surety gets discharged of all his liabilities under the contract of guarantee, when the creditor does any act which is inconsistent with the rights of the surety, or when the creditor omits to do any act which is inconsistent with the rights of the surety, or even omits to do any act which is required of him as his duty towards the surety, and thereby the eventual remedy available to the surety against the principal debtor himself gets adversely affected and impaired.

Examples

(a) C has entered into a contract with B for construction of his (B's) house, for a sum of Rs 10 lakh on the condition that the amount will be paid by B to C in a phased manner, commensurate with the progress of the construction work, in stages. S has stood as a surety of due performance of the contract of house-construction by C. But, without the knowledge of S, B pays to C the remaining three instalments also, prematurely, i.e. incommensurate with the stage of the construction of the house. Thus, S is discharged of his liability as a surety due to such pre-payment.

(b) A bank has given a loan of Rs 50, 000 to B, which has been guaranteed by S. After some time, S informs the bank that the principal borrower B has sold off his goods, hypothecated to the bank, to a certain

person at a given address. The bank, however, fails to take the necessary remedial action in this regard. Thus, S is discharged of his liability as a surety due to such inaction on the part of the bank.

12.10 Rights and Duties (Obligations) of the Surety

The rights of the surety are three-fold, viz.

(a) Rights against the creditor;
(b) Rights against the principal debtor; and
(c) Rights against the co-sureties.

(a) Rights against the Creditor

In the case of a fidelity guarantee, the surety is entitled to direct the creditor to dismiss the employee, whose honesty he had guaranteed, in case the dishonesty of the employee is proved. If the creditor fails to do so, the surety is discharged of his liabilities.

(b) Rights against the Principal Debtor

(i) Under **Section 140**, when the surety, on the default of the principal debtor, repays the guaranteed debt on its falling due, or when he performs the duty he had guaranteed to be performed by the principal debtor, all the rights that the creditor has against the principal debtor, automatically get invested in him. Alternatively speaking, the surety is subjugated to all the rights that the creditor had against the principal debtor. Accordingly, if the creditor happens to lose, or part with any of the securities that were given to him by the principal debtor by way of security against the loan, without the consent of the surety in this regard, the surety is discharged of his liabilities to the extent of the value of such securities. It, however, is immaterial whether the surety is in the know of such security or not [**Section 141**].

Example

S has guaranteed the loan of Rs 50,000 granted by the bank to B. The bank has also obtained another collateral security by way of an equitable mortgage of the immovable items of machinery of the principal borrower B worth Rs 20,000. Subsequently; somehow the bank releases the equitable mortgage of the machinery of the principal borrower B, without the specific consent of the surety S. Finally, B becomes insolvent. The bank sues the guarantor for recovery of the loan amount from him as a guarantor to the loan. In this case the surety is discharged of his liabilities to the extent of the value of such securities, i.e. to the extent of Rs 20,000.

The law also requires that the creditor must hand over to the surety, all the securities, obtained by him in regards to the debt, in the same condition as they were formerly standing in his possession.

(ii) The surety also has the right to recover from (i.e. to be indemnified by) the principal debtor the amount he has rightfully paid to the creditor under his contract of guarantee.

(c) Rights against the Co-sureties

(i) In the case of refusal or default on the part of the principal debtor, the co-sureties are responsible to the creditor, in equal proportions. Accordingly, under **Section 146,** the co-sureties enjoy the right of contribution amongst themselves. That is, in the event of one of the co-sureties paying more than his proportionate share, he enjoys the legal right to receive back from the remaining co-sureties the extra amount so paid.

Example

X, Y, and Z are the co-sureties to the loan of Rs 60,000 granted by C to B. On refusal or default on the part of the principal debtor B, the three co-sureties are liable to pay to C to the extent of Rs 20,000 each.

In case Y has paid the entire amount of Rs 60,000, he is entitled to contribution from X and Z to the extent of Rs 20,000 each at a later date. Similarly, if X and Y have paid to C Rs 35,000 and Rs 25,000 respectively, Z must pay to X and Y Rs 15,000 and Rs 5,000 respectively, and so on.

Further, in case one of the co-sureties becomes insolvent, the remaining co-sureties will have to share the total liability equally amongst them, i.e. to the extent of Rs 30, 000 each in the above example.

(ii) But, as provided under **Section 147**, where the co-sureties happen to guarantee a loan, but to the extent of different amounts, and the principal debtor defaults or refuses to repay, they will be held liable to pay to the creditor equally (and not proportionately), of course, only upto the extent of the specified guaranteed amount.

Examples

(i) X, Y, and Z are the co-sureties to the loan of Rs 1 lakh granted by C to B. They have, however, executed separate contracts of guarantee, to the extent of Rs 20,000, Rs 30,000 and Rs 60,000 respectively. Thus, on refusal or default on the part of the principal debtor B, to the extent of Rs 45,000, they will be required to pay to C a sum of Rs 15,000 each (Rs 45,000 divided by 3 = Rs 15,000).

(ii) In the above example, if the principal debtor B refuses or defaults to the extent of Rs 60, 000, all the three will be paying Rs 20,000 each (Rs 60,000 divided by 3 = Rs 20,000).

(iii) But in the event of refusal or default by B to the extent of Rs 70,000, each should pay Rs 23,333.33 (Rs 70,000 divided by 3 = Rs 23,333.33). But as per the guarantee agreement, X is liable upto a maximum amount of Rs 20,000 only. Thus, X will be required to pay Rs 20,000 only, and the liability of the balance amount of Rs 50,000 will be equally shared by Y and Z to the extent of Rs 25,000 each.

(iv) Similarly, in the case of refusal or default by B to the extent of Rs 80,000, each should pay Rs 26.666.66 (Rs 80,000 divided by 3 = Rs 26.666.66). But as per the guarantee agreement, X is liable upto a maximum amount of Rs 20,000 only. Thus, X will be required to pay Rs 20,000 only, and Y and Z will equally share the liability of the balance amount of Rs 60,000 to the extent of Rs 30,000 each.

(v) Likewise, if B refuses or defaults to the extent of Rs 90,000, each should pay Rs 30,000 (Rs 90,000 divided by 3 = Rs 30,000). But as per the guarantee agreement, X is liable upto a maximum amount of Rs 20,000 only. Thus, X will be required to pay Rs 20,000 only, and Y and Z should have been required to equally share the liability of the balance amount of Rs 70,000, i.e. to the extent of Rs 35,000 each. But, as per the guarantee agreement, Y is also liable upto a maximum amount of Rs 30,000 only. Thus, Y will be required to pay Rs 30,000 only, and Z alone will have to meet the balance liability of Rs 40,000. And, so on.

12.11 Liabilities of Surety

Under **Section 128,** the liability of the surety is co-extensive with that of the principal debtor, unless provided in the contract otherwise. Alternatively speaking, the guarantor is liable for the repayment of all the amounts (i.e. the principal amount of the loan, plus the amount of interest and other charges due thereon) that the principal debtor is liable for.

Example

G guarantees the working capital loan of Rs 1 lakh granted by the bank to B. Thus, on the refusal or default by B to repay the loan when due, G will have to repay the principal loan amount of Rs 1 lakh, as also the amount of interest and the other bank charges, if any, due thereon.

It may be pertinent to reiterate here that the liability of the surety is referred to as the secondary or contingent liability, due to the fact that the liability of the guarantor begins only after the principal debtor has

refused to pay, or has defaulted in repaying the debt. But then, immediately on default by the principal debtor, the liability of the guarantor starts, and also runs concurrently with that of the principal debtor. That is to say that the guarantor will be held liable for the repayment of the entire outstanding loan amount (principal plus interest and other charges) for which the principal debtor is liable.

It may be further noted with care that it is not necessary for the creditor to first file a suit against the principal debtor, and then alone to file a suit against the guarantor(s). In fact, the creditor may even prefer not to file a suit against the principal debtor at all, and may file a suit against the guarantor(s) only. [But it may be pertinent to mention here that, as per the usual practice, the creditors (like the banks) usually prefer to file a suit by making the principal debtor and the surety all together as the co-accused parties.]

It has further been provided in law that in the situations where the creditor happens to hold some securities, offered by the principal debtor, to cover the loan amount, it is not necessary for the creditor to first exhaust all the remedies pertaining to such securities before filing a suit against the guarantor, unless specifically provided in the guarantee document to such effect.

Not only that. The creditor is not bound even to give notice of the default on the part of the principal debtor to the guarantor, unless specifically so provided in the guarantee document.

12.12 Position of the Surety in the Case where the Principal Debtor is a Minor

In **Kashiba vs Shripat (ILR 10, Bom. 1927),** it was held by the Bombay High Court that despite the fact that the minor cannot be held liable to repay the loan, the surety to such a loan can be held liable to repay it, all the same. But later, the Bombay High Court itself decided to the contrary, holding that in view of the fact that the liability of the surety is co-extensive with the liability of the principal debtor (**Section 128**), he is liable to the extent of the full amount (principal debt plus interest and other charges) for which the principal debtor is liable. But, it also implies that his liability cannot be more than that of the principal debtor. Thus, in view of the fact that the liability of the minor to repay the debt is nil, so is the liability of the surety, too **[Manju Mahadeo vs Shivappa Manju, as also Pestonji Mody vs Meherbai].**

The logic is simple enough. That is, if the minor cannot be held to have defaulted, and that the liability of the surety, being secondary and contingent thereto, can arise only thereafter, this liability as well cannot be said to be there at all. The Madras High Court has also held similar views in the case of **Edavan Nambiar vs Moolaki Raman [AIR 1957 Mad. 164].** It has, however, been further observed that, unless otherwise specifically provided to the contrary, the surety cannot be held liable for having guaranteed a minor's debt. Alternatively speaking, the surety can be held liable for having guaranteed a minor debt, if it has been so specifically provided to this effect in the guarantee document.

12.13 Discharge of Surety

In view of the foregoing discussions, we may consolidate at one place the following circumstances under which the surety is discharged of his liabilities:

(i) By giving Prior Notice of Revocation to the Creditor

The surety can be absolved of all his future liabilities by giving due prior notice to the creditor of revoking his guarantee any time (**Section 130**). That is to say that the surety will be absolved of all his liabilities but pertaining only to the future transactions, arising after his having served the notice of revocation on the creditor. Accordingly, he will still be held liable in the cases of all the transactions that might have already taken place, prior to his notice of revocation to the creditor.

Example
S guarantees payment to C for the supply of goods to B for a period of one year, and to the extent of Rs 5 lakh, in case B fails to do so. S, however, serves a notice on C, revoking his guarantee after four months from the date of the contract of guarantee. C has, by now, supplied goods to B for an aggregate value of Rs 3 lakh. C, however, continues to make the supplies to B on credit to the extent of Rs 5 lakh. Thus, if B fails to make the payment, S will be held liable to pay upto Rs 3 lakh only, that is upto the value of the goods already supplied to B prior to the aforementioned notice, and not for the remaining Rs 2 lakh, as these goods were supplied by C to B after the notice of revocation was already served by S on C.

However, if one of the co-sureties revokes his guarantee by notifying the creditor to this effect, but the other co-sureties do not do so, they will be held liable for the repayment of the dues, along with the principal debtor, if the principal debtor would refuse or fail to repay the loan **[Anil Kr. and others vs Central Bank of India, AIR 1997 HP 5].**

(ii) In the Event of the Death of the Surety

As already discussed earlier, the death of the surety in itself has the effect of revocation of the continuing guarantee, of course, only in the absence of any other contract to the contrary. But again, such revocation will also be operative only in regard to the transactions taking place subsequent to the death of the surety. In other words, the liability of the surety will continue to be operative in respect of all the transactions entered into prior to his death, and such obligation(s) will have to be satisfied by his legal heirs, to that extent only, out of the inherited property of the deceased surety **(Section 131).**

Further, in case the creditor fails to abide by his various duties (obligations) towards the guarantor, it will have the effect of absolving the guarantor of his obligations under the contract of guarantee. These have already been discussed earlier, and are recapitulated here as follows:

(iii) When the Creditor Changes the Terms and Conditions of the Contract with the Principal Debtor

The creditor is required, under Section 133 of the Act, not to change any of the terms and conditions of the original contract entered into by him with the principal debtor, without seeking a specific consent of the surety in this regard, preferably in writing. That is to say that, in the event of changing any of the terms and conditions of the original contract entered into with the principal debtor, without the specific consent of the surety in this regard, the surety automatically gets discharged of all his obligations under the contract of guarantee, of course, in regard to the transactions that have taken place only after (and not prior to) such variation(s) made in the terms and conditions of the contract.

(iv) When the Creditor Releases or Discharges the Principal Debtor

Under Section 134 of the Act, the creditor is required, not to release or discharge the principal debtor. That is, if the creditor happens to enter into a contract with the principal debtor to release him, or if any act or omission on his part has the legal effect of discharging him (principal debtor), it has the effect of discharging the surety of all his obligations under the respective contract of guarantee.

(v) When the Creditor Compounds, or gives Time to, or Agrees Not to Sue the Principal Debtor

Under Section 135, the surety gets discharged of all his liabilities under the contract of guarantee, in case a contract is entered into between the creditor and the principal debtor, whereby the creditor makes a composition with, or promises to give time to, or not to sue him (principal debtor), without any specific consent of the surety in this regard, preferably in writing.

But, under **Section 136**, the surety is not discharged of his liabilities, even if his specific consent has not been taken, in the case where the creditor enters into an agreement with any third party (and not the principal debtor) to give some extension of time to the principal debtor.

(vi) When the Creditor's Action or Omission Impairs the Surety's Eventual Remedy

Under Section 139, the surety gets discharged of all his liabilities under the contract of guarantee, when the creditor does any act which is inconsistent with the rights of the surety, or when the creditor omits to do any act which is inconsistent with the rights of the surety, or even omits to do any act which is required of him as his duty towards the surety, and thereby the eventual remedy available to the surety against the principal debtor himself gets adversely affected and impaired.

(vii) When the Creditor Loses or Parts with any of the Securities given by the Principal Debtor

As provided in Section 141, if the creditor happens to lose, or part with any of the securities that were given to him by the principal debtor by way of security against the loan, without the consent of the surety in this regard, the surety is discharged of his liabilities to the extent of the value of such securities. This is so because the law also requires that the creditor must hand over to the surety, all the securities, obtained by him in regards to the debt, in the same condition as they were formerly standing in his possession. It, however, is immaterial whether the surety is in the know of such security or not.

Example

S has guaranteed the loan of Rs 50,000 granted by the bank to B. The bank has also obtained another collateral security by way of an equitable mortgage of the immovable items of machinery of the principal borrower B worth Rs 20,000. Subsequently, somehow the bank releases the equitable mortgage of the machinery of the principal borrower B, without the specific consent of the surety S. Finally, B becomes insolvent. The bank sues the guarantor for recovery of the loan amount from him as a guarantor to the loan. In this case, the surety is discharged of his liabilities to the extent of the value of such securities, i.e. to the extent of Rs 20,000.

Let us Recapitulate

A contract of indemnity is a contract whereby one party promises to save the other party from the loss caused to him by the conduct of the promisor himself or by the conduct of any other person (**Section 124**).

Essential Elements of Indemnity

(a) There must necessarily be some loss sustained by the promisee. If no loss is sustained by the promisee, the promissor cannot be held liable.
(b) But, on a strict interpretation of this Section, the loss caused by the conduct of the promisee himself, or by an act of God like death, or by natural calamity like flood or fire may not be covered. This way, the whole system of insurance (life and general insurance) will collapse. Therefore, the Courts in India follow the provisions of the English Law in this regard, whereby the losses caused by the events or accidents like death, disability, destruction by fire, flood, cyclone, tsunami, etc., are also covered.
(c) Above all, the contract of indemnity, like the other contracts, must also have all the elements required for a valid contract.

A contract of indemnity may arise

(a) By way of an express agreement; or
(b) By operation of any law.

Rights of the Indemnity Holder (Indemnified Party) [Section 125]

(a) To recover all damages sustained by him by way of payment made by him in any legal suit pertaining to the matter for which the promisor had undertaken to indemnify him against.
(b) To recover all costs of suits which he was required to pay to any third party under the authority of the indemnifier, provided he did not act in contravention of the order of the indemnifier, and acted in such a way as a man of ordinary prudence would act in his own case, and under similar circumstances.

The indemnifier (indemnifying party), however, does not enjoy any legal rights, except those of the surety or guarantor under Section 141, viz. to get title to all the benefits of the entire securities already obtained by the creditor from the principal debtor, whether he was aware of such securities or not.

Commencement of the Liabilities of the Indemnifier (Indemnifying Party)

While some Courts of Law have held that the indemnifier's liability does not commence unless and until the indemnified party has actually incurred the loss or damages to be compensated for, some others have opined that the indemnified party can legally compel the indemnifier to place him (indemnified party) in a position such that he may meet his obligation under the indemnity without waiting for actually suffering the loss by way of actual payment in a legal case. By now, the latter point of view is quite well established and settled. Thus, the indemnified party need not first make the payment and only thereafter claim the repayment and reimbursement from the indemnifier. In essence, the contract of indemnity requires that the indemnified party should never be called upon to make the payment out of his own sources.

Contract of Guarantee

A contract of guarantee is 'a contract to perform the promise or to discharge the liability of a third person in case of his default.' The person who gives the guarantee is known as the 'Surety', the person on whose behalf the guarantee is given is called the 'Principal Debtor', and the person or party to whom the guarantee is given is referred to as the 'Creditor'. Such guarantee could be either in writing or even verbally. The English law, however, requires it to be necessarily 'evidenced in writing'.

Thus, in the case of guarantee there are two distinct sets of agreements, viz.

(a) The principal contract between the principal debtor and the creditor, and
(b) The secondary contract between the creditor and the surety.

Further, in a contract of guarantee there are three parties, viz. the creditor, the principal debtor, and the surety.

Varieties of Guarantees

(a) Specific Guarantee

(i) A 'specific guarantee' is one, which pertains to a specific debt, and once such debt is repaid, the guarantee automatically ends and gets cancelled.
(ii) Further, a specific guarantee is irrevocable, and even after his (guarantor's) death, his legal successors may have to honour the commitment of the deceased to the extent of the value of the inherited property.

(b) Continuing Guarantee

(i) A 'continuing guarantee' pertains to a series of transactions, instead of just one.
(ii) Moreover, the continuing guarantee may be revoked, but in regard to the future transactions only, and not to the transactions prior to the revocation.
(iii) After the death of the surety, a continuing guarantee gets revoked (unless there is a contract to the contrary), but only in regard to the transactions subsequent to the death. Thus, the obligation(s) pertaining to the prior transactions will have to be satisfied by his legal heirs, to that extent only, out of the inherited property of the deceased surety.

Rights and Duties of a Creditor

(a) Rights

(i) To demand from the surety the repayment of the loan given to the principal debtor, immediately after the latter fails or refuses to make the repayment when due, even before exhausting all the remedies available to him against the principal debtor

(ii) The creditor also enjoys the legal right of 'general lien' on the securities of the surety in his possession, but only after the default or refusal on the part of the principal debtor.

(iii) In the event of the surety being declared insolvent, the creditor can also proceed in the insolvency proceedings of the surety, and claim his dividend on a *pro rata* basis.

(b) Duties (obligations)

(i) Not to change the term and conditions of the contract with the principal debtor, without specific consent of the surety. Otherwise, the surety automatically gets discharged of all his future (not earlier) obligations.

(ii) Not to release or discharge the principal debtor Otherwise, the surety automatically gets discharged of all his future (not earlier) obligations.

(iii) Not to compound with, or give time to, or agree not to sue the principal debtor

The creditor is refrained from giving any extension in time, as it is quite possible that the principal debtor, during such extended period, may die, or become insane or insolvent, or his financial position may worsen.

Rights and Duties (Obligations) of the Surety

(a) Rights against the Creditor

To direct the creditor to dismiss the employee, whose honesty he had guaranteed, in case the dishonesty of the employee is proved. If the creditor fails to do so, in such case of a fidelity guarantee, the surety is discharged of his liabilities.

(b) Rights against the Principal Debtor

(i) All the rights that the creditor has against the principal debtor automatically get invested in the surety, when he repays the debt of the principal debtor, or when he performs the duty he had guaranteed to be performed by the principal debtor. The surety is subjugated to all the rights that the creditor had against the principal debtor. Accordingly, if the creditor happens to lose, or part with any of the securities that were given to him by the principal debtor by way of security against the loan, without the consent of the surety in this regard, the surety is discharged of his liabilities to the extent of the value of such securities. It, however, is immaterial whether the surety is in the know of such security or not.

(ii) The surety also has the right to recover from (i.e. to be indemnified by) the principal debtor the amount he has rightfully paid to the creditor under his contract of guarantee.

(c) Rights against the Co-sureties

(i) As the co-sureties are responsible to the creditor, in equal proportions, they enjoy the right of contribution amongst themselves. That is, to receive back from the remaining co-sureties the extra amount so paid by one of them.

(ii) Further, in case one of the co-sureties becomes insolvent, the remaining co-sureties will have to share the total liability equally amongst them, of course, only upto the extent of the specified agreed guaranteed amounts, if these happen to be different.

Liabilities of Surety

(i) It is co-extensive with that of the principal debtor, unless provided in the contract document otherwise. Thus, the guarantor is liable for the repayment of all the amounts (i.e. the principal amount of the loan, plus the amount of interest and other charges due thereon).

(ii) But it is only a secondary or contingent liability, as the liability of the guarantor begins only after the principal debtor has refused to pay, or has defaulted in repaying the debt. But then, immediately on

default by the principal debtor, the liability of the guarantor starts, and also runs concurrently, i.e. for the repayment of the entire outstanding loan amount (principal plus interest and other charges) for which the principal debtor is liable.

(iii) Further, it is not necessary for the creditor to first file a suit against the principal debtor, and then alone to file a suit against the guarantor(s). The creditor may even prefer not to file a suit against the principal debtor at all, and may file a suit against the guarantor(s) only [though, the creditors (like the banks) usually prefer to file a suit by making the principal debtor and the surety all together as the co-accused parties].

(iv) Moreover, where the creditor happens to hold some securities, offered by the principal debtor to cover the loan amount, it is not necessary for the creditor to first exhaust all the remedies pertaining to such securities before filing a suit against the guarantor, unless specifically provided in the guarantee document.

(v) Besides, the creditor is not bound even to give notice of the principal debtor's default to the guarantor, unless specifically so provided in the guarantee document.

Discharge of Surety

The following are the circumstances under which the surety is discharged of his liabilities:

(i) By giving prior notice of revocation to the creditor, but pertaining only to the future transactions. However, if one of the co-sureties revokes his guarantee by notifying the creditor to this effect, and the other co-sureties do not do so, they will be held liable for the repayment of the dues.

(ii) In the event of the death of the surety, but pertaining only to the future transactions, and only in the absence of any other contract to the contrary.

(iii) When the creditor changes the terms and conditions of the contract with the principal debtor, without prior specific consent of the surety in this regard (of course, pertaining to the transactions that have taken place only after (and not prior to) such variation(s).

(iv) When the creditor releases or discharges the principal debtor.

(v) When the creditor compounds, or gives time to, or agrees not to sue the principal debtor without any specific consent of the surety in this regard.

But, the surety is not discharged of his liabilities, even if his specific consent has not been taken, in the case where the creditor enters into an agreement with any third party (and not the principal debtor) to give some extension of time to the principal debtor.

(vi) When the creditor's action or omission impairs the surety's eventual remedy, or even if he omits to do any act, which is required of him as his duty towards the surety, and thereby the eventual remedy available to the surety against the principal debtor himself gets adversely affected and impaired.

(vii) When the creditor loses or parts with any of the securities given by the principal debtor, without the consent of the surety in this regard, the surety is discharged of his liabilities to the extent of the value of such securities.

Questions for Reflection

1. (a) What is a contract of indemnity?
   (b) What are the essential elements of a contract of indemnity?
2. 'A contract of indemnity may arise by way of an express agreement, or even by operation of any law.' Do you agree with this contention? Explain with the help of some suitable illustrative examples.
3. What are the various legal rights of the following?
   (a) Indemnity holder (Indemnified Party), and
   (b) Indemnifier (Indemnifying Party).
4. 'It is necessary that the indemnified party must first make the payment and only thereafter he may claim the repayment and reimbursement from the indemnifier'. Do you agree with this contention? Give reasons for your contention in this regard.

5. What are the salient features of a contract of guarantee?
6. What are the main distinguishing features of the 'contract of indemnity' and the 'contract of guarantee'? Give suitable examples to illustrate your points.
7. Distinguish between 'specific guarantee' and 'continuing guarantee', by citing suitable examples in each case.
8. Under the contract of guarantee, what are the various rights and obligations of each of the three parties, viz. the 'creditor', the 'principal debtor', and the 'surety' in respect the other two parties? Cite suitable illustrative examples in each case in support of your answer.
9. (a) In the event of one of the co-sureties paying more than his proportionate share, he enjoys the legal right to receive back from the remaining co-sureties the extra amount so paid. Do you agree? Give reasons for your answer with the help of illustrative examples.
   (b) Will the position be any different, in case one of the co-sureties becomes insolvent?
10. Where the co-sureties happen to guarantee a loan, but to the extent of different amounts, and the principal debtor defaults or refuses to repay, they will be held liable to pay to the creditor
    (i) Equally or proportionately,
    (ii) Equally or upto the extent of the specified guaranteed amount, whichever is higher or lower?
    Explain with the help of some illustrative examples.
11. P, Q, and R are the co-sureties to the loan of Rs 5 lakh granted by C to B. They have, however, executed separate contracts of guarantee, to the extent of Rs 90,000, Rs 1,50,000, and Rs 3,00,000 respectively. Thus, how much amount P, Q, and R would be required to pay to C when the default by B is upto the following amounts?
    (a) Rs 2.4 lakh
    (b) Rs 3.0 lakh
    (c) Rs 3.9 lakh
    (d) Rs 4.0 lakh
    (e) Rs 5.0 lakh
12. (a) Why is the liability of the surety referred to as the secondary or contingent liability?
    (b) Can the creditor prefer not to file a suit against the principal debtor and file a suit against the guarantor(s) only? What are the obligations of the creditor in such cases?
    (c) Is it necessary for the creditor to first exhaust all the remedies pertaining to the securities offered by the principal debtor to cover the loan amount, before filing a suit against the guarantor?
13. What are the liabilities of the surety in the case where the principal debtor is a minor?
14. What are the various circumstances under which the surety gets discharged of his liabilities? Give suitable illustrative examples in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

A shareholder had applied to the company concerned to issue a duplicate share certificates comprising 100 shares, which was registered with the company in his own name and was held by him in physical form, and not in dematerialised form. On completion of all the required formalities, including the execution of an indemnity bond from him (the present shareholder) on its prescribed form for the purpose, the company had issued the duplicate share certificates in his name and had sent the same to him per registered post. After a few days, the company received a valid share transfer deed from the genuine purchaser of the share for transferring and registering the shares in its register in his name. Thus, it was apparent that, while feigning to have lost the share certificates, the transferor share holder had sold the shares to some other person. In such an event, the company wrote back to the old shareholder (transferor) to compensate the company for all the

losses and expenses to be incurred by it in this connection, on the basis of the indemnity bond that was executed by him earlier. On receipt of the company's letter, the transferor share holder, who had executed the usual indemnity bond agreed to indemnify the company on the basis of the indemnity bond. But he had taken the plea that first the company must compensate the new shareholder (transferee), and only thereafter he would indemnify the company with the actual amount. Do you think that the contention of the transferor share holder (who had got the duplicate share certificates, on execution of the indemnity bond) justified in the eyes of law? Give reasons for your answer.

Solution

In the instant case, the moot point involved is regarding the commencement of the liabilities of the indemnifier (indemnifying party).

Different Courts of Law have held different views in the matter as to the time from when the liability of the indemnifier actually starts. The High Courts of Lahore, Nagpur, and Bombay have held the view that the indemnifier's liability does not commence unless and until the indemnified party has actually incurred the loss or damages to be compensated for.

As against this, in some other cases, the High Courts of Calcutta, Allahabad, and Bombay, have opined that the indemnified party can legally compel the indemnifier to place him (indemnified party) in a position such that he may meet his obligation under the indemnity without waiting for actually suffering the loss by way of actual payment in a legal case.

And, by now, the latter point of view is quite well-established and settled. That is, it is now no longer necessary that the indemnified party must first make the payment and only thereafter he may claim the repayment and reimbursement from the indemnifier. In essence, the contract of indemnity requires that the indemnified party should never be called upon to make the payment out of his own sources, at any stage.

Problem 2

Ashok had got a bank draft for Rs 10,000 issued in favour of a firm in Mumbai. After some time, he applied to the bank to issue a duplicate draft in lieu thereof as the original one was lost by him. On completion of all the required formalities, including the execution of an indemnity bond from Ashok on its prescribed form for the purpose, the bank had issued the duplicate draft in lieu of the original one reported lost, and had handed it over to Ashok in person against his acknowledgement of the duplicate draft so issued. And, on the same day, he had also received the payment of the duplicate draft by cancellation at the issuing branch. After a few days of the issuance of the duplicate bank draft, the rightful beneficiary of the bank draft (the firm in Mumbai), presented the original bank draft for payment at the bank's branch on which it was drawn. Thus, it is apparent that, while feigning to have lost the original bank draft, Ashok had actually sent the bank draft to the beneficiary firm in Mumbai against some purchases or whatever. Under the circumstances, bank was left with no alternative but to pay the amount of the original bank draft to the rightful beneficiary of the same. When the issuing branch of the bank came to know of this fact, it wrote back to the applicant of the bank draft (to whom the duplicate draft was issued) to compensate the bank for all the losses and expenses incurred by it in this connection, on the basis of the indemnity bond that was executed by Ashok earlier. On receipt of the bank's letter, Ashok, who had executed the usual indemnity bond, agreed to indemnify the bank on the basis of the indemnity bond. But he had taken the plea that first the bank must compensate the beneficiary of the firm in Mumbai, and only thereafter he would indemnify the bank with the actual amount. Do you think that the contention of Ashok (who had got the duplicate bank draft issued, on execution of the indemnity bond, and had also received the payment thereof by cancellation at the issuing branch), justified in the eyes of law? Give reasons for your answer.

Solution

In the instant case also, as in Problem 1 above, the moot point involved is regarding the commencement of the liabilities of the indemnifier (Indemnifying Party). And the legal position and stand in this case also will be almost identical as in the Solution 1 above, which is reproduced hereafter for the sake of convenience and reinforcement.

Different Courts of Law have held different views in the matter as to the time from when the liability of the indemnifier actually starts. The High Courts of Lahore, Nagpur, and Bombay have held the view that the indemnifier's liability does not commence unless and until the indemnified party has actually incurred the loss or damages to be compensated for.

As against this, in some other cases, the High Courts of Calcutta, Allahabad, and Bombay, have opined that the indemnified party can legally compel the indemnifier to place him (indemnified party) in a position such that he may meet his obligation under the indemnity without waiting for actually suffering the loss by way of actual payment in a legal case.

And, by now, the latter point of view is quite well-established and settled. That is, it is now no longer necessary that the indemnified party must first make the payment and only thereafter he may claim the repayment and reimbursement from the indemnifier. In essence, the contract of indemnity requires that the indemnified party should never be called upon to make the payment out of his own sources, at any stage.

Problem 3

Sujata had guaranteed the payment to Chandra for the supply of bags of cement to Bachchan to the extent of Rs 5 lakh, from time to time, in case Bachchan failed to make the required payment to him. Chandra, however, had supplied bags of cement to Bachchan to the extent of Rs 6 lakh, from time to time. Finally, Bachchan had failed to make any payment to Chandra. Accordingly, Chandra had asked Sujata to make the payment of the amount of Rs 6 lakh to him. But Sujata had refused to make any payment to him on the ground that he had made the supply of cement bags to Bachchan in excess of the amount of Rs 5 lakh that was guaranteed by her, and accordingly she was relieved of all her liabilities under the agreement of guarantee, the terms of which were violated by Chandra. Is the aforementioned stand of Sujata or the demand of Chandra, legally justified in the instant case? Give reasons for your answer.

Solution

No. Neither the stand of Sujata nor the demand of Chandra is legally justified in absolute terms. In the instant case, Sujata will have to pay to Chandra a sum of Rs 5 lakh only, and not Rs 6 lakh, as was demanded from her by Chandra.

Problem 4

Sagar guarantees all the advances made by Chaman to Bindra to the extent of Rs 10 lakh, during the period of 12 months from now. Chaman advances Rs 7 lakh to Bindra during the first four months. But in the sixth month, Sagar revokes his guarantee. Chaman makes a further advance of Rs 3 lakh to Bindra in the seventh month. Bindra fails to repay the loan aggregating Rs 10 lakh. Accordingly, Chaman asks Sagar to repay the amount of Rs 10 lakh advanced by him to Bindra. Sagar refuses to pay any amount as he (Chaman) had advanced a further amount of Rs 3 lakh to Bindra even after his revocation of the guarantee, whereby he was relieved of his entire liability under the agreement of guarantee. Do you think that Sagar is relieved of his entire liability under the agreement of the guarantee in question? Give reasons for your answer.

Solution

No. Sagar is not relieved of his entire liability under the agreement of the guarantee in question. In the instant case, Sagar will be held liable to the extent of Rs 7 lakh only, as Chaman had advanced this amount to Bindra prior to the revocation of the guarantee by Sagar. That is, the revocation cannot be effective in the case of the earlier transactions. But he (Sagar) cannot be held liable for the repayment of Rs 3 lakh, as this amount was advanced by Chaman to Bindra subsequent to the revocation of the guarantee by Sagar.

Problem 5

Sonu had executed an agreement of guarantee in favour of Raju to the effect that Karan will pay all the time bills drawn by him (Raju) on Karan, but only to the extent of Rs 1 lakh, in the aggregate. Raju had drawn a time bill for Rs 75,000 on Karan, which Karan had duly accepted for payment on or before the due date. Thereafter, Sonu had revoked his guarantee, and had informed Raju accordingly. Subsequently, Raju had drawn another bill of Rs 25,000, which was also duly accepted by Karan. Karan had subsequently failed to

pay both the bills, aggregating Rs 1 lakh, on the respective due dates. Thereupon, Raju had approached Sonu to the effect that, as per the agreement of guarantee executed by him (Sonu), he must pay the amount of Rs 1 lakh, for which Karan had defaulted. Do you think that such demand by Raju is justified? Give reasons for your answer.

Solution

In the instant case, Sonu will be held liable as a surety, but only to the extent of Rs 75,000, inasmuch as this transaction had already taken place prior to the notice of the revocation given by him (Sonu) to Raju. But, he cannot be held liable for payment of the amount of Rs 25,000, as this transaction had taken place after Sonu had already revoked his guarantee in question.

Problem 6

Ganpat had guaranteed an advance of Rs 5 lakh, given by the bank to Banwari to run his (Banwari's) business. But unfortunately, soon thereafter, Ganpat had died. As on the date of the death of Ganpat, a sum of Rs 4.55 lakh only was outstanding on the loan account of Banwari with the bank. On coming to know of the death of Ganpat, the bank had stopped giving any further loan to Banwari. After some time, Banwari had defaulted to repay the loan amount of Rs 4.55 lakh, despite repeated reminders from the bank. Finally, the bank had approached the legal heirs of Ganpat to repay the loan amount as per the agreement of guarantee executed by Ganpat in favour of the bank, as aforementioned. But the legal heirs of Banwari had flatly refused to pay any amount due from Banwari as the agreement of guarantee in question had already got terminated immediately on the death of Ganpat, the guarantor. Thereupon, the bank had filed a case against the legal heirs of Ganpat for recovery of the amount Rs 4.55 lakh from them. What are the chances of the bank winning the case? Give reasons for your answer.

Solution

The bank is sure to win the case for the following reasons:

It is true that the death of the guarantor, in itself, has the effect of revocation of the guarantee, with immediate effect. But then, such revocation becomes operative only in regard to the transactions taking place subsequent to the death of the guarantor. That is to say that the liability of the guarantor will continue to be operative in respect of all the transactions entered into prior to his death, and such obligation(s) will have to be satisfied by his legal heirs, to that extent only, out of the inherited property of the deceased guarantor. Such contention is based on the provisions of Section 131 of the Act. Thus, in the instant case, inasmuch as the sum of Rs 4.55 lakh only was outstanding on the loan account of Banwari with the bank, as on the date of the death of Ganpat, this amount will have to be paid to the bank by the legal heirs of Ganpat, the deceased guarantor.

Problem 7

A bank had given a loan of Rs 2 lakh to Basant. This loan had been guaranteed by Sujata. One day, Sujata had informed the bank that Basant had loaded in the truck all his goods and items of machinery, hypothecated to the bank against the loan, and was about to run away from the place to some unknown place in Rajasthan. The bank, however, had failed to take the necessary preventive and remedial action in this regard promptly. Do you think that Sujata would be deemed as having been discharged of her liability as a surety due to such inaction on the part of the bank?

Solution

Yes. Sujata would be deemed to have been discharged of her liability as a surety due to such inaction on the part of the bank. This is so because, under Section 139 of the Act, the surety gets discharged of all his or her liabilities under the contract of guarantee, when the creditor does any act which is inconsistent with the rights of the surety, or when the creditor omits to do any act which is inconsistent with the rights of the surety, or even omits to do any act which is required of him as his duty towards the surety, and thereby the eventual remedy available to the surety against the principal debtor himself gets adversely affected and impaired. And, in the instant case, as the bank had failed in its duty to act promptly, and thereby had adversely affected the eventual remedy available to the surety (Sujata) against the principal debtor (Basant) himself, Sujata would be deemed to have been discharged of her liability as a surety.

Problem 8

Akash, Subhash, and Vikas are the three co-sureties to the loan of Rs 10 lakh granted by Gaurav to Madhurima. They have, however, executed separate contracts of guarantee, to the extent of Rs 1 lakh, Rs 3 lakh, and Rs 6 lakh respectively. Madhurima, however, has defaulted to the bank to the extent of Rs 9 lakh. How much amount Akash, Subhash, and Vikas will be required to pay to Gaurav under their respective contracts of guarantee?

Solution

In the instant case, as Madhurima had defaulted to the extent of Rs 9 lakh, each of the guarantors would have paid Rs 3 lakh, if all had been the guarantor for equal amount. But as per the guarantee agreement, Akash is liable upto a maximum amount of Rs 1 lakh only. Thus, Akash will be required to pay Rs 1 lakh only, and Subhash and Vikas would be required to equally share the liability of the balance amount of Rs 8 lakh, i.e. to the extent of Rs 4 lakh each. But, as per the guarantee agreement, Subhash is also liable upto a maximum amount of Rs 3 lakh only. Thus, Subhash will be required to pay Rs 3 lakh only, and Vikas alone will have to meet the balance liability of Rs 5 lakh, which is within the amount guaranteed by him, i.e. Rs 6 lakh.

Problem 9

Subal had guaranteed the loan of Rs 11 lakh granted by the bank to Vikas. The bank had also obtained another collateral security by way of an equitable mortgage of the house property of Vikas valued at Rs 5 lakh. Subsequently; somehow the bank had released the equitable mortgage of the house property of Vikas, without any specific consent of the surety, Subal, in this regard. Finally, Vikas had become insolvent, when the amount outstanding in his loan account with the bank was to the extent of Rs 10.5 lakh. The bank had sued Subal for the recovery of the loan amount of Rs 10.5 lakh from him as a guarantor to the loan. Subal, however, had refused to pay the amount on the contention that he was absolved of his liability as a guarantor because the bank had released the equitable mortgage of the house property of Vikas, without obtaining any specific consent from him in this regard. Now, the Manager of the bank has approached you for some legal advice in the matter. What sound legal advice will you give to him, quoting the relevant legal provisions contained in the respective Section of the respective Act?

Solution

The Bank Manager will be well-advised on the following lines:

As has been specifically provided under Section 141 of the Indian Contract Act, if the creditor (the bank, in the instant case) happens to lose, or part with any of the securities that were given to him by the principal debtor (Vikas, in the instant case), by way of security against the loan, without the consent of the surety (Subal, in the instant case) in this regard, the surety (Subal, in the instant case) is discharged of his liabilities to the extent of the value of such securities. This is so because the law also requires that the creditor must hand over to the surety, all the securities, obtained by him in regards to the debt, in the same condition as they were formerly standing in his possession. It, however, is immaterial whether the surety is in the know of such security or not.

Accordingly, in the instant case, Subal, the surety, will be deemed to have been discharged of his liabilities to the extent of the value of such securities, i.e. upto the extent of Rs 5 lakh—this being the value of the house property of Vikas, which was mortgaged by Vikas to the bank as a collateral security against the advance of Rs 11 lakh, which was obtained from the bank by Vikas, and which was guaranteed by Subal. Thus, the bank is entitled to recover a sum of Rs 10.50 lakh less Rs 5 lakh, i.e. Rs 5.50 lakh only, from Subal, the gurantor.

Chapter Thirteen

Contract of Bailment

> *It is far better to be trusted and respected than it is to be liked.*
> **Source Unknown**

13.1 What is Bailment?

As defined in **Section 148**, the bailment is 'the delivery of goods by one person (known as the bailor), to another person (known as the bailee), for some purpose, upon a contract that the goods shall be returned to the bailor (or otherwise disposed of, according to the direction of the bailor) by the bailee, immediately after the purpose for which the goods were initially bailed, had been accomplished (completed)'.

For example, the delivery of a box for safe custody, or the giving of a watch for repair, lending of book(s) for study, delivery of goods to a transport company for transportation to a designated destination, and so on. Here, it may be noted that when a locked box is delivered, but the key of its lock is not delivered, and is retained by the person delivering it, it does not constitute a bailment. Thus, the delivery of a box, deposited with a bank for safe custody, or the goods kept in the bank's lockers, do not come under the category of bailment, as the depositor retains the relative keys **[Kailaperumal vs Visalakshimi, AIR 1938 Mad. 32].**

Let us take another example. If, in a marriage party, some tents have been hired, this may constitute a bailment, and accordingly, these tents are required to be returned to the bailor, after the occasion, i.e. when the marriage party is over. In the case of such bailment, some charges may, as well, have to be paid. But, if such tents were borrowed from friends and relatives, free of any charges, such lending may as well constitute a 'bailment', though without charging any fee for the same.

13.2 Main Characteristics of Bailment

From the aforementioned definition and discussions on bailment, its following main characteristics may emerge:

(a) Delivery of Goods

In the case of bailment, the delivery of the goods bailed, or to be bailed, is a must.

Actual and Constructive Delivery

The delivery, however, may be either actual or constructive. The actual delivery of goods for bailment takes place when the goods are actually handed over to the other person. But, in case the goods in question are already in the possession of the other person, the bailment to him may take place by way of constructive delivery only.

Let us take an illustrative ***example***. B has bought a car from S, the seller. But B tells S to keep the car for some time on his behalf. This will constitute a constructive (and not actual) delivery (**Section 149**). This is so because the car is already in the possession of S, and therefore, the question of its delivery to him does not arise. In this case, however, B has now, after the purchase of the car, become the owner of the car, and he has also become a bailor of the car to S, who (S) in turn, has now become the bailee, instead of the owner/seller.

It may be further emphasised and clarified here that the bailment can take place only in regard to some goods, and not anything else, like currency notes, etc. Therefore, the deposit of currency notes with the banks or others does not constitute a bailment.

(b) Contract

Further, in the cases of bailment, the goods so delivered are delivered under some contract to the effect that the goods will be returned to the bailor by the bailee on completion of the purpose for which it was given by way of bailment. Thus, in the case of the bailment of the items of furniture, required for a marriage party, are delivered under the condition that after the marriage ceremony is over, these goods will be returned to the bailor together with the agreed charges/rental. The same will be the case when a scooter is given for repairs.

Exception

But then, there may be some exceptional cases also where there may not be any contract, whatsoever, though a bailment may be considered to have taken place. For example, when some one finds the lost goods, he (the finder of such lost goods) is treated in law as if holding the goods as a bailee on behalf the owner of the lost goods, though, obviously, there is no contract between the two.

(c) Return of Goods in Specie (i.e. Specific)

It is also provided in law that the same specific goods (in specie) must be delivered back by the bailee to the bailor, which were actually bailed, by the latter. Thus, in the cases where there is a provision in the contract to the effect of returning not necessarily the same but some similar or equivalent value of goods, such agreement will not constitute a bailment.

13.3 Duties (Obligations) of Bailor

The bailors have the following duties and obligations to perform:

(a) (i) To Disclose the Known Faults in the Goods

Under **Section 150**, the bailor is legally bound to disclose to the bailee any fault in the goods bailed, which the bailor is aware of, and which may materially interfere with the use of such goods, or may expose the bailee to some extraordinary risks. Thus, in case he (bailor) fails to do so, he will be held responsible for the damages caused to the bailee directly due to such fault.

Examples

(i) A lends a car to B. A knows that the brakes of the car are defective. But he does not disclose this fault to B. The car meets with an accident due to this defect, and B sustains some injury. A is liable for damages to B for the injury sustained by him.

(ii) In the above Example (i) , if A was not in knowledge of the defect in the car, he would not be held liable for damages, but only if it was bailed for free; that is, where no remuneration was payable to A by B.

(a) (ii) Responsibility of the Hirer, in Case of even Unknown Faults

It may, accordingly, be carefully noted here that in case the goods are bailed for hire (i.e. against some charges/rentals to be paid by the bailee), he (bailor) will be held responsible for the damages caused to the bailee directly due to such fault, irrespective of the fact whether such fault was known to him or not.

Example

In the above Example (i), notwithstanding the fact that A was not in the know of the defect in the car, he would still be held liable for damages, if it was bailed not for free; that is, where some agreed remuneration was payable to A by B.

In summary we may say that, in the cases where the bailor, despite having the knowledge of the fault in the goods bailed, does not disclose it, he will be held liable for the damages for the injury sustained, in both the cases; that is, whether the bailment is with or without remuneration. But, in the cases where the bailor is not in the know of such defect, and thus, does not disclose it, he will be held liable only in the cases where he is to receive some remuneration and not otherwise, that is, where no remuneration is payable.

(b) Liability for Breach of Warranty Regarding the Authority to Bail

Section 164 provides that the bailor will be held responsible to the bailee for any loss sustained by the bailee for the reason that the bailor was not entitled:

(a) To make the bailment, or

(b) To receive the goods back, or

(c) To give direction in respect of the disposal of the goods so bailed.

Example

B (bailor) gives the truck of O (owner) to E (bailee), without the permission and knowledge of O. O sues E and receives compensation. The bailor (B) is liable to E (bailee) to make good such loss sustained by him (E) by way of having paid the compensation to O.

(c) To Bear all Necessary Expenses in Case of Gratuitous Bailment

The bailment, where no remuneration is payable to the bailee is referred to as the 'Gratuitous Bailment'. It has been provided under Section 158 that in the cases of gratuitous bailment, the bailor is required to repay to the bailee all the necessary expenses incurred by him (bailee) for the purpose of the bailment, unless agreed upon to the contrary.

(d) To Bear only Extra-ordinary Expenses in Case of Non-gratuitous Bailment

As against the gratuitous bailment, in the case of non-gratuitous bailment, the bailor is required to repay to the bailee only the extra-ordinary expenses (and not the necessary expenses) incurred by him (bailee).

Example

H has, on terms of payment of an agreed remuneration, bailed his one pair of bullocks to F, to plough his field in his village. The expenses like feeding the bullocks will be treated as the ordinary expenses, and thus, these

will have to be borne by the bailee (F) himself. But in case one or both the bullocks happen to fall sick, the expenses pertaining to such treatment incurred by the bailee (F) will be treated as extraordinary expenses, and thus, these will have to borne by the bailor H; that is, he must reimburse the amount of extraordinary expenses to the bailee (F).

In summary we may say that, in the case of gratuitous bailment, the bailor is required to repay to the bailee all the necessary expenses (both ordinary and extraordinary expenses) incurred by him (bailee) for the purpose of the bailment, in the absence of any contract to the contrary. But, in the case of non-gratuitous bailment, the bailor is required to repay to the bailee, none of the necessary expenses, but only the extraordinary expenses, incurred by him (bailee).

13.4 Duties (Obligations) of Bailee

The bailees have the following duties and obligations to perform:

(i) To take Due Care of the Goods Bailed

Section 151 stipulates that in the case of bailment, the bailee must take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take in the case of his own goods of the same bulk, quality and value as the goods bailed. Thus, unless otherwise provided in any special contract, in case the bailee has taken as much care as aforementioned, he would not be held responsible for any loss, destruction, deterioration or damage caused to the goods bailed **(Section 152).** Conversely speaking, he would be held responsible if he would fail to act accordingly. For example, in case some tents have been bailed, and one of the tents get somewhat damaged, though the bailee had taken due care, as aforementioned, the cost thereof may not have to be compensated by the bailee in both the cases, i.e. whether these are bailed against payment of some agreed rent and remuneration, or just for free (i.e. in the case of gratuitous bailment).

The real problem lies in the fact the burden of proof, to the effect that the bailee had taken the required due care, lies on him alone. It would thus, augur well if he would take additional care so as to prove that he had taken the required due care as a man of ordinary prudence would take.

Let us take an ***example***. Suppose that the goods bailed by R to E are destroyed by fire for no fault on the part of the bailee E. In this case, the bailee, in order to get absolved of his responsibility, will have to prove the following two things:

(a) That the goods were actually destroyed by fire, and also
(b) That there was no negligence on his part in this regard.

This is so because the Bombay High Court has observed in the case: **R S Deboo vs M V Hindleker, AIR 1995, Bom. 68,** that the very fact that the bailee did not return the goods bailed to the bailor is, in itself, a prima facie proof that there was negligence on the part of the bailee. As the onus (burden) of proof lies squarely on the bailee, it is not necessary for the bailor to incontrovertibly prove that there was negligence on the part of the bailee. In fact, it is deemed to be so, unless proved otherwise. It would, therefore, be a wise act on the part of the bailee to usually get the goods insured against fire, theft, and the like, as a man of ordinary prudence is supposed to have done in the case of his own goods of the same bulk, quality and value as the goods bailed. A detailed discussion on this point appears in the next Chapter 14, dealing with pledge.

(ii) Not to make any Unauthorised use of the Goods Bailed

As provided under **Section 154**, in case the bailee makes any unauthorised use of the goods bailed (i.e. uses them for the purpose not specifically authorised by the bailor in terms of the agreement of the bailment), he (the bailoee) would be held liable to compensate the bailor for any damage caused to the goods bailed, arising from or during such use of the goods by the bailee.

Examples

(i) R lends his car to E specifically for his self-driving only. But E allows his daughter D also to drive it. D drives the car with full care but the car meets with an accident, and gets damaged. E is liable to compensate R for the expenses incurred by R in its repair, denting, painting, etc. This is so because E has transgressed the authority by allowing some one else (his daughter) other than himself, which he was not authorised to do.

(ii) E hires a car in Lucknow from R expressly for going from Lucknow to Kanpur and back. But, instead, E proceeds towards Moradabad, and on his way, meets with an accident, despite having taken all possible care to drive the car slowly and safely. E is liable to compensate R for the expenses incurred by R in its repair, denting, painting, etc. This is so because E has transgressed the authority by proceeding to Moradabad, instead of to Kanpur, for which alone he was authorised.

(iii) Not to Mix up Bailor's Goods with His Own (Sections 155 to 157)

The bailee is not authorised to mix up the goods of the bailor with his own goods, or with those of some other persons, without the specific consent of the bailor to this effect. In other words, if the bailee mixes up the goods of the bailor with his own goods, or with those of some other persons, without the specific consent of the bailor to this effect, he will be held liable in such cases.

Such mixing up of the goods may be of two different categories, viz.

(a) Where such mixed up goods can be separated or divided, and
(b) Where such mixed up goods cannot be separated or divided.

Thus, in the case (a) above, i.e. where these mixed up goods can be separated or divided, the bailee will be held liable to bear the expenses connected with the separation or division of the goods, as also of some damages, if any, arising out of such mixing up of the goods.

Examples

(a) R has bailed to E his 10 bags of wheat sealed and marked K 68. R mixes up these 10 bags marked K 68 with his own 100 bags of wheat sealed and marked RR 21, without the specific consent of the bailor to this effect. R is entitled to receive back his 10 bags of wheat sealed and marked K 68, duly separated from the other 100 bags of wheat sealed and marked RR 21, together with the charges involved in such separation, plus all the incidental charges and/or damages arising in the process of such separation.

(b) But in the case (b) above, i.e. where the bailed goods have been mixed up in such a manner that these just cannot be possibly separated or divided, and delivered back to the bailor, the bailee will be held liable to compensate the bailor of the entire loss suffered by him (bailor) in regard to the bailed goods, due to such mixing up.

Example

R has bailed to E his 10 quintals of wheat of K 68 variety purchased at Rs 20 per kg, but not in duly sealed and marked bags. R mixes up these 10 quintals of wheat of K 68 variety with his own lose stocks of 100 quintals of wheat of RR 21 variety priced at Rs 15 per kg, without the specific consent of the bailor to this effect. As these stocks of wheat of the two different varieties have been mixed up loose, and not in duly sealed and marked bags, it is just not possible to separate them and deliver back to the bailor R. Thus, R is entitled to get duly compensated by the bailee E to the extent of the full amount of the loss sustained by R due to the aforementioned lapse on the part of E.

(iv) To Return the Bailed Goods (Section 160)

The bailed goods are required to be returned by the bailee to the bailor, or to be delivered as per the direction of the bailor, without demand, immediately after the expiry of the period for which these were bailed, or on the accomplishment of the purpose for which these were bailed. In other words, the aforesaid action (i.e. return or disposal of the goods), is implied to be taken by the bailee immediately after the expiry of the period

or accomplishment of the purpose, without waiting for such demand to be made by the bailor, over again. Thus, in case the bailee fails to take immediate action, as aforesaid, he will be held liable by the bailor for any loss, destruction, or deterioration of the goods caused by such delay, from the due time.

(v) To Return any Accretion (Addition) to the Bailed Goods (Section 163)

In the absence of any contract to the contrary, the bailee is duty bound, as per law, to return to the bailor, or to deliver as per the direction of the bailor, the bailed goods as aforementioned, together with any addition, increase or profit, that might have accrued (taken place) to the goods bailed.

Example

R has left his bitch in the custody of E to take care of her, while he is away on tour. The bitch gives birth to four puppies. E is legally bound to return to R, not only his bitch bailed, but also all the four puppies, born during the period of the bailment.

13.5 Rights of the Bailee

We have already discussed the various duties/obligations of the bailor in the earlier pages. Alternatively put, all the duties/obligations of the bailor, conversely speaking, will become the rights of the other party, viz. the bailee.

1. Thus, in the very first place, the bailee enjoys the legal rights to sue the bailor on the following counts:
   (a) For claiming compensation for the damages caused due to the non-disclosure of the faults in the goods;
   (b) For breach of the warranty regarding the authority to bail, and the damages arising due to the transgression of such authority; and
   (c) To claim all the expenses in case of gratuitous bailment, and only extra-ordinary expenses in case of non-gratuitous bailment.

13.6 Right of Lien (Sections 170 and 171)

Second, the bailee enjoys the right of lien. Lien is the right of a person to retain the goods in his possession, though owned by the other person, till such time the other person pays some debt or claim due, in full.

Thus, in lien, the following two ingredients are of essence:

(a) The person, who enjoys the right to exercise the lien, must already be in the possession of the goods or security concerned, and that also in the ordinary course of business; and
(b) The owner of such goods or security (bailor, in our instant case) has some rightful debt due for payment, or some obligation due for performance, to the person (bailee, in our instant case), who happens to be in the possession of the goods or securities in question. Further, in view of the fact that the right of lien remains operative only until such time the dues or obligations remain unsettled, the moment these are settled in full by the bailor, the right of lien so far available to the bailee, ceases to be operative. Accordingly, immediately thereafter, the bailee must return the goods or securities to the owner (bailor), or else to place it at his disposal.

Lien may be classified under the following two broad categories:

(a) Particular lien, which refers to the right of the claimant to retain only such of the goods against which some dues and/or claims are yet to be settled.
(b) General lien, on the other hand, pertains to the right to retain the goods not just against settlement of some debts or claims due for payment against the retained goods alone, but also against the other dues and claims of the creditor (or bailee) unsettled by the debtor (or bailor) so far.

Let us now explain the legal implications of (**a**) **Particular lien** and (**b**) **General lien**, in a little greater detail, with illustrative examples.

(**a**) **Particular lien** of the bailee refers to his right to retain only such of the goods against which some dues and/or claims are yet to be settled. **Section 170** stipulates: 'Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of contract to the contrary, a right to retain such goods until he receives the due remuneration for the service he has rendered in respect of them.'

Examples

(i) R gives his watch to E for repairs. E has repaired the watch as agreed. Therefore, E has the right of lien against this watch only, but only till such time R does not settle the bill of repairs.

(ii) Let us take another example where the position may become materially different.

R gives some gold biscuits to E for making some gold ornaments of the desired design for some charges. But at the same time, R requests E to give him a credit of two months for making payment of the labour charges, and to deliver to him the ornaments so made immediately when ready, even before R pays the labour charges. E has agreed to wait for two months for the payment. In this case, E does not enjoy the right of lien (i.e. to retain the ornaments) until the labour charges are paid by R, inasmuch as, by virtue of another contract (to the contrary, as aforementioned), E has surrendered his right to his particular lien in this case.

(**b**) Under **Section 171**, only certain categories of the bailees are entrusted with the right to exercise a **general lien** in certain cases, like in the cases of the bankers, factors, wharfingers, attorneys of the High Courts, and the policy brokers. These types of bailees are entitled to retain all the goods of the bailor, already in their possession, till such time any amount remains due for payment to them by the bailor/debtor, unless, of course, there is a contract to the contrary.

13.7 Rights against Wrongful Deprivation or Injury to Goods (Sections 180 and 181)

In the cases where a third person wrongfully deprives the bailee of the use or possession of the goods bailed to him, or causes any injury to these goods, the bailee is entitled to resort to such remedies as an owner of the goods would have been entitled to exercise in the case of his own goods, if these goods were not bailed. In such cases, either of the two parties involved in the bailment, i.e. the bailee or the bailor, can file a suit against the third parson for causing such deprivation or injury. Further, under **Section 181**, whatever is realised from the third party, by way of compensation or relief in the suit, it will be appropriately apportioned between the bailor and the bailee in accordance with their respective interests.

13.8 Rights of the Bailor

The bailor enjoys the following rights, as provided in the Act:

(a) He can file legal suits to enforce all the duties and obligations of the bailee towards him.

(b) In the case of gratuitous bailment (i.e. where no reward is payable by the bailee to the bailor), the bailor is entitled to demand the return of the goods bailed whenever he may choose to do so, i.e. even before the expiry of the stipulated period, or accomplishment of the purpose for which the goods were bailed. But then, in such cases, where the bailee has acted by believing that the bailment of the goods will be for the full period, he (bailee) is entitled to be compensated by the bailor for all the expenses and losses incurred by the bailee due to such premature recall of the goods, but only to the extent these are in excess of the benefits that would have accrued to the bailee in case of such gratuitous bailment (**Section 159**).

13.9 Termination of Bailment

All contracts of bailment automatically get terminated (i.e. come to their natural end) in the following circumstances:

1. On the Expiry of the Stipulated Period

A contract of bailment comes to an end on the expiry of the stipulated period, e.g., after the expiry of two months, where the car was bailed for two months. Thus, after two months the bailee must return the car to the bailor.

2. On the Accomplishment of the Particular Purpose

Similarly, where the various items of furniture and crockery were bailed for a marriage party, the contract of bailment terminates immediately after the marriage ceremony is over. Here also, the bailee must return these goods to the bailor after the marriage.

3. By the Action of the Bailee, being Inconsistent with the Conditions of Contract

When the bailee acts in regard to the goods bailed, in any manner, which is in contravention of the conditions specified in the contract of bailment, the bailor has the option to terminate the contract of bailment on this very ground (**Section 153**).

Examples

(i) When E hires a car from R for going to Kolkata, and he, instead, proceeds for Agra.
(ii) When car is bailed by R to E for his self-driving only, and he instead, allows his sister-in law to drive it.
(iii) When E hires a horse from R for riding proposes only, but E instead, drives the horse in a carriage.

In all these aforementioned circumstances, the bailor R will have the option to terminate the bailment to the bailee E.

4. Termination of a Gratuitous Bailment

In the case of a gratuitous bailment, however, the bailor has the option to terminate the contract of bailment, and to recall the bailed goods, any time, at his sweet will and choice, even prematurely, that is well before the expiry of the stipulated period or the accomplishment of the specific task **(Section 159).** But then, it is also simultaneously provided under the same Section that in such an event, the bailor will have to compensate the bailee for any loss sustained by the bailee (in excess of the benefits derived out of such gratuitous bailment), due to such early recall of the bailed goods.

5. Termination of a Gratuitous Bailment on the Death of Either Party (Section 162)

A gratuitous bailment, however, automatically gets terminated in the event of the death of either of the two involved parties in the contract of such bailment, i.e. the bailor and bailee.

13.10 Finder of the Lost Goods

A person who happens to find some lost goods is treated as a bailee of such goods, though there is no contract to this effect between the two parties involves, i.e. the finder and the owner of such goods. Accordingly, he is also required to discharge the various responsibilities of a bailee, like taking the required care of the goods, and so on, as aforementioned. Besides, it is also his responsibility to make a reasonable effort to trace the real

owner of the lost and found goods, and to deliver the same to him. Accordingly, he is also entitled to reimbursement of the expenses incurred by him in this connection.

13.11 Rights of the Finder

In view of the foregoing discussions, the finder enjoys the following legal rights:

(a) Right to Retain the Goods (Section 168)

(i) The finder has the right to retain the goods till such time he has been able to find the true owner thereof, and till he is duly compensated with the amount spent by him towards preserving and safe keeping of the goods, and in tracing the true owner thereof. The finder, however, does not enjoy the right to sue the owner for such recovery.

(ii) Further, where the owner of the lost goods has announced some specific reward, payable to the finder of the lost goods, he (finder) is entitled to receive such reward as well on returning the goods. Here, he even enjoys the right to sue the owner for the recovery of such reward, as also to retrain such goods pending receipt of the reward.

(b) Right to Sell the Goods (Section 169)

The finder of the lost goods enjoys the right to sell the goods under the following circumstances:

(i) Where the true owner may not be found despite reasonable effort made in this regards, and the goods so found are usually subject to sale.

(ii) Where such goods are perishable in nature, and are in the danger of perishing, or losing a major portion of their value.

(iii) Where the true owner refuses to pay the reasonable charges to the finder, on demand, provided such charges amount to two-third of the value of such lost goods.

Let us Recapitulate

Bailment is 'the delivery of goods by one person (known as the bailor), to another person (known as the bailee), for some purpose, upon a contract that the goods shall be returned to the bailor (or otherwise disposed of, according to the direction of the bailor) by the bailee, immediately after the purpose for which the goods were initially bailed, had been accomplished' (**Section 148).**

Main Characteristics of Bailment

(a) Delivery of goods by way of actual delivery, or even constructive delivery where the goods in question are already in the possession of the other person (bailee).

(b) Delivery of goods only, and not of any thing else, like the currency notes, etc.

(c) Further, there must be some contract to the effect that the goods will be returned to the bailor by the bailee on completion of the purpose for which it was bailed (like tent for marriage party, scooter for repairs), or on completion of the stipulated period (like three months or so).
Exception: But, the finder of the lost goods holds such goods as a bailee on behalf the owner, though there is no contract between the two.

(d) Moreover, the bailee must return the same specific bailed goods (in specie) to the bailor. Thus, a contract to return not necessarily the same but some similar or equivalent value of goods will not constitute a bailment.

Duties (Obligations) of Bailor

(a) (i) To disclose the known faults in the goods (**Section 150**), which may materially interfere with the use of such goods, or may expose the bailee to some extraordinary risks

(ii) In the case of non-gratuitous bailment (i.e. the hirer), however, the bailor is liable for damages in the cases of both known and unknown faults in the bailed goods. A gratuitous bailor, however, is liable only in the cases of the known faults, and not in the cases of the unknown faults.

(b) Liability for breach of warranty regarding the authority to bail (**Section 164**) i.e. where the bailor was not entitled:

(i) To make the bailment, or

(ii) To receive the goods back, or

(iii) To give direction in respect of the disposal of the goods so bailed.

(c) (i) In the case of gratuitous bailment, he (the bailor) is liable to bear all the expenses (i.e. both ordinary and extraordinary expenses) incurred by the bailee for the purpose of the bailment, in the absence of any contract to the contrary (**Section 158**).

(ii) But in the case of non-gratuitous bailment, the bailor is liable to bear only the extra-ordinary expenses (and not the necessary expenses) incurred by the bailee.

Duties (Obligations) of Bailee

(i) To take due care of the goods bailed (**Section 151**)

(ii) Not to make any unauthorised use of the goods bailed (**Section 154**)

(iii) Not to mix up bailor's goods with his own (**Sections 155 to 157**)

(a) Where such mixed up goods can be separated or divided, he is liable to bear the expenses of separation or division of the goods, and also for the damages, if any, arising out of such mixing up of the goods.

(b) Where such mixed up goods cannot be separated or divided, he (bailee) will be liable to compensate the bailor of the entire loss suffered by him (bailor) in regard to the bailed goods, due to such mixing up.

(iv) To return the bailed goods (**Section 160**) to the bailor, or to deliver them as per the direction of the bailor, without demand immediately after the expiry of the period for which these were bailed, or on the accomplishment of the purpose for which these were bailed, failimg which he will be held liable by the bailor for any loss, destruction or deterioration of the goods caused by such delay, from the due time.

(v) To return any accretion (addition) to the bailed goods (**Section 163**), in the absence of any contract to the contrary (i.e. to return the cow with the calf born to her).

Rights of the Bailee

All the duties /obligations of the bailor, conversely speaking, will become the rights of the other party, viz. the bailee.

1. Thus, the bailee can sue the bailor on the following counts:
   (a) For claiming compensation for the damages caused due to the non-disclosure of the faults in the goods;
   (b) For breach of the warranty regarding the authority to bail, and the damages arising due to the transgression of such authority; and
   (c) To claim all expenses in case of gratuitous bailment, and only extra- ordinary expenses in case of non-gratuitous bailment.
2. Right of Lien (**Sections 170 and 171**)
   Secondly, the bailee enjoys the right of lien, i.e. the right to retain the goods in his possession, though owned by the other person, till such time the other person pays some debt or claim due, in full.

(a) **Particular lien** refers to the right of the claimant to retain only such of the goods against which some dues and/or claims are yet to be settled, e.g., to retain the repaired watch till the repair charges are paid in full (**Section 170**).

(b) **General lien**, on the other hand, pertains to the right to retain the goods even against the other dues and claims of the creditor (or bailee) unsettled by the debtor (or bailor) so far, unless, of course, there is a contract to the contrary. However, under **Section 171**, only certain categories of the bailees are entrusted with the right to exercise a general lien, like the bankers, factors, wharfingers, attorneys of the High Courts, and the policy brokers.

3. Rights against wrongful deprivation or injury to goods (**Sections 180 and 181**)
Where a third person wrongfully deprives the bailee of the use or possession of the goods bailed to him, or causes any injury to these goods, the bailee is entitled to resort to such remedies as an owner of the goods would have been entitled to exercise in the case of his own goods, if these goods were not bailed. In such cases, either of the two parties can file a suit against the third parson for causing such deprivation or injury. Further, under **Section 181**, the amount of compensation realised from the third party, will be appropriately apportioned between the bailor and the bailee in accordance with their respective interests.

Rights of the Bailor

(a) He can file suits to enforce all the duties and obligations of the bailee towards him.

(b) In the case of gratuitous bailment, the bailor can demand the return of the goods bailed even before the expiry of the stipulated period, or accomplishment of the purpose for which the goods were bailed. However, in such cases, where the bailee has acted by believing that the bailment of the goods will be for the full period, he (bailee) is entitled to be compensated by the bailor for all the expenses and losses incurred by the bailee due to such premature recall of the goods, but only to the extent these are in excess of the benefits that would have accrued to the bailee in the case of such gratuitous bailment (**Section 159**).

Termination of Bailment

All contracts of bailment automatically get terminated in the following circumstances:

1. On the expiry of the stipulated period (like bailment of a car for two months).
2. On the accomplishment of the particular purpose (like the marriage ceremony).
3. By the action of the bailee, being inconsistent with the conditions of the contract (**Section 153**).
4. Termination of a Gratuitous Bailment
Here, the bailor has the option to terminate the contract of bailment, and to recall the bailed goods, any time, even prematurely (**Section 159**). But then, the bailor will have to compensate the bailee for any loss sustained by the bailee (in excess of the benefits derived out of such gratuitous bailment), due to such early recall of the bailed goods.
5. Termination of a Gratuitous Bailment, automatically, on the death of either party (**Section 162**).

Duties of the Finder of the Lost Goods

1. The finder of the lost goods is treated as a bailee of such goods. Accordingly, he is also required to discharge the various responsibilities of a bailee, like taking the required care of the goods, and so on.
2. Besides, he must make a reasonable effort to trace the real owner of the lost goods, and to deliver the same to him. Accordingly, he is also entitled to the reimbursement of the expenses incurred by him in this connection.

Rights of the Finder of the Lost Goods

1. The finder has the right to retain the goods till such time he has been able to find the true owner thereof, and till he is duly compensated with the amount spent by him towards preserving and safe keeping of the goods, and in tracing the true owner thereof. The finder, however, does not enjoy the right to sue the owner for such recovery (**Section 168**).

2. Further, where the owner of the lost goods has announced some specific reward, payable to the finder of the lost goods, he (finder) is entitled to receive such reward as well, on returning the goods. Here, he even enjoys the right to sue the owner for the recovery of such reward, as also to retain such goods pending receipt of the reward.
3. The finder of the lost goods enjoys the right to sell the goods under the following circumstances (**Section 169**):
   (i) Where the true owner may not be found despite reasonable effort made in this regards, and the goods so found are usually subject to sale,
   (ii) Where such goods are perishable in nature, and are in the danger of perishing, or losing a major portion of their value.
   (iii) Where the true owner refuses to pay the reasonable charges to the finder, on demand, provided such charges amount to two thirds of the value of such lost goods.

Questions for Reflection

1. (a) What is bailment?
   (b) What are the main characteristics of bailment? Explain, with the help of illustrative examples in each case.
2. What are the various obligations and rights of a bailor? Explain, by citing suitable examples in each case.
3. (a) Distinguish between a 'gratuitous bailment' and a 'non-gratuitous bailment', with the help of suitable examples.
   (b) Are there any material differences in regard to any of the respective liabilities and rights of a 'gratuitous bailor' and a 'non-gratuitous bailor' (or hirer)? Discuss, by giving illustrative examples in each case.
4. What are the various obligations and rights of a bailee? Explain by citing suitable examples in each case.
5. What are the various obligations and rights of the finder of the lost goods? Explain, by citing suitable examples in each case.
6. If the bailee mixes up the goods of the bailor with his own goods, or with those of some other persons, without the specific consent of the bailor to this effect, what would be his liabilities in the following cases?
   (a) Where such mixed up goods can be separated or divided, and
   (b) Where such mixed up goods cannot be separated or divided.

   Giving of illustrative examples is a must in each case.
7. (a) How much (or upto what extent), is the bailee obliged to take care of the bailed goods?
   (b) On which of the two involved parties does lie the onus of proof to establish whether the required reasonable care of the bailed goods was taken by the bailee or not?
   (c) What are the legal ramifications of such legal provisions? Explain and elucidate your points by citing illustrative examples in each case.
8. Whether the bailee is required to return the bailed goods to the bailor only after a demand to this effect is made by the bailor, or otherwise?
9. Can a 'gratuitous bailor' and /or a 'non-gratuitous bailor' force the bailee to return the goods before the accomplishment of the purpose for which the bailment was effected? If so, under what circumstances, and with what specific legal ramifications, can this be done? Give illustrative examples in each case.
10. 'In the absence of any contract to the contrary, the bailee is duty bound, as per law, to return to the bailor, or to deliver as per the direction of the bailor, the bailed goods as aforementioned, together with

any addition, increase or profit that might have accrued to the goods bailed.' Discuss, with the help of illustrative examples.

11. (a) What do you understand by the term, 'Right of Lien'?
    (b) What are the main ingredients of such right?
    Suitable examples are also required to be cited.
12. (a) Distinguish between a ' Particular Lien' and a 'General Lien'.
    (b) Are all the bailees entitled to either the rights of a 'Particular Lien' or a 'General Lien', or both of them? Is there any exception in this regard?

    Give suitable illustrative examples in all the cases.
13. Under what circumstances do the contracts of gratuitous bailment and non gratuitous bailment automatically get terminated?
14. Under what circumstances does the finder of the lost goods enjoy the following rights?
    (a) Right to retain the goods, and
    (b) Right to sell the goods.

Problems for Practice (With Suggested Solutions)

Problem 1

Vishal had given his car on rent to Mithun for a week at a rental of Rs 1,000 per day. But the brakes of the car were defective. This defect was in the full knowledge of Vishal. But he had not disclosed to Mithun that the brakes of the car were defective. Consequently, the same day, the car had met with an accident due to this defect, and Mithun had fractured his right leg. Mithun, had, accordingly, filed a suit against Vishal claiming damages from him. Do you think that Mithun will be awarded damages by the Court of law in the instant case? Give reasons for your answer.

Solution

Yes. The Court is most likely to hold Vishal liable for payment of damages to Mithun for the injury sustained by him. This is so because, under Section 150 of the Act, the bailor (Vishal, in the instant case) is legally bound to disclose to the bailee (Mithun, in the instant case) any fault in the goods bailed, which the bailor is aware of, and which may materially interfere with the use of such goods, or may expose the bailee to some extraordinary risks. Thus, in the given case, as Vishal (bailor) had failed to do so, he will be held responsible for the damages caused to the bailee (Mithun, in the instant case) directly due to such fault.

Problem 2

Will the legal position be any different, if in Problem 1 above, Vishal would not be knowing that the brakes in his car were defective, and if he would have lent the car to Mithun, on a rental of Rs 500 per day? Give reasons for your answer.

Solution

No. The legal position, even in that case, would not have been any different. Instead, it would have remained the same in that Vishal would have even then been held liable to make payment of damages to Mithun. This is so because, in case the goods are bailed for hire (i.e. against some charges/rentals to be paid by the bailee, and not for free, referred to as 'Gratuitous Bailment'), he (bailor) will be held responsible for the damages caused to the bailee directly due to such fault, irrespective of the fact whether such fault was known to him or not.

Problem 3

Will the legal position be any different, if in Problem 2 above, Vishal would not be knowing that the brakes in his car were defective, and if he would have lent the car to Mithun just for free (referred to as 'Gratuitous Bailment'? Give reasons for your answer.

Solution

Yes. In that event Vishal would not be held liable for payment of any damages to Mithun, on the following two valid grounds:

(a) That the defect in the brakes of the car was not known to him, and

(b) That he had bailed the car for free, that is no remuneration was payable to Vishal by Mithun. Such bailment is referred to as 'Gratuitous Bailment'.

Problem 4

Will the legal position be any different, if, in Problem 3 above, Vishal would have known that the brakes in his car were defective, and still he would have failed to disclose this defect to Mithun, while lending the car to Mithun just for free? Give reasons for your answer.

Solution

Yes. The legal position, in that event, would have completely changed, because in that case, Vishal would have been held liable for payment of damages to Mithun, on the ground that he had failed to disclose the defect in the brakes of his car, which was known to him, even though the car was lent by him to Mithun just for free (referred to as 'Gratuitous Bailment'). This is so, because, in the cases where the bailor, despite having the knowledge of the fault in the goods bailed, does not disclose it, he will be held liable for damages for the injury sustained, irrespective of the fact, whether the bailment is with or without remuneration.

[Incidentally, we may clarify the legal position even a little further by emphasising the other relevant and inter-related points, involved in Problems 1, 2, 3, and 4 above. These are:

(i) In the cases where the bailor is not in the know of the defect in the goods bailed, and thus, does not disclose it, he will not be held liable for damages, but only in the cases where he is not to receive any remuneration, that is, where he bails the goods for free.

(ii) As against this, in the cases where the bailor is not in the know of such defect, and thus, does not disclose it, he will even then be held liable in the cases where he is to receive some remuneration, that is, where he bails the goods not for free.]

Problem 5

Rahim had bailed the car owned by Omar to Ehsan, without the permission and knowledge of Omar in this regard. Later, Omar had sued Ehsan and had received compensation from Ehsan. Consequently, Ehsan had filed a suit against Rahim for recovery of the amount of compensation from him (Rahim) that he (Ehsan) had to pay to Omar. Do you think that Omar will win the case? Give reasons for your answer.

Solution

Yes. Omar will, for sure, win the case. We say so because, Section 164 of the Act provides that the bailor (Rahim, in the instant case) will be held responsible to the bailee (Ehsan, in the instant case) for any loss sustained by the bailee (Ehsan) for the reason that the bailor (Rahim) was not entitled to make the bailment of the car, inasmuch as the car so bailed by him was not owned by him, but by Omar, and that too, without the permission and knowledge of Omar in this regard. Therefore, Rahim, the bailor, was liable to Ehsan, the bailee, to make good such loss sustained by him (Ehsan) by way of having paid the compensation to Omar.

Problem 6

Nina had lent her motorcycle to Shanti on the condition that she (Shanti) would drive the motorcycle herself alone. But Shanti had even allowed her friend, Fazal, to drive it. Though Fazal was driving the vehicle with full care, it had met with an accident, and had thus, got damaged. Will Shanti be held liable to compensate Nina for the expenses incurred by her (Nina) towards the repair of the motorcycle? Give reasons for your answer.

Solution

Yes. Shanti will be held liable to compensate Nina for the expenses incurred by her (Nina) towards the repair of her motorcycle. This is so because the bailee (Shanti, in the instant case), had transgressed the authority by

allowing some one else (Fazal, in the instant case), other than herself, which she was not authorised to do by the bailor (Nina, in the instant case). This contention is based on the provisions of Section 154 to the effect that, in case the bailee (Shanti, in the instant case) makes any unauthorised use of the goods bailed (i.e. uses them for the purpose not specifically authorised by the bailor (Nina, in the instant case), in terms of the agreement of bailment), he or she would be held liable to compensate the bailor (Nina, in the instant case) for any damage caused to the goods bailed, arising from or during such use of the goods by the bailee (Shanti, in the instant case).

Problem 7

Robert had left his cow in the custody of George to take care of her (cow), during the period of his foreign trip for a year or so. While Robert was away on tour, the cow had given birth to a calf. When Robert had returned from his foreign tour, George had immediately returned Robert's cow to him. But, when Robert wanted the calf also back, George flatly refused to do so, on the ground that only the cow, and not the calf, was delivered to him by Robert. Do you think George's aforementioned contention will be held valid in the Court of law? Give reasons for your answer.

Solution

No. George's contention, as stated in the instant case, will not be held valid in the Court of law, inasmuch as, George is legally bound to return to Robert, not only his cow bailed, but also the calf, that was born during the period of the bailment. This is so because, as per the provisions of Section 163 of the Act, in the absence of any contract to the contrary, the bailee (George, in the instant case), is duty bound, as per law, to return to the bailor (Robert, in the instant case), or to deliver as per the direction of the bailor (Robert, in the instant case), the bailed goods as aforementioned, together with any addition, increase or profit that might have accrued (taken place) to the goods bailed. Therefore, as there is no mention of any contract to the contrary, George will have to return even the calf to Robert, as the calf, in the instant case, is the addition that has accrued to the cow that was bailed by Robert to George.

Problem 8

Arti had given her colour TV to Sudha, the owner of a repair shop, for its repair, on payment of certain agreed amount as its repair charges. Sudha had got the colour TV repaired, as per the instructions of Arti. But when Arti had gone to collect the colour TV from Sudha, she had refused to deliver it to Arti, unless Arti would pay her the amount in full settlement of the repair bill. Do you think that the retention of the colour TV of Arti by Sudha is legally justified? Give reasons for your answer.

Solution

Yes. The stand taken by Sudha is fully justified in the eyes of law, as she has the right of lien against the colour TV of Arti, but only till such time Arti does not settle the bill of repairs. This contention is based on the provisions of Section 170 of the Act, clarified by way of the illustration number (a) given to the aforementioned Section 170.

Problem 9

Subhash had found a pouch, containing a gold necklace, lying on the roadside. After making some serious efforts, he finally succeeded in tracing the real owner of the gold necklace. When he had gone to the residence of Prerna, its real owner, to deliver the same to her, she was very happy to find her lost gold necklace, which she had recently purchased for Rs 90,000. The real owner wanted to reward Subhash with a sum of Rs 2,000. But Subhash did not want any reward in this regard. He wanted to be paid a sum of Rs 5,000, instead, towards the reimbursement of the actual expenses that he had incurred in connection with tracing Prerna, the true owner of the gold necklace. Is Subhash entitled to the payment of Rs 5,000, as was demanded by him from Prerna? Give reasons for your answer.

Solution

Yes. Subhash is entitled to the payment of Rs 5,000, as was rightfully demanded by him from Prerna, because this amount happened to be the actual expenses that he had incurred in connection with tracing Prerna, the

true owner of the gold necklace. This is so because, as has been provided under Section 168 of the Act, the finder of the lost goods is legally entitled to be duly compensated with the amount spent by him in tracing the true owner thereof.

Problem 10

In Problem 9 above—in the event of Prerna refusing to pay to Subhash, the amount of Rs 5,000, as was claimed by him from her, towards the actual expenses that he had incurred in connection with tracing Prerna—which of the following legal remedies, in your considered opinion, would be available to Subhash?

(a) To retain the gold necklace till such time he is duly compensated by Prerna with the amount spent by him in tracing Prerna, the true owner thereof.

(b) To file suit against Prerna for recovery of the amount of Rs 5, 000, being the actual amount spent by him in tracing Prerna, the true owner thereof.

(c) To sell the gold necklace, on the ground that Prerna, the true owner thereof, had refused to pay him the amount of Rs 5,000, as was rightfully demanded by him, being the amount of actual expenses that he had incurred in connection with tracing Prerna. Give reasons for your answers.

Solution

(a) As regards part (a) of the question, under provisions of Section 168 of the Act, Subhash can rightfully retain the gold necklace till such time he is duly compensated by Prerna with the amount spent by him in tracing her, the true owner thereof.

(b) Regarding part (b) of the question, Subhash cannot file a suit against Prerna for recovery of the amount of Rs 5,000. This is so because, Section 168 of the Act specifically provides that the finder of the lost goods does not enjoy the right to sue the owner for such recovery.

(c) So far as part (c) of the question is concreted, Subhash cannot rightfully sell the gold chain of Prerna, on the ground that Prerna had refused to compensate him with the amount of Rs 5,000, actually spent by him in tracing her, because, in the instant case, this amount (Rs 5,000) was less than Rs 60,000, i.e. the two-thirds of the value of the lost gold necklace, which was worth Rs 90,000, as is mentioned in Problem 9 above. This contention is based on the provisions of Section 169 of the Act, which categorically specifies to the effect that the finder of the lost goods enjoys the right to sell the goods, where the true owner refuses to pay the reasonable charges to the finder, on demand, but only where such lawful charges of the finder amount to two-thirds of the value of such lost goods. And, in the given case, such lawful charges of the finder, i.e. Rs 5,000, is far below the amount of Rs 60,000, being the two-thirds of the value of such lost goods, i.e. gold chain of Prerna worth Rs 90,000.

Chapter Fourteen

Contract of Pledge

> *Possession is nine tenths of the law.*
> **Proverb**

14.1 What is Pledge or Pawn?

Pledge is the bailment of goods, by way of security, for payment of a debt, or performance of a promise, against some advances (**Section 172**). Further, like in the case of bailment, the person who delivers the goods as security is referred to as the 'pledgor' or 'pawner' (like the bailor in the case of bailment) and the person to whom the goods are so delivered is known as the 'pledgee' or 'pawnee' (like the bailee in the case of bailment). It may be further reiterated here that in the case of pledge, only the possession is given to the pledgee, and the ownership still remains with the pledgor; only a charge gets created on the goods and that the pledged goods cannot be delivered back to the pledgor unless the amount of loan is repaid by him to the creditor (like the bank) in full. In fact unless the loan is repaid in full, no other creditor, person or authority, including the government, can take possession of such goods. This point has been well-established in the case of **Bank of Bihar vs State of Bihar and Others (1971, Comp. Cas. 591),** wherein the government of Bihar, who had seized the stocks of sugar, pledged to the creditor Bank (the erstwhile Bank of Bihar, since merged with the State Bank of India), was required to reimburse the bank with the amount that the Bank would have been able to realise, in the ordinary course, as the sale proceeds of the pledged and seized stocks.

We thus see that the pledge is nothing but just one of the types of bailment itself, with the one single difference in that it is delivered by way of a security against some loan or advance. Thus, all the provisions of law pertaining to bailment will likewise equally apply in all the cases of pledge, too. We will, however, prefer to recapitulate the salient features of law pertaining to pledge, separately here.

14.2 Main Characteristics of Pledge

(a) Delivery of Goods

In the case of pledge also, like in the case of bailment, the delivery of the goods pledged, or to be pledged, is

a must. Such delivery is to be made to the lender (or to someone on his behalf) with the intention of providing security against the loan obtained. That is why, the bankers prefer to obtain a letter of pledge (usually on a printed proforma), whereby the pledgor (borrower) provides a documentary evidence, in writing, to the effect that the goods, specified, in detail therein, had actually been delivered by the borrower to the creditor bank, with the specific intention of pledging the same with the bank, as a security against the advance. This procedure is meticulously followed by the banks such that the borrower may not, at a later date, take the plea that the goods, in question, were not willingly delivered but, instead, were forcibly taken possession of by the bank, or by any other creditor, for that matter.

Such delivery may be either actual or constructive. Actual delivery may take place in case of bags of wheat, or stocks of iron ingots, actually transported and delivered. Constructive delivery, however, can take place by way of delivery of the key(s) of the godown where the stocks to be pledged are stored. Delivery of the documents of title to goods (like the bill of lading or the railway receipt), when duly endorsed, also constitutes constructive delivery of the goods, for the purpose of pledge. In England, only the bill of lading is treated as the document of title to goods, and not the railway receipt. But, in India, even the railway receipt is treated as a document of title to goods, and a valid pledge can be created on its delivery after due endorsement by the owner of such goods. Such opinion was held in the case **Madras Official Assignee vs Mercantile Bank of India Ltd.,** and was also endorsed by the Supreme Court of India in the case **Morvi Mercantile Bank Ltd. vs Union of India, 1965.**

Similarly, where the goods are already in the possession of the borrower, and these continue to remain in his possession, but when he agrees to retain the goods as a bailee on behalf the pledgee, and subject to the pledgee's order, it tantamounts to be a constructive delivery and a valid pledge **(Reeves vs Capper).**

The security of pledge obtained by the banks by way of a *mandi* type pledge may well- illustrate the point. In such cases, the bank delivers the keys of the godown, wherein the pledged stocks are stored, to the borrower himself, for his free and uninterrupted transactions in the godown (that is to take out the stocks out of the godown, and put the fresh stocks in the godown, whenever required and desired). However, a written undertaking is obtained from the borrower, duly signed by him, on a plane (unstamped) paper, to the effect that he has received the keys of the godown, which he will keep, not as the owner of the stocks, but only in trust as a trustee (bailee) on behalf the bank (creditor), under the specific condition to return the keys to the banker immediately whenever demanded back. Thus, the stocks are deemed to be pledged to the bank as a security against the advance, and the stocks are also deemed to remain in the custody and possession of the bank, and the keys are virtually retained by the bank (though through the trustee borrower, if we may be permitted to say so).

Such *mandi* type advances are granted by the banks in the cases where the factory of the borrower runs round the clock, where the stocks are required regularly and frequently, throughout the day and night, and where the stocks pledged are very bulky and heavy-weight (like pig iron, iron scraps, bales of cotton, and so on), and above all, in the cases where the borrower is considered to be financially sound and of unimpeachable integrity.

The bank invariably gives its own locks and keys to be placed on the main gates and all the doors of the borrower's godown with its (bank's) name engraved thereon. This way, the bank intends to give due notice to the members of the public that the goods, stored in the godown, are in the possession of the bank, as the pledgee of the same. The banks take various other precautions, too, some of which have been discussed in Appendix 14.1 at the end of the chapter.

(b) Contract

Further, like in the cases of bailment, the goods delivered by way of pledge as security are as well delivered under the contract and condition to the effect that the goods will be returned to the pledgor by the pledgee on completion of the purpose for which it was given by way of pledge, i.e. on repayment of the loan amount in full with interest and other charges.

(c) Return of Goods in Specie (i.e. Specific)

The provision of law that the same specific goods (in specie) must be delivered back by the bailee to the bailor, which were actually bailed, by the latter, equally applies in the case of pledge also. Thus, in the cases where there is a provision in the contract to the effect of returning not necessarily the same but some similar or equivalent value of goods, such agreement will not constitute a bailment or pledge.

14.3 Duties of a Pledgee

The pledgee, like the bailee, has the following duties and obligations:

(a) To take Due care of the Goods Pledged

We have seen in the previous chapter 13 that under **Section 151**, in the case of bailment, the bailee must take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take in the case of his own goods of the same bulk, quality and value as the goods bailed. Further, as the pledge is also a type of bailment only, where the goods are delivered against some loan, the provision of law in this regard will equally apply in the case of pledge, too. That is why, when the goods are pledged to the bank, the bank is expected to take as much care as a man of ordinary prudence would take in the case of his own goods of similar nature, etc.

(i) **For example,** if paper has been pledged to the bank, the bank must take care to get the stocks insured against fire and theft, and also to treat the stocks of paper with termite treatment, and to take care to over-turn the stocks, periodically, to save it from termite attack and/or damage due to dampness, rain, etc.

(ii) Let us take yet another **example**. A company has pledged the stocks of pig iron and iron ingots. But, as these stocks do not get damaged due to fire, a fire-insurance of such stocks may not be warranted. But then, if any theft takes place of any goods pledged to the bank, and if these were not insured against theft, the bank may be held responsible, and may have to compensate the borrower with the cost of the damages/loss sustained due to theft. But again, as we all know, in the event of getting the goods insured against theft, the fire-insurance thereof is a pre-requisite, a necessary pre-condition/requirement. But then, fire-insurance of pig iron and iron ingots may be the most unwarranted; an unwise action, and a wasteful expenditure. Therefore, the banker, with a view to playing safe, just sends a letter to the borrower concerned, suggesting therein that the stocks pledged to the bank may be got insured against theft, if the borrower considered it necessary to do so. Moreover, the duly acknowledged copy of such letter is kept, along with the other legal documents with the bank, so as to prove, in the Court of law, at any later date, that the bank had taken due care to forewarn the borrower to get the stocks insured against theft. And, in case the borrower (pledgor) had preferred, not to get the stocks insured against theft, as suggested by the bank, he himself should be held solely and exclusively responsible in this regard, and not the bank (pledgee).

(b) Not to make any Unauthorised use of the Goods Pledged

As in the case of a bailee, the plegee is also likewise prohibited under the law not to make any unauthorised use of the goods pledged (i.e. to use them for the purpose not specifically authorised by the pledgee in terms of the agreement).

(c) Not to Mix Up Pledgor's Goods with His Own

Like a bailee, the pledgee too, is not authorised to mix up the goods of the pledgor with his own goods, or with those of some other persons, without the specific consent of the pledgor to this effect, failing which he will be held liable for the damages and loss. Such mixing up of the goods may be of two different categories, viz.

(a) Where such mixed up goods can be separated or divided, and
(b) Where such mixed up goods cannot be separated or divided.

Thus, in the two different cases, the remedy and penalty, too, will be different, as in the case of a bailee.

(d) To Return the Pledged Goods

The pledged goods, like the bailed goods, are also required to be returned by the pledgee to the pledgor, or to be delivered as per the direction of the pledgor, without demand, immediately after the expiry of the period for which these were pledged, or on the accomplishment of the purpose for which these were pledged. Thus, the pledgee is required to return the pledged goods immediately after the short-term loan is repaid on demand, or the term-loan is repaid when falling due. Otherwise, he will be held liable by the pledgor for any loss, destruction, or deterioration of the goods caused by such delay.

(e) To Return any Accretion (Addition) to the Bailed Goods

In the absence of any contract to the contrary, the pledgee, like the bailee, is duty-bound, as per law, to return to the pledgor, or to deliver as per the direction of the pledgor, the pledged goods as aforementioned, together with any addition, increase or profit that might have accrued (taken place) to the goods pledged.

For ***example***, in the case of the advance granted against the pledge of quoted equity shares of some companies, the bonus shares declared or issued will belong to the pledgor, and accordingly, these also need to be returned to the pledgor along with the shares. **[M R Dhawan vs Madan Mohan and Others]**. The same will be the position in regard to the periodical dividends paid on such shares.

The detailed discussions, explanations, and examples cited in the previous Chapter 13 regarding the bailee will, likewise, apply in the case of the pledgee also.

14.4 Rights of a Pledgee

Under Section 176, in the event of the pledgor failing to repay his loan, or to complete the performance of his promise/obligation, at the stipulated time, the pledgee is entitled to exercise any of his following rights against the pledgor:

(a) To bring a lawsuit against the pledgor, when he fails to repay his debt, or defaults in completion of the performance, as promised;
(b) To retain the possession of the goods pledged, as a collateral security against the advance;
(c) To sell the pledged goods after giving reasonable notice of such sale to the pledgor.

Further, in case the sale proceeds of the pledged goods are found to be insufficient to meet the entire obligation of the pledgor to the pledgee (i.e. the amount of principal with interest and other charges), the pledgee can proceed against the pledgor for recovery of the balance amount still lying unredeemed. Similarly, in case some surplus amount is left out of the sale proceeds of the pledged goods, after meeting the entire obligation of the pledgor to the pledgee, such surplus amount belongs to the pledgor and, accordingly, should be returned to him.

We thus, observe that before initiating the proceedings of sale of the pledged goods, a reasonable notice has to be given by the pledgee to the pledgor for such sale. In the case, **Prabhat Bank Ltd. vs Babu Ram (AIR 1966, All. 134),** the learned judge had observed: 'What is contemplated by Section 176 is not merely a

notice but a 'reasonable' notice, meaning thereby a notice of intended sale of the security by the creditor within a certain date so as to afford an opportunity to the debtor to pay up the amount within the time mentioned in the notice'.

It was further held by the Allahabad High Court in the aforementioned case itself that, even in the case of there being a contract between the pledgor and pledgee to the specific effect that such notice will not be required to be given by the pledgee to the pledgor, the notice will necessarily have to be given all the same, inasmuch as it is so required by a specific provision of the law, and any such clause in the relative agreement to the contrary, will be deemed to be inconsistent with the provisions of the Act, and hence, void and unenforceable.

Reasonabe notice, however, is subjective in nature, and thus, may vary from case to case.

Further, it has been held in some case that a notice of 15 days in advance may usually be considered to be a reasonable notice for the purpose.

It may be pertinent to mention here that even if the pledged goods are sold by the pledgee without giving reasonable notice to the pledgor, such sale will not be held as void but valid; that is, it may not be set aside. In such cases, however, the pledgee will be held liable to the pledgor for the damages.

Further, before the actual execution of the sale may take place, the pledgor has the following rights:

(i) To supervise the entire sale proceedings so as to see and assure himself that the goods fetch a reasonable and right price; and
(ii) To meet his obligation by way of a last chance.

It must, however, be clearly understood in this context that, in case the goods are being sold through auction or even otherwise, and the final selling price is being settled which is short of the total amount of the debt (i.e. amount of principal plus interest and other charges) payable by the pledgor, he (pledgor) cannot exercise his right of redemption of the goods at that lower price. He will, instead, be required, under the law, to pay and settle the entire outstandings on his loan account. This is so, because otherwise the borrowers will get the incentive to allow for the settlement of a lower price for the sale of the goods, and thereby, to get back the goods himself at such lower price. It thus, seems quite reasonable that the pledgor should be required to repay the entire outstandings on the account, failing which the goods will get sold of for a lower amount, at the deprivation and detriment of the pledgor, and he will have to repay the balance amount still remaining outstanding on his loan account.

In addition to the aforementioned rights, given to the pledgee under **Section 176**, he is also entitled to the following further rights:

(a) In view of the fact that the pledgor, like the bailor, is obliged, under the law, to disclose any defects or faults in the goods pledged, which are within his knowledge, his failure to do so naturally gives the legal right to the pledgee to hold him liable and claim compensation for the damages caused due to the non-disclosure of the faults and defects in the goods pledged. The same will be true in case the pledgor fails to disclose to the pledgee the abnormal character, like the explosive or fragile nature of the goods pledged.
(b) The pledgee is also entitled to claim damages from the pledgor, in case he (pledgee) suffers any loss due to the defective title of the pledgor.
(c) The pledgee can also claim and recover any extraordinary expenses incurred towards the preservation of the goods pledged.
(d) In the case of injury to the goods or their deprivation by a third party, the rights of the pledgee do not remain limited to the extent of his own interest alone in the pledged goods. Instead, all the remedies that are available to the owner of the goods in respect of his own goods, when such goods were not pledged, will be available to the pledgee in the case of the pledged goods.

Example

In the case, **Morvi Mercantile Bank Ltd vs Union of India, 1965,** the Supreme Court of India had held that the owner of the goods can create a valid pledge over such goods by duly endorsing and

delivering the document of title to these goods (railway receipt in the instant case) in favour of the creditor. *(In the English Law, however, only the bill of lading is treated as the document to title to the goods, and not the railway receipt).*

It was further held in the case that the creditor bank (pledgee) will be entitled to the compensation from the railways not only to the extent of the amount advanced by the bank against the railway receipt (i.e. to the extent of Rs 20,000 only), but to the extent of the full invoice value of the goods in question (i.e. upto Rs 35,500). In such a case, the bank will retain the amount of Rs 20,000 in full settlement of the outstanding on the pledgor's account, and the balance amount of Rs 15, 500 will be retained by it only as a trustee on behalf of the pledgor, to be finally returned by the bank to the pledgor, the owner of the goods.

(e) Further, the pledgee, like a bank, and so on, also enjoys the right of lien (both particular lien and general lien), that is the right to retain the pledged goods in his possession, though owned by the pledgor, till such time the pledgor has not paid the specific debt granted against the specific goods (i.e. by way of a particular lien), and also till such time any other dues, on any other accounts of the pledgor, still remain unpaid (i.e. by way of a general lien), unless there is a contract to the contrary.

A detailed discussion pertaining to the right to lien already appears in Chapter 13.

14.5 Rights of a Pledgor

The pledgor enjoys the flowing rights, as provided in the Act:

(a) The pledgor can claim the return of the pledged goods immediately after he has paid the entire outstandings on the loan account (i.e. the amount of principal plus interest and any other charges), without necessarily making any specific demand to this effect.

(b) He has the right to receive a reasonable notice from the pledgee of his intention to sell the goods, in the case of non-payment of his entire dues within the specified time. Accordingly, in the case of default on the part of the pledgee to do so, he (pledgor) has the right to claim the damages from the pledgee for the losses caused to him by such sale.

(c) In the event of a due sale of such pledged goods by the pledgee, the pledgor has the right to receive back the surplus amount, if any, left after the settlement of the entire outstandings on the accounts of the pledgor.

(d) The pledgor also enjoys the right to redeem his goods as a final opportunity before the sale deal is completed, but only against the repayment of the entire dues outstanding in his accounts, and not merely at the value of the final sale deal.

(e) The pledgor, like the bailee, has his legal claim on any addition or accrual arising to the pledged goods, like the dividend or bonus shares issued by the respective companies in regards to their equity shares pledged as security by the pledgor.

(f) In case the pledgee, like the bailee, fails to take due care of the goods pledged, as required by law in this regard, the pledgor can claim damages from the pledgee for the loss caused to the pledged goods due to the negligence or mishandling of such goods on the part of the pledgee.

14.6 Duties/Obligations of a Pledgor

The pledgor has the following duties and obligations to perform:

(a) A pledgor, like a bailor, is legally bound to disclose to the pledgee any material fault, extraordinary risks, or the abnormal character, like the explosive or fragile nature of the goods pledged, which may expose the pledgee to some extraordinary risks. Thus, in case he (pledgor) fails to do so, he will be held responsible for the damages caused to the pledgee directly due to such faults or risky nature of such goods.

(b) It may, however, be carefully noted here that the pledgor will be held responsible for the damages caused to the pledgee directly due to such fault, irrespective of the fact whether such fault was known to the pledgor or not.
(c) The pledgor will be held responsible for any loss sustained by the pledgee due to any defect in his (pledgor's) title to the goods so pledged.
(d) Further, the pledgor is required to repay to the pledgee any extra-ordinary expenses (and not the necessary expenses) incurred by him (pledgee) towards the preservation of the pledged goods.
(e) In the event of the sale of the pledged goods, the pledgor is required to repay to the pledgee any shortfall that may still remain outstanding in the loan account, even after depositing the entire sale proceeds of such goods.

14.7 Pledge by Non-owners

As a matter of general rule, only the owners of the goods are usually entitled to create a valid pledge of the goods. But then, even the non-owners of the following categories can create a valid pledge of goods by way of an exception:

(a) Pledge by Mercantile Agent

A mercantile agent can create a valid pledge of the goods, if such goods are already in his possession (and that too with the consent of the real owner), or even by endorsement of the relative document to the title to goods, but only while acting as a mercantile agent, in the ordinary course of business, despite the fact that he is not the owner of the goods involved. The pledge so created by the mercantile agent will be as valid as if he was expressly authorised by the owner of the goods to this effect. Further, such pledge will be valid only if the pledgee accepts such pledge in good faith, and that he did not have, at the material time of such pledge, any notice to the effect that the mercantile agent did not have the authority of the real owner of the goods to pledge them.

We may thus, observe that a pledge made by a mercantile agent will be valid only if all the following conditions are fully satisfied:

(i) The mercantile agent must have acted in the ordinary course of business. That is, he must have operated from his usual place of business, and that too, during the usual business hours. Accordingly, if he had operated from any place, other than his usual place of business, and/or outside the usual business hours (i.e. before or after the usual business hours), such pledge would not be held valid **[Coppenheimer vs Attenborough & Son (1908) 1 KB 221].**
(ii) Moreover, the pledgee must have acted in good faith, meaning thereby that he must be under the belief that the mercantile agent must have been duly and specifically authorised by the real owner of these goods to create a valid pledge of these goods on his behalf. Such authority is usually presumed to have been given in such cases, unless the pledgee had due notice, at the material time of creation of the charge of pledge, to the effect that he (mercantile agent) was not authorised by the real owner to pledge these goods. Further, in such cases, the onus of proof to establish that the pledgee had not acted in good faith, and also that he, in fact, had the notice and knowledge that the mercantile agent was not authorised by the real owner to create a valid pledge, squarely rests with the person or party disputing the validity of such pledge **[Stadium Finance vs Robbins (1962) 2 QB 664 (673)]**

[A 'mercantile agent' has been defined under Section 2(9) of the Sale of Goods Act 1930 as the one who, in the usual course of business, has the authority as such an agent either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of the goods.]

(b) Pledge by Seller or Buyer in Possession of the Goods after the Sale

As stipulated under Section 30 of the Sale of Goods Act 1930, a seller who is left in the possession of the goods after the sale, as also a buyer who obtains possession of the goods with the consent of the seller before the sale thereof, can create a valid charge of pledge of such goods. Here again, it is necessary that the pledgee must have acted in good faith, as also without the notice of the previous sale of the goods to the buyer, or of the lien of the seller over the goods, respectively, when alone such pledge can be held valid.

(c) Pledge by a Person in Possession of the Goods under a Voidable Contact

A person who has obtained the possession of the goods under a voidable contract, can also create a valid pledge, provided the following two conditions are fulfilled:

(i) The contract had not been rescinded by the person (who had the option to do so) before the creation of such pledge; and
(ii) The pledgee had acted in good faith and without notice of any defect in the title of the pledgor in respect the pledged goods.

(d) Pledge by a Co-owner in Possession of the Goods

Even only one of the many co-owners of the goods, by virtue of being in the sole possession thereof, can create a valid pledge of these goods, but only with the consent of all the remaining co-owners **[Shadi Ram vs Mehtab Chand (1895), Punj].**

(e) Pledge by a Person having Limited Interest (Section 179)

In case a person, having only a limited interest in the goods, pledges them; such pledge is valid, though only to the extent of his own interest therein. Accordingly, a pledgee may create a further charge of pledge in regard to the same goods to the extent of the amount he has advanced against them.

14.8 Advantages of Pledge

The security created by way of pledge of goods has been considered to be far more sure and safe, as compared to the other securities like hypothecation, mainly for the following reasons:

(i) The security of the goods pledged remains in the actual and continued possession and control of the creditor, under his lock and key. Thus, the debtor usually may not have a chance of manipulating and/or misappropriating the pledged goods. Moreover, this way, the possibility of pledging the same stocks of goods to some other creditor, for the purpose of obtaining double finance thereagainst, also becomes rather difficult, though not impossible, as illustrated in Appendix 14.1, at the end of the chapter.
(ii) Second, the security created by way of pledge has the priority over the charge of hypothecation, though created even earlier to the pledge, in case the pledgee concerned did not have the knowledge of such earlier hypothecation at the material time of the pledge.
(iii) Third, in the event of default in the repayment of the loan by the pledgor, the pledgee can resort to the sale of the pledged goods, for recovery of the loan amount, without the intervention and permission of the Court, of course, after giving a reasonable notice to the pledgor regarding the intended sale.
(iv) Moreover, in the event of the borrower becoming insolvent, the creditor can sell the pledged goods and claim for the balance of the debt, if any, still remaining due for payment.

But, despite the fact that the security of pledge is preferable to other types of securities, it is imperative on the part of all the pledgees (creditors, like the bankers), to take all possible precautions and safeguards before

accepting and storing the pledged goods, and also to exercise continued vigilance and supervision over the pledged goods after and during the entire period of the pledge.

The various relevant aspects and the comparative advantages and disadvantages of the securities created by way of pledge and hypothecation have been discussed in detail in Appendix 14.1 at the end of the chapter.

Let us Recapitulate

Pledge is the bailment of goods, by way of security, for payment of a debt, or performance of a promise, against some advances (**Section 172**). The person who delivers the goods as security is referred to as the 'pledgor' or 'pawner', and the person to whom the goods are so delivered is known as the 'pledgee' or 'pawnee'.

Main Characteristics of Pledge

These are similar to those of bailment, that is,

(a) Delivery of goods; it may be either actual or constructive
(b) Further, the goods are delivered by way of pledge as security under the contract that the goods will be returned to the pledgor by the pledgee on repayment of the loan amount in full, with interest and other charges.
(c) The same specific goods are required to be returned that were pledged.

Duties of a Pledgee

The pledgee, like the bailee, has the following duties and obligations:

(a) To take due care of the goods pledged.
(b) Not to make any unauthorised use of the goods pledged.
(c) Not to mix up the pledgor's goods with his own, failing which he is liable to the pledgor for different types of damages under the conditions where such mixed-up goods can be separated and where these cannot be separated.
(d) To return the pledged goods or to deliver them as per the direction of the pledgor, without demand, immediately after the short-term loan is repaid on demand, or the term-loan is repaid when falling due. Otherwise, he will be held liable by the pledgor for any loss, destruction or deterioration of the goods caused by such delay.
(e) To return any accretion (addition) to the bailed goods, like the bonus shares along with the shares pledged, of course, in the absence of any contract to the contrary.

Rights of a Pledgee (Section 176)

(a) To bring a lawsuit against the pledgor, when he fails to repay his debt, or defaults in completion of the performance as promised;
(b) To retain the possession of the goods pledged, as a collateral security against the advance;
(c) To sell the pledged goods after giving reasonable notice to the pledgor regarding the intended sale within a certain date, giving an opportunity to the debtor to repay the amount within the stipulated time.
(d) If the pledged goods are sold without giving reasonable notice, such sale will be valid but the pledgee will be liable to the pledgor for the damages.

Further, before the actual sale, the pledgor has the rights:

(i) To supervise the sale proceedings to see that the goods fetch a reasonable price; and
(ii) To meet his obligation by way of a last chance. But the pledgor can exercise his right of redemption of the goods on payment of the entire dues on the loan amount, and not at the lower settled price.

Rights to Some Other Claims

(a) For the damages caused due to the non-disclosure of the faults, defects, and abnormal character, like the explosive or fragile nature of the goods pledged.
(b) For any loss suffered due to the defective title of the pledgor.
(c) For expenses incurred towards the preservation of the goods pledged.
(d) For injury to the goods or their deprivation by a third party, his claim covers the owner's rights in full, and not limited to his own interest (loan amount) only.
(e) Further, the pledgee also enjoys the right of lien; of 'particular lien' on the pledged goods advanced against and in his possession, and of 'general lien', for any other dues, but only in the case of the bankers, factors, wharfingers, attorneys of the High Courts, and the policy brokers, unless there is a contract to the contrary (**Section 171**).

Rights of a Pledgor

(a) To claim the return of the pledged goods immediately after repayment of the entire dues, without necessarily making any specific demand to this effect.
(b) To receive a reasonable notice from the pledgee of his intention to sell the goods, in the case of non-payment of his entire dues within the specified time, failing which he has the right to claim the damages from the pledgee for the losses caused to him by such sale. Such sale, without notice, however, is held valid.
(c) To receive back the surplus amount of the sale proceeds, if any, left after the settlement of the entire dues.
(d) To redeem his goods as a final opportunity before the sale deal is completed, but only against the repayment of the entire dues in full, and not merely at the value of the final sale deal.
(e) To claim any addition or accrual arising to the pledged goods, like the dividend or bonus shares issued on the equity shares pledged.
(f) To claim damages if the pledgee fails to take due care of the goods pledged, as required by law, for the loss caused to the pledged goods due to his such negligence or mishandling.

Duties/Obligations of a Pledgor

(a) To disclose any material fault, extraordinary risks, or the abnormal character, like the explosive or fragile nature of the goods pledged, which may expose the pledgee to some extraordinary risks, failing which he will be liable to damages caused to the pledgee directly due to such faults or risky nature of such goods, irrespective of the fact whether such fault was known to the pledgor or not.
(b) Liability for any loss sustained by the pledgee due to any defect in his (pledgor's) title to the goods so pledged.
(c) To repay to the pledgee any extra-ordinary expenses (and not the necessary expenses), incurred by him (pledgee) towards the preservation of the pledged goods.
(d) To repay to the pledgee any shortfall that may still remain outstanding in the loan account, even after realising the entire sale proceeds of such goods.

Pledge by Non-owners

(a) Pledge by Mercantile Agent
    (i) If such goods are already in his possession and that too with the consent of the real owner, or even by endorsement of the relative document to the title to goods, but only while acting as a mercantile agent, in the ordinary course of business (i.e. from his usual place of business, and that too during the usual business hours), despite the fact that he is not the owner of the goods involved. It is presumed as if he was expressly authorised by the owner to pledge the goods.
    (ii) Further, such pledge will be valid only if the pledgee accepts such pledge in good faith, and that he did not have, at the material time of such pledge, any notice to the effect that the mercantile agent

did not have the authority of the real owner of the goods to pledge them. The onus of proof to establish that the pledgee had not acted in good faith, and also that he, in fact, had the notice and knowledge that the mercantile agent was not authorised by the real owner to create a valid pledge, squarely rests with the person or party disputing the validity of such pledge.

(b) Pledge by the seller in possession of the goods after the sale, and by the buyer who obtains possession of the goods with the consent of the seller before the sale thereof. Here again, the pledgee must have acted in good faith, as also without notice of the previous sale of goods to the buyer, or of the lien of the seller over the goods, respectively (**Section 30 of the Sale of Goods Act 1930**).

(c) Pledge by a person in possession of the goods under a voidable contact, provided
   (i) The contract had not been rescinded by the person (who had the option to do so) before the creation of such pledge; and
   (ii) The pledgee had acted in good faith and without notice of any defect in the title of the pledgor in respect the pledged goods.

(d) Pledge by one of the many co-owners of the goods, by virtue of being in the sole possession thereof, but only with the consent of all the remaining co-owners.

(e) Pledge by a person having limited interest, only to the extent of his own interest therein (**Section 179**).

Advantages of Pledge

(i) The goods pledged remains in the actual and continued possession and control of the creditor, under his lock and key, whereby the debtor usually may not have a chance of manipulating and/or misappropriating the pledged goods, or of pledging the same stocks of goods to some other creditor, to obtain double finance

(ii) Second, the security of pledge has the priority over the charge of hypothecation, though created even earlier to the pledge, in case the pledgee did not have the knowledge of such earlier hypothecation at the material time of the pledge.

(iii) Third, the pledgee can resort to the sale of the pleged goods, for recovery of the loan amount, without the intervention and permission of the Court, of course, after giving a reasonable notice to the pledgor regarding the intended sale.

(iv) Moreover, if the borrower becomes insolvent, the creditor can sell the pledged goods and claim for the balance of the debt, if any, still remaining due for payment.

But, the pledgees (creditors, like the bankers), must take all possible precautions and safeguards before accepting and storing the pledged goods, and also to exercise continued vigilance and supervision over the pledged goods after and during the entire period of the pledge.

Questions for Reflection

1. (a) What is a pledge?
   (b) What are the main characteristics of a pledge? Explain, with the help of illustrative examples in each case.
2. What are the various obligations and rights of a pledgor? Explain by citing suitable examples in each case.
3. What are the various obligations and rights of a pledgee? Explain by citing suitable examples in each case.
4. If the pledgee mixes up the goods of the pledgor with his own goods, or with those of some other persons, without the specific consent of the pledgor to this effect, what would be his liabilities in the following cases?
   (a) Where such mixed up goods can be separated or divided, and
   (b) Where such mixed up goods cannot be separated or divided.
   Giving of illustrative examples is a must in each case.

5. (a) How much (or upto what extent), is the pledgee obliged to take care of the pledged goods?
   (b) On which of the two involved parties does the onus of proof lie to establish whether the required reasonable care of the bailed goods was taken by the pledgee or not? What are the legal ramifications of such legal provisions? Explain and elucidate your points, by citing illustrative examples in each case.
6. Whether the pledgee is required to return the pledged goods to the pledgee on his two own or only after a demand to this effect is made by the pledgor? Explain, by citing specific circumstances, relevant for the purpose.
7. 'In the absence of any contract to the contrary, the pledgee is duty-bound, as per law, to return to the pledgor, or to deliver as per the direction of the pledgor, the pledged goods, together with any addition, increase or profit that might have accrued to the goods pledged.' Discuss, with the help of illustrative examples.
8. (a) What do you understand by the term, ' Right of Lien'?
   (b) What are the main ingredients of such right?

   Suitable examples are also required to be cited.
9. (a) Distinguish between a ' Particular Lien' and a 'General Lien'.
   (b) Are the pledgees entitled to either the rights of a 'Particular Lien' or a 'General Lien', or both of them? Is there any exception in this regard?

   Give suitable illustrative examples in all the cases.
10. Under what circumstances do the contracts of pledge automatically get terminated?
11. What specific conditions must be satisfied to make the pledge created by the following non-owners of goods as a valid contract?
    (i) A Mercantile Agent;
    (ii) A Seller;
    (iii) A Buyer;
    (iv) A person in possession of the goods under a voidable contact;
    (v) A co-owner in possession of the goods;
    (vi) A person having limited interest in the goods.
12. (a) For what specific reasons is the security created by way of pledge of goods been considered to be far more sure and safe, as compared to the other types of securities like hypothecation?
    (b) What precautions should the pledgee (like the banker) take to safeguard his interest before accepting and storing the pledged goods?
    (c) What types of vigilance and supervision should be exercised over the pledged goods after and during the entire period of the pledge?

Support your statements by citing some live case(s) to strengthen your contention on each of the respective points.

Problems for Practice (With Suggested Solutions)

Problem 1

Gopal had taken a loan from a bank against the security of pledge of paper. But after a couple of months, the stocks of paper, pledged to the bank, had been damaged. Besides, some other stocks had been got destroyed in a minor fire, and some portions of the stocks were even found stolen. All these incidents had caused a substantial loss to Gopal, the borrower. Gopal, the borrower, therefore, asked the bank to compensate him for the loss sustained by him due to the carelessness and neglect of the bank in that it had not taken due care to get the stocks insured against fire and theft, and also to treat the stocks of paper with termite treatment, and to take care to over-turn the stocks, periodically, so as to save it from termite attack and/or damage due to

dampness, rain, etc. But the bank had refused to compensate the borrower on the plea that all such actions were squarely the responsibility of the borrower by virtue of his still being the owner of the goods pledged. Thereupon, the borrower filed a suit against the bank. Do you think that Gopal, the borrower, will win the case? Give reasons for your answer.

Solution

Gopal, the borrower, will definitely win the case against the bank for the following reasons**:**

(a) As defined under Section 172, a pledge is the bailment of goods, by way of security, for payment of a debt, or performance of a promise, against some advances. Therefore, the bank, by virtue of being a pledgee, is also a bailee, in the first place. Accordingly, all the roles and responsibilities of the bailee will also be those of the bank, by virtue of it being also a bailee at the same time.

(b) Further, as has been categorically stipulated under Section 151, in the case of bailment, the bailee must take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take in the case of his own goods of the same bulk, quality and value as the goods bailed. Further, as the pledge is also a type of bailment only, where the goods are delivered against some loan, the provision of law in this regard (i.e. in regard to bailment), will equally apply in the case of pledge, too. That is why, when the goods are pledged to the bank, the bank is expected to take as much care as a man of ordinary prudence would take in the case of his own goods of similar nature, etc.

(c) Accordingly, as the stocks of paper had been pledged to the bank, the bank must have taken due care to get the stocks insured against the imminent risks of fire and theft, and also to treat the stocks of paper with termite treatment, and to take care to over-turn the stocks, periodically, to save it from termite attack and/or damage due to dampness, rain, etc.

Taking into account all the aforementioned points together, we may safely contend that the borrower will win the case inasmuch as the bank had obviously not taken as much care of the goods (stocks of paper) bailed to it as a man of ordinary prudence would, under similar circumstances, take in the case of his own goods of the same bulk, quality, and value, as the goods bailed.

Problem 2

Krishna Iron Works Limited, a private sector company, had pledged the stocks of pig iron and iron ingots with the Bank of Lucknow. Further, as these stocks do not get damaged due to fire, a fire-insurance of such stocks may not be warranted. But then, if any theft would take place of any goods pledged to the bank, and if these were not insured against theft, the bank may be held responsible, by virtue of it being a bailee, too, and may, therefore, have to compensate the borrower with the cost of the damages/loss sustained due to theft. But again, as we all know, in the event of getting the goods insured against theft, the fire-insurance thereof is a necessary pre-condition. But then, fire-insurance of pig iron and iron ingots may be most unwarranted; an unwise action and a wasteful expenditure, on the part of the borrower. In this connection, both the banker and the borrower company have approached you for your expert legal advice such that the borrower company may be saved of the aforementioned wasteful expenditure, and the bank also may be absolved of the responsibility of a bailee, who is required to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take in the case of his own goods of the same bulk, quality and value as the goods bailed. What will be your expert legal way out in this case? Give reasons for your answer.

Solution

In the instant case, the banker, with a view to playing safe, will be well-advised to just send a letter, to the borrower concerned, suggesting therein that the stocks pledged to the bank may be got insured against theft, if the borrower considered it necessary to do so. Further, the duly acknowledged copy of such letter, signed by the borrower, must be kept, along with the other legal documents with the bank, so as to prove, in the Court of law, at any later date, that the bank had taken due care to forewarn the borrower to get the stocks insured against theft. And, in case the borrower (pledgor) had preferred, not to get the stocks insured against theft, as suggested by the bank, he himself should be held solely and exclusively responsible in this regard,

and not the bank in the role of a bailee/pledgee. This way, the borrower company may also be saved of the aforementioned wasteful expenditure, and the bank also may be absolved of the responsibility of a bailee in this regard.

Problem 3

Kishore had taken a loan from a bank against pledge of certain goods. In the relative pledge agreement, the bank had taken extra precaution to incorporate a clause therein to the effect that in the event of default by the borrower in the repayment of the loan amount with interest, on demand and/or when due, the bank will be entitled to sell the pledged goods without giving any prior reasonable notice of such intended sale to the borrower (pledgor), though required under Section 176 of the Indian Contract Act. On the strength of this clause, when the borrower had become a wilful defaulter in repayment of his debt, the bank had sold out the goods without giving any prior reasonable notice of such intended sale. Thereafter, the borrower had filed a suit in the Court of law claiming damages from the bank on the ground that the pledged goods were sold out by the bank without giving him a reasonable notice of such intended sale, in contravention of the legal provision to this effect in Section 176 of the Indian Contract Act. The bank, on it part, had pleaded in the Court that it had done so on the strength of the contract entered into between it and the borrower, in writing, to the effect that such prior reasonable notice will not be required to be given by the bank to the pledgor. In view of the foregoing circumstances, and the arguments advanced by each of the two parties involved in the case, which one of the two is likely to win the case? Give reasons for your answer.

Solution

Under Section 176, in the event of the pledgor failing to repay his loan, or to completely perform his promise/obligation, at the stipulated time, the pledgee is entitled, *inter alia* (i.e. among other rights) against the pledgor: 'to sell the pledged goods after giving reasonable notice of such sale to the pledgor'.

In the case, **Prabhat Bank Ltd. vs Babu Ram (AIR 1966, All. 134),** the learned judge had observed: 'What is contemplated by Section 176 is not merely a notice but a 'reasonable' notice, meaning thereby a notice of intended sale of the security by the creditor within a certain date so as to afford an opportunity to the debtor to pay up the amount within the time mentioned in the notice'.

It was further held by the Allahabad High Court in the aforementioned case itself that, even in the case of there being a contract between the pledgor and pledgee to the specific effect that such notice will not be required to be given by the pledgee to the pledgor, the notice will necessarily have to be given all the same, inasmuch as it is so required by a specific provision of the law, and any such clause in the relative agreement to the contrary, will be deemed to be inconsistent with the provisions of the Act, and hence void and unenforceable.

In view of the aforementioned judgement given by the leaned judge in a similar case, the borrower will win the case and the bank will have to pay the damages to the borrower (pledgor).

Problem 4

In Problem 3 above, as the pledged goods were sold by the pledgee without giving reasonable notice to the pledgor, in contravention of Section 176 of the Act, such sale will be held as void or valid; that is, whether it may be set aside.

Solution

In the instant case, the sale will not be held as void but valid; that is, it may not be set aside. In such cases, however, the pledgee will be held liable to the pledgor for the damages.

Problem 5

Wasim had taken a loan from a bank for a sum of Rs 5 lakh against pledge of the stocks of inventories (i.e. raw materials, work-in-process and finished goods). But after some time, the outstanding debit balance in his loan account had become Rs 6 lakh by application of the periodical interest therein. The borrower, Wasim, had not been repaying the amount of the loan, along with the amount of interest applied thereon, despite repeated reminders and even personal approaches made by the Bank Manager in this regard. The bank had, thus,

deemed Wasim as a wilful and recalcitrant borrower. Accordingly, the bank had sent a registered notice to Wasim to the effect that in case he will not repay the loan amount with interest and other charges presently aggregating Rs 6 .25 lakh, the entire stocks of inventories pledged on his account will be sold out by way of public auction, after 15 days from the date of the letter. The particular date so stipulated by the bank for the intended sale was also specifically mentioned in the letter. And, on legal advice, this much of prior notice, i. e. of 15 days, for the intended sale, was considered to be a sufficient and reasonable notice, as stipulated under Section 176 of the Act. As Wasim had failed to repay the entire outstandings on his loan account by the date, stipulated in the bank's aforementioned notice, the bank had proceeded with the sale of the pledged stocks by way of a public auction. But the amount realised by way of public auction was Rs 5 lakh only. In the instant case, is there any further legal remedy available to the bank to realise the balance amount still outstanding on Wasim's loan account? Give reasons for your answer.

Solution

As in the instant case, the sale proceeds of the pledged goods are found to be insufficient to meet the entire obligation of the pledgor, Wasim (i.e. the amount of principal with interest and other charges), to the pledgee (bank), the pledgor (Wasim), will be still held liable to pay the balance amount to the pledgee (bank), as per the provisions of Section 176 of the Act. Thus, the bank can now file a civil suit against the borrower (pledgor) and proceed against him (Wasim), for the recovery of the balance amount still lying unpaid.

Problem 6

What would be the legal position, if in Problem 5 above, the pledged goods were sold for a higher amount, say for Rs 7 lakh, instead of Rs 5 lakh? Give reasons for your answer.

Solution

In this case, the sale proceeds of the pledged goods are found to be greater than the entire obligation of the pledgor, Wasim (i.e. the amount of principal with interest and other charges), to the pledgee (bank). Thus, as per the provisions of Section 176 of the Act, the surplus amount, so left out of the sale proceeds of the pledged goods, after meeting the entire obligation of the pledgor to the pledgee, belongs to the pledgor and, accordingly, the bank must return such surplus amount to Wasim, the pledgor.

Problem 7

In Problem 5 above, when the goods were being sold through public auction, and the final selling price was being settled for Rs 5 lakh, which happened to be short of the total amount of the debt (i.e. amount of principal plus interest and other charges) payable by the pledgor, Wasim, the defaulting debtor, wanted to exercise his right of redemption of the goods at that lower price, i.e. at Rs 5 lakh, by way of availing of the last opportunity. Can Wasim be allowed to do so? Give reasons for your answer.

Solution

In the aforementioned circumstances, Wasim, the defaulting borrower cannot be allowed to redeem the debt by paying an amount which happens to be lesser than the entire obligation of the pledgor, Wasim (i.e. the amount of principal with interest and other charges), to the pledgee (bank); he will, instead, be required, under Section 177 of the Act, to pay and settle the entire outstandings on his loan account. This is so, because otherwise the borrowers will get the incentive to allow for the settlement of a lower price for the sale of the goods, and thereby to get back the goods himself at such lower price. It thus, seems quite reasonable that the pledgor should be required to pay the entire outastndings on the account, failing which the goods will get sold of for a lower amount, at the deprivation and detriment of the pledgor, and he will have to repay the balance amount still remaining outstanding on his loan account.

Thus, the pledgor, the defaulting debtor Wasim, can exercise his right to redeem his goods as a final opportunity before the sale deal is completed, but only against the repayment of the entire dues outstanding in his account, and not merely at the value of the final sale deal.

Appendix 14.1
Pledge, Hypothecation, and Mortgage: A Comparison

(A) Pledge and Hypothecation

(i) Fixed (specific) vs Floating (fluid, fluctuating, changing) Charge

As against pledge, in which case the charge is specific and fixed (i.e. it relates to only those specific items of goods actually pledged), the charge of hypothecation is in the nature of a floating charge, in that all the goods that are stored and stocked in the company's godown(s) or factory premises, etc., or even in transit, automatically get charged (hypothecated) to the bank, and the moment these stocks are taken out of the company's godowns, factory premises, etc., and/or from the possession of the company, such goods automatically get released, and are, accordingly, deemed to be out of the bank's charge (of hypothecation) too.

Thus, the various items of the goods keep going out and fresh items of the goods keep coming in, and the moment such goods come in, these get automatically charged, by way of hypothecation, to the bank. Similarly, the moment these goods go out of the possession of the company, these also get out of the hypothecation charge of the bank, simultaneously. Thus, as the actual (specific) stocks of goods, this way, keep changing and are turned-over, the charge of hypothecation is referred to as the floating charge, an ever-changing charge, over the ever-changing items of goods and stocks.

As we have seen earlier, while the charge, in respect of pledge is fixed and specific, in terms of the specified goods pledged, the charge in respect of hypothecation keeps floating, fluctuating and changing, with each and every 'entry' and 'exit' of the goods. The hypothecation charge, thus, keeps shifting and changing over, with each and every event of the turnover of the goods.

(ii) Sale of Goods Pledged vs Hypothecated

In the case of the goods pledged against advances, the pledgee has the lawful right to sell the goods pledged, without obtaining specific prior permission of the Court, in the event of the pledgor failing to pay the debt, in time. Thus, in the case of pledge, the pledgee can sell the goods pledged, after giving a reasonable notice of such intended sale to the pledgor (as per **Section 176** of the Indian Contract Act). The pledgor, however, in turn, has the right to redeem (vide **Section 177** of the Indian Contract Act).

But, as against this, in the case of hypothecated goods, these cannot be sold off, to recover the outstanding in the loan account, without prior specific written order of a competent Court, on this behalf. The sale of the hypothecated goods, without the Court permission may, however, become possible and permissible, provided the charge of hypothecation itself is got converted into the charge of pledge, instead, by the simple act of the delivery of a pledge letter, duly signed by the borrower concerned, to this effect.

But then, a defaulting and recalcitrant borrower may usually be most unwilling to sign such letter of pledge, so as to convert the charge of hypothecation into that of pledge, inasmuch as this is, obviously, going to be against his own 'interest'.

In such cases, however, some 'prudent and pragmatic' bankers, if we may say so, have acted smartly (or have over-acted, over-smartly) by forcing the borrower, under coercion, to per force sign the letter of pledge, knowing full well that an agreement, signed under pressure, or threat makes such an agreement as voidable (not void *ab initio),* i.e. at the option of the party whose consent was so caused (vide **Section 19** of the Indian Contract Act). But then, such agreement may turn, and be treated as, void, only and only after it is proved to have been obtained under coercion (i.e. under threat) and/or undue influence.

A live example may illustrate and clarify the point.

Illustrative Case One
'Down the Shutter'

Rakesh Mohan, the chief manager of a public sector bank, had gone to the shop of a defaulting borrower, to request him to sign a letter of pledge, converting the charge of hypothecation into pledge. But, the borrower was, naturally, most reluctant to do so. When all sorts of appeasements, appeals, and pleas failed, Rakesh Mohan lost his temper, and asked his junior officer, accompanying him, to down the shutter of the shop and lock him (the borrower) inside his own (small) shop, and let him die there, for lack of fresh air and oxygen. The junior officer, standing by, got the signal and readily complied with the instructions, instantaneously. Soon thereafter, both of them left the place. But then, the prudent and pragmatic officer came back (on the advice of the chief manager), and started counselling the recalcitrant borrower to come to terms and sign the 'simple' pledge letter, and save his precious life, sharing with him, a 'top secret', in a serious and sincere manner, that the bank manager, though apparently a soft spoken and kind-hearted person, was, in fact, a very tough and daringly dangerous person, so much so that he had been reported to have been responsible even for some three/four murders, by now. This, surely and suddenly scared the borrower and he readily agreed to sign the pledge letter, and ultimately did so, too. Rakesh Mohan, thus, had all smiles on his face—a victorious smile—(the virtue or vice whereof is not the point of debate or discussion here).

One may wonder and start arguing that it was most immoral and illegal on the part of the bank manager to have acted in such an irresponsible and uncivilised and, above all, in a blatantly illegal and unlawful manner, most unbecoming of a responsible and senior officer of a bank, in the public sector. But then, one must always bear in mind that being in the business or in the bank, one must have some practical and pragmatic business-sense; neither moral nor immoral but, a-moral. And, as the adage goes – 'Possession is ninety per cent ownership'.

Just take a hypothetical case. Suppose that a well-built person, lawyer by profession, is walking on the street, and a road-side raffish person pushes him, and slaps him on his face, for no fault of him (lawyer). The lawyer, too, instantaneously and, by way of a natural reaction and a reflex action, may raise his hand to slap him back. But then, he may stop mid-way, reflecting back, on his immense knowledge of law, that slapping him back may tantamount to assault, which is a cognisable and punishable offence under some specific Section(s) of the Indian Penal Code (IPC), with imprisonment or fine, or both.

Such law-abiding person may be ideal, but, at the same time, too dull and idle, to take prompt and appropriate action, in the right and ripe time, and may go on getting slapped, off and on, for no fault of his own. This is so, because, it may prove to be too difficult to prove the aforesaid offence in the Court of law.

Similarly, if the aforesaid recalcitrant and defaulting borrower would plead in the Court of law that he was forced and threatened by the bank manager, to sign the letter of pledge, the bank manager may, in turn, plead to the court somewhat like:

'My Lord! I am a responsible and law-abiding officer of a public sector bank, and am not expected to have behaved the way I am being alleged by the defaulting borrower to have done. The allegation is most baseless and fabricated, an after-thought and blatant lie, with a view to avoiding the payment of the loan amount', and so on. Thus, the honourable judge may, most likely, tend to believe the contention of the bank manager, as against that of the defaulting borrower, the facts of the case being to the contrary, notwithstanding.

We are, however, by no stretch of imagination, suggesting that we should always act in the manner Rakesh Mohan had done, in the instant case. But then, it is a matter for serious consideration as to how moral and legal is the action and behaviour on the part of the borrower, who is wilfully defaulting to repay the loan of the bank, and thereby, defrauding the public money. An 'appropriate' and 'effective' action needs to be taken promptly, with some pragmatic wisdom, depending upon the merit and circumstances of each case.

Suffice it to say that, ***'If threat can do the trick, go, do it, or get it done'***. This act may well be termed as an administrative and business strategy, and mostly a winning strategy at that.

(iii) Priority of Pledge over Hypothecation

We have seen earlier in Chapter 14, Sub-section 14.8(ii) that, as per the provisions of law, the charge of pledge, created subsequently, after the creation of the charge of hypothecation, may have the priority and preference thereto (though created afterwards) provided, of course, the pledgee did not have the knowledge and notice of the prior charge of hypothecation.

Registration of the Charge(s) of Hypothecation:

Under **Section 125 of the Companies Act, 1956**, the charge of hypothecation of stocks of inventories and book debts [as also of equitable mortgage, created by the deposit of the title deed (usually in original) of the immovable property charged] must be registered with the Registrar of Companies, within 30 days from the date of the creation of the charge. The application, along with the relative legal agreement documents, should be filed in the office of the Registrar of Companies concerned. Such application can, however, be filed either by the borrower or by the creditor (banker) concerned.

Such registered charges may as well be got vacated, but such application, for the vacation of the registered charge, can be filed only by the borrowing company, and not by the creditor concerned.

Here, it must be observed and emphasised that, as per the requirement of law, the application, for the registration of the charge, along with the relevant documents, must be filed with the Registrar of Companies within the stipulated time, and it is not necessary that it should be actually recorded and registered by the Registrar of Companies in his books, and/or a certificate of such registration must be issued by the Registrar of Companies, within such stipulated time itself. Just the act of filing, within the stipulated (30 days) time, is good enough.

Such application, along with the copies of the relative documents creating the charge, along with the brief particulars thereof, is to be submitted on Form-8, in triplicate.

[It may, however, be pertinent to mention here that the application for the modification of the charge, or the satisfaction of the charge, is required to be submitted on Form-10 and Form-17, respectively, in triplicate.]

Further, the registration of the charge, created by way of pledge of movable items of goods and/or movable items of machinery, is not statutorily compulsory, though it is permissible, all the same. The words used in the Companies Act are 'not being a pledge', which implies that the intention of the framers of the law was that such registration (of pledge) should not be necessary, inasmuch as the creditor, in such a case, happens to be in the possession of the goods charged (pledged).

Date of Notice of the Charge

Under Section 126 of the Companies Act-1956, the date of the execution of a charge (i.e. the date of the signing of the relative documents), is the date of creation of the charge, for the purpose of computing the time for its registration, prescribed by **Section 125 of the Companies Act, 1956**.

Priority between the Charges of Hypothecation

If the charge has been executed earlier to another charge, but had been got registered afterwards (of course, within the prescribed time limit of 30 days), such a charge (executed earlier) will have the priority over the other; it having been registered subsequently, notwithstanding.

For example, suppose that the charge of hypothecation is executed by ABC Company on 30th November 2008, in favour of one creditor, and again subsequently on 21st December 2008 in favour of yet another creditor, and if these were filed for registration on 27th and 23rd December 2008, respectively, the charge executed on 30th November 2008 will have the priority over the charge executed on 21st December 2008, though the charge dated 30th November 2008 was filed for registration, subsequently, i.e. on 27th December 2008, but of course, within the stipulated time of 30 days.

In view of the aforesaid provisions of law, the banks usually take the following precautions:

Before granting any advance to a company, against the charge of pledge or hypothecation, the banks first undertake a thorough search in the office of the Registrar of Companies (where the company concerned is registered with) to ascertain, as to what are all the various charges, already created by the company in favour

of the other creditors, and whether any of the goods, now being charged to the bank, are already charged to some other creditor(s) by way of hypothecation or even pledge. Thereafter, only if the securities, now being offered, were found to be unencumbered in all respects, the bank would go ahead with the creation of the charge in its favour, and execute the necessary documents.

Further, after the bank and the borrower execute the necessary hypothecation documents, such documents are promptly submitted to the office of the Registrar of Companies concerned, for the purpose of registration of the charge in his books.

This is a must, inasmuch as such registration is deemed to be a due public notice and thus, any subsequent charge, on the goods concerned, even by way of pledge, will not have any priority or preference, over such hypothecation charge.

Such documents have to be filed in the office of the Registrar of Companies within 30 days [raised from 21 days, vide Section 62 and the Schedule to the Companies (Amendment) Act (31 of 1965) w.e.f. 15.10.1965] from the date of its execution (vide **Section 125 of the Companies Act 1956**).

Further, after a month from the date of the execution of the document, yet another search needs to be conducted in the office of the Registrar of Companies, this time to ascertain whether any other charge had also been created, a little before the creation of such charge on the goods in favour of the bank, because, in that event, the prior charge of hypothecation will naturally have the priority and, thus, a preferential treatment, *vis-a-vis* the bank's subsequent charge.

This is so because, the public has been given 30 days time to get the charge registered with the Registrar of Companies. Thus, a charge of hypothecation, created on 30th November 2008 can well be submitted for the required registration up to 29th December 2008 and, similarly, the hypothecation charge created in favour of the bank on 21st December 2008 can well be filed for registration by 19th January 2009. Further, supposing that the bank has filed the legal documents for registration of the charge with the Registrar of Companies on 23rd December 2008, and the other (prior) creditor as late as on 24th December 2008, the charge of the other (prior) creditor will have the priority over that of the bank, inasmuch as the priority will be computed from the date of the creation of the charge, and not from the date of the filing of the charge, inasmuch as the filing is valid, in the eye of law, so long as it is done within the stipulated time, i.e. within 30 days from the date of the execution of the documents. This is the rationale behind undertaking the second search in the office of the Registrar of Companies, after say, a month or so, of the execution and filing of the hypothecation documents in the office of the Registrar of Companies, for registration purposes.

One more word of caution and extra precaution. Usually, the formal recording in the office of the Registrar of Companies may take some time, maybe a couple of months or even more. Therefore, the bank's officer must take care to look into all the other documents filed with the Registrar of Companies for recording in its Register, though these are still lying pending for registration, of course, only such documents need to be verified which have been filed upto one month after the execution of the documents by the bank. This is so, because of one of the following two reasons:

(i) Either, the documents have been got executed well before the bank but the creditor has failed to get it registered with the Registrar of Companies, and the stipulated time (30 days) has lapsed;

(ii) Or, the documents have been got executed after the date of its execution in favour of the bank.

Thus, in the case number (i), as the stipulated period (30 days) has already elapsed, the same document may not be got registered, after the expiry of the stipulated 30 days. Accordingly, fresh sets of documents will have to be got executed, whereby the date of their execution will fall subsequent to the date of the execution of the documents by the bank, and hence the bank's charge will have the priority.

In the case number (ii), however, as the documents have themselves been got executed subsequent to the execution of the documents by the bank, these naturally, cannot have the priority over those of the bank.

But then, it will augur well if the bank will prefer to have such searches conducted in the office of the Registrar of Companies at regular half-yearly or yearly intervals to ensure that no subsequent charge (even second charge) has been created and registered, or even submitted for registration, with the Registrar of

Companies. In such cases, the documents pertaining only to the intervening period need to be perused and examined.

Possession and Ownership

While in the case of pledge, the possession of the goods pledged are transferred to the pledgee, in the case of hypothecation, however, the possession of the goods continues to remain with the borrower (hypothecator); only a floating charge is created thereon, in favour of the bank or the other creditor. But, so far as the ownership of such goods is concerned, it remains with the borrower in the cases both of the pledge and hypothecation.

(B) Mortgage

Distinction between the Charge of Pledge and Hypothecation vs Mortgage

While the charges by way of pledge and hypothecation are created in respect of movable goods or items only, the charge in regard to immovable property (land and building) or even immovable items of plants and machinery, are required to be created necessarily by way of mortgage only.

Mortgages are broadly of two types

(i) Registered Mortgage, and
(ii) Equitable Mortgage (by deposit of title deeds).

Why Equitable Mortgage?

The rationale behind creation of the charge by way of equitable mortgage lies in the fact that the stamp duty exigible in the case of an equitable mortgage is nominal, i.e. the relative documents are required to be stamped as a simple agreement. As against this, the documents pertaining to the registered mortgage have to be stamped ad valorem [i.e. as per the value of the relative document (like the debenture deed)], which may come to a very huge amount, as the large scale companies usually issue debentures for a very large amount.

However, if we look at the relative advantage of the registered mortgage, it lies in the fact that such mortgage has the effect of giving a public notice, and thereby, any subsequent mortgage may not be held valid in the eyes of the law. But then, in the case of limited liability companies, even the charge created by way of an equitable mortgage, is required to be reported to, and registered with, the Registrar of Companies, which too, has the effect of a public notice. This is so because, all the creditors, before accepting any asset of a company as a security against the advance, are required to make a search in the books of the Registrar of Companies at his Office (on depositing a nominal search fee, for the purpose), with a view to ensuring that no prior charge has already been registered in regard to the immovable assets and properties, now being offered by the company as a security against the current advance now being granted to the company.

How is the Equitable Mortgage Created?

It will augur well for the officers in the banks and business to get a fairly good idea as to the detailed procedure involved in the creation of the charge by way of an equitable mortgage.

The Directors of the company, duly authorised by the company on this behalf, through a resolution passed by the company to this effect, come to the office of the branch manager of the bank, at the branch concerned. They then stand up and actually hand over the relative title deed, in original, to the branch manager, stating that they are hereby delivering the relative title deed to the bank on behalf of the company with the intention of creating an equitable mortgage on the same, by depositing the title deed, for the purpose. Thereupon, the branch manager stands up and accepts the title deed accordingly, and keeps it in his custody on behalf of the Bank.

The aforesaid act takes place in the presence of at least two witnesses, and all of them must be the bank officials only. Why so? Because, the whole episode is recorded in the Branch Document Register and is duly signed by the bank manager as also by the witnesses. Further, as all these signatories are signing on behalf of the bank only, no stamp duty becomes exigible thereon, as it does not amount to an agreement, inasmuch as it has been signed by, and on behalf of, a single party (i.e. the bank). As against this, if it were to be signed by

the witnesses belonging to both the bank and the borrower, it may have been construed as an agreement, and may have, therefore, to be stamped accordingly.

The borrower company is also required to hand over the title deed along with a title deed delivery letter, so as to evidence, in writing, that the title deed was actually delivered to the bank manager for the aforesaid purpose. Otherwise, the executives of the company may always have the option of taking the plea that the title deed was not actually delivered, but they had, by mistake, left the same in the bank manager's office, through an oversight. In that event, the equitable mortgage may not be held to be valid in the eyes of law.

The matter does not end here. The bank manager, by way of an abundant precaution, also hands over a printed proforma letter to be duly completed and signed by the Directors, on behalf of the company, and then to be posted later, per registered post, which too, is recorded at the branch of the bank, along with the other relative documents. This, too, is held as an evidence to prove that the equitable mortgage was created with the free will of the Directors and that the earlier Title Deed Delivery Letter was not got signed by them under duress, in which case the contract, as per the Contract Act, may be treated as void, *ab initio*. It may be worthwhile to mention here that, the relative proforma has also since been printed by way of an Inland Letter, so as to incontrovertibly prove that the same letter had been sent by the company's Directors, per registered post, inasmuch as if sent in an envelop, some unscrupulous companies could as well take the plea that some other letter (and definitely not the Title Deed Delivery Letter) was sent under the cover (envelop) in question, sent per registered post.

Immovable Items of Machinery

As per the Transfer of Property Act, all the immovable property, including the immovable items of machinery, are required to be mortgaged, and that the charges by way of pledge and hypothecation can be created only for movable items of machinery and other movable goods.

Here, we must know that the items of machinery, embedded to earth, are treated as immovable. But, if say, only the four iron frames/angles are embedded to the earth, and the heavy lathe machine's all the four legs are tightened thereto, with nuts and bolts, such that the lathe machine can easily be removed just by loosening and removing the nuts and bolts, leaving the four iron frames/angles undisturbed, the whole lathe machine is considered to be movable. As against this, if the legs of the lathe machine themselves were embedded to the earth, and the machine could not have been removed without digging and disturbing the 'Mother Earth', it would be treated as an immovable property in the eyes of law, and accordingly, may necessitate mortgage thereof.

Primary and Collateral (Additional) Securities

A prudent banker always tries to play safe enough, and therefore, insists on some collateral (additional) securities, too, in addition to the primary security. To put it differently, a prudent banker wants to tighten his pant, not with belt alone, but with suspenders, too, so that if one of them incidentally breaks, the other would hold the pant in place. Therefore, the banks usually take additional security by way of:

(i) Third party guarantee, and/or
(ii) Equitable mortgage of some fixed assets or immovable properties, in addition to those purchased out of the term loan granted; and/or
(iii) By way of pledge/hypothecation of the company's current assets, already charged against working capital loans, by way of the second charge thereon.

Thus, while the assets purchased out of the loan amount itself are considered to be the primary security, any other securities, as aforesaid, in addition thereto, are known as the collateral (or additional) securities. Similarly, in case of working capital loans, the current assets (like inventories and sundry debtors) may be treated as primary security (inasmuch as the Drawing Power is determined thereagainst). Further, any other security, obtained by way of the third party guarantee and/or equitable mortgage of some other immovable property, would be considered as the collateral (or additional) security.

Precautions to be taken by the Creditors (Bankers) in case of Pledge

The various precautions that the creditors (like banks) must take in the case of pledge may be well-understood and appreciated with the help of the following illustrative live case.

Illustrative Case Two
'The Rightful Pledgee'

One of the borrowers of the State Bank of India (SBI) had fraudulently taken concurrent borrowings from another bank also, on the security of pledge of the same stocks stored in the same godown, having two entry doors on the opposite sides of the godown. One day, when the godown-keeper of State Bank of India (SBI) had gone to effect the delivery of some stocks from the godown, he, to his utter surprise, happened to see that the godown-keeper of the other bank had also come to the godown premises. On enquiry, he found that the same stocks were pledged to the other bank, too, and its godown-keeper had come to effect some delivery and pledge in the same godown. Being a smart and intelligent person, he immediately rushed to his branch office, took the required number of locks, engraved with the name of the bank thereon, and locked all the entrances to the godown from out side, even over and above the locks of the other bank, wherever these were found. Besides, all the doors were locked from inside, too, which could be used as an incontrovertible evidence as to which of the two banks actually had the entry into the godown. Further, as per the practice of State Bank of India (SBI), the godown card was also kept inside the godown, wherein the entries, matching with the entries in the godown register, appeared on a day-to-day basis.

Thus, in the Court of law, the State Bank of India (SBI) could prove, beyond doubt, that the officials of State Bank of India (SBI) alone had the entry inside the godown, and that the other bank apparently and obviously had put on its lock later, and that too, only from outside, as there was no documentary (or even circumstantial) evidence to prove that its officials had ever gone inside the godown.

Learning Points from the Illustrative Case

(i) It may, therefore, be gathered from the Case that the bank officers must invariably make a thorough inspection of the godowns (in a completely empty state) wherein the goods are proposed to be stocked and stored, and ultimately pledged to the bank, so that all the entries into the godown, from outside, could be thoroughly checked.

(ii) Further, all the doors and locking arrangements should be verified to be strong enough to prevent any easy unauthorised entry into the godown.

(iii) As a matter of abundant precaution, all the entry doors and windows of the godown should be locked from inside, too, to prevent any unauthorised entry from outside.

(iv) Further, all the locks affixed therein must bear the bank's name prominently engraved thereon, so as to constitute as a public notice that the stocks stored therein are already pledged to the bank.

(v) Prominently painted signboard should also be distinctly displayed at the main entrance to the godown, as also on the other sidewalls, etc., to serve the purpose of giving a public notice, as aforementioned.

(vi) A set of godown cards must also be kept inside the godown, wherein the entries, matching with the entries in the godown register, should be made by the bank officials, on a day-to-day basis, so as to prove, beyond doubt, that the officials of this bank alone had the entry inside the godown, wherein the pledged goods are stored.

(vii) Above all, after accepting the pledge of stocks with all possible precautions taken, as aforementioned, the creditors would do well to be ever alert and to keep a regular vigil over the pledged stocks so as to avoid and avert any possible deterioration of the pledged goods and/or adversely affecting the interest of the creditor (banker) in any manner, at any of the post-pledge stage.

Chapter Fifteen

Contract of Agency

"*Obedience is the fruit of faith.*
Christina Rossetti

Let every eye negotiate for itself and trust no agent.
William Shakespeare

Don't trust the person who has broken faith once.
William Shakespeare

It is better to be faithful than famous.
Theodore Roosevelt

Absolute faith corrupts as absolutely as absolute power.
Eric Hoffer

Faith lives in honest doubt.
Lord Alfred Tennyson

Every act is to be judged by the intention of the agent.
Source Unknown"

15.1 Who is an Agent?

An agent is a 'person employed to do any act for another or to represent another in dealings with third person' (**Section 182**). Thus, an agent is one who acts on behalf of, or represents another person. The person on whose behalf he acts, or whom he represents, is referred to as the 'Principal' (**Section 182**). The relationship

between these two persons, viz. agent and principal, is known as the agency, and the contract between them is referred to as the contract of agency, which may be either expressed or even implied.

Example

P appoints A as his agent to sell his house on his behalf. Here, P is the 'principal', A is the 'agent', the relationship between P and A is that of 'agency', and the contract between the two is known as 'contract of agency'. We may thus, observe that, the function of an agent is to establish a contractual relationship between his principal and the third persons/parties. He thus, rightly serves as a connecting link, a 'conduit pipe' between his principal and the third persons/parties.

Accordingly, when he acts on behalf of his principal, within the scope of his authority given to him by the principal, and transacts some business deal with the third party, he binds his principal to such business deal, as if the principal himself had transacted the deal, though through his authorised agent, authorised by him on that behalf. This is based on the dictum: 'He who does through another does by himself.'('qui facit per alium facit per se'). Simply put, the act of the agent is the act of the principal himself.

15.2 Competence to Appoint an Agent

As per **Section 183**, any person who is of the age of majority according to the law to which he is subject and who is of sound mind, may employ an agent. Conversely speaking, a minor and a person of unsound mind (lunatic), who cannot enter into a contract himself, cannot enter into a contract of agency, and cannot appoint even an agent, and accordingly, cannot enter into a contract through his agent either. Thus, a person who contracts as an agent of a minor or a lunatic cannot bind third parties thereby. Instead, he himself will be bound by such a deal as against the third party. A group of persons, like a partnership firm, or a company, can also appoint an agent, and transact through him. In fact, a company, being a legal entity (and thus, only an artificial person), can invariably transact only through an agent.

15.3 Competence to Become an Agent

We have seen in the preceding paragraph that a person, who is not competent to contract himself, cannot appoint an agent, either. But such person who is not competent to contract (like a minor or a person of unsound mind), can very well be appointed as an agent of a person who himself must be competent to contract. This is so because the agent is only a connecting link, a 'conduit pipe', between his principal and the third persons/parties, and therefore, his himself being competent to contract is not necessary. He can bind his principal without binding himself. That is to say that a contract entered into between an agent (who is a minor or is of unsound mind) and a third party, can very well bind the principal *vis-à-vis* the third party, but not the agent who happens to be a minor or a person of unsound mind. This is so because **Section 184** clearly lays down that 'As between the principal and third persons, any person can become an agent, but no person, who is not of the age of majority and of sound mind, can become an agent, so as to be responsible to his principal according to the provisions in that behalf, herein contained'. In other words, if the agent happens to be a person not capable of entering into a contract himself, such agent cannot be held liable by his principal for his (agent's) misconduct or negligence in performance of his duties as an agent.

Example

P appoints A, a minor, as his agent to sell his house for a minimum price of Rs 10 lakh. A, however, sells P's house to B for Rs 9 lakh, instead. Under such a contract, P will be bound by the transaction of the sale of his house to B for Rs 9 lakh only. But then, P cannot hold A liable for compensation for disobeying the instructions of P (for having sold the house for an amount lesser by the minimum stipulated price by Rs 1 lakh). This is so because A is a minor, and any contract with a minor is *void-ab-initio.*

15.4 Agent vs Servant

The agents, as also the servants, are obliged to follow all the reasonable instructions of their respective masters. But, while the servant acts on specific orders of his master under his direct supervision and control, the agent, on the other hand, does not act under the direct supervision and control of his principal, though he has to work within his limited authority. Further, while a servant has to work exclusively for his single master, the agent can work for more than one principal at the same time. It may, however, be said that while a servant may also act as his master's agent under certain circumstances, the agent never acts and works as a servant at any time.

Creating Agency without Consideration

At the very outset it may be clarified that under **Section 185**, the contract of agency may be created even without any consideration being there. The very fact that the principal has consented to be represented by a person as his agent, by itself constitutes a sufficient consideration to hold the promises made by such agent valid and binding on the principal. But, in the absence of any consideration, the person is well within his rights not to act as his agent. But again, once he starts doing the agreed work as an agent, without consideration, he has to complete that assignment, to the satisfaction of the principal, even without consideration.

15.5 Different Modes of Creating Agency

A contract of agency may be created by way of the following different methods:

(a) Agency by Expression (Written or Verbal) , i.e. Express Agency

An agreement of agency may be entered into in writing or even verbally; and in both these cases, such agreement will constitute an express agency. Further, there is no specifically prescribed format of an agency agreement. In fact, usually, an agreement of agency is created by executing a 'power of attorney' on a stamped paper **[Section 187].**

(b) Agency by Implication, i.e. Implied Agency

Where an agency emerges from the conduct, situation or relationship, of the two parties, it is referred to as the implied agency **[Section 187].**

Thus, an implied agency comprises the following types of agencies:

(i) Agency by Estoppel

When a person, by his statement or behaviour, induces the other persons to believe that a certain person is acting as his agent, he is estopped from denying it at any later stage, irrespective of the fact whether it is true or otherwise **[Section 237].**

Examples

(a) Prakash permits Anurag to tell Shashank that he (Anurag) is working as the agent of Prakash. Taking Anurag to be Prakash's agent, Shashank supplies some goods to Anurag. Later, Prakash cannot take the plea that Anurag was, in fact, not his agent. Instead, he will be liable to make the payment for the goods supplied by Shashank to Anurag, in his capacity as the agent of Prakash. That is, having made Shashank to believe that Anurag was his (Prakash's) agent, he is estopped from subsequently pleading to the contrary, the fact being otherwise, notwithstanding.

(b) P lives in Bangalore. He owns a shop in Mysore also, which is being managed and looked after by A. Accordingly, A has to place orders to S, on behalf of P, for the supply of goods required for the shop. He

also makes the payment for these purchases to S periodically, out of the account of P, with the full knowledge of P. Occasionally, P pays his visit to his shop in Mysore also. In the foregoing circumstances, A has an implied authority from P to place orders with S, in the name of P, for the supply of the goods required for the shop.

(ii) Agency by Holding Out

Though being a part of the law of estoppel, some affirmative (positive) conduct is necessarily required to be performed by the principal for the purpose of creating an agency by way of holding out.

Examples

(a) M has employed S as his servant, a domestic help. He has allowed S to bring the goods for him from G on credit. At the end of each month, M regularly pays the cost of the goods bought by S on credit from G. However, once M gives the required cash to S to get some goods from G against cash payment. S, however, takes these required goods also on credit, instead, and pockets the amount for his personal use. In such a situation, M will be required under the law to make the payment to G, for the goods bought by S, inasmuch as, by way of his previous dealings and conduct of making payment of the goods bought by S on credit, M has held out S to be his agent.

(b) In the above example, if S would have got some goods, even of a reasonably high amount from G, and would have slipped away to his native town therewith, even then G can claim the amount from M, on the same aforementioned ground.

(iii) Agency of Necessity

Sometimes one may be confronted with certain special situations and circumstances where, despite there being no express or even implied appointment of a person as an agent of another person, the emergency of the situation may demand certain urgent action on the part of the person to act on behalf of the other person as his agent, all the same. The position can be better explained with the help of some illustrative examples.

Examples

(a) P has transported his cow to a particular destination by rail. But neither P nor his people turn up at the railway station to take delivery of the cow. Accordingly, the station master had to per force feed the cow to keep her alive. In such a situation, though P has not appointed the station master as his agent, expressly or impliedly, P will have to reimburse him (station master) for the expenses incurred by him in the maintenance of the cow for the period it was not taken delivery of by the consignee. In this case, the station master will be considered as the agent of P by necessity **[Great Northern Railway vs Swaflield (1874) LRS Ex 132]**.

(b) The same will be the position in a situation where a ship is on its voyage, and requires some urgent repairs, and therefore, the captain of the ship pledges the ship and/or cargo to raise the required high amount to meet the expenses for the urgent repair work so as to continue the voyage; there being no express or implied agency agreement notwithstanding. This will also be a case of the captain of the ship acting as an agent of the owner of the ship, by necessity.

The doctrine of 'agency by necessity' may also extend to the other situations where the agent has exceeded his authority, provided:

(a) It is not reasonably possible to get the special specific instruction/sanction of the principal in this regard;
(b) The agent has taken all necessary and reasonable steps to safeguard the interest of the principal; and
(c) He has acted in a *bona fide* manner.

(iv) Agency by Ratification (Sections 196 to 200)

The agent is expected to act only with the authority, as also within the prescribed limits, of his delegated powers, as authorised by his principal. Thus, in the cases where the agent acts, beyond his specified authority and without the knowledge of his principal, even though for his principal, such acts and transactions do not bind the principal, but the agent himself personally. But, under the provisions of **Section 196,** he (principal) can as well ratify such actions and transactions of his agent at a later stage, provided he chooses as such. And if he (principal) prefers to subsequently ratify his agent's such 'unauthorised' acts, it will have the effect of having been done as if under his authority originally itself. Alternatively speaking, the agency so created by ratification is deemed to have been in its existence right from the time the transaction or action concerned had been initially taken, and not subsequent to such ratification by the principal. In simpler terms, such ratification by the principal is invariably deemed to be effective from the retrospective and not prospective effect. The agency created under such circumstances is referred to as the 'agency by ratification'.

Example

The case of **Bolton Partners vs Lambert** is an illustrative case in point. Here, L had made an offer to B, the managing director of the company, which was accepted by B, despite the fact that, at the material time, B did not have the authority from his principal to do so. Later, L withdrew the offer. But, the company, on its part, subsequently, ratified the action (of acceptance of the offer) by B. It was held that L was bound by the acceptance of his offer by B on the following grounds:

(a) In view of the fact that the ratification becomes operative with retrospective effect, it (ratification) related back to the time of the acceptance by B, as if he had the authority to do so at the time of the acceptance itself.

(b) The withdrawal (revocation) of the offer was non-operative inasmuch as the offer once accepted cannot be withdrawn at any stage later.

It may, however, be noted in this context that the rule of relation back (i.e. being operative with retrospective effect), cannot apply if the agent were to reveal, at the material time, that he did not have the principal's authority to do such an act, and therefore, the approval or ratification of the principal will be required. In other words, the agent must not, at the material time, show that he lacked the authority to act as such, so that the rule of relation back (i.e. being operative with retrospective effect), could apply.

Accordingly, in the above example, if B would have accepted the offer of L, subject to ratification (approval) by his company, the subsequent ratification by the company will not be effective, if it were made after the revocation of the offer had already been made by L and communicated to the other party (B). This is so because, the ratification in such cases (where the agent has revealed that he lacked the required authority) does not apply retrospectively. But then, we should note that even in such cases (i.e. where the agent has revealed that he lacked the required authority), the subsequent ratification does apply, though only with prospective effect, and not with retrospective effect. Accordingly, in the above example, if the company had made the ratification, subsequent to the act of acceptance, but before the revocation of the offer by L, the acceptance by B would have been held valid.

Further, under Section 197, the ratification may not necessarily be express alone; it may be even implied. Some of the examples of implied ratification are given below.

Examples

(a) A lends P's money to B, though A did not have the authority to do so at the material time. But then, P accepts the amount of interest paid by B on the amount so advanced by A. Thus, the act of P, by accepting the amount of interest on the amount so advanced by A, has the effect of an implied ratification by P of A's action of lending money to B out of the funds of P.

(b) A purchases some goods for P without having such authority from P. However, P sells these goods to some other persons. Thus, the act of P, in selling the goods to a third party, constitutes an implied P's

ratification of A's act of making the purchase for P, despite having no such authority at the material time of the purchase.

Requirements of a Valid Ratification

The ratification to be valid must satisfy the following conditions/requirements:

(i) The agent must present himself to the other parties as an agent of some one else (being his principal), and must enter into a contract accordingly, that is, in the capacity of an agent only, and not on his own personal behalf, as if he was the principal himself. Conversely speaking, if he, despite being an agent of some one, presents himself not as an agent of some other person, but as if he himself was entering into the contract on his personal behalf, he cannot bind his principal under such contract. This is so because, after having entered into a contract in his personal capacity, he cannot later shift the responsibility and obligation to the other party (principal) after having made the other party (to the contract) to believe that he was not acting as an agent but in his on personal capacity, as if he was the principal himself.

(ii) Second, the principal must have been in actual existence at the material time when his agent was originally entering into the contract. Thus, if the promoters of a joint stock company, by way of acting as agents of the forthcoming company, enter into a contract at the preliminary stage of the formation of the company, on behalf of the company, which itself is yet to be formed and incorporated, such contract will not bind the company but the promoters themselves. This is so because a joint stock company, which itself was non-existent at the material time, cannot even ratify the contract after its incorporation at a later stage. Because, if such ratification would be permitted, it will relate back to the point in time (retrospectively, that is), when the promoters had initially acted, whereas at the material time the company (principal) was itself non-existent **[Kelner vs Baxter (1896)]**. This contention is based on the simple logic as to how at all is it possible for a person to enter into a contract, or to act in any manner, whatsoever, at the time when he himself was not in existence.

(iii) Further, the principal should not only be in existence at the material time, but should also be competent to enter into a contract at the same time. Thus, if a minor appoints an agent during the period of his minority, he will not be bound by the act of the 'so-called' agent, as he, by virtue of being incompetent to enter into any contract, can neither enter into a contract of agency nor can ratify it during the age of minority. In fact, he cannot even subsequently ratify it on his attaining the age of majority.

(iv) The ratification must be made within a reasonable time. However, the period, which may constitute a reasonable time, will depend upon the merit of each case.

(v) Further, the act to be ratified must necessarily be a lawful and valid act. In other words, any unlawful act or an act, which is *void-ab-initio*, cannot be ratified at any stage.

(vi) **Section 198** postulates that 'No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective'. In other words, the principal, ratifying the act of his agent, must be in the full and materially correct knowledge of the facts of the case. Here, the word 'materially' may go to suggest that if there is some minor deviation in the actual facts of the case, and its knowledge by the principal, which does not have any significant bearing, will not disqualify such ratification.

(vii) Moreover, the ratification must pertain to the contract in its entirety, and not only to some of its selected parts. Alternatively speaking, it is not permissible for the principal to ratify some of the parts of the act of his agent, which seem to be beneficial to him, and not to ratify the remaining other parts, which may seem to be rather disadvantageous or liability to him. In other words, the law demands that if you prefer to ratify, do so but only in full, or just do not ratify it at all.

(viii) Again, the principal, ratifying the act of his agent, must himself have the authority to enter into such contract or transaction. Thus, the company cannot ratify the contract entered into by its chairman and managing director (by virtue of being the company's agent) pertaining to something, which does not fall within the competence or scope of functions of the company (principal) itself.

(ix) Finally, the ratification, to be held valid, should not subject the third party to any damages or else to have the effect of terminating any right or interest of the third person **(Section 200).**

Examples

(a) A has not been authorised by P to demand the delivery of any property from P's tenants. A, however, serves notice on T (tenant) in possession of P's property, on behalf of P, to vacate it, failing which he (T) would be held liable for damages. T, however, does not comply with this demand. In this case, P cannot ratify the act of A at a later stage, so as to hold T liable for some damages.

(b) L is a leaseholder of P's property, terminable at any time on three months notice. A, however, has not been authorised by P to serve any termination notice to L on his (P's) behalf. Despite this fact, A unauthorisedly serves a termination notice on L. In such a situation, P cannot ratify the act of A at a later stage, so as to bind L.

15.6 Types of Agents

Agents may be broadly classified under the following categories:

(i) 'Special' and 'General'; and
(ii) 'Mercantile' and 'Non-mercantile'.

(i) 'Special' and 'General' Agent

A special agent is a person, who has been appointed to perform some specific task, or to enter into a specific contract, for example, to sell a specified property of P located in New Delhi. That is to say that a special agent has the authority to perform a specified task only, so much so that immediately on completion thereof, his agency terminates. Thus, after the sale of P's specified property, the agency in question comes to an end. Therefore, if such agent (A) does any further unauthorised act thereafter, on behalf of P, he cannot bind P thereby, if P does not later ratify such act. That is, A will be personally liable for his act for which he had not been authorised by P.

As against a special agent, a general agent is a person who has been authorised by his principal to represent him and perform all the activities on his behalf, pertaining to all the matters concerning a particular business; for example, the chairman, and the managing director of a company, the branch manager of a particular branch of a bank, a manager of a firm, and so on.

(ii) 'Mercantile' and 'Non-mercantile' Agent (also Referred to as a 'Commercial' and 'Non-commercial' Agent)

'Mercantile' or 'Commercial' Agent

A 'mercantile agent' has been defined under Section 2(9) of the Sale of Goods Act 1930 as the one who, in the usual course of business, has the authority as such an agent either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of the goods. The following types of agents fall under this category:

(a) Broker, who buys and/or sells properties or makes bargain or contract between the principal (referred to as the engager) and the third party, and charges for the services so rendered, which is commonly referred to as brokerage; for example the property broker, share broker, and so on.

(b) Commission agent, who also buys and/or sells goods, or to transact business on behalf of his principal, and charges commission for such services.

(c) Factor, who is given the possession of the goods with the authority to sell them. He can sell these goods in cash or even on credit, and even in his own name. He can also raise loan against the security of these goods. He also has a general lie on these goods, but he cannot barter these goods without a specific authority on this behalf.

(d) *Del credere* agent, who, in consideration of an extra remuneration (called a *Del credere* commission), guarantees the performance of the other party. This way the *del credere* agent assumes the position of a guarantor –cum – agent. A *del credere* agent is usually appointed in the case of foreign transactions where the party has no knowledge of the other party operating in some foreign country.

(e) Auctioneer is appointed for the purpose of selling the goods by way of auction only. He is authorised to deliver the goods so auctioned on receipt of the amount from the highest bidder and also to file a suit for the recovery of such amount in his personal name. However, as against the factor, an auctioneer has only a particular lien on the goods auctioned (and not a general lien, as is the case with a factor). Further, as has been held in the case **Marsh vs Jeff, 1862**, an auctioneer has been authorised to sell the goods by way of public auction only, and not by way of a private contract.

(f) Banker, who acts as a collecting agent, when he sends the bills, cheques or drafts, of his customers, on collection basis or through local clearing, and credits the amount to their respective accounts on the realisation of such instruments. He also acts as an agent of his customers when he collects on their behalf the amount of periodical interest on their debentures and government securities, and the dividends on their shares, as also when he sells and purchases the shares and securities. As their agent, he also pays, out of the customers' accounts, on the basis of their mandate in this regard, the insurance premium, telephone and electricity bills, income tax and sales tax, and so on, on their behalf.

(g) *Pakka Arhatia* is a person who can perform the contract himself too, instead of entering into the contract on behalf of his principal, and that too, only with the third party. Besides, he also functions as a mutual guarantor, in that he guarantees the performance of the contract by both the parties involved, i.e. his principal on the one side and the broker (shroff) on the other.

(h) *Kachcha Arhatia*, however, can guarantee the performance of the contract on the part of his principal only, and not on the part of the other party involved in the contract. Thus, in the case of non-performances of the contract by his principal, he himself will be responsible to the other party to the contract.

(i) Intender is also like a commission agent, who arranges the sale or purchase of some commodities on behalf of his principal, but with a merchant in some foreign country, instead (and not in the home country). Such agents are authorised to charge their commission at the rate mentioned in the indent.

'Non-mercantile' or 'Non-commercial' Agent

Advocates (counsels), attorneys, estate agents, etc., fall under the category of 'non-mercantile' or 'non-commercial' agent. But then, the wife is supposed to be most prominent and pertinent example of a 'non-mercantile' or 'non-commercial' agent of her husband.

Let us now examine as to how far the wife can act as an agent of her husband in the following different situations and circumstances:

(a) In the cases where both the wife and husband are living together, and the wife is looking after the necessaries of life, she is presumed to be an agent in the eye of law**. [Debenham vs Mellon (1880), 6 AC 24].** But the husband is entitled to refute such legally presumed relationship, and escape his liability as the principal of his wife, if he can prove the following:
   (i) That, he had expressly asked his wife not to purchase anything on credit, nor to borrow any money from any one;
   (ii) That, the goods purchased by his wife on credit did not fall in the category of necessaries;
   (iii) That, he had already given sufficient money to his wife to purchase the necessaries on cash payment basis; or
   (iv) That, the trader concerned had already been expressly forewarned not to supply any goods to his wife on credit.

   Thus, in all such cases the husband will be absolved of his responsibility as a principal of his wife.

(b) Even in the cases where the wife and husband are not living together but separately, but then, without any fault on the part of the wife, the husband is liable to pay for the maintenance of his wife. If, however,

he does not pay for her maintenance, she has the implied authority to bind her husband for necessaries, that is, he will have to pay the bill for the necessaries purchased by her on credit.

(c) As against this, if the wife is living separately from her husband, for no justifiable reason, or under no justifiable circumstances, she cannot be deemed to be her husband's agent, and accordingly, she cannot bind him as her principal, even for the necessaries.

15.7 Sub-Agent and Substituted Agent (Sections 190 to 195)

A person, to whom some power has been delegated, is not authorised to delegate it any further. This is based on the principle: *'Delegatus non potest delegare',* which means that a delegate cannot delegate further. In a similar manner, an agent as well is not authorised to appoint his own agent, that is, a sub-agent. This is so because a person appoints another person as his agent only when he feels that he can trust him. But it does not mean that he can necessarily have the same level of trust and confidence in the other person (sub-agent) also, even if he is appointed by his agent, in whom he undoubtedly has full trust. Accordingly, the sub-agency is not a generally recognised arrangement.

But then, there may be certain circumstances under which it may become expedient to appoint a sub-agent. **Section 190**, therefore, specifies the following circumstances under which the agent can legally appoint his own agent, i.e. a sub-agent:

(a) Where he is expressly permitted by his principal to do so,
(b) Where it is generally permitted as per the prevalent practice of the trade,
(c) Where the nature and magnitude of the task is such that it just cannot be accomplished without appointing a sub-agent,
(d) Where the nature of the job entrusted to the main agent is of a clerical and routine nature, not requiring application of discretionary capabilities. For example, where the agent has been assigned some typing job, and for lack of time, he gives the typing work to an equally competent typist, and
(e) Under some unforeseen emergent circumstances.

It may, however, be pertinent to clarify here that an agent can appoint another person in his place, which may assume the characteristics and nature of a sub-agent or else that of a substituted agent.

Let us first discuss the nature and role of a **sub-agent**.

As defined under **Section 191**, a sub-agent is a person who is employed by, and acts under the control of, the original agent, in the business of the agency.

Thus, as the sub-agent is employed by, and acts under the control of, the original agent, there is no privity of contract between the sub-agent and the principal (of the original agent). Accordingly, neither the sub-agent can sue the principal (of the original agent) for his remunerations, nor can the principal sue the sub-agent for any of his dues from him. That is, each of them can proceed only against their respective direct and immediate contractual party, viz. the sub-agent against the (original) agent, who has appointed him as his sub-agent, and the principal also against the original agent only. However, in case the sub-agent has committed some fraud, the principal also has the concurrent right to proceed against his original agent as also against the sub-agent, involved in the fraud.

It may be further pointed out that in case the original agent has duly appointed a sub-agent, with due permission from his principal to this effect, even the sub-agent can represent the principal and bind him for his acts as the original agent can do, i.e. as if he himself was also appointed by the principal himself. As against this, if the original agent appoints the sub-agent, without having the permission of his principal to do so, the principal is not deemed to be represented by such sub-agent, nor can he be held responsible for any of his (sub-agent's) acts. Instead, he can bind only the original agent (his appointing authority or his employer), for his acts and contracts entered into with the third parties.

We will now discuss the nature and role of a **substituted agent (Section 194).**

Where the original agent has been authorised by his principal to name (i.e. recommend the name of) some third person, and accordingly, he names such other person to his principal, to be appointed by him as his agent in his place (i.e. in substitution of himself), such person is referred to as the substituted agent, and not as a sub-agent. **Section 194** clearly states that 'where an agent, holding an express or implied authority to name another person, has named another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him.'

Examples

(a) P has directed his agent A to sell his car through an auction and also tells him to employ an auctioneer for the purpose. A names the auctioneer N as the auctioneer to execute the sale through an auction. In this case, the auctioneer N is not the sub-agent of A, but a substituted agent, i.e. the agent of P himself for the purpose of conducting the sale thorough an auction.

(b) P has authorised A to recover his (P's) dues from M, a merchant in Delhi. A thereupon instructs S, a solicitor, to initiate the necessary legal proceedings against M for the purpose of recovering the money from him. In this case also S is not the sub-agent, but a solicitor of P.

15.8 Obligations (Duties) of an Agent

The agent has the following obligations (duties) towards his principal:

(i) Under **Section 211**, the agent is obliged to conduct the business of agency in strict accordance with the specific instructions and directions of his principal. In other words, he does not have the right to make any deviation in this regard, even for the benefit of his principal. And if does deviate in any manner, he will be held personally responsible for all the losses accruing thereby; but the surplus or profit, if any, accrued thereby, will have to be passed on to the principal.

Examples

(a) P had instructed his agent A to deposit the bags of rice in a particular warehouse. But A, instead, deposited the bags of rice in some other warehouse, which was equally reputed and cheaper as well. But unfortunately, the goods were destroyed in the fire in the warehouse. The agent was held liable to compensate his principal for such loss caused to him due to non-compliance of the principal's instructions meticulously **[Lilley vs Doubleday (1881), 7 QBD 590].**

(b) Similarly, if the principal has instructed his agent to sell his goods against cash payment only, and if the agent sells the entire goods or a portion thereof on credit, the agent himself will have to make good the amount, which may remain still to be recovered from the purchaser. **[Paul Bier vs Chottalal, 30 Bombay 1].**

However, as provided under **Section 211** itself, in case there is no specific instruction to the agent from the principal on certain points, the agent should act in accordance with the accepted and normal custom of the business prevalent at the place where the transaction is taking place.

Example

If there is a prevalent custom at the place of business that any surplus fund must be invested in some avenues of investment, and if the agent fails to do so, the agent will have to compensate the principal with the amount that the principal would have usually earned by way of interest on such investments.

(ii) The agent must conduct the business with the skill and diligence that are normally expected from the persons engaged in similar business, except, in the cases, where the principal knows that his agent lacks in such skills and proficiency (**Section 212**).

Examples

(a) In case a solicitor files a suit by citing a wrong Section in the plaint, he will be held personally liable for the loss sustained thereby.

(b) P has authorised his agent A to sell his goods even on credit. Accordingly, A sells some of P's goods to C on credit, but he does so without making the necessary trade enquiries regarding C's financial position and credibility. C fails to make the payment for the credit purchases. It later transpires that C was already declared as an insolvent at the time the credit sale was effected to him. A will be held personally liable for the losses sustained by P thereby, and therefore, he will be required to compensate the amount of such loss to his principal P.

(c) A, an insurance broker, has been asked by P to effect an insurance on a ship. A does so, but through an oversight, a usual and significant clause is not included by A in the relative insurance policy document. The ship is later lost, and P sustains substantial loss, as no compensation becomes payable by the insurance company for the lack of the pertinent clause in the policy. A will, therefore, be held personally liable and will have to compensate his principal P for the losses suffered by him in this regard.

(iii) To submit Proper Accounts

Under **Section 213**, the agent is required to submit proper accounts, which means that the accounts must be submitted in detail, and the items must be supported by the respective vouchers/bills also, **[Anandprasad vs Dwakanath, 6 Cal 574].** Thus, if the agent fails to submit the respective voucher in support of any of the items of expenditure, the presumption will go against him, as if the claimed expenditure was not incurred. Accordingly, the agent will be required to make good the amount so claimed, but presumed not to have been incurred at all, due to these being not evidenced by the supporting vouchers.

(iv) In the cases of difficulty in contacting the principal **(Section 214)**

In the cases where it becomes rather difficult to contact, consult or communicate with the principal to seek some clarification or approval in certain matters of the business transaction, the agent is expected to make all possible reasonable efforts to communicate with him, and if despite the best possible efforts in this direction, fail to yield the desired result (i.e. establishing the contact with the principal), the agent is required to use his own discretion in the matter and take all possible steps and action as a reasonable man would take under similar circumstances with regard to his own goods. Here, he becomes and acts as an agent of necessity, which aspect has already been discussed in the preceding paragraphs.

(v) Not to make any secret profit

The agent is expected to handover to his principal the entire amount received by him on his (principal's) behalf, including the secret profit, if any. He, however, is authorised to make all lawful deductions from such amount, like his own remuneration and the expenses incurred by him in this connection.

(vi) Not to deal on his own account

The agent is not expected to transact any business on his own account (that is to earn any profit therefrom) without any prior permission or consent from his principal to this effect. If, however, he prefers to do so, without obtaining prior permission from his principal, he will be required to handover to his principal the entire profit resulting from such transactions, if so claimed by the principal. **[H Wilson and Co. vs Bata (1927), 54 Cal 549].**

Example

P has asked his agent A to purchase an imported car, which was being sold at a sufficiently cheaper price. A, however, feigns that it was no longer available. But, in fact, A had himself purchased the car for his own use. When P came to know of this fact, A had to sell off the car to P at the same price that he (A) had originally purchased for. Further, A was now no longer entitled even to his usual commission/ brokerage that he would have been usually entitled to. **[Harvalabh vs Jivanji, 1902, 26 Bombay 689]**.

(vii) Agent not entitled to remuneration for the business misconducted

As provided under **Section 220**, if an agent is found guilty of having misconducted the business of agency (i.e. of having conducted the business of agency not in the professional manner usually expected

of him as an agent), he will not be entitled even to his usual remuneration on that part of the business which he has not conducted in a professional manner.

Examples

(a) P has asked his agent A to recover a sum of Rs 5 lakh due from D, and to invest the entire amount in good shares and securities. A recovers the full amount from D and invests Rs 4.5 lakh in good shares and securities, but takes a chance and invests the balance amount of Rs 50, 000 in some shares and securities which were know to be not safe and secured investment. As a result, P incurs a loss of Rs 40, 000 on the second rate investment. In the circumstance, A will get his remuneration for recovering a sum of Rs 5 lakh from D, and for investing Rs 4.5 lakh in good shares and securities, as per the instructions of his principal. But, as regards the investment of Rs 50,000 in second grade securities, against the clear instructions of P, he will not be entitled to any remuneration for this work. On the contrary, he will have to compensate P for the loss of Rs 40,000 sustained on account of the inferior investments, made in contravention of the principal's direction.

(b) P employs A to recover the long outstanding dues aggregating Rs two lakh from C. But, due to the misconduct of A, the money could not be recovered from C. Under the circumstances, A is not entitle to receive any remuneration from A. Instead, he will have to compensate P for the loss sustained by him due to such non-recovery, caused by the misconduct of A.

(viii) Not to disclose any confidential information
The agent is also required not to disclose or leak any information of a confidential nature, supplied to him by the principal, to any outsider/third party. **[Weld Blundell vs Stephens (1920) AC 1956]**

(ix) On termination of the agency caused by the death of the principal (or on his becoming of unsound mind), the agent is bound to take all reasonable steps, on behalf of the representatives of the late principal, to safeguard the interest in the matters entrusted to him by the late principal. **(Section 209).**

15.9 Rights of an Agent

The agent enjoys the following rights:

(i) Right to Remuneration (Sections 219 and 220)

The agent is entitled to receive the amount of his remuneration or commission at the agreed rate, and in the absence of any agreement on this point, he is entitled to receive a reasonable amount by way of his remuneration or commission. But he cannot be entitled to receive his remuneration or commission unless he has carried out the object of his agency, or has completed the task that was assigned to him as an agent, except where there is some agreement to the contrary. Now a question may arise as to when shall the task be deemed to have been completed or the object of the agency carried out. And the answer is, as per the terms of the contract of agency. For example, the commission or brokerage will become payable to an agent (broker) when he has been able to find a person who is agreeable to negotiate the purchase of the house of his principal at a reasonable price, on which a deal could be clinched, and a contract entered into. **[Sheikh Farid Baksh vs Hasgulal Singh, AIR (1937) All 46; Raja Ram vs Ganesh Pd. (1959) All. 29; and Roopji and Sons vs Dyer Meaken (1930) All 545].**

It must be further noted in this context that the transaction, for which the agent is claiming his remuneration or commission, must have been the direct result of his services (effort and action). **[Green vs Barlett (1863) 14 CB (NS) 631].**

Moreover, in case the agent is found guilty of any misconduct in the business of agency, he will not be entitled to receive his remuneration for that part of the transaction which he has misconducted, i.e. not conducted satisfactorily and proficiently **(Section 220),** as already discussed in the preceding paragraph, item (vii) of Sub-Section 15.8.

(ii) Right of Retainer (Section 217)

The agent has the right, which is referred to as the 'agent's right of retainer'. That is to say that, he can rightfully retain with himself the entire amount, received by him on behalf of his principal in the business of agency, and he will be legally required to handover to his principal only the balance amount that remains, after deducting and retaining with himself the amount of his remuneration and commission payable to him as an agent, as also the amount of loan, if any, taken by him, and any expenses properly and duly incurred by him, in connection with the discharge of his responsibilities as an agent.

It may, however, be clearly understood in this context that the agent's right of retainer applies only and exclusively in regard to the amount received by him in the course of the business of the specific agency, and not in any other manner or connection, whatsoever. Accordingly, he cannot retain the money received by him in the discharge of his duties in the case of one agency, in adjustment of any of his aforementioned dues (like his commission or remuneration, etc.) in some other agency, even if both such agencies be under the same principal.

(iii) Right of Lien (Section 221)

In the absence of a contract to the contrary, an agent is entitled to retain, by virtue of exercising his lien on the goods, papers and property (both movable and immovable) of his principal, that he might have received on his behalf as his agent, till such time the principal pays to him his dues like his commission and remuneration, etc., or else accounts for the same. Such lien is in the nature of a particular lien. That is, it applies in respect of all the claims pertaining only and exclusively to that very particular goods and property, and not to anything else. However, the agent may get a right of general lien also, but by way of entering into a special contract to this effect. In that event, the agent's general lien will extend to all his claims arising out of the agency.

Here, it may be noted with interest and care that the right of lien pertains to 'retain possession', which, in turn, suggests to 'continue to keep' with himself, whatever papers or goods or property are already in the possession of the agent, by way of an actual or even constructive possession. That is, it does not pertain to seizing and thereafter retaining, but only to keeping and to continue such keeping only still further. Further, the agent will lose his right of such lien the moment he will part with the goods or papers or property to the principal. But again, if the principal happens to get the possession of such goods, papers or property from his agent thorough fraud or some other unlawful means, the agent's right to lien does not, in any way, get adversely affected by way of his losing the possession in such a manner.

(iv) Right of Stoppage-in-Transit

The agent enjoys the right of stoppage-in-transit under the following two circumstances:

(a) Let us presume that the agent has purchased the goods on behalf of his principal out of his own funds, or else, has not so far paid for the same to the seller, whereby he will be personally liable to the seller to pay for it, failing which the seller will be entitled to exercise his right of the 'unpaid seller', as against the agent. In such a situation, if the principal has not paid for these goods, and in the mean time he becomes insolvent, the agent will be entitled to exercise the right of the unpaid seller vis-à-vis the principal, and thus, will have the right of stoppage-in-transit in regard to such goods.

(b) In the case of a *del credere* agent, where the agent himself is personally liable to his principal for realising the price of the goods sold, he will be entitled to the rights of an unpaid seller, as against the buyer, in the event of the buyer of such goods becoming insolvent in the mean time.

(v) Right to be Indemnified (Sections 222 to 225)

The agent is entitled to get indemnified by his principal against the consequences of all the lawful acts performed by him (agent) under instructions from, and under the authority conferred upon him, by his principal.

Examples

(a) Under instructions from his principal P at Delhi, A, the agent of P, enters into a contract with B in Germany to deliver certain goods to him, in Germany. P, however, fails to send the goods to Germany, and consequently B files a suit against A for breach of contract. A thereupon informs P of this fact. P authorises A to defend the case. A defends the suit as authorised by P. But A loses the case, and is required to pay the damages with cost, and also incurs some expenses in this connection. In this case, P is liable to indemnify A for all the damages, costs and expenses incurred by him (A).

The example (a) above refers to a case where the principal fails to sell and deliver the goods to the third party. As against this, the second example (b) below, pertains to a similar situation of default but with a difference in that in this case the breach of contract pertains to the agent, he being the defaulting buyer and not the defaulting seller.

(b) Under instructions from his principal P at Delhi, A, the agent of P, enters into a contract with S in Germany to purchase certain goods from him (S). P, however, later backs out and refuses to buy the goods from S, and consequently S files a suit against A for breach of contract. A thereupon informs P of this fact. P authorises A to defend the case. A defends the suit as authorised by P. But A loses the case, and is required to pay the damages with cost, and he also incurs some other expenses in this connection. In this case, the principal P is liable to indemnify the agent A for all the damages, costs and expenses incurred by him.

Section 223 also stipulates that the agent will enjoy the right to be indemnified by his principal even in the cases of the consequences of his action, where he had acted in good faith. **Section 223** reads as under:

'Where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the rights of third persons.'

Example

Some goods of F are in the possession of P. But P does not have the right to dispose off these goods. However, P asks his agent A to sell the goods. A, who is not in the know of the fact that his principal P, does not have the right to dispose off the goods of F, sells them off as per P's instructions, and hands over the sale proceeds to P. Later on, F, the real owner of the goods, sues A for his act (of such unauthorised sale) and recovers the full value of the goods and costs. In this case, P is liable to indemnify A for the amount A has been forced under the law to pay to F as also his own expenses incurred in this connection.

It may, however, be clearly understood here that the agent cannot claim to be indemnified by his principal in the cases where he has committed some criminal act, even if his principal had agreed for his agent's involving himself in such a criminal act. **(Section 224).**

Examples

(a) P has employed A to break the legs of Q, and has agreed to compensate him for all the consequences of such act. A thereafter breaks the legs of Q, and consequently has to pay the damages to Q for such act. In this case, P is not required under the law to indemnify A for the amount of the damages paid by A to Q for his having broken the legs of Q, despite his aforementioned agreement with P, inasmuch as, an agreement to execute any criminal act is not enforceable in law.

(b) E, the editor of a daily newspaper paper, has agreed, at the request of P, to publish a story about R, the rival of P, which amounts to a libel (a defamation in writing, as against just a verbal defamation). E has agreed to do so on the promise of P that he (P) will indemnify him (E) for all the consequences, like costs and damages, arising out of publishing such libellous material. E later publishes that libellous piece. Subsequently, R files a suit against E, and E is required to pay the damages and costs to R. Besides, he (E) also incurs some expenses in this connection. In this case as well, E cannot compel P to indemnify him with the amount of damages, costs and expenses incurred by him (E), for the same reason as stated in example (a) above.

(vi) Right to Compensation for Injury Caused by the Neglect of the Principal

As stipulated under **Section 225,** the principal is bound by the law to compensate his agent for any injury caused to him (agent) due to any neglect or lack of skill, on the part of the principal.

Example

P was constructing his house. He had engaged A as a mason for the purpose. Though P did not know how to fix up the scaffolding, he had himself fixed it up in an unprofessional and unskilful manner. After A's working for some time on the scaffolding, it gave way, and A was injured in the process. P will be held liable to pay compensation to A.

15.10 Duties of the Principal towards the Agent

Rights of the agent as against his principal, as discussed in the preceding paragraphs, will, conversely speaking, constitute the duties of the principal towards his agent. Thus, the principal has the following obligations towards his agent:

(i) He is legally bound to indemnify the agent for all the consequences arising out of all the lawful acts performed by such agent in the exercise of his authority conferred upon him by his principal. **(Section 222).**

(ii) He is also bound to indemnify the agent for all the consequences arising out of the acts performed by such agent in good faith, even if it causes some injury to the rights of the third persons. **(Section 223).**

(iii) Further, the principal is bound by law to compensate his agent for any injury caused to him (agent) due to any neglect or lack of skill, on the part of the principal. **(Section 225).**

(iv) The principal, however, is not required to compensate the agent for any of his acts, which are criminal in nature, even if it were done by the agent at the instance of the principal himself. **(Section 224)**.

15.11 Liability of the Principal to the Third Persons

(i) The agent is merely a representative of his principal. He is just a connecting link, merely a conduit. Accordingly, all the acts done by an authorised agent, on behalf of the principal, are deemed to have been done by the principal himself, and accordingly, bind the principal for all the acts done by his agent within the scope of his authority. In other words, it will have the same effect as it would have had when done by the principal himself, instead of through his agent. **Section 226** categorically stipulates that 'contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner and will have the same legal consequence, as if the contracts had been entered into and the acts done by the principal in person.'

Example

A, the agent of P, has been authorised to collect the dues from his clients on his behalf. C, one of the clients of P, pays a certain sum of money due to P, to his agent A. Thus, C is discharged of his liabilities to pay to P, after making the payment to his authorised agent A. In the circumstances it will have the same effect as if the amount was paid to P in person.

(ii) Further, the principal is liable for the acts done by his agent not for only such acts, which fall under his actual authority, but also for those acts, which are within the scope of his apparent or ostensible authority.

(iii) There may, however, be some cases where the agent might have done certain acts, which fall within his actual authority, and also some other cases, which do not fall within his actual authority. In such cases, provided these two categories of the action can be segregated and separated, the principal will be held liable only for his agent's such acts which have been performed by the agent within his actual authority **(Section 227)**. Accordingly, as a corollary of this statement, the agent himself, and not his principal, will be personally liable for such acts, which he had performed without and beyond his actual authority.

Example

P, the owner of a truck, loaded with the household effects of a third person for transportation from Lucknow to Bangalore, authorises his agent A to get the truck insured. The agent A, however, gets the insurance done for the truck as also for the household effects loaded thereon. In this case, the principal will be liable to pay for the insurance premium for the insurance of the truck only, and not for the insurance charges of the household effects (which, instead, will obviously have to be borne by the agent himself). This is so because of the following two reasons, taken together:

(a) Because, the insurance of the household effects had been done by the agent for which he was not authorised, and

(b) Also because, the two acts (the insurance charges for the truck and for the household effects) can be separated from each other.

Alternatively speaking, in the cases where the two such acts cannot be separated, the provisions of **Section 227** will not apply. Instead, the provisions of **Section 228** will be applicable, which is discussed hereafter.

(iv) **Section 228** stipulates that where an agent does more than he is authorised to do, and what he does beyond the scope of his authority, cannot be separated from what is within it, the principal is not bound by the transaction. In other words, the agent will be personally responsible to the third party. That is to say that, in case (in the above example) the amount of the premium on the insurance of the truck and the household effects were not charged separately, and also that it could not be separated (just for the sake of taking an illustrative example), the agent will have to pay for the entire amount of insurance charges, and the principal will not be required to make any payment in that case, on the ground that the authorised and unauthorised acts of the agent could not be separated. Let us take another appropriate example to illustrate the point where the two acts cannot be actually separated.

Example

The agent A is authorised by his principal P to draw a bill for Rs 50,000. A, instead, draws a bill for Rs 90,000. The principal will not be liable to pay the bill of Rs 90,000. In fact, he will not be liable to pay the bill even to the extent of the agreed amount of Rs 50, 000, as these two amounts (of Rs 50,000 and Rs 90,000) are not separable in the single bill drawn for Rs 90,000.

(v) Misrepresentations by the Agent

In the case of any misrepresentation made or fraud committed by the agent in the business of agency for the benefit of the principal, the principal will be held liable, and not the agent, provided, of course, when the agent acts within his actual authority. Alternatively speaking, if the agent makes any misrepresentation or commits some fraud, in the business of agency, even for the benefit of the principal, but without or beyond his authority, he cannot bind his principal but himself. **(Section 238).**

Examples

(a) A is the agent of P for selling his (P's) goods. A induces a customer C to buy some of his goods, but by making some misrepresentation, which P had not authorised him to do. In this case, the contract will be voidable as between the principal P and the buyer C.

(b) But if A, being P's agent, by virtue of being the captain of a ship owned by P, issues a bill of lading to C, without having received the goods on board, he (A) has acted without having the authority to do so. This is so because the captain of the ship is authorised to issue the bill of lading, in acknowledgement of having received the goods on board, only after having actually received such goods on board, and not before or without having received such goods on board. Thus, in this case, as the agent has acted beyond or without having the actual authority, he cannot bind the principal. Accordingly, in this case, the bill of lading issued by A will be considered void as between P and C, the pretended consigner. That is to say that, if at all, C can proceed only against A, the agent, and not against P, the principal, the principal can still be held liable to the third parties, even if his name is not disclosed to them initially. That is to say that, as soon as the third party may come to know of the name of the principal at any subsequent point in time, he can proceed against him (principal) in regard to the contract.

(vi) Further, the principal is bound by any notice or information given to the agent, during the course of business transacted by him (agent).
(vii) The principal can still be held liable to the third parties, even in the cases where the agent may be actually liable personally. This is so because **Section 233** gives an option to the third parties to proceed against the principal or the agent or against both of them simultaneously.

15.12 Personal Liability of an Agent

By virtue of being just a conduit, a medium, a connecting link, between his principal and the third parties, he can neither personally enforce the contract entered into by him on behalf of the principal, nor can he be held personally responsible for complying with the terms of the contract so entered into by him on behalf of his principal. But this situation prevails only when there is no contract to the contrary, between the agent and the principal. In other words, if there be a contract to this effect, express or implied, he will be personally bound to enforce the contract as also to personally comply with the terms of the contract.

Further, as stipulated under **Section 230**, a contract to this effect will be presumed to be there in the following conditions:

(a) Where the agent enters into a contract for the sale or purchase of goods for a merchant residing abroad;
(b) Where the agent does not disclose the name of his principal; and
(c) Where the principal, despite being disclosed, cannot be sued. For example, where the principal is a minor or a person of unsound mind.

The agent also incurs his personal liability in the following cases:

(i) Breach of Warranty

In the cases where an agent acts either without the authority, or beyond the authority, he is deemed to have committed a breach of warranty of authority. Accordingly, he will be held personally liable if the principal concerned does not subsequently ratify his acts.

It may be further noted in this context that the agent will be held guilty of the offence of breach of warranty of authority, and accordingly, will be held liable all the same, even in the cases where his agency had been terminated without his knowledge, for example in the cases of the termination of his agency due to the death of the principal, or where the principal has become a person of unsound mind, in the mean time. **[Yonge vs Toynbee (1910) 1 KB 215].**

(ii) Where an Agent Expressly Agrees to be Personally Responsible

An agent is usually required (presumably, by the principal himself), to enter into an agreement to the effect that he will be held personally responsible, primarily in such cases where the principal himself may not be enjoying sufficiently good credibility and credit-worthiness in the market, and accordingly, the transaction may not take place unless the agent, considered more credible and credit-worthy, as compared to his principal, agrees to be held personally liable, such that the third parties to the contract could remain reasonably assured that the payment or the performance, as required under the contract, will be complied with.

(iii) Where an Agent Signs a Negotiable Instrument in his Own Name

As provided under **Section 28 of the Negotiable Instruments Act, 1881**, where the agent signs a negotiable instrument without clarifying the point that he is signing the instrument in the capacity only of an agent of his specific principal, and not in his personal capacity, he may be held personally liable on such instrument. That is, he would be held personally liable as the maker of the D.P. note, despite the fact that in the body of the D.P. note he might have been described as the agent only.

(iv) Where an Agent has some Special Interest or some Beneficial Interest

Where an agent has some special interest or some beneficial interest (for example, as a factor or an auctioneer), he can personally sue and can be sued against personally, too. **[Subramaniya vs Narayana, 24 Mad. 130]**

(v) Where found Guilty of Fraud or Misrepresentation

Where an agent is found guilty of fraud or misrepresentation in the matters, which do not fall within his authority, he incurs his personal liability in such cases. (**Section 238**).

(vi) Under the Usage and Customs of Trade

Where the usage and customs of trade stipulate that the agent will be made personally liable, this has to be as such.

(vii) Where the Agency is one that is Coupled with Interest

In the case, where the authority is given to the agent whereby he may derive some benefit to himself, it is known as the agency coupled with interest. Alternatively speaking, in the cases where the agent himself has some interest in the matter of the agency, such agency is known as the agency coupled with interest.

Examples

(a) P has consigned 10 bales of cotton to A. Further; A has advanced certain sum of money to P against the supply of the bales of cotton by P to A. P also authorises A to sell the bales of cotton and adjust the amount advanced to him (P), out of such sale proceeds of the cotton bales. In this case, the authority given to A (agent) by P (principal) is the authority coupled with interest.

(b) P has sold his book debts to A, and has also appointed him as his agent to recover his dues. In this case also, the authority given to A (agent) by P (principal) is the authority coupled with interest.

As is evident from the aforementioned illustrative examples, the 'authority coupled with interest' does not include the usual and ordinary interest of the agent, like getting his mutually agreed remuneration and commission, and the like. In other words, only some special types of interest, which the agent possesses, constitute the 'agency coupled with interest'.

It may be noted further that under the provisions of **Section 202**, the 'agency coupled with interest' cannot be terminated to the detriment of such interest, unless there is an express contract to the contrary. Accordingly, in the absence of a contract to the contrary, such agency becomes irrevocable to the extent of such interest. Furthermore, the 'agency coupled with interest' does not get terminated even due to insanity or death of the principal.

15.13 'Undisclosed Principal' vs 'Concealed Principal'

'Undisclosed Principal'

In the case of an 'Undisclosed Principal', the agent candidly and clearly discloses the fact to the third parties to the effect that he was working in the business deal, not in his own personal capacity, but only as an agent of some other person or party, who was his principal for the purpose. However, he also clarifies the point that he had only preferred not to disclose (reveal) the name of his principal concerned. Such a principal is referred to as the 'Undisclosed Principal'. In such a case also, the liability of the agent will be the same, as it would have been in the case of a 'disclosed principal', i.e. where even the name and identity of the principal concerned were disclosed, unless there was a trade custom to hold the agent personally liable in the case of an undisclosed principal. In this context, it must be further noted with care that, in the case of an undisclosed principal, such undisclosed principal must already be in existence, and that too, in the capacity of the principal of the agent,

at the material time, i.e. when the contract was being entered into by the agent of the undisclosed principal. Alternatively speaking, such person cannot be brought into existence as the (undisclosed) principal, after the contract had already been entered into by the agent.

'Concealed Principal'

As against the 'Undisclosed Principal', in the case of a 'Concealed Principal', the agent concerned, besides not disclosing the name of his principal concerned, even conceals the very fact that he was working as an agent of some other person or party, and not in his personal capacity. This way, he gives the false impression to the third parties to the effect that there was no principal as such, involved in the case, and that he himself was acting in his own personal capacity, and not as an agent of any other person, whatsoever. Such a principal is referred to as the 'Concealed Principal'. Accordingly, the third parties must demand the payment or performance under the contract from the agent himself. Besides, in the case of a 'Concealed Principal', the agent can sue or be sued against, in the matters connected with the contract entered into by him. Further, as provided under **Section 233**, in the cases of contracts entered into with a 'Concealed Principal', in the absence of a contract to the contrary, the agent is held personally liable to the third parties. Accordingly, the third parties may hold either the agent or the principal, or both of them, liable for the performance of the contract.

Example

S enters into a contract with A to sell him 100 bags of sugar. Subsequently, he discovers that A was working as the agent of P. S may sue either A or P, or both, for the price of the sugar.

15.14 Termination of an Agency

As provided under **Section 201**, any agency may be terminated, or may come to an end, under the following circumstances:

1. By Revocation by the Principal

The principal may revoke his authority, given by him to his agent, at any time, after giving sufficient notice to the agent. But, where the agent has been appointed for the purpose of doing only a single act, the agency may be revoked by the principal at any time, but before the commencement of the specific single act by the agent. In the case of a continuous agency, however, the notice of revocation has to be given by the principal, not only to the agent, but also to the third parties who have acted on the agency with the knowledge of the principal.

Further, in the cases where the agency is for a fixed period of time, and the contract of agency has been revoked, without giving sufficient cause for such revocation, the agent will have to be paid compensation by the principal (**Section 205**).

However, the agency cannot be revoked by the principal in the following two cases:

(a) Where the agency is one that is coupled with interest.

Under the provisions of **Section 202**, the 'agency coupled with interest' cannot be terminated to the detriment of such interest, unless there is an express contract to the contrary. Detailed discussions, with some illustrative examples, already appear in the preceding paragraphs in this chapter, at Section 15.12, Sub-Section (vii).

(b) Where the authority has been partly exercised.

As provided under **Section 204,** 'the principal cannot revoke the authority given to his agent after the authority has been partly exercised, in regard to such acts and obligations as arise from acts already done in the agency'.

Examples

(i) P authorises A to buy 1,000 bales of cotton on account of P, and to pay for it out of P's money, remaining in A's hands. A buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. P cannot revoke A's authority so far as regards the payment for the cotton, out of P's money, remaining in A's hands.

Let us take another example where the situation is slightly but significantly different.

(ii) P authorises A to buy 1,000 bales of cotton on account of P, and to pay for it out of P's money, remaining in A's hands. A buys 1,000 bales of cotton in P's name, so as not to render himself personally liable for the price. In this case, P can revoke A's authority to pay for the cotton.

As we may observe from the example (ii) above, P (Principal) can revoke the authority of his agent A, because in this case [as against the example (i) above], A has bought 1,000 bales of cotton in P's name (and not in his own name), so as to bind P, and not to render himself personally liable, for the price of the cotton.

2. On the Expiry of Fixed Period of Time

In the cases where the agency is for a fixed period of time, it automatically comes to an end on the expiry of that fixed (stipulated) period of time.

3. On the Performance of the Specific Purpose

In the cases where the agent is appointed for the purpose of performing a particular act, the contract of agency comes to an end when the act concerned is done, or else when the performance of that specific act becomes impossible.

4. Insanity or Death of the Principal or the Agent

The contract of agency automatically comes to an end in the event of the insanity or death of either the principal or the agent. But, in the event of the insanity or death of the principal, the agent is bound to take all the necessary reasonable steps for the protection and preservation of the interests and property entrusted to him, on behalf of the insane principal, or the legal representatives of the deceased principal, as the case may be **(Section 209).**

5. When the Subject Matter is Either Destroyed or is Rendered Unlawful

The contract of agency automatically comes to an end, when the subject matter is either destroyed or is rendered unlawful.

6 Insolvency of the Principal

The contract of agency also comes to an end in the event of the insolvency of the principal (but not that of the agent).

7. By Renunciation of the Agency by the Agent

We have seen in item 1 above, that the principal may revoke his authority, given by him to his agent, at any time, after giving notice to the agent. Further, in the cases where the agency is for a fixed period of time, and the contract of agency has been revoked, without giving sufficient cause for such revocation, the agent will have to be paid compensation by the principal **(Section 205)**.

Similarly, the agent may also renounce his agency, at any time, after giving sufficient notice to the principal to that effect.

Further, in the cases where the agency is for a fixed period of time, and the contract of agency has been renounced by the agent, before the expiry of the fixed period, and without giving sufficient cause for such renunciation of the agency, the principal will have to be paid compensation by the agent (**Section 205**).

15.15 When does Termination of Agency Become Effective?

(a) As regards the agent, the termination of his authority does not become effective unless and until he comes to know of it (i.e. of such termination of his authority). **(Section 208)**.

(b) In regard to the third parties, however, they can continue to deal with the agent (and bind the principal thereby), unless and until they happen to come to know of it (i.e. of such termination of the authority of the agent by his principal).

(c) In this connection, it must be further noted that the termination of the authority of the agent automatically has the effect of the termination of authority of all the sub-agents appointed by him (Agent).

Let us take some illustrative examples to clarify the points **(Section 208)**.

Examples

(i) Prakash (the Principal) had given instructions to his agent, Amar, to sell 100 bags of sugar of 50 kg each on his behalf. In this connection, Prakash had also agreed to pay to Amar ten per cent (10%) of the sale proceeds of the sugar by way of commission in this regard. Some time later, but before Amar had sold out the sugar to Bala for a sum of Rs 1,00,000, Prakash (Principal) had sent a letter to his agent, Amar, terminating his authority as his agent. This letter of revocation of the authority, however, was received by Amar after he had already sold out the sugar. In other words, at the time of selling the sugar, Amar was not in the know of the fact that his authority had been terminated by Prakash (Principal), inasmuch as he had received the letter after he had already sold the sugar. Under the circumstances, the sale will be binding on Prakash (the Principal). This is so because Amar, the agent, had received the letter after he had already sold the sugar. Not only that. Amar will also be entitled to receive the commission of Rs 10,000 as was promised by Prakash.

(ii) In example (i) above, if Amar (Agent) would have sold the sugar to Bala, even after having received the letter of Prakash (the Principal), revoking his authority as his agent, and thereafter Amar (Agent), would have absconded, the payment made by Bala to Amar will be held good and valid as against Prakash (the Principal), provided, of course, that Bala was not aware of the letter of Prakash (the Principal), revoking the authority of Amar as his agent.

Let us Recapitulate

'Agent' and 'Principal' Defined

An 'agent' is a 'person employed to do any act for another or to represent another in dealings with third person'. **(Sections 182).** Thus, an agent is one who acts on behalf of, or represents, another person. The person on whose behalf he acts, or whom he represents, is referred to as the 'Principal' **(Sections 182).** The relationship between these two persons, viz, agent and principal, is known as the agency, and the contract between them is referred to as the contract of agency, which may be either expressed or even implied. Thus, the function of an agent is to establish a contractual relationship between his principal and the third persons/parties. Accordingly, he rightly serves as a connecting link, a 'conduit pipe', between his principal and the third persons/parties.

Competence to Appoint an Agent

As per **Section 183**, any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent. Conversely speaking, a minor and a person of unsound mind (lunatic), who cannot enter into a contract himself, and thus, cannot enter into a contract even of agency, cannot appoint even an agent and accordingly, cannot enter into a contract through his agent either. Further, a group of persons, like a partnership firm, or a company, can also appoint an agent, and transact through him. In fact, a company, being a legal entity (and thus, only an artificial person), can invariably transact only through an agent.

Agent vs Servant

The agents, as also the servants, are obliged to follow all the reasonable instructions of their respective masters. But, while the servant acts on specific orders of his master under his direct supervision and control, the agent, on the other hand, does not act under the direct supervision and control of his principal, though he has to work within his limited authority. Further, while a servant has to work exclusively for his single master, the agent can work for more than one principal at the same time. It may, however, be said that while a servant may also act as his master's agent under certain circumstances, the agent never acts and works as a servant at any time.

Different Modes of Creating Agency

(a) Agency by Expression (Written or Verbal), i.e. Express Agency

(b) Agency by Implication, i.e. Implied Agency

An **implied agency** comprises the following types of agencies:

(i) Agency by Estoppel

(ii) Agency by Holding Out

(iii) Agency of Necessity

The doctrine of 'agency by necessity' may also extend to the other situations where the agent has exceeded his authority, provided:

(a) It is not reasonably possible to get the special specific instruction/sanction of the principal in this regard;

(b) The agent has taken all necessary and reasonable steps to safeguard the interest of the principal; and

(c) He has acted in a *bona fide* manner.

(iv) Agency by Ratification (Sections 196 to 200)

Requirements of a Valid Ratification

(i) The agent must present himself to the other parties as an agent of some one else (being his principal), and must enter into a contract accordingly.

(ii) Second, the principal must have been in actual existence at the material time when his agent was originally entering into the contract.

(iii) Further, the principal should not only be in existence at the material time, but should also be competent to enter into a contract at the same time. Thus, if a minor appoints an agent during the period of his minority, he will not be bound by the act of the 'so-called' agent, as he, by virtue of being incompetent to enter into any contract, can neither enter into a contract of agency nor can ratify it during the age of minority. In fact, he cannot even subsequently ratify it on his attaining the age of majority.

(iv) The ratification must be made within a reasonable time. However, the period, which may constitute a reasonable time, will depend upon the merit of each case.

(v) Further, the act to be ratified must necessarily be a lawful and valid act.

(vi) **Section 198** postulates that 'No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective'. In other words, the principal, ratifying the act of his agent, must be in the full and materially correct knowledge of the facts of the case.

(vii) Moreover, the ratification must pertain to the contract in its entirety, and not only to some of its selected parts.
(viii) Again, the principal, ratifying the act of his agent, must himself have the authority to enter into such contract or transaction.
(ix) Finally, the ratification, to be held valid, should not subject the third party to any damages, or else, to have the effect of terminating any right or interest of the third person **(Section 200).**

Types of Agents

Agents may be broadly classified under the following categories:

(i) 'Special' and 'General'; and
(ii) 'Mercantile' and 'Non-mercantile'.

The following types of agents fall under the category of a 'Mercantile' agent:

(a) Broker
(b) Commission agent
(c) Factor
(d) *Del credere.*
(e) Auctioneer
(f) Banker
(g) *Pakka Arhatia*
(h) *Kachcha Arhatia.*

'Non-mercantile' or 'Non-commercial' Agent

Advocates (counsels), attorneys, estate agents, and so on, fall under the category of 'non-mercantile' or 'non-commercial' agent. But then, the wife is supposed to be most prominent and pertinent example of a 'non-mercantile' or 'non-commercial' agent of her husband, except under certain circumstances, discussed in this chapter.

Obligations (duties) of an Agent

(i) Under **Section 211**, the agent is obliged to conduct the business of agency in strict accordance with the specific instructions and directions of his principal.
(ii) The agent must conduct the business with the skill and diligence that are normally expected from the persons engaged in similar business, except, in the cases where the principal knows that his agent lacks in such skills and proficiency **(Section 212).**
(iii) To submit Proper Accounts
(iv) In the cases of difficulty; to contact the principal **(Section 214)**
(v) Not to make any secret profit
(vi) Not to deal on his own account
(vii) Agent not entitled to remuneration for the business misconducted
(viii) Not to disclose any confidential information
(ix) On termination of the agency caused by the death of the principal or on his becoming of unsound mind, the agent is bound to take all reasonable steps, on behalf of the representatives of the late principal, to safeguard the interest in the matters entrusted to him by the late principal **(Section 209).**

Rights of an Agent

(i) Right to Remuneration **(Sections 219 and 220)**
(ii) Right of Retainer **(Section 217)**
(iii) Right of Lien **(Section 221)**
(iv) Right of Stoppage-in-Transit
(v) Right to be Indemnified **(Sections 222 to 225)**
(vi) Right to Compensation for Injury caused by the Neglect of the Principal

Duties of the Principal towards the Agent

(i) The principal is legally bound to indemnify the agent for all the consequences arising out of all the lawful acts performed by such agent in the exercise of his authority conferred upon him by his principal. **(Section 222).**
(ii) He is also bound to indemnify the agent for all the consequences arising out of the acts performed by such agent in good faith, even if it causes some injury to the rights of the third persons. **(Section 223).**
(iii) Further, the principal is bound by law to compensate his agent for any injury caused to him (agent) due to any neglect or lack of skill, on the part of the principal. **(Section 225).**
(iv) The principal, however, is not required to compensate the agent for any of his acts which are criminal in nature, even if it were done by the agent at the instance of the principal himself. **(Section 224)**.

Personal Liability of an Agent

By virtue of being just a connecting link between his principal and the third parties, he can neither personally enforce the contract entered into by him on behalf of the principal, nor can he be held personally responsible for complying with the terms of the contract so entered into by him on behalf of his principal, provided there is no contract to the contrary, between the agent and the principal.

The agent also incurs his personal liability in the following cases:

(i) Breach of warranty
(ii) Where an agent expressly agrees to be personally responsible
(iii) Where an agent signs a negotiable instrument in his own name **(Section 28 of the Negotiable Instruments Act, 1881).**
(iv) Where an agent has some special interest or some beneficial interest
(v) Where found guilty of fraud or misrepresentation **(Section 238).**
(vi) Under the usage and customs of trade.
(vii) Where the agency is one that is coupled with interest.

'Undisclosed Principal' vs 'Concealed Principal'

'Undisclosed Principal'

In the case of an 'Undisclosed Principal', the agent clearly discloses to the third parties to the effect that he was working not in his own personal capacity, but only as an agent of some other person or party, who was his principal for the purpose, whose name he had preferred not to disclose (reveal).

'Concealed Principal'

In the case of a 'Concealed Principal', the agent concerned, besides not disclosing the name of his principal concerned, even conceals the very fact that he was working as an agent of some other person or party, and not in his personal capacity. Accordingly, the third parties may hold either the agent or the principal, or both of them, liable for the performance of the contract.

Termination of an Agency

As provided under **Section 201**, any agency may be terminated, or may come to an end, under the following circumstances:

1. By revocation by the principal
   However, the agency cannot be revoked by the principal in the following two cases:
   (a) Where the agency is one that is coupled with interest (**Section 202**)
   (b) Where the authority has been partly exercised (**Section 204**)
2. On the expiry of fixed period of time
3. On the performance of the specific purpose, or else, when the performance of that specific act becomes impossible.
4. Insanity or death of the principal or the agent

5. When the subject matter is either destroyed or is rendered unlawful.
6. In the event of insolvency of the principal (but not that of the agent).
7. By renunciation of the agency by the agent.

When does termination of agency become effective?

(a) As regards the agent, the termination of his authority does not become effective unless and until he comes to know of it (i.e. of such termination of his authority) (**Section 208**).
(b) In regard to the third parties, however, they can continue to deal with the agent (and bind the principal thereby), unless and until they happen to come to know of it (i.e. of such termination of the authority of the agent by his principal) (**Section 208**).
(c) In this connection, it must be further noted that the termination of the authority of the agent automatically has the effect of the termination of authority of all the sub-agents appointed by him (Agent).

Questions for Reflection

1. How would you define the terms 'Agent' and 'Principal', as stipulated in the Indian Contract Act? Explain with the help of some illustrative examples.
2. As per the Indian Contract Act, who are the persons who have been declared competent and incompetent to appoint an agent? Cite some illustrative examples to clarify the points.
3. As per the Indian Contract Act, who are the persons who have been declared competent and incompetent to be appointed as an agent? Cite some illustrative examples to clarify the points.
4. Distinguish between the roles and responsibilities of an 'Agent' and a 'Servant', with the help of some illustrative examples.
5. Distinguish between 'Express Agency' and 'Implied Agency' by citing some illustrative examples to clarify the points in each case.
6. Explain the following types of 'implied agencies' by citing suitable illustrative examples in each case:
   (i) Agency by Estoppel.
   (ii) Agency by Holding Out.
   (iii) Agency of Necessity.
   (iv) Agency by Ratification.
7. What are the various conditions/requirements which must be satisfied such that a specific ratification may be held to be valid in the eyes of law? Explain, with the help of some illustrative examples in each case.
8. Bring out the various distinguishing features between the following types of agents, with the help of some suitable examples in each case:
   (a) 'Special' and 'General' agents, and
   (b) 'Mercantile' and 'Non-mercantile' agents.
9. 'The wife is supposed to be the most prominent and pertinent example of a 'non-mercantile' or 'non-commercial' agent of her husband. But then, there are certain cases where the husband will be absolved of his responsibility as a principal of his wife.'
   (a) Explain, with the help of some illustrative examples in each case, the various circumstances under which the wife can be held as acting as the agent of her husband and binding him for her lawful acts.
   (b) Also explain, with the help of some illustrative examples in each case, the various circumstances under which the wife cannot be held as acting as the agent of her husband, and the husband can escape his liability as the principal of his wife.

10. Distinguish between 'Sub-Agent' and 'Substituted Agent' by citing some illustrative examples to clarify the points in each case.
11. Explain the various obligations (duties) of an agent towards his principal.
12. Explain the following rights of an agent as against his principal:
    (i) Right to Remuneration
    (ii) Right of Retainer
    (iii) Right of Lien
    (iv) Right of Stoppage-in-Transit
    (v) Right to be Indemnified
13. Explain the various obligations (duties) of the Principal towards his Agent.
14. Explain the various liabilities of the Principal and the Agent towards the third persons.
15. Under what special circumstances can the agent be held personally liable?
16. Explain the following cases under which the agent also incurs his personal liabilities:
    (i) Breach of warranty.
    (ii) Where an agent expressly agrees to be personally responsible.
    (iii) Where an agent signs a negotiable instrument in his own name.
    (iv) Where an agent has some special interest or some beneficial interest.
    (v) Where an agent is found guilty of fraud or misrepresentation.
    (vi) Under the usage and customs of trade.
    (vii) Where the agency is one that is coupled with interest.
17. What are the essential elements that distinguish an 'Undisclosed Principal' from 'Concealed Principal'? Explain, with the help of some illustrative examples in each case,
18. Explain the following circumstances under which, any agency may be terminated, or may come to an end. Give some illustrative examples to clarify the points in each case.
    (a) By revocation by the principal.
    (b) On the expiry of the fixed period of time.
    (c) On the performance of the specific purpose, or else when the performance of that specific act becomes impossible.
    (d) Insanity or death of the principal or the agent.
    (e) When the subject matter is either destroyed or is rendered unlawful.
    (f) In the event of insolvency of the principal.
    (g) By renunciation of the agency by the agent
19. Explain the following circumstances under which any agency cannot be terminated, or may come to an end. Give some illustrative examples to clarify the points in each case.
    (a) Where the agency is one that is coupled with interest.
    (b) Where the authority has been partly exercised.
20. When does the termination of agency become effective in the following cases?
    (a) As regards the agent, and
    (b) In regard to the third parties.

    Explain, with the help of some illustrative examples in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

Parag had appointed Arun, a minor, as his agent to sell his car for a minimum price of Rs 2 lakh. Arun, however, had sold Parag's car to Varun for Rs 1.50 lakh, instead.

(a) Under such a contract, do you think that Parag will be bound by the transaction of the sale of his car to Varun for Rs 1.50 lakh only, instead?

(b) Further, can Parag hold Arun liable for compensation for disobeying his instructions, i.e. for having sold the car for a lesser amount, lower than the minimum stipulated price by Rs 0.50 lakh?

Give reasons for your answer in both the cases.

Solution

(a) Under such a contract, Parag will be bound by the transaction of the sale of his car by his agent, Arun to Varun for Rs 1.50 lakh only, instead of Rs 2 lakh, as was instructed by Parag. This is so because, though a minor cannot appoint his agent, a minor can be legally appointed as an agent, all the same. Accordingly, by virtue of being the lawful agent of Parag, Arun's deal of the sale of the car for Rs1.50 lakh will be binding on his principal, Parag. (**Section 184**).

(b) But then, Parag cannot hold Arun liable for compensation for disobeying the instructions of Parag (for having sold the car for an amount lesser than the minimum stipulated price by Rs 0.50 lakh). This is so because Arun is a minor. And, as provided under **Section 184**, though a minor may be appointed as an agent, he cannot be held responsible to his principal, though he can bind the principal as against the third persons.

Problem 2

Prakash permits Anurag to tell Shashank that he (Anurag) was working as the agent of Prakash. Taking Anurag to be Prakash's agent, Shashank supplies some goods to Anurag. Later, Prakash prefers to take the plea that Anurag was, in fact, not his agent. Accordingly, he cannot be held liable to make the payment for the goods supplied by Shashank to Anurag. Do you think that the plea taken by Prakash will be held valid in the eye of law? Give reasons for your answer.

Solution

Prakash cannot take the plea that Anurag was, in fact, not his agent. Instead, he will be liable to make the payment for the goods supplied by Shashank to Anurag, in his capacity as the agent of Prakash. That is, having made Shashank to believe that Anurag was his (Prakash's) agent, he is estopped from subsequently pleading to the contrary.

This is so because, as has been specifically provided under Section 237, when a person, by his statement or behaviour induces the other persons to believe that a certain person is acting as his agent, he is estopped from denying it at any later stage, irrespective of the fact whether it is true or otherwise.

Problem 3

M had employed S as his servant. He had allowed S to bring the goods for him from G on credit. At the end of each month, M had been regularly paying the cost of the goods bought by S on credit from G. However, once M had given the required cash to S to get some goods from G against cash payment. S, however, had taken these required goods also on credit, instead, and had pocketed the amount for his personal use. In such a situation, will M be required under law, to make the payment to G, for the goods brought by S on credit, for the purchase of which S was given sufficient cash to purchase the same against cash payment and not on credit? Give reasons for your answer.

Solution

In such a situation, M will be required under law to make the payment to G, for the goods bought by S, inasmuch as, by way of his previous dealings and conduct of making payment of the goods bought by S on credit, M has held out S to be his agent.

Problem 4

P had transported his horse to a particular destination by rail. But neither P nor his people turned up at the railway station to take delivery of the horse. Accordingly, the station master had to, per force, feed the horse to keep it alive. Do you think that, under the given circumstances, P will have to reimburse the station master

for the expenses incurred by him in the maintenance of the horse for the period it was not taken delivery of by the consignee? Give reasons for your answer.

Solution

In the given situation, though P had not appointed the station master as his agent, expressly or impliedly, P will have to reimburse him (station master) for the expenses incurred by him in the maintenance of the horse for the period it was not taken delivery of by the consignee. In this case, the station master will be considered as the agent of P by necessity.

Problem 5

L had made an offer to B, the managing director of the company, which was accepted by B, despite the fact that, at the material time, B did not have the authority from his principal to do so. Later, L withdrew the offer. But, the company, on its part, subsequently, ratified the action (of acceptance of the offer) by B. Do you think that L will be bound by the acceptance of his offer by B? Give reasons for your answer.

Solution

Yes. L will be bound by the acceptance of his offer by B on the following grounds:

In view of the fact that the ratification becomes operative with retrospective effect, it (ratification) related back to the time of the acceptance by B, as if he had the authority to do so at the time of the acceptance itself.

The withdrawal (revocation) of the offer was non-operative inasmuch as the offer once accepted cannot be withdrawn at any stage later.

It may, however, be noted in this context that the rule of relation back (i.e. being operative with retrospective effect), cannot apply if the agent were to reveal, at the material time, that he did not have the principal's authority to do such an act, and therefore, the approval or ratification of the principal will be required. In other words, the agent must not, at the material time, show that he lacked the authority to act as such, so that the rule of relation back (i.e. being operative with retrospective effect), could apply.

Problem 6

In the cases where both the wife and husband are living together, and the wife is looking after the necessaries of life, she is presumed to be an agent of her husband in the eye of law**.** But can the husband refute such legally presumed relationship, and escape his liability as the principal of his wife, for payment of the goods purchased by his wife on credit, if he can prove the following?

(i) That he had expressly asked his wife not to purchase anything on credit, nor to borrow any money from any one;
(ii) That the goods purchased by his wife on credit did not fall in the category of necessaries;
(iii) That he had already given sufficient money to his wife to purchase the necessaries on cash payment basis; and
(iv) That the trader concerned had not been expressly forewarned not to supply any goods to his wife on credit.

Give reasons for your answer in each case.

Solution

In the aforementioned cases marked (i) (ii), and (iii), the husband will be absolved of his responsibility as a principal of his wife. This is so because the cases where both the wife and husband are living together, and the wife is looking after the necessaries of life, she is presumed to be an agent of her husband in the eye of law**.** But then, the husband will have to prove that the facts, as stated in (i) (ii), and (iii) are true.

But in the case marked (iv) above, he will not be absolved of his responsibility, because till such time the shopkeeper is not specifically forewarned, not to supply any goods to the wife on credit, he will be legally right in presuming that the wife had the authority to buy the goods on credit.

Problem 7

P had directed his agent A to sell his house through an auction and had also told him to employ an auctioneer for the purpose. A names the auctioneer N as the auctioneer to execute the sale through an auction. In the

instant case, the auctioneer N should be treated as the sub-agent of A, or a substituted agent, i.e. the agent of P himself for the purpose of conducting the sale thorough an auction? Give reasons for your answer.

Solution

In this case, the auctioneer N will not be deemed to be the sub-agent of A, but a substituted agent, i.e. the agent of P himself for the purpose of conducting the sale thorough an auction. This is so because of the following reasons:

(a) As defined under Section 191, a sub-agent is a person who is employed by, and acts under, the control of, the original agent, in the business of agency. Thus, as the sub-agent is employed by, and acts under the control of, the original agent, there is no privity of contract between the sub-agent and the principal (of the original agent). Accordingly, neither the sub-agent can sue the principal (of the original agent) for his remunerations, nor can the principal sue the sub-agent for any of his dues from him.

(b) Where the original agent has been authorised by his principal to name (i.e. recommend the name of) some third person, and accordingly he names such other person to his principal, to be appointed by him as his agent in his place (i.e. in substitution of himself), such person is referred to as the substituted agent, and not as a sub-agent. Section 194 clearly states that 'where an agent, holding an express or implied authority to name another person, has named another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him.'

Problem 8

M (principal) had instructed his agent S to deposit the bags of cotton in a particular warehouse. But S, instead, had deposited the bags of cotton in some other warehouse, which was equally reputed and cheaper as well. But unfortunately, the bags of cotton were destroyed in the fire in the warehouse. In your considered opinion in this case, which of the two, viz. M, the principal, or S, the agent, would be held liable to bear the loss caused by the fire? Give reasons for your answer.

Solution

In the instant case S, the agent, will be held liable to compensate his principal (M) for such loss caused to him (M) due to non-compliance of the principal's instructions by the agent (S) meticulously, i.e. to deposit the bags of cotton in a particular warehouse.

This is so because, under Section 211, the agent is obliged to conduct the business of agency in strict accordance with the specific instructions and directions of his principal. Alternatively speaking, he does not have the right to make any deviation in this regard, even for the benefit of his principal. And if he does deviate in any manner, he will be held personally responsible for all the losses accruing thereby; but the surplus or profit, if any, accrued thereby, will have to be passed on to the principal.

Problem 9

P, the principal, had instructed his agent, A, to sell his goods against cash payment only. But the agent, in his own enthusiasm, to boost the sales, for the benefit of his principal, had also sold a portion of the goods on credit. But some of such credit sales had remained unpaid, despite the best efforts made by the agent. In the instant case, which of the two, viz. P, the principal, or A, the agent, would be held liable to bear the loss caused by the non-payment of the credit sales made by the agent? Give reasons for your answer.

Solution

In the instant case, A, the agent, will be held liable to compensate his principal (P) for such loss caused to him (P) due to non-compliance of the principal's specific instructions by the agent (A) meticulously, i.e. to sell the goods on cash payment basis alone, which has the effect of prohibiting the agent to effect any sale of the goods on credit basis at all.

This is so because, under Section 211, the agent is obliged to conduct the business of agency in strict accordance with the specific instructions and directions of his principal. Alternatively speaking, he does not have the right to make any deviation in this regard, even for the benefit of his principal. And if he does deviate

in any manner, he will be held personally responsible for all the losses accruing thereby; but the surplus or profit, if any, accrued thereby, will have to be passed on to the principal.

Problem 10

P had authorised his agent A to sell his goods even on credit. Accordingly, A had sold some of P's goods to C on credit, but he had done so without making the necessary trade enquiries regarding B's financial position and credibility. C had subsequently failed to make the payment for the credit purchases. It later further transpired that C was already declared as an insolvent at the time the credit sale was effected to him. Do you think that, under the aforementioned circumstances, A will be held personally liable for the losses sustained by P thereby, and accordingly, he will have to compensate the amount of such loss to his principal, P? Give reasons for your answer.

Solution

A will be held personally liable for the losses sustained by P thereby, and therefore, he will be required to compensate the amount of such loss to his principal, P. This is so because, as has been specifically provided under Section 212, the agent must conduct the business with the skill and diligence that are normally expected from the persons engaged in similar business, except, in the cases where the principal knew that his agent lacks in such skills and proficiency. And there is no mention in the instant case to the effect that the principal knew that his agent lacked in such skills and proficiency.

Problem 11

A, an insurance agent, had been asked by P to effect an insurance on a ship. A acted accordingly, but through an oversight, a usual and significant clause was omitted from being included by A in the relative insurance policy document. The ship was later lost, and P sustained substantial loss, as no compensation had become payable by the insurance company for the lack of the pertinent clause in the policy. In your considered opinion, which one of the two, viz. the agent A or the principal P, will be held liable to bear the loss? Give reasons for your answer.

Solution

In the instant case, A, the insurance agent, will be held personally liable and will have to compensate his principal P for the losses suffered by him in this regard.

This is so because, as per Section 212, the agent must conduct the business with the skill and diligence that are normally expected from the persons engaged in similar business, which was very well-expected from a professional insurance agent.

Problem 12

P had asked his agent A to purchase a house, which was being sold at a much cheaper price, as the owner of the house had since settled abroad. A, however, wrongly advised his principal P, that the house had already been sold out to some one else. But, in fact, A had himself purchased the house for his own use. When P came to know of this fact, he asked his agent A to sell off the house to him at the same price that he (A) had originally purchased for. When A refused to do so, P filed a suit against A. What are the chances of P's winning the case? Give reasons for your answer.

Solution

P is sure enough to win the case in that A will have to sell off the house to P at the same price that he (A) had originally purchased for. Further, A will now no longer be entitled even to his usual commission/brokerage that he would have been usually entitled to. This contention is based on the decision held in the case of Harvalabh vs Jivanji, 1902, 26 Bombay 689.

Problem 13

P (principal) had asked his agent A to recover a sum of Rs 5 lakh due from B, and to invest the entire amount only in good shares and securities. A had recovered the full amount from B and had invested Rs 4.5 lakh in good shares and securities, but had taken a chance and had invested the balance amount of Rs 50, 000 in some shares and securities which were known to be not safe and secured investment. As a result, P had incurred a loss of Rs 30, 000 on the second rate investment.

(a) In the aforementioned circumstances, will A be entitled to get his remuneration for recovering a sum of Rs 5 lakh from B, and for investing Rs 4.5 lakh in good shares and securities, as per the instructions of his principal?
(b) Will A be entitled to any remuneration for having invested Rs 50, 000 in some shares and securities which were known to be not safe and secured investment?
(c) Further, as regards the investment of Rs 50,000 in the second grade securities, which one of the two, viz. P and A, will have to bear the loss of Rs 30,000 sustained on account of the inferior investments, made in contravention of the principal's direction?

Give reasons for your answers in all the three cases.

Solution

As provided under Section 220, if an agent is found guilty of misconduct by the business of agency (i.e. of having conducted the business of agency not in the professional manner usually expected of him as an agent), he will not be entitled even to his usual remuneration on that part of the business which he had not conducted in the professional manner.

(a) Accordingly, A will get his remuneration for recovering a sum of Rs 5 lakh from B, and for investing Rs 4.5 lakh in good shares and securities, as per the instructions of his principal.
(b) But, as regards the investment of Rs 50,000 in second grade securities, against the clear instructions of P, he will not be entitled to any remuneration for this work.
(c) Further, A will have to compensate P for the loss of Rs 30,000 sustained on account of the inferior investments, made in contravention of the principal's instructions.

Problem 14

Under instructions from his principal P at Varanasi, A, the agent of P, enters into a contract with F in France to deliver certain goods to him in France. P, however, fails to send the goods to France, and consequently F files a suit against A for breach of contract. A thereupon informs P of this fact. P authorises A to defend the case. A defends the suit as authorised by P. But A loses the case, and is required to pay the damages with cost, and also incurs some expenses in this connection. In this case, can P be held liable to indemnify A for all the damages, costs, and expenses incurred by him? Give reasons for your answer.

Solution

In this case, P is liable to indemnify A for all the damages, costs, and expenses incurred by him. This is so because, under Section 222, the agent is entitled to get indemnified by his principal against the consequences of all the lawful acts performed by him (agent) under instructions from, and under the authority conferred upon him, by his principal.

Problem 15

Under instructions from his principal P at Delhi, A, the agent of P, enters into a contract with S in Germany to purchase certain goods from him (S). P, however, later backs out and refuses to buy the goods from S, and consequently S files a suit against A for breach of contract. A thereupon informs P of this fact. P authorises A to defend the case. A defends the suit as authorised by P. But A loses the case, and is required to pay the damages with cost, and also incurs some expenses in this connection. In this case, will the principal P be held liable to indemnify the agent A for all the damages, costs and expenses incurred by him? Give reasons for your answer.

Solution

In this case also, as stated in Solution 14 above, P will be held liable to indemnify A for all the damages, costs, and expenses incurred by him. This is so because, under Section 222, the agent is entitled to get indemnified by his principal against the consequences of all the lawful acts performed by him (agent) under instructions from, and under the authority conferred upon him, by his principal.

Problem 16

E, the editor of a daily newspaper paper, has agreed, at the request of F, to publish a story about C, the rival of F, which amounts to a libel (a defamation in writing, as against just a verbal defamation). E had agreed to do so on the promise of F that he (F) will indemnify him (E) for all the consequences, like costs and damages, arising out of publishing such libellous material. E later publishes that libellous piece. Subsequently, C files a suit against E, and E is required to pay the damages and costs to C. Besides, he (E) also incurs some expenses in this connection. In the instant case, can E compel P to indemnify him with the amount of damages, costs, and expenses incurred by him (E)? Give reasons for your answer.

Solution

In this case, E cannot compel F to indemnify him with the amount of damages, costs, and expenses incurred by him (E). This is so because, under Section 224, the agent cannot claim to be indemnified in the cases where he has committed some criminal act, even if his principal had agreed to indemnify his agent, or his involving himself, in such a criminal act.

Problem 17

P was constructing his own house. He had engaged M as a mason for the purpose. Though P did not know how to fix up the scaffolding, he fixed it up himself in an unprofessional and unskilful manner. After working for some time on the scaffolding, it gave way and M was injured in the process. Can P be legally held liable to pay compensation to M? Give reasons for your answer.

Solution

In this case, P will be legally held liable to pay compensation to M. This is so because, as stipulated under Section 225, the principal is bound by law to compensate his agent for any injury caused to him (his agent) due to any neglect or lack of skill, on the part of the principal.

Problem 18

P, the owner of a truck, loaded with the household effects of a third person, for transportation from Varanasi to Hyderabad, had authorised his agent A to get the truck insured. The agent A, however, got the insurance done for the truck as also for the household effects loaded thereon. In this case, whether the principal will be held liable to pay for the insurance premium for the insurance of the truck only, and not for the insurance charges of the household effects? Give reasons for your answer.

Solution

In this case, the principal will be held liable to pay for the insurance premium for the insurance of the truck only, and not for the insurance charges of the household effects, which will have to be borne by the agent himself.

This is so because of the following two reasons, taken together:

(a) Because, the insurance of the household effects had been done by the agent for which he was not authorised by his principal, and

(b) Also because, the two acts (the insurance charges for the truck and the household effects) can be separated from each other.

Our aforementioned contentions are based on the provisions of Section 227, which stipulates that, in the cases where the agent might have done certain acts, which fall within his actual authority, and also some other cases, which do not fall within his actual authority, and also where these two categories of the action can be segregated and separated, the principal will be held liable only for his agent's such acts which have been performed by the agent within his actual authority. Accordingly, as a corollary of this statement, the agent himself, and not his principal, will be personally liable for such acts, which he had performed without and beyond his actual authority.

Problem 19

(a) The agent A is authorised by his principal P to draw a bill for Rs 50,000. A, instead, draws a bill for Rs 90,000. Will the principal be held liable to pay the bill of Rs 90,000?

(b) Alternatively, can the agent force the principal to pay at least a sum of Rs 50,000, inasmuch as the agent was authorised to draw the bill for such amount?

Give reasons for your answers in both the cases.

Solution

(a) The principal will not be held liable to pay the bill of Rs 90,000, as his agent had acted against the specific instructions of his principal.

(b) In fact, he (principal) will not be liable to pay the bill even to the extent of the agreed amount of Rs 50,000, as these two amounts (of Rs 50,000 and Rs 90,000) are not separable in the single bill drawn for Rs 90,000.

This is so because the Section 228 stipulates that where an agent does more than he is authorised to do, and what he does beyond the scope of his authority, cannot be separated from what is within it, the principal is not bound by the transaction. In other words, the agent will be personally responsible to the third party.

Incidentally, we may also clarify here that in case even in the Problem 18 above, the amount of the premium on the insurance of the truck and the household effects were not charged separately, and also that it could not be separated (just for the sake of taking an illustrative example), the agent will have to pay for the entire amount of insurance charges, and the principal will not be required to make any payment in that case, on the ground that the authorised and unauthorised acts of the agent could not be separated.

Problem 20

A, being P's agent, by virtue of being the captain of a ship owned by P, had issued a bill of lading to C, without having received the goods on board, which he (A) was not authorised by P to do. This is so because, the captain of the ship is authorised to issue the bill of lading, in acknowledgement of having received the goods on board, only after having actually receives such goods on board, and not before or without having received the therein mentioned goods on board. Thus, in this case, as the agent has acted beyond authority or without having the actual authority, can he bind the principal? Give reasons for your answer.

Solution

In this case, the bill of lading issued by A will be considered void as between P and C, the consigner. That is to say that, if at all, C can proceed only against A, the agent, and not against P, the principal.

Problem 21

Prakash (the Principal) had given instructions to his agent, Amar, to sell 100 bags of sugar of 50 kg each on his behalf. In this connection, Prakash had also agreed to pay to Amar 10% of the sale proceeds of the sugar by way of commission in this regard. Some time later, but before Amar had sold out the sugar to Bala for a sum of Rs 1,00,000, Prakash (Principal) had sent a letter to his agent, Amar, terminating his authority as his agent. This letter of revocation of the authority, however, was received by Amar after he had already sold out the sugar. In other words, at the time of selling the sugar, Amar was not in the knowledge of the fact that his authority had been terminated by Prakash (Principal), inasmuch as, he had received the letter after he had already sold the sugar. In the instant case, whether the sale will be binding on Prakash (the Principal), or on Amar, the agent, as the principal had revoked his agent's authority?

Solution

In the instant case, the sale will be binding on Prakash (the Principal), because Amar, the agent, had received the letter after he had already sold the sugar. Besides, Amar will also be entitled to receive the commission of Rs 10,000 as was promised by Prakash.

This is so because, under Section 208, as regards the agent, the termination of his authority does not become effective unless and until he comes to know of it (i.e. of such termination of his authority).

Problem 22

In Problem 21 above, what will be the legal position, if Amar (Agent) would have sold the sugar to Bala, even after having received the letter of Prakash (the Principal), revoking his authority as his agent, and thereafter

Amar (Agent), would have absconded with the amount so paid by Bala to him? That is, whether the payment made by Bala to Amar will be held good and valid, as against Prakash (the Principal), if Bala was not aware of the letter of Prakash (the Principal), revoking the authority of Amar as his agent?

Solution

Yes, the payment made by Bala to Amar will be held good and valid as against Prakash (the Principal), because Bala was not aware of the letter of Prakash (the Principal), revoking the authority of Amar as his agent. This is so because, under Section 208, in regard to the third parties, they can continue to deal with the agent (and bind the principal thereby), unless and until they happen to come to know of it (i.e. of such termination of the authority of the agent by his principal).

Problem 23

On 12th June 2009, Prakash (the Principal) had given instructions to his agent, Amar, to sell 500 bags of sugar of 40 kg each on his behalf. In this connection, Prakash had also agreed to pay to Amar five per cent (5%) of the sale proceeds of the sugar by way of commission in this regard. But on 14th June 2009, Prakash (Principal) had sent a letter to his agent, Amar, terminating his authority as his agent. This letter of revocation of the authority was received by Amar on 18th June 2009. On 21st June 2009, however, Amar had sold out the sugar.

(a) Under the foregoing circumstances, will the sale be binding on Prakash (the Principal)?
(b) Will Amar be entitled to receive the commission as was promised by Prakash?

Solution

(a) In the foregoing circumstances, the sale will not be binding on Prakash (the Principal). This is so because Amar, the agent, had received the letter well before he had sold the sugar.
(b) Amar will not be entitled even to receive the commission as was promised by Prakash.

PART 2

Law of Negotiable Instruments

(Negotiable Instruments Act, 1881)*

Chapter Sixteen

Introduction to Law of Negotiable Instruments

"*A book that furnishes no quotations is no book – it is a plaything.*
Thomas Love Peacock

Let every eye negotiate for itself and trust no agent.
William Shakespeare

Let us never negotiate out of fear, but let us never fear to negotiate.
John F. Kennedy"

16.1 What is a Negotiable Instrument?

The term 'Negotiable Instrument' is made up of two parts, viz. 'Negotiable' and 'Instrument'. The word, 'negotiable' means being transferable (from one person to another), and the word 'instrument' signifies 'any written document' through which a right is created in favour of some person. Thus, the term 'Negotiable Instrument' signifies any 'document, necessarily in writing', through which the rights, vested in one person, could be transferred in favour of another person, of course, in accordance with the provisions of the Negotiable Instruments Act, 1881.

16.2 Reserve Bank of India Act, 1934 (Sections 31 and 32)

At the very outset, it must be clarified and doubly emphasised that the Negotiable Instruments Act, 1881, has to be operative and enforceable within the provisions of **Sections 31 and 32 of the Reserve Bank of India Act, 1934**, and any violation of such provisions will be punishable under the law with fine. Let us now see what these provisions are.

Section 31 of the RBI Act stipulates that 'no person (other than the Reserve Bank of India or the Central Government), can draw, accept, make or issue any bill of exchange or a promissory note, payable to bearer on demand'.

Section 32 of the RBI Act is a punitive clause which provides that if a person issues any bill of exchange or a promissory note, payable to the bearer on demand, shall be punishable with fine.

16.2.1 Rationale behind Sections 31 and 32 of the RBI Act

The reasons behind Sections 31 and 32 of the RBI Act are the following:

(a) As we know, the demand drafts issued by the bank are freely accepted in the business world in payments for purchases or any other payments, because the payment of a bank draft is expected to be sure and does not involve any risk of its non-payment for lack of funds or something like that, as is usually the fear and risk involved in the case of accepting cheques in lieu of cash payments.

(b) Thus, if the banks will be allowed to issue bank promissory note, bank drafts, or banker's cheques, made payable to the bearer, the title of such negotiable instruments could, in that case, be transferred to any other person, for any number of times, just by mere delivery, without requiring any endorsements on the reverse of these negotiable instruments. This way, these instruments would start changing hands like currency notes.

(c) Consequently, in that event, the banks would be virtually issuing currency notes, which power and authority has been given only to the RBI for issuing currency notes of the denominations of Rs 2 and above (which are in the nature of promissory notes, issued by the Governor, RBI), and to the Government of India, for issuing currency notes of Re 1, which bear the signature of the Secretary, Finance, Government of India.

(d) That is why, Sections 31 and 32 have been incorporated in the RBI Act.

16.3 Definition of a Negotiable Instrument (Section 13)

As defined under **Section 13**, 'A negotiable instrument means a promissory note, bill of exchange or cheque, payable either to order or to bearer'. It may, however, be clarified here that Section 13 does not exclude any other instrument from being treated as a negotiable instrument, provided, of course, it does have the characteristics of being negotiable. We may, thus, say that while the promissory notes, bills of exchange, or cheques come under the categories of negotiable instruments under the Act itself, the other instruments like the bank promissory notes, bank drafts, interest warrants, dividend warrants, bearer debentures, share certificates, and treasury bills, fall under this category by way of the usage. However, the bank drafts have as well been later included as a negotiable instrument, by incorporation of **Section 85A** in the Act.

16.3.1 Salient Features of a Negotiable Instrument

A 'Negotiable Instrument' must have the following main features:

(i) Free Transferability

The instrument must be freely transferable, i.e. the title to the ownership of the instrument could be transferred, from one person to any other person, without any restrictions. Such transfer of title could take place by way of mere delivery, in the case of a bearer instrument (i.e. the instrument, which is made payable to the bearer of the instrument), and by endorsement together with its delivery, in the case of an order instrument (i.e. the instrument, which is made payable to the order of the payee of the instrument, or that of the last endorsee of the instrument).

Here, it must be clarified that, in the case of both a bearer and an order instrument, the actual delivery of the instrument to the other person is of essence and prime importance.

Example

David draws a bearer cheque in favour of John but, instead of delivering it to him, keeps it in the drawer of his table. However, in the absence of David, John picks up the cheque from David's drawer. This will not amount to a valid transfer of the title to the cheque, drawn in favour of John, even though it is made payable to the bearer.

Further, in the case of an order instrument (i.e. the instrument, which is made payable to the order of the payee of the instrument), mere delivery is not enough. It needs to be endorsed also, on the reverse of the instrument.

Example

Suppose that an order instrument is made payable to Ramesh or order, and it is delivered by the drawer of the cheque to Ramesh, it does give a valid title to Ramesh by mere delivery alone, because the instrument is made in his favour only. Thus, the element of transference of the title does not arise in this case. But if Ramesh were to deliver it to Raghunath, without making any endorsement in favour of Raghunath (usually on the back of the instrument), it does not amount to a valid transfer of the title to Raghunath, inasmuch as the second requirement, essential for the transfer of the title to an order instrument, viz. endorsement, is lacking in this case.

Example

This reminds me of an interesting incident. A person presented a bearer cheque for Rs 1,000 at the counter of the drawee bank (i.e. the bank on which it was drawn by the accountholder of the bank) for payment in cash. When the bank official requested him to sign the cheque on the back of the cheque, the payee refused to do so, on the ground that a bearer cheque did not require any endorsement. And, he was legally absolutely right. Therefore, the bank could not insist for the endorsement on the back of the bearer cheque. But then, the bank official also knew his job well, including the legal provisions affecting the bankers. So, he passed the cheque for payment without insisting on the endorsement on the reverse of the cheque. But then, before making the payment of the cheque in cash, he insisted that the payee should give him a separate receipt in token of having received the cash payment, and that too, on a revenue stamp of one rupee, as the amount happened to exceed Rs 500. This is so because the signature on the back of the instrument at the time of taking the amount in cash from the bank is not in the nature of an endorsement, but by way of a receipt in token of having received the cash payment from the bank. Further, as the receipt given on the reverse of the negotiable instrument is exempt from the stamp duty, the signature on the reverse of the cheque does not attract payment of any stamp duty. But if a separate receipt is to be given on a plain paper as an evidence (proof) of having received the cash payment of the cheque, it is required to be obtained on a revenue stamp of Re 1, if the amount of such cheque were to exceed Rs 500.

(ii) Holder's Title to be Free from Defects

Let us first understand the subtle but significant distinguishing features between the terms 'holder' and 'holder in due course'.

A **'holder in due course'** is one who gets the title to the instrument, in consideration of some value, and that too, in good faith, that is, without any notice in regard to any defect in the title of the previous endorser or transferor of the instrument. Thus, the 'holder in due course' acquires a good title even in the cases where there might have been some defect in the title of the last endorser or transferor, of course, not in the knowledge of the 'holder in due course'. As against the 'holder in due course', a **'holder'** is just a holder of the instrument, and not in consideration of any value. The holder may hold the instrument in the capacity of an agent or a collecting agent (of the owner of the instrument).

Let us take an example from the banking area.

Example

A bank might have purchased (also referred to as 'negotiated', in the banking jargon) a demand bill of exchange, or a cheque, or a bank draft, which signifies that the bank has paid the amount in cash to the person from

whom it (bank) had purchased the instrument in question; or else, it might have credited the face value of the amount of the instrument to the person's account with the bank. The bank may, however, deduct its charges and postages in case of an outstation instrument, drawn not on a local party or bank, but at some other location. In this case, the bank has become a holder in due course, inasmuch as it is holding the instrument in consideration of some value, that is, by virtue of having already paid the amount of the instrument in question in consideration of its having received the instrument. Thus, it enjoys all the rights and protection that are available to a holder in due course, as aforementioned.

As against this, the bank remains just a 'holder' (and not a 'holder in due course') in the cases where it sends the local or outstation instruments on collection basis, and pays the amount to the owner of the instrument only after the realisation of the proceeds of the instrument, as against paying the amount of the instrument at the time of receiving the instrument itself. The collection of local cheques through clearing or collection of outstation cheques is done by the bank as a collecting agent only. Here, the bank gets as much title as the last endorser himself would be having at the material time. Even in the cases, where the bank advances a percentage of the trade bills of exchange, and not the full face value of the instrument, it remains a holder only, and not a holder in due course. That is why, the instrument, which has been purchased by the bank, is treated as a tangible security, and the banks treat the advance granted against the same as a secured advance. But in the other cases, where the bank is just a holder, the advance granted against such instruments is treated as clean or unsecured advance.

(iii) Holder in Due Course can Sue in His Own Name

The holder in due course is entitled to sue in his own name in regard to the instrument, on the ground that he is holding it in consideration of some value, i.e. having his own stake involved in the instrument.

[A detailed discussion on the distinction between '**Holder'** and **'Holder in due course'** appears in Chapter 19, Sub-Sections 19.9 and 19.9.1.]

(iv) Can be Transferred any Number of Times

A negotiable instrument can be transferred innumerable number of times (i.e. any number of times, also referred to as *infinitum*) during its maturity, currency, or validity.

16.3.2 Presumptions Relating to Negotiable Instruments (Sections 118 and 119)

As provided under Sections 118 and 119, unless otherwise proved to the contrary, certain conditions are presumed in regard to any negotiable instrument. These are:

(i) Regarding Consideration

Unless otherwise proved to the contrary, it is presumed that all the negotiable instruments have been drawn, made, accepted, endorsed, negotiated (or purchased), discounted, or transferred, for some consideration (for value received).

[Let us first understand here itself the different contexts in which the aforementioned terms are used. For example,

(a) A cheque, bill of exchange or bank draft, etc. are said to have been drawn, while a promissory note is said to have been made,
(b) A time (usance) bill is required to be accepted for payment,
(c) A cheque, bank draft, or bill of exchange is endorsed,
(d) A cheque, bank draft, or demand bill of exchange is negotiated (or purchased), while a time (usance) bill of exchange is technically speaking (in banking jargon) said to be discounted.

(e) The title to a negotiable instrument is transferred by mere delivery in the case of bearer instruments, and by endorsement and delivery in the case of instruments made payable to order.

But then, it must be clearly understood by us that it should not be automatically presumed that a consideration invariably and necessarily exists in all the cases of negotiable instruments. In other words, the presumption regarding the existence of consideration in respect of the negotiable instruments is not irrefutable, i.e. it is refutable all the same, unless the existence of consideration is proved to be there. This contention is based on the observations made by the learned judge of the Kerala High Court in the case of **Marimuthu Kounder vs Radhakrishnan and others, AIR, 1991, Ker, 39.** The onus of proof, however, lies either on the defendant or else on the plaintiff, depending upon the different situations and circumstances, as has been discussed hereafter.

(a) In the case of a dispute, first of all the plaintiff has to prove that the defendant has executed the instrument (Promissory Note, in the instant case). However, in the cases where the defendant has already admitted that the instrument was executed by him, the plaintiff will not be required to prove this point.

(b) Thereafter, if the Court is satisfied that the instrument was executed by the defendant, the onus (burden) of proof would now lie on the defendant to prove that there was no consideration involved in the case. This is based on the observations made by the Court to the effect that in the cases where the execution of the instrument is admitted or proved, it is presumed that it was executed for some valuable consideration, and accordingly, in the case of dispute, the defendant will have to prove that the consideration was lacking.

(ii) Regarding Date

Every negotiable instrument must bear the date of its execution or drawing or acceptance for payment.

(iii) Regarding Acceptance

It is presumed that every time (usance) bill of exchange was accepted within a reasonable time after the date appearing thereon, and before the date of its maturity, i.e. its due date of payment. It may be noted here that if the time bill is made payable so many days or months after its date, its date of maturity will be calculated from the date appearing thereon. But, if it is made payable after the date of its acceptance, its date of maturity will be calculated from the date of its acceptance. We will discuss in detail about the procedure of calculating the due dates in these cases a little later in Chapter 18, Sub-Section 18.6 in the book.

(iv) Regarding Transfer

The other presumption is that every transfer of an instrument was made before the date of its maturity, i.e. before the date it was falling due for payment. This presumption will naturally apply only in the cases of time bills, and not in the case of any demand bill of exchange, like cheque or bank draft, which are invariably payable on demand, and, consequently, in such cases the question of calculating its due date does not arise.

(v) Regarding the Order (Sequencing) of the Endorsement

The sequencing of the endorsements is presumed to have been made in the same order as these appear on the instrument (i.e. on the reverse of the instrument, or on the additional sheet(s) attached thereto, usually referred to as 'allonge'), because the instrument can be endorsed for any number of time, and thus, it may, on some occasions, require attaching some additional sheet(s) of paper.

(vi) Regarding Lost or Destroyed Instruments

In the cases where the instrument gets lost or destroyed, it is presumed that it was duly stamped as also that the stamps affixed thereon were duly cancelled.

(vii) Regarding Holder in Due Course

It is generally presumed that the holder of the instrument is its holder in due course; unless it is proved that he is merely a 'holder', instead.

(viii) Regarding Dishonour of an Instrument

In the case, where a suit has been filed, involving the dishonour of an instrument, the Court will, on production of the proof of its having been duly protested, presume that the bill of exchange was dishonoured, unless it is proved otherwise.

We will now proceed to discuss, in detail, about Promissory Notes, Bills of Exchange, and Cheques and Bank Drafts, in the following chapters.

Let us Recapitulate

The term 'Negotiable Instrument' signifies any 'document, necessarily in writing', through which the rights, vested in one person, could be transferred in favour of another person, of course, in accordance with the provisions of the Negotiable Instruments Act (N I Act), 1881.

Further, the N I Act will be enforceable within the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934, and any violation of such provisions will be punishable under the law with fine

Section 31 of the RBI Act stipulates that 'no person (other than the Reserve Bank of India or the Central Government), can draw, accept, make or issue any bill of exchange or a promissory note payable to bearer on demand'.

Section 32 of the RBI Act is a punitive clause which provides that if a person issues any bill of exchange or a promissory note, payable to the bearer on demand, shall be punishable with fine.

This is so because, if the banks will be allowed to issue bank promissory note, bank drafts or banker's cheques, made payable to the bearer, the title of such negotiable instruments could, in that case, be transferred to any other person, for any number of times, just by mere delivery, without requiring any endorsements on the reverse of these negotiable instruments. This way these instruments, which are widely accepted without any fear of dishonour for want of funds, would start changing hands like currency notes.

But such power and authority vests only with the RBI for issuing currency notes of the denominations of Rs 2 and above (which are in the nature of promissory notes, issued by the Governor, RBI), and to the Government of India, for issuing currency notes of Re 1, which bear the signature of the Secretary, Finance, Government of India.

As defined under **Section 13**, 'A negotiable instrument means a promissory note, bill of exchange or cheque, payable either to order or to bearer'. But it does not exclude any other instrument from being treated as a negotiable instrument; if it has the characteristics of being negotiable. Thus, the other instruments like the bank promissory notes, bank drafts, interest warrants, dividend warrants, bearer debentures, share certificates, and treasury bills, also fall under this category by way of usage. Later, under **Section 85A,** bank drafts have also been included as a negotiable instrument.

A 'Negotiable Instrument' must have the following main features:

(i) The instrument must be **freely transferable**, i.e. the title to the ownership of the instrument could be transferred, from one person to any other person, without any restrictions, by mere delivery, in the case of a bearer instrument, and by endorsement and delivery, in the case of an order instrument. Thus, in both the cases, the actual delivery of the instrument to the other person is of essence and prime importance.

(ii) The title of the **holder** of the instrument must be free from defects. As against this, the **'holder in due course'**, that is, who gets the title to the instrument, in consideration of some value, in good faith (i.e. without any notice in regard to any defect in the title of the previous endorser of the instrument),

acquires a good title even in the cases where there might have been some defect in the title of the last endorser.

(iii) Further, the **holder in due course can sue in his own name**.

(iv) A negotiable instrument can be **transferred any number of times** during its maturity, currency or validity.

Under **Sections 118 and 119**, the following **conditions are presumed** in regard to all the negotiable instruments, unless otherwise proved to the contrary:

(i) That, all the negotiable instruments have been drawn, made, accepted, endorsed, negotiated (or purchased), discounted, or transferred, for some consideration (i.e. for value received).

(ii) That, every instrument must bear the date of its execution or drawing or acceptance for payment.

(iii) That every time (usance) bill of exchange was accepted within a reasonable time after the date appearing thereon, and before the date of its maturity, i.e. its due date of payment.

(iv) That, every transfer of a time (usance) instrument was made before the date of its maturity, i.e. before the date it was falling due for payment.

(v) That, the sequencing of the endorsements was made in the same order as these appear on the instrument or on the 'allonge'.

(vi) That**,** if the instrument gets lost or destroyed, it is presumed that it was duly stamped and such stamps were duly cancelled, too.

(vii) That, the holder of the instrument is its 'holder in due course'; unless it is proved that he is merely a 'holder', instead.

(viii) That, where a suit has been filed, involving the dishonour of an instrument, the Court will, on production of the proof of its having been duly protested, presume that the bill of exchange was dishonoured.

Questions for Reflection

1. (a) Define a 'Negotiable Instrument', quoting the number of the Section that has defined it.
   (b) What are the main features of 'Negotiable Instruments'?
2. Section 31 of the RBI Act stipulates that 'no person (other than the Reserve Bank of India or the Central Government), can draw, accept, make or issue any bill of exchange or a promissory note payable to bearer on demand'. What are the specific reasons and rationale behind these provisions?
3. What are the various conditions that are presumed in regard to all the negotiable instruments, under Sections 118 and 119, unless otherwise proved to the contrary?

Problems for Practice (With Suggested Solutions)

Problem 1

Deepali had drawn a bearer cheque in favour of Ankita, but, instead of delivering it to her, she had kept it in the drawer of her table, and had gone to her office. In the meantime, Ankita had happened to visit her house to take delivery of the cheque from her, as she (Deepali) had promised to her. But, as Deepali was not available at her residence, Ankita had picked it up from Deepali's drawer, because it was drawn payable to her, and that Deepali had already promised to give the cheque to her. Will it amount to be a valid transfer of the title to the cheque, drawn in favour of Ankita, in view of the fact that it was made payable to the bearer?

Give reasons for your answer.

Solution

It is true that a valid transfer of title, in the case of a bearer instrument, could take place by way of mere delivery, as against an order instrument, in which case the title to the instrument can be transferred by endorsement together with its delivery. But then, we must not forget that the actual delivery of the instrument

to the other person is of essence and prime importance in both the cases, i.e. of a bearer and an order instrument. Therefore, as the cheque in question was not actually delivered to Ankita by Deepali, it will not amount to a valid transfer of the title to the cheque, even though the cheque was drawn in favour of Ankita and that it was also made payable to the bearer.

Problem 2

(a) An order cheque, made payable to John or order, is delivered by Joseph (drawer of the cheque) to John. Will it give a valid title to John by mere delivery of the cheque to him by Joseph, without any endorsement thereon? Give reasons for your answer.

(b) If John were to deliver it to Ramsay without making any endorsement in favour of Ramsay, will it likewise amount to a valid transfer of the title to Ramsay? Give reasons for your answer.

Solution

(a) In the case (a), we observe that the cheque was delivered by Joseph, the drawer of the cheque, to John, who himself happened to be the payee of cheque. In such cases, mere delivery of the cheque in itself is considered sufficient enough. This is so because, in such cases the question of endorsement does not arise at all. For the aforementioned reasons, John (payee) will get a valid title by mere delivery of the cheque to him by Joseph (drawer), without any endorsement thereon.

(b) In the case of an order instrument, mere delivery is not enough. It needs to be endorsed also, on the reverse of the instrument. Thus, in the instant case, it does not amount to a valid transfer of the title to Ramsay inasmuch as the second requirement, in addition to delivery, essential for the transfer of the title to an order instrument, viz., endorsement (by John in favour of Ramsay, in the instant case), is lacking here.

We may also highlight the point that, in the case (b), the position is absolutely different from the case (a), in that while in the case (a) the cheque was delivered by the drawer of the cheque to the payee himself, where no endorsement was required. As against this, in the case (b), the order cheque has been delivered to a third party by the payee (and not by the drawer of the cheque to the payee thereof). That is why, we have opined that, in the instant case, it does not amount to a valid transfer of the title to Ramsay.

Problem 3

(a) A person presents a bearer cheque for Rs 5,000 at the counter of the drawee bank for its payment in cash. When the bank officer requests him to sign the cheque on the back of the cheque, the payee refused to do so, on the ground that a bearer cheque did not require any endorsement. Do you think that the payee of the cheque is legally right? Give reasons for your answer.

(b) In case you are of the considered opinion, in the above case, that the bank cannot insist for the endorsement on the back of the bearer cheque, what specific legal opinion will you give to the banker to safeguard his position in such case? Give reasons for your answer.

Solution

(a) The payee of the cheque is legally right because, the bank cannot insist for the endorsement on the back of the bearer cheque. Therefore, the bank official may have to pass the cheque for payment, without insisting on the endorsement on the reverse of the cheque.

(b) But then, before making the payment of the cheque in cash, he can legally insist that the payee should give him a separate receipt in token of having received the cash payment, and that too, on a revenue stamp of one rupee, as the amount happened to exceed Rs 500, in the instant case.

In this connection, we should be quite clear on the point that the signature on the back of the instrument, at the time of taking payment of the amount in cash from the bank, is not in the nature of an endorsement, but by way of a receipt, in token of having received the cash payment from the bank. Further, as the receipt given on the reverse of the negotiable instrument is exempt from the stamp duty, the signature

on the reverse of the cheque does not attract payment of any stamp duty. But, if a separate receipt is to be given on a plane paper, as an evidence (proof) of having received the cash payment of the cheque, it is required to be obtained from the payee on a revenue stamp of Re 1, if the amount of such cheque were to exceed Rs 500.

Problem 4

(a) A bank has purchased a demand bill of exchange from one of his customers and has paid the full amount of the bill of exchange by credit to his (customer's) account with the bank. In this case, will the bank be considered as a mere holder of the instrument or its holder in due course? Give reasons for your answer.

(b) A bank has received an outstation cheque from one of his customers for crediting the full amount of the cheque immediately on its realisation. In this case, will the bank be considered as a mere holder of the instrument or its holder in due course? Give reasons for your answer.

Solution

(a) In this case, the bank will be considered, not as a mere holder of the instrument, but as its holder in due course, instead.

This is so because, here the bank has purchased the demand bill of exchange from his customers and has paid the full amount of the bill of exchange by credit to his (customer's) account with the bank. The bank will, therefore, be considered as holder for value, also known as the holder in due course.

(b) In this case, we observe that the banker has received the outstation cheque from his customers for crediting the full amount of the cheque, in fact, not immediately on its receipt, but only after its realisation. Therefore, the banker cannot be considered as a holder for value or holder in due course, but only as a mere holder of the cheque, in the capacity of the collecting agent of his customer.

Chapter Seventeen

Promissory Notes

"*Promises make debt, and debt makes promises.*
Dutch Proverb

There is no greater fraud than a promise not kept.
Gaelic Proverb

Promises are like crying babies in a theatre, they should be carried out at once.
Norman Vincent Peale

Losers make promises they often break. Winners make commitments they always keep.
Denis Waitley

The promise given was the necessity of the past: the word broken is the necessity of the present.
Niccolo Machiavelli "

17.1 Definition of a Promissory Note (Section 4)

Section 4 defines a promissory note as 'an instrument, in writing (not being a bank note or a currency note), containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to, or to the order of, a certain person, or to the bearer of the instrument'.

Let us first discuss the main characteristics or the essential ingredients of a promissory note.

17.1.1 Analysis of Various Clauses Contained in the Definition of a Promissory Note

We will first try to split the various clauses contained in the definition of a promissory note, to understand and appreciate the legal significance and ramifications thereof hereunder:

(a) An instrument (i.e. a document, necessarily in writing, through which the rights, vested in one person, could be transferred in favour of another person),
(b) In writing (i.e. not just verbally),
(c) Not being a bank note or a currency note (vide **Sections 31 and 32 of the RBI Act**),
(d) Unconditional (there should be no condition attached thereto, except such events which are bound to happen, e.g., the death of a particular person or the like),
(e) Undertaking (and not just an acknowledgement of a debt or the like),
(f) Signed by the maker (i.e. it must necessarily bear the signature of the maker of the promissory note; alternatively speaking, it must necessarily be signed by the maker, failing which it will be deemed to be a nullity),
(g) To pay (and nothing else),
(h) A certain sum of money (and money only, and not anything else, like the delivery of a car or the like),
(i) To, or to the order of,
(j) A certain person (i.e. the payee must be a definite and particular person, identified further by adding clauses like 'son/daughter/husband/wife of ……., resident of ……' and the like),
(k) Or to the bearer of the instrument.

17.1.2 Parties to a Promissory Note

Thus, there are two parties to a **promissory note**, at the time of its making (execution), viz.

(a) the **maker** or **drawer**, who makes (draws) the **promissory note, promising to pay the amount stated therein, and**
(b) the **payee**, to whom the amount, written on the **promissory note, is payable**.

But then , besides the maker (drawer) and the payee, the following may also become the parties to a **promissory note,** after it has been endorsed and delivered, in the case of an order instrument, and just by delivery only (i.e. without endorsement) in the case of a bearer instrument.

(a) The holder, i.e. the original payee or the endorsee, where the order instrument has been endorsed. In case of a bearer instrument, however, the bearer or the possessor of the instrument is the holder, as a bearer instrument does not require any endorsement.
(b) The endorser, i.e. the person who endorses the instrument in favour of another person, and
(c) The endorsee, i.e. the person in whose favour the instrument has been endorsed.

We will now proceed to discuss, in some further details, the various legal principles and provisions, contained and inherent in the definition of a promissory note hereafter.

17.2 Essential Ingredients of a Promissory Note

17.2.1 In Writing

A promissory note has to be necessarily in writing. Here, the term 'in writing' includes even printed, typewritten, or computer-printed matter. Further, for the sake of an argument, we may also interpret the term 'in writing' to suggest that the promissory note could as well be written in pencil, and not necessarily in ink. However, it is safer to make the promissory note, and any instrument for that matter, in ink, so as to avoid an easy, quick, and undetectable material additions/alterations in the instrument.

17.2.2 A promise to Pay

Further, a promissory note must contain an undertaking or promise to pay. In other words, a mere acknowledgement of a debt is not good enough. Similarly, a receipt for money, in itself, without containing an

expressly stated promise to pay, does not constitute a promissory note. Alternatively speaking, a receipt for money, together with a specifically stated promise to pay, of course, constitutes a promissory note. It may be further clarified in this context that, for a promissory note to be considered as a valid one, it is not necessary that the word 'promise' has to be necessarily used. That is, the use of some other word having the connotation of a promise or undertaking can as well be used.

Example

'We have received a sum of Rs 9,000 from Shri Suresh Gopal. This amount will be repaid on demand. We have received the amount in cash'.

In this case, we find that it is in the nature of a receipt or an acknowledgement (of having received the within-mentioned amount) in cash, plus the assurance that this amount will be repaid on demand, though the specific word 'promise' has not been used, but the intention is in the nature of a promise or an undertaking. The learned judge in the case **Surjit Singh vs Ram Ratwan, AIR (1975), Gan. 15,** had held that the instrument was a valid Demand Promissory Note (DP Note).

17.2.3 Unconditional

To constitute a valid Promissory Note, the promise to pay contained therein has got to be necessarily an unconditional promise, not dependent upon some event taking place or not taking place, or a certain work being accomplished or not accomplished, and so on.

Examples

(a) P promises to pay to Q Rs 10,000 in case R, on his (R's) death, leaves sufficient money in favour of P, is not a promissory note, inasmuch as it is dependent upon some event taking place (like the death of R, and his leaving sufficient money in favour of P).

(b) P promises to pay to Q Rs 10,000 one month after his marriage with R, is again not a valid promissory note for the same reason, viz. the promise to pay the amount is conditional, depending upon in the event of the marriage of P taking place with R, and not if such marriage does not take place.

Here, we may stress a legal point, viz. in case the taking place of an event is definite and certain to take place, as per our ordinary experience, e.g., depending upon the death of a particular person, such condition or provision will not stand in the way of the promissory note being a valid instrument, a valid promissory note.

Thus, a promise to pay a certain amount on the death of a particular person will constitute a valid promissory note in view of the known and certain fact that every one of us must die some day or the other, today, tomorrow, or on some other near or distant future date.

As we have seen in the above example, where P promises to pay to Q Rs 10,000 in case R, on his (R's) death, leaves sufficient money in favour of P, is not a promissory note, inasmuch as it is dependent upon some event taking place (like the death of R, and his leaving sufficient money in favour of P).

A against this, in the case where P promises to pay to Q Rs 10,000 on the death of R, is a promissory note because the condition stipulated in this case is an event which is sure to take place in the future, i.e. the death of R.

17.2.4 Signed by the Maker

A promissory note, to be a valid negotiable instrument, must necessarily be signed by the maker thereof, failing which it shall not be deemed to be a valid negotiable instrument, even if it might have been written in the maker's own handwriting, and his name also appears on the body of the promissory note.

The term 'signature' in this context means the maker (of the instrument) writing his full name or his signature on the body of the instrument at the stipulated place, with a view to authenticating the terms of the contract contained in the promissory note in question.

It may, however, be noted here that the promissory note executed by an authorised attorney (agent), under his own signature, would be held as a valid negotiable instrument.

Meenakshi vs Chettiar, AIR (1957) Mad. 8 is a legal case in point.

17.2.5 Certain Person

The promissory note must contain the names of the maker of the instrument as also the name of its payee with certainty, sans any ambiguity, by giving further identification details like the son/daughter/wife of the maker and payee of the instrument, as also their residential address and so on. The identification of the payee may as well be by his or her description/designation, and so on, like the Chief Manager, State Bank of India, Gomti Nagar Branch, Lucknow- 226010.

It may be noted in this context that a promissory note cannot be made payable to the maker himself. Such promissory note will be held to be null and void, a nullity. But then, if it is endorsed by the maker to some other person, or even if endorsed in blank, it will be held to be a valid promissory note. **[Gay vs Landal (1848) LT CP 286]**

17.2.6 Certain Sum of Money

The sum of money, payable against the promissory note must be certain or else it must be capable of being made certain. For example, where the rate of interest payable against the promissory note is specified [like 3 per cent above the 'prime lending rate (PLR) of the State Bank of India', rising and falling therewith, or like 5 per cent above the 'bank rate' (i.e. the rate of interest at which the Reserve Bank of India (RBI) lends money to the commercial banks), the sum of money will be deemed to be certain, and thus, such promissory note will be held to be a valid instrument. This is so because the 'PLR of SBI' and the 'bank rate' of the RBI are certain. As against this, the clause like 'at market rate of interest' will not go to make the sum of money certain, or even capable of being made certain, as the expression like 'at market rate of interest', will be deemed to be uncertain and hence, ambiguous. This is so because, the market rate of interest may keep varying with the source of the borrowing, the purpose of borrowing, the financial standing of the borrower, and so on.

17.2.7 Promise to Pay Money Only

The promissory note must stipulate payment of money and only money, and nothing else, in addition to money. Alternatively speaking, if the promissory note contains a promise to pay something else also, in addition to money (like the car or house and so on), it would not be held to be a valid promissory note. For example, an instrument reading as 'I promise to pay Varsha a sum of Rs 1,00,000 and also to deliver to her a Honda motorcycle', it will not be held to be a valid promissory note.

17.2.8 Date, Place, Number, and So On

It has been found that usually the promissory notes also incorporate information like the date, place, number, and so on, but these information are not necessary, as per law, though such additional information/particulars do not invalidate such promissory notes. It may also be stressed here that, in case the promissory note does not bear the date of its execution, it would be deemed (presumed) to have been made on the date it has been delivered by the maker to the payee concerned.

17.2.9 Payable in Instalments

A promissory note may be made payable not necessarily in full in one go, but it may be made payable even in instalments, as has been provided under **Section 5, paragraph 3.**

17.2.10 Types of Promissory Note

There are two types of Promissory notes; these are:

17.2.10.1 Promissory Note Made Payable on Demand, and

17.2.10.2 Promissory Note Made Payable after a Definite Period.

(i) As defined under **Section 19,** the demand promissory notes are such notes which are made payable 'on demand' or 'at sight' or 'on presentation'. These are also known as sight notes. That is, no time for their payment is specified therein.

The term 'payable on demand' means that it must be paid immediately on demand, or else, any time till it becomes time-barred. Further, under the provisions of the Indian Limitation Act, a demand promissory note (DP Note) becomes time-barred after the expiry of three years from the date given thereon.

(ii) As against a demand promissory note, a usance (time) promissory note is made payable after a definite period, i.e. after so many days or after so many months, as stated therein.

But, in the cases where a promissory note is made payable in two distinct parts, i.e. where the first part is made payable within six months any time on demand, and the second part is made payable within the next six months any time on demand, the Bombay High Court had observed that such promissory note cannot be held to be a valid 'promissory note payable on demand', **[Kallapa Pundalik Reddy vs Laxmibai, AIR (1995) Bom.160].** Alternatively speaking, such promissory note would be held as a 'Time Promissory Note' (TP Note), instead, and therefore, it would be required to be stamped accordingly, and not for the amount of the stamp duty that is exigible on a DP Note.

Thus, we see that there are two types of promissory notes, viz. 'Demand Promissory Note (DP Note), and 'Time Promissory Note' (TP Note). The specimens of these two types of Promissory Note are given a little later in this chapter.

17.2.11 Not to be made Payable to the Bearer

A 'Promissory Note' cannot be made 'payable to the bearer on demand', or even made 'payable to the bearer after a certain period', as per the provisions of the **Sections 31 and 32 of the RBI Act.**

17.2.12 Duly Stamped

Both the DP Notes and the TP Notes must be properly stamped (for the required value) as per the provisions made in the Indian Stamp Act. The State Stamp Acts, which vary from State to State, do not apply in the cases of Negotiable Instruments, with a view to maintaining uniformity all over India.

Further, the stamps of the requisite amount, affixed on the promissory note, must be duly cancelled too, either before or at the time of executing (making) it. This is important because, a promissory note, which is not duly stamped and thereafter the stamps affixed thereon are duly cancelled, such promissory note will be held to be invalid—a nullity—in the eye of law.

17.3 Revival of a DP Note after it has Already Become Time-barred (Expired)

As per the Indian Limitation Act, a Demand Promissory Note (DP Note) becomes time-barred after expiry of three years from the date of its execution. That is why, the banks and other creditors prefer to make a diary note around nine months prior to the date of the expiry of the DP Note, so as to initiate the procedure for the

revival of the DP Note in the right earnest and obtain the required DP Note Revival Letter well within the expiry of the DP Note. Thereafter, the diary note is made again after two and a quarter year (or nine months before the expiry of three years) from such fresh date of the execution of the DP Note. This procedure of the revival of a DP Note is in order.

But there could be some stray cases where the creditor (even banks), might have forgotten to get the DP Note revived in the regular manner, i.e. well before its actual date of expiry, as aforesaid. In such cases, where the DP Note has already expired, it cannot be legally revived thereafter. The simple analogy that could be given in this context and that too, just by way of an illustration, could be that you can revive a sinking person, only before he is finally dead, by administering or injecting some life-saving injection to him. But you just cannot revive him after he is finally dead. The DP Note too, after the expiry of three years from the date of its execution is, in effect, finally 'dead', well beyond its revival hereafter, under any circumstances, whatsoever

Let us now consider various manners in which the creditor may prefer to get an expired DP Note revived, which may **not** be valid in the eye of law.

(a) Some of the banks have the practice of getting a duly stamped DP Note Revival Letter in blank duly signed by the borrowers so as to put the required date a little before the date of its expiry, in case the (recalcitrant) borrower may refuse to give a DP Note Revival Letter at the appropriate time. But then the efficacy and validity of such a strategy and procedure seems rather doubtful. Moreover, this legal point has not been tested in any Court of law so far.

(b) Some may suggest that we may obtain a DP Note revival letter in the back date, but again its legal validity is doubtful, if it could be proved that the revival letter was so obtained after the DP Note had already expired.

In this context, the provisions of the **Sub-Section 25 (3) of the Indian Contract Act** may prove to be of great help to come out of such tricky situation. The aforementioned Section provides that **'**if some other conditions are also satisfied, a promise to pay even a time barred debt, even without consideration, would be held valid and binding upon the promisor, and the time-barred debt would get revived'**.** The other specified conditions, required to be fulfilled, are discussed hereunder:

(a) There must be a clear and existing debt, of a certain amount, which would have been otherwise actually enforceable in law, but for it's having, by now, become time-barred. Thus, a contingent liability (which, in fact, does not constitute a debt), would not be covered under this exemption. Moreover, the debt must be of a certain amount. Thus, a promise to pay whatever amount is due, after taking the accounts, would not be covered under this provision. **[Chowksi vs Chowksi, 8 Bom. 194].**

(b) There must be an expressed promise (to pay the debt), and not just an implied promise. For example, the statement from the debtor that he owes to the creditor a debt of Rs 10, 000, in itself, would not amount to a promise to pay.

(c) Further, such an expressed promise should be to pay the time-barred debt, and not just an acknowledgement thereof. That is, if the debtor just says that he owes a sum of Rs 10,000 to the other party, it would not amount to a promise to pay the debt, and accordingly, this exemption would not apply in such a situation. But then, an acknowledgement of a debt may extend the period of limitation of the debt only, and not that of the DP Note, by another three years, provided it has been given before the debt has already become time–barred.

(d) The promise to pay the time-barred debt must come from that very person who was originally liable under the debt. In other words, the provisions of the **Sub-Section 25 (3) of the Indian Contract Act** do not apply in the cases where the third party (i.e. the person other than the original debtor) makes such a promise to pay the debt owed by the original debtor. **[Pestonji vs Meherbai, 30, Bom. LR 1407].**

(e) The promise so made must be in writing, and must be duly signed by the original borrower himself. Such written promise could be prepared by way of a separate document, specifically prepared for the purpose, or else it may be given even by way of a simple letter.

17.3.1 In the foregoing circumstances, it will be in order to get a fresh DP Note, with the correct (subsequent) date, along with a letter, as aforementioned.

Here, it must also be remembered that even if the DP Note would have expired and the borrower is not willing to execute a fresh DP Note, as aforesaid, the debt (which also, like a DP Note, becomes time-barred after expiry of three years) will be valid, all the same, provided it has been revived in one of the following manners:

(i) By getting the confirmation of the debit balance on the account outstanding on a particular date, duly signed by the borrower, and thus, the debt's limitation period gets extended for three years from the date of such letter/confirmation.

(ii) A letter from the borrower, acknowledging the debt, extends the limitation period by three years, from the date of such letter.

(iii) A letter, signed by the borrower, even if denying the debt, has the effect of extending the limitation period. Therefore, the creditors, like the banker, must also carefully preserve such letter.

(iv) Any transaction/operation (deposit or withdrawal) on the loan account also extends the limitation periods. A deposit by the borrower, or by his authorised agent, has the effect of extending the limitation period. And remember. The person/employee of the borrower who frequently visits the branch of the bank, to transact business, on behalf of the borrower, can be treated in law, as the authorised agent.

Further, more than ordinary care must be taken to file a suit for the recovery of the dues, before the debt itself becomes time barred. Moreover, as per the provisions of the Bankers' Books of Evidence Act, the very fact that the respective books/ledgers of the bank evidence that the person owes a certain sum of money to the bank, will be sufficient enough to establish the debt, and accordingly, the lack of a valid (un-expired) DP Note will not have any adverse effect on the merit of the case.

17.4 Stampings and Cancellation of the Stamps Thereof

As per the Indian Stamp Act, a DP Note [a specimen of a Demand Promissory Note (DP Note) is shown in Figure 17.1] is required to be executed on a revenue stamp of Rupee one (Re 1). The TP Notes [as shown in Figure 17.2 be a specimen of a Time Promissory Note (TP Note)], however, are required to stamped, depending upon the period after which it is made payable. The respective legal provisions in this regard, have been discussed, in detail, in chapter 18, dealing with the Bills of Exchange.

Further, in the case of a DP Note, the revenue stamp must be affixed thereon at the time of its execution itself or even beforehand. However, to evidence this fact, the signature of the person, making the DP Note, must appear on the revenue stamp itself, along with the date of its execution thereon. Moreover, it should be done in such a manner that a portion of both the signature as also the date must be on the revenue stamp, and the remaining parts of each should be on the DP Note document, too, so as to evidence that the required revenue stamp was already affixed on the DP Note when it was executed, and not that it was affixed thereon later. With a view to dispelling any doubt that it was affixed, on some other document earlier, and that the same pre-used revenue stamp has been reaffixed on this DP Note, the signature, with the date, is put in the manner, as suggested earlier, so as to ensure that the same revenue stamp had never been, and can never be used over again on any other document, at a later date. One more advantage is there. In case the revenue stamp, somehow gets removed from the DP Note, the blank space of the exact size matching with the size of the missing part of the signature and date, would suggest that the DP Note was actually duly stamped at the time of its execution. Further, by way of an abundant precaution, yet another signature, with date, must also be obtained on the DP Note, entirely away from the revenue stamp, such that if the stamp gets somehow removed, and a part of the signature therewith, a separate full signature, with date, will be available on the DP Note document, any way, for verification purposes, whenever required, and even in the Court of law, if need be.

17.5 Specimen of Promissory Notes

17.5.1 Specimen of Demand Promissory Notes (DP Notes)

Rs 1, 00,000 Lucknow
Dated the 5th September 2008

On demand I/we promise to pay State Bank of India or order a sum of Rupees one lakh only, with interest @ 14 per cent per annum, with quarterly rests* for value received.

Signature and date on Revenue Stamp(s)

*Quarterly rests means that interest will be applied on the loan amount compounded every quarter.

Figure 17.1 Specimen of a Demand Promissory Note (DP Note)

17.5.2 Specimen of Time Promissory Notes (TP Notes)

Rs 1, 00,000 Lucknow
Dated the 5th September 2008

90 days after date
Nine months after acceptance I/we promise to pay to the State Bank of India or order a sum of Rupees one lakh only, with interest @ 14 per cent per annum, with quarterly rests* for value received.

To
State Bank of India
Hazrat Ganj, Lucknow

Signature and date on Revenue Stamp(s)

*Quarterly rests means that interest will be applied on the loan amount compounded every quarter.

Figure 17.2 Specimen of a Time Promissory Note (TP Note)

Let us Recapitulate

Section 4 defines a promissory note as 'an instrument, in writing (not being a bank note or a currency note), containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to, or to the order of, a certain person, or to the bearer of the instrument'.

Analysis of various clauses contained in the definition of a promissory note

(a) An instrument (i.e. a document, through which the rights, vested in one person, could be transferred in favour of another person),
(b) In writing (i.e. not just verbally),
(c) Not being a bank note or a currency note (vide **Sections 31 and 32 of the RBI Act**),
(d) Unconditional (there should be no condition attached thereto, except such events which are bound to happen, e.g., the death of a particular person or the like),
(e) Undertaking (and not just an acknowledgement of a debt or the like),
(f) Signed by the maker (i.e. it must necessarily bear the signature of the maker of the promissory note,
(g) To pay (and nothing else),
(h) A certain sum of money (and money only, and not anything else, like the delivery of a car or the like),
(i) To, or to the order of,
(j) A certain person (i.e. the payee must be a definite and particular person),
(k) Or to the bearer of the instrument.

Parties to a promissory note

Thus, there are two parties to promissory note, viz.

(a) the **maker** or **drawer**, who makes (draws) the **promissory note, promising to pay the amount stated therein, and**

(b) the **payee**, to whom the amount, written on the **promissory note, is payable**.

But then, after it has been endorsed and delivered, in the case of an order instrument, and just by delivery in the case of a bearer instrument, the following persons also become parties to the promissory note:

(c) The holder, i.e. the original payee or the endorsee, where the order instrument has been endorsed.

(d) The endorser, i.e. the person who endorses the instrument in favour of another person, and

(e) The endorsee, i.e. the person in whose favour the instrument has been endorsed.

Essential ingredients of a promissory note

(i) In writing
(ii) A promise to pay
(iii) Unconditional
(iv) Signed by the maker
(v) Certain person
(vi) Certain sum of money
(vii) Promise to pay money only
(viii) Date, place, number, and so on
(ix) Payable in instalments

There are the following **two types** of Promissory notes:

(i) **Payable 'on demand' or 'at sight' or 'on presentation'** (also known as sight notes), i.e. must be paid immediately on demand, or at any time till it becomes time-barred; i.e. before expiry of three years from its date; and

(ii) **Payable after a definite period**. i.e. after so many days or after so many months, as stated therein.

Revival of a DP Note after it has already become time-barred (Expired)

As per the Indian Limitation Act, a Demand Promissory Note (DP Note) becomes time-barred after expiry of three years from the date of its execution. An already expired DP Note cannot be legally revived thereafter.

The **Sub-Section 25 (3) of the Indian Contract Act** provides that 'if some other conditions are also satisfied, a promise to pay even a time barred debt, even without consideration, would be held valid and binding upon the promisor, and the time-barred debt would get revived'.

All DP Notes and TP Notes must be made **payable to the order**, and never to the bearer

Both the DP Notes and TP Notes must be **properly stamped** (for the required value) as per the provisions of the Indian Stamp Act.

Manner of cancelling the stamps

Further, the stamps must be duly cancelled too, either before or at the time of executing (making) it, and in such a manner that a portion of both the signature as also the date must appear on the revenue stamp, and the remaining parts of each should be on the DP Note document, too. This will evidence that the required revenue stamp was already affixed on the DP Note when it was executed, and that neither it was affixed thereon later, nor that the same pre-used revenue stamp has been reaffixed on this DP Note, nor that it can ever be used over again on any other document. As per the Indian Stamp Act, a DP Note is required to be executed on a revenue stamp of Rupee one (Re 1). The TP Notes, however, are required to stamped, depending upon the period after which it is made payable.

Questions for Reflection

1. (a) Define a 'Promissory Note', quoting the number of the Section that has defined it.
   (b) Analyse the various clauses contained in the definition of a promissory note.
2. (a) Name the parties that are there in a promissory note, in the following cases:
      (i) At the time of its making (execution); and
      (ii) After it has been endorsed and delivered.
   (b) Define each of the parties to a promissory note, in each of the above cases, citing examples in each case.
3. What are the essential ingredients of a promissory note? Explain each of them separately.
4. How many different types of Promissory notes are there? Name and explain the distinguishing features of each of them, by citing suitable illustrative examples in each case.
5. As per the Indian Limitation Act, a Demand Promissory Note (DP Note) becomes time-barred after expiry of three years from the date of its execution. But, most of the banks seem to have adopted different methods to get an already expired DP Note, which all may not be considered as a legally valid method.
   (a) What are the various such methods followed by most of the banks, and why each of such methods cannot be held to be legally valid? Give reasons for your answer in each case.
   (b) What expert legal opinion will you give to your banker clientele for adopting a legally valid method, in the cases of already-expired DP Notes? Quote the relevant Section(s) and the name(s) of the Act in your such expert legal opinion.
6. (a) Do you think that the loan, granted by a bank against the execution of a DP Note, will also become time-barred, in case the DP Note itself has already expired, and the recalcitrant borrower has refused to revive the expired DP Note? Give reasons for your answer.
   (b) If your answer to the question (a) above is in the negative, what are the various ways/ methods in which a debt, which has not already become time barred, can be revived for another three years from the date of such action?
   (c) What expert legal opinion will you give to your banker client, if the recalcitrant borrower were to refuse to revive even the debt by way of any of the methods adopted by the banker [as suggested by you in your answer to question (b) above], and the loan is also about to expire shortly, say, within a fortnight from now?
7. Sub-Section 25 (3) of the Indian Contract Act provides that 'if some other conditions are also satisfied, a promise to pay even a time barred debt, even without consideration, would be held valid and binding upon the promissor, and the time-barred debt would get revived'.

   What are the 'some other conditions' that are also required to be satisfied in such cases? Explain by citing illustrative examples in each case.
8. What is the rationale behind the following provisions made in the Negotiable Instruments Act?

   A 'Promissory Note' cannot be made 'payable to the bearer on demand', nor can it be made 'payable to the bearer after a certain period'.

   Quote the number of the relevant Section(s) and the name of the Act, if these may be deemed to be of any relevance in the context of your answer.
9. What is the rationale behind the following suggestions?
   (a) The revenue stamps, affixed on a DP Note should be cancelled in such a manner that a portion of both the signature of its maker as also the date must be on the revenue stamp, and the remaining parts of each should be on the DP Note document, too.

(b) Yet another signature of the maker, with date, must also be obtained on the DP Note, entirely away from the revenue stamps.

10. Who are the persons who may make or endorse a promissory note?

Problems for Practice (With Suggested Solutions)

Problem 1

In your considered opinion, do the following cases constitute valid Demand Promissory Notes? Give reasons for your answer in each case.

(a) We have received a sum of Rs 20,000 from Shri Sanjay Sethi. This amount will be repaid on demand. We have received the amount in cash.

(b) Prakash promises to pay to Quraishi a sum of Rs 10,000 in case Rohit, on his (Rohit's) death, leaves sufficient money in his (Prakash's) name.

(c) Prasanna promises to pay to Gopalakrishnan a sum of Rs 25,000 three month after his (Prasanna's) marriage with Rohini.

(d) Prakash promises to pay to Quraishi a sum of Rs 50,000 after the death of Rohit.

Solution

(a) In this case, we find that it is in the nature of a receipt or an acknowledgement (of having received the amount of Rs 20, 000 in cash), plus the assurance that this amount will be repaid on demand, though the specific word 'promise' has not been used, but the intention is in the nature of a promise or an undertaking. The learned judge in the case **Surjit Singh vs Ram Ratwan, AIR (1975), Gan. 15,** had held that the instrument was a valid Demand Promissory Note (DP Note).

(b) Here, we find that Prakash has promised to pay to Quraishi a sum of Rs 10,000 in case Rohit, on his (Rohit's) death, leaves sufficient money in his (Prakash's) name. In this case, while the death of Rohit, some day or the other, is a certainty, the other condition, viz., Rohit, on his (Rohit's) death, leaving sufficient money in his (Prakash's) name, is not a certainty. Thus, one of the essential elements of a Promissory Note, i.e. the element of certainty, is missing in this case. Therefore, it cannot be deemed to be a valid Promissory Note.

(c) Prasanna's promise to pay to Gopalakrishnan a sum of Rs 25,000 three month after his (Prasanna's) marriage with Rohini, is again not a valid Promissory Note for the same reason, viz. the promise to pay the amount is conditional, depending upon his such marriage and not if such marriage does not take place. Further, as Prasanna's marriage with Rohini is an uncertainty, one of the essential elements of a Promissory Note, i.e. the element of certainty, is missing in this case. Therefore, it cannot be deemed to be a valid Promissory Note.

(d) In the cases, given in questions (b) and (c) above, where, in the respective Promissory Notes, the conditions stipulated viz., 'Rohit, after his death, leaving sufficient money in Prakash's name', and 'Prasanna's marriage with Rohini', are such events which are indefinite and uncertain to take place. That is, one of the essential elements of a Promissory Note, i.e. the element of certainty, is missing in both these cases. Therefore, these cannot be deemed to be valid Promissory Notes.

As against this, the condition stipulated in this question (d), viz., 'after the death of Rohit', is an event, i.e. the death of Rohit, which is definitely going to take place, some day or the other, the eternal truth being that all of us must die some day or the other. Therefore, the element of certainty can be deemed to be present in this case. Accordingly, such Promissory Note will be considered to be a valid promissory note.

Problem 2

In your considered opinion, do the following cases constitute valid Demand Promissory Notes? Give reasons for your answer in each case.

(a) I promise to pay State Bank of India a sum of Rupees two lakh with interest at the rate of 5 per cent above the 'prime lending rate (PLR) of the State Bank of India' per annum, rising and falling therewith.
(b) I promise to pay Ram Gopal a sum of Rupees one lakh with interest at the rate of 15 per cent per annum.
(c) I promise to pay Bank of India a sum of Rupees three lakh with interest at the rate of 7 per cent above the 'bank rate' per annum. rising and falling therewith.
(d) I promise to pay Amon a sum of Rupees five lakh with interest at the rate to be decided by Amon.
(e) I promise to pay Deepali a sum of Rupees one lakh with interest at the rate of 15 per cent per annum, and a car viz. Maruti 800.
(f) I promise to pay Pooja a sum of Rupees ten lakh with interest at the rate to be decided by Pooja, and also a Maruti 800.

Solution

One of the essential elements of a Promissory Note is that the sum of money, payable thereagainst must be certain, or else it must be capable of being made certain.

(a) Thus, as in this case, the rate of interest payable against the promissory note is specified [i.e. 5 per cent above the 'prime lending rate (PLR) of the State Bank of India', rising and falling therewith], it will be held to be valid.
(b) Again, as in this case, the rate of interest payable against the Promissory Note is specified, i.e. 15 per cent per annum, it will as well be held to be valid..
(c) Similarly, as in this case also, the rate of interest payable against the Promissory Note is specified [i.e. 7 per cent above the 'bank rate' per annum. rising and falling therewith], it will also constitute a valid Promissory Note.
(d) As against the cases cited in questions (a) (b), and (c) above, wherein the rate of interest payable against the Promissory Note is specified, in the case cited in question (d), the rate of interest payable against the Promissory Note is not specified, inasmuch as it is yet to be decided by Amon. Accordingly, it will not constitute a valid Promissory Note because, one of the essential elements of a Promissory Note, that is, that the sum of money, payable against Promissory Note must be certain, or else it must be capable of being made certain, is conspicuously absent here.
(e) Again, in this case, it will not constitute a valid Promissory Note because, one of the essential elements of a Promissory Note, that is, that it must stipulate payment of money and only money, and nothing else, in addition to money, has been violated in this case. This is so because, in addition to paying money, the delivery of a Maruti 800 car has also been promised in this case.
(f) It will not constitute a valid Promissory Note either, because, it has violated the following two of the various essential ingredients, which go to constitute a valid Promissory Note:
    (i) The rate of interest payable against the Promissory Note is not specified, inasmuch as it is yet to be decided by Pooja; and
    (ii) It involves not only payment of money and only money, and nothing else as required, but also a Maruti 800 car in addition to money.

Problem 3

(a) A Promissory Note is made payable in two distinct parts, i.e. while the first part is made payable within six months any time on demand, and the second part is made payable within the next six months any time on demand. Can such promissory note be held to be an invalid 'Promissory Note', a valid 'Demand Promissory Note', or 'none of these'?
(b) In case your answer to question (a) above is 'none of these', what else will it constitute, instead?

Solution

(a) Such Promissory Note cannot be deemed to be an invalid Promissory Note, because it is one of two types of valid Promissory Notes i.e. a 'Time Promissory Note' (TP Note), instead, and not a Demand Promissory Note. Thus, it cannot be deemed to be a valid 'Demand Promissory Note'.

(b) It can neither be held to be an invalid 'Promissory Note' nor a valid 'Demand Promissory Note'. It is none of these two, as it a valid Time Promissory Note' (TP Note), instead. Therefore, it would be required to be stamped accordingly (i.e. as a TP Note), and not for the amount of the stamp duty that is exigible on a DP Note.

Problem 4

(a) Can a Demand Promissory Note, drawn in the following pattern, constitute a valid Demand Promissory Note? Give specific reasons for your answer.

'On demand I promise to pay to Kalam or Bearer a sum of Rupees five lakh only, with interest @ 15 per cent per annum.'

(b) Can a Time Promissory Note, drawn in the following pattern, constitute a valid Time Promissory Note? Give specific reasons for your answer.

'Six months after date I promise to pay to Rahim or Bearer a sum of Rupees three lakh only, with interest at the rate of 16 per cent per annum.'

Solution

(a) A Demand Promissory Note, made payable to a certain person or 'Bearer' cannot constitute a valid Demand Promissory Note, because a Demand Promissory Note must be invariably made payable to 'Order', and never made payable to 'Bearer', as has been wrongly done in the instant case. This is so because the making of a Promissory Note payable to the bearer, has been specifically prohibited, and has even been made punishable, under Sections 31 and 32 of the RBI Act. The reason behind such provision is that, in the event of a bearer DP Note being allowed to be issued, it will be possible to transfer the title thereto, without any endorsement, and by mere delivery, as is being done in the case of currency notes.

(b) A Time (Usance) Promissory Note, made payable to a certain person or 'Bearer' cannot constitute a valid Time (Usance) Promissory Note, because a Time (Usance) Promissory Note, just like a Demand Promissory Note, is required to be invariably made payable to 'Order' and never made payable to 'Bearer', as has been wrongly done in the instant case. This is so because the making of a Time (Usance) Promissory Note payable to the bearer, has been specifically prohibited, and has even been made punishable, under Sections 31 and 32 of the RBI Act. The reason behind such provision is that, in the event of a bearer Time (Usance) Promissory Note being allowed to be issued, it will be possible to transfer the title thereto, without any endorsement, and by mere delivery, as is being done in the case of currency notes.

Chapter Eighteen

Bills of Exchange

"*When I die, my epitaph should read: She Paid the Bills. That's the story of my private life.*
Gloria Swanson

It is only by not paying one's bills that one can hope to live in the memory of the commercial classes.
Oscar Wilde

You can take a chance with any man who pays his bills on time.
Terence

Experience is a good teacher, but she sends in terrific bills.
Minna Antrim"

18.1 Definition of Bill of Exchange

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 the order of, a certain person, or to the bearer of the instrument'.

18.1.1 Analysis of Various Clauses Contained in the Definition of a 'Bill of Exchange'

We will first try to split the various clauses contained in the definition of a 'bill of exchange', to understand and appreciate the legal significance and ramifications thereof hereunder:

(a) An instrument (i.e. a document, necessarily in writing, through which the rights, vested in one person, could be transferred in favour of another person),
(b) In writing (i.e. not just verbally),

(c) Order (i.e. it must contain an order to pay and not a promise or request. Thus, the clause like 'Please pay Rs 1 lakh to Ramesh on demand and oblige', written on the instrument, will not be deemed to be a bill of exchange.
(d) Unconditional order (there should be no condition attached thereto, except such events which are bound to happen, e.g., the death of a particular person or the like),
(e) There are three parties to a bill of exchange, viz. (a) the **drawer**, who makes (draws) the bill of exchange (b) the **drawee**, who has been ordered by the drawer to pay the amount written on the bill of exchange, and (c) the **payee**, to whom the drawee has been ordered to pay the amount written on the bill of exchange. But then, it is quite possible that one person or party may perform the twin roles of two parties, like one single person or party may draw a bill of exchange in his own favour (i.e. made payable to himself only), in which case he will assume the twin roles of both the drawer and the payee. But then, he himself cannot assume the twin roles of both the drawer and the drawee. This is so because, in that case, the instrument will become a promissory note, instead, and will not constitute a bill of exchange.
(f) But then , besides the drawer, the drawee and the payee, the following may also become the parties to the instrument, after it has been endorsed and delivered, in the case of an order instrument, and just by delivery only (i.e. without endorsement) in the case of a bearer instrument.
    (a) The **holder**, i.e. the original payee or the endorsee, where the order instrument has been endorsed. In case of a bearer instrument, however, the bearer or the possessor of the instrument is the holder, as a bearer instrument does not require any endorsement.
    (b) The **endorser**, i.e. the person who endorses the instrument in favour of another person, and
    (c) The **endorsee**, i.e. the person in whose favour the instrument has been endorsed.
(g) Signed by the maker (i.e. it must necessarily bear the signature of the maker (drawer) of the bill of exchange; alternatively speaking, it must necessarily be signed by the maker (drawer) of the bill of exchange, failing which it will be deemed to be an nullity,
(h) Directing a certain person (by giving his complete residential or office address, and such identification details),
(i) To pay (and nothing else),
(j) A certain sum of money (and money only, and not anything else, like the delivery of a car or the like),
(k) To, or to the order of,
(l) A certain person (i.e. the payee must be a definite and particular person, identified further by adding clauses like 'son/daughter/husband/wife of ……., resident of ……' or his complete office address, and so on,
(m) Or to the bearer of the instrument.

We will now proceed to discuss, in some further details, the various legal principles and provisions contained and inherent in the definition of a bill of exchange hereafter.

18.2 Essential Ingredients of a 'Bill of Exchange'

(i) In Writing

A bill of exchange has to be necessarily in writing. Here, the term 'in writing' includes even printed, typewritten, or computer-printed matter. Further, for the sake of an argument, we may also interpret the term 'in writing' to suggest that the bill of exchange could as well be written in pencil, and not necessarily in ink. However, it is safer to make the bill of exchange, and any instrument for that matter, in ink, so as to avoid easy, quick, and undetectable material additions/alterations in the instrument.

(ii) An Order to Pay (i.e. a bill of exchange must contain an order to pay)

That goes to suggest that it must contain an order to pay, and not a promise or request. Thus, the clause like 'Please pay Rs 1 lakh to Saurabh on demand and oblige', written on the instrument, will not be deemed to be a bill of exchange.

(iii) Unconditional Order

To constitute a valid bill of exchange, the order to pay contained therein has got to be necessarily an unconditional order, not dependent upon a certain event taking place or not taking place, or a certain work being accomplished or not accomplished, and so on.

Here, we may stress a legal point, viz. in case the taking place of an event is definite and certain to take place, as per our ordinary experience, e.g., depending upon the death of a particular person, such condition or provision will not stand in the way of the bill of exchange being a valid instrument; a valid bill of exchange.

Thus, an order to pay a certain amount on the death of a particular person will constitute a valid bill of exchange in view of the known and certain fact that every one of us must die some day or the other, today, tomorrow, or on some other near or distant future date.

(iv) Signed by the Maker (Drawer)

A bill of exchange, to be a valid negotiable instrument, must necessarily be signed by the maker thereof, failing which it shall not be deemed to be a valid negotiable instrument, even if it might have been written in the maker's (drawer's) own handwriting and his name also appearing on the body of the bill of exchange.

The term 'signature' in this context means the maker (of the instrument) writing his full name or his signature on the body of the instrument at the stipulated place, with a view to authenticating the terms of the contract contained in the bill of exchange in question.

It may, however, be noted here that the bill of exchange executed by an authorised attorney (agent), under his own signature, would be held as a valid negotiable instrument.

(v) Certain Persons

The bill of exchange must contain the names of all the three parties thereto, viz. (a) the name of the maker of the instrument (i.e. the drawer), the name of the person who has been ordered by the maker to pay the amount written on the bill of exchange (i.e. the drawee), and the name of its payee, with certainty, sans any ambiguity, by giving further identification details like the son/daughter/wife of the maker and payee of the instrument, and / or their residential or office address, and so on. The identification of the payee may as well be by his or her description/designation, and so on, like the Chief Manager, State Bank of India, Ashok Marg Branch, Lucknow- 226010.

But then, as has already been stated earlier, and we may reiterate here, it is quite possible that one person or party may perform the twin roles of two parties, like one single person or party may draw a bill of exchange in his own favour (i.e. made payable to himself only), in which case he will assume the twin roles of both the drawer and the payee. But then, he himself cannot assume the twin roles of both the drawer and the drawee. This is so because, in that case, the instrument will become a promissory note, instead, and will not constitute a bill of exchange.

(vi) Certain Sum of Money

The sum of money, payable against the bill of exchange must be certain or else it must be capable of being made certain. For example, where the rate of interest payable against a bill of exchange is specified [like 2 per

cent above the 'prime lending rate (PLR) of the State Bank of India', rising and falling therewith, or like 4 per cent above the 'bank rate' (i.e. the rate of interest at which the Reserve Bank of India (RBI) lends money to the commercial banks), the sum of money will be deemed to be certain, and thus, such a bill of exchange will be held to be a valid instrument. This is so because the 'PLR of SBI' and the 'bank rate' of the RBI are certain. As against this, the clause like 'at market rate of interest' will not go to make the sum of money certain, or even capable of being made certain, as the expression like 'at market rate of interest', will be deemed to be uncertain and hence, ambiguous. This is so because, the market rate of interest may keep varying with the source of the borrowing, the purpose of borrowing, the financial standing of the borrower, and so on.

(vii) Order to Pay Money Only

The bill of exchange must stipulate the order to make the payment of money and only money, and nothing else, in addition to money. Alternatively speaking, if the a bill of exchange contains a promise to pay something else also, in addition to money (like the car or house and so on), it would not be held to be a valid a bill of exchange. For example, an instrument giving an order to pay Anil a sum of Rs 1, 00,000 and also to deliver to him a Maruti car', will not be held to be a valid a bill of exchange.

(viii) Date, Place, Number, and So On

It has been found that usually a bill of exchange also incorporates information like the date, place, number, and so on, but these information are not necessary, as per law, though such additional information/particulars do not invalidate such bill of exchange. It may also be stressed here that in case the bill of exchange does not bear the date of its execution, oral evidence may be obtained regarding the date and place of its execution.

(ix) Duly Stamped

At the very outset, we must be clear in our mind that a demand bill of exchange does not attract any stamp duty. That is to say that only time (usance) bill of exchange attract stamp duty.

Thus, all the time (usance) bills of exchange must be duly stamped for the required value, as per the provisions made in the Indian Stamp Act. The State Stamp Acts, which vary from State to State, do not apply in the cases of Negotiable Instruments, with a view to maintaining uniformity all over India.

Further, the adhesive stamps of the requisite amount, affixed on the time (usance) bills of exchange, must be duly cancelled too, either before or at the time of executing (making) it. This is important because, a time (usance) bill of exchange, which is not duly stamped and thereafter the stamps affixed thereon are duly cancelled, such time (usance) bills of exchange will be held to be invalid – a nullity – in the eye of law.

A comparison of the distinguishing features of promissory note and bill of exchange is presented in **Table 18.1**.

Table 18.1 *Distinguishing Features of Promissory Note and Bill of Exchange*

Promissory Note	*Bill of Exchange*
(i) Here, only **two parties** are involved, viz. the maker (debtor) and the payee (creditor).	(i) Here, there are **three parties** involved, instead, viz. the drawer, the drawee, and the payee.
(ii) It contains an unconditional **promise** made by the maker to make payment to the payee.	(ii) It contains an unconditional **order** given by the drawer to the drawee to pay, as per the drawer's instructions.
(iii) Here, no prior presentation for acceptance is required.	(iii) Here, prior presentation for acceptance is required to be made to the drawee or his agent, and it is only after acceptance that it could be presented for payment on due date.

(*Contd.*)

(*Contd.*)

(iv) Here, the liability of the maker is primary and absolute.	(iv) Here, the liability of the maker is not primary and absolute, but only secondary and conditional, which may arise only after the non-payment of the bill of exchange by the drawee, and not otherwise.
(v) Notice of dishonour need not be given in this case.	(v) Notice of dishonour is required to be given in this case by the holder to the drawer, as also to the intermediate endorsers to hold them liable thereon.
(vi) The maker of the promissory note stands in immediate and direct relationship with the payee.	(vi) The maker (drawer) of the bill of exchange does not stand in immediate and direct relationship with the drawee or the payee.

18.3 Who may Make, Draw, Accept, or Endorse a Promissory Note or a Bill of Exchange

All persons or parties who are declared as being competent to enter into a valid contract under **Section 11 of the Indian Contract Act**, are entitled to make, draw, accept, or endorse a promissory note or a bill of exchange. Thus, all the persons who are of the age of majority, who are of sound mind, and who are not disqualified from contracting (i.e. who are not declared as insolvent), are entitled to do so. Alternatively speaking, the minors, lunatics, idiots, and those persons who are disqualified from contracting (i.e. who are declared as insolvent), are not competent to make, draw, accept, or endorse a promissory note or a bill of exchange. Accordingly, a minor, lunatic, idiot, or an insolvent person cannot be held liable on a promissory note or a bill of exchange by either making, drawing, accepting, or endorsing the instrument. But then, as specified under **Section 26**, such persons can make, draw, accept, or endorse a D.P. note or bill, but in that event they may bind all the other parties to the instrument except themselves. We may thus, observe that the instrument may not become void just because it has been made, drawn, accepted, or endorsed by a minor, lunatic, idiot, or an insolvent person. It can be held enforceable against all the other parties thereto, except they themselves personally. Thus, if a minor were to make a promissory note or accept a bill of exchange, the endorser or the drawer of the bill will be held liable, but not the minor himself.

Companies and Corporations

The capacity of companies and corporations to incur liabilities on negotiable instruments depends upon their constitution and nature of business on the same pattern and principle as its capacity to contract and borrow money and lend money is determined.

Hindu Undivided Family (HUF)

The '*karta*' of a Hindu Undivided Family (HUF) enjoys an implied authority to borrow money for the family on a promissory note or a bill of exchange. Such promissory notes and bills of exchange, however, bind all the members of the joint family including the minor members to the extent of their share in the business. But then, the minor members cannot be held personally liable

18.4 Types of Bills of Exchange: Demand and Time Bills of Exchange

The Bills of Exchange can broadly be classified under two main categories. These are:

(i) Demand Bills of Exchange; and
(ii) Time (Usance) Bills of Exchange.

As defined under **Section 19,** the demand bills of exchange or promissory notes are such bills which are made payable 'on demand' or 'at sight' or 'on presentation'. These are also known as sight bills. That is, no time for their payment is specified therein.

As against the demand promissory notes and bills of exchange, usance (time) promissory notes and usance (time) bills of exchange are, instead, drawn payable after some specified days or months from the date of the note or bill, or from the date of the acceptance of the note or bill.

A time note or bill, also known as 'usance' note or bill, may also be made payable after so many days or months after the taking place of an event which is sure and certain to take place, like 60 days after, or four months after, the death of the drawer himself.

18.4.1 A specimen each of the Demand Bill and Time Bill are given in Figure 18.1 and Figure 18.2 respectively.

Lucknow
Dated the 5th June 2009

On Demand* Pay ***State Bank of India*** or Bearer/Order a sum of Rupees ***One lakh*** only for value received.

Rs 1,00,000/-

To
M/S XYZ Company Limited
5/55, Hazratganj
Lucknow-226001

For ABC Company Limited
Signature
Director

*In some of the Demand Bills, the term 'At Sight' or 'On Presentation' is used, instead.

Figure 18.1 Specimen of Demand Bill of Exchange

Lucknow
Dated the 5th June 2009

60 Days after *Date* Pay ***State Bank of India***
3 months after *Sight/Acceptance*

a sum of Rupees ***One lakh*** only for value received.

Rs 1,00,000/-

To
M/S XYZ Company Limited
5/55, Hazratganj,
Lucknow- 226001

For ABC Company Limited
Signature
Director

Figure 18.2 Specimen of Time (Usance) Bill of Exchange

In the case of 'after date' the due date will be counted from the date of the bill of exchange, while in the case of 'after acceptance' (or 'after sight'), it will be calculated from the date of acceptance of the bill of exchange (as shown in Figure 18.2). The bill of exchange could be drawn as either order or bearer.

Incidentally, it may be mentioned here that a cheque is also a bill of exchange but it is invariably a demand bill of exchange only, wherein the drawee is always a bank and the drawer is the account holder of the same branch of the bank.

And, a bank draft is also a bill of exchange, invariably a demand bill of exchange, wherein both the drawer and the drawee are the two branches of the same bank or of two different banks e.g.,

(i) a bank draft issued by the State Bank of India, Lucknow, on State Bank of India, Bangalore, or else;
(ii) by the State Bank of Hyderabad on State Bank of India, Bhopal; or by Grindlays Bank, New Delhi, on State Bank of India, Sitapur (by an special arrangement between the two different banks).

It must also be borne in mind that while cheques may be drawn as either order or bearer, the Bank Draft, as per law, has necessarily to be drawn payable on order only (and never in the form of a bearer draft), as has been specifically provided under **Sections 31 and 32 of the RBI Act**. Why?

Because, in that event, the Bank Draft could as well be used as a currency note, as the title to a bearer of the bill of exchange (Bank Draft) gets transferred merely by delivery, and no endorsement, whatsoever, is required. But, in the case of (an order) Bank Draft, the title cannot get transferred merely by delivery (as is done in the case of the currency notes issued by the Reserve Bank of India, i.e. currency notes of Rupees Two and above [and not Rupee One Notes, which are issued under the signature of the Union Finance Secretary, instead]. The currency notes of Rupees Two and above are issued in the form of a Promissory Note, under the signature of the Governor, Reserve Bank of India (RBI).

Incidentally, it may be mentioned here that, in the case of a Promissory Notes (both Demand and Time) there are only two parties (instead of three, as in the case of a Bills of Exchange). In the case of a Promissory Note, the two parties are the drawer and the payee only (no drawee being involved). And, in the case of Reserve Bank of India currency notes, the drawer of the (promissory) note is the Governor, Reserve Bank of India, and the payee is the bearer of the currency note. That is why, a currency note is invariably drawn in the form of a Demand Promissory Note (DP Note) payable to the bearer, wherein it reads as in Figure 18.3.

RESERVE BANK OF INDIA
GUARANTEED BY THE CENTRAL GOVERNMENT

I PROMISE TO
PAY THE BEARER
THIS SUM OF * *ONE*
HUNDRED RUPEES

SIGNATURE

GOVERNOR

*Here the amount of the respective denomination of the currency note is written.

Figure 18.3 Specimen of a Currency Note

18.5 Stamp Duty Exigible on Time (Usance) Bills

While the Demand Bills are expected to be paid immediately on demand, usually some specified period say, of 30 days or 45 days, etc. are granted by the drawer to the drawee to make the payment by that time, whereafter some overdue interest may become payable at the specified rate.

Further, the Demand Bills of Exchange do not attract any stamp duty. As against this, stamp duty is invariably exigible on all the Time Bills of Exchange, which varies in terms of the amount and the period after which the amount is made payable, as per the Indian Stamp Act, i.e. the stamp duty is exigible at the same rate all over India. (The rate of stamp duly payable under State Stamp Acts, however, varies from State to State. For example, stamp duties payable on Agreements, Pledge documents, etc.).

The Table of Stamp Duty, exigible on Time (Usance) Bills of Exchange, as per the Indian Stamp Act, is given in **Table 18.2.**

Table 18.2 *Stamp Duty Exigible on Time (Usance) Bills of Exchange [Vide Section 13 of the Indian Stamp Act]*

Sl. No.	*Descriptions*	*Rupees*
6(b)	Where payable otherwise than on demand:	
(i)	Where payable not more than three months after date or sight:	
	if the amount of the bill or note does not exceed Rs 500;	One Rupee
	if it exceeds Rs 500 but does not exceed Rs 1,000;	Two Rupees
	and for every additional Rs 1,000 or part thereof in excess of Rs 1,000.	Two Rupees
(ii)	Where payable more than three months but not more than six months after date or sight:	
	if the amount of the bill or note does not exceed Rs 500;	Two Rupees
	if it exceeds Rs 500 but does not exceed Rs 1,000;	Five Rupees
	and for every additional Rs 1,000 or part thereof in excess of Rs 1,000;	Five Rupees
(iii)	Where payable more than six months but not more than nine months after date or sight:	
	if the amount of the bill or note does not exceed Rs 500;	Three Rupees
	if it exceeds Rs 500 but does not exceed Rs1,000;	Seven Rupees
	and for every additional Rs 1,000 or part thereof in excess of Rs 1,000;	Seven Rupees
(iv)	Where payable more than nine months but not more than one year after date or sight:	
	if the amount of the bill or note does not exceed Rs 500;	Five Rupees
	if it exceeds Rs 500 but does not exceed Rs 1,000;	Ten Rupees
	and for every additional Rs 1,000 or part thereof in excess of Rs 1,000;	Ten Rupees
(v)	Where payable at more than one year after date or sight:	
	if the amount of the bill or note does not exceed Rs 500;	Ten Rupees
	if it exceed Rs 500 but does not exceed Rs 1,000;	Twenty Rupees
	and for every additional Rs 1,000 or part thereof in excess of Rs 1,000;	Twenty Rupees

18.6 Maturity of Bill of Exchange

As stipulated under **Section 22,** the maturity of a usance (time) promissory note or a usance (time) bill of exchange is the date on which it falls due for payment. The mode of calculation of the due dates of a usance (time) promissory note or a usance (time) bill of exchange, as laid down in the Negotiable Instruments Act, has been discussed hereunder:

18.6.1 Calculation of Due Date of a Bill of Exchange Made Payable after Specified Number of Days

Example 1

A Time Bill of Exchange is dated February 15, 2009, and is made payable 60 days after date and has been accepted on February 20, 2009.

Calculation of Due Date

Now let us calculate the due date of the bill, in the instant case, step by step.

Step 1

Find out the starting point. In the instant case, it is given as 15.02.2009 (being the date of the bill of exchange).

Step 2

As provided under **Section 24 of the N I Act, '**In calculating the date at which a promissory note or bill of exchange made payable a certain number of days after date or after sight or after a certain event, is at maturity, the day of the date, or of presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, shall be excluded.

Therefore, we will exclude the starting point, i.e. 15th February, and count the days now remaining in the month of February i.e. 28 days less 15 days = 13 days (Because the year 2009 is not a leap year [And remember, a full century should be divisible by 400 (and not by only 4), and, accordingly, the month of February in 3000 will have only 28 days (and not 29 days). In 2008 and 4000 however, the month of February will have 29 days].

Step 3
Now, add 31 days of March to the balance 13 days of February i.e. 13+31 = 44 days.

Step 4
Now, how many more day(s) need to be added from the next month (i.e. April) to make it a complete 60 days period?

That is 60 – 44 = 16 day

Step 5
That is, finally the due date comes to 44+16 = 60 days i.e. on 16th April 2009.

Days of Grace
But, the matter does not end here. One more step remains to be completed, and that is, granting of three days of grace. Because, as per **Section 22 of the NI Act**, 3 days of grace have invariably to be granted while calculating the due date of a Time Bill of Exchange. **Section 22 of the N I Act** reads as under:

'Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentment, is at maturity on the third day after the day on which it is expressed to be payable.' Thus, if such instruments are presented earlier than the third day of grace, such presentation will be treated as invalid. **[Wijfen vs Roberts, 1975].**

Step 6
Thus, finally the 3 days of grace has to be granted, and accordingly added to the due date calculated earlier i.e. 16th April, 2009 + 3 days of grace = 19th April 2009.

Thus, finally the due date comes to be the 19th April 2009, in the instant case.

But, the exercise has not ended up even here; because one more step still remains.

Step 7
That is, if the due date, finally calculated, including the three days of grace, happens to be a public holiday, what shall be the due date, under such circumstances?

Section 25 of the NI Act provides that the Bill of Exchange, in such a case, will fall due on 'the next **preceding** business day'.

Section 25 of the NI Act reads as under:
'When the day on which a promissory note or bill of exchange is at maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day.

Explanation:
The expression 'Public Holiday' includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.

Here, the terms 'next' and 'preceding' are of great significance. That is, if the 19th April 2009 happens to be a bank holiday, the due date will be the next (i.e. immediately) preceding (and not succeeding) business day i.e. the 18th April 2009; [The term 'next preceding' day should not be confused with the term 'next' day, which means the next succeeding day]. And, the term used in the NI Act is 'the next preceding business day', which means that if the 18th April 2009 also happens to be a bank holiday, the due date will be the 17th April 2009, instead. And, if the 17th April 2009 also happens to be a bank holiday, the due date will be deemed to have fallen on the 16th April 2009, and so on.

[In the case of the Bank's Term Deposit Receipts (TDRs), however, if the due date falls on say the 19th April 2009, and the 19th April 2009 happens to be a bank holiday, it will be deemed to have matured for payment on the next **succeeding** business day, instead, i.e. on the 20th April 2009, and so on].

18.6.2 Calculation of Due Date of a Bill of Exchange Made Payable After Specified Number of Months

Now, let us take another example, where the bill is made payable so many months after acceptance.

Example 2

Suppose that the bill is drawn payable 4 months after acceptance, and is dated 14.02.2009 and has been accepted for payment on 15.02.2009.

Calculation of Due Date

Step 1

The starting point, in this case, will be the date of acceptance of the bill, i.e. 15.02.2009. [If the bill was drawn four months after date, the starting point would have, instead, been 14.02.2009].

Step 2

Add 4 months to the starting point i.e. 15.02.2009 + 4 months = 15.06.2009.

(But, if the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month, as has been explained a little later).*

Step 3

Add 3 days of grace, i.e. 15.06.2009 + 3 days of grace = 18.06.2009.

Step 4

And, if 18.06.2009 happens to be a bank holiday, then 17.06.2007 (i.e. the **next preceding business day**) will be the due date, and so on, as has been discussed in Example 1, earlier.

Illustrations

(i) A negotiable instrument, dated 29th January 2009, is made payable one month after date. The instrument is at maturity on the 28th February, 2009 + 3 days of grace = 3rd March 2009.

(ii) A negotiable instrument, dated 30th August 2009 is made payable three months after date. The instrument is at maturity on 30th November 2009 + 3 days of grace = 3rd December 2009

(iii) A promissory note or bill of exchange, dated 31st August 2009, is made payable three months after date. The instrument is at maturity on 30th November 2009 + 3 days of grace = 3rd December 2009.

Let us take another example.

Example 3

If the date of the bill is 30.10.2008 and the bill is payable 4 months after date, we will proceed as under:

Step 1	Starting date	30.10.2008
	Add 4 months	30.02.2009

But, February 2009 will have only 28 days. So, the principle is to take the last date of the month, instead. Now we will add 3 days of grace. Thus, the bill will fall due for payment on 03 March 2009.

[Similarly, if the date so calculated in some case comes to 31 November, we will lake it as on the last date of November, i.e. 30 November, and so on.]

18.7 Presentation of the Time Bills for Acceptance

It may be pertinent to mention here that time bills of exchange (and not demand bills) are usually required to be presented to the drawee for acceptance purposes, so as to hold the drawee liable for dishonour of the bill of exchange for non-acceptance and/or for non-payment.

Even in the cases where the presentation of the bill of exchange for acceptance is not made compulsory but only optional, it would be always desirable and preferable to present the bill of exchange for acceptance, and get it accepted as soon as possible. This way, when the bill will be accepted for payment, it will be beneficial in the following two ways:

(i) This way an additional security will be obtained by virtue of the name of the acceptor being written on the bill; and

*Further, **Section 23 of the NI Act** has, *inter alia*, the following provisions:

'……If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

(ii) An immediate right of recourse will become available against the drawer of the bill and the other parties thereto, in case the bill is dishonoured for non-acceptance.

And, if the bill is refused to be accepted, it would be deemed to have been 'dishonoured for non-acceptance'. In such cases, the bill may have to be noted (or protested, if no notary public is available in the area of the drawee's place of business) to proceed further against the drawee and the other involved parties in the Court of law.

18.7.1 Who may Accept a Bill of Exchange

The following persons are legally entitled to accept a bill of exchange:

(i) The drawee of the bill, as mentioned therein;
(ii) In the case where there are more than one drawee, it could be accepted by all them jointly, or by only some of them. But where the bill has been accepted by only some of the drawees, only those drawees who have accepted the bill will be held liable thereto, unless they are partners and one has an express or implied authority to accept the bill for payment on behalf of all the drawees, named in the bill.
(iii) The drawee in case of need;
(iv) An acceptor for honour ;
(v) An agent of any of the aforementioned persons;
(vi) The legal representatives of the drawee, if the drawee is dead;
(vii) The official receiver or assignee, in the cases where the drawee has been declared insolvent.
(viii) Where no drawee has been mentioned in the bill, and a person accepts it, such person becomes an acceptor by 'estoppel'.

18.7.2 When and Where to Present the Bill of Exchange for Acceptance?

18.7.2.1 Time of Presentation of the Bill of Exchange for Acceptance

The bills of exchange must be presented for acceptance before the date of its maturity. In the cases where the period for the presentation of the bill has been specified, it needs to be presented within that period. But then, in the cases where the period for the presentation of the bill has not been specified, but the presentation of the bill has been made compulsory, it must be presented within a reasonable time.

18.7.2.2 Place of Presentation of the Bill of Exchange for Acceptance

The time bill should be presented for acceptance (and payment) at the usual place of business of the drawee (i.e. where the drawee usually transacts his business, i.e. his shop/show room, and so on) and that too, on a business day and during the usual business hours, or else, at a mutually agreed reasonable place and at a reasonable time. The terms 'mutually agreed', and 'reasonable place', is of great essence, in that the drawee may not ask the payee (usually a bank) to compulsorily come to present the bill say, at the graveyard/burning *ghat* or such other lonesome/dangerous place, at the dead of night, say at 2.00/3.00 a.m. In case, however, the drawee does not have a place of business, the bill could be presented at his residence during reasonable hours.

If, however, his place of business is found to be closed for more than 48 hours consecutively, during the usual hours of business, a message may be sent to him, or it may be prominently displayed at his usual place of business, to the effect that he must report to the bank for acceptance of the bill within 48 hours, failing which the bill will be deemed to have been dishonoured (for non-acceptance).

18.7.2.3 When the Presentation for Acceptance gets Automatically Excused

In the cases where the presentation of the bill of exchange has been made compulsory, and if the holder of the bill does not present it for acceptance, the drawer and all the other parties involved therein cease to be liable to him. Thus, he ceases to be entitled to a decree, and to his right to base his claim on the original consideration.

However, under the following circumstances, the presentation of the bill of exchange for acceptance gets excused automatically:

(i) Where the drawee cannot be found even after a reasonable search. (**Section 61**);
(ii) Where the acceptance is not absolute but only qualified; (**Section 91**)
(iii) Where the drawee is a fictitious person, or else where he is incompetent to enter into a valid contract, like a minor, an insane person or an idiot. (**Section 91**)
(iv) Where the presentation is somehow irregular but the acceptance as been refused not on this ground but on some other ground altogether.

Incidentally, it may be mentioned here that under the English Law, the presentation of a bill of exchange for acceptance gets excused automatically, in the cases of the death of the drawee or his being declared insolvent. But this is not so in India. In India, the bill must be presented

(a) To the legal representatives of the drawee, if the drawee is dead; or
(b) To the official receiver or assignee, in the cases where the drawee has been declared insolvent.

18.7.3 Mode of Acceptance of a Time Bill

As stipulated under **Section 7,** an acceptance is the signature of the drawee of a bill of exchange, who has signed his assent upon the bill and delivered it, or has given the notice of his such signing, to the holder of the bill, or to some person on his behalf. Accordingly, an acceptor is the drawee of a bill of exchange, who has signed his assent upon the bill and delivered it to the holder, or has given the notice of his such signing to the holder or to some person on his behalf. However, the writing of the word 'Accepted' is not necessary to establish the acceptance of the bill of exchange by the drawee and his liability thereunder. His signature on the face of the bill of exchange is enough for the purpose, with or without the word 'Accepted' written thereon. But, as against this, the drawee's oral acceptance, or even his writing the word 'Accepted' **on the face of the bill of exchange**, without his signature thereon, is not enough to establish his acceptance and his corresponding liabilities.

To summarise, we may say that a valid acceptance must invariably comprise the following:

(a) It must be in writing, and not just oral acceptance;
(b) It must necessarily be signed by the drawee or his authorised agent;
(c) It must be signed by the drawee **on the face of the bill of exchange**, and not on the reverse thereof; and
(d) The acceptance must be completed by delivering it to the holder duly signed, or by giving the notice of his such acceptance, to the holder or to some person on his behalf.

Jagjivan Mauji Vithlani vs M/s Ranchhodas Meghaji (1945) is a case in point.

In this connection, it may be pertinent to discuss some finer legal points involved in the acceptance of a bill of exchange.

Supposing the bill is accepted for payment in the following manner:

['Accepted
For XYZ Company Limited
Signature
Director
15.7.2009']

In such a case, the bill will have to be presented again on the due date for payment at the usual place of business of the drawee, and the payment so collected there itself, maybe in cash, may have to be brought back to the branch of the bank, at the risk of the bank, for deposit of the collected cash at the branch.

With a view to avoiding such a situation, it would be preferable to get the time bill accepted for payment at the specific branch of the bank concerned. For example;

['Accepted for payment at State Bank of India, Hazaratganj, Lucknow.

For XYZ Company Limited
Signature
Director
15.7.2009']

In such a case, the drawee will have to come to the specific branch of the bank on the due date, when the bank can conveniently present the bill for payment, and collect the payment, in cash or otherwise, there itself.

It must also be ensured that the time bill, while being accepted, also clearly bears the date of its acceptance, whether the bill is made payable so many days or months after date or after acceptance of the bill. This is a legal requirement, perhaps to stand as the evidence that the bill was accepted for payment on the specific date. But, more importantly, it serves as the basis (the starting point) for calculating the due date, if the bill is drawn payable so many days/month(s) after the date of acceptance of the bill itself.

18.7.4 Acceptance of the Time Bill should be Written on the face of Bill?

The acceptance of the time bill must be stated on the face of the bill and not on the reverse of the bill.

18.7.5 General or Qualified Acceptance of a Time Bill

18.7.5.1 General Acceptance

A general acceptance of a time bill of exchange is one where it has been accepted by the drawee without his stipulating any condition or qualification, regarding its payment, etc. Alternatively speaking, a general acceptance of a time bill of exchange is the one where the drawee has accepted the order of the drawer in its absolute terms and conditions, regarding its payment and so on.

18.7.5.2 Qualified Acceptance

As against the general acceptance, a qualified acceptance is the one where a bill of exchange has been accepted, but with certain condition(s) or qualification(s), and whereby the effect of the bill gets changed from the way it had been originally drawn. As per the general rule, the bills are required to be accepted generally, i.e. in its absolute terms, without stipulating any condition or qualification in regard to its payment, and so on. Thus, in case of a conditional acceptance by the drawee, and not in its absolute terms and conditions, the payee or the holder of the instrument is free to treat such conditional acceptance as its non-acceptance, instead. Accordingly, he can treat such a bill as dishonoured for non-acceptance, and he may proceed further as such. But then, in the cases where the payee or the holder, as the case may be, accepts a qualified acceptance, such (qualified) acceptance can bind only him and the acceptor, and not the other parties to the bill, if they do not consent to such qualified acceptance.

18.7.6 Types of Qualified Acceptance of a Time Bill

A qualified acceptance may pertain to the place, time, mode of payment, happening of a specified but certain event, or acceptance by only some of the drawees and not all of them jointly. As per the **explanation to Section 86**, the following are the cases of qualified acceptance:

(i) Where it is a case of conditional declaring of the payment to be dependent upon the happening of the event stated therein;
(ii) Where, by acceptance, the drawee undertakes to make the payment only of a part of the sum ordered by the drawer to be paid;
(iii) (a) Where no place of payment has been specified by the drawer in the bill, the drawee undertakes to make the payment at a specified place, and not otherwise or elsewhere; or
(b) Where a place of payment has been specified by the drawer in the bill, the drawee undertakes to make the payment at some other place, and not otherwise or elsewhere.
(iv) Where the drawee undertakes to make the payment at a time other than the time when the bill will fall due for payment, as per the law in this regard.

18.7.7 Drawee in case of Need

A 'drawee in case of need' is the person who has been named in the bill of exchange as an alternative drawee, when a need may arise to approach him for acceptance and/or payment of the bill of exchange. Such an eventuality may arise when the original drawee may refuse to accept and/or pay the bill, or he may not be available at the given address. Such a person is referred to as the 'drawee in case of need', because the payee is expected to first approach the original drawee for acceptance and /or payment, as the case may be, and it is only after he (original drawee) refuses to accept and/or pay the bill in question, or is not available at the given address, that the alternative drawee, viz., the 'drawee in case of need' must be approached. The name and address of the 'drawee in case of need' is usually mentioned in the case of a foreign bill of exchange. This may be so because, in the case of the dishonour of a foreign bill of exchange, it may involve a heavy amount of avoidable expenditure in calling back the goods transported by road, train, ship, or air. That is why an exporter may usually have his agent in the foreign country so as to take delivery of the goods against payment and sell the goods in that country on behalf of the drawer (exporter). In the English Law, however, a 'drawee in case of need' is called the 'reference in case of need', instead.

The specimen of a bill of exchange, with the name of a 'drawee in case of need' is given in Figure 18.4 with the name of the 'drawee in case of need' mentioned thereon.

Lucknow
Dated the 5th June 2009

60 Days after *Date* Pay ***State Bank of India***
3 months after *Sight/Acceptance*
a sum of Rupees ***One lakh*** only for value received.

Rs 1,00,000/-

To,
M/S XYZ Company Limited
5/55, King's Road,
LONDON (U.K.)

For ABC Company Limited
Signature

Director

In case of need:
State Bank of India
London Branch,
LONDON

Figure 18.4 Specimen of a Time (Usance) Bill of Exchange, with the name of the 'drawee in case of need' mentioned thereon.

18.8 Whom, When, and Where to Present the Bill of Exchange for Payment?

18.8.1 Whom to Present the Bill of Exchange for Payment?

A negotiable instrument must be presented for its payment to its maker, acceptor, or drawee as the case may be, by the holder or his agent. In the case of dishonour of the instrument for non-payment, the parties other than its maker, acceptor, or drawee are not liable to such holder or his agent. (**Section 64**).

The same rule applies in the case of '*hundies*' also in that the acceptor remains liable as has been observed in the case titled **Benares Bank Ltd vs Hormasji Pestonji (1930).**

18.8.2 Time of Presentation of the Bill of Exchange for Payment

A negotiable instrument must be presented for its payment during the usual business hours, or during the usual banking hours, in the case of a bank. (**Section 65**).

But in the cases, where the instrument has been presented at an unreasonable hour, and it has been dishonoured for non-payment, but for some reasons other than this reason (i.e. presentment at an unreasonable hour), the instrument will be treated as having been duly presented for payment.

However, as required under **Section 66**, a promissory note or a bill of exchange, if made payable at a specific period after its date or the date of its acceptance, must be presented for payment when it actually falls due for payment, and not earlier, because an earlier presentation for payment will be deemed as ineffective.

As regards a demand promissory note or a demand bill of exchange, it must be presented by the holder within a reasonable time of its receipt by him. (**Section 74**).

In the cases where a promissory note has been made payable by instalments, it must be presented for payment on the third day after the date of payment of each instalment. A non-payment on such presentation will have the same effect as a non-payment of a promissory note on its maturity. (**Section 67**).

18.8.3 Place of Presentation of the Bill of Exchange for Payment

In the cases where the negotiable instrument has been made payable at a specific place and not at any other place, it must be presented at that very specified place for payment, so as to make the respective parties liable thereon. (**Sections 68 and 69**).

However, if no such place for payment has been specified in the instrument, it must be presented at the usual place of business, if any, or else at the usual residence of the maker, drawee, or acceptor, as case may be. (**Section 70**).

But then, if the maker, drawee, or acceptor does not have any known place of business, nor a fixed place of residence, and where no place for payment has been specified in the instrument, the presentation for payment of the instrument must be made at any place where he may be found out.

18.8.4 When Presentation for Payment may become Unnecessary

As stipulated under **Section 76,** the presentation for payment becomes unnecessary, and the instrument can well be treated as having been dishonoured, in the following cases:

(i) Where the maker, drawee, or acceptor intentionally prevents the presentation of the instrument;
(ii) Where the instrument is payable at the place of business of the maker, drawee, or acceptor, and his place of business is found closed during the usual business hours on the due date for payment;
(iii) Where the place of business is found open on the due date, but then there is no one to make the payment of the instrument;
(iv) Where he has promised to make the payment despite non-presentation of the instrument on the due date;

(v) Where the presentation of the instrument on the due date has been expressly or impliedly waived by the party entitled to the presentation of the instrument and liable for making the payment on the due date;
For example, in the case where he makes a part payment of the amount due on the instrument, or where he promises to pay the amount due thereon, in whole or in part, or otherwise waves his right to take advantage of any default in the presentation of the instrument for payment;
(vi) As against the drawer, in the case where he could not have suffered any damage due to non-presentation of the instrument;
(vii) Where the drawee is a fictitious person or where he is incompetent to enter into a valid contract, e.g., a minor, lunatic, idiot, or an insolvent person;
(viii) Where the drawer and the drawee are found to be the same person, e.g., in the case of an accommodation bill;
(ix) Where the bill has already been dishonoured for non-acceptance; and
(x) Where the presentation of the bill has become impossible.

18.9 Dishonour of a Bill of Exchange

A Bill of Exchange may be dishonoured in the following two ways:

(i) By non-acceptance; and
(ii) By non-payment.

18.9.1 Dishonour by Non-acceptance

Under **Section 91**, a bill of exchange may be deemed to have been dishonoured by non-acceptance in the following circumstances:

(i) Where the drawee does not accept it within 48 hours from the time of its presentation for acceptance;
(ii) Where its presentation for acceptance has been waived, and it remains unaccepted;
(iii) Where the drawee is a person incompetent to enter into a valid contract, like a minor, lunatic, idiot, or an insolvent person;
(iv) Where the drawee could not be found even after a reasonable search;
(v) Where the acceptance is not absolute, but qualified; and
(vi) Where one or more of the several drawees refuse to accept the bill.

18.9.2 Dishonour by Non-payment

Under **Section 92**, a bill of exchange may be deemed to have been dishonoured by non-payment **w**here the maker, drawee, or acceptor, as the case may be, fails to make payment of the instrument when presented for payment on its due date for payment.

Further, as provided under **Section 76**, a bill of exchange may be deemed to have been dishonoured by non-payment **w**here the presentation for payment has been waived, but the instrument remains unpaid on its due date for payment.

18.9.3 Effect of Dishonour

The effect of dishonour of an instrument, by way of its non-acceptance or its non-payment on maturity, is that the drawer, and all the endorsers involved therein, are held liable to its holder. But then, their liability can be invoked only if the holder gives them the notice of such dishonour. The drawer, however, can be held liable only if the instrument has been dishonoured for non-payment.

18.9.4 Notice of Dishonour

In the case of the dishonour of a negotiable instrument by non-acceptance or non-payment, notice of such dishonour is required to be given by the holder to the drawer and all the other parties involved therein, whom he wants to hold liable. However, under **Section 93**, notice of such dishonour is not required to be given to the maker of a promissory note or to the drawee or acceptor of the dishonoured bill of exchange or cheque. Further, as stipulated under **Section 95**, all the parties, who receive such notice of dishonour, with a view to holding any prior party liable to himself, are required to, in turn, give notice of such dishonour to such parties within a reasonable time from the receipt of such notice of dishonour. Such notice may be given either orally or in writing, but, with a view to playing safe, the holder will be well advised to give such notice invariably in writing only.

The notice of dishonour is required to be given by all the aforementioned parties within a reasonable time. With a view to clarifying as to what would be deemed as a reasonable time in the eye of law, **Section 106** provides that if both the receiver and the giver of the notice reside in the same place, it should be given so as to be received by the other party at least on the very next day of the date of its dishonour. As against this, in the cases where they happen to live at different places, such notice must be posted to them at least on the very next day of the day of the dishonour, and not later than that. Here, the word 'posted' is of essence. That is, if such notice, though correctly addressed and posted within a reasonable time, as aforementioned, is miscarried by the post office, even such miscarriage of the notice by the post office will be deemed, in the eye of law, to be valid and not invalid.

Example

The case titled **Yeoman Credit Ltd vs Gregory (1963)** is a case in point. The plaintiffs were holding 12 bills of exchange for an aggregate amount of Rs 10,965. On 28th January 1960, all these 12 bills were dishonoured. In this case, both the holders and the endorsers were residing in the same place. But the notice of dishonour was given on 30th January 1960, instead of the required latest date i.e. 29th January 1960. That is, it was late by one single day. Accordingly, it was held by the Court that, in view of the fact that the notice of dishonour was delayed even by a single day, it was deemed as out of time, and thereby the claim in respect of the bills of exchange had failed.

Section 135 provides that in the cases where the bill of exchange is made payable in some foreign country, the law of the place of such payment (i.e. that foreign country), will determine as to what will constitute a dishonour of the bill, as also as to what will determine the giving of the due notice of such dishonour within a reasonable time and to be legally binding on the parties concerned.

Section 97 provides that in case the person to whom the notice of dishonour has been sent has died, but the party who has despatched the notice was not knowing about the death of such person at the time of despatching the notice, such notice will be considered to be sufficient enough.

Further, as per **Section 107**, the party, who has received such notice, will also be allowed the same time after the receipt of such notice to send such notice to the prior party or parties.

It may be stressed here that the notice of dishonour must be given by the holder, or by any other person who is liable on the bill of exchange. Further, the agent of any of the aforementioned persons can also give such notice on behalf his principal. But then, any stranger to the bill of exchange is not entitled to give such notice, because the notice, if sent by him, will be considered to be invalid.

18.9.5 Where Notice of Dishonour is Deemed Unnecessary

It may be reiterated here that the notice of dishonour, sent by the holder to the drawer or the endorser, is one of the material part of the cause of action, if a suit is filed by the holder against them (i.e. the drawer and/or the endorser). However, as stipulated under **Section 98**, the giving of the notice of dishonour is not considered necessary under the following circumstances:

(i) In the case where the notice is dispensed with by the party entitled to such notice. **For example**, if the drawer tells the holder that he will see to it whether the bill is paid by the acceptor on the due date of its payment, the notice of dishonour need not be sent to him.
(ii) The notice of dishonour is again unnecessary, in order to charge the drawer, where he has himself cancelled (countermanded) the payment of the bill. This is so because, in that case the bill is already dishonoured by the express mandate of the drawer himself.
(iii) Where the party charged might not suffer any damages, if the notice of dishonour were not given to him.
(iv) Where the party, who is entitled to receive the notice of dishonour, could not be found even after reasonable search for him.
(v) Where the party, who is required to give the notice of dishonour, is not able to give it, without any fault on his part. **For example**, in the event of the death or even serious illness of the holder of the bill, or his agent, or for any such other accident.
(vi) Where the promissory note is not negotiable.
(vii) Where the drawer is himself the acceptor of the bill, the notice of dishonour of the bill is not necessary. This is so because, in such a case, the drawer can be charged without giving any notice to him.
(viii) Where the party entitled to the notice of dishonour knows the fact of such dishonour and promises unconditionally to pay the amount due on the bill of exchange.

18.10 Noting and Protesting for Dishonour

18.10.1 Noting for Dishonour

A notary public is a lawyer specifically appointed by a competent authority for the purpose of noting, under the Notaries Act, 1952.

Noting is a formal method of authenticating the fact of the dishonour of a bill of exchange by its non-acceptance and/or by its non-payment. In the case of the dishonour of a promissory note or a bill of exchange, the holder must first give a notice of such dishonour (as discussed a little later in this chapter), and thereafter, he should get the instrument 'noted' by the notary public. The notary public, in turn, will present the note or bill to the maker of the note or the drawee of the bill, as the case may be, and then will note down in his register the date of such dishonour, and its reason, if any, given by the maker of the note, or the drawee or acceptor of the bill .In case the note or the bill has been expressly dishonoured, the reason as to why does the holder treat the note or bill as dishonoured, as also the charges of the notary public in this regard, must be mentioned. Further, such noting needs to be made within a reasonable time after the instrument has been dishonoured. Moreover, as provided under **Section 99**, the holder may cause such dishonour to be noted by the notary public upon the instrument or upon a paper attached thereto or partly upon each.

Every notary public must have and use the seal of his own, because his act can be deemed to be the act of a notary public only after it has been performed by the notary public under his signature and his official seal.

Here, it may be mentioned that, in the case of an inland (domestic) promissory note or bill of exchange, the noting is only optional and not compulsory. But then, in the case of a foreign promissory note or bill of exchange, it needs to be noted and protested, if it is so required by the law of the country where the instrument is drawn.

18.10.2 Protesting for Dishonour

As against the noting, the protest is a formal certificate issued by the notary public, attesting the dishonour of the bill, based on the noting itself. Further, after the bill has been noted, the notary public may draw up the

formal protest at his own convenience. But then, when formal protest has been drawn up, it will relate back to the date when it was noted.

Sometimes, a bill of exchange may be protested for a better security, usually when the acceptor of the bill has become insolvent, or has suspended payment or his credit has been publicly impeached before the bill has fallen due for payment. The acceptor, however, is not bound by law to give a better security, and the holder also cannot sue the acceptor on this count, before the date of the maturity of the bill, even though it might have already been formally protested.

A valid protest must contain the following essential papers and particulars:

(i) The instrument in original or its literal transcript;
(ii) The names of the parties against whom the instrument has been protested;
(iii) The fact and the reason(s) for dishonour;
(iv) The place and time of such dishonour, or else the refusal to give a better security;
(v) The signature of the notary public under his seal; and
(vi) In the case of acceptance for honour or of payment for honour, the name of the person by whom, or the name of the person for whom, and the manner in which, such acceptance or payment was offered and effected.

18.10.3 Distinction between Noting and Protesting

The following are the main distinguishing features between 'noting' and 'protesting':

(i) Noting is the first step for protesting;
(ii) The noting is made by the notary public on the instrument by way of a memorandum, whereas a protest is a formal certificate issued by the notary public only later, though based on the noting itself.
(iii) At all the places where there is a notary public, all the dishonoured bills must be got noted by that notary public, if a definite instruction has not been given by the drawer of the bill to get it protested also.
(iv) However, at such places where there is no notary public, and accordingly, the dishonoured bills may not be got noted, these must be got protested by the lawyer of the bank or by any respectable person in the locality, in the prescribed pro forma for the purpose. The bills for small amounts, however, are not required to be protested.

18.11 Acceptance for Honour after Noting or Protesting of a Bill

In the cases where a bill of exchange has been noted or protested for non-acceptance, or for not providing a better security as asked for by the notary, and any other person accepts it, *supra protest*, for the honour of the drawer, or of any one of the endorsers, such person is referred to as an acceptor for honour (**Section 7**).

Even after the acceptance of the bill for honour (after noting or protesting), such bill has to be presented, on the due date, by the payee or the holder, first to the drawee, as mentioned in the bill, for its payment. And only after it has been even dishonoured for non-payment by the drawee, and it has been noted or protested for non-payment in this case, it must be presented by him to the acceptor for honour for its payment, and not earlier.

But then, the acceptance for honour is required to be made with the written consent of the holder of the bill, because the holder is not legally bound to accept such acceptance for honour. Such acceptance must be written on the face of the bill of exchange. As **Section 108** specifically provides, 'when a bill of exchange has been noted or protested for non-acceptance or for better security, any person, not being a party already liable thereon, may, with the consent of the holder by writing on the bill, accept the same for the honour of any party thereto'.

Section 109 further provides that a person desiring to accept for honour must, by writing on the bill under his hand, declare that he accepts under protest the protested bill for the honour of the drawer or of a particular endorser whom he names, or generally for honour.

Section 110 further clarifies that where the acceptor for honour does not state for whose honour it is made, it shall be deemed to be made for the honour of the drawer.

18.12 Payment for Honour after Noting or Protesting of a Bill

As a general rule of law, no person, by voluntarily paying the debt of another, can make himself his creditor. But **Section 113** makes an exception to this general rule of law in regard to negotiable instruments by providing that 'when a bill of exchange has been noted or protested for non-payment, any person may pay the same for the honour of any party liable to pay the same, provided that the person so paying or his agent in that behalf, has previously declared before a notary public the party for whose honour he pays, and that such declaration has been recorded by the notary public'. Thus, any person may make the payment of the bill of exchange *supra protest*, which has already been noted and protested for non-payment, for the honour of any party liable on the bill.

Further, the person who pays the bill of exchange *supra protest*, after paying such bill acquires all the rights of the holder for whom he pays the bill, and becomes entitled to all the remedies available to the holder of the bill. These remedies, however, are available to him only against the party for whose honour he makes the payment, and all the other parties prior to such person. In other words, all the other parties subsequent to such person get automatically discharged.

18.13 Some Other Categorisation of the Bill of Exchange, Besides Demand and Time Bills

18.13.1 'DA' Bill and 'DP' Bill

(i) In the cases where, as per the instructions of the drawer, the documents to the title to goods (like Railway Receipt, Lorry Receipt, Bill of Lading, Air-way Bill, and so on), pertaining to the time bills, are required to be delivered against acceptance of the bill of exchange (i.e. Delivery against Acceptance; 'DA' for short), such bills are referred to as 'DA' bills.

(ii) As against this, in the cases where, as per the instructions of the drawer, the documents to the title to goods (like Railway Receipt, Lorry Receipt, Bill of Lading, Air-way Bill, and so on), pertaining to the time bills, are required to be delivered against payment of the bill of exchange (i.e. Delivery against Payment; 'DP' for short), such bills are referred to as 'DP' bills.

18.13.2 Documentary Bills of Exchange and Clean Bills of Exchange

(i) A documentary bill of exchange is the one which is accompanied by the relative title to goods (as aforesaid), which may have to be delivered against acceptance or payment of the bill, as required by the drawer. But usually, time bills are made 'DA' bills i.e. Delivery against Acceptance, so that, on the acceptance of the bill, the relative documents to the title to goods could be delivered to the drawees, duly endorsed in their favour. This way, the drawees will be able to get the delivery of the goods, well before making the payment of the amount of the bill. And thus, they would be able to sell the entire goods or a large quantity of them, well before the due date for payment. Such sale proceeds, thus, could well be used by the drawees for making the payment of the bill on the due date.

(ii) As against this, the clean bill of exchange is the one which is not accompanied by any documents to the title to goods [like RR (Railway Receipt), LR (Lorry Receipt), Air-way Bill, Bill of Lading, and so on].

That means that such documents have already been sent to the drawee concerned direct, by the drawer of the bill. Such cases, however, may be rather rare; that is only where the drawer (seller) considers the drawee (buyer) to be highly credit-worthy. The bank, in turn, should also have full faith in the integrity and honesty of the drawer (seller), while discounting such time bills.

Further, it may as well be possible, under such cases, where the product of the drawer concerned enjoys a very high demand in the market, and, therefore, no drawee will ever like to dishonour the bill, lest he may be black listed by the drawer, and his agency/dealership arrangement may get cancelled for ever. Nirma Industries (manufacturing detergent powders and soaps) may be one of several such examples. Similar may be the case when 'DA' (Documents against Acceptance) term is stipulated, in the bill of exchange.

18.13.3 Inland (Domestic) Bills of Exchange and Foreign Bills of Exchange

(i) Inland (also known as domestic) bill of exchange is one wherein both the drawers (sellers) and the drawees (buyers) are of the one and the same country, say, India, and it is also made payable in India. For example, a bill of exchange drawn by Krishna Iron Company Limited, Lucknow, on SAIL, Salem – both the parties being Indians companies, and located in India – and also made payable at the State Bank of India, New Delhi Main Branch in India.

But, as per the definition provided under **Section 11**, an inland bill or instrument is 'a promissory note, bill of exchange or cheque drawn or made in India and payable in or drawn upon any person resident in India'. Accordingly,

(a) An inland bill must be drawn and made payable in India, or
(b) It must be drawn in India and upon any person resident in India, though it may be made payable outside India.

Examples

(a) Steel Authority of India Limited (SAIL), Delhi, may draw a bill of exchange on Tata Steels Limited, Jamshedpur, and made payable at the State Bank of India, Calcutta Main branch. This bill is drawn in India, is drawn on a person (company) in India, and is also made payable in India.
(b) Tata Consultancy Services (TCS), Mumbai, may draw a bill of exchange on National Thermal Power Corporation (NTPC), New Delhi, and made payable at the State Bank of India, Singapore branch. This bill is drawn in India, is drawn on a person (company) resident in India, though it is made payable outside India (at Singapore). This is also treated as an inland bill of exchange, all the same, as per the definition given in **Section 11**.

(ii) As against this, in the case of a foreign bill of exchange, the drawers and the drawees belong to two different countries.

But, as per the definition provided under **Section 12**, a foreign bill or instrument is a negotiable instrument which is not an inland bill of exchange. Accordingly,

(a) A foreign bill of exchange must be drawn in India, but upon any person resident outside India, and also made payable outside India, or
(b) It must be drawn outside India but made payable in India.

Examples

(a) Steel Authority of India Limited (SAIL), Delhi, may draw a bill of exchange on Sony International, Tokyo, Japan, and made payable at the State Bank of India, Tokyo branch. This bill is drawn in India, but is drawn on a person (company) outside India, and is also made payable outside India.
(b) Sony International, Tokyo, Japan, may draw a bill of exchange on National Thermal Power Corporation (NTPC), New Delhi, and made payable at the State Bank of India, Hyderabad branch. This bill is drawn in Tokyo, Japan, is drawn on a person (company) resident in India, and it is also made payable in India (at Hyderabad). This is also treated as a foreign bill of exchange, all the same, as per the definition given in **Section 12**.

18.13.4 Bills of Exchange in Sets

Foreign bills of exchange are generally drawn in sets of three. Each of these three sets is referred to as *'via'*. However, only one of these three *'vias'* (sets) are required to be accepted and paid on the due date. Further, the acceptance and payment of any one of these three *'vias'* (sets) makes the other two sets (*'vias'*) inoperative. But then, as provided under **Section 132**, if any person happens to endorse different parts of the bill in favour of different persons, he himself as also all the subsequent endorsers of each part of the bill are held liable on such part as if it were a separate bill.

18.13.5 Trade (Genuine) Bill and Accommodation Bill

A trade bill, or a genuine bill, represents genuine business transactions where a bill of exchange is drawn by the seller of the goods on the buyer of the goods for the amount of the goods so sold and despatched.

But, there may be quite a few cases where the bill might not represent any trade transaction. It may, instead, be drawn to get some funds from the bank for a short period of time, which is utilised during the intervening period by the drawer of the bill, and as on the due date, the bill is paid by the drawer himself, or even by the drawee with an understanding with the drawer that finally he will reimburse the drawee with the amount so paid by him against the accommodation bill. Banks and business houses will, therefore, be well advised to exercise more than ordinary supervision and follow-up measures so as to detect the cases of accommodation bills at the early stage itself.

18.14 Amount of Compensation

Under **Section 117**, the following rules have been laid down for determining the amount of compensation that may become payable to the holder or the endorser, in the event of the dishonour of a negotiable instrument:

18.14.1 Compensation Payable to the Holder

The holder of a bill of exchange is entitled to receive the amount due for payment on the bill together with the amount of interest thereon, as also the expenses duly incurred by him in connection with the noting and protesting of the bill. However, where the holder of the bill resides in a country other than in which the bill is payable, he is entitled to receive such amount at the current exchange rate between the two countries prevailing on the day the bill had fallen due for payment.

18.14.2 Compensation Payable to the Endorser

In case the endorser of the bill has already paid the amount due thereon, he is entitled to receive the amount so paid by him, together with the expenses duly incurred by him in connection with the noting and protesting of the bill, with interest at the rate of 6 per cent per annum, from the date he had so paid the amount upto the date of his receiving back the amount. However, where the endorser of the bill and person charged on the bill reside in two different countries, the endorser will be entitled to receive such amount at the current exchange rate between the two countries.

18.14.3 Compensation Payable Against the Banker

There is no provision made in the Act for determining the amount of compensation payable by a banker in the event of his wrongfully dishonouring the cheque duly drawn by his customer. Under the circumstances, the rule as it prevails under the English Law may be made applicable in India as well. The rule in this regard, as laid down in the English Law, is that in the event of a wrongful dishonour of a cheque of its customer, the

bank will have to pay the compensation to its customer, which compensation would include the damages to the credibility and reputation of the drawer (customer) in the market. In such cases, the Court is most likely to award exemplary and/or vindictive damages.

Let us take two hypothetical examples to further clarify the point.

(i) Where a cheque for Rs 50,000 has been wrongfully dishonoured by the bank by way of its non-payment, and

(ii) Where a cheque for Rs 5 has been wrongfully dishonoured by the bank by way of its non-payment.

In the above noted two cases, the amount of exemplary and/or vindictive damages may be far higher in the case of the dishonour of the cheque for Rs 5, in comparison to the damages for wrongful dishonour of the cheque for Rs 50, 000. This is so because, if a cheque of a person, drawn for a petty sum of Rs 5 gets returned (wrongfully though) for want of funds in his account, it will mean that he is not even worth Rs 5. The damage to the reputation and creditworthiness of the person gets drastically damaged as compared to the return of his cheque (wrongfully though) for Rs 50,000.

18.15 Discharge of Negotiable Instruments

Discharge of a Negotiable Instrument has the following two distinct connotations:

(i) Discharge of the Instrument, and

(ii) Discharge of one or more of the parties from their liabilities on the Instruments.

We will now discuss these two types of discharges on the instrument one after the other.

18.15.1 Discharge of the Instruments

An instrument may be said to be discharged when it becomes completely useless, in the sense that

(a) It cannot be negotiated any further,

(b) No action may lie thereon,

(c) The rights of, as also against, all the parties thereto come to an end,

(d) No party, not even the holder in due course, can claim the amount of the instrument from any of the parties thereto.

When the party, primarily and ultimately liable on the instrument, gets discharged of his liability, such instrument itself gets discharged.

The instrument itself gets discharged in the following cases:

(i) When the party, primarily and ultimately liable on the instrument (i.e. the maker of a promissory note, acceptor of a bill of exchange, or the drawee bank), makes its payment in due course, to its holder, as also after its maturity (**Section 78**). But then, the payment by a party, who is only secondarily (and not primarily) liable, makes the payment of the bill, the instrument does not get discharged, because in such a case the payer can hold it to enforce its payment to him by the prior endorsers as also by the principal debtor.

(ii) Under **Section 90**, when a bill of exchange, which has been negotiated, is held by the acceptor in his own right, even on or after its maturity, such bill is deemed to be discharged

(iii) When the party, primarily and ultimately liable on the instrument, is declared insolvent, the instrument is deemed to be discharged, and the holder cannot make any of the other prior parties liable thereon.

Here, it may be noted with interest that it is only when the person liable to pay the promissory note or the bill of exchange **refuses** to make the required payment, such note or bill is deemed to be dishonoured for non-payment, and all the prior parties may be held liable thereon. But, in the case of insolvency of the maker of the promissory note or the acceptor of a bill of exchange, it is not his **refusal** to pay the note or the bill, but, instead, it is his **inability** to pay the note or the bill.

(iv) As per **Section 87**, when any material alterations is made in the instrument the party, primarily and ultimately liable on the instrument, gets discharged of his liability, and consequently, even such instrument itself also gets discharged.
(v) The instrument also gets discharged when it becomes time-barred under the Indian Limitation Act.
(vi) Under **Section 82**, when the holder of the instrument cancels it with a view to releasing the party, primarily and ultimately liable thereon, from its liability, the instrument is discharged, and cannot be endorsed any further.

18.15.2 Discharge of One or More of the Parties to the Instruments

When the liability of any party to the instrument comes to an end, such party is said to be discharged of his liabilities on the instrument. But then, when only some of the parties to the instrument are discharged, it still remains negotiable and the remaining parties thereto still continue to remain liable thereon. Alternatively speaking, in the event of the discharge of just one or only some of the parties to the instrument, the instrument, as such, does not get discharged. That is to say that the rights, still remaining available to the parties thereon, can even then be enforced in law against all those parties who are not discharged till then, and thus, they continue to remain liable thereon.

In the following circumstances, one or more of the parties to the instrument get discharged from their liabilities thereon:

(i) By Cancellation [Section 82 (a)]

In the event of the holder of a negotiable instrument deliberately cancelling the name of any of the party thereto (by drawing a line through his name in the instrument), who are held liable on the instrument, with a view to discharging him from his such liability to the instrument, such party, as also all the endorsers subsequent to him, who all had the right of legal action against the party, whose name has been so cancelled by the holder of the instrument, are discharged from their respective liabilities thereon. For **example**, in the cases where the name of the maker, drawer or acceptor has been cancelled by the holder of the instrument, the liabilities of all the other parties thereto, who night have become parties thereto, subsequent to its maker, drawer or acceptor, by virtue of being a guarantor (surety) to such maker, drawer, or acceptor, will naturally come to an end. In fact, as a result of such an eventuality, the instrument in itself will be deemed to have been discharged (cancelled or countermanded). Alternatively speaking, if only the name of the endorser, instead, has been cancelled by the holder of the instrument (and not the name of its maker, drawer or acceptor), such cancellation will not countermand the instrument itself. In such cases, only all the subsequent holders (subsequent to such endorser, whose name has been so cancelled by the holder), will be discharged of their respective liabilities. Conversely speaking, all the prior endorsers (i.e. prior to such endorser, whose name has been so cancelled by the holder), will continue to remain liable of their respective responsibilities under the instrument. This is so because, as stipulated under **Section 40**, if the holder of an instrument, destroys, impairs, or adversely affects the remedies of the endorsers against any prior party, without the consent of such endorser, he (endorser) is absolved (discharged) of his liabilities under the instrument.

But then, it must be doubly emphasised here that, in the cases where such cancellation has been done by some person (other than the holder of the instrument) under some mistake, or without the authority of the holder of the instrument, it will be deemed to be inoperative and ineffective, and thus, it will not discharge any party liable under the instrument.

(ii) By Release [Section 82 (b)]

In the event of the holder of a negotiable instrument releasing any of the parties thereto by some method other than the cancellation of the name (as aforementioned), for example, by way of a separate agreement of waiver, release or remission, the party so released, together with all the other parties subsequent to him, who have the right of action against the person so released by the holder, are discharged of their respective liabilities.

(iii) By Payment [Sections 82 (c) and 78]

In the cases where the party, primarily responsible and liable on the instrument, makes the payment in due course to the holder of the instrument, on or after the date of its maturity (i.e. on or after the due date of payment of the instrument), all the parties to the instrument automatically get discharged. This is so because, by virtue the due payment of the instrument, it, in itself, is fully discharged.

(iv) By Allowing the Drawee more than 48 Hours to Accept (Section 83)

In the cases where the holder of a bill of exchange happens to give to its drawee more than the stipulated 48 hours, excluding the public holidays, for its acceptance, all the prior parties, who have not consented to give him (drawee) such extended time, are consequently discharged of their respective liabilities to such holder of the bill.

(v) By Taking Qualified Acceptance of the Bill of Exchange (Section 86)

Where the holder of a bill of exchange takes a qualified acceptance from its drawees, instead of the required absolute acceptance, all the prior parties to such a bill, whose consents were not taken by the holder to this effect (i.e. for accepting a qualified acceptance of the bill), are consequently discharged of their respective liabilities to such a holder of the bill.

(vi) By Not Giving Notice of Dishonour of the Bill of Exchange

In the cases where the holder of a bill of exchange does not send the notice of dishonour of the bill of exchange to any of the parties (other than the party primarily liable thereto), such parties are discharged of their respective liabilities to such a holder of the bill.

(vii) By Non-presentation for Acceptance of a Bill of Exchange (Section 61)

All time (usance) bills of exchange (i.e. the bills which are made payable, not on demand, but after some stipulated days or months from its date, or from the date of its acceptance, its payee or the holder is required to present it, for its acceptance, by its respective drawee, and that also within a reasonable time. Thus, in the cases where the payee or the holder of the bill fails to comply with such legal requirement (by not presenting the bill to its drawee within a reasonable time), the drawer of the bill, together with all the endorsers thereof, are discharged of their respective liabilities to such a holder of the bill.

(viii) By Undue Delay in Presentation of a Cheque (Section 84)

The payee or the holder of a cheque is required to present it for payment to its drawee banker within a reasonable time from the date of its drawing by the respective account holder (drawer). Thus, in the event of the failure on the part of its payee or the holder, to present it to the drawee banker within a reasonable time, and in case the drawee bank happens to fail in the mean time, and thereby causes the consequential damage to the drawer of the cheque, such drawer is discharged of his liabilities to the payee or the holder, but only to the extent of the actual damage suffered by him (drawer) in this regard.

18.16 What are *Hundis*?

The term '*Hundis*' are usually referred to the bills of exchange that are drawn in the oriental languages, though sometimes these are drawn even in the form of promissory notes. The term '*hundi*' seems to owe its origin to the Sanskrit word *'hund'*, which literally means 'to collect'. In fact, '*Hundis*' were originally being used for the

purpose of colleting the amounts of debts, and even now these continue to be used mostly for the same purpose. Negotiable instruments like *Hundis* were being used in India from much earlier days, well before the enactment of the Negotiable Instruments Act, 1881. Even today, the provisions of this Act do not necessarily apply in the cases of *hundis*, unless it is specifically provided therein that the provisions of this Act will apply in deciding the legal relationships and liabilities amongst the parties thereto, with the exclusion of the well established usages in regard thereto. Thus, if such indication is not expressly given in the *hundi*, it will be governed by the prevalent local usages applicable to such instruments. This point has been well established in the case titled **Kanhyalal vs Ramkumar** (1956).

18.17 Types of *Hundis*

Different varieties of *hundis* are currently in circulation in India. We will now discuss each kind of such *hundis*, one after the other.

18.17.1 *Shah-Jog Hundi*

The term '*shah*' refers to a rich, respectable, and worthy person, enjoying good credibility in the local market. A *Shah-Jog Hundi* is drawn by one merchant on another merchant ordering the latter to pay the amount mentioned in the *hundi* to a *shah* named therein. As a *Shah-Jog Hundi* is made payable to, or through, a *shah*, he (*shah*) undertakes the responsibility to duly compensate the amount mentioned in the h*undi*, in case he himself, or the party on whose behalf he has claimed such payment, happens to become the holder of the *hundi* by means of fraud or any other offence. In other words, if a *Shah-Jog Hundi* transpires to be a stolen, false, or forged one, the *shah* is obliged to refund the entire amount of the *hundi* with interest.

A *Shah-Jog Hundi* is not deemed to be a bill of exchange as such, as per the definition thereof provided under **Section** *5* of the Act. But then, it is deemed to be a negotiable instrument all the same, independently of the provisions of the Act. This is so because these are recognised by the customs and usages as being negotiable, and the Act, in turn, gives legal recognition and validity to the customs and usages, as they pertain to *hundis*. This point has been established by the case titled **Mangal Sen Jaideo Prasad vs Ganeshi** (1936).

18.17.1.1 Some special Features of a *Shah-Jog Hundi*

(a) A *Shah-Jog Hundi* is not payable either to the bearer or to order but only to a respectable holder thereof (i.e. to a *shah*, as explained earlier) as per the prevalent practice, usage and custom in this regard. This way the drawee of the bill cannot avoid his liability even after having paid the bill unless he can establish that the bill was paid to a *shah*. Thus, the term '*Shah-Jog',* added to the *hundi*, gives an additional credibility thereto, and thereby it assumes the nature of a cheque, crossed generally, and not specially, like 'A/C Payee', etc.

(b) As against a bill of exchange, the acceptance of a *Shah-Jog hundi* is usually not written on the face of it, but, instead, its particulars are recorded in the books of the drawee. Further, it is generally not presented for its acceptance before its maturity, either. In fact, a *Shah-Jog' hundi* keeps on passing from hand to hand, just like a bearer instrument, till it reaches in the hands of a *shah*, who, in turn, makes a reasonable enquiry in this regard, and thereafter, if satisfied, presents it to the drawee for its acceptance or for its payment. Thus, the negotiability of the *hundi* comes to an end immediately after it reaches the hands of a *shah*. Further, in case the s*hah*, after the acceptance of the *hundi*, prefers to endorse it to an ordinary person, the drawee thereof can lawfully decline to honour the *hundi* for this very reason.

(c) Further, as already explained earlier, though a *Shah-Jog hundi* does not enjoy the legal status of a negotiable instrument or a bill of exchange, it is recognised as such all the same. Accordingly, in the case of the dishonour of a *hundi*, a notice of dishonour is required to be given to all the parties concerned, as it is

done in the case of other negotiable instruments. This point has been established by the case titled **Central Bank of India vs Khub Ram Roop Chand (1960)**.

18.17.2 *Darshani Hundi*

A *darshani hundi* is one which is made payable at sight (meaning *darshan*). It, however, may sometimes be sold at a premium, and sometimes even at a discount. Further, it must be presented for payment within a reasonable time, after it is received by the holder. Accordingly, in the case of any delay in its presentation by its holder, which may result in some loss to its drawer, such loss is required to be borne by the defaulting party (the holder, who makes such delay in its presentation), and not by the drawer thereof.

18.17.3 *Muddati Hundi* or *Miyadi Hundi*

A *Muddati Hundi* or *Miyadi Hundi* is made payable after a specified period of time, as mentioned therein. Such *hundis* may be drawn by way of *shah-jog* (explained earlier), *nam-jog,* or *dhani-jog hundis* (explained hereafter).

18.17.4 *Nam-Jog Hundi*

A *Nam-Jog Hundi* is one which is made payable to a specified person named therein. It is drawn in a form similar to the form of a *shah-jog hundi*, with the only difference that in the place of the word *'shah'*, the name of the specific payee is mentioned. Further, as a *nam-jog hundi* is made payable to the specific payee or to his order, it can be negotiated by endorsement and delivery.

18.17.5 *Nishan-Jog Hundi*

A *Nishan-Jog Hundi* is made payable only to the person who presents it. In such a *hundi*, the term '*Nishan-Jog'* is mentioned therein.

18.17.6 D*hani-Jog Hundi*

The term '*Dhani*' means 'owner' [i.e. the owner of the *dhan* (amount) of the *hundi*]. A **D*hani-Jog Hundi*** is made payable to the *dhani,* the owner of the *hundi.* In other words, it is made payable to the holder of the *hundi*, whosoever he may be. This way, it assumes the nature and feature of a negotiable instrument payable to the bearer; he may be the *dhani* (owner) or the holder, but he is, in all these cases, the bearer of the *hundi.* Further, in a *Dhani-Jog hundi*, the term '*Dhani-Jog'* is mentioned therein.

18.17.7 *Farman-Jog Hundi*

The term 'Farman' means 'Order'**.** Thus, a *Farman-Jog Hundi* is the one which is made payable to order.

18.17.8 *Dekhanhar-Jog Hundi*

The term '*Dekhanhar*' means 'the one who sees it'. Thus, a *Dekhanhar-Jog Hundi* is the one which is made payable to its seer or its holder, i.e. it is made payable to the bearer.

18.17.9 *Jawabee Hundi*

The *hundi*, which is used as a means of remittance of money from one place to another, through a banker, is termed as a *Jawabee Hundi.* It involves the following nature of transaction:

A person, who wants to remit some money to a person residing at another place, writes a letter to the payee, and delivers this letter to the banker concerned. The banker concerned, in turn, remits the money to

its branch, located near the residence of the payee, named therein. In case the bank does not have a branch of its own at that palace, it will endorse the letter to its correspondent banker with whom it may be having an agency arrangement, and send it to the branch of the correspondent banker located near the residence of the payee. When the banker receives this letter, he, in turn, sends it to the payee concerned at his given address. On receipt of this letter, the payee, in turn, comes to the branch of such bank and gives his receipt for having received the money mentioned in the letter. This receipt, given by the payee, is in the form of a reply (*jawab*) to the drawer, the original writer of the letter. That is why this type of *hundi* is referred to as a *Jawabee Hundi* (*Jawabee* means, in reply).

18.17.10 *Jokhami Hundi*

The term '*Jokham*' means 'risk' and the term '*Jokhami*' means 'risky'. That is why a *Jokhami Hundi*, has been termed by Justice Baley, in the case titled **Raisey Amerchand vs Jusraj Vizpal (1871)**, as being in the nature of an insurance policy. But with a difference in that, in the case of a *Jokhami Hundi*, the amount mentioned therein is paid in advance, which may, however, be recovered in case the slip is not lost.

There are the following three parties in a *Jokhami Hundi*:

(i) The drawer or the shipper (consigner) of the goods;
(ii) The *hundiwala*, i.e. the underwriter, who undertakes the risk; and
(iii) The *malwala*, i.e. the consignee of the goods.

Such *hundi* is drawn by the consignor of the goods on the consignee of the goods, and is negotiated by the underwriter together with the amount of the insurance premium. In the event of the goods arriving at the destination safely, the underwriter may obtain them to their value as stated in the *hundi*. But the underwriter (*hundiwala*) does not have any legal right to file a suit against the consignee in the event of his non-payment of the amount of the *hundi*, nor in the case of his non-acceptance of the *hundi*. He has the right to recover the amount of the bill only from the consignor (the drawer of the *hundi*). But then, in case of a total loss of the goods so consigned, the underwriter cannot recover any amount of the *hundi* from the drawer (the consigner). However, in the case of only a partial loss of, or damage to, the goods consigned, the underwriter (*hundiwala*) will become entitled to receive or recover the full amount of the *hundi* from the drawer (consignee). But again, in the event of a general average loss, a rebate is made to the extent of the loss of, or damage to, the goods.

Let us Recapitulate

As defined under **Section 5**, a 'bill of exchange is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person, or to the bearer of the instrument'.

Analysis of various clauses contained in the definition of a 'bill of exchange'

(a) An **instrument** (i.e. a document through which the rights of one person could be transferred to another person),
(b) **In writing** (i.e. not just verbally),
(c) **An order** to pay, and not just a promise or request.
(d) **Unconditional order** (i.e. no condition attached thereto, except such events which are bound to happen, like the death of a particular person),
(e) There are **three parties** to a bill of exchange, viz. (i) the **drawer**, who makes (draws) the bill of exchange (ii) the **drawee**, who has been ordered to pay the amount written on the bill of exchange, and (iii) the **payee**, to whom the drawee has been ordered to pay the amount.

Essential ingredients of a 'bill of exchange'

(i) **In writing,** i.e. printed, typewritten or computer-printed, or even written in pencil. But to avoid easy, quick and undetectable material additions/alterations in the instrument, one must desist from writing in pencil.
(ii) **An order to pay,** and not a promise or request.
(iii) **Unconditional order,** with the exception of only such conditions which are sure to take someday or the other, like the death of a particular person.
(iv) **Signed by the maker (drawer)** or by his authorised attorney (agent).
(v) **Certain persons,** i.e. the three parties involved in the bill, like the drawer, the drawee, and the payee, should all be ascertainable.
(vi) **Certain sum of money**, i.e. the amount payable should be certain or else it must be capable of being made certain.
(vii) **Order to pay money only**, and nothing else, in addition to money, like a car or scooter.
(viii) **Date, place, number,** and so on, though not legally necessary.
(ix) **Duly stamped,** but only time (usance) bills, as demand bills do not attract any stamp duty.

The '*karta*' of a **Hindu Undivided Family** (HUF) enjoys an implied authority to borrow money for the family on a promissory note or a bill of exchange, whereby he binds all the members of the joint family including the minor members to the extent of their share in the business. But then, the minor members cannot be held personally liable

The **Bills of Exchange** are mainly of the following two types:

(a) Demand Bills of Exchange; and
(b) Time (Usance) Bills of Exchange.

Calculation of Due Date of a Bill of Exchange Made Payable after Specified Number of Days: Stepwise:

1. Find out the starting point (i.e. date of the bill or its date of acceptance, as the case may be).
2. Exclude this date (i.e. date of the bill or its date of acceptance, as the case may be).
3. Find out the remaining days of the month.
4. Add to No.3 the remaining days of the next month(s) so as to arrive at the required number of days.
5. Now add 3 days of grace to the date at No.4.
6. If such due date happens to be a public holiday, the bill will fall due for payment on 'the next **preceding** business day' (and **not** on the next **succeeding** business day).

Calculation of Due Date of a Bill of Exchange, Payable after Specified Number of Months: Step-wise:

1. Find out the starting point (i.e. date of the bill or its date of acceptance, as the case may be).
2. Add the required number of months to this starting point.
3. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.
4. Now add 3 days of grace to the date at No.3.
5. If such due date happens to be a public holiday, the bill will fall due for payment on 'the next **preceding** business day' (and **not** on the next **succeeding** business day).

Mode of Acceptance of a Time Bill

A valid acceptance must invariably be in writing, duly signed by the drawee or his authorised agent, on the face of the bill of exchange, with the date of acceptance, and its delivery to the holder, or to some person on his behalf.

General or Qualified Acceptance of a Time Bill

(a) A general acceptance of a time bill of exchange is one where it has been accepted by the drawee, in its absolute terms, without stipulating any condition or qualification, regarding its payment, etc.

(b) As against this, a qualified acceptance is the one where a bill of exchange has been accepted, but with certain condition(s) or qualification(s), and whereby the effect of the bill gets changed from the way it had been originally drawn.

Drawee in case of Need

A 'drawee in case of need' is the person who has been named in the bill of exchange as an alternative drawee, when a need may arise to approach him for acceptance and/or payment of the bill of exchange, i.e. when the original drawee may refuse to accept and/or pay the bill, or he may not be available at the given. However, it is usually done in the cases of foreign bills of exchange.

Effect of Dishonour

The effect of dishonour of an instrument, by way of its non-acceptance or its non-payment on maturity, is that the drawer and all the endorsers involved therein are held liable to its holder. But then, their liability can be invoked only if he holder gives them the notice of such dishonour. The drawer, however, can be held liable only if the instrument has been dishonoured for non-payment.

Noting and Protesting for Dishonour

A notary public is a lawyer specifically appointed by a competent authority for the purpose of noting, under the Notaries Act, 1952. Noting is a formal method of authenticating the fact of the dishonour of a bill of exchange by its non-acceptance and/or by its non-payment.

As against the noting, the protest is a formal certificate issued by the notary public, attesting the dishonour of the bill, based on the noting itself.

Acceptance for Honour after noting or protesting of a bill

In the cases where a bill of exchange has been noted or protested for non-acceptance, or for not providing a better security as asked for by the notary, and any other person accepts it, *supra protest*, for the honour of the drawer, or of any one of the endorsers, such person is referred to as an acceptor for honour (**Section 7**).

Even after the acceptance of the bill for honour (after noting or protesting), such bill has to be presented, on the due date, by the payee or the holder, first to the drawee of the bill, for its payment. And only after it has been even then dishonoured for non-payment by the drawee, and it has been noted or protested for non-payment in this case, it must be presented by him to the acceptor for honour for its payment, and not earlier.

Payment for Honour after noting or protesting of a bill

Any person may make the payment of the bill of exchange *supra protest*, which has already been noted and protested for non-payment, for the honour of any party liable on the bill.

Some Other Categorisation of the Bill of Exchange

'DA' Bill and 'DP' Bill

1. (i) **'DA' Bill**, meaning 'delivery against acceptance' is one where the documents to the title to goods (like Railway Receipt, Lorry Receipt, Bill of Lading, Air-way Bill, and so on), pertaining thereto, are required to be delivered against acceptance of the bill of exchange.
   (ii) **'DP' Bill**, meaning 'delivery against payment' is one where the documents to the title to goods (like Railway Receipt, Lorry Receipt, Bill of Lading, Air-way Bill, and so on), pertaining thereto, are required to be delivered against payment of the amount of the bill of exchange.
2. (i) A **documentary bill** is the one which is accompanied by the relative title to goods (as aforesaid), which may have to be delivered against acceptance or payment of the bill, as required by the drawer.
   (ii) A **clean bill** of exchange is the one which is not accompanied by any documents to the title to goods [mostly when such documents have already been sent to the drawee concerned direct, but only where the drawer (seller) considers the drawee (buyer) to be highly credit-worthy.]
3. (i) **Inland bill** (also known as domestic bill), generally speaking, is the one wherein both the drawers (sellers) and the drawees (buyers) are of the one and the same country.
   (ii) In the case of a foreign bill of exchange, the drawers and the drawees belong to two different countries.

4. **Foreign bills** of exchange are generally **drawn in sets of three**, each of which is referred to as *'via'*. However, only one of these three *'vias'* (sets) are required to be accepted and paid on the due date. Further, the acceptance and payment of any one of these three *'vias'* (sets) makes the other two sets (*'vias'*) inoperative. But then, as provided under **Section 132**, if any person happens to endorse different parts of the bill in favour of different persons, he himself as also all the subsequent endorsers of each part of the bill are held liable on such part as if it were a separate bill.
5. (i) A **trade bill, or a genuine bill,** represents genuine business transactions involving actual sale and purchase of goods.
   (ii) An **accommodation bill** is the one which does not represent any genuine business transactions involving any sale and purchase of goods.

Compensation payable to the Holder

The holder of a bill of exchange is entitled to receive the amount due for payment on the bill plus the amount of interest and the expenses towards noting and protesting of the bill.

Compensation payable to the Endorser

The endorser of the bill, who has already paid the amount due thereon, is entitled to receive the amount so paid by him, plus expenses towards noting and protesting of the bill, with interest at the rate of 6 per cent per annum, from the date he had so paid the amount upto the date of his receiving back the amount.

Compensation payable by a Banker for wrongful dishonour of cheques

In the event of wrongful dishonour of a cheque, the bank will have to pay due compensation to its customer, which compensation would include the damages to the credibility and reputation of the drawer (customer) in the market. In such cases the Court is most likely to award exemplary and/or vindictive damages.

Undue Delay in Presentation of a Cheque (Section 84)

The payee or the holder of a cheque must present it for payment to its drawee banker within a reasonable time from the date of its drawing by the respective account holder (drawer).

What are *Hundis*?

'*Hundis*' usually refer to the bills of exchange drawn in the oriental languages, though sometimes these are drawn even in the form of promissory notes. Even today, the provisions of the Negotiable Instruments Act do not necessarily apply in the cases of *hundis*, unless it is specifically provided therein. Thus, mostly it is governed by the prevalent local usages applicable to such instruments.

Types of *Hundis*

(a) In ***Shah-Jog Hundi*,** the payee is invariably a *shah*, i.e. a rich, respectable and worthy person, enjoying good credibility in the local market.
(b) A ***Darshani Hundi*** is one which is made payable at sight (meaning *darshan*). It is sometimes sold at a premium, and sometimes even at a discount.
(c) A ***Muddati Hundi*** or ***Miyadi Hundi*** is made payable after a specified period of time. It may be drawn in the form of *shah-jog, nam-jog* or *dhani-jog hundis.*
(d) A ***Nam-Jog Hundi*** is made payable to a specified person named therein.
(e) A ***Nishan-Jog Hundi*** is one wherein the term '*Nishan-Jog'* is mentioned and which is made payable only to the person who presents it.
(f) The term '*Dhani*' means 'owner' [i.e. the owner of the *dhan* (amount) of the *hundi*). A **D*hani-Jog Hundi*** is made payable to the *dhani,* the owner of the *hundi,* i.e. to the holder of the *hundi*, whosoever he may be. This way it is in the nature of a bearer *hundi*. Further, in this *hundi*, the term '*Dhani-Jog'* is mentioned.
(g) The term '*Farman*' means 'Order'. Thus, a ***Farman-Jog Hundi*** is the one which is made payable to order.
(h) The term '*Dekhanhar*' means 'the one who sees it'. Thus, a ***Dekhanhar-Jog Hundi*** is the one which is made payable to its seer or its holder, i.e. it is made payable to the bearer.

(i) The *hundi*, which is used as a means of remittance of money from one place to another, through a banker, is termed as a ***Jawabee Hundi***.

(j) The term '*Jokham*' means 'risk' and the term '*Jokhami*' means 'risky'. Thus, a *Jokhami Hundi* is in the nature of an insurance policy, but with a difference, in that in the case of a ***Jokhami Hundi***, the amount of the *hundi* is paid in advance, which may, however, be recovered in case the slip is not lost.

Questions for Reflection

1. (a) Define a 'Bill of Exchange', quoting the number of the Section that defines it.
   (b) Analyse the various clauses contained in the definition of a 'Bill of Exchange'.
2. (a) Name the parties that are there in a Bill of Exchange, in the following cases:
      (i) At the time of its making (execution); and
      (ii) After it has been endorsed and delivered.
   (b) Define each of the parties to a bill of exchange, in each of the above cases, citing examples in each case.
3. What are the essential ingredients of a Bill of Exchange? Explain each of them separately.
4. How many different types of bills of exchange are there? Name and explain the distinguishing features of each of them, by citing suitable illustrative examples in each case.
5. Bring out a comparison of the distinguishing features of a promissory note and a bill of exchange.
6. Who are the persons who may make, draw, accept, or endorse a bill of exchange?
7. Distinguish between the following pairs of different types of bills of exchange:
   (a) Demand Bills of Exchange and Time (Usance) Bills of Exchange
   (b) 'DA' Bills of Exchange and 'DP' bills of Exchange
   (c) Documentary Bills of Exchange and Clean Bills of Exchange
   (d) Trade (Genuine) Bills and Accommodation Bills
   (e) Inland (Domestic) Bills of Exchange and Foreign Bills of Exchange
8. Write a short note on 'Bills of Exchange in Sets'.
9. While both the cheques and bank drafts are bill of exchange, what are the main distinguishing features between these two?
10. What are the specific reasons for which Sections 31 and 32 of the RBI Act have provided that the Bank Drafts have necessarily to be drawn payable on order only (and never in the form of a bearer draft)?
11. Who are the persons legally entitled to accept a bill of exchange?
12. When and where should a bill of exchange be presented for its acceptance?
13. When and where should a bill of exchange be presented for its payment?
14. Under what different circumstances the presentation of the bill of exchange for acceptance gets automatically excused?
15. What are the specific conditions that must be fulfilled to constitute a valid acceptance of a bill of exchange?
16. What are the specific legal points involved where the bill of exchange has been accepted for payment by the drawee writing the following words on the face of the bill under his full signature?
   (a) 'Accepted'
   (b) 'Accepted for payment at Union Bank of India, Gomti Nagar, Lucknow.
17. Write short notes on the various types of qualified acceptance of a time bill of exchange.
18. Write short notes on the 'drawee in case of need'.
19. Under what circumstances presentation of the bill of exchange for payment may become unnecessary?

20. (a) Under what circumstances a bill of exchange may be deemed to have been dishonoured for the following reasons?
    (i) For non-acceptance; and
    (ii) For non-payment.
    (b) What are the various legal ramifications of the dishonour of a bill of exchange for the following reasons?
    (i) For non-acceptance; and
    (ii) For non-payment.
21. Under what different circumstances the giving of the notice of dishonour of a bill of exchange may become unnecessary?
22. What are the various distinguishing features between 'Noting for Dishonour' and 'Protesting for Dishonour'?
23. What are the laid down rules for determining the amount of compensation that may become payable to the holder and the endorser, in the event of the dishonour of a bill of exchange?
24. (a) Under what different circumstances a negotiable instrument may be deemed to have been discharged?
    (b) Under what different circumstances one or more of the parties to a negotiable instrument may be deemed to have been discharged?
25. Write short notes on the following types of *Hundis*:
    (a) *Shah-Jog Hundi*;
    (b) D*arshani Hundi*;
    (c) *Muddati Hundi* or *Miyadi Hundi*;
    (d) *Nam-Jog Hundi*;
    (e) *Nishan-Jog Hundi*;
    (f) D*hani-Jog Hundi*;
    (g) *Farman-Jog Hundi*;
    (h) *Dekhanhar-Jog Hundi;*
    (i) *Jawabee Hundi;* and
    (j) *Jokhami Hundi.*
26. What are the similarities and distinguishing points between the following pairs of *hundis?*
    (a) *Shah-Jog Hundi* and *Nam-Jog Hundi*;
    (b) *Darshani hundi* and *Muddati Hundi;*
    (c) *Dhani-Jog Hundi* and *Farman-Jog Hundi;* and
    (d) *Dekhanhar-Jog Hundi* and *Farman-Jog Hundi.*

Problems for Practice (With Suggested Solutions)

Problem 1

A Time Bill of Exchange is dated 24.7.2009, and is made payable 45 days after date, and has been accepted on 27. 7. 2009. When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of the bill, i.e. 24.7.2009.
2. We will exclude this date.
3. We will now find out the remaining days of this month, which comes to 31 less 24 = 7.

4. By adding to No.3 the remaining days of the next month(s) so as to arrive at the required number of 45 days, we come to 7 days of July + 31 days of August +7 days of September, which completes 45 days . Thus, on 7.9.2009 the required 45 days are completed.
5. We will now add 3 days of grace to the date at No.4, i.e. 7 + 3 = 10 September 2009.

Thus, 10 September 2009 is the actual due date.

Problem 2

The bill is drawn payable 3 months after acceptance, and is dated 27.8.2008 and has been accepted for payment on 31.8.2008. When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of acceptance of the bill, i.e. 31.8. 2008.
2. Add 3 months to the starting point i.e. 31. 8. 2008 + 3 months = 31.11.2008.
   But, as the month of November does not have the corresponding day, the period shall be held to terminate on the last day of the month, i.e. on 30.11.2008
3. Add 3 days of grace, i.e. 30.11.2008 + 3 days of grace = 3.12.2008.

Thus, 3.12.2008 is the actual due date.

Problem 3

A Time Bill of Exchange is dated 31.8.2008, and is made payable 60 days after acceptance, and has been accepted on 7. 9. 2008. Presume that the actual due date so arrived at happens to be a public holiday.

When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of acceptance of the bill, i.e. 7. 9.2008.
2. We will exclude this date.
3. We will now find out the remaining days of this month, which comes to 30 less 7 = 23.
4. By adding to No.3 the remaining days of the next month(s) so as to arrive at the required number of 60 days, we come to 23 days of September + 31 days of October + 6 days of November, which completes 60 days. Thus, on 6.11.2008 the required 60 days are completed.
5. We will now add 3 days of grace to the date at No.4, i.e. 6 + 3 = 9 November 2008.
   Thus, 9 November 2008 is the actual due date, so calculated.
6. But as this date, i.e. 9 November 2008 happens to be a public holiday, the bill will fall due for payment on 'the next **preceding** business day', i.e. on 8 November 2008 (and **not** on the next **succeeding** business day, i.e. 10 November 2008).
   Thus, 8 November 2008 is the actual due date.

Problem 4

A Time Bill of Exchange is dated 30.10.2008, and is made payable 4 months after date, and has been accepted on 9.11 2008. When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of the bill, i.e. 30.10.2008.
2. Add 4 months to the starting point i.e. 30.10.2008 + 4 months = 30.2.2009.
   But, as the month of February does not have the corresponding day, the period shall be held to terminate on the last day of the month, i.e. on 28.2.2009 (The year 2009 not being the leap year).
3. Add 3 days of grace, i.e. 28.2.2009 + 3 days of grace = 3.3.2009
   Thus, 3.3.2009 is the actual due date.

Problem 5

A Time Bill of Exchange is dated 29.7.2008, and is made payable 2 months after date, and has been accepted on 5.8.2008. When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of the bill, i.e. 29.7.2008.
2. Add 2 months to the starting point i.e. 29.7.2008 + 2 months = 29.9.2008.
3. Add 3 days of grace, i.e. 29.9.2008 + 3 days of grace = 2.10.2008
4. But as 2 October each year is a public holiday on account of Gandhi Jayanti, the bill will fall due for payment on 'the next **preceding** business day', i.e. on 1.10 2008 (and **not** on the next **succeeding** business day, i.e. 3.10.2008).
   Thus, 1 October 2008 is the actual due date.

Problem 6

A Time Bill of Exchange is dated 25.7.2008, and is made payable 90 days after acceptance, and has been accepted on 31.7. 2008. Presume that the actual due date so arrived at happens to be a public holiday. When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of acceptance of the bill, i.e. 31. 7. 2008.
2. We will exclude this date.
3. We will now find out the remaining days of this month, which comes to 31 less 31 = 0.
4. By adding to No.3 the remaining days of the next month(s) so as to arrive at the required number of 90 days, we come to 0 days of July + 31 days of August +30 days of September + 29 days of October, which completes 90 days. Thus, on 29.10.2008 the required 90 days are completed.
5. We will now add 3 days of grace to the date at No. 4, i.e. 29.10.2008 + 3 days = 1 November 2008.
   Thus, 1 November 2008 is the actual due date, so calculated.
6. But as this day, i.e. 1 November 2008 happens to be a public holiday, the bill will fall due for payment on 'the next **preceding** business day', i.e. on 31.10.2008 (and **not** on the next **succeeding** business day, i.e. 2 November 2008).
   Thus, 31.10.2008 is the actual due date.

Problem 7

A Time Bill of Exchange is dated 31.8.2008, and is made payable 75 days after date, and has been accepted on 3.9.2008. Presume that, besides the actual due date so arrived at happening to be a public holiday, even the immediately next preceding day as also the immediately next succeeding day happens to be public holidays.

When will the bill actually fall due for payment? Show the calculation step by step.

Solution

1. In the instant case, the starting point is the date of the bill, i.e. 31.8.2008.
2. We will exclude this date.
3. We will now find out the remaining days of this month, which comes to 31 less 31 = 0.
4. By adding to No.3 the remaining days of the next month(s) so as to arrive at the required number of 75 days, we come to 0 days of August + 30 days of September + 31 days of October + 14 days of November, which completes 75 days. Thus, on 14.11.2008 the required 75 days are completed.
5. We will now add 3 days of grace to the date at No.4, i.e. 14.11.2008 + 3 days = 17.11.2008
   Thus, 17 November 2008 is the actual due date, so calculated.
6. But as this date, i.e. 17 November 2008 happens to be a public holiday, the bill will fall due for payment on 'the next **preceding** business day', i.e. on 16 November 2008. Further, as the immediately next preceding day (i.e. 16 November 2008) also happens to be a public holiday the bill will fall due for payment on 'the next **preceding** business day', i.e. on 15 November 2008.
   Thus, 15 November 2008 is the actual due date.

Problem 8

Sunrise Industries was holding 9 bills of exchange for an aggregate amount of Rs 51,427. On 5.9.2008, all these 9 bills were dishonoured. Let us presume that in this case, both the holders and the endorsers were residing in the same place. The notice of dishonour was promptly given on 7.9.2008.

(a) In this case, whether the notice of the dishonour of the bill will be deemed to have been served as on due time or as out of time; and

(b) What will be the legal effect in the instant case, in regard to the claim in respect of the bills of exchange? That is, will the claim remain valid or it will fail?

Solution

As per **Section 106**, if both the receiver and the giver of the notice of dishonour reside in the same place, it should be given so as to be received by the other party at least on the very next day of the date of its dishonour. In this case, as both the holders and the endorsers of the bills of exchange were residing in the same place, the notice of dishonour must have been given the same day (i.e. on 5.9.2008), or latest by the very next day (i.e. on 6.9.2008). Thus, the notice of dishonour, served on 7.9.2008, was late by one day. Accordingly, in view of the fact that the notice of dishonour was delayed even by a single day, it will be deemed as out of time, and thereby the claim in respect of the bills of exchange will fail. These observations are based on the judgement delivered in the case titled: **Yeoman Credit Ltd vs Gregory (1963).**

Problem 9

A bill of exchange, after adding the statutory 3 days of grace, had actually fallen due for payment on 24.9.2008. But, the payee of the bill had contended that the 3 days of grace were optional and depended upon the choice of the payee to show such grace (of adding 3 days of grace). Accordingly, he had presented this instrument to the drawee concerned for payment on 21.9.2008 itself.

Will such presentation be treated as a valid presentation? Give reasons for your answer.

Solution

As provided under **Section 22** of the N I Act, 'Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentment, is at maturity on the third day after the day on which it is expressed to be payable.' Thus, the adding of 3 days of grace is not optional but a statutory obligation. Thus, the presentation of the bill for payment by the drawee concerned before the actual due date is a wrongful presentation for payment, and not a valid one. This contention is based on the judgement delivered in the case titled: **Wijfen vs Roberts, 1975.**

Chapter Nineteen

Cheques and Bank Drafts

"*Any general statement is like a cheque drawn on a bank. Its value depends on what is there to meet it.*
Ezra Pound

Yesterday is a cancelled cheque: Forget it. Tomorrow is a promissory note: Don't count on it. Today is ready cash: Use it!
Edwin C. Bliss

We can tell our values by looking at our chequebook stubs.
Gloria Steinem

If you're not using your smile, you're like a man with a million dollars in the bank and no chequebook.
Les Giblin

The two most beautiful words in the English language are: 'Cheque Enclosed'.
Dorothy Parker"

19.1 Definition of Cheque

As defined under **Section 6** [as amended by the Negotiable Instruments (Amendment) Act, 2002 (w.e.f. 6. 2. 2003)], 'A Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand'. Further, the definition includes the electronic image of a truncated cheque, as also a cheque in the electronic form.

In other words, a cheque is also a bill of exchange, but it is invariably drawn as a demand bill of exchange only [and not as a time (usance) bill of exchange], wherein the drawee is always a specific branch of a specified bank, and the drawer is the account holder of the same branch of the bank.

19.1.1 A **cheque in the electronic form** means a cheque, containing the exact mirror image of a paper cheque, and is generated, written, and signed in a secure system, ensuring the minimum safety standards, with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

19.1.2 A **truncated cheque** refers to a cheque**,** which is truncated during the course of a clearing cycle, either by the clearing house or by the bank, whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

19.2 Salient Features of a Cheque

(i) A Cheque is a bill of exchange, i.e. it also has three parties involved, viz. (a) a drawer (b) a drawee, and (c) a payee.
(ii) Drawn on a specified banker, i.e. in the case of a cheque, the drawee will invariably be a bank and bank alone. Alternatively speaking, a cheque will invariably be drawn on a bank and bank only.
(iii) Not expressed to be payable otherwise than on demand. That is to say that a cheque must be payable only on demand. Alternatively speaking, a cheque cannot be made payable so many days or months after date. To put it again differently, a time (usance) cheque cannot be issued.
(iv) It may, however, be made payable to the bearer or to the original payee named therein or to his order.

A comparison of the distinguishing features of bill of exchange and cheque is presented in **Table 19.1**.

Table 19.1 *Distinguishing Features of Bill of Exchange and Cheque*

Bill of Exchange	*Cheque*
(i) Here, there are **three parties** involved, viz. the drawer, the drawee, and the payee.	(i) Here also, there are **three parties** involved, viz. the drawer, the drawee, and the payee.
(ii) It contains an unconditional **order** given by the drawer to the drawee to pay, as per the drawer's instructions.	(ii) It also contains an unconditional **order** given by the drawer to the drawee to pay, as per the drawer's instructions.
(iii) It can be made payable on demand, or after so many days or month(s).	(iii) It can be made payable on demand only, and not after so many days or month(s).
(iv) Here, in case of time (usance) bills, prior presentation for acceptance is required to be made to the drawee or his agent, and it is only after acceptance that it could be presented for payment on due date.	(iv) Here, no prior presentation for acceptance is required because, cheques are made payable on demand only, as time (usance) cheques cannot be issued, as per law.
(v) It can be drawn on any person, including a bank.	(v) It can be drawn on a bank only, and that also on a specific branch of a specific bank where the drawer maintains an account.
(vi) It can be drawn on any format, printed or hand-written.	(vi) It can be drawn on the cheque from the specific cheque book, issued by the bank, or a withdrawal form given by the bank.
(vii) Here, in case of time (usance) bills, prior presentation for acceptance is required to be made to the drawee or his agent, and it is only after acceptance that it could be presented for payment on due date.	(vii) Here no prior presentation for acceptance is required because, cheques are made payable on demand only, as time (usance) cheques cannot be issued, as per law.

(*Contd.*)

(*Contd.*)

(viii) In the case of a time (usance) bill of exchange, three days of grace are necessarily required to be given, while calculating the due date of its payment.	(viii) Here, no days of grace are required to be given as cheques are made payable on demand only, as time (usance) cheques cannot be issued, as per law.
(ix) In the case of a bill of exchange, crossing is not required, or even permitted.	(ix) A cheque can, however, be crossed as well.
(x) In the case of a time (usance) bill of exchange, notice of dishonour, by non-acceptance or non-payment on the due date, is necessarily to be given to all the parties involved therein, so as to hold them liable. Thus, a party, who does not receive a notice of dishonour of the bill of exchange, can very well escape his liabilities thereon.	(x) Here, no notice of dishonour, by non-acceptance or non-payment on the due date, is required to be given to all the parties involved therein, because a time (usance) cheque cannot be issued. Thus, all the parties involved therein remain liable thereon, without being given a notice of dishonour.
(xi) In the case of a time (usance) bill, it is required to be noted or protested, for non-acceptance or non-payment on due date, to prove such dishonour in the Court of law.	(xi) A cheque, however, is not required to be noted or protested, for non-acceptance or non-payment on due date because, cheques are made payable on demand only, and time (usance) cheques cannot be issued, as per law.
(xii) The protection given to the paying banker, in case of a crossed cheque, is not available to the drawee in the case of a bill of exchange.	(xii) In case of a crossed cheque, some protection is given to the paying banker, which provision is special and peculiar to crossed cheques only.

19.2.1 Requisites of a Cheque

As a cheque is also a bill of exchange, it must also contain all the other features of a bill of exchange. These are the following:

(a) An instrument (i.e. a document, necessarily in writing, through which the rights, vested in one person, could be transferred in favour of another person).

(b) In writing (i.e. not just verbally).

But the Act does not specify the mode or material to be used in writing a cheque. Accordingly, it may be written with a pen or a dot pen, or it may be type-written or computer printed, or it may be got printed in a printing press or even written with a pencil. But then, a cheque, drawn with an ordinary lead pencil, can be easily erased and materially altered (in regard to the amount, the name of the payee, and the date), at the detriment of the drawer, which may not be possibly detected by the paying banker. Therefore, the banks invariably discourage the drawing of a cheque with an ordinary lead pencil.

In fact, in India, even till 1996, the bankers were discouraging drawing of a cheque even with ball pens. But later, on being satisfied with the improved quality of the ball pens, they had allowed the drawing of the cheques with ball pens as well.

They even require that the cheques must be drawn by the drawer on the leaves of a cheque book issued to the specific account holder. These cheques are printed on special security paper, which is quite sensitive to chemicals, so much so that any alteration made, after erasing any particulars written on the cheque, makes it obvious and noticeable. These days, even special cheque books are printed by the bank for each of its account holder, with his or her name, address, and account number printed thereon.

The law does not specify the material to be used for drawing a cheque, either. Therefore, in a case, an account holder of the specific branch of a bank in UK, had drawn a cheque on a sole of an old shoe and the bank was required to honour and make payment of such a cheque, which was treated to be legally in order.

In another case, a person had drawn a cheque on his banker on the body of a huge ship, which had arrived at the port. The banker, though initially perplexed, had played even smarter, and asked its payee concerned to present the cheque at the counter of the bank, as a cheque can be paid by a banker on its presentation at the bank only. As it was not possible for the payee to comply with such legal requirements, the bank could well avoid the payment of such a cheque, and keep it on its records.

(c) Order (i.e. it must contain an order to pay and not a promise or request).

But then, it is not required that the word like 'order' or its equivalent has to be necessarily used, so as to make the instrument to be treated as a cheque. But then, though a cheque is in the form of an (unconditional) 'order' to the banker to 'Pay', the words like 'please' or 'kindly', preceding the word 'Pay' – like 'Please Pay' or 'Kindly Pay' – in themselves, will not render the cheque as an invalid negotiable instrument on such grounds alone.

(d) Unconditional order (i.e. there should be no condition attached thereto).

(e) There are three parties to a cheque also, viz.

(i) The **drawer**, who makes (draws) the cheque; but the drawer must be maintaining an account with the specified branch of the specified bank,

(ii) The **drawee**, who has been ordered by the drawer to pay the amount written on the cheque (who, in the case of a cheque , must invariably be a bank and bank only, and necessarily specified branch of the specified bank, where the drawer must be maintaining an account), and

(iii) The **payee**, to whom the drawee has been ordered to pay the amount written on the cheque, or to his (original payee's) order, or to the bearer, as the case may be.

(f) Signed by the maker (i.e. it must necessarily bear the signature of the maker (drawer) of the cheque; alternatively speaking, it must necessarily be signed by the maker (drawer) of the cheque, failing which it will be deemed to be an nullity.

(g) Directing a certain branch of a specific bank, where the drawer is maintaining his or her account.

(h) To pay (and nothing else).

(i) A certain sum of money (and money only, and not anything). The amount payable must also be stated in certain and specific terms. Accordingly, a direction, given to the banker by an account holder, to deliver certain shares or securities, instead, will not tantamount to a cheque. Similarly, an order to pay a certain sum of money with interest, without specifying the exact rate at which such interest is required to be paid, will not be treated as a cheque, on the ground that the amount required to be paid is not certain, or not capable of being ascertained.

(j) To, or to the order of, a certain person; or to the bearer of the instrument. Here the term 'person' does not include only human beings. That is to say that the cheques made payable to a company, firm, club, association, institutions, society, local bodies, or authorities, and so on , will also be deemed to be valid cheques.

(k) Payable on demand only. Alternatively speaking, a cheque cannot be made payable so many days or months after date. To put it again differently, a time (usance) cheque cannot be issued. But then, it is not required in law that the words 'on demand' or some other equivalent terms must necessarily be used. The order made to the specified banker ' To Pay' in itself will amount to be an order to pay on demand and not otherwise, provided, of course, no time is specified for its payment like so many days or months after date, and so on (**Section 19**).

(l) The amount payable must be written both in words and figures.

However, as provided under **Section 18**, where the amount in words and figures are stated differently on a cheque – or the other negotiable instruments, like the bill of exchange and promissory note – the amount written in words shall be taken as the amount ordered or undertaken to be paid. But then, the banks are not yet complying with such provisions of the Act, and still continue to return such cheques under the objection reading as 'Amount in words and figures differs'. Such objection is also included by almost all the banks as one of the possible objections, in their printed list of objections, for returning the

cheque unpaid. The specimen of the printed 'list of objections' of the State Bank of India, Gomti Nagar, Lucknow, on the ground of which the bank usually returns the cheques unpaid has been given in Appendix 19.1 at the end of this chapter.

(m) The bankers also suggest to their customers that they, in their own interest, must leave no space between the words 'Rupees' and 'Rs', printed on the cheque leaves, issued by the bank, as also at the end of the amount written in words and figures respectively, so that some other person may not, by way of an undetectable and successful forgery, interpolate, and thereby increase the amount made payable on the relative cheque. This is so because, if the drawer, even innocently, leaves sufficient space in the beginning and/or in the end of the amount written in words and figures, and the banker makes payment of such 'forged' cheque, on the ground that the forgery was not noticeable despite the banker having exercised due and reasonable care, the banker will be justified in having debited the account of his customer concerned with the (higher) amount actually paid.

(n) The cheque must be dated, too. Thus, a cheque without bearing the date will be considered to be incomplete and accordingly, it may be returned unpaid by the bank on such ground. But after such cheque has been issued and delivered to the payee without dating it, the payee or the endorser or the endorsee, or any other person for that matter, can put any date on the blank space meant for the purpose on the cheque leaf, and it will not amount to a material alteration, either. Thus, the cheque may be paid by the bank. In this connection, it may be asserted here that if a drawer signs (i.e. draws) and delivers a cheque in blank, without giving the date, the name of the payee, or the amount in words and figures, the drawer is deemed to have authorised any other person to complete these particulars at his or her sweet will and, thereby the drawer undertakes to abide by the same. Such cheque, when completed by another person, will be paid accordingly, provided the amount written thereon is within the amount of the available balance in the drawer's account concerned, maintained with that specific bank and branch.

19.3 Anti-dated, Stale, and Post-dated Cheques

The drawer of a cheque is at liberty to date a cheque with an earlier or a later date than the date on which he actually draws and signs the cheque.

(a) Anti-dated Cheque

A cheque bearing a date, which is earlier than the actual date of the signing of the cheque by the drawer, is referred to as an anti-dated cheque. That is, if a drawer signs a cheque on 16th August 2009, and puts the date thereon as 27th June 2009, instead, it will be known as an anti-dated cheque. Such cheque will have to be presented to the banker for payment before six months from such earlier date, i.e. on or before 26th December 2009, failing which it must be returned by the banker unpaid, under the objection 'the cheque is stale' or out-dated, or expired. This is so, because in India, the validity of a cheque is limited to six months from its date. Thus, if the banker, even through an oversight, pays such a (stale) cheque on or after 27th December 2009, he will have to replenish the customer's account as he has committed the irregularity and illegality of having paid a stale cheque. In the case of interest and dividend warrants, however, these are usually required to be presented for payment within three months from the dates put thereon, as is generally marked thereon, accordingly.

(b) Stale Cheque

Thus, we can easily infer that, in India, a cheque bearing a date earlier than six months (unless specifically stated to be payable within a shorter period than six months, say, three months, as is usually the case with a dividend warrant or an interest warrant), it will be deemed by the banker, as a stale cheque. It will, accordingly,

be returned unpaid under the objection reading as 'cheque is stale' or 'cheque is outdated' or 'cheque is out of date'. A stale cheque may, however, be revalidated by the drawer. That is why, in the case of a dividend warrant or an interest warrant, which is super-scribed as 'Payable within three months from the date of the warrant' it is required to be revalidated by the drawer company concerned, before it could be represented for payment over again.

In England, however, the validity of the cheque is for one year, instead. That is, the aforementioned cheque, dated 27th June 2009, if drawn on and payable by a banker in England, it may be legally and rightfully paid by the banker there, if it is presented on or before 26th June 2010.

(c) Post-dated Cheque

As against an anti-dated cheque, a cheque, bearing a date, which is later than the actual date of the signing of the cheque by the drawer, is referred to as a post-dated cheque.

It may thus, be reiterated here:

(i) That, even a post-dated cheque could be issued, in which case, it can be paid only on or after the date written thereon.

(ii) That, the cheques are usually valid only for six months in India, from the date of its issue, unless specifically marked otherwise. For example, most of the dividend warrants (on shares) and interest warrants (on debentures and bonds), which are also in the nature of a cheque, are marked 'valid for warrants three months from the date of issue', or else 'valid up to a certain specified date', e.g., warrants dated 30.9.2008, may be marked valid upto 30.12.2008, after which these are required to be revalidated by the drawer. Otherwise, all these instruments, including the cheques, may be returned by the bank unpaid, under the objection reading as 'cheque is stale' or 'cheque is outdated'.

(iii) That, the defence department usually issues every month the salary cheques, payable to the defence personnel, say dated 24.11.2008, marked 'not payable before a particular date, say 01.12.2008'. Some of the Companies, like Lakme and others, also issue dividend warrants and interest warrants to their shareholders or debenture holders, say, dated 21.10.2008 marked 'not payable before a particular date, say, 01.11.2008'.

(iv) That, some persons or parties may issue post-dated cheques, like the cheque is dated 15.10.2008, but issued and delivered to the payee on 01.10.2008 itself, i.e. with the intention that the cheque must be paid on or after 15.10.2008, and not earlier. And if such cheque were to be presented on 10.10.2008, instead, it would be returned by the bank unpaid under the objection reading as 'cheque is post-dated'.

Date _____200

PAY _____

_____Or BEARER

RUPEES _____

_____

Rs _____

A/C No. _____L.F. _____ INITIALS_____

STATE BANK OF INDIA
Gomti Nagar, Lucknow – 226010
Cheque No. _____

Figure 19.1 Specimen of a Bearer Cheque

Date _____200

PAY _____

_____Or ORDER

RUPEES _____

_____

Rs _____

A/C No. _____L.F. _____ INITIALS_____

STATE BANK OF INDIA
Gomti Nagar, Lucknow – 226010
Cheque No. _____

Figure 19.2 Specimen of an Order Cheque

19.4 Bearer Cheque and Order Cheque

Even a **Bearer** cheque (as in Figure 19.1) may be converted into an **Order** cheque (as in Figure 19.2), merely by cancelling the word **'Bearer',** with or without writing the word **'Order'** above the word **'Bearer'**. Such alteration can be made by the drawer of the cheque, or even by the payee or the endorsee, and so on, as such alteration is not deemed to be a material alteration, nullifying the cheque in question. We will discuss, in detail, a little later in the chapter, as to what all constitute material alterations, and what do not amount to material alterations.

19.4.1 Cheques marked 'Bearer' or 'Order'

As stipulated under **Section 47**, an 'order cheque' or an 'order bill of exchange' can be negotiated, i.e. its title can be transferred, by endorsement and delivery. But, the title to a bearer cheque can be transferred without any endorsement, i.e. by mere delivery of the cheque.

On this plea, some person, while taking cash payment of a bearer cheque, may refuse to sign (endorse) on the back of the bearer cheque. But, in that case, he will have to give an acknowledgement, for receipt of the amount, in cash, on a separate piece of paper, and that, too, on a revenue stamp of Re 1, if the amount involved happens to be over Rs 500. As against this, if he would have, instead, agreed to sign on the back of the bearer cheque, no stamp fee would have been required, as the cheques are, as per law, exempt from stamp duty.

It may be further stressed here that, in the cases of both the order and bear cheques or bills of exchange, the delivery of the instruments is essential. It may be delivered by the drawer himself, or by his agent, clerk or servant. Alternatively speaking, if the drawer signs a cheque or bill made payable to a particular person, and leaves it on his table or in his drawer, and if the particular payee himself picks it up on his own, i.e. without it being actually delivered to him by such drawer, or by his agent, clerk or servant, the title to the instrument will not legally pass on to the payee.

Further, such delivery may be either actual or constructive. When the instrument is delivered by the drawer himself, it is called actual delivery. As against this, if the possession of the instrument is given to the agent, clerk or servant of the transferee, on behalf of the drawer, it is referred to as a constructive delivery.

19.4.2 When is an Instrument Deemed Payable to Bearer?

An instrument is deemed to be payable to the bearer under the following circumstances:

(i) When it is made payable to the bearer;
(ii) Where it was originally made payable to order, but the single endorser, or the last endorser, endorses it in blank, i.e. without mentioning the name of any specific person above his endorsement;
(iii) Based on the principle: '*once a bearer, always a bearer*', a cheque made payable to bearer will remain payable to bearer only, even in the cases where it has been endorsed not in blank but in full, i.e. where the name of a specific person is written above the signature of the endorsee. Therefore, if the payee or any of the endorsers of a bearer cheque wants to make the mode of payment even stricter, he should better change a bearer cheque into an order cheque merely by cancelling the word 'bearer' written on the cheque, by writing the word 'order' above it, or even without doing so (i.e. without writing the word 'order' above it).
(iv) In the cases where the payee, mentioned on the cheque, is a fictitious person, and not a real person.
(v) Further, in the case of a bearer cheque, as its negotiation can be made merely by its delivery (i.e. without any endorsement), its transferor does not incur any liability or obligation to any of the parties other than the immediate transferee thereof.

19.4.3 It may be pertinent to reiterate here that, after the transformation in the banking systems and procedures, from the traditional banking to e-banking, after the enactment of the Negotiable Instruments (Amendment) Act, 2002 (w.e.f. 6. 2. 2003), the electronic form, or electronic image of a cheque is also held as a valid cheque. Thus, in place of a cheque in physical form, the appropriate and desired instructions/directions can be given by the drawer to the banker through an e-mail or such other electronic medium, as per the mutual arrangement between the bank and the accountholder concerned.

19.5 Crossed Cheque and Open (Uncrossed) Cheque

Crossed cheque is a direction given by the drawer to the paying banker to the effect that the payment of the cheque should not be made in cash across the bank's cash counter, but it must be paid through a banker by credit to an account only, maintained at the same branch of the bank or at any other branch of any bank. Thus, the crossing of a cheque is a further safety measure to prevent an unauthorised payment of the cheque if stolen or lost in transit, or otherwise.

But, there had been several cases where the dividend warrants and interest warrants, payable on shares and debentures respectively, issued by the companies and sent by ordinary post, were somehow stolen in transit by some unscrupulous persons and were credited to some false accounts opened by them exclusively for this purpose only. That is why the paying bankers have been asked to exercise more than ordinary care while crediting the amounts of cheques or warrants into an account which has been opened and operated for less than six months. By way of a further safeguard, these days the companies have requested their shareholders and debenture holders to advise them the particulars of their account (i.e. savings account or current account), the account number, and the name of the bank and the branch where they will like to credit the amount of their dividend warrants and/or interest warrants. By way of further safeguard and sophistication, several companies (like Ranbaxy Laboratories) have, of late, started crediting the amount of dividend and interest electronically to the respective accounts of their shareholders and debenture holders.

Under **Section 123**, crossing has been defined as 'Where a cheque bears across its face an addition of the words 'and Company' or any abbreviation thereof (like '& Co.') between two parallel transverse lines, or two parallel transverse lines simply, either with or without the words 'not negotiable', that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally.' But a cheque bearing a cross mark (i.e. 'X') cannot be deemed as a crossing.

As against the crossed cheque, a cheque that has not been crossed is referred to as an open cheque.

19.5.1 General Crossing and Special Crossing

(a) General Crossing

Where a cheque bears across its face an addition of the words 'and Company' or '& Co.', between two parallel transverse lines, or simply two parallel transverse lines, either with or without the words 'not negotiable', such crossing is referred to as a 'General Crossing'.

The examples of general crossing are where the following words are written simply or between **two parallel transverse lines:**

(i)

(ii) & Company

(iii) & Co.

(iv) Not Negotiable

(v) A/c Payee

or

(vi) A/c Payee only

(b) Special Crossing

As against a 'General Crossing', a 'Special Crossing' bears across the face of the cheque the name of a banker. As defined under **Section 124**, 'Where a cheque bears across its face, an addition of the name of a bank, either with or without the words 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed to that banker. Drawing of two parallel transverse lines is not necessary in case of a 'specially crossed cheque.' The purpose of special crossing is to instruct the drawee (paying) banker to make payment of the cheque only if it is presented for payment through that particular bank, as mentioned thereon, and not otherwise. This way the payment of the cheque is made even safer.

Detailed discussions on the significance/ramifications of various types of general and special crossings appear a little later in this chapter.

19.6 Material and Immaterial Additions/Alteration on Cheques

Cheques are not expected to be altered by any person other than the drawer of the cheque himself. Thus, if a cheque is altered by an unauthorised person, other than its drawer, during the period of its issuance and its presentation to the bank for payment, it is said to have been altered. But such alteration may be broadly classified under the following two categories:

(i) Material Addition/Alteration on Cheques, and
(ii) Additions/Alteration on Cheques, which are not Material.

We will now discuss these two types of alterations one after the other.

19.6.1 Material Additions/Alteration on Cheques

A material alteration is one where it materially (substantially) alters the operation of the instrument and consequently the rights and obligation of the parties involved. As defined in the case titled **Aldons vs Cornwall,** a material alteration is 'an alteration which alters the business effect of the instrument if used for any business purpose. Any change made in the instrument that causes it to speak a different language from what is originally intended, or which changes the legal identity of the instrument in its terms or in relation to parties thereto is a material alteration'.

19.6.2 Examples of Material Alteration

Where the alteration pertains to:

(a) The date of the instrument,
(b) The amount payable on the instrument,
(c) The time of payment of the instrument,
(d) The place of payment of the instrument,
(e) The number of parties involved in the instrument,
(f) The relationship between the parties involved in the instrument,
(g) The legal character of the instrument,
(h) Converting an 'Order' cheque into a 'Bearer' cheque, and
(i) Opening a crossed cheque.

It may, however, be stressed here that it is immaterial as to who makes the alteration. That is, even if a stranger to the instrument or an outsider makes the alteration(s) in question, it would be held that the payee or the holder of the instrument has made the alteration(s) concerned. This is so because it is the duty of the payee or the holder of the instrument to keep it safely and securely so that no alteration or forgery may be possible.

19.6.3 Effects of Material Alteration

As provided under **Section 87**, 'Any material alteration of a negotiable instrument renders the same void as against any one who is a party thereto at the time of making such alteration and does not consent thereto unless it was made in order to carry out the common interest of the original parties, and any such alteration, if made by an endorsee, discharges his endorsers from all liability to him in respect of the consideration thereof'.

Thus, when a cheque is altered materially, it is no longer deemed to be a valid cheque at all. Accordingly, if a banker makes payment of such a cheque, he cannot rightfully and legally debit the account of his customer concerned. Alternatively speaking, if the banker has erroneously debited the account of his customer concerned, he will have to replenish the account with the amount of the cheque so paid. Further, the material alteration to be valid must be duly authenticated by the drawer himself under his full signature. Conversely speaking, if a material alteration is not duly authenticated by the drawer himself under his full signature, such a cheque must be returned by the maker under the objection reading as 'Alteration in the cheque requires drawer's confirmation', and such confirmation must be under the full signature of the drawer in conformity with the one already on the bank's records.

The paying bankers, however, have been given certain protection under **Section 89**, in the cases where such alteration is not noticeable apparently, provided the payment of such a cheque has been made by the

banker in due course, as per the stipulations made under **Section 10**. **Section 89** provides that 'where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered, or where a cheque is presented which does not, at the time of presentation, appear to be crossed or to have had a crossing which has been obliterated, payment thereof by a person or banker liable to pay and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such person or banker from liability thereon and such payment shall not be questioned by reason of the instrument having been altered or the cheque crossed'.

19.6.4 Forgery

But it may be pertinent to stress here that no protection has been provided to the paying banker under the Act, for payment of a cheque bearing a forged signature of the drawer. The paying banker is not absolved of his liability and responsibility, even where the forgery of the signature of the drawer has been made so cleverly that it may become well-nigh impossible to detect the same with the naked eye, despite the paying banker taking reasonable care in this regard, at the time of making its payment. This is so because the payment of a cheque, whereon the drawer's signature is a forged one, is deemed to be a payment by the banker without the authority of his account holder, and accordingly, it tantamount to be a breach of an implied contract between the banker and the account holder (customer).

But then, in the cases where the loss has been caused directly through the conduct, carelessness, or negligence of the drawer (customer), the banker can rightfully debit the account of the customer, even if the drawer's signature has been forged. **For example**, in the cases where the drawer of the cheque has initially confirmed that his signature on the cheque in question is a genuine one, the paying banker cannot be held liable for having paid such a cheque, even when the signature of the drawer is later proved to be forged.

In the case of a joint account, to be operated by two or more of the joint account holders jointly, all the signatures appearing thereon must be genuine, in strict conformity with the signatures in the paying bank's records. Alternatively speaking, if any one or more of the signatures of the joint account holders happen to be forged one(s), the cheque must not be paid by the paying banker. Otherwise, the paying banker will be held liable for having unauthorisedly and negligently paid a forged cheque, and he would be held liable accordingly.

19.6.4 .1 What is a Forgery?

Let us now examine some of the cases which may amount to forgery.

(i) The most common example of a forgery is to write (copy and forge) the signature of a real (existing) person on the instrument so cleverly (or even not-so-cleverly) with the fraudulent intention that it may pass as a genuine signature of that real person.

(ii) To write (copy and forge) the signature even of a fictitious (non-existing) person on the instrument, with such fraudulent intention, also constitutes a forgery.

(iii) Even if a person signs his own name on the instrument, it may as well be deemed as a forgery, in case it has been so signed with the fraudulent intention that it may pass as the genuine signature of another person, having the same name.

(iv) Fraudulently changing (chemically or otherwise) the date and amount on the instrument, or the name of its payee, and so on, which all amount to material alterations, also tantamount to forgery.

19.6.4.2 Legal Position pertaining to Forgery

(i) At the very outset, we must clearly understand that an instrument bearing a forged signature is a useless and worthless document, which may confer no title to anyone. Accordingly, if a banker were to pay a cheque with a forged signature of the drawer thereon, he cannot escape his liability, even on the ground that it (the forgery of the drawer's signature) was so cleverly done that it could not be detected from the

naked eye. This is so because, as the banker has the specimen of the genuine signatures of all his customers, he is expected to discriminate between a genuine and forged signature of each of his customers, i.e. the drawers of each cheque. Thus, the bank will be required to pay back the amount of such forged cheque wrongfully debited to the account of the drawer concerned.

(ii) Further, the holder of a forged instrument cannot enforce the payment of such instrument. He cannot give even a valid discharge thereon.

But it may be carefully noted, and with interest, that in case such holder happens to somehow obtain the payment of such forged instrument, he is legally entitled to retain such amount paid to him on such forged instrument.

(iii) Moreover, the true owner of the instrument will be within his legal rights to compel the debtor to pay the amount to him over again by means of another cheque in repayment of his dues.

(iv) More importantly, even a 'holder in due course' cannot enforce payment on a forged instrument, though he is within his legal rights to obtain payment in the case of any defective title in the instrument. This is so because there is a vast difference between a 'defective title' to an instrument and a 'forged' instrument itself, which does not confer any title to any one, who-so-ever he may be. In fact, in the case of a forged instrument, the element of title is absolutely absent.

(v) But then, the person whose signatures have been forged may, by his conduct, be estopped from denying its genuineness subsequently to an innocent person.

Examples

(a) On a bill of exchange, the signature of Anand, its acceptor, transpires to be a forged one. Someone informs Anurag, the genuine holder of the bill, that the signature of Anand, as its acceptor, is a forged one. Anurag, thereupon, writes to Anand to enquire about the truth in the matter, and Anand categorically replies and confirms that the signature on the bill as its acceptor is genuinely his own. Under the foregoing circumstances, Anand will be held liable to the bill as its acceptor.

(b) Let us take a **live example** of an actual case in UK, wherein the person, whose signatures had been forged had, by his conduct, been estopped from denying their genuineness subsequently to the bank.

An account holder was in the habit of keeping his chequebook, issued by his banker, in a casual manner. His sister-in-law, living with him, had observed such an irresponsible behaviour on the part of her brother-in-law. She, therefore, drew a cheque by forging the signature of her brother-in-law and successfully encashed the cheque from the bank. The account holder had failed to promptly detect such cases of unauthorised withdrawals from his account by forging his signature on the cheques. Thus, this process and practice was continued by her for quite some time. Later on, the customer made a complaint to the bank that it had made many unauthorised payments on the basis of forged cheques, and accordingly, he asked the paying banker to replenish his account with the amount of the forged cheques unauthorisedly paid by him from time to time.

It was held by the Court in this case that the forgery had been made possible directly by the conduct and negligence on the part of the account holder (drawer), in handling the chequebook and verifying the bank's statement of his account periodically. That is to say that, if the account holder (drawer) would have taken due care in handling the chequebook and verifying the bank's statement of his account periodically, the forgeries could have been averted.

That is why, with a view to preventing forgeries, frauds, etc., all the banks write, *inter alia*, on the cover page of their cheque books, to the following effect:

'This book must be kept in a place of security under lock and key. Constituents are advised to periodically verify whether all unused forms are intact and promptly intimate to the bank the loss, if any, of the unused cheque forms/cheque requisition slip.' The term 'cheque requisition slip' has been used in the singular, because each cheque book contains only a single cheque requisition slip.

19.6.5 Examples of Immaterial Alteration

As we have seen in the preceding paragraphs, any unauthorised addition/alteration on a negotiable instrument is not permitted. For example, changing the date of the instrument or its amount, or payee's name, and so on. But some additions/alterations are permitted, too, under the Act itself, as such changes are not considered to be in the nature of material alterations.

Examples

(a) Filling the blanks in the negotiable Instrument (**Section 20**),
(b) Converting a blank endorsement into a full endorsement (**Section 49**),
(c) Converting a bearer cheque into an order cheque,
(d) Crossing of an open cheque (**Section 125**),
(e) Converting a general crossing into a special crossing (discussed, in detail, a little later in this chapter),
(f) Converting a special crossing into a further restrictive special crossings, and
(g) Alteration(s) made with the consent of the parties concerned.

We have observed in item (c) above that any one can alter a 'bearer' cheque into an 'order' cheque, just by striking out the word 'bearer'. But an 'order' cheque cannot be converted into a 'bearer' cheque, by any one else, other than the drawer himself, and that too, under his full signature. Further, crossing of an open cheque, or converting a general crossing into a special crossing, or converting a special crossing into still further restrictive special crossings, as discussed in items (d) to (f) above, fall into the category of immaterial crossings, which can be done by any one. But opening of a general crossing, or converting a special crossing into a general crossing, and so on (i.e. going in the reverse direction) cannot be done by any one else, other than the drawer himself, and that too, under his full signature. Thus, we see that, one is permitted to alter the cheque to make it more restrictive, but not the other way round.

19.6.6 Types of Crossing of a Cheque

In a similar manner, the following changes are also permitted inasmuch as these tantamount to imposing even further restrictions and providing far more safety measures on the instrument:

1. An open cheque (uncrossed cheque) can be made crossed, by drawing two transverse parallel straight lines, with or without writing the words 'and company' or '& Co' in between.
2. It can be further restricted by adding the words, 'Not Negotiable', thereon.
3. Such crossing could be further restricted by writing the words 'A/c Payee' or 'A/c Payee only'.
4. It can be still further restricted by writing the name of a specific bank also thereon; e.g., State Bank of India. That is, this cheque can be credited to the account maintained at any of the branches of the State Bank of India only, and with no other bank.
5. It can be further restricted by writing the name of a specific branch of the bank also e.g., 'State Bank of India, Lucknow Main Branch'. This will mean that the cheque can be credited to the specific account, maintained only at the Lucknow Main Branch of the State Bank of India, and at no other branch of even State Bank of India, leave alone of any other bank.

To summarise, the crossings, added one after the other, on a cheque, will look like:

(i) _____ and company or '& Co.'
(ii) Not Negotiable
(iii) A/c Payee
(iv) State Bank of India
(v) State Bank of India, Lucknow Main Branch

That is, one or more, or even all these, crossings may appear on the face of the same single cheque.

19.6.7 What are the Significance/Ramifications of each of such Crossings?

(i) '…….and Company' or '_____& Co.'

Such crossing just means that this cheque can be paid not in cash but only through the credit of any bank account; that is, to the account of any individual or even firm/company/organisation, and that, too, maintained at any of the banks, whatsoever.

(ii) Not Negotiable

A cheque marked 'Not Negotiable' does not restrict its transferability in any manner. It does not amount to 'Not Transferable'. Such cheque can well be transferred by endorsement and delivery in the case of an order cheque, and merely by delivery in the case of a bearer cheque. Such crossing is just by way of a safeguard and sounding a note of caution to the first endorsee, as also to all the subsequent endorsees, to the cheque, that if any of the endorsement happens to be unauthorised or illegal, all the subsequent endorsees and holders will cease to be the valid title holders to the cheque (or the 'holders in due course', as it is said in the legal parlance).This means that all the endorsees, right from the first one, must, in their own interest, ensure, before accepting such cheque by endorsement, that the first endorsee, as also all the subsequent endorsees in the chain, are genuine and valid. This is so because, as provided under **Section 130**, a person who takes a cheque crossed 'Not negotiable' shall not have and shall not be capable of giving a better title to the cheque than that which the person, from whom he took it in the first instance had'. As in the case of the sale of goods, the title of the transferee is always subject to the title of the transferor, so is the case with the cheques crossed as 'Not negotiable'. This way, the effect of crossing a cheque as 'Not Negotiable' is that the cheque loses its special feature of negotiability. Paying banks will, therefore, be well advised to exercise more than ordinary care while paying a cheque crossed 'Not negotiable'. That is to say that such crossed cheques must be paid by them only after satisfying themselves that the person asking for its payment, is the same person who is genuinely entitled to receive the payment thereagainst.

(iii) A/C Payee

Such crossing means that the title to the cheque cannot be transferred to any one else by endorsement, and that such cheque can be paid only by credit to the account of the payee named therein, of course, maintained with any of the bank, or at any of the branch of any of the banks.

But in the case titled **National Bank vs Lilke (1981),** a cheque, with the crossing 'Account of J. F. Moriarty Esq., National Bank, Dublin', it was held by the court to be negotiable. In yet another case titled **'Atlanta Mines Ltd vs Economic Bank**, it was observed that such crossing is a mere direction to the collecting banker as to how the money is to be dealt with after receipt of the amount mentioned in the cheque.

But then it must be clarified here that, as per the prevalent practice in the banks in India, the collecting bankers invariably abide by the specific direction of the drawer and do not permit any endorsement on the cheques crossed 'A/C Payee'. Such cheques are invariably credited to the account of the payee as mentioned therein, and to the account of none else.

(iv) 'Account Payee' and 'Not Negotiable'

Such double crossing of a cheque is considered to be one of the safest crossings on a cheque, as it has the double protection also. Such crossing comprises the following two directions to the paying banker simultaneously:

(i) The 'Not Negotiable' crossing holds the paying banker responsible to ensure that the payment of such crossed cheque is made by crediting the amount of the cheque into the account of the person who is genuinely entitled to receive the payment of the cheque, and

(ii) The 'Account Payee' crossing instructs the collecting banker to collect it for credit to the account of the payee only. It further sends a warning signal to him to the effect that if the amount of the cheque collected by him for some one else, other than the payee of the cheque, he could be held liable for the damages.

That is why, by way of playing doubly safe, the companies usually issue their dividend warrants and interest warrants by crossing them 'Account Payee' as also 'Not Negotiable'. Further, by way of an extra precaution, a statement to the following effect is also incorporated on the reverse of most of the dividend warrants and interest warrants:

'The Company and its Banker will in no way be responsible if loss occurs due to the Warrant falling into improper hands or through forgery or fraud.'

In addition thereto, some words of caution to the collecting bankers are also printed on the reverse of most of the dividend warrants and interest warrants, to the following effect:

'ATTENTION COLLECTING BANKERS. HELP PREVENT *FRAUDULENT* ENCASHMENT.

If you are collecting this instrument through a newly opened account, then please exercise caution and in particular, match the details of the payee indicated on the warrant with the details of your depositor.

(v) State Bank of India

Such crossing restrict the payment of the cheque at any of the branch, but only of the specified bank, viz. of the State Bank of India, in the present case.

(vi) State Bank of India, Lucknow Main Branch

Such crossing further restricts that this cheque can be credited to the account of the payee, but maintained only at the specified branch of State Bank of India, i.e. only at the Lucknow Main Branch of State Bank of India.

(vii) State Bank of India, Lucknow Main Branch, a/c William, Current Account No.: 555

Further, a cheques drawn payable to, say 'State Bank of India, Lucknow Main Branch, a/c William, Current Account No.: 555', can be credited to the specific account number of the specific person at this specified branch of the specified bank. Such cheques are the safest mode of payment, ensuing that it can be credited to the account of the specific person stated (specified) in the cheque. That is why, the companies insist that the share holders and debenture holders must advise the name of the bank, its branch and the type and number of the account maintained by them so that the dividend/interest warrants can be sent to them by post, by making it payable accordingly, such that no unauthorised person may get it credited to his/her (fake) account. Incidentally, it may be mentioned that to avoid any loss of dividend/interest warrant, companies are gradually facilitating credit of the payable amount electronically, on line, in some specified cities, which is gradually being widened, from time to time.

19.6.8 A Bearer Cheque – Crossed 'A/C Payee' Only

The two terms- 'Bearer' and also 'A/c Payee only', in my personal view, appear to be rather contradictory in nature. If an 'Order' cheque is crossed 'A/c Payee Only', its title cannot be transferred to any other person by endorsement and delivery, because no endorsement is permitted on a cheque marked 'A/c Payee'. Accordingly, the title of even a bearer cheque crossed 'A/c Payee' is not intended to be transferred, either, by mere delivery, because the underlying intention of the drawer of the cheque is that it must be credited only to the account of the specific payee, mentioned in the cheque.

If we further analyse and expand the intention of the drawer, we may infer him saying something like 'you (banker) may credit the proceeds of the cheque to any account, provided it is the account of the payee, as mentioned in the cheque.'[It reminds me of a joke attributed to Mr. Ford, the automobile tycoon, who is said to have once said that 'you all have full freedom to paint the car in any of the colours of your own liking, so long as it is black'].

The only effect of a bearer cheque crossed 'A/c Payee only' is that it does not require the certificate of the collecting banker, on the reverse of the cheque saying – 'Payee's Account Credited'. This is so because; a bearer cheque does not require an endorsement. But, the collecting banker has the legal responsibility to credit the proceeds of the cheque to the specified payee's account only. In this context, I am reminded of a live case when a friend of mine in the bank, received a bearer cheque of a heavy amount in clearing, marked 'A/c Payee only', without any endorsement of the collecting banker on the back of the cheque, saying 'Payee's A/c Credited'. He was in two minds, that is 'to pay or not to pay'. Finally, he played smart and cancelled the word 'Bearer' appearing on the face of the cheque and returned it under the objection 'Banker's endorsement required'. The cheque was, however, presented again in the clearing, the very next day, with the banker's aforesaid endorsement, and was duly paid. In this connection, I would like to suggest that, 'It is better to play safe today, rather than to feel sorry tomorrow'. I must thank my friend to have taught me (nay, all of us!) the aforesaid lesson.

19.6.9 Who Can Cross a Cheque?

As we have seen in the preceding paragraphs, the act of crossing a cheque is a means to impose further restrictions and safety measures in the course of the payment of a cheque. Therefore, it can be crossed by the drawer himself, as also by the payee or the holder of a cheque, if it has been issued uncrossed (open) by the drawer. They can cross the cheque generally or specially, at their sweet will. Further, a general crossing can as well be changed to a special crossing, but not the other way. That is, a special crossing cannot be changed by the payee or holder of the cheque; this can be done by the drawer himself. This is so because crossing an uncrossed (open) cheque does not amount to any material alteration. But opening a crossed cheque, or converting a special crossing into general crossing amounts to a material alteration. The reason is simple. Any addition which further restricts the payment of a cheque constitutes an immaterial alteration, which can be done by the drawer or even by the payee or the holder of a cheque. But the act of releasing or lifting any restriction imposed on the cheque amounts to a material alteration. Therefore, such restrictions, imposed earlier by any one of the drawer, payee or holder of a cheque, can be released or relaxed by the drawer and drawer alone, and none else other than the drawer.

Further, the banker, in whose name the cheque has been crossed specially, can over again cross it in favour of another bank. Under such circumstances, the latter (other) banker is treated as an agent of the former (first) banker.

It may be pertinent to mention here that when a collecting bank receives a crossed or open cheque, whether marked bearer or order, it affixes its own crossing stamp thereon immediately on receiving the same, so that even if it were to fall in some unauthorised hands, it could not be paid by any other bank.

19.6.10 Who Can Open a Crossed Cheque?

A crossed cheque may be converted into an open cheque again, but by the drawer himself, and by none else. For this purpose, the drawer is required to cancel the crossing and write the words 'Pay Cash', under his full signature - and not just his initials - and that too, in strict conformity with his signature on the bank's records. Further, after the crossing has been cancelled by the drawer, as aforementioned, such subsequently opened cheques are paid by the banks in cash across the cash counter at the bank to drawer himself or else to his known agent. The known agent may be such person who usually comes to the bank to transact banking

business on behalf of the drawer, i.e. for depositing cash or cheques or for taking payment on behalf of the drawer.

The London Clearing Bankers Committee, in their resolution passed in the year 1912, also asserted that 'no opening of cheques be recognised unless the full signatures of the drawer be appended to the alteration, and then only when presented for payment by the drawer or his known agent'.

Further, if a crossed cheque is opened by the payee or the holder of the cheque, by forging the signature of the drawer, the paying banker will not be protected on the ground that the banker is expected to know the genuine signature of the drawer, and must verify it with the one already on the bank's records. These days the verification of the signature of the drawer has been further facilitated as the signature of the drawer is scanned and displayed on the monitor of the computer, when the file of the respective account is opened therein. It may be always borne in mind that, in the event of the drawer's signature being forged, howsoever cleverly, the paying banker does not enjoy any legal protection, whatsoever.

19.7 Stopping Payment of a Cheque by Telegram or over the Telephone, or by Fax or E-mail

The payment of a cheque can be stopped only by the account holder (i.e. the drawer of the cheque), advising the banker, in writing, quoting the number, date, payee's name, and amount of the cheque, duly signed by him, in conformity with his specimen signature, recorded with the bank. But if, under emergent circumstances, he advises his banker over the telephone or by Telegram/Fax/E-mail to stop payment of a cheque, the bank should not return the cheque, under the objection 'Payment stopped by the drawer'. But then, should the bank pay the cheque on presentation? The right answer is an emphatic 'NO' on the principle that 'It is better to play safe today than to feel sorry tomorrow'. The cheque should definitely be returned unpaid, but under the objection: 'Drawer's confirmation required', instead. This way, the legal position will be that neither the cheque has been paid nor has it been wrongfully dishonoured.

19.8 Bank Draft Drawn on One Branch of a Bank on Another, Payable to Order

As provided under **Section 85 A** 'Where any draft, that is an order to pay money, drawn on one office of a bank upon another office of the same bank, for a sum of money payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course'.

Thus, a bank draft is also a bill of exchange, but it is invariably drawn as a demand bill of exchange, as is the case with a cheque. But, as against the cheque, in the case of a demand draft, both the drawer and the drawee are the two branches of the same bank or of two different banks.

Example

(i) A bank draft issued by the State Bank of India, Lucknow, on State Bank of India, Bangalore, or else;
(ii) By the State Bank of Hyderabad on State Bank of India, Bhopal; or by Grindlays Bank, New Delhi, on State Bank of India, Sitapur (by a special arrangement between the two different banks).

Besides, it must invariably be made payable to order, and never made payable to the bearer. Further, in the case of a demand draft also, like in the case of a cheque, the bank is discharged by payment in due course.

19.8.1 Banks are Not Permitted to Issue Bank Drafts made Payable to the Bearer. Why?

It must also be borne in mind that while cheques may be drawn as either order or bearer, the Bank Draft, as per law, has necessarily to be drawn payable on order only (and never in the form of a bearer draft), as has been specifically provided under **Sections 31 and 32 of the RBI Act**. Why?

Because, in that event, the bank draft could as well be used as a currency note, as the title to a bearer bank draft also could be transferred merely by delivery, without any endorsement thereon. But, in the case of an order bank draft, the title cannot get transferred merely by delivery (as is done in the case of the currency notes issued by the Reserve Bank of India, i.e. currency notes of Rupees Two and above [and not Rupee One Notes, which are issued under the signature of the Union Finance Secretary, instead]. The currency notes of Rupees Two and above are issued in the form of a Promissory Note, under the signature of the Governor, Reserve Bank of India (RBI).

A comparison of the distinguishing features of cheque and bank draft is presented in **Table 19.2**.

Table 19.2 *Distinguishing Features of Cheque and Bank Draft*

Cheque	*Bank Draft*
(i) In the case of a cheque, like the bill of exchange, there are **three parties** involved, viz., the drawer, the drawee, and the payee.	(i) In the case of a bank draft also, there are **three parties** involved, viz., the drawer, the drawee, and the payee.
(ii) It contains an unconditional **order** given by the drawer to the drawee to pay, as per the drawer's instructions.	(ii) It also contains an unconditional **order** given by the drawer to the drawee to pay, as per the drawer's instructions.
(iii) It can be made payable on demand only, and not after so many days or month(s).	(iii) It also can be made payable on demand only, and not after so many days or month(s).
(iv) Here, no prior presentation for acceptance is required because, cheques are made payable on demand only, as time (usance) cheques cannot be issued, as per law.	(iv) Here also, no prior presentation for acceptance is required because, bank drafts are made payable on demand only, as time (usance) bank drafts cannot be issued, as per law.
(v) It can be drawn on a bank only, and that also on a specific branch of a specific bank where the drawer maintains an account.	(v) It also can be drawn on a bank only, but by a specific branch of a bank on another specific branch of the same bank, or even on some other bank by agency arrangements between these different banks in this regard.
(vi) It can be drawn on the cheque from the specific chequebook, issued by the bank, or a withdrawal form given by the bank	(vi) It is also drawn on the bank draft form printed by the specific bank for this specific purpose.
(vii) A cheque can, be crossed generally or specially.	(vii) A bank draft can also be crossed generally or specially.
(viii) In the case of a cheque, no notice of dishonour, by non-acceptance or non-payment is required to be given to all the parties involved therein, because a time (usance) cheque cannot be issued. Thus, all the parties involved therein remain liable thereon, without being given a notice of dishonour.	(viii) In the case of a bank draft as well no notice of dishonour, by non-acceptance or non-payment is required to be given to all the parties involved therein, because a time (usance) bank draft cannot be issued. Thus, all the parties involved therein remain liable thereon, without being given a notice of dishonour.
(ix) A cheque is not required to be noted or protested, for non-acceptance or non-payment on due date because, cheques are made payable on demand only, and time (usance) cheques cannot be issued, as per law.	(ix) A bank draft also is not required to be noted or protested, for non-acceptance or non-payment on due date because, bank drafts are made payable on demand only, and time (usance) bank drafts cannot be issued, as per law.
(x) In case of a crossed cheque, some protection is given to the paying banker, which provision is special and peculiar to crossed cheques.	(x) In case of a crossed bank draft also similar protection is given to the paying banker.

(*Contd.*)

(*Contd.*)

(xi) A cheque can be issued, made payable to the bearer, or to the order of the payee or the endorsee.	(xi) As against this, a bank draft can be issued made payable only to the order of the payee or the endorsee. In other words, a bearer bank draft cannot be issued by any bank. This is so because issuance of a bearer bank draft by any bank is prohibited under Section 31 of the RBI Act. Furthermore, the issuance of a bearer bank draft by a bank is treated as a punishable offence, too, under Section 32 of the RBI Act. This is one of the most significant and striking differences between a cheque and a bank draft.

A detailed discussion on the rationale of such legal provisions in Sections 31 and 32 of the RBI Act appears in Chapter 1, Section 1.2.1.

19.9 'Holder' vs 'Holder in Due Course'

As stipulated under **Section 8,** a **'holder'** of a negotiable instrument is 'a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto'. Accordingly, the person, who has somehow obtained the possession of an instrument by theft or under a forged instrument, is not considered as holder, and, therefore, he is not entitled to receive or recover the amount due thereon.

As against this, as defined under **Section 9**, a **'Holder in due Course'** is 'a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title'.

Accordingly, a person who receives a negotiable instrument, without consideration, may not be deemed to be a 'holder in due course', but merely a 'holder' thereof. Further, it may be carefully noted here that the title of a 'holder' of a negotiable instrument, is invariably subject to the title of its transferor, while a 'holder in due course' acquires a better title than the transferor. Accordingly, if a lost negotiable instrument is transferred to a person, who takes it without consideration, and accordingly, becomes the 'holder', will not be entitled to enforce his claim as against its real owner. As against this, if he happens to be a 'holder in due course', instead, as stipulated under **Section 9,** he will be entitled to establish his claim even against the real owner of such negotiable instrument. Alternatively speaking, a 'holder' cannot get a better title than that of the transferor, but a 'holder in due course' does get a better title than the transferor, provided he did not have any knowledge or notice of any defect in the title of the transferor.

19.9.1 Privileges of a 'Holder in Due Course'

A 'holder in due course' gets entitled to the following additional privileges under the Act, which, however, are not made available to a 'holder':

(i) As provided under **Section 20**, a person, who has signed and delivered to another person, a stamped but otherwise incomplete (referred to in legal jargon as 'inchoate') instrument, he is stopped from asserting, as against a holder in due course, that the instrument has not been filled in, in accordance with the authority given by him, provided the amount filled in, is covered by the stamp duty paid thereon.

(ii) As stipulated under **Section 34**, all the prior parties to a negotiable instrument, i.e. the maker or drawer, the acceptor, and all the intermediate endorsers, continue to remain liable to the holder in due course till such time the instrument is duly satisfied.

(iii) As provided under **Section 42**, in the case where a bill of exchange is drawn by a fictitious person, and is payable to his order, the acceptor cannot be relieved of his liability to the holder in due course. The holder in due course, however, will have to prove that the instrument was endorsed by the same hand as drawer's signature.

(iv) **Sections 46 and 47** provide that where an instrument is negotiated to a holder in due course, the parties to the instrument cannot escape their liability on the ground that the delivery of the instrument was conditional, or only for a special purpose.

(v) **Section 53** provides that, in addition to the fact that the title of the holder in due course is not subject to the defect in the title of the previous holder, another privilege enjoyed by the holder in due course is that once the instrument passes through the hands of a holder in due course, it is purged of all defects. Accordingly, any person who acquires it, he takes it free of all defects, unless he was himself a party to the fraud.

(vi) As provided under **Section 120**, no maker of a promissory note, and no drawer of a bill of exchange or a cheque, shall be permitted, in a suite filed thereon by the holder in due course, to deny the validity of the instrument, as originally made or drawn.

(vii) **Section 121** stipulates that no maker of a promissory note, and no acceptor of a bill of exchange, marked payable to order, is permitted, in a suite filed thereon by the holder in due course, to deny the capacity of the payee to endorse it at the date of the promissory note or a bill of exchange.

19.10 Cheques Drawn by a Minor

As provided under **Section 26**, a minor may draw, endorse, deliver, and negotiate negotiable instruments so as to bind all the parties involved therein, except himself.

That is why, though the banks have, for quite some time now, started opening savings account of a minor with cheque book facility, they have been cautious enough to allow a limited credit balance therein, say, upto Rs 1,000 only, so as to keep the obligations of the various parties involved in the cheques issued by a minor limited to that extent only, and not more. A minor is, however, allowed to open a savings bank account without a cheque book facility upto the usual limit on the maximum credit balance therein, as is usually allowed in the cases of major account holders. This is so because, in the case of such savings account, the account holder can only deposit cash and withdraw cash also, but through a withdrawal form marked 'Pay to Self' printed thereon. This way no third party gets involved as the two parties in this case will be the bank and the minor account holder, and no third party, whosoever.

19.11 Marking of Cheques as 'Good for Payment'

Bank drafts are freely accepted in the business world against payment for goods purchased, as the payments thereof are guaranteed and the possibility of their being returned unpaid for want of funds is 'nil'. As against this, the businessmen are usually quite reluctant to accept cheques against payments for goods sold to some not-so-well-known persons, as the possibility of their cheque being returned unpaid for lack of sufficient funds and such other objections, can hardly be ruled out. In such cases the drawee bank may be approached to mark the cheque as 'good for payment', authenticating such marking under the full signature of an authorised officer of the bank. Such marking, when made, has the authenticity of certification to the effect that the paying banker has verified the account of the drawer of the cheque and thereby certifies that there are sufficient funds in the respective account to meet the amount of the cheque drawn. **[Sita Ram vs Bombay Bullion Association (1965)]**.

It has been argued that such markings by the paying banker may have the effect of virtually accepting a 'demand bill of exchange'. But, as so succinctly clarified by Lord Halsbury in **Gaden vs New Foundland Savings Bank,** 'the only effect of certifying is to give the cheque additional currency by showing on the face that it is drawn in good faith on funds sufficient to meet its payment and by adding to the credit of the drawer, the credit of the bank on which it is drawn.

The paying banker can do such marking at the instance of any one of the following three parties to the cheque:

(i) The drawer of the cheque,
(ii) The payee of the cheque, or
(iii) The collecting banker of the cheque.

But then, the effect of such markings in the aforementioned three cases is different. We shall now discuss the effect of such markings in each case one after the other.

(i) Marking at the instance of the drawer of the cheque

When the paying banker marks or certifies a cheque at the instance (request) of its drawer himself, the banker can rightfully retain an equivalent amount in the drawer's account, usually by marking a lien in the account for the amount for the specific purpose of honouring the cheque marked or certified by it as 'good for payment'. Consequently, if any cheque, drawn on this account by the drawer, is subsequently presented for payment, the banker can rightfully return such cheque(s) unpaid for want of sufficient funds, if sufficient fund is not available in the account after earmarking the amount against the marked or certified cheque, as aforementioned. Further, in such cases the drawer no longer enjoys the right to countermand the payment of the marked cheque. Besides, even the death or bankruptcy of the drawer of the cheque, before the actual payment of the marked cheque, does not bar (stop) the payment of the marked cheque.

It may, however, be noted here that the bank is not legally obliged to mark or certify a cheque. Alternatively speaking, the bank has an absolute right to refuse marking or certifying any cheque, for any reason whatsoever. Such refusal does not tantamount to dishonour of the cheque and, accordingly, the bank does not incur any liability for refusing to mark or certify a cheque. This is so because, marking or certifying a cheque only has the effect of certifying the genuineness of the signature of the drawer and that sufficient balance is available in his account at the time of marking or certifying the cheque and nothing more than that, i.e. not even the endorsements on the cheque.

But usually the banks mark or certify a cheque as 'good for payment', if they, in their own judgement and considered opinion, find it safe and justified to do so, on the merit of each case.

(ii) Marking at the instance of the payee or holder of the cheque

In the cases where the paying banker marks or certifies a cheque at the instance (request) of its payee or holder, it constitutes nothing more than the fact that the bank informs the payee or holder of the cheque, as the case may be, that at the time of its marking the cheque, the bank had sufficient funds in the drawer's account to honour the cheque. In such cases, however, the paying banker does not earmark the amount of the marked cheque by noting a lien on the drawer's account. Accordingly, in such cases, the drawer of the cheque can legally exercise his right to stop payment of the cheque, even after it had been marked or certified by the paying banker at the request of the payee or the holder of the cheque.

But in the US the legal position is different in that in that country the marking or certification of a cheque by the paying (drawee) bank, even at the request of the payee or holder of the cheque, is recognised legally, and accordingly, the paying banker is required to retain the amount of the cheque by noting a lien on the drawer's account. Thus, in such cases also, if any cheque, drawn on this account by the drawer, is subsequently presented for payment, the banker can rightfully return such cheque(s) unpaid for want of sufficient funds, if sufficient fund is not available in the account after earmarking the amount against the marked or certified cheque, as aforementioned. Further, by (rightfully) returning the cheque, as aforesaid, the paying banker does not incur any liability on this count. Further, in such cases the drawer no longer enjoys the right to countermand

(stop) the payment of the marked cheque. Besides, even the death or bankruptcy of the drawer of the cheque, before the actual payment of the marked cheque, does not bar (stop) the payment of the marked cheque.

(iii) Marking at the instance of the collecting banker of the cheque

As regards the marking of a cheque at the instance of the collecting banker, various legal authorities and experts have given their considered opinions, as have been discussed hereafter.

Chief Justice Cockburn, in the case titled **Godwin vs Roberts** observed that, 'as between the paying and collecting bankers 'a custom has grown up among bankers themselves of marking cheques as good for the purpose of clearance, by which they become bound to one another'.

Thus, in the event of receiving a cheque from its customer, rather too late for presentation in the clearing that very day – i.e. after the closing of the clearing house – the collecting banker may like to know the fate of the cheque at the earliest, and therefore, it may approach the paying banker direct after the closing hours of the banks, to mark the cheque as good for payment, which will have the effect of certifying by the paying banker to the collecting banker that the cheque will be cleared if presented in the clearing on the next business day of the banks.

Sir John Paget is also of the opinion that such markings between the paying banker and the collecting banker tantamount to a constructive payment of the cheque. Further, as this marking constitutes an appropriation of funds in the hands of the paying banker for a specific purpose, he is entitled to deduct the amount of such marked cheque when estimating the balance available for meeting other cheques.

Sheldon, in his book titled 'Practice and Law of Banking' has clarified the position even further, and has observed: 'The banker may debit the drawer's account with the marked cheque when it is actually presented for payment, notwithstanding that the drawer may have died or become bankrupt or that a garnishee order may have been served on the banker in the meantime. The drawer has no power to countermand payment of a cheque marked for this purpose.'

19.11.1 Marking of Post-dated Cheques

Marking of post-dated cheques is not permitted. Such marking has been held to be anomalous and thus, invalid. This is so because, as held in the case titled **Punjab National Bank vs Bank of Baroda (1944),** the marking of a post-dated cheque amounts to a promise requiring some consideration to support it. It would, however, be in order and legal to mark such cheque at a later date when it becomes due for payment, i.e. on and after the date of the cheque, but within six months of its date.

Let us Recapitulate

'A Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand'. Further, the definition includes the electronic image of a truncated cheque, as also a cheque in the electronic form' (**Section 6).**

Salient Features of a Cheque

(i) A Cheque is a bill of exchange, i.e. it also has three parties involved, viz., drawer, drawee, and payee.
(ii) It is invariably drawn on a specified branch of a specific bank.
(iii) It is always made payable on demand, and never so many days or months after date.
(iv) It may, however, be made payable to the bearer or to the original payee named therein or to his order.

Requisites of a Cheque

A cheque, being a bill of exchange, must also contain all the other following features of a bill of exchange:

(a) An instrument (i.e. a document, necessarily in writing, through which the rights, vested in one person, could be transferred in favour of another person).

(b) In writing (i.e. not just verbally), i.e. with a pen or a dot pen, or type-written, computer printed, or printed in a printing press.
(c) It must contain an order to pay (and not a promise or request to pay). But the words like 'Please Pay' or '(Kindly Pay)' will not render the cheque as an invalid
(d) Unconditional order (i.e. there should be no condition attached thereto).
(e) There are three parties to a cheque also, viz.
  (i) The **drawer**, who makes (draws) the cheque;
  (ii) The **drawee**, who has been ordered by the drawer to pay the amount written on the cheque, i.e. necessarily specified branch of the specified bank, where the drawer must be maintaining an account) and
  (iii) The **payee**, to whom the drawee bank has been ordered to pay the amount written on the cheque, or to his (original payee's) order, or to the bearer, as the case may be.
(f) Signed by the maker (i.e. it must necessarily be signed by the maker (drawer) of the cheque.
(g) Directing a certain branch of a specific bank, where the drawer is maintaining his or her account.
(h) To pay (and nothing else).
(i) A certain or ascertainable sum of money (and money only, and nothing else, like to deliver certain shares or securities). To pay an amount with a certain rate of interest will mean an ascertainable sum of money.
(j) To, or to the order of, a certain person; or to the bearer of the instrument. Here the term 'person' also includes a company, firm, club, association, institutions, society, local bodies or authorities, and so on.
(k) Payable on demand only, and not so many days or months after date.
(l) The amount payable must be written both in words and figures.
(m) The bankers also suggest that no blank space must be left between the words 'Rupees' and 'Rs', printed on the cheque leaves, as also at the end of the amount written in words and figures respectively, so as to avoid any undetectable forgery.
(n) The cheque must be dated; otherwise it will be considered incomplete and accordingly, returned unpaid.

However, the payee or the endorser or the endorsee, and so on, can put any date on the blank space meant for the purpose, which will not amount to a material alteration.

Anti-dated, Post-dated, and Stale Cheques

The drawer of a cheque is at liberty to date a cheque with an earlier date, or with a later date, than the date on which he actually draws and signs the cheque. Such cheque is known as an 'anti-dated cheque', and a 'post dated cheque', respectively. These cheques are returned by the bank unpaid under the objections: 'cheque is anti-dated' or 'cheque is post-dated', as the case may be. A 'stale cheque' is one which is presented after six months (after three months, in the cases of a dividend warrant and an interest warrant), from the date put thereon. Such cheque is returned by the bank unpaid under the objection: 'cheque is stale' or: 'cheque is out-dated'. A stale cheque may, however, be presented again after it is revalidated by the drawer concerned.

Cheques marked 'Bearer' or 'Order'

A bearer cheque can be negotiated, i.e. its title can be transferred without any endorsement, i.e. by mere delivery of the cheque. But, in the case of an 'order cheque', its title can be transferred not just by its delivery, but by both endorsement and delivery **(Section 47).**

When is an Instrument Deemed Payable to Bearer?

An instrument is deemed, to be payable to the bearer under the following circumstances:

(i) When it is made payable to the bearer.
(ii) Where it was originally made payable to order, but the single endorser, or the last endorser, endorses it in blank, i.e. without mentioning the name of any specific person above his endorsement.
(iii) Based on the principle: '*once a bearer, always a bearer*', a cheque made payable to bearer will remain payable to bearer only, even in the cases where it has been endorsed not in blank but in full, i.e. where the name of a specific person is written above the signature of the endorsee.

(iv) In the cases where the payee, mentioned on the cheque, is a fictitious person, and not a real person.
(v) Further, in the case of a bearer cheque, as its negotiation can be made merely by its delivery (i.e. without any endorsement), its transferor does not incur any liability or obligation to any of the parties other than the immediate transferee thereof.

Crossed Cheque and Open (Uncrossed) Cheque

By crossing a cheque, its drawer is deemed to have given direction to the paying banker to pay the cheque not in cash, but only through a banker by credit to the bank account of the payee or the endorsee. However, the paying bankers will be well advised to exercise more than ordinary care while crediting the amounts of crossed cheques or warrants into a recently opened account, operated for less than six months. Further, of late, some companies have started crediting the amount of dividend and interest electronically to the respective accounts of their shareholders and debenture holders.

As against the crossed cheque, a cheque that has not been crossed is referred to as an open cheque.

General Crossing and Special Crossing

(a) **General Crossing:** Where a cheque bears across its face two parallel transverse lines, either with or without the words '….& Company' and/or 'Not Negotiable', or 'A/c Payee, ', such crossing is referred to as a 'General Crossing'.
(b) **Special Crossing:** As against a 'General Crossing', a 'Special Crossing' bears across the face of the cheque the name of a banker (**Section 124**). This way, the drawer of the cheque instructs the drawee (paying) banker to make payment of the cheque only through that specified bank, whereby its payment becomes even safer.

What is a Forgery?

(i) To write (copy and forge) the signature of a real (existing) person on the instrument so cleverly (or even not-so-cleverly) with the fraudulent intention that it may pass as a genuine signature of that real person.
(ii) To write (copy and forge) the signature even of a fictitious (non-existing) person on the instrument, with such fraudulent intention.
(iii) Even if a person has signed his own name on the instrument, it may as well be deemed as a forgery, in case it has been so signed with the fraudulent intention that it may pass as the genuine signature of another person, having the same name.
(iv) To fraudulently change (chemically or otherwise) the date and amount on the instrument, or the name of its payee, and so on, which all amount to material alterations, also tantamount to forgery.

Legal Position pertaining to Forgery

(i) The paying banker cannot escape his liability, even on the ground that the forgery of the drawer's signature was so cleverly done that it could not be detected from the naked eye.
(ii) Further, the holder of a forged instrument cannot enforce the payment of such instrument. He cannot give even a valid discharge thereon.
(iii) Moreover, the true owner of the instrument will be within his legal rights to compel the debtor to pay the amount to him over again by means of another cheque in repayment of his dues.
(iv) More importantly, even a 'holder in due course' cannot enforce payment on a forged instrument, because there is a vast difference between a 'defective title' to an instrument and a 'forged' instrument itself.
(v) But then, the person whose signature has been forged may, by his conduct, be estopped from denying its genuineness subsequently to an innocent person.

Types of Crossing of a Cheque

To summarise, the crossings, added one after the other, on a cheque, will look like: '_____ and Company' or '& Co.', or 'Not Negotiable', or 'A/c Payee' or ' State Bank of India' or 'State Bank of India, Lucknow Main

Branch', or 'State Bank of India, Lucknow Main Branch, a/c Johnson Current Account No. 51'. Further, one or more, or even all these, crossings may appear on the face of the same single cheque.

Bank Draft

A bank draft is also a bill of exchange, but it is invariably drawn as a demand bill of exchange, as is the case with a cheque. But, in the case of a demand draft, both the drawer and the drawee are the two branches of the same bank or of two different banks. Further, in the case of as demand draft also, like in the case of a cheque, the bank is discharged by payment in due course (**Section 85 A**).

'Holder' vs 'Holder in due Course'

A person who receives a negotiable instrument, without consideration, is deemed to be merely a 'holder' thereof. Further, the title of a 'holder' of a negotiable instrument is invariably subject to the title of its transferor. As against a 'holder, the 'holder in due course' is 'a person who receives a negotiable instrument, with some consideration. Accordingly, he acquires a better title than the transferor (**Sections 8 and 9).**

Cheques drawn by a minor

A minor may draw, endorse, deliver, and negotiate negotiable instruments so as to bind all the parties involved therein, except himself (**Section 26**). That is why, the banks are cautious enough to open savings account of a minor with cheque book facility, with a limited credit balance, say, upto Rs 1,000 only. But a minor is allowed to open savings bank account without cheque book facility upto the usual limit on the maximum credit balance therein because, in such account, the account holder can only deposit cash (and not any cheque for collection) and withdraw cash only through a withdrawal form marked 'Pay to Self' printed thereon. This way no third party gets involved.

Marking of Cheques as 'Good for Payment'

The drawer, payee, or collecting banker of a cheque may request the drawee bank to mark the cheque as 'good for payment', duly authenticating such marking under the full signature of an authorised officer of the bank. By authenticating such marking, the paying banker has certified that there are sufficient funds in the respective account to meet the amount of the cheque drawn.

Marking of Post-dated Cheques

Marking of post-dated cheques is not permitted, because in that case, it will amount to a promise requiring some consideration to support it. A post-dated cheque can, however, be marked only at a later date when it becomes due for payment, i.e. on and after the date of the cheque, but within six months of its date.

Questions for Reflection

1. (a) Define a 'cheque', quoting the number of the Section that defines it.
   (b) Analyse the various clauses contained in the definition of a cheque
2. (a) Name the parties that are there in a cheque, in the following cases:
      (i) At the time of its making (drawing); and
      (ii) After it has been endorsed and delivered.
   (b) Define each of the parties to a cheque, in each of the above cases, citing examples in each case.
3. What are the various requisites of a cheque? Explain each of them separately.
4. How many different types of cheques are there? Name and explain the distinguishing features of each of them, by citing suitable illustrative examples in each case.
5. Bring out a comparison of the distinguishing features of a bill of exchange and cheque.
6. Bring out the main distinguishing features between a cheque and a bank draft.
7. What are the specific reasons for which Sections 31 and 32 of the RBI Act have provided that the bank drafts have necessarily to be drawn payable on order only (and never in the form of a bearer draft)?
8. (a) Why is it suggested that the cheques must not be drawn in ordinary lead pencil? Give reasons for your answer.

(b) What are the various precautionary steps that the bankers usually suggest to their customers to take, in their own interest in regard to the following?
(i) While drawing a cheque;
(ii) For safe keeping of the cheque book; and
(iii) For verifying the statement of their accounts, sent by the bank periodically, usually monthly.

9. Are the bankers justified in returning a cheque unpaid, wherein the amount in words and figures are stated differently? Give reasons for your answer.
10. (a) Are the bankers justified in returning a cheque unpaid, wherein the date has not been mentioned?
(b) What pragmatic action the payee or the endorser or the endorsee, or any other person for that matter, can take in such cases?
Give reasons for your answer in each case.
11. What are the striking differences between the following pairs of terms?
(a) 'Anti-dated' and 'Post-dated' cheques'
(b) 'Out-dated' and 'Post-dated' cheques;
(c) 'Bearer' and 'Order' cheques';
(d) 'Open' and 'Crossed' cheques; and
(e) 'General Crossing' and 'Special Crossing' on cheques.
12. (a) What are the various alterations that come within the category of material alteration on cheques? Give suitable illustrative examples in each case.
(b) What are the legal ramifications of material alterations? Give reasons for your answer in each case.
13. (a) What are the various alterations which do not come within the category of material alteration on cheques? Give suitable illustrative examples in each case.
(b) What are the legal ramifications of immaterial alterations? Give reasons for your answer in each case.
14. (a) What are the various protections that have been provided to the paying banker, for payment of a cheque bearing a forged signature of the drawer, where the forgery of the signature of the drawer has been made so cleverly that it may become well-nigh impossible for the banker to detect the same with the naked eye,? Give reasons for your answer.
(b) What are the various protections that have been provided to the paying banker, for payment of a cheque, whereon only one of the joint signatories in the joint account is forged, and the other one is genuine? Give reasons for your answer.
15. What are the various cases which may amount to forgery? Give suitable illustrative examples in each case.
16. What are the various protections that have been provided to the paying banker, for payment of a cheque bearing a forged endorsement thereon? Give reasons for your answer.
17. (a) What are the various types of crossings that may be inserted on a cheque? Give suitable illustrative examples in each case.
(b) What are the significance/ramifications of each of such crossings?
18. Whether in the following cases the alterations will be deemed to be material alterations? Give reasons for your answer.
(i) An open cheque (uncrossed cheque) has been made crossed 'Account payee only'.
(ii) An order cheque has been converted into a bearer cheque by a person other than its drawer.
(iii) In a generally crossed cheque, the words, 'Not Negotiable' have been added thereto.
(iv) In a cheque crossed as 'A/c Payee only' and 'Oriental Bank of Commerce' the words 'A/C John, savings bank account No 555' have been added thereon.
(v) A generally crossed cheque has been opened by a person other than its drawer.
(vi) In a generally crossed cheque, the words, 'A/c Payee only' have been added thereto.

(vii) In a cheque crossed as 'A/c Payee only' the words 'Oriental Bank of Commerce' have been added thereto.

19. What are the significance and ramifications of a 'Bearer Cheque – Crossed 'A/C Payee Only'? Give reasons for your answer.
20. (a) What are the basic requirements that must be ensured by the paying banker before he should stop payment of a cheque?
    (b) What actions and precautions should the paying banker take when the information regarding stopping payment of a cheque has been received by him by e-mail? Give reasons for your answer.
21. (a) Who is a 'holder' and a 'holder in due course'? Give suitable illustrative examples in each case.
    (b) What are the main legal distinguishing features between a 'holder' and a 'holder in due course'?
22. What are the various special privileges that a 'holder in due course' gets entitled to, which are not made available to a 'holder'?
23. (a) Can a minor draw, endorse, deliver, and negotiate negotiable instruments?
    (b) Can he be held personally responsible to the payee, holder, and endorser, as the case may be, in the case of a cheque drawn by him?

    Give reasons for your answer in each case.
24. (a) What specific precautions does a banker take while opening a savings account of a minor with a cheque book facility?
    (b) What specific precautions does a banker take while opening a savings account of a minor without a cheque book facility?

    Give reasons for your answer in each case.
25. (a) What are the legal ramifications where a paying banker marks a cheque as 'good for payment', at the request of the following parties thereto?
        (i) The drawer of the cheque,
        (ii) The payee of the cheque, and
        (iii) The collecting banker of the cheque.
    (b) What specific actions does a paying bankers take in each of the above three cases?
    (c) Is the marking of post-dated cheques as 'good for payment' permitted? Give reasons for your answer.

Problems for Practice (With Suggested Solutions)

Problem 1

The following cheques/dividend warrants have been received by a paying banker on 21.12.2008. Should the bank pay these cheques? If not, under what specific objection should each of the cheque be returned unpaid? Give reasons for your answer in each case.

(a) The cheque is dated 29.12.2008.
(b) The cheque is dated 29.6.2008.
(c) The cheque is dated 19.6.2008.
(d) The dividend warrant, marked payable within three months from date, is dated 30.11.2008.
(e) The dividend warrant, marked payable within three months from date, is dated 31.12.2008.
(f) The dividend warrant, marked payable within three months from date, is dated 20.9.2008.

Solution

(a) The cheque will be returned unpaid under the objection 'cheque is post-dated', as the cheque dated 29.12.2008 has been presented earlier, i.e. on 21.12.2008.
(b) The cheque will be paid as it has been presented for payment within six months from its date.

(c) The cheque will be returned unpaid under the objection 'cheque is out-dated' as it has been presented for payment after six months from its date.
(d) The dividend warrant will be paid as it has been presented for payment within three months from its date.
(e) The dividend warrant will be returned unpaid under the objection 'dividend warrant is post-dated', as the dividend warrant dated 31.12.2008 has been presented earlier, i.e. on 21.12.2008.
(f) The dividend warrant will be returned unpaid under the objection 'cheque is out-dated' as it has been presented for payment after three months from its date.

Problem 2

A cheque dated 5.12.2008 for Rs 1,00,000 issued in favour of Vishnu has been presented for payment on 9.12.2008 by Vishnu, wherein the word 'bearer' has been cancelled without authentication of the drawer under his full signature. Will the paying banker pay or return the cheque? If he decides to return the cheque, he will do so under what specific objection? Give reasons for your answer in each case.

Solution

The cheque will be paid, and therefore, no objection is required to be specified. This is so because, a bearer cheque may be converted into an order cheque, merely by cancelling the word 'Bearer', with or without writing the word 'Order' above the word 'Bearer'. Such alteration can be made by the drawer of the cheque, or even by the payee or the endorsee, and so on, as such alteration is not deemed to be a material alteration, requiring authentication of the drawer under his full signature.

Problem 3

A cheque dated 15.11.2008 for Rs 1,000 issued in favour of Emon has been presented for payment on 29.12.2008 by Emon, wherein the word 'order' has been cancelled and substituted by the word 'bearer' duly authenticated by Emon under his full signature. Will the paying banker pay or return the cheque? If he decides to return the cheque, he will do so under what specific objection? Give reasons for your answer in each case.

Solution

This cheque will be returned unpaid under the objection 'alteration requires drawer's full signature'. This is so because, though a bearer cheque may be converted into an order cheque, merely by cancelling the word 'Bearer', it is not permitted in the reverse order. That is, an order cheque cannot be converted into a bearer cheque, without the authentication of the drawer under his full signature, in strict conformity with the one already on the bank's records. The reason is that such alteration is deemed to be a material alteration, and not an immaterial one. Here, we may add that while imposing some further restrictions and safeguards in the cheque are considered to be immaterial alterations, in the reverse case they are treated as material alterations, requiring drawer's authentication under his full signature.

Problem 4

Vasundhara had presented a bearer cheque for Rs 1,000 for payment. When the paying banker had requested her to put her signature on the reverse of the cheque, she refused to do so on the ground that no endorsement was required in the case of a bearer cheque. How should a prudent banker respond in such cases? Give reasons for your answer.

Solution

In such cases, the paying banker should not insist that Vasundhara, the payee of the bearer cheque, should sign on the reverse of the cheque. In fact, such signature is obtained by the paying banker, not by way of an endorsement, but in token of the fact that the payee of the cheque has acknowledged receipt of the payment of the amount of the cheque. In such cases, the banker must request the payee to give an acknowledgement, for receipt of the amount, in cash, on a separate piece of paper, and that, too, on a revenue stamp of Re 1, as the amount involved happened to be over Rs 500 in the instant case. As against this, if the payee would have, instead, agreed to sign on the back of the bearer cheque, no stamp fee would have been required, as the cheques are, as per law, exempt from stamp duty.

Problem 5

Rhitu had come to the office of Radha to collect a cheque from her for the services she had rendered to her last week. Radha had issued a bearer cheque in favour of Rhitu for Rs 2,000, and leaving it on her table, she had gone to the account's department for some official work. As it took some time for Radha to come back to her office chamber, and Rhitu was in some hurry, she picked up the cheque on her own and left Radha's office. Will Rhitu get a valid title to the cheque in the instant case? Give reasons for your answer.

Solution

Rhitu will not get a valid title to the cheque in the instant case. This is so because, in the cases of both the order and bear cheques, the delivery of the instrument is essential. It should have, therefore, been delivered by the drawer herself, or by her agent, clerk, or servant. Alternatively speaking, if the drawer signs a cheque made payable to a particular person, and leaves it on her table or in her drawer, and if the particular payee herself picks it up on her own, i.e. without it being actually delivered to her by such drawer personally, or by her agent, clerk, or servant on her behalf, the title to the instrument will not legally pass on to the payee, i.e. to Rhitu in the instant case.

Problem 6

A cheque for Rs 2,000 was originally drawn made payable to Reshma or order, but Reshma had endorsed it under her full signature, without mentioning the name of any specific person above her signature on the reverse of the cheque. The cheque, presented by Raghavendra for payment, duly signed by him on the reverse of the cheque, was returned by the paying banker unpaid, under the objection, 'Verification of payee's endorsement required'. Is this a case of a rightful or wrongful dishonour of the cheque by the bank?

Give reasons for your answer.

Solution

This is a clear case of a wrongful dishonour of the cheque by the bank. This is so because, though the cheque was originally made payable to order, its original payee, i.e. Reshma in the instant case, had endorsed it in blank, i.e. without mentioning the name of any specific person above her signature (endorsement) on the reverse of the cheque. This way the cheque had thereafter become a bearer cheque, which could be paid to any one presenting it to the bank for payment. Therefore, the bank should have paid the amount of the cheque to Raghavendra, instead of returning it under the objection, 'Verification of payee's endorsement required'.

Problem 7

(a) A cheque for Rs 1,000 was made payable to Sushma or bearer, but Sushma had endorsed it under her full signature, by mentioning the name of Saryu above her signature on the reverse of the cheque, as she had desired that the payment of the cheque must be made to him or to his order. The cheque, however, was delivered by Saryu to Ravi without any endorsement thereon. Ravi had, accordingly, presented the cheque to the banker for payment, duly signed by him on the reverse of the cheque. But it was returned by the paying banker unpaid, under the objection, 'endorsement irregular', treating it as an order cheque, as Sushma had endorsed it under her full signature, by mentioning the name of Saryu above her signature on the reverse of the cheque. Is this a case of a rightful or wrongful dishonour of the cheque by the bank? Give reasons for your answer.

(b) What specific suggestion would you like to give to Sushma, such that she could ensure that the payment of the cheque is made by the bank to Saryu or to his order?

Solution

(a) This is a case of a wrongful dishonour of the cheque by the bank beyond any doubt. This is so because, based on the principle: '*once a bearer, always a bearer*', a cheque made payable to bearer will remain payable to the bearer only, even in the cases where it has been endorsed not in blank but in full, i.e. where the name of a specific person is written above the signature of the payee or endorsee.

(b) We will suggest to Sushma that she should first strike out the word 'Bearer', written on the face of the cheque, whereby the bearer cheque would have been converted into an order cheque. Such conversion can be done by any one, as it does not amount to be a material alteration, because this way the payment of the cheque is being made even more restrictive and safe. Thereafter, if she would have delivered the cheque to Saryu, she could have ensured that the payment of the cheque is made by the bank to Saryu or to his order.

Problem 8

(a) A cheque, crossed generally, has been presented at the cash counter of the paying banker for payment of the amount of the cheque in cash. Should the banker pay the amount of the cheque at the cash counter? Give reasons for your answer.

(b) If the paying banker would decide to return the cheque unpaid, what specific objection he would return the cheque with?

Solution

(a) The banker should not pay the amount of the cheque in cash at the cash counter. This is so because, in the case of a crossed cheque, even if crossed generally, there is a clear direction given by the drawer to the paying banker to the effect that the payment of the cheque should not be made in cash across the bank's cash counter, but it must be paid through a banker by credit to an account only, maintained at the same branch of the bank or at any other branch of any bank. Further, even if the drawer happens to issue an open cheque, any one can convert it into a crossed cheque, because such alteration is deemed to be an immaterial alteration, and not a material one. This is so because, imposition of some further restrictions and safeguards in the cheque are considered to be immaterial alterations.

(b) The paying banker should return the cheque unpaid, under the objection: 'Crossed cheque: must be presented through a bank'.

Problem 9

A cheque was paid by the paying banker where the signature of the drawer was forged so cleverly that it was well-nigh impossible for him to detect the forgery with the naked eye, despite taking reasonable care in this regard, at the time of making its payment. Will the paying banker be absolved of his liability and responsibility, on the ground that the forgery of the signature of the drawer had been made so cleverly?

Solution

The paying banker will not be absolved of his liability and responsibility on this ground. This is so because, the payment of a cheque, whereon the drawer's signature is forged, howsoever cleverly, is deemed to be a payment by the banker without the authority of his account holder, and accordingly, it tantamount to be a breach of an implied contract between the banker and the account holder (customer).

Problem 10

The drawer had initially confirmed that his signature on the cheque concerned was a genuine one. But later it was found that the signature of the drawer was a forged one. Will the paying banker be held liable for having paid such a cheque?

Solution

The paying banker will not be held liable for having paid the cheque in question because, in this case, the drawer of the cheque had initially confirmed that his signature on the cheque was a genuine one.

Problem 11

A cheque, drawn on a joint account, operated by both the accounts holders jointly, has been presented for payment, wherein the signature of one of the joint account holders is genuine and that of the other account holder is a forged one. Will the paying banker be held liable for having paid such a cheque?

Solution

The paying banker will be held liable for having paid the cheque in question as the signature of the other

account holder was a forged one. This is so because, in the case of a joint account, to be operated by the two account holders jointly, both the signatures appearing thereon must be genuine, in strict conformity with the signatures in the paying bank's records. Accordingly, as one of the signatures of the joint account holders happened to be a forged one, the cheque must not have been paid by the paying banker. Therefore, the paying banker will be held liable for having unauthorisedly and negligently paid a forged cheque, and he would be held liable accordingly.

Problem 12

John was in the habit of keeping his chequebook, issued by his banker, in a casual manner. His younger brother had observed such an irresponsible behaviour on the part of his brother. He, therefore, drew a cheque by forging the signature of his brother and successfully encashed the cheque from the bank. The account holder had failed to promptly detect such cases of unauthorised withdrawals from his account by forging his signature on the cheques. Thus, this process and practice was continued by his brother for quite some time. Later on, the customer made a complaint to the bank that it had made many unauthorised payments on the basis of forged cheques, and accordingly, he asked the paying banker to replenish his account with the amount of the forged cheques unauthorisedly paid by him from time to time. As the paying banker had refused to oblige John, he (John) had preferred to file a case in the Court of law. What are chances of John winning the case? Give reasons for your answer.

Solution

The chance of John winning the case is rather 'nil'. This contention is based on the judgement delivered by a Court in UK, wherein it was held by the Court in a similar case that the forgery had been made possible directly by the conduct and negligence on the part of the account holder (drawer), in handling the chequebook and verifying the bank's statement of his account periodically. That is to say that, if the account holder (drawer) would have taken due care in handling the chequebook and verifying the bank's statement of his account periodically, the forgeries could have been averted. That is why, with a view to preventing forgeries, frauds, etc., all the banks forewarn their customers by writing, *inter alia*, on the cover page of their cheque books, to keep it in a place of security under lock and key and to promptly intimate to the bank the loss of any of the unused cheque forms, to enable it to note caution in this regard.

Problem 13

A bearer cheque for Rs 10, 00,000 crossed 'A/C Payee only', was received by a banker through local clearing, where the certificate of the collecting banker, on the reverse of the cheque saying—'Payee's Account Credited'—was missing.

(a) What will be the adverse effect if the bank would pay such cheque?
(b) What precaution can the paying banker take in such cases to satisfy himself that the payee's account has been credited by the collecting banker?

Solution

(a) There will be no adverse effect if the bank would pay such cheque. This is so because, the only effect of a bearer cheque crossed 'A/c Payee only' is that it does not require the certificate of the collecting banker, on the reverse of the cheque saying – 'Payee's Account Credited'. This is so because, a bearer cheque does not require an endorsement. But, the collecting banker has the legal responsibility to credit the proceeds of the cheque to the specified payee's account only.

(b) But then, if the paying banker would insist to satisfy himself that the payee's account has been credited by the collecting banker, through his (collecting banker's) certificate on the reverse of the cheque saying – 'Payee's account credited', he (paying banker) should strike the word 'Bearer' printed on the face of the cheque, and return it under the objection 'Banker's endorsement required'. This way the cheque will be converted into an order cheque, and the collecting banker will have to represent the cheque through the next local clearing by affixing the certificate to the effect: 'Payee's account credited'.

Problem 14

A paying banker had received a telegram from the drawer of a cheque to stop payment of a bearer cheque, quoting its number, date, name of the payee and the amount mentioned therein. Should the banker pay the cheque or return it under the objection 'Payment stopped by drawer'? Give reasons for your answer.

Solution

The paying banker should not pay the cheque even on the basis of an unauthenticated message, as it has been sent through a telegram, though purported to have been sent by the drawer of the cheque. In fact, the payment of a cheque can be stopped only by the account holder (i.e. the drawer of the cheque), advising the banker, in writing, quoting the number, date, payee's name, and amount of the cheque, duly signed by him, in conformity with his specimen signature, recorded with the bank. But if, under emergent circumstances, he advises his banker by Telegram/Fax/E-mail to stop payment of a cheque, the bank should, of course, not pay the cheque. He should be on guard, and must be careful in the event of the cheque being presented for payment. But then, he should take care to return the cheque, not under the objection 'Payment stopped by the drawer', but under the objection: 'Drawer's confirmation required', instead. This way, the legal position will be that neither the cheque has been paid nor has it been wrongfully dishonoured.

Problem 15

(a) The paying banker had marked a cheque for Rs 55,000 as 'good for payment', at the request of its drawer himself. The credit balance on his account, as on that date, was Rs 90,000. A cheque for Rs 45,000 was presented for payment the very next day, when the credit balance in his account had remained unchanged at Rs 90,000, as the cheque for Rs 55,000, already marked as 'good for payment', had not yet been presented for payment. The paying banker had returned the cheque for Rs 45,000 under the objection 'Insufficient funds', though the credit balance on his account had still remained unchanged at Rs 90,000, as aforementioned. Do you think that the paying banker had wrongfully returned the cheque for Rs 45,000, under the circumstances stated above? Give reasons for your answer.

(b) After the cheque for Rs 45,000 was returned unpaid by the paying banker, the drawer of the cheque had duly stopped payment of the cheque for Rs 55,000, already marked as 'good for payment', well before the cheque was presented for payment. But the very next day, the cheque for Rs 55,000 was presented at the bank's counter, and it was duly paid by the banker. Do you think that the paying banker had wrongfully paid the cheque for Rs 55, 000, under the circumstances stated above? Give reasons for your answer.

Solution

(a) The paying banker had rightfully, and not wrongfully, returned the cheque for Rs 45,000, in the instant case. This is so because, the banker can rightfully retain an equivalent amount in the drawer's account, usually by marking a lien in the account for the amount for the specific purpose of honouring the cheque marked or certified by him as 'good for payment'. Consequently, if any cheque, drawn on this account by the drawer, is subsequently presented for payment, the banker can rightfully return such cheque unpaid for want of sufficient funds, if sufficient funds are not available in the drawer's account, after earmarking the amount against the marked or certified cheque, as aforementioned. Thus, in the instant case, when the cheque for Rs 45,000 was presented for payment, the actual credit balance in his account, after deducting the amount of the cheque for Rs 55,000 already marked as 'good for payment', was Rs 35,000 only (i.e. Rs 90,000 less Rs 55,000 = Rs 35,000). Thus, the cheque for Rs 45,000 was rightfully returned under the objection: 'Insufficient funds', as a sum of Rs 35,000 only was actually available in the drawer's account at the material time.

(b) The paying banker had rightfully, and not wrongfully, paid the cheque for Rs 55,000, in the instant case. This is so because, in such cases the drawer no longer enjoys the right to countermand (stop) the payment of the cheque already marked as 'good for payment'.

Problem 16

(a) The paying banker had marked a cheque for Rs 1,00,000 as 'good for payment', at the request of its drawer himself. The credit balance on his account, as on that date, was Rs 1,50,000. But, well before the cheque was presented for payment, the banker had received the notice of the death of the drawer. Therefore, when the cheque was presented for payment, the banker had returned it under the objection: 'Drawer deceased'. Do you think that the paying banker had wrongfully returned the cheque for Rs 1,00,000, under the circumstances stated above? Give reasons for your answer.

(b) On 15th December 2008, the drawer of the cheque had requested his banker to mark the cheque for Rs 75,000 dated 24th December 2008 as 'good for payment', against the credit balance of Rs 1,00,000 in his account. Do you think that the banker should mark the cheque as 'good for payment', under the circumstances stated above? Give reasons for your answer.

(c) Will the legal position be any different if the drawer of the cheque would have over again requested his banker on 27th December 2008 to mark the cheque for Rs 75,000 dated 24th December 2008 as 'good for payment', against the credit balance of Rs 1,00,000 in his account.

Solution

(a) The paying banker had rightfully, and not wrongfully, returned the cheque for Rs 1,00,000 in the instant case. This is so because, even the subsequent death of the drawer of the cheque, already marked as 'good for payment', does not bar (stop) the payment of the marked cheque.

(b) The banker should not mark the cheque as 'good for payment', in the instant case, because the marking of post-dated cheques is not permitted under law. Such marking has been held to be anomalous and thus, invalid. This is so because, the marking of a post-dated cheque amounts to a promise requiring some consideration to support it **[Punjab National Bank vs Bank of Baroda (1944)].**

(c) The legal position will definitely be different in this case because on 27th December 2008 the cheque dated 24th December 2008 is neither post-dated nor anti-dated (out of date), because it has been presented for payment after its date and also within six months of its date. Therefore, the banker would now mark the cheque as 'good for payment', in the instant case.

It may, however, be pertinent to re-emphasise here that the bank is not legally obliged to mark or certify a cheque as 'good for payment'. That is, the bank has an absolute right to refuse marking or certifying any cheque, for any reason whatsoever. But usually the banks mark or certify a cheque as 'good for payment', if they, in their own judgement and considered opinion, find it safe and justified to do so, on the merit of each case.

Appendix 19.1

Specimen of the printed 'list of objections' of the State Bank of India, Gomti Nagar, Lucknow

Cheque No. …… .For Rs …….
is Returnened For Reason No…… (Please particularly see Reason No. 11)

1. Effects not yet cleared: Please present again.
2. Not arranged for.
3. ……payee's endorsement required.
4. ……payee's endorsement irregular.
5. Refer to drawer.
6. Drawer's signature differs.
7. Endorsement requires Bank's guarantee.
8. Alteration requires full signature.
9. Cheque is post-dated.
10. Cheque is out of date.
11. Amount in words and figures differs.
12. Crossed cheque: must be presented through a bank.
13. No advice.
14. Payment stopped by the drawer.
15. Payee's separate discharge to the Bank required.
16. Insufficient fund.
17. Not drawn on us.
18. ……
19. ……
20. ……

STATE BANK OF INDIA
Gomti Nagar Branch,
Lucknow – 10
Code No. (9916)
C.O.S. 50

Chapter Twenty

Endorsements

"*One should not confuse the craving for life with endorsement of it.*
Elias Canetti

*Goals should be **SMART**: **S** = Specific **M** = Measurable **A** = Assignable (who does what) **R** = Realistic **T** = Time-Related.*
Source Unknown"

20.1 What is an Endorsement?

The mode of negotiating a negotiable instrument is known as its endorsement. As discussed earlier, while an order instrument may be negotiated by endorsement and delivery, a bearer instrument may be negotiated just by its delivery. That is, in case of a bearer instrument, endorsement is not required.

As defined under **Section 15,** an endorsement is 'When the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto …….. he is said to endorse the same and is called the endorser'. As against this, the person in whose favour it is endorsed is referred to as the endorsee. Here, it may be noted that though the Act permits the endorsements to be either on the back of it or else upon the face of it, as per the usual practice, the endorsements are generally made on the back of it. Further, where there is no space left on the instrument, for the purpose of further endorsements, a slip of paper may be annexed (attached) thereto for the purpose. Such slip of paper attached thereto, is called the 'allonge'.

20.2 What is a Valid Endorsement?

A valid endorsement must contain the following essential features:

(i) First, it must be written on the instrument itself, and must be signed by the endorser.

However, where there is no space left on the instrument itself, for the purpose of further endorsements, it may be endorsed on a slip of paper that may be annexed (attached) thereto for this purpose. The signature of the endorser on the attached slip of paper (allonge) is considered to be as if written on the instrument itself.

(ii) The endorsement must pertain to the entire instrument in full. Alternatively speaking, a partial endorsement on the instrument will not be considered as an endorsement at all.
A partial endorsement is an endorsement which intends to transfer only a part of the amount made payable on the instrument, and not its full amount. Further, a partial endorsement also pertains to the transfer of the title to the instrument in favour of two or more persons (endorsees) separately, instead of jointly, as provided under the law.

(iii) In the cases where, the instrument has been made payable to the order of two or more persons jointly, or to the order of two or more endorsees jointly, all the joint payees or the endorsees, as the case may be, must endorse it also jointly, unless one of the persons, endorsing the instrument has the authority of the remaining payees or the endorsees to endorse the same on their behalf as well. But in the case where the joint payees or the endorsees happen to be partners of a firm, each of the partners are presumed to be having the authority of the remaining partners (payees or the endorsees) to endorse the same on their behalf also.

(iv) Further, in the cases where, on the instrument, made payable to order, the designation of the payee or the endorsee has been wrongly mentioned, or else, where his name has been wrongly spelt, he is required under law to sign thereon in the same manner as has been mentioned in the instrument. This is so because one of the ingredients of a 'payment in due course' (and similarly, in the case of an 'endorsement in due course') is that the instrument must be made according to its apparent tenor. But then, such payee or the endorsee has the option of writing his correct designation or name also, under his earlier signature (endorsement) put thereon as per the instrument, if he so desires.

(v) In the cases where, two or more endorsements appear on the instrument, these will be presumed to have been made in the order that these two endorsements appear on the instrument, unless proved to the contrary.

We will now proceed to discuss the various types of endorsements as per the Act.

20.3 Various Types of Endorsements

20.3.1 Endorsement in Blank

As provided under **Section 16**, in the case of an 'endorsement in blank', the endorser just writes his name or puts his signature on the instrument, without mentioning the name of any specific person (endorsee) above his name or signature. The effect of an endorsement in blank, as stipulated under **Section 54**, is that thereafter the instrument becomes payable to the bearer, even if it was originally made payable to order. Thus, no endorsement may be required on such instrument thereafter because, after the endorsement in blank, it had become a bearer instrument, not requiring any endorsement thereon.

For example, if an order cheque has been drawn in favour of Suresh, and Suresh, in turn, signs on the back of it, without mentioning any specific name above his signature, it will automatically get converted into a bearer cheque, requiring no endorsement thereon, as its title could now be transferred by its mere delivery, without any endorsement. But then, an endorsement in blank may be converted into an endorsement in full (discussed next), if the holder of the order cheque, endorsed by Suresh in blank, prefers to endorse it in favour of another specific person named, say, Krishna, and writes his name above the signature of Suresh (e.g., Pay to Krishna or Order),without putting his own signature thereon, such cheque thereafter ceases to be a bearer cheque, and again becomes an order cheque, and thus, requiring endorsement thereon, in addition to its delivery. The holder can also endorse it in favour of Krishna by writing his name above his own signature,

instead of above the signature of Suresh. But in case he does not sign on the cheque and prefers to write the name of Krishna above the signature of Suresh itself, he will be in an advantageous position in that he will not be held liable as an endorser against any one, like in case the cheque is dishonoured. This is so because, in fact, his own signature does not appear at any place on the instrument.

20.3.2 Endorsement in Full

As provided under **Section 16**, where, in the case of an order negotiable instrument, the endorser writes the name of the endorsee (a specific person) above his signature, it is known as an 'endorsement in full'. In such cases, the title to the cheque can be transferred not by mere delivery but along with an endorsement thereon. **For example**, if a cheque has been drawn by Gopal as 'Pay to Jagdish or Order', and Jagdish, in turn, endorses it in favour of Manohar by writing 'Pay to Manohar or Order', it constitutes an endorsement in full.

20.3.3 Restrictive Endorsement

When an endorsement restricts (prohibits) any further endorsement of a negotiable instrument, it is called a 'restrictive endorsement'. As provided under **Section 50**, 'The endorsement may, by express words, restrict or exclude the right to negotiate, or may constitute the endorsee as an agent to endorse the instrument or to receive its contents for the endorser or for some other specified person'.

For example, if a cheque is endorsed as 'Pay to Rashmi only', it cannot be endorsed by Rashmi any further. Thus, such endorsement will be referred to as a restrictive endorsement. Similarly, if a cheque is endorsed as 'Pay to State Bank of India for the account of Satish', it cannot be negotiated by the State Bank of India any further.

20.3.4 Conditional Endorsement

As provided under **Section 52**, in the case of a 'conditional endorsement', the endorsement, by the endorser, in favour of the endorsee, is made in such a way that the transfer of the title to the property in the negotiable instrument to the endorsee is made dependent upon the fulfilment of a specific condition, as mentioned in the endorsement. Thus, in the case, where the endorser makes his own liability on the instrument conditional on the happening of a particular incident or event, such endorsement is called a conditional endorsement. Similarly, in the case of a conditional endorsement, the rights of the endorsee on the instrument are also made conditional on the happening of a particular incident or event.

Here, it may be noted that such incident or event may take place or even may not take place. Alternatively speaking, such specified event need not necessarily be in the nature of a certainty, e.g., the death of a particular person or the like. **For example**, the endorsements like 'Pay to Ramaswami, if he marries Rajni', or 'Pay to Ramaswami, if he reaches Lucknow', are conditional endorsements. Thus, in such cases Ramaswami can claim the amount mentioned in the instrument only if he marries Rajni, or if he reaches Lucknow, and not otherwise. Here, it may be observed that in the aforementioned examples, both the conditions like Ramaswami marrying Rajni, or his reaching Lucknow, are such which may take place or even may not take place. Nothing is certain to happen.

20.3.5 Endorsement Sans Recourse

As provided under **Section 52,** an 'endorsement sans recourse' (or 'without recourse to me'), is one where the endorser endorses the negotiable instrument by expressing, in words, in his endorsement to the effect that he excludes his own liability thereon.

For example, where Sachin endorses a cheque like 'Pay to Saurav or Order Sans Recourse' or like 'Pay to Saurav or Order Without Recourse to me', Sachin cannot be held liable on the instrument in such cases, in the event of the instrument being dishonoured.

20.3.6 Facultative Endorsement

A 'facultative endorsement' is one where the endorser endorses the negotiable instrument by expressing, in words, in his endorsement, to the effect that he (endorser) waives his legal right to receive the notice of dishonour of the instrument.

20.3.7 Partial Endorsement

A 'partial endorsement' is one where the endorser endorses the negotiable instrument only for a part of the amount, as against for its full amount, as required by law. Such endorsements are, accordingly, not held valid in the eye of law.

20.4 Effect of Different Types of Endorsement

20.4.1 Effect of Unconditional Endorsement

An unconditional endorsement of a negotiable instrument, also followed by its unconditional delivery, has the effect of transferring the amount (property) in the instrument to the endorsee. In such cases (of unconditional endorsement), the endorsee concerned acquires all the legal rights to negotiate the instrument to any person whom he likes to. Further, he also acquires all the legal rights to file suits against any of the parties whose names appear on it.

20.4.2 Effect of an Endorsement in Blank

The effect of an endorsement in blank is that, by virtue of such an endorsement, an order instrument (i.e. the instrument made payable to the order of a specific person) can be converted into a bearer instrument. Thus, the title of such instrument can thereafter be transferred by mere delivery, without requiring any endorsement thereon.

20.4.3 Effect of a Restrictive Endorsement

The following are the effects of a restrictive endorsement:

(i) To restrict or prohibit any further endorsement and negotiation thereafter;
(ii) To constitute the endorsee as the agent of the endorser, to endorse the document; or
(iii) To constitute the endorsee as an agent to receive its contents for some other person specified therein.

However, in case of an instrument made payable to the joint payees or the endorsees, it must be endorsed by all of them jointly, failing which such endorsement may be held invalid in the eye of law, even if it is endorsed in favour of another person.

20.4.4 Effect of a Forged Endorsement

A negotiable instrument, endorsed in full, cannot be negotiated or endorsed any further except where such endorsement is made by the same person to whom it was originally made payable (or to his order) or where it was endorsed in full in his favour (or to his order). But then, if such instrument is negotiated by endorsement, by forging the signature of such specific payee or endorsee, the endorsee in such cases will not acquire any title, even in the cases where such endorsee may be the purchaser for value and in good faith. This is so because a forged endorsement is a nullity in the eye of law.

As against the case involving endorsement in full, in the case of an endorsement in blank, it can be negotiated by mere delivery, as no endorsement is required in the case of a bearer instrument. That is, the holder of such

an instrument derives his legal title thereon just by its delivery, and thus, can claim the amount of the instrument from any of the parties involved therein, irrespective of the fact whether any endorsement is there or not. Thus, as the endorsement itself is ignored and not taken any cognisance or notice thereof, in the case of a bearer instrument (and likewise, in the case of a blank endorsement), the endorsement being genuine or even a forged one, does not matter or alter the legal position in any way.

20.5 Negotiation vs Assignment

The title to a negotiable instrument may be transferred by way of negotiation as also by way of assignment. In the case where a negotiable instrument is transferred by way of negotiation, its transferee, if he happens to be a holder in due course, gets a better title than that of his transferor or the endorser.

As against this, in the case where a negotiable instrument is transferred by way of assignment, its assignee, even if he happens to be a holder in due course, does not get a better title than that of the assignor. In other words, the assignee gets only those rights that the assigner himself had possessed at the time of the assignment of the instrument. Thus, we may observe that, though the law has permitted the transfer of a negotiable instrument by way of both negotiation and assignment, its transfer by way of negotiation has certain aforementioned inherent advantages over the transfer made by way of an assignment.

20.5.1 Transfer by Negotiation vs Transfer by Assignment

(i) In the case of a bearer instrument, the transfer of the title to the instrument can be transferred by mere delivery, as the endorsement is not required in the case of a bearer instrument. But, in the case of an order instrument, the transfer of the title to the instrument can be transferred not merely by its delivery, but when such delivery is accompanied by an endorsement also. As against this, an assignment invariably requires a written document to this effect executed by the assigner (transferor) concerned.

(ii) In the case of negotiation of an instrument, a holder in due course gets a better title than its transferor himself had at the time of such negotiation.

As against this, in the case where a negotiable instrument is transferred by way of assignment, its assignee, even if he happens to be a holder in due course, does not get a better title than that of the assignor. In other words, the assignee, even if he happens to be a holder for value and in good faith, gets only those rights that the assigner himself had possessed at the time of the assignment of the instrument.

(iii) In the case of negotiable instruments, consideration is invariably presumed to be there. As against this, in the case, where a negotiable instrument is transferred by way of assignment, the transferee is required to prove that there was consideration involved in the transfer.

(iv) In the case of negotiation of an instrument, no information or notice is required to be given to the debtor. As against this, in the case, where a negotiable instrument is transferred by way of assignment, an information or notice is required to be given to the debtor, and obtain his consent thereon, so as to bind him thereunder. Conversely speaking, an assignment in itself does not bind the debtor unless a notice of such assignment is given to him and he has given his consent thereto, expressly or impliedly.

Let us Recapitulate

Endorsement is the mode of negotiating a negotiable instrument. While an order instrument may be negotiated by endorsement and delivery, a bearer instrument may be negotiated merely by delivery. An **endorser** is one who puts his signature (known as endorsement) usually on the back of an order instrument, or on a slip of paper annexed thereto (called allonge), for the purpose of negotiation. The person in whose favour it is endorsed is referred to as the **endorsee**.

Essentials of a valid endorsement

(i) It must be written on the instrument itself (or on an allonge), and must be signed by the endorser.
(ii) The endorsement must pertain to the full amount of the instrument and not only a part of it.
(iii) Instruments made payable to the order of two or more persons jointly, or to two or more endorsees jointly, all the joint payees or the endorsees, as the case may be, must endorse it also jointly, unless the one of the persons endorsing the instrument has the authority of the remaining payees or the endorsees to endorse it on their behalf.
(iv) In an order instrument, if the designation of the payee or the endorsee is wrongly mentioned, or where his name is wrongly spelt, he is required under law to sign (endorse) thereon in the same manner as has been mentioned in the instrument.
(v) In the cases of two or more endorsements made on the instrument, these will be presumed to be made in the order that these may appear thereon, unless proved to the contrary.

Various Types of Endorsements

(i) Endorsement in Blank
Here, the endorser just writes his name or puts his signature on the instrument, without mentioning the name of any specific person (endorsee) above his name or signature. This way, such instrument becomes payable to the bearer, even if it was originally made payable to order. Thus, no endorsement may be subsequently required on such instrument.

(ii) Endorsement in Full
Where, on an order negotiable instrument, the endorser writes the name of the endorsee (a specific person) above his signature, it is known as an 'endorsement in full'. In such cases, the title to the cheque can be transferred by an endorsement and delivery.

(iii) Restrictive Endorsement
A 'restrictive endorsement' is one which restricts (prohibits) any further endorsement of a negotiable instrument.

(iv) Conditional Endorsement
In the case, where the endorser makes his own liability on the instrument conditional on the happening of a particular incident or event, such endorsement is called a conditional endorsement.

(v) Endorsement Sans Recourse
An 'endorsement sans recourse' (or 'without recourse to me'), is one where the endorser endorses the negotiable instrument by expressing, in words, in his endorsement, to the effect that he excludes his own liability thereon.

(vi) Facultative Endorsement
A 'facultative endorsement' is one where the endorser endorses the negotiable instrument by expressing, in words, to the effect that he (endorser) waives his legal right to receive the notice of dishonour of the instrument.

(vii) Partial Endorsement
A 'partial endorsement' is one where the endorser endorses the negotiable instrument only for a part of the amount, as against for its full amount, as required by law. Such endorsements are, accordingly, not held valid in the eye of law.

Effect of Some Types of Endorsement

(i) An **unconditional endorsement** of a negotiable instrument, also followed by its unconditional delivery, has the effect of transferring the amount (property) in the instrument to the endorsee.
(ii) An **endorsement in blank** has the effect of converting an order instrument into a bearer instrument, whereby the title to it can be transferred by mere delivery, without requiring any endorsement thereon.
(iii) A **restrictive endorsement** has the following effects:
  (a) To restrict or prohibit any further endorsement and negotiation thereafter;

(b) To constitute the endorsee as the agent of the endorser, to endorse the document; or
(c) To constitute the endorsee as an agent to receive its contents for some other person specified therein.

Effect of a Forged Endorsement

A negotiable instrument, endorsed in full, cannot be negotiated or endorsed further except where such endorsement is made by the same person to whom it was originally made payable (or to his order) or where it was endorsed in full in his favour or to his order. But then, if such instrument is negotiated by endorsement, by forging the signature of such specific payee or endorsee, the endorsee, in such cases, will not acquire any title, even in the cases where such endorsee may be the purchaser for value and in good faith. This is so because a forged endorsement is a nullity in the eye of law.

However, in the case of an endorsement in blank, it can be negotiated by mere delivery, without any endorsement. Thus, as the endorsement itself is ignored and not taken any cognisance or notice thereof, in the case of a bearer instrument (and likewise, in the case of a blank endorsement), the endorsement being genuine or even a forged one, does not matter or alter the legal position in any way.

Negotiation vs Assignment

The title to a negotiable instrument may be transferred by way of negotiation as also by way of assignment. In the case, where a negotiable instrument is transferred by way of negotiation, its transferee, if he happens to be a holder in due course, gets a better title than that of his transferor or the endorser. However, where a negotiable instrument is transferred by way of assignment, its assignee, even if he happens to be a holder in due course, does not get a better title than that of the assignor.

Transfer by Negotiation vs Transfer by Assignment

(i) The transfer of title to an instrument by way of negotiation does not require any endorsement in the case of bearer instruments.
(ii) In the case of negotiation of an instrument, a holder in due course gets a better title than its transferor himself had at the time of such negotiation.
(iii) In the case of the transfer of title to an instrument by way of negotiation, consideration is invariably presumed to be there. As against this, in the case where a negotiable instrument is transferred by way of assignment, the transferee is required to prove that there was consideration involved in the transfer.
(iv) In the case of negotiation of an instrument, no information or notice is required to be given to the debtor.

Questions for Reflection

1. (a) What is an Endorsement?
   (b) Who is known as the endorser and who is known as the endorsee?
   Give suitable illustrative examples in each case.
2. (a) What do you understand by the term 'allonge'?
   (b) When is an 'allonge' to be used?
3. What are the essential features of a Valid Endorsement?
4. Write short notes on the following types of endorsements:
   (i) Endorsement in Blank;
   (ii) Endorsement in Full;
   (iii) Restrictive Endorsement;
   (iv) Conditional Endorsement;
   (v) Endorsement Sans Recourse;
   (vi) Facultative Endorsement; and
   (vii) Partial Endorsement.

   Give suitable illustrative examples in each case.

5. What are the legal effects of the following types of endorsements?
   (i) Unconditional Endorsement;
   (ii) Endorsement in Blank; and
   (iii) Restrictive Endorsement.

   Give suitable illustrative examples in each case.
6. (a) What constitutes a Forged Endorsement?
   (b) What are the legal ramifications of forged endorsements in the following cases?
      (i) An order instrument, and
      (ii) A bearer instrument.
7. (a) What are the distinguishing features of 'Negotiation' and 'Assignment' of a negotiable instrument?
   (b) What are the legal ramifications of 'Transfer by Negotiation' and 'Transfer by Assignment'? Give suitable illustrative examples in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

An open order cheque has been drawn in favour of Amir, and Amir, in turn, signs on the back of it, without mentioning any specific name above his signature. Can Prahlad, the holder of the cheque, receive the cash payment of the cheque by the paying banker, without his name being mentioned as an endorsee thereon?

Give reasons for your answer.

Solution

This is the case of an 'endorsement in blank', as the endorser has just written his name or puts his signature on the instrument, without mentioning the name of any specific person (endorsee) above his name or signature. Thus, under Section 54, the instrument has now become payable to the bearer, even if it was originally made payable to order. Thus, no endorsement may be required on such instrument thereafter because, after the endorsement in blank, it had become a bearer instrument, not requiring any endorsement thereon. Therefore, Prahlad, the holder of the cheque, can receive the payment of the cheque by the paying banker, though his name is not mentioned as an endorsee thereon. But then, he will have to put his signature (write his name) on the back of the cheque by way of receipt of the payment in cash.

Problem 2

An open order cheque has been drawn in favour of Amir, and Amir, in turn, signs on the back of it, without mentioning any specific name above his signature. Prahlad, the holder of the cheque, writes the name of Prashant above the signature of Amir, without putting his signature thereon.

(a) Can Prashant receive the cash payment of the cheque by the paying banker, in the absence of the endorsement by Prahlad, the holder of the cheque?
(b) Can Prahlad be held liable, in case the cheque is dishonoured?
(c) Can Poonam receive the cash payment of the cheque by the paying banker, if it is not endorsed by Prashant in her favour?

Give reasons for your answer, in each case.

Solution

(a) Prashant can receive the cash payment of the cheque by the paying banker, as it is duly endorsed in his favour, apparently by Amir though. This way Prahlad has converted the 'blank endorsement' by Amir, into an 'endorsement in full', by writing the name of Prashant above the signature of Amir, even without putting his own signature thereon. The legal effect of writing the name of Prashant above the signature of Amir, without putting his signature thereon, is just that it has now been converted into an order cheque, requiring endorsement(s) from now onwards, and nothing else other than this effect.

(b) In this case, Prahlad cannot be held liable, in case the cheque is dishonoured, because he has not signed anywhere in the cheque and, instead, has preferred to write the name of Prashant above the signature of Amir itself.

(c) Poonam cannot receive the cash payment of the cheque by the paying banker, unless it is duly endorsed by Prashant in her favour. This is so because the cheque has now ceased to be a bearer cheque, and has again become an order cheque, after Prahlad has written the name of Prashant above the signature of Amir. Thus, the transference of its title will now require the endorsement also, in addition to its delivery.

Problem 3

An open order cheque has been drawn in favour of Amir, and Amir, in turn, signs on the back of it, without mentioning any specific name above his signature. Prahlad, the holder of the cheque, instead of putting his own signature on the back of the cheque, signs on the reverse of the cheque by forging the signature of Prashant.

Can Prahalad receive the cash payment of the cheque by the paying banker, by forging the signature of Prashant on the back of the cheque, instead of putting his own signature thereon?

Give reasons for your answer.

Solution

This is the case of an endorsement in blank, and not an endorsement in full. And, in the case of an endorsement in blank, an order cheque gets converted into a bearer cheque, after the endorsement in blank. Therefore, it can now be negotiated by mere delivery, as no endorsement is required in the case of a bearer instrument. That is, the holder of such an instrument derives his legal title thereon just by its delivery, and thus, can claim the amount of the instrument from any of the parties involved therein, irrespective of the fact whether any endorsement is there or not. Thus, the endorsement itself is ignored and not taken any cognisance or notice thereof, in the case of a bearer instrument. Likewise, in the case of a blank endorsement, whether the endorsement is genuine or a forged one, does not matter or alter the legal position in any way. Accordingly, Prahalad can very well receive the cash payment of the cheque by the paying banker, even by forging the signature of Prashant on the back of the cheque, instead of putting his own signature thereon?

Problem 4

An open order cheque has been drawn in favour of Amir, and Amir, in turn, signs on the back of it, without mentioning any specific name above his signature. Prahlad, the holder of the cheque, writes the name of Prashant above the signature of Amir, without putting his signature thereon.

(a) Can Sukumar, the holder of the cheque, receive the cash payment of the cheque by the paying banker, by forging the signature of Prashant on the reverse of the cheque?

(b) Can Sukumar, by virtue of being the 'holder in due course' of the cheque, receive the cash payment of the cheque by the paying banker, by forging the signature of Prashant on the reverse of the cheque?

Give reasons for your answer, in each case.

Solution

(a) This is the case of an endorsement in full, because Prahlad, the holder of the cheque, has written the name of Prashant above the signature of Amir, though without putting his own signature thereon. This way, Prahlad has over again converted the bearer cheque into an order cheque, requiring endorsement thereon. Further, a negotiable instrument, endorsed in full, cannot be negotiated or endorsed any further except where such endorsement is made by the same person to whom it was originally made payable (or to his order) or where it was endorsed in full in his favour (or to his order). But then, if such instrument is negotiated by endorsement, by forging the signature of such specific payee or endorsee, the endorsee in such cases will not acquire any title. This is so because a forged endorsement is a nullity in the eye of law. Therefore, Sukumar, the holder of the cheque, cannot receive the cash payment of the cheque by the paying banker, by forging the signature of Prashant on the reverse of the cheque.

(b) Similarly, even by virtue of being the 'holder in due course' of the cheque, Sukumar cannot receive the cash payment of the cheque by the paying banker, by forging the signature of Prashant on the reverse of the cheque. This is so because, even the purchaser for value and in good faith (i.e. holder in due course) cannot receive the cash payment of the cheque, by forging the signature of Prashant on the reverse of the cheque, inasmuch as a forged endorsement is a nullity in the eye of law.

Problem 5

(a) A cheque has been endorsed as 'Pay to Seema only'.
Can it be endorsed by Seema any further?

(b) A cheque has been endorsed as 'Pay to Union Bank of India for the account of Pooja'.
Can it be negotiated by the Union Bank of India any further?

Give reasons for your answer, in each case.

Solution

(a) It cannot be endorsed by Seema any further, as it is a case of restrictive endorsement, prohibiting any further endorsement thereafter.

(b) Similarly, as the cheque is endorsed as 'Pay to Union Bank of India for the account of Pooja', it cannot be negotiated by the Union Bank of India any further, as it is a case of restrictive endorsement, prohibiting any further endorsement thereafter.

Problem 6

(a) A cheque has been endorsed as 'Pay to Joseph, if he marries Mary', a condition which may take place or may not take place. Can such conditional endorsement be held valid in the eye of law?

(b) A cheque has been endorsed as 'Pay to Joseph, after the death of Philip', a condition which is sure to take place, some day or the other. Can such conditional endorsement be held valid in the eye of law?

Give reasons for your answer, in each case.

Solution

(a) This is the case of a 'conditional endorsement', and the condition is an uncertainty, i.e. it may or may not take place. But the condition being a certainty or even an uncertainty does not matter in law in the case of a 'conditional endorsement'. The only legal effect of such an endorsement is that the transfer of the title to the property in the negotiable instrument to the endorsee is made dependent upon the fulfilment of a specific condition, as mentioned in the endorsement. Therefore, in the instant case, Joseph can claim the amount mentioned in the instrument, only if he marries Mary, and not otherwise.

(b) This is also a case of 'conditional endorsement', but with the only difference that here the condition (the death of Philip), is a certainty, i.e. it is sure to take place, some day or the other. But then, the condition being a certainty or even an uncertainty does not matter in law in the case of a 'conditional endorsement'. The only legal effect of such an endorsement is that the transfer of the title to the property in the negotiable instrument to the endorsee is made dependent upon the fulfilment of a specific condition, as mentioned in the endorsement. Therefore, in the instant case, Joseph can claim the amount mentioned in the instrument, only after the death of Philip, and not earlier.

Problem 7

Amon has endorsed a cheque like 'Pay to Amit or Order Sans Recourse'. The cheque is dishonoured on presentation to the paying banker in the local clearing. Can Amon be held liable on the instrument in the instant case?

Give reasons for your answer.

Solution

This is a case of 'endorsement sans recourse' (or 'without recourse to me'), as Amon has endorsed the cheque like 'Pay to Amit or Order Sans Recourse. Such endorsement by Amon has the legal effect that he had expressly excluded his own liability thereon. Therefore, Amon cannot be held liable on the instrument, in the event of its dishonour.

Problem 8

An open order cheque for Rs 50,000 has been drawn by Dravid in favour of Piyush. Piyush has endorsed the cheque for Rs 20,000 in favour of Tulsi. Can Tulsi, the endorsee of the cheque, receive the cash payment of Rs 20,000 against the cheque by the paying banker, as per the aforementioned endorsement?

Give reasons for your answer.

Solution

This is a case of 'partial endorsement', as the endorser has endorsed the cheque only for a part of the amount (i.e. Rs 20,000), as against for its full amount (i.e. Rs 50,000), as required by law. Such (partial) endorsements are not held valid in the eye of law. Accordingly, Tulsi, the endorsee of the cheque, cannot receive the cash payment of Rs 20,000 against the cheque for Rs 50,000.

Problem 9

(a) A cheque has been drawn by Macmillan in favour of William. William, in turn, endorses it in favour of Hobbes. Robert, by forging the signature of Hobbes, endorses it in favour of Ruskin, against its full payment by him (Ruskin), in good faith and without the knowledge of the forgery involved in the endorsement.

Can Ruskin get a valid title in the instant case of forgery?

Give reasons for your answer.

(b) Will the legal position be any different, in the question (a) above, in case Robert, by forging the signature of Hobbes, would have assigned the cheque in favour of Ruskin, against its full payment by him (Ruskin), in good faith and without the knowledge of the forgery involved in the endorsement?

Give reasons for your answer in each case.

Solution

(a) Ruskin will get a valid title to the cheque, by virtue of being a 'holder in due course', as he has obtained the cheque against its full payment by him in good faith, and without the knowledge of the forgery involved in the endorsement. This is so because, in the case where a negotiable instrument is transferred by way of negotiation, its transferee, if he happens to be a holder in due course, gets a better title than that of his transferor or the endorser.

(b) It is true that the title to a negotiable instrument may be transferred by way of negotiation as also by way of assignment. But, in the case where a negotiable instrument is transferred by way of assignment, its assignee, even if he happens to be a holder in due course, does not get a better title than that of the assignor. That is to say that the assignee gets only those rights that the assigner himself had possessed at the time of the assignment of the instrument. Therefore, Ruskin will not get a valid title in the instant case, involving forgery, as the assigner (Robert) himself did not possess any valid title to the cheque at the time of its assignment of the instrument. Here, it may be reiterated that the inherent advantages available to a holder in due course, in the case of transfer of the title to a negotiable instrument, by way of negotiation, are not available in the case of transfer of the title in the instrument by way of an assignment.

Problem 10

Macmillan has drawn a bearer cheque in favour of William. William, in turn, wants to assign it in favour of Robert for its full value. But when Robert asked him (William) to execute a separate document pertaining to the intended assignment, William declined to oblige him on the plea that a bearer cheque did not require any endorsement thereon, and its title could be transferred merely by its delivery to any one.

Do you think that the stand taken by William is legally right?

Give reasons for your answer.

Solution

The stand taken by William is not legally right. This is so for the following reasons:

It is true that the title to a bearer instrument can be transferred by mere delivery, as the endorsement is not required in the case of a bearer instrument. Thus, the stand taken by William is legally right. But such provision is applicable only in the case of the negotiation of the instrument. But, in the case of an assignment, even of a bearer instrument, a separate written document of assignment is invariably required, to be executed by the assigner concerned.

Chapter Twenty One

Miscellaneous Legal Provisions on Negotiable Instruments

> *Men are sent into the world with bill of credit, and seldom draw to their full extent.*
>
> **Horace Walpole**

21.1 Ambiguous Instrument (Section 17)

An instrument, which can be interpreted both as a promissory note as also as a bill of exchange, is known as an ambiguous instrument. As provided under **Section 17**, such instruments may be treated by the holder, at his own choice, either as promissory note or as a bill of exchange. But, after the holder has made his choice in favour of one of the two options available to him, this instrument will be treated accordingly thereafter.

21.2 Inchoate Instrument (Section 20)

The term 'inchoate' means 'incomplete'. Thus, an **inchoate instrument** means an incomplete instrument; it may be incomplete in one respect or the other.

Example

Where a person signs a paper, stamped for some value, in accordance with Indian Stamp Act applicable to negotiable instruments, enforceable in India at the material time, and delivers it to another person, entirely blank (i.e. without filling any of the particulars mentioned therein), or by filling in only some of the particulars and leaving the remaining particulars (like amount and so on) incomplete, such instrument is referred to as an inchoate (or incomplete) instrument. By signing such incomplete instrument (even on a stamp paper), the maker or drawer of the instrument thereby is *prima facie* presumed to have authorised the holder of such instrument to make or complete such incomplete instrument, as the case may be, for any amount of his choice, by mentioning the same amount in the blank space left thereon for the purpose. But then, due care must be taken to ensure that such amount should be within the amount covering the value for which the paper is already stamped, and not for any extra amount whereby the instrument may be declared under-stamped, and hence not enforceable in law. Under such circumstances, the person who had signed such

incomplete instrument will be liable in the capacity he had signed such instrument to any 'holder in due course' for the amount so mentioned later in the instrument.

It may, however, be remembered in this context that any person, other than the 'holder in due course', cannot recover from the person who had signed and delivered such incomplete instrument any amount in excess of the amount that the person signing the instrument had originally intended to be payable on the instrument.

Explanations to Section 20

(i) A promissory note, bill of exchange, or cheque is considered to be payable to the bearer wherein it has been expressly stated to be payable to bearer, or else where the only endorsement or the last endorsement is an endorsement in blank, even in the case of an order instrument.

(ii) A promissory note, bill of exchange, or cheque is considered to be payable to order wherein it is expressed to be so payable, or which is payable to a specific person, and does not contain any word signifying prohibition of further transfer, or indicating any intention to the effect that it will not be transferable henceforth.

(iii) Where a promissory note, bill of exchange, or cheque, either originally or later by endorsement, is expressed to be payable to the order of a particular person, and not to him, it will be still be payable to him or to his order, at his own option and discretion.

(iv) A promissory note, bill of exchange, or cheque may be drawn and made payable to two or more payees jointly. Alternatively, it may even be made payable to any one of the two persons, or to one or some of several payees.

21.3 Agency (Section 27)

A person capable of entering into a valid contract can bind himself thereunder. Such person can also appoint an agent, and by appointing an agent to work on his behalf, he can be bound by his agent while working on his behalf within the authority given to him by his principal. But then we should be clear in our mind that a general authority given by the principal to the agent to transact business on his behalf, and to obtain and discharge debts on his behalf, does not, in itself, entrust the agent with the power or authority to accept or endorse bills of exchange on behalf of his principal so as to bind him (principal). In a similar manner, an authority given by the principal to his agent to draw bills of exchange on his (principal's) behalf, does not, in itself, empower the agent with the authority to endorse the bills of exchange.

21.4 Liability of the Agent Signing the Instrument in his Own Name (Section 28)

An agent who makes or draws in his own name a promissory note, bill of exchange, or cheque, by signing his own name thereon, without mentioning that by so signing it, he does not have any intention of incurring any personal liability on the instrument, he will be held personally liable thereon, except to those persons who had induced him to so sign the instrument, by making him to believe that the principal alone will be held liable in such case, and not him personally.

21.5 Liabilities of Legal Representative (Section 29)

A legal representative of a deceased person, who makes or draws a promissory note, bill of exchange, or cheque, without expressly mentioning thereon that he will be liable only to the extent of his share in the property of the deceased person inherited by him, will be held liable for the entire amount mentioned therein.

21.6 Negotiable Instruments without Consideration (Section 43)

A promissory note, bill of exchange, or cheque, made, drawn, accepted, endorsed, or transferred without consideration, or for a consideration which fails, can create no obligation for its payment between the parties to such transaction. As against this, where any of such parties has transferred the instrument, with or without endorsement thereon, to a holder for consideration, such a holder and each and every subsequent holder, who had derived the title from him, may recover the amount due on such instrument from the transferor for consideration, or from any prior party thereto.

21.7 Partial Absence or Failure of Monetary Consideration (Section 44)

Where the consideration, for which a person had signed a promissory note, bill of exchange, or cheque, consisted of money, and was originally absent in part, or had subsequently failed in part, the amount for which a holder, standing in immediate relationship with such signatory, will be entitled to receive from him, will be proportionately reduced.

21.7.1 Parties standing in immediate relationship with the signatory

We will now consider as to who are the various parties who may be said to be standing in immediate relationship with the signatory, in the following different conditions:

(i) The drawer of a bill of exchange is said to be standing in immediate relationship with the acceptor;
(ii) The maker or drawer of a promissory note, bill of exchange, or cheque is deemed to be standing in immediate relationship with the acceptor;
(iii) The maker or drawer of a promissory note, bill of exchange, or cheque is deemed to be standing in immediate relationship with the payee, and the endorser is deemed to be standing in immediate relationship with the endorsee; and
(iv) The other signatories may, however, be considered to be standing in immediate relationship with the holder, as per an agreement to this effect.

21.8 Partial Failure of Non-Monetary Consideration (Section 45)

In the cases, where a part of the consideration, for which a person has signed a promissory note, bill of exchange, or cheque, does not consist of money, but the amount is ascertainable in terms of money all the same, without any additional (collateral) enquiry in this regard, and there had been a failure of that part, the amount, which a holder standing in immediate relationship with such signatory will be entitled to receive from him, will be proportionately reduced.

21.9 Instruments Lost or Stolen, or Obtained by Unlawful Means or Unlawful Consideration

Section 58, which deals with the negotiable instruments which might have been lost or stolen, as also which might have been obtained by unlawful means or for unlawful consideration, has made the following stipulations:

When a negotiable instrument has been lost, or has been obtained from any maker, acceptor, or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or endorsee, who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder. However, if such possessor or endorsee is a holder in due course he shall be entitled to receive the payment thereof.

21.10 Position regarding Instruments Lost or Stolen, or Obtained by Unlawful Means or for Unlawful Consideration

Let us now discuss, in detail, the positions in respect of lost or stolen instruments, and those obtained by some unlawful means or for some unlawful consideration, one after the other.

21.10.1 Lost negotiable instruments

(i) As has been held in the case titled **Lowell vs Martin**, the finder of a lost promissory note, bill of exchange, or cheque, cannot acquire any title thereto, as against its rightful owner. Accordingly, he cannot even file a suit against its acceptor or maker so as to demand its payment.

(ii) As has been held in the case titled **Burn vs Morris**, if the finder of a lost promissory note, bill of exchange, or cheque, happens to obtain payment thereagainst, the person who makes such payment in due course can get a valid discharge for the instrument. However, the true owner of the lost instrument can, in such case, recover the amount due on the instrument by way of damages from such finder of the lost instrument.

(iii) Let us now take the case of a lost promissory note, bill of exchange, or cheque, which was originally made payable to the bearer, or else where the instrument, though originally made payable to order, was subsequently endorsed in blank, whereby it had become transferable by mere delivery without requiring any endorsement (as is the case with bearer instruments). In such cases where the finder of such lost instrument negotiates to *bonafide* transferee for value, such transferee acquires a valid title thereto, so much so that he can retain the instrument, as against the rightful owner thereof and, at the same time, he becomes entitled to enforce payment from the other parties who are liable on such lost instrument.

(iv) We will now take the case of a lost promissory note, bill of exchange, or cheque, which was originally made payable to order, in which case the title thereto can be transferred not only by mere delivery, but an endorsement thereon is also equally and simultaneously necessary. In the cases, where the finder of such lost instrument forges the signature of the endorsee, who had lost it, and negotiates it to a *bonafide* transferee for value, even such *bonafide* transferee cannot acquire any legally valid title to such instrument on the ground that a forgery cannot confer any title, whatsoever, to the instrument. Therefore, the payment made by the acceptor does not confer any title. Similarly, the payment made by the acceptor, or even by the other parties liable to a person, claiming payment against a forged endorsement, even if made in good faith, will not relieve him of his liabilities.

21.10.2 Stolen negotiable instruments

(i) The person, who has stolen a promissory note, bill of exchange, or cheque, cannot acquire any title thereto. Accordingly, he cannot demand its payment from any party involved therein, nor can he retain it with himself as against the party from whom he had stolen it.

(ii) In the case, where such a thief negotiates the stolen promissory note, bill of exchange, or cheque, to a buyer for value, who already had the notice of such theft, such transferee cannot acquire a better title than the thief himself had at the material time. Accordingly, even the transferee for value, with the prior notice of the involved theft, cannot enforce payment of such stolen instrument. Conversely speaking, we may infer that the buyer for value, who did not have any prior notice of the theft, such transferee can acquire a better title than the thief himself had at the material time. Accordingly, the transferee for value, with no prior notice of the involved theft, can very well enforce payment even of such stolen instrument.

(iii) But then the legal position is different in the case of a stolen promissory note, bill of exchange, or cheque, made payable to the bearer. That is, in case the thief of the stolen bearer instrument transfers it

by means of a mere delivery, to a holder in course, he is deemed to have conferred a valid title on him, or on any other person deriving valid title from such holder in course.

21.10.3 Negotiable instruments obtained by fraud

(i) **Under Section 13 of the Indian Contract Act**, the term 'consent' means that the two or more parties involved in the agreement agree to the same thing in the same sense, and at the same time. That is, there must be *'consensus-ad-idem'*. Further, the term 'free consent' has been defined under **Section 14 of the Indian Contract Act** when it (consent) is not caused, *inter alia* (i.e. among other things), by fraud.

Thus, where a person has obtained a negotiable instrument by means of a fraud, the essential element of 'free consent' is said to be conspicuously absent in such cases, as per **Section 14 of the Indian Contract Act**. Further, a contact entered into without a 'free consent' is generally considered to be voidable at the option of the person whose consent was so obtained, as has been provided under **Section 19 of the Indian Contract Act**. Accordingly, the person who happens to obtain a negotiable instrument by means of a fraud does not have any right to claim money thereagainst.

(For a detailed discussion on 'free consent' and 'fraud', please refer to part one of the book.)

(ii) Similarly, in the cases, where a negotiable instrument, which has been obtained by means of a fraud, is negotiated, the transferee will not be entitled to enforce any payment thereon, provided he had the prior knowledge of such fraud. Conversely speaking, in the cases, where such transferee did not have any prior knowledge of such fraud, he will be entitled to enforce payment thereon.

(iii) Generally speaking, a holder in due course, or a holder who has derived his title from such holder in due course, cannot be deprived of his title to the negotiable instrument just on the ground of fraud. But, in the cases where it could be proved that the person, who had acted without any negligence on his part, was induced by another person to put his signature on a negotiable instrument, which was represented to him to be some document other than a negotiable instrument, such person cannot be held liable against such negotiable instrument even against the holder in due course. Alternatively speaking, in the cases, where a person, while signing a document, does not really know that he was actually signing a negotiable instrument, and, instead, was under the firm impression and belief that he was signing a document other than a negotiable instrument, such person will not be held liable under such negotiable instrument.

The aforementioned views are based on the judgement delivered in the case titled **Foster vs McKinnon [(1869) L.R. 4 C. P. 704]**. In this case, an old illiterate man was made to understand by another person, by way of a false representation, that the document, he was required to sign, was a guarantee (whereas, in fact, it was a bill of exchange, instead). The old man had signed the document thinking it to be a guarantee, and not a bill of exchange. The contract, accordingly, was held as void.

21.10.4 Negotiable Instruments Obtained for Unlawful Consideration

(i) As provided under **Section 24 of the Indian Contract Act**, an agreement, based on unlawful consideration and/or unlawful object, is void. Accordingly, a negotiable instrument will be declared as void in the cases where its consideration and/or object is unlawful. This is so because, the general rules, applicable to the legality of the object and consideration in the case of contracts, as provided under **Sections 23 and 24 of the Indian Contract Act**, will be equally and invariably applicable to the contracts pertaining to the negotiable instruments, too.

(ii) But then, in the case where a negotiable instrument was originally made or drawn for lawful consideration, but was subsequently negotiated for some unlawful consideration, the holder in due course of such instrument will enjoy a good title thereto.

Let us Recapitulate

An instrument is known as an **ambiguous instrument**, which can be interpreted both as a promissory note as also as a bill of exchange. Such instruments may be treated by the holder, at his own choice, as either of the two. But, thereafter, it will be treated accordingly.

The term 'inchoate' means 'incomplete. Thus, an **inchoate instrument** means an incomplete instrument; it may be incomplete in one respect or the other.

A person capable of entering into a valid contract can also **appoint an agent**. By appointing an agent to work on his behalf, he can be bound by his agent while working on his behalf, and within the authority given to him by his principal. But a general authority given by the principal to the agent to transact business on his behalf, and to obtain and discharge debts on his behalf, does not, in itself, entrust the agent with the power or authority to accept or endorse bills of exchange on behalf of his principal so as to bind him (principal).

An agent who makes or draws in his own name a negotiable instrument, by signing his own name thereon, without mentioning that by so signing it, he does not have any intention of incurring any personal liability on the instrument, he will be held personally liable thereon, except to those persons who had induced him to so sign the instrument, by making him to believe that the principal alone will be held liable in such case, and not him personally.

A **legal representative of a deceased person**, who makes or draws a negotiable instrument, without expressly mentioning thereon that he will be liable only to the extent of his share in the property of the deceased person inherited by him, will be held liable for the entire amount mentioned therein.

A negotiable instrument made, drawn, accepted, endorsed, or transferred **without consideration**, or for a consideration which fails, can create no obligation for its payment between the parties to such transaction. But, where any of such parties has transferred the instrument, with or without endorsement thereon, to a holder for consideration, such a holder, and each and every subsequent holder, who had derived the title from him, may recover the amount due on such instrument from the transferor for consideration, or from any prior party thereto.

Where the consideration, for which a person had signed a negotiable instrument, consisted of money, and was originally absent in part, or had subsequently failed in part, the amount for which a holder, standing in immediate relationship with such signatory, will be entitled to receive from him will be proportionately reduced.

The following parties may be said to be **standing in immediate relationship** with the signatory, in the following conditions:

(i) The drawer of a bill of exchange with the acceptor;
(ii) The maker or drawer of a negotiable instrument with the acceptor;
(iii) The maker or drawer of a negotiable instrument with the payee, and the endorser with the endorsee; and
(iv) The other signatories with the holder, as per an agreement to this effect.

In the cases where, a part of the consideration, for which a person has signed a negotiable instrument, does not consist of money, but the amount is ascertainable in terms of money all the same, without any additional (collateral) enquiry in this regard, and there had been a failure of that part, the amount, which a holder standing in immediate relationship with such signatory will be entitled to receive from him, will be proportionately reduced.

The finder of a **lost negotiable instrument** cannot acquire any title thereto, as against its rightful owner. Accordingly, he cannot demand its payment from any party involved therein, nor can he retain it with himself as against the party from whom he had stolen it. Further, he cannot even file a suit against its acceptor or maker so as to demand its payment. (**Lowell vs Martin).**

If the finder of a lost negotiable instrument obtains payment thereagainst, the person who makes such payment in due course can get a valid discharge for the instrument. However, the true owner of the lost instrument can, in such case, recover the amount due on the instrument by way of damages from such finder of the lost instrument (**Burn vs Morris).**

In the cases, where a lost negotiable instrument was originally made payable to the bearer, or where an order negotiable instrument was subsequently endorsed in blank, and the finder of such lost instrument negotiates it to a *bonafide* transferee for value, such transferee acquires a valid title thereto, so much so that he can retain the instrument, as against the rightful owner thereof and, he also becomes entitled to enforce payment from the other parties who are liable on such lost instrument.

In the cases, where the finder of a lost instrument, which was originally made payable to order, forges the signature of the endorsee, who had lost it, and negotiates it to a *bonafide* transferee for value, even such *bonafide* transferee cannot acquire any legally valid title to such instrument on the ground that a forgery cannot confer any title, whatsoever, to the instrument. Therefore, the payment made by the acceptor does not confer any title. Similarly, the payment made by the acceptor, or even by the other parties liable to a person, claiming payment against a forged endorsement, even if made in good faith, will not relieve him of his liabilities.

In the case where such a thief negotiates the **stolen negotiable instrument** to a buyer for value, who already had the notice of such theft, such transferee cannot acquire a better title than the thief himself had at the material time. He can neither enforce payment of such stolen instrument. But the buyer for value, who did not have any prior notice of the theft, can acquire a better title than the thief himself had at the material time. That is, he can enforce payment even of such stolen instrument.

But then, in case the thief of the stolen bearer instrument transfers it by means of a mere delivery, to a holder in course, he is deemed to have conferred a valid title on him, or on any other person deriving valid title from such holder in course.

The person who obtains a negotiable instrument by means of a **fraud** does not have any right to claim money thereagainst.

When a negotiable instrument, which has been obtained by means of a fraud, is negotiated, the transferee will not be entitled to enforce any payment thereon, provided he had the prior knowledge of such fraud. But, where such transferee did not have any prior knowledge of such fraud, he will be entitled to enforce payment thereon.

But, in the cases, where it could be proved that the person, who had acted without any negligence on his part, was induced by another person to put his signature on a negotiable instrument, which was represented to him to be some document other than a negotiable instrument, such person cannot be held liable against such negotiable instrument even against the holder in due course.

Questions for Reflection

1. Write short notes on the following types of negotiable instruments:
   (i) Ambiguous Instrument; and
   (ii) Inchoate (incomplete) Instrument.
2. Who are the persons who can appoint an agent, to work on his behalf?
3. Under what circumstances can an agent be held personally liable while signing on a negotiable instrument?
4. Under what circumstances can a legal representative of a deceased person be held liable for the entire amount mentioned in the negotiable instrument, instead of only upto the extent of his share in the property of the deceased person inherited by him?

5. Which are the parties to a negotiable instrument who can be said to be the parties standing in immediate relationship with the signatory of the instrument?
6. Is the finder of a lost promissory note, bill of exchange, or cheque, permitted in law, to do take the following actions?
   (i) To acquire a valid title thereto, as against its rightful owner?
   (ii) To file a suit against its acceptor or maker so as to demand its payment?
   (iii) To demand its payment from any party involved therein?
   (iv) To retain it with himself as against the party from whom he had stolen it?

   Give reasons for your answer in each case.
7. (a) If the finder of a lost promissory note, bill of exchange, or cheque, has already obtained its payment, can the person who makes such payment in due course get a valid discharge for the instrument?
   (b) Can the true owner of the lost instrument recover the amount due on the instrument by way of damages from such finder of the lost instrument, or else from the person who has made such payment in due course?

   Give reasons for your answer in each case.
8. (a) If a thief negotiates a stolen negotiable instrument (promissory note, bill of exchange, or cheque) to a buyer for value, who already had the notice of such theft, can such transferee, by virtue of being a 'holder in due course', acquire a better title than the thief himself had at the material time?
   (b) What will be the legal position, as against in question (a) above, if the buyer for value, by virtue of being a 'holder in due course', did not have any prior notice of the involved theft?
   (c) Can the transferee, in questions (a) and (b) above, by virtue of being a 'holder for value', with no prior notice of the involved theft, enforce payment even of a stolen instrument?
   Give reasons for your answer in each case.
9. (a) What will be the legal position, in case the thief of the stolen bearer instrument transfers it by means of a mere delivery, to a holder in course?
   (b) Will the thief of the stolen bearer instrument be deemed to have conferred a valid title on a holder in due course, or on any other person deriving valid title from such holder in course?
   Give reasons for your answer in each case.
   (c) Will the legal position be any different, if in question number (b) above, the lost negotiable instrument, though originally made payable to order, was subsequently endorsed in blank?
   (d) What will be the legal position where the finder of such lost negotiable instrument [i.e. the one stated in question (c) above], negotiates it to a *bonafide* transferee for value?
   (e) Will such *bonafide* transferee for value [i.e. the one stated in question (d) above], acquire a valid title to the lost bearer negotiable instrument, so much so that he can retain the instrument, as against the rightful owner thereof and, at the same time, he can now become entitled to enforce payment even from the other parties who are liable on such lost instrument?
10. (a) John has obtained a negotiable instrument by means of a fraud. He has negotiated the instrument in favour of Newton, who had prior knowledge of such fraud. Will Newton be entitled to enforce any payment thereon?
   (b) Jahangir has obtained a negotiable instrument by means of a fraud. He has negotiated the instrument in favour of Jagdish, who did not have any prior knowledge of such fraud. Will Jagdish be entitled to enforce any payment thereon.
11. A person, while signing a document, did not really know that he was actually signing a negotiable instrument, and, instead, was under the firm impression and belief that he was signing a document other than a negotiable instrument, can such person be held liable under such negotiable instrument?
12. (i) Can a negotiable instrument be held valid where its consideration and/or object is unlawful?
   (ii) A negotiable instrument has originally been made or drawn for lawful consideration, but it was subsequently negotiated for some unlawful consideration. Will the holder in due course of such instrument enjoy a good title thereto?

Give reasons for your answer in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

Anthony has signed a time (usance) bill of exchange, stamped for some value, in accordance with Indian Stamp Act applicable to negotiable instruments, enforceable in India at the material time, and has delivered it to Martin, the holder in due course, without filling in the amount therein. But Martin mentions an amount of Rs 1 lakh in the blank space left thereon for the purpose.

(a) Can Martin be deemed to be entitled to receive the amount of Rs 1 lakh that he had himself mentioned in the instrument?

(b) In question (a) above, will it make any legal difference if Martin was just a holder of the instrument, and not a holder in due course?

Give reasons for your answer in each case.

Solution

(a) Martin, by virtue of being a holder in course, will be deemed to be entitled to receive the amount of Rs 1 lakh that he had himself mentioned in the instrument. This is so because, such instrument is known as an incomplete (inchoate) instrument, and by signing such incomplete instrument (even on a stamp paper), the maker or drawer of the instrument thereby is *prima facie* presumed to have authorised the holder of such instrument to make or complete such incomplete instrument, as the case may be, for any amount of his choice by mentioning the same amount in the blank space left thereon for the purpose. But then, in the instant case, Martin will have to take due care to ensure that the amount of Rs 1 lakh written by him thereon, is within the amount covering the value for which the time (usance) bill of exchange is already stamped, and not for any extra amount whereby the instrument may be declared under-stamped and hence not enforceable in law. Under such circumstances, the person who had signed such incomplete instrument will be liable in the capacity he had signed such instrument to any 'holder in due course' for the amount so mentioned later in the instrument.

But, in this context, it will be pertinent to add that any person, other than the 'holder in due course', cannot recover from the person, who had signed and delivered such incomplete instrument, any amount in excess of the amount that the person signing the instrument had originally intended to be payable on the instrument.

(b) Yes, it will make a legal difference, if Martin was just a holder of the instrument, and not its holder in due course. This is so because any person, other than the 'holder in due course', i.e. merely a holder, cannot recover from the person, who had signed and delivered such incomplete instrument, any amount in excess of the amount that the person signing the instrument had originally intended to be payable on the instrument. Thus, as against Martin being a holder in due course, Martin, as merely a holder, cannot recover an amount of Rs 1 lakh from Anthony, but only the amount, say, Rs 50,000 only, if he (Anthony) originally had intended to pay to him only such amount.

Problem 2

Azam has appointed Wasim as his agent, and has authorised him to draw demand and time bills of exchange on his behalf. Based on such authority, Wasim had accepted a time bill of exchange drawn on Azam, his principal. Later, Azam refused to own his liability in this case, and held Wasim, the agent, as being personally responsible for his acceptance of the bill. Thereupon, Wasim had filed a case against Azam.

What are the possibilities of Wasim winning the case?

Give reasons for your answer.

Soution

Wasim does not have the slightest chance of winning the case. This is so because, a general authority given by the principal to the agent to transact business on his behalf, and to obtain and discharge debts on his behalf,

does not, in itself, entrust the agent with the power or authority to accept or endorse bills of exchange on behalf of his principal so as to bind him (principal). Similarly, an authority given by the principal to his agent to draw bills of exchange on his (principal's) behalf, does not, in itself, empower the agent with the authority to endorse or accept the bills of exchange. Thus, as the agent, Wasim, in the instant case, has transgressed his authority as an agent of Azam, he will be held personally liable for having unauthorisedly accepted the time bill of exchange draw on his principal, Azam.

Problem 3

Arjun, the legal representative of his deceased father, had made a promissory note for Rs 10 lakh in favour of Rahim. But when the bill was presented to him by Rahim, at his residence, he had refused to pay the entire amount of the bill, but to pay only to the extent of Rs 5,690; this being the amount of the assets that he had inherited from his deceased father. Do you think that the contention of Arjun is legally valid?

Give reasons for your answer.

Solution

The contention of Arjun, in the instant case, is not legally valid. This is so because, according to law, a legal representative of a deceased person, who makes or draws a promissory note, bill of exchange, or cheque, without expressly mentioning thereon that he will be liable only to the extent of his share in the property of the deceased person inherited by him, will be held liable for the entire amount mentioned therein. Therefore, as Arjun had failed to take the aforementioned precaution, he will be liable to pay to Rahim the full amount of Rs 10 lakh, despite the fact that he had inherited a substantially lesser amount (i.e. Rs 5,690 only) from the property of his deceased father.

Problem 4

Padma has found a cheque, lying on the road side.

(a) Can Padma acquire a valid title thereto, as against its rightful owner?
(b) Can Padma file a suit against its drawer to demand its payment?
(c) Can Anil, who has obtained this cheque from Padma, against payment of its full value, obtain a valid discharge for the instrument?
(d) Can the true owner of the cheque recover the amount due thereon by way of damages from Anil or else, from Padma?

Give reasons for your answer in each case.

Solution

(a) No; Padma, the finder of the lost cheque, cannot acquire a valid title thereto, as against its rightful owner, because, as per the provisions of **Section 58,** when a negotiable instrument has been lost, its finder is not entitled to receive the amount due thereon. This contention is based on the decision in the case titled **Lowell vs Martin.**
(b) No; Padma, the finder of the lost cheque, cannot file a suit against its drawer to demand its payment, because she has not even acquired a valid title thereto, as against its drawer or its rightful owner, as per the provisions of **Section 58.** This contention is also based on the decision in the case titled **Lowell vs Martin.**
(c) Yes; Anil, who has obtained this cheque from Padma, against payment of its full value, can obtain a valid discharge for the instrument, as he (Anil) has now become a holder in due course of the cheque by paying the full amount thereof. This is so because, as per the provisions of **Section 58,** if such possessor or endorsee is a holder in due course, he shall be entitled to receive the payment thereof. This contention is based on the decision in the case titled **Burn vs Morris.**
(d) The true owner of the cheque cannot recover the amount due thereon by way of damages from Anil, as he is the holder in due course. However, the true owner of the lost instrument can, in the instant case, recover the amount due on the instrument by way of damages from the finder of the lost instrument, i.e. from Padma, instead. This contention is also based on the decision in the case titled **Burn vs Morris.**

Problem 5

(a) Rekha has stolen an order cheque and has sold it to Ashok for value, who (Ashok) had a prior notice of such theft. Can Ashok acquire a good title to the cheque, by virtue of him being a holder in due course?

(b) Rashmi has stolen an order cheque and has sold it to Alok for value, but Alok did not have any prior notice of such theft. Can Alok acquire a good title to the cheque, by virtue of him being a holder in due course?

(c) Reshma has stolen a bearer cheque and has sold it to Alka for value. Can Alka acquire a good title to the cheque, by virtue of her being a holder in due course?

Give reasons for your answer in each case.

Solution

(a) Ashok cannot acquire a good title to the cheque, even by virtue of him being a holder in due course, because he had a prior notice of such theft. This is so because, in the cases, where holder in due course had a prior notice of the theft, even he cannot get a better title than the thief herself had at the time of the negotiation (sale) of the cheque for value. And the thief does not get a good title to a negotiable instrument.

(b) In the instant case, Alok can acquire a good title to the cheque, by virtue of him being a holder in due course, coupled with the fact that he (Alok) did not have any prior notice of such theft. This is so because, as per law, the buyer for value, who did not have any prior notice of the theft, can acquire a better title than the thief herself had at the material time. Accordingly, Alok (the transferee for value), with no prior notice of the involved theft, can very well enforce payment even of such stolen instrument.

(c) As the instant case involves a stolen bearer cheque (as against an order cheque), here the legal position will be different. This is so because, in the case of a stolen negotiable instrument, made payable to the bearer, its title can be transferred by means of a mere delivery, to a holder in course. Such holder in course is deemed to have conferred a valid title on himself, or on any other person deriving valid title from such holder in course. Therefore, Alka can acquire a good title to the cheque, by virtue of her being a holder in due course.

Problem 6

(a) Edward has obtained a cheque by means of a fraud, and has endorsed it in favour of George. But George did not have any prior knowledge of such fraud.
Will he be entitled to enforce payment thereon?

(b) Edward has obtained a cheque by means of a fraud, and has endorsed it in favour of George. George, however, had a prior knowledge of such fraud.

Will he be entitled to enforce payment thereon in both the cases marked (a) and (b) above? Give reasons for your answer in each case.

Solution

(a) Yes; George will be entitled to enforce payment the cheque, in view of the fact that he did not have any prior knowledge of the involved fraud.

(b) No; George will not be entitled to enforce payment the cheque, in view of the fact that he had a prior knowledge of the involved fraud.

Problem 7

Banwari, an old illiterate man, was made to understand by Bhola, by way of a false representation, that the document, Banwari was required to sign, was a guarantee (whereas, in fact, it was a bill of exchange, instead). Banwari had signed the document thinking it to be a guarantee and not a bill of exchange. Do you think that the drawing of the bill of exchange in question by Banwari, under the aforementioned circumstances, can be held as valid? Give reasons for your answer.

Solution

No; the drawing of the bill of exchange in question by Banwari, under the aforementioned circumstances, cannot be held as valid, but void. This is so because, in the cases where a person, while signing a document, does not really know that he was actually signing a negotiable instrument, and, instead, was under the firm impression and belief that he was signing a document other than a negotiable instrument, such person will not be held liable under such negotiable instrument. This contention is based on the judgement delivered in the case titled **Foster vs McKinnon [(1869), L.R. 4 C. P. 704].**

Problem 8

Rohan has drawn a cheque in favour of Rahim on some unlawful consideration and unlawful object. Will such cheque be held valid in the eye of law? Give reasons for your answer.

Solution

As provided under **Section 24 of the Indian Contract Act**, an agreement, based on unlawful consideration and/or unlawful object, is void. Accordingly, a negotiable instrument, where its consideration and/or object is found to be unlawful, will likewise be declared as void. This is so because, the general rules, applicable to the legality of the object and consideration in the case of contracts, as provided under **Sections 23 and 24 of the Indian Contract Act**, will equally and invariably apply to the contracts pertaining to the negotiable instruments, too. Therefore, the cheque in question will not be held valid in the eye of law.

Problem 9

Rohan had drawn a cheque in favour of Rahim on some lawful consideration and lawful object. However, it was subsequently negotiated by Rahim for some unlawful consideration and object, for full value thereof, in favour of Rahman. Will Rahman enjoy a good title thereto? Give reasons for your answer.

Solution

Yes; Rahman will enjoy a good title to the cheque in question as, by virtue of paying the full amount of the cheque to Rohan, he (Rahman) had become its holder in due course. Further, as per law, in the case where a negotiable instrument was originally made or drawn for lawful consideration, but was subsequently negotiated for some unlawful consideration, the holder in due course of such instrument will enjoy a good title thereto. Therefore, Rahman, the holder in due course, will enjoy a good title to the cheque in question.

Chapter Twenty Two

The Paying Banker

"*Friendship is like a bank account. You can't continue to draw on it without making deposits.*
Source Unknown

Good bankers, like good tea, can only be appreciated when they are in hot water.
Jaffar Hussein"

22.1 Who is a Paying Banker?

A 'paying banker' is the drawee banker, i.e. the banker on whom the cheque has been drawn by its drawer (i.e. the bank's customer), and to whom such cheque is required to be presented for its payment.

22.2 Duties and Responsibilities of a Paying Banker

As provided under **Section 31**,'The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required so to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default'.

Thus, the paying banker has been assigned with the following two responsibilities and liabilities:

(a) To the true owner (payee or holder) of the cheque for conversion of the amount, if the cheque is wrongly dishonoured (i.e. returned unpaid); and
(b) To the drawer of the cheque, first, for the liabilities of damages for wrongfully dishonouring the cheque, and second, for wrongly debiting the amount of the cheque to his account.

In the case titled **Rolin vs Steward,** it was observed that though the cheque was inadvertently dishonoured (i.e. returned unpaid) by the paying banker, and it was subsequently paid too, the Court will not award mere nominal damages , in view of the fact that credit of the drawer of the cheque was affected seriously.

Similar would be the legal position in the cases where, though the account of the customer was already overdrawn, the paying banker had agreed to honour the cheques drawn by his such customer on his overdraft account upto a certain limit allowed thereon. The aforementioned views are based on the judgement delivered in the case titled **Fleming vs Bank of New Zealand.**

22.2.1 However, the duties and responsibilities of the paying banker, to honour the cheques drawn by his customers, have been restricted to the following conditions:

(i) The paying banker has the responsibility of paying only such cheques which are drawn by his customers on their account maintained at his (paying banker's) own specific branch, as also where these are presented for payment at his very branch, and not on any of his other branches or even at his head office, unless such prior special arrangement has already been made by the customer with the banker. **For example**, if a customer, who maintains an account with the State Bank of India, Gomti Nagar, Lucknow branch, draws a cheque on this branch and the payee or holder of such cheque presents it for payment to the bank's Ashok Marg, Lucknow, branch or its Lucknow Main branch, and so on, the bank's aforementioned branches, other than its Gomti Nagar, Lucknow branch, will be well within their legal rights to return the cheque under the objection 'not drawn on us'. In such case, the bankers at the Ashok Marg branch or the Lucknow Main branch, will not incur any legal liability in returning such cheque unpaid when these are presented to them for payment, instead. The aforementioned view is based on the judgement delivered in the case titled **Bank of India vs Official Liquidator**.

But then, in the modern days of internet banking, if a cheque drawn on a branch of a bank is presented to its another branch located anywhere in India, but covered under the networking system of the bank, it may be paid at such other branch of the bank as well. **For example**, let us take the case of a cheque which is drawn on the State Bank of India, Gomti Nagar, Lucknow branch, and is presented for its payment at the State Bank of India, Mandi Samiti, Lucknow branch, or even at the State Bank of India, Dharmpur, Dehradun branch, where all these branches are actually covered under the internet banking system of the bank. In such cases, the cheques may be generally paid by them by debit to the drawer's account at its Gomti Nagar, Lucknow branch. I have deliberately used the term 'generally' because such cheque can be paid by the other branches of the SBI covered under the internet banking system, only in such cases where the drawee bank of the bank has scanned the signature of the drawer and has properly recorded the same in its internet system. It is most painful to observe that some of the branches, not only of the SBI but even of some other banks, are found to be lethargic enough in recording and transmitting the scanned signatures of most of their customers, whereby the facilities of high-tech internet banking system has not yet been really made available to a majority of the customers, specially the small customers, mostly maintaining savings accounts.

(ii) Further, the paying bankers are obliged to pay only such cheques which are presented to him for payment within a reasonable time. Here, it may be mentioned that the validity of a cheque is limited to six months only. Thus, a cheque, older than six months from the date of its drawing stated thereon, is called a stale cheque, or an outdated cheque. Hence, such cheques may be returned unpaid by the paying banker under the objection 'Cheque is stale' or 'Cheque is outdated', both the terms meaning the same thing. In such cases, the paying banker can rightfully return the outdated cheques, and he will not incur any liability on his part. Such cheques, however, can be paid by the paying banker only after it is revalidated by the drawer by his putting a fresh date thereon. Such date will usually be the very date of its revalidation, or even somewhat earlier date which should be well within the possible date of its presentation for payment.

(iii) The payment of a cheque can be deemed to be a 'payment in due course', only when it is paid, *inter alia* (i.e. besides other things), in the usual course of business, and during the business hours of the paying branch of the bank. Thus, a cheque, when presented after the usual business hours of the paying branch

of the bank, it can very well be refused payment of by the paying banker without incurring any liability thereon.

(iv) Further, the paying banker is supposed to pay the cheques drawn on an account maintained with it, provided there are sufficient funds available therein to meet the amount of the cheque. Conversely speaking, if the credit balance in the account falls short of the amount of the cheque presented for payment, its payment can be refused by the paying banker without incurring any liability thereon. The objection usually given by the paying banker in such cases is 'Refer to drawer', or 'Effects not yet cleared; Please present again', or 'Not arranged for'.

Conversely speaking, if some prior arrangement has already been made between the banker and the drawer of the cheque to honour his cheques upto a certain amount, or against the amount of the cheque or bill sent for collection pending realisation, the paying banker will have to pay such cheques within such permitted overdrawing on the account, failing which he is bound to pay damages to the drawer of the cheque for the wrongful dishonour of his cheque.

Again, in case an overdraft limit has been granted in favour of a customer, the cheques presented and covered by the overdraft limit, will have to be honoured by the paying banker, failing which he will have to pay damages to the drawer of the cheque for such wrongful dishonour of his cheque.

Example of a tricky situation

Here, it may be pertinent to highlight a tricky situation where two cheques, say, for Rs 50 and for Rs 50, 000, drawn on the same account, are presented to the paying banker through the local clearing simultaneously the same day, against the credit balance on the drawer's (customer's) account on that day standing at Rs 50,010 only. Further, let us also presume that there is no overdraft limit sanctioned in favour of the drawer concerned, nor any prior arrangement with the paying banker is in place for honouring his cheques beyond his credit balance to a certain extent.

Possible Solutions

Here the following two diametrically opposite solutions seem to be possible:

(a) Some of us may think that it would be in order for the paying banker to pay the cheque of higher value first, and if sufficient balance is not available in the drawer's account thereafter, the cheque for the smaller amount must be returned for want of sufficient funds in the account.

(b) Some others may opine that the cheque for the smaller amount must be paid first, and if sufficient balance is not available in the drawer's account thereafter, the cheque for the higher amount must be returned for want of sufficient funds in the account.

Practical Solution

Out of the two aforementioned solutions, the one at item (b) above seems to be more practical and defensible for the following reasons:

(a) If the cheque for a small amount of Rs 50 would be preferred to be returned by the paying banker, the prestige and credibility of the drawer concerned would be greatly damaged in view of the fact that the people will get an impression that the person (drawer of the cheque) is not worth even a small sum of Rs 50.

(b) As against this, if the cheque for a higher amount of Rs 50,000 would be returned by the paying banker, the prestige and credibility of the drawer concerned would be damaged even in this case but, of course, to a comparably lower extent, as, in this case, the people will think that the person (drawer of the cheque) is not worth a comparatively higher amount of Rs 50,000.

Practical Tips

But, in my personal opinion, it would be far more pragmatic, beneficial, and gainful approach on the part of the paying banker, if he would prefer to pay both the cheques, i.e. one for Rs 50 and the other for Rs 50,000, because in such an event, the drawer's account will get overdrawn, no doubt, but with a small sum of Rs 40

only. Alternatively, the paying banker may ask the drawer concerned over the phone to deposit a sum of Rs 40 or so, the same day or the next day, so as to regularise the position of his overdrawn account. This way the banker will earn a valuable regard in the eyes of his customers, which will go a long way in the area of 'Customer Relations Management' (CRM).

(v) The paying banker is legally entitled to refuse payment of a cheque which is not drawn in a proper form. That is, a cheque may be paid by the paying banker only after ensuring that it is drawn in conformity with the provisions made under **Section 5,** read with **Section 6**, to the effect that it contains 'an unconditional order … to pay a certain sum of money only … not expressed to be payable otherwise than on demand'.

22.3 Legal Protection to a Paying Banker

22.3.1 Where the Endorsement is Forged

A paying banker gets the protection under **Section 85**, which provides: 'Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course.' In this section the clause used 'purports to be endorsed' is of great significance. These words imply that the payee might have, or even might not have, actually endorsed it under his own signature. Alternatively speaking, if some person, other than the genuine payee, would have forged the endorsement of the payee, and obtained the payment of the cheque, the paying banker will be discharged of his liabilities, and he can rightfully debit the account of its drawer with the amount of the cheque, provided the endorsement is *prima facie* (i.e. apparently, or on the face of it) in order, and the payment has been made in due course. That is, under such cases, the paying banker will not be held liable under **Section 31** to have made such payment to a wrong person.

Further, the 'payment in due course of business' has been defined under **Section 10** as the 'payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned'.

(A detailed discussion on 'payment in due course of business', appears in Sub-section 22.4 of this chapter.)

In this connection, Charley has observed that 'it is obvious that the available routine in a bank and the clearing house gives no opportunity for investigation of endorsements, except as to their outward irregularity. If enquiries were to be made, much expenditure of time and money would be involved and instrument could only be nominally payable on demand, and indeed the system, which we know, would be impossible'.

It may, however, be doubly stressed here that though the paying banker has been granted statutory (legal) protection, under **Section 85**, in the cases of forged endorsements, such protection will not be available to him in the cases where he happens to pay a cheque wherein the drawer's signature itself has been forged. This is so because, as it is well nigh impossible for the paying banker to verify the genuineness of all the endorsements, as aforementioned, it is expected of the paying banker to verify the signature of the drawer from the one available on his record.

22.3.2 In payment of Crossed Cheques

The paying banker has also been granted protection in the cases of payment of crossed cheques under **Section 128**, which provides that 'where the banker on whom a crossed cheque is drawn has paid the same in due course, the baker paying the cheque and the drawer thereof (in case such cheque has come to the hands of the payee) shall be respectively entitled to the same rights and placed in the same position if the amount of the cheque had been paid to and received by the true owner thereof'. Accordingly, if the paying banker pays such crossed cheque (if crossed generally, through any banker, and if crossed specially to a specific banker, through that specified banker), he is protected under this Section even if it subsequently turns out to be a payment made to a wrong payee.

Here, the words 'in case such cheque has come to the hands of the payee' are of great significance, which imply that the cheque must initially be received by its true payee, and it might have reached some other person's hands only thereafter (presumably due to the negligence of the payee himself, or otherwise, like it was stolen or lost). Alternatively speaking, if such crossed cheque, instead of its first coming to the hands of the payee, had initially itself gone into the hands of any person other than the payee himself, by way of wrong delivery by the post office, or where it was intercepted during its transit, or even otherwise, the protection granted to the paying banker under **Section 128** will not be available to him in such cases.

22.4 Payment in Due Course of Business (Analysis of Section 10)

We will now proceed to analyse the various clauses contained in Section 10, as quoted in Sub-section 22.3.1 of this chapter, to appreciate the various conditions, which must be satisfied before a payment of a negotiable instrument, made by the paying banker, can be termed as a 'payment in due course of business'.

22.4.1 Payment made 'in Accordance with the Apparent Tenor of the Instrument'

The meaning of the word 'tenor', as per the Oxford dictionary, means the general routine or course of something. Thus, the words 'in accordance with the apparent tenor of the instrument' will mean that, when the instrument is paid in a routine manner, in the usual course of business of the bank. Thus, the payment of a stale (outdated) or post-dated cheque cannot constitute a payment 'in accordance with the apparent tenor of the instrument'. Similarly, a premature payment of a time (usance) bill of exchange (i.e. before it has already fallen due for payment), cannot constitute a payment 'in accordance with the apparent tenor of the instrument'. Therefore, such payments cannot be called payments in dire course.

22.4.2 Payment made 'in Good Faith and Without Negligence'

Lord Dunedin in the case titled **Commissioner of Taxation vs English, Scottish, and Australian Bank Ltd,** quoted in **Chapter 23, Sub-section 23.4 (iii)**, has tried to specify the presence of the following elements by way of the test of negligence:

'Where the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so out of the ordinary course that it ought to have aroused doubts in the bankers' mind and caused them to make enquiry.' Thus, in such cases, which should ordinarily give rise to some doubt in the mind of the banker regarding the genuineness or otherwise of the payee or the holder of the cheque concerned, and despite such circumstances, he does not hold any enquiry in this regard, he will be held liable for having been negligent. Accordingly, in such cases, the payment cannot be called a payment in due course. Similarly, a payment cannot be called a payment in due course when the banker pays a cheque materially altered, chemically or otherwise, without exercising due care like examining it under ultraviolet ray lamp, and so on. But, an opposite observation has been made by the Supreme Court of India in the one of the relatively recent cases titled **Bank of Maharashtra vs Automotive Engineering Company (1993)**.

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In this case, the name of the payee and the amount on a cheque were chemically erased, and the cheque had thereby become quite different from the one that was actually drawn by the customer, and was presented at the counter of the paying banker, and was paid by him, the Supreme Court of India had made the following observations:

If the impugned cheque (i.e. the cheque in question) would have been scrutinised under the ultraviolet ray lamp, the aforementioned material alteration made therein could have been detected. But, the Court had held that the paying banker could not be held to be guilty of negligence on the ground that the cheque was not put to such test (i.e. under the ultraviolet ray lamp). Sufficient authority was shown by the bank that if a

cheque *prima facie* (i.e. on the face of it) did not show that it was a forged one, and when it was presented for its payment there were sufficient funds available in the drawer's account to honour the cheque in question, the payment so made by the banker was a payment in due course, in view of the fact that its payment was made according to the apparent tenor of the cheque. It was also contended that to say that no cheque should be collected without a thorough enquiry as to its history, would render the banking business impossible.

(*For a further detailed discussion and examples of 'in good faith and without negligence', please refer to Chapter 23, Sub-section 23.4 (iii), of this book*).

22.4.3 Payment made 'to any Person in Possession Thereof' (i.e. of the Instrument)

Only such payments, which are made to the person who is entitled to receive the payment, can be called a payment in due course. Thus, the words, 'to any person in possession thereof', does not include a thief or a finder of a lost instrument, as such persons are not entitled to receive the payment. Therefore, it is imperative on the part of the paying banker to make necessary enquiries in the cases where some apparently suspicious circumstances may seem to exist. All considered, based on the principle of 'it is better to play safe today than to feel sorry tomorrow', the paying bankers may be well advised to return such instruments unpaid under he objection 'drawer's confirmation required'. This way the instrument cannot be termed as having been wrongfully dishonoured, nor can the paying banker be held liable for having paid the amount of the instrument to a wrong person.

22.4.4 Payment made 'under Circumstances which do not Afford a Reasonable Ground for Believing that He is not Entitled to Receive Payment'

There may be quite a few circumstances, which may not give a reasonable ground to suspect that the person, who has come to the bank to take payment of the cheque, is not really entitled to receive its payment. **For example**, where a peon, or a clerk of a company, or of a defence department, or of a government department, and so on, comes to take payment of a cheque drawn for a heavy amount, apparently comprising monthly salary of the staff, and such employees usually come to the bank for such purposes. But then, where a peon or clerk comes to encash a cheque for a heavy amount, not coinciding with the salary day, etc. (i.e. where it is not in conformity with the bank's past experiences in such cases), the paying banker must naturally get alerted and he must not pay the cheque unless the drawer's confirmation is received, preferably in writing.

22.4.5 Payment made 'of the Amount Therein Mentioned'(that is, in Terms of 'Amount', i.e. Money Only)

The words 'amount therein mentioned' go to indicate that the payment must be made in terms of money only. Further, the term 'money' in this context includes the bank notes or currency notes only, and does not include promissory note, bill of exchange, cheque or goods. But then, if the payee agrees to accept the payment in some form other than money, like a promissory note or bill of exchange, the paying banker may act accordingly.

22.5 When Should the Paying Banker Refuse Payment?

We will now discuss the various circumstances under which a paying banker must refuse payment of a cheque.

22.5.1 Where the Drawer of the Cheque Countermands (Stops) its Payment

The paying banker should not pay the cheque after having received the drawer's instructions to stop its

payment. But the paying banker must act on the drawer's instruction to stop payment of a cheque only when the following conditions have been fulfilled:

(i) Such instruction has been received in writing;
(ii) Such letter must be signed by the drawer himself in strict conformity with his signature already on the bank's records;
(iii) All the relevant particulars of the cheque, like its number, date, amount, and the name of the payee have been mentioned in the letter;

This letter must be kept on the bank's records, and a caution to this effect must be conspicuously noted in the respective ledger account of the drawer. Such caution, however, can be deleted by the banker after expiry of six months from the date of such cheque, because the cheque would have already become outdated by that time and thus, cannot be paid even otherwise.

However, in case a blank cheque leaf has been lost or stolen, the account holder should immediately inform the banker accordingly through a letter duly signed by him. In such cases, the letter must be put on the permanent record of the bank; as such cheque leaf can be misused any time by some unscrupulous person, as it will never become stale or outdated, because this cheque does not bear any date thereon.

(iv) Further, in the case of a joint account, or a partnership account, any one of the joint account holders or the any one of the partners of the firm, can stop the payment of a cheque. As against this, if the instruction regarding stopping the payment of the cheque has to be cancelled, such letter of cancellation must be jointly signed by all the joint account holders or all the partners of the firm, as the case may be. But then, it may be a still better option if the paying banker would advise the drawer to issue a fresh cheque, instead.

Here, it must be doubly emphasised that the paying bankers must very carefully note the instructions of 'stop payment' in the respective ledger account, so as to avoid his liability for having paid a cheque payment whereof had already been stopped. This is being stressed because in the case titled **Hilton vs Westminster Bank Ltd (1927),** it was observed that 'a bank could be sued as much for failing to honour a cheque as for encashing a cheque that had been stopped'.

22.5.1.1 Banker's Liability in Paying a Stopped Cheque

Further, in the case of paying a cheque, payment whereof has already been duly stopped by the drawer; the paying banker incurs the following twin liabilities, viz.:

(i) To refund the amount of the stopped cheque into the drawer's account for its wrongful payment; and
(ii) To pay damages to the drawer of the cheque for wrongfully dishonouring any further cheque for insufficiency of funds in his account, caused by such wrongful payment of the stopped cheque, i.e. which could have been honoured if the stopped cheque would not have been paid.

22.5.1.2 'Stop Payment' Information when Received by Telegram, Telephone, Fax, E-mail, etc.

When the information regarding stopping payment of a cheque is received by the paying banker through telegram, telephone, fax, e-mail, and so on, he is faced with a dilemma: 'to stop or not to stop'. This is so because, the authenticity of such message is doubtful, as it has not been received by him through a letter, duly signed by the drawer concerned. Under such circumstances, the paying banker is faced with a problem both ways; that is

(a) If he pays the cheque, taking the information as unauthentic and, therefore, false; and
(b) If he does not pay the cheque, and returns it, instead, under the objection 'payment stopped by drawer', based on such message, though unauthenticated.

In the case (a) above, if he pays such cheque, and the message transpires to have actually been sent by or on behalf of the drawer, he may be held liable for having paid the cheque wrongfully. Thus, he may incur the aforementioned two liabilities, viz.,

(i) To refund the amount of the stopped cheque into the drawer's account for its wrongful payment; and
(ii) To pay damages to the drawer of the cheque for wrongfully dishonouring any further cheque for insufficiency of funds in his account, caused by such wrongful payment of the stopped cheque, i.e. which could have been honoured if the stopped cheque would not have been paid.

As against this, in the case (b) above, if the paying banker does not pay the cheque and, instead, returns it under the objection 'payment stopped by drawer', and the unauthenticated message later transpires to be a mischievous one, and not sent by the drawer, he (paying banker) will be held liable for paying damages to the drawer for having wrongfully dishonoured the cheque.

The paying banker may be well advised to follow the following lines of action in such cases:

(i) He must immediately make a precautionary noting in the ledger account of the respective drawer; so as to guard against an erroneous payment of the cheque, through an oversight, if it is presented for payment in cash or even through a banker;
(ii) He must simultaneously try to contact the drawer and advise him to send a letter duly signed by him to stop payment of the cheque, to enable him to note the 'stop payment' in the banks records, and act accordingly;
(iii) Further, if in the mean time, i.e. before receiving confirmation or otherwise from the drawer of the cheque, the paying banker must play safe and return the cheque under the objection 'drawer's confirmation required'. This way the banker will neither be paying the cheque nor can he be held liable for having wrongfully dishonoured the cheque.

22.5.2 On Receiving Notice of Customer's Death

The paying banker must not make any payment from the account of his customer after he has received the notice regarding his (customer's) death. Conversely speaking, if the paying banker makes any payment on the account of the (deceased) customer, before having any knowledge of, or receiving the notice of, his customer's death, he will not be held liable for a wrongful payment.

22.5.3 On Receiving Notice of Customer's Insanity

The paying banker must not make any payment from the account of his customer after he has received the notice regarding his customer's insanity. Conversely speaking, if the paying banker makes any payment on the account of his insane customer, before having any knowledge of, or receiving the notice of, his customer's insanity, he will not be held liable for a wrongful payment.

Further, any cheque even drawn by the customer after he has been declared insane must not be paid, as an insane person is not legally considered to be competent to enter into any agreement under **Section 11 of the Indian Contract Act.** Thus, as the act of opening and operating on a bank's account is also in the nature of a contract between the banker and the customer, the paying banker must not pay any cheque drawn by the insane drawer on his account.

22.5.3.1 How to Ascertain Customer's Insanity

The paying bankers may be satisfied to the effect that the customer concerned has actually become insane, under the following circumstances:

(a) In case the customer concerned has been admitted to a lunatic asylum; or

(b) When he obtains or receives a certificate duly signed by a competent doctor confirming the insanity of the customer concerned.

22.5.4 On Receiving Notice of Customer's Insolvency

On receipt of the notice of the customer's insolvency, payments on his account must be stopped with immediate effect, after the receipt of such notice. This is so because, after a person is declared (or adjudicated) insolvent, all his properties, including his credit balances in his accounts with the various banks, are vested in the official receiver or assignee. Thus, such insolvent customer is no longer authorised to operate any of his accounts with the banks.

22.5.5 On receiving Garnishee Order

On receipt of a 'garnishee order', which is absolute, i.e. whereby the entire credit balance available on the account is attached, no cheque drawn on the account must be paid, if it is presented for payment after the receipt of such order. As against this, where the 'garnishee order', instead of being absolute, is for a specific amount, the credit balance still available on the account, i.e. after leaving the amount attached by such garnished order, any cheque presented on the account against such remaining balance must be paid by debit to the account.

22.5.6 On assignment of Credit Balance

No cheque drawn on the account must be paid, if it is presented for payment after the receipt of a 'notice of assignment' on the credit balance on the account, duly signed by the customer.

22.5.7 On Suspicious Title

In the cases where the paying banker has any doubt regarding the validity of the title of the holder of the cheque, i.e. when he happens to believe that the person, presenting the cheque for payment, is not really entitled to receive the payment thereof (like when he believes that the cheque has been stolen or else has been found lying on the roadside), such cheque should not be paid by him (banker).

22.5.8 On Suspicious Misuse by Trustee

In the case of an account of a trust, being operated by the trustees concerned, in their fiduciary capacity, and if a trustee draws a cheque on the trust account to receive the payment apparently for his personal use, instead of for the use on behalf of the trust, such cheque should not be paid by him (banker).

22.6 When the Paying Banker may Refuse Payment?

We may observe that in **Section 22.5**, we have used the word 'must', while in this **Section 22.6** we have deliberately used the word 'may', instead. Why? Because, under the circumstances, discussed under **Section 22.5** of this chapter, the bank has no option but to return the cheque unpaid, otherwise he may be held liable for making a wrongful payment. As against this, the circumstances, now being discussed under this **Section 22.6** of this chapter, the bank has the option to pay or not to pay the cheque, at his own discretion and professional judgement of the particular circumstances, the conduct of the account by the customer, and so on.

We will now discuss the various circumstances under which the paying banker is at his full liberty either to return the cheque without incurring any liability for a wrongful dishonour, or even to pay the cheque if he so desired and preferred.

22.6.1 Insufficient Funds in the Account

The banker is within his full legal right to return the cheque for want of sufficient funds in the drawer's account under the objection like 'insufficient funds in the account', or 'not arranged for', or 'refer to drawer', and so on. He may, at the same time, even prefer to pay the cheque drawn on the account and allow the account to be overdrawn to some extent, to be regularised by the customer shortly thereafter, if he has faith and belief in the honesty and credibility of his customer concerned.

22.6.2 Outdated (Stale) Cheque

The outdated (stale) cheques, i.e. which are presented after six months from the date put thereon, are mostly returned by the paying banker under the objection 'cheque is out of date'.

22.6.3 Post-dated Cheque

Similarly, when post-dated cheques, i.e. which are presented before the date put thereon, are usually returned by the paying banker under the objection 'cheque is post-dated'.

22.6.4 Cheques Not Duly Presented

If a cheque is not duly presented for payment, **for example**, if it is presented after the usual banking hours, it may be returned by the bank unpaid. In fact, the cheques presented after the usual banking hours are usually not even entertained at the paying branch, and mostly the main door of the bank is closed when its business hours are over. This is so because, if the cheque is paid after the bank's usual banking hours, it may not constitute a payment in due course and the paying banker may not get the protection granted under **Section 85**.

This is the legal position. But then, usually the banks allow the entry of the person into the bank and make payment of the cheques presented outside the business hour, if the payment is to be made to the drawer himself. This is so because, if the cheque is paid to some person other than the drawer outside the usual working hours of the bank, and the drawer subsequently stops payment of the cheque, the same day or just at the opening of the bank on the next working day, the paying banker may be held liable for wrongful payment of the cheque, and may have to refund the amount of the cheque so paid, to the drawer by crediting the amount back to the credit of his (drawer's) account. But then, if the payee, other than the drawer himself, happens to be well known to the paying banker, and he is satisfied that such person is highly trustworthy, so much so that he will pay back the amount if the aforementioned eventuality, like stopping the payment of the cheque by the drawer on the very next working day, and immediately on the opening of the bank for business for the next day, the paying bank may prefer to take the risk of paying such cheque even to the person other than the drawer.

22.6.5 Cheques Drawn on Joint Accounts

In the cases where the cheque is drawn on a joint account, which is to be operated by both or all the account holders jointly, and a cheque, drawn by only one or only some of the operators on the account, is presented for payment, it will be usually returned by the paying banker unpaid under the objection 'cheque must be drawn by all the account holders jointly' or 'signature of the remaining account holders also required'.

But then again, if the paying banker is fully satisfied beyond any doubt

(i) That the account holders are so very reliable, and
(ii) That the remaining joint account holder(s), whose signature(s) are still wanting on the cheque, and
(iii) That the person, who happens to be one of the signatories on the cheque, has come to take payment of the cheque personally, and

(iv) That he is in an emergent need of money that very day, and
(v) That the remaining account holder(s) is/are not readily available to sign the cheque,

The paying banker may go to the extent of taking the extra risk of paying such cheque

(a) On the undertaking by the person,
(b) Who has come to take payment, and
(c) Who also happens to be one of the signatories on the cheque, to the effect that the remaining joint account holder(s) will sign the cheque immediately on their availability soon enough, and will regularise the position of the incomplete cheque.

But, all said and done, such risk may be taken by the paying banker in only the rarest of the rare cases, as the extent of personal risk of the bank officer authorising payment of such incomplete cheque is obviously very high.

22.7 Objections Frequently Used by the Paying Bankers while Returning Cheques Unpaid

It is not legally obligatory on the part of the paying banker that he must give the reason (quote objection), in writing, while returning a cheque unpaid. But then, as per the prevalent banking practice, all the paying bankers do so. In fact, to facilitate this procedure, the banks have a printed list of objections, which are more frequently used for dishonouring a cheque presented for payment. They tick mark the number containing the relevant objection in each case. Further, at the end of such printed list of objections, they also have some blank spaces therein for writing, in hand, such objections, which are not used so frequently. An illustrative specimen of the printed 'list of objections' of the State Bank of India, Gomti Nagar, Lucknow, is placed at **Appendix 19.1** of this book.

However, the paying bankers will be well-advised, in their own interest, to take due care to see to it that no cheque is returned under such objection which may damage the credit and reputation of their customers (drawers of the cheque), by giving some unwarranted and avoidable objection(s), while dishonouring any cheque. They must also be careful enough to guard against giving such objection(s) which could mislead the party, who has presented the cheque for its payment.

Further, they must invariably take more than ordinary care to ensure that no cheque is wrongfully dishonoured because, in such cases, they may incur serious liabilities of compensating his customer for any loss or damage, incurred or sustained by him (his customer), as has been discussed, in detail, at **Section 22.11** of this chapter.

The specific meanings of some of the most frequently used objections have been given hereafter.

22.7.1 Refer to Drawer

The objection 'refer to drawer' signifies that the funds available in the account of the drawer of the cheque are not sufficient enough to honour the cheque. Accordingly, the payee or the holder of the cheque must refer the matter to the drawer, and ask him personally to pay the amount of the cheque.

22.7.2 Insufficient Fund or 'No funds'

The objection 'insufficient fund', or even 'no funds', also signifies that the funds available in the account of the drawer of the cheque are not sufficient enough to honour the cheque.

The objections like 'refer to drawer' and 'insufficient fund', or even 'no funds', are derogatory and defamatory in their connotation. Therefore, the bankers may be well-advised to avoid such objections, as far as possible, while returning the cheques for want of sufficient funds in the account. That is, they may prefer to return the

cheque under some other objections, which are not so derogatory and defamatory in their meanings. The alternative objections could be like 'not arranged for' or 'effects not yet cleared: please present again', discussed hereafter.

But then, we should, at the same time, appreciate and understand that it may not be always possible for the paying bankers to oblige their customers in the aforementioned manner in all the cases, for the imminent danger that they (bankers) may themselves be held liable for giving a wrong and misleading objection, as suggested above.

They may, therefore, play safe and give only some (protective) objections only in such cases where they can prove that the objection given was justifiable and factual, and not otherwise.

It is only suggested that they may use their discretion and managerial judgement only in genuine and justifiable cases. This is so, because in the cases, where the cheques are returned under the objections like 'refer to drawer' or 'insufficient fund', or even 'no funds', may attract the penalties under **Section 138**, as has been discussed in the very next **Section 22.8** of this chapter.

22.7.3 Not Arranged For

The objection 'not arranged for' signifies that no prior arrangements have been made by the drawer of the cheque with the bank to pay the amount of the cheque, like by getting an appropriate overdraft limit sanctioned in his account, or getting a firm commitment from the bank to honour the cheque(s), presented for payment, against the cheque(s) or bill(s) of exchange sent to some outstation for collection, or some local cheque(s) presented through the local clearing, pending realisation of the amount of the instrument(s).

22.7.4 Effects not yet Cleared: Please Present Again

The objection 'effects not yet cleared: please present again' signifies that cheque(s) or bill(s) of exchange, sent to some outstation for collection, or some local cheque(s) presented through the local clearing, are yet to be realised. Therefore, please present the cheque again, as it is expected that the amount might be realised a little later.

22.7.5 Cheque is Post-dated

The objection 'Cheque is post-dated' signifies that the cheque bears a date which will fall on a later date than on the day the cheque has been presented for payment. For example, if a cheque dated 31 December 2008 has been presented for payment on 21 December 2008, instead.

22.7.6 Cheque is Out of Date

The objection 'cheque is out of date' or 'cheque is outdated' or 'cheque is stale' signifies that the cheque has been presented for payment to the bank when six months, or even more, have already expired from the date that it bears, by the date on which the cheque has been presented for payment to the bank. For example, if a cheque dated 31 May 2009 has been presented for payment on 21 December 2009, instead.

Incidentally, it may be mentioned here that the interest warrants or dividend warrants, issued by the companies, are required to be presented for payment within three months (instead of the usual six months). Accordingly, such instruments must be presented for payment within three months from the date that it may bear. Otherwise, it may be returned by the bank unpaid, and it will have to be got revalidated by the authorised signatory of the company concerned.

22.7.7 Alteration Requires Full Signature

The objection 'alteration requires full signature' signifies that there are some material alterations in the cheque

(like in its date, amount, name of the payee and so on), which require authentication at all the required place(s) bearing such material alteration(s), by the drawer, and that too, under his full signature, in conformity with the one already on the records of the paying banker.

22.7.8 Payee's Separate Discharge to the Bank Required

The objection 'payee's separate discharge to the bank required' signifies that the payee of the cheque must sign on the reverse of the cheque, in token of his having received the payment of the amount of the cheque from the paying banker.

Incidentally, it may be mentioned here that in the interest warrants or dividend warrants, issued by the companies (invariably specially crossed 'A/C Payee' and 'Not Negotiable'), a separate endorsement (signature) of the payee is mostly required to be given in the place specified for the purpose, on the reverse of the instrument, before it is presented for payment.

22.7.9 Amount in Words and Figures Differs

A cheque is returned with the objection 'amount in words and figures differs' wherever such is the case, i.e. where on the cheque the amount payable is written in words are different (e.g. Rupees fifty thousand), from such amount written (erroneously though) in figures (e.g., Rs 5,000).

It may be pertinent to recall here that **Section 18** provides that where the amount in words and figures are stated differently on a cheque - or the other negotiable instruments, like the bill of exchange and promissory note – the amount written in words shall be taken as the amount ordered or undertaken to be paid. But then, the banks are not yet complying with such provisions of the Act, and still continue to return such cheques under the objection reading as 'amount in words and figures differs'. Such objection is also included by most of the banks as one of the possible objections, in their printed list of objections, for returning the cheque unpaid. In confirmation of the aforementioned point, the specimen of the printed 'list of objections' of the State Bank of India, Gomti Nagar, Lucknow, has been given in Appendix 19.1 at the end of Chapter 19 of this book.

22.7.10 Crossed Cheque: Must be Presented Through a Bank

Such objection is given in the cases where a crossed cheque, crossed generally or specially, is presented at the counter of the paying banker for payment in cash, instead of being legally payable through a bank account only.

22.7.11 Not Drawn on Us

The objection 'not drawn on us' is given where a cheque, drawn on a specific branch of the same bank or on some other bank, is presented for payment to a banker other than the actual drawee banker concerned. For example, where a cheque, drawn on Corporation Bank, Hazrat Ganj, Lucknow branch, is presented for payment at its Gomti Nagar Lucknow branch, or else on its Haridwar or Varanasi branch, and so on. But then, it must be remembered here that, in the modern age of internet banking, a cheque drawn on some other local or even outstation branches, can be presented for payment at any of the branches of the bank all over India, if the both the branches (i.e. the paying branch and the drawee branch) are covered in the internet banking system of the bank.

22.7.12 Drawer's Signature Differs

Such objection is given in the cases where the drawer's signature on the cheque does not appear to be in strict conformity with the one already recorded with the bank. Here it may be clarified that even in the case where

the cheque was, in fact, signed by the drawer himself, but it had even slightly differed from its recorded specimen with the paying banker, he (banker) cannot, in any case, be held responsible for having made a wrongful dishonour of the cheque. This is so because, if the signature of the drawer on the cheque has given even the slightest doubt in the mind of the paying banker, he will be justified in returning the cheque under the objection 'drawer's signature differs'. This can be done by the banker even based on the principle that it is better to play safe today than to feel sorry tomorrow. This is so because, in case the cheque so paid, was in fact, bearing a forged signature of the drawer of the cheque, the paying banker will not get any legal protection under **Section 85.** The valid reason for such legal provision is that, it is expected of the paying banker to verify the signature of the drawer from his signature which is already available on his record.

22.7.13 Payment Stopped by the Drawer

The cheque is returned under the objection 'Payment stopped by the drawer' when its payment has been duly stopped (countermanded) by the drawer. For a detailed discussion on this point, please refer to the Sub-sections 22.5.1, 22.5.1.1, and 22.5.1.2 of this chapter.

22.7.14 Drawer is Dead or Drawer Deceased

Where the paying banker comes to know of the death of the drawer, all the cheques, drawn prior to his death, if presented thereafter (i.e. after the banker has come to know of the fact of the death of the drawer of the cheque), are returned under the objection 'drawer is dead' or 'drawer deceased'. For a detailed discussion on this point, please refer to the Sub-section 22.5.2 of this chapter.

22.7.15 Endorsement Irregular

The cheque is returned under the objection 'endorsement irregular' when the endorsement of the cheque is not in order, i.e. when the spelling of the name of the payee or the holder of the cheque does not exactly match with every letter of such name of the payee or the holder of the cheque, written on the cheque by the drawer or by its endorsee respectively.

22.8 Criminal Penalties in Dishonour of Cheque for Want of Funds

Now, with the addition of **Sections 138 to 142**, to the Negotiable Instruments Act by the (Amendment) Act 1988, criminal penalties have been provided in the cases of dishonour of the cheques for want of funds in the drawer's account with the bank.

Under **Section 138**, the drawer of the cheque may be punished

(a) With imprisonment upto two year, under the Negotiable Instruments (Amendment) Act, 2002 (raised from one year, as was the position earlier to this amendment), or
(b) With a fine upto twice the amount of the cheque so returned, or
(c) With even both of these two.

Here, it may be pointed out that the Court may be quite flexible in the matter of imposition of fine, which could be any amount not exceeding double the amount of the cheque, as aforementioned. Further, the Court may also prefer not to impose any fine at all, and may just pass a sentence of imprisonment only.

22.8.1 Conditions for Application of Section 138

But then, the aforementioned punishments provided under **Section 138** can be attracted only when the following conditions are satisfied:

22.8.1.1 (a) Insufficient Funds in the Account

As provided under **Section 31**,'The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required so to do..'. Conversely speaking, when the drawer of the cheque does not have sufficient funds in his account, the paying banker is within his full legal rights to return the cheque for want of sufficient funds in the drawer's account maintained with him, under the objection 'refer to drawer' or 'insufficient funds' and so on.. Thus, when the cheque is dishonoured for want of sufficient funds in the drawer's account maintained by him with the paying banker, the provisions made under **Section 138** will apply.

22.8.1.1 (b) Payment Stopped by the Drawer

Even in the case where the payment of a cheque has been subsequently stopped by the drawer, such stopped cheque will also be deemed to have been returned for want of funds, and accordingly, the provisions of **Section 138** will apply, unless the drawer is able to prove the justification for his having rightfully stopped the payment thereof. For example, where the goods, for the purchase of which the cheque had been issued, are found to be of sub-standard quality, or short in quantity, and for such other justifiable reasons. The aforementioned contention is based on the judgement delivered by the Supreme Court of India in the case titled **ET and TD Corporation Ltd vs Indian Technologies Engineers (Private) Ltd, AIR (1996) SC 2339.**

It may, thus, be inferred here that only in such cases where sufficient funds were not available in the drawer's account so as to honour the issued cheque on its presentation to the bank, and its payment had been stopped by its drawer, only to avert the dishonour of the cheque for the reason of insufficient funds in the account and, therefore, with a view to averting the penalties attracted under **Section 138,** such stopped cheque will also be deemed to have been returned for want of funds, and accordingly, the provisions of **Section 138** will apply.

22.8.1.1 (c) Account Closed

Similarly, in the event of the closure of the account of the drawer also, the cheque will be deemed to have been returned for want of funds.

But then, in the cases titled **S. Prasanna vs R. Vijayalakshmi (1993), 76, Comp. Cas. 522** and **Hunasikatimath vs State of Karnataka (1993), 76, Comp. Cas. 278,** it was held that **Section 138** does not include a situation where the cheque is returned for the reason that the account is closed.

We may, however, argue that though **Section 138** does not expressly include the case of the closed account, the case of closing the account by the drawer with the intention of avoiding the attraction of penalties under **Section 138,** the cheque will be deemed to have been returned for want of funds, all the same. Our aforementioned argument is based on the principle of *'mens rea'* - i.e. the presence of the elements both of intention and action to constitute a criminal offence.

In support of our aforementioned contention, we may prefer to cite the judgement delivered in one of the recent cases titled **N.E.P.C. Micon Ltd vs Magma Leasing Ltd (1999) 96, Comp. Cas. 822,** wherein it has been held that, in the event of the closure of the account of the drawer also, the cheque will be deemed to have been returned for want of funds. It was further observed in the judgement that, if in such cases of transfer of account, it will be interpreted otherwise (i.e. in a different manner), it will only encourage the dishonest persons to issue cheques and thereafter close his account.

But then, we may prefer to add here that only if sufficient funds were not available in the drawer's account so as to honour the issued cheque on its presentation to the bank, and after, or even before, issuing the cheque, the drawer of the cheque had requested the bank to transfer the account (with insufficient funds therein) to some of its other branch, only to avert the dishonour of the cheque for the reason of insufficient

funds in the account and, therefore, with a view to averting the penalties attracted under **Section 138,** the transfer of the account in such cases alone will be deemed to have been returned for want of funds, and accordingly, the provisions of **Section 138** will apply.

22.8.1.1 (d) Requesting Payee not to Present the Cheque

Again, as has been held in the judgement in the case titled **Modi Cement Ltd vs Kuchil Kumar Nandi,** where the drawer of the cheque personally makes a request to its payee, not to present the cheque for payment, it will also be deemed to have been returned for want of funds, if such also be the case.

In such cases, however, the drawer of the cheque would be well advised not to issue the cheque unless there are sufficient funds in his account to honour the cheque by the bank.

Alternatively, he (drawer) may issue a post-dated cheque, instead, by which date he expects to receive funds from some known sources, to avoid the penalties stipulated under **Section 138.**

In the case titled **Manoj K. Seth vs Fernandez (1992) 73, Comp. Cas.**, it was observed by the Kerala High Court that the return of a cheque by the drawee (paying bank) can take place only when it is presented for its payment. Further, the cheque can be presented for its payment by its payee (or holder) only when he is capable of presenting it for encashment. But then, a post-dated cheque can be presented for payment only on or after the date put on the cheque, and not before that date. Thus, if a post-dated cheque is presented on or after the date put on the cheque, within six months of such date, its presentation will be deemed to be in order. Accordingly, if it is so presented and is thereon returned for want of sufficient funds in the drawer's account, the penalties provided under **Section 138** will apply.

As against the aforementioned view, both the Madras High Court and the Punjab and Haryana High Court had held quite a different view, in the respective cases titled **Babu Xavier vs Lalchand Munoth (1992) 74, Comp. Cas.** (of Madras High Court) and **Gulshan Rai vs Anil Kumar (1993) 76, Comp. Cas. 685** (of Punjab and Haryana High Court)**.**

But again, in the case titled **Anil Kumar Sawhney vs Gulshan Rai (1993)**, the Supreme Court of India, had reversed the judgements of the Madras High Court and the Punjab and Haryana High Court in the aforementioned two cases. It had observed that in the case of a post-dated cheque, it remained just as a bill of exchange till the date that was written thereon. It, however, becomes a cheque only from the date that it bears, and not earlier. This is so because, a cheque is payable not otherwise than on demand, i.e. it is payable only on demand, and not otherwise. But a post-dated cheque is not payable on demand till the date that is written thereon. The Supreme Court of India had further observed that the period of six months must be calculated only from the date that was given on the post-dated cheque.

22.9 In Discharge of a Legal Debt or Liability

Further, the cheque, returned for want of funds in the drawer's account, must have been issued in the discharge of some legally enforceable debt or some other liability, either in full or even in part thereof, so as to attract the provisions of **Section 138**. Further, as provided under **Section 139**, the holder of the cheque will be presumed that he had received the cheque for the purpose of the discharge of some legally enforceable debt or some other liability, either in full or even in part thereof.

As observed by the Calcutta High Court**,** in order to attract the provisions of **Section 138**, it is necessary that the cheques are issued in discharge of a debt or liability. Conversely speaking, unless the cheques are so issued (i.e. in discharge of a debt or liability), the drawer of the cheque will not be guilty of the offence under **Section 138**, even if the other conditions stipulated under this section are fulfilled **[Inmark Finance & Investment Company (Private) Ltd and another vs Metropolitan Magistrate, Bombay and others (1993) 76, Comp. Cas. 156 (Cal.)].**

22.9.1 Presented within Six Months

To attract the provisions of **Section 138,** the cheque is required to be presented within six months from the date that is written thereon. Moreover, if the cheque is required to be presented even earlier, say, within three months from the date of its issue (which is usually the case with the dividend warrants and interest warrants issued by the companies), it must be presented within that specified date. This is so, because if the cheque is presented after six months or three months or so, it will be usually and justifiably returned by the paying bank under the objection 'cheque is outdated' and not for want of sufficient funds in the account, even if this also may be the case.

22.9.2 Notice of Dishonoured Cheque within 30 Days

To attract the penalties under **Section 138**, the payee or the 'holder in due course' of the cheque, must have given the notice to its drawer, within 30 days from the receipt of the advice from the paying banker about the non-payment of the cheque for want of funds in the drawer's account, as per the provisions made by the Negotiable Instruments (Amendment) Act 2002 (earlier it was 15 days). In such notice, the payee or the 'holder in due course' of the cheque must demand the payment of the dishonoured cheque from the drawer within 15 days of such notice.

In case such notice has already been served on the drawer of the cheque within the stipulated 30 days from the date of receiving the notice of dishonour from the bank, no fresh cause of action can be created by presenting the cheque for payment over again. This observation is based on the judgement given by the Supreme Court of India in the case titled **Sadanandan Bhadran vs Madhavan Sunil Kumar (1998) & CLJ 228**.

But, in case such notice has not been given, the presentation of the cheque over again for its payment, will create a fresh cause of action, as was observed by the Supreme Court of India in the case titled **Uniplex India Ltd vs Government of NCT of Delhi (2002) SC.**

Thus, it may be observed that there is no legal compulsion for the payee or the 'holder in due course' of the cheque to serve the aforementioned notice on the drawer of the cheque on the very first default (i.e. dishonour of the cheque for want of funds). This view has been expressed in the case titled **Station Shox Company (Private) Ltd vs Auto Tensions (Private) Ltd (1994) Delhi.**

22.9.3 Giving Notice after Cause of Action

As aforementioned, it is not necessary for the payee or the 'holder in due course' of the cheque to serve the aforementioned notice on the drawer of the cheque on the very first default. But it must be doubly emphasised here that, giving of the aforesaid notice to the drawer of the cheque by its payee or the 'holder in due course' within 30 days from the cause of action, is a necessary condition so as to attract the penalties under **Section 138**.

Here, we may cite the decision of the Supreme Court of India, in the case titled **Tomy Jacob Kattikoran vs Thomas Manjali, AIR 1998 SC 366,** wherein it was held that if the complainant has not served the required notice within the period prescribed under **Section 138,** i.e. within 30 days from the cause of action, the complaint, filed in the Court under this Section, will not be sustainable.

22.9.4 If Drawer Fails to Pay within 15 days of the Notice Period

The drawer of the cheque, dishonoured for want of funds, will attract the punishment and penalty under **Section 138**, only if he fails to make the payment to the payee or the 'holder in due course' of the cheque within 15 days of such notice period. Conversely speaking, if the drawer of such dishonoured cheque makes

the payment of the amount of the dishonoured cheque to the payee or the 'holder in due course' of the cheque, within 15 days of the notice period, he will not attract the penalty under this Section.

22.9.4.1 On Complaint in Writing

The Court will take cognisance of an offence punishable under **Section 138** only if a complaint is made, in writing, by the payee or the 'holder in due course' of the cheque, as the case may be, and not otherwise.

22.10 Competence and Jurisdiction of Court

No Court, inferior to the Court of a Metropolitan Magistrate or a Judicial Magistrate of the First Class, is considered competent to try any offence punishable under **Section 138.**

Further, as regards the 'jurisdiction of the Court' to entertain complaints under **Section 138**, the Kerala High Court, in the case title: **P. K. Muralidharan vs C. K. Pareed (1993) 76, Comp. Cas. 615,** has observed that the cause of action, as contemplated under **Section 142,** arises at the place where the drawer of the cheque fails to make the payment of the amount of the cheque. Such place can be:

(a) Either where the drawee bank (i.e. the bank on which the cheque is drawn), is located,
(b) Or where the cheque was issued or delivered.

Thus, the Court under whose jurisdiction any of the two places, mentioned at item (a) or (b) above, falls, will have the jurisdiction to try the cases alleging the offence committed under **Section 138**.

22.11 Period of Limitation

(a) Under **Section 142 (b)**, the action under **Section 138** (i.e. of serving the notice of dishonour of the cheque to its drawer), must be taken by the payee (or the 'holder in due course' of the cheque, as the case may be), within 30 days from the receipt of the information from the paying banker, regarding the dishonour of the cheque for want of funds. Further, in the notice, the payee must ask the drawer to pay the amount of the cheque within fifteen days from the receipt of the notice. Thus, the drawer has the time to pay the amount of the cheque within 15 days after receiving the notice.
(b) The other provision, stipulated under **Section 138** states that, a petition must be filed by the payee in the Court [complaining of the offence committed under **Section138, Sub-Section (c)**], within 15 days from the date of receipt of the aforementioned notice by the drawer.
(c) Thus, the limitation will start from the date of expiry of 15 days from the receipt of the notice by the drawer. Further, the expiry of 15 days will be counted from the very next day (i.e. from the 16th day) of the receipt of the notice by the drawer).

It may be pertinent to re-emphasise the following subtle points involved in the three subparagraphs above:

(a) First, the payee must send a notice to the drawer of the cheque within 30 days from the receipt of the information of dishonour of the cheque from the banker.
(b) Second, the payee must file the complaint in the Court, within 15 days from the date of receipt of the aforementioned notice by the drawer.
(c) Third, the period of limitation will start from the 16th day of the receipt of the notice by the drawer.

The position, involving the period of limitation in such cases, has been amply clarified by the Andhra Pradesh High Court in the judgement delivered in the case titled **M/s Mahalakshmi Enterprises, Calicut, Kerala, and Another vs M/s Sri Vishnu Trading Company and Others, AIR (1991) A.P. 74**, wherein it was held that the period of limitation, starts from the 16th day after the receipt of the notice by the drawer of such dishonoured cheque.

The facts of the case, in brief, are the following:

M/s Sri Vishnu Trading Company had filed a complaint under **Section 138** on the ground that the cheque dated 16.7.1989 for Rs 15,260 drawn by the drawer was dishonoured on 24.7.1989. On such dishonour of the cheque they (M/s Sri Vishnu Trading Company) had issued a notice to the drawer on 20.8.1989 [i.e. within 30 days of the cause of action (dishonour of the cheque) arising on 24.7.1989]. Such notice was received by the drawer (petitioner) on 24.8.1989. On 5.9.1989, they had filed the petition before the Court complaining of the offence committed by the drawer (petitioner) under **Section 138 (c)**.

The Court had observed that the notice was received by the drawer (petitioner) on 24.8.1989. Thus, after 24.8.1989, he had the time to pay the amount of the cheque within 15 days. Thus, the limitation will start in this case from the date of expiry of 15 days, i.e. with effect from 9.9.1989, it being the 16th day counted from 24.8.1989. The complaint was filed in this case on 5.9.1989 which, therefore, is within the limitation.

The 16th day from 24.8.1989 has been calculated in the following manner:

Step 1: The remaining days in the month of August, excluding the starting point (i.e. 24.8.1989), are 31 days less 24 days = 7days;

Step 2: By taking 8 days from the month of September, to be added to the remaining 7 days in the month of August, so as to come to 15 days from 24.8.1989, we come to 8.9.1989.

Thus, the complaint filed upto 8.9.1989 will be deemed to have been filed within the limitation period; and the limitation will start from the following day of 8.9.1989, i.e. from 9.9.1989.

22.12 Effect of Part-Payment

Section 138 (b), *inter alia* (among other things) requires that, on dishonour of the cheque, the payee or the 'holder in due course' of the cheque shall make a demand from the drawer for the payment of the 'said amount of money', by giving a notice to the drawer in writing. This may be interpreted to mean that in the notice the demand will be made 'for the payment of the amount mentioned in the cheque'. Further, **Section 138 (c)**, refers only to the failure on the part of the drawer of such dishonoured cheque to make payment of the 'said amount of money'. This clause makes it amply clear that, in this context, the drawer will have to pay the entire amount of money mentioned in the cheque in full. Conversely speaking, any part-payment of the cheque will not have any effect on the cause of action and legal right of such payee or the 'holder in due course' of the dishonoured cheque, to file a complaint in the Court under **Section 138**. That is, by making a part-payment of the amount of the dishonoured cheque, its drawer cannot avoid or evade the prosecution under this Section. This is so because, if part-payment could have protected the drawer of such dishonoured cheque from prosecution under this Section, it would prove to be a very easy and handy measure for any unscrupulous person to frustrate the very purpose of **Section 138**, and stipulating the punishment thereunder).

It may be further stressed here that, even if the drawer of such dishonoured cheque would have issued another cheque, in part-payment of the amount of the dishonoured cheque, and even if the payee or the 'holder in due course' of the dishonoured cheque, as the case may be, would have even encashed such other cheque, after his having already filed the complaint in the Court, the earlier position will not get altered or even softened in any manner, whatsoever.

This point may be well explained by taking the example of the criminal offence of theft, committed under **Section 379 of the Indian Penal Court (IPC)**. If the thief, after being caught, returns all the goods stolen by him, will it undo his act of theft, or will he be acquitted under any law? The answer will invariably be in a forceful and assertive negative. This is so because, once an offence has already been committed, any subsequent conduct or action, either on the part of the accused, or even of the complainant, cannot wash away, or even mitigate, the offence. Accordingly, the act of making of a part-payment by the defaulting drawer of the dishonoured cheque, will not be of any effect and consequence in regard to the question of maintainability of the complaint in the Court.

22.13 Liability for Wrongful Dishonour

Under **Section 31**, in the case of a wrongful (unjustifiable) dishonour of a cheque, the paying banker incurs the liability of compensating his customer for any loss or damage, incurred or sustained by him (his customer). The term 'loss or damage', used in **Section 31,** connotes that the paying banker has the following twofold liabilities, viz.:

(i) To compensate his customer for any monetary (pecuniary) loss; and
(ii) To pay to his customer (drawer of the cheque), the damages for the loss of his credit, and for the injury caused to him (customer), due to such wrongful dishonour of his cheque.

Further, as regards the quantum of such damages, it will depend upon the fact whether the drawer of the cheque is a trader/businessman, or someone else.

This is so because, in the case of the dishonour of a cheque, drawn by a trader/businessman, the quantum of such damages may be quite substantial, as such wrongful dishonour of the cheque will adversely affect his financial stability and credibility in the marker which, in turn, may cause a substantial loss of business and may even adversely affect his dealings with his banker and other creditors. But in the case of wrongful dishonour of the cheque drawn by a non- trader/non-businessman, the quantum of such damages may not be as high, because, though it will adversely affect his reputation in the society, he will not suffer any loss involving any business, as he is not a businessman.

That is why, in the case titled **Gibbs vs Westminster Bank**, Mrs. Margaret Gibbons, a non-trader, was allowed only nominal damages, on the ground that no special (business) loss was involved in the case.

It may be mentioned here that while assessing the quantum of damages for injury to the credit, the Courts give due consideration to the various factors involved in each case, like the financial position and the market reputation of the drawer of the cheque, as also the usual custom of the trade to which he may belong.

22.14 Offences by Companies

In the cases where a company commits an offence under **Section 138**, every person, who was in charge of, and was responsible to the company, for managing the banking business of the company with the banker, at the time such offence was committed, will be deemed to be guilty of having committed the offence, along with the company itself, and therefore, all of them shall be liable to be proceeded against and punished accordingly. But, the notice of such dishonour of the cheque should be served on the company so as to invoke the liability of the company under the provisions of this Section. Further, as was held in the case titled **Rajneesh Aggarwal vs Amit Bhalla (2001)**, the notice served on the director of the company, who had signed the dishonoured cheque, will also be deemed to be a valid notice. Besides, a director, manager, secretary, or any other officer of the company shall also be liable to be proceeded against and punished accordingly, provided such offence was committed with the consent or connivance of such persons, or it is attributed to any neglect on their part in the matter.

But then, a person (of the company) will not be held liable under this Section, in the following cases:

(a) Where such person is able to prove that the offence was committed without his knowledge;
(b) Where such person is able to prove that he had exercised all possible due diligence to prevent the commitment of such offence; and
(c) Where such person is nominated as a director of the company *ex officio* (i.e. by virtue of holding any office), or employment in the Central Government or the State Government, or the Financial Corporation owned or controlled by the Central Government or the State Government, as the case may be.

In this context, the term 'company' includes any corporate body as also a firm or association of individuals. Further, the term 'director' used in the context of a firm means a partner in the firm.

22.15 Liability of a Company in Liquidation

The offence committed under **Section 138** by a company would be deemed to be complete when the drawer of the dishonoured cheque will fail to make the payment of the amount of such cheque within the stipulated time (i.e. within 15 days after the serving of the notice). Accordingly, the company will not be allowed to avoid its punishment under this Section, merely on the ground that the company's petition for its winding up had already been submitted before it was served the notice, demanding the payment of the amount of the dishonoured cheque. This view is based on the decision of the Supreme Court of India in the case titled **Pankaj Mishra vs State of Maharashtra (200), 255 CL 13.**

22.16 Power of Court for Summary Trial

Despite the provisions contained in the **Code of Criminal Procedure, 1973**, all the offences committed, as discussed under this **chapter 22**, shall be tried by the Court of a Metropolitan Magistrate or a Judicial Magistrate of the First Class, and the provisions of **Section 262 to 265 (both inclusive) of the aforementioned Code** shall apply to such trials, as far as possible.

But then, in the cases of all the convictions in a summary trial under **Section 143** [added by the Negotiable Instruments (Amendment) Act, 2002] the Metropolitan Magistrate or a Judicial Magistrate of the First Class can, under the law, pass the sentence of imprisonment for a term not exceeding one year, and a fine not exceeding Rs 5,000.

But, at the commencement of the summary trial, or even during the course of such trial, under **Section 143**, the Magistrate, trying the case, may, in some cases, feel that either the nature of the offence in the case is such

(a) That the sentence of imprisonment for a term exceeding one year may have to be passed to meet the ends of justice, or else
(b) That, even for any other reason, it is undesirable to try the case summarily.

Under both the aforementioned circumstances, the Magistrate shall, after hearing the parties to the case, pass and record an order to the effect that the case should not be tried summarily. In such an event, he (Magistrate) may recall any of the witnesses who may have been already examined, and thereafter, he may proceed to hear or even rehear the case in the manner provided under the aforementioned Code (i.e. the Code of Criminal Procedure, 1973).

Further, the summary trial of the cases under **Section 143,** as far as it is practicable and is consistent with meeting the ends of justice, shall be continued by the Magistrate on a day-to-day basis, till it is finally concluded. However, in the cases where he (Magistrate) feels that the adjournment of the trial of the case beyond the very next working day is considered necessary, for some reason or the other, he may do so. But then, in the cases of such adjournments, he will have to give and record the specific reason(s) for the adjournment.

But again, all the summary trials under **Section 143** must be conducted as expeditiously as possible, and the Magistrate concerned must make endeavours to conclude the trial within six months from the date of the filing of the complaint.

Further, as per the provisions of **Section 147** [added by the Negotiable Instruments (Amendment) Act, 2002], all the offences punishable under the Negotiable Instruments Act shall be compoundable.

Let us Recapitulate

Duties and Responsibilities of a Paying Banker

As provided under **Section 31,** a paying banker has been assigned with the following two responsibilities and liabilities:

(a) To the true owner (payee or holder) of the cheque for conversion of the amount, if the cheque is wrongly dishonoured (i.e. returned unpaid); and
(b) To the drawer of the cheque, first, for the liabilities of damages for wrongfully dishonouring the cheque, and second, for wrongly debiting the amount of the cheque to his account.

In the cases where a cheque is inadvertently dishonoured by the paying banker and even if it is subsequently paid by him, the Court will not award mere nominal damages, in view of the fact that the credit of the drawer of the cheque was already affected seriously. (**Rolin vs Steward**).

But the following conditions/restrictions will apply for the payment of the cheque:

(i) Where it is drawn on the specific branch of the bank which maintains the drawer's (customer's) account (**Bank of India vs Official Liquidator**), provided such branch is not covered under the bank's internet banking.
(ii) Where it is presented for payment within a reasonable time, i.e. within six months of its date.
(iii) Where it is presented for payment during the business hours of the paying branch of the bank.
(iv) Where sufficient funds are available in the drawer's account.
(v) Where it is drawn in conformity with the provisions made under **Section 5,** read with **Section 6**, to the effect that it contains 'an unconditional order … to pay a certain sum of money only … not expressed to be payable otherwise than on demand'.

Legal Protection to a Paying Banker

(i) In the case of **forged endorsement** (and not of the drawer's signature), the paying banker has been granted statutory (legal) protection, under **Section 85**, as it is well-nigh impossible for the paying banker to verify the genuineness of all the endorsements (as against the drawers' signature).
(ii) In the cases of payment of **crossed cheques**, if paid **in due course of business** (**Section 128**), even if it subsequently turns out to be a payment made to a wrong payee.

When should the Paying Banker Refuse Payment?

1. (a) Where the drawer of the cheque has stopped its payment, in writing, duly signed by him, stating all the relevant particulars of the cheque, like its number, date, amount, and the name of the payee.
   (b) If the paying banker pays a stopped cheque, he incurs the following two liabilities, viz.:
      (i) To refund the amount of the stopped cheque into the drawer's account for its wrongful payment; and
      (ii) To pay damages to the drawer of the cheque for wrongfully dishonouring any further cheque for insufficiency of funds in his account, caused by such wrongful payment of the stopped cheque.
   (c) When the 'stop payment' instruction is received through telegram, telephone, fax, e-mail, and so on, the paying banker is faced with the following dilemma:
      (i) If he pays such cheque, and the message later transpires to have actually been sent by or on behalf of the drawer, he may be held liable for having paid the cheque wrongfully and thus, he may incur the two liabilities aforementioned in 1(b) above; and
      (ii) If the paying banker returns it under the objection 'payment stopped by drawer', on the basis of such unauthenticated message, which was not actually sent by the drawer, he (paying banker) will be held liable for paying damages to the drawer for having wrongfully dishonoured the cheque.

The paying banker may, therefore, be well-advised:

(i) To make a precautionary noting in the ledger account of the respective drawer; so as to guard against an erroneous payment of the cheque, through an oversight;
(ii) To simultaneously try to contact the drawer and advise him to send a confirmatory letter duly signed by him to stop payment of the cheque,

(iii) To return the cheque under the objection 'drawer's confirmation required' (and not that 'Payment stopped by drawer), if the cheque in question is presented before the receipt of the drawer's confirmatory letter. This way the banker will not be held liable for (wrongfully) paying the cheque nor for having wrongfully dishonoured the cheque.

2. The paying banker must not make any payment from the account of his customer after he has received the notice regarding his (customer's) death.
3. Similarly, the paying banker must not make any payment from the account of his customer after he has received the notice regarding his customer's insanity. Further, he must confirm that the customer concerned has actually become insane, under the following circumstances:
   (i) In case the customer concerned has been admitted and removed to a lunatic asylum; or
   (ii) When he obtains or receives a certificate duly signed by a competent doctor confirming the insanity of the customer concerned.
4. On receipt of the notice of the customer's insolvency, payments on his account must be stopped with immediate effect, after the receipt of such notice, because thereafter, all his properties, including his credit balances in his accounts with the various banks, are vested in the official receiver or assignee.
5. On receipt of a 'garnishee order', which is absolute, i.e. whereby the entire credit balance available on the account is attached, no cheque drawn on the account must be paid thereafter.
6. On receipt of a 'notice of assignment' on the credit balance on the account, duly signed by the customer, no cheque drawn on the account must be paid thereafter.
7. Where the paying banker has any doubt regarding the validity of the title of the holder of the cheque (like when he believes that the cheque has been stolen or else has been found lying on the roadside), such cheque should not be paid by him.
8. Where a trustee (who is supposed to be always operating in a fiduciary capacity),draws a cheque on the trust account to receive the payment apparently for his personal use, instead of for the use on behalf of the trust, such cheque should not be paid by the banker.

When the Paying Banker may Refuse Payment

Under the following circumstance, the paying banker is at his full liberty either to return the cheque without incurring any liability for a wrongful dishonour, or even to pay the cheque if he so desired and preferred.

(a) When there are insufficient funds in the account, the cheque may be returned under the objection like 'insufficient funds in the account', or 'not arranged for', or 'refer to drawer', and so on.
(b) On presentation of an outdated (stale) cheque (i.e. after six months from its date), it is usually returned under the objection 'cheque is out of date'.
(c) Similarly, on presentation of a post-dated cheques (i.e. which are presented before the date put thereon), are usually returned under the objection 'cheque is post-dated'.
(d) If a cheque is not duly presented for payment, for example, if it is presented after the usual banking hours.
(e) Where the cheque is drawn on a joint account, to be operated by both or all the account holders jointly, and a cheque, drawn by only one or only some of the operators on the account, is presented for payment, it will be usually returned by the paying banker unpaid under the objection 'cheque must be drawn by all the account holders jointly' or 'signature of the remaining account holders also required'.

Specific meanings of some of the most frequently used objections

(i) The objection 'refer to drawer' signifies that the funds available in the account of the drawer of the cheque are not sufficient enough to honour the cheque.
(ii) The objection 'insufficient fund', or even 'no funds', also signifies that the funds available in the account of the drawer of the cheque are not sufficient enough to honour the cheque.

(iii) The objection 'not arranged for' signifies that no prior arrangements have been made by the drawer of the cheque with bank to pay the amount of the cheque prior to its realisation, like by getting an appropriate overdraft limit sanctioned, or getting a firm commitment from the bank to honour the cheque(s).

(iv) The objection 'effects not yet cleared: please present again' signifies that cheque(s) or bill(s) of exchange, sent to some outstation for collection, or some local cheque(s) presented through the local clearing, are yet to be realised. Therefore, please present the cheque again, as it is expected that the amount might be realised a little later.

(v) The objection 'cheque is post-dated' signifies that the cheque bears a date which will fall on a later date than on the day the cheque has been presented for payment.

(vi) The objection 'cheque is out of date' or 'cheque is outdated', or 'cheque is stale' signifies that the cheque has been presented for payment to the bank after six months (after three months in the cases of dividend warrants and interest warrants), from its date.

(vii) The objection 'alteration requires full signature' signifies that there are some material alterations in the cheque (like in its date, amount, name of the payee, and so on), which require authentication at all the required place(s) bearing such material alteration(s), by the drawer, under his full signature.

(viii) The objection 'payee's separate discharge to the bank required' signifies that the payee of the cheque (mostly in the cases of dividend warrants and interest warrants) must sign on the reverse of the cheque/ warrant, in token of his having received the payment of the amount.

(ix) A cheque is returned with the objection 'amount in words and figures differs' where such is the case, despite the fact that **Section 18** provides that in such cases, the amount written on the negotiable instrument in words shall be taken as the amount ordered or undertaken to be paid.

(x) The objection 'Crossed cheque: must be presented through a bank' is given in the cases where a crossed cheque is presented for payment in cash, instead of being legally payable through a bank account only.

(xi) The objection 'not drawn on us' is given where a cheque, drawn on a specific branch of the same bank or on some other bank, is presented for payment to a banker other than the actual drawee banker concerned.

(xii) The objection 'drawer's signature differs' is given in the cases where the drawer's signature on the cheque does not appear to be in strict conformity with the one already recorded with the bank.

(xiii) The cheque is returned under the objection 'Payment stopped by the drawer' when its payment has been duly stopped (countermanded) by the drawer.

(xiv) Where the paying banker comes to know of the death of the drawer, all the cheques, drawn prior to his death, if presented thereafter (i.e. after the banker has come to know of the fact of the death of the drawer of the cheque), are returned under the objection 'drawer is dead' or 'drawer deceased'.

(xv) The cheque is returned under the objection 'endorsement irregular' when the endorsement of the cheque is not in order, i.e. when the spelling of the name of the payee or the holder of the cheque does not exactly match with every letter of such name of the payee or the holder of the cheque, written on the cheque by the drawer or by its endorsee, respectively.

Criminal Penalties in Dishonour of Cheque for want of Funds

Under **Section 138**, the drawer of the cheque may be punished

(a) With imprisonment upto two years, under the Negotiable Instruments (Amendment) Act, 2002 (raised from one year, as was the position earlier to this amendment), or

(b) With a fine upto twice the amount of the cheque so returned, or

(c) With even both of these two.

Conditions for application of Section 138

(a) Where the cheque is returned for want of sufficient funds in the account, i.e. under the objection like 'refer to drawer', or 'insufficient funds in the account', or 'not arranged for', and so on.

(b) Where the payment of a cheque is subsequently stopped by the drawer, such stopped cheque will also be deemed to have been returned for want of funds, unless the drawer is able to prove the justification for his having rightfully stopped the payment thereof, like where the goods supplied are defective, or are of sub-standard quality, and so on.

(c) Similarly, in the event of the closure of the account of the drawer also, the cheque will be deemed to have been returned for want of funds, if the account was closed by the drawer with the intention of avoiding the attraction of penalties under **Section 138** (i.e. when there were insufficient funds in the account on that date).

(d) Again, where the drawer of the cheque personally makes a request to its payee, not to present the cheque for payment, it will also be deemed to have been returned for want of funds, if such also be the case.

(e) Further, the cheque, returned for want of funds, must have been issued in the discharge of some legally enforceable debt or some other liability, either in full or even in part thereof.

(f) The cheque must be presented within six months (or within three months in the cases of dividend warrants and interest warrants), from its date, otherwise, it will be usually and justifiably returned by the paying bank under the objection 'cheque is outdated' and not for want of sufficient funds in the account, even if this also may be the case.

(g) The payee or the 'holder in due course' of the cheque has given the notice to its drawer, within 30 days from the receipt of the advice from the paying banker about the non-payment of the cheque for want of funds (earlier it was 15 days).

(h) If the drawer fails to pay within 15 days of the notice period, he will attract the penalty under **Section 138**, otherwise not.

(i) The Court will take cognisance of an offence punishable under **Section 138** only if a complaint is made, in writing, by the payee or the 'holder in due course' of the cheque, as the case may be, and not otherwise.

Competence and Jurisdiction of Court

No Court, inferior to the Court of a Metropolitan Magistrate or a Judicial Magistrate of the First Class, is considered competent to try any offence punishable under **Section 138**.

Further, the 'jurisdiction of the Court' to entertain complaints under **Section 138**, can be (a) Either where the drawee bank is located, or (b) where the cheque was issued or delivered.

Period of Limitation

The period of limitation starts from the 16^{th} day after the receipt of the notice by the drawer of such dishonoured cheque. Further, by making a part-payment of the amount of the dishonoured cheque, its drawer cannot avoid or evade the prosecution under **Section 138**. Otherwise, it would prove to be a very easy and handy measure for any unscrupulous person to frustrate the very purpose of **Section 138**.

Liability for Wrongful Dishonour

(i) To compensate his customer for any monetary (pecuniary) loss; and

(ii) To pay to his customer (drawer of the cheque), the damages for the loss of his credit, and for the injury caused to him (customer), due to such wrongful dishonour of his cheque.

Offences by Companies

In the cases where a company commits an offence under **Section 138**, every person, who was in charge of, and was responsible to the company, for managing the banking business of the company with the banker, at the time such offence was committed, will be deemed to be guilty of having committed the offence, along with the company itself, and therefore, all of them shall be liable to be proceeded against and punished accordingly. But, the notice of such dishonour of the cheque should be served on the company so as to invoke the liability of the company under the provisions of this Section.

Liability of a Company in Liquidation

The company will not be allowed to avoid its punishment under **Section 138**, merely on the ground that the company's petition for its winding up had already been submitted before it was served the notice.

Power of Court for Summary Trial

Despite the provisions contained in the **Code of Criminal Procedure, 1973**, all the offences committed (as discussed under this chapter 22), shall be tried by the Court of a Metropolitan Magistrate or a Judicial Magistrate of the First Class, and the provisions of **Section 262 to 265 (both inclusive) of the aforementioned Code** shall apply to such trials, as far as possible.

But then, in the cases of all the convictions in a summary trial under **Section 143**, the Metropolitan Magistrate or a Judicial Magistrate of the First Class can, under the law, pass the sentence of imprisonment for a term not exceeding one year, and a fine not exceeding Rs 5,000.

Questions for Reflection

1. (a) Who is a Paying Banker?
   (b) What are the various duties/responsibilities of a Paying Banker?
   (c) Under what specific conditions is the paying banker responsible to honour the cheques drawn by his customers?
2. What are the various legal protections available to a Paying Banker?
3. Write short notes on the following terms:
   (a) 'Payment in due course of business';
   (b) 'Payment in accordance with the apparent tenor of the instrument';
   (c) 'Payment in good faith'; and
   (d) 'Payment without negligence'.
4. The 'payment in due course of business' has been defined under Section 10 as the 'payment in accordance with the apparent tenor of the instrument in good faith and without negligence, to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned'.

   Analyse the various clauses contained in Section 10 quoted above, and discuss the various conditions which must be satisfied before a payment of a negotiable instrument, made by the paying banker, may be termed as a 'payment in due course of business'. Give suitable examples in each case.
5. Under what conditions should the paying banker refuse payment of a cheque?
6. (a) What are the various conditions required to be fulfilled when the paying banker must act on the drawer's instruction to stop payment of a cheque? Give reasons for each of such specified conditions.
   (b) What specific actions should the bank take under the following conditions?
      (i) When the payment of a dated cheque has been duly stopped by the drawer;
      (ii) When the payment of an undated cheque has been duly stopped by the drawer; and
      (iii) Where a blank leaf of a cheque is reported lost by the drawer.

   Give reasons for your answer in each case.
7. What are the two specific liabilities of the paying banker in paying a stopped cheque?
8. What specific actions the paying banker must take when the information regarding 'Stop payment' of a cheque has been received by telegram, telephone, fax, e-mail, etc.?
9. What would be the specific liabilities of a paying banker under the circumstances stated in Question 8 above, in the following two cases?
   (a) If he pays such cheque, and the unauthenticated message transpires to have actually been sent by the drawer himself; and

(b) If the paying banker does not pay the cheque and, instead, returns it under the objection 'payment stopped by drawer', and the unauthenticated message later transpires to be a mischievous one, and not sent by the drawer

(c) What expert legal opinion will you give to the paying banker so as to play safe and avoid any liability under such tricky situations? Give reasons for your answer.

10. In what specific ways can a paying banker ascertain his customer's insanity?
11. (a) Under what specific conditions, the paying banker may make payment of a cheque, even though it may not be legally obligatory on his part to necessarily do so?

(b) Under what specific conditions the paying banker usually refuses payment of a cheque, i.e. when it is legally obligatory on his part to necessarily do so?

12. Under what specific circumstances the paying bankers usually return the cheques unpaid with the following objections?

(i) Refer to drawer
(ii) Insufficient fund or 'No funds'
(iii) Not arranged for
(iv) Effects not yet cleared: Please present again
(v) Cheque is post-dated
(vi) Cheque is out of date
(vii) Alteration requires full signature
(viii) Payee's separate discharge to the Bank required
(ix) Amount in words and figures differs
(x) Crossed cheque: must be presented through a bank
(xi) Not drawn on us
(xii) Drawer's signature differs
(xiii) Payment stopped by the drawer
(xiv) Drawer is dead or Drawer deceased
(xv) Endorsement irregular.

13. What are the various criminal penalties for dishonour of cheques for want of funds in the bank account of its drawer?
14. What are the various conditions which must be fulfilled before a complaint under Section 138 may be sustained in the Court?
15. Under what specific conditions can the provisions of Section 138 may be applied even in the following cases?

(a) Where the payment of the cheque has been duly stopped by the drawer;
(b) Where the account has been closed by the drawer; and
(c) Where the drawer has requested the payee not to present the cheque for payment.

16. (a) Within how many days should the payee or the 'holder in due course' of the cheque must give the notice to its drawer, as from the date of the receipt of the advice from the paying banker about the non-payment of the cheque for want of funds in the drawer's account, so as to attract the penalties under Section 138?

(b) Within how many days of the receipt of the notice, detailed in question (a) above, the drawer of the dishonoured cheque must make payment to the payee or to the 'holder in due course' of the cheque, so as to avoid or avert the penalties under Section 138?

17. (a) Which Courts are considered to be competent to try any offence punishable under Section 138?

(b) At which places does the 'jurisdiction of the Court' arise to entertain complaints under Section 138?

18. Will a part-payment of the cheque have any effect on the cause of action and legal right of the payee or the 'holder in due course' of the dishonoured cheque, returned unpaid for want of sufficient funds, to file a complaint in the Court under Section 138? Give reasons for your answer.

19. (a) What are the various liabilities that a paying banker may incur in the case of wrongful (unjustifiable) dishonour of a cheque?
    (b) Will the quantum of damages be any different in the cases where the drawer of the cheque happens to be a trader/businessman, or someone else? Give reasons for your answer.
20. (a) Under what specific conditions a person of the company, whose cheque has been returned unpaid for want of funds, may not be held liable under Section 138?
    (b) Does the term 'company', used in the context of Section 138, include any corporate body, firm or association of individuals?
    (c) Will the term 'director', used in the context of Section 138, in relation to a firm, mean a partner in the firm?
21. (a) Will the company be allowed to avoid punishment under Section 138, on the ground that the company's petition for its winding up had already been submitted before it was served the notice, demanding the payment of the amount of the dishonoured cheque?
    (b) Under what special conditions can a competent Court pass and record an order to the effect that a particular case should not be tried summarily?

Problems for Practice (With Suggested Solutions)

Problem 1

Two cheques for Rs 1,000 and for Rs 1, 00,000, drawn on the same account, have been presented to the paying banker through the local clearing simultaneously the same day, against the credit balance on the drawer's (customer's) account on that day standing at Rs 1, 00,900 only. Further, there is no overdraft limit sanctioned in favour of the drawer concerned, nor any prior arrangement with the paying banker is in place for honouring his (drawer's) cheques beyond his credit balance.

(a) Which of these two cheques should be paid by the paying banker, in case he does not prefer to allow any overdraft on any of his customers' accounts?
(b) What pragmatic suggestions will you like to give to the paying banker in such cases?

Give reasons for your answer in each case.

Solution

(a) Here, the following two diametrically opposite solutions may seem to be possible:
    (i) Some of us may think that it would be in order for the paying banker to first pay the cheque of higher value (i.e. of Rs 1, 00,000), and if sufficient balance is not available in the drawer's account thereafter, the cheque for the smaller amount (i.e. of Rs 1,000), must be returned for want of sufficient funds in the account.
    (ii) Some others may opine that the cheque for the smaller amount (i.e. of Rs 1,000), must be paid first, and if sufficient balance is not available in the drawer's account thereafter, the cheque for the higher amount (i.e. of Rs 1, 00,000), must be returned for want of sufficient funds in the account.

But then, out of the two aforementioned solutions, the one at item (ii) above seems to be more practical and defensible for the following reasons:

(i) If the cheque for a small amount of Rs 1,000 would be preferred to be returned by the paying banker, the prestige and credibility of the drawer concerned would be greatly damaged in view of the fact that the people will get an impression that the person (drawer of the cheque) is not worth even a small sum of Rs 1,000.
(ii) As against this, if the cheque for a higher amount of Rs 1, 00,000 would be returned by the paying banker, the prestige and credibility of the drawer concerned would be damaged even in this case, but, of course, to a comparably lower extent, as in this case the people will think that the person (drawer of the cheque) is not worth a comparatively higher amount of Rs 1, 00,000.

(b) But, all considered, it would be far more pragmatic, beneficial and gainful approach on the part of the paying banker, if he would prefer to pay both the cheques, i.e. one for Rs 1,000 and the other for Rs 1,00,000, because, in such an event the drawer's account will get overdrawn, no doubt, but with a small sum of Rs 100 only. Alternatively, the paying banker may ask the drawer concerned over the phone to deposit a sum of Rs 100 or so, the same day or the next working day, so as to regularise the position of his overdrawn account. This way the banker will earn a valuable regard in the eyes of his customers, which will go a long way in the area of 'Customer Relations Management' (CRM).

Problem 2

(a) A paying banker has paid an order cheque whereon the endorsement of the payee later transpires to be a forged one. Will the paying banker get any legal protection in this case?

(b) Will the legal position be any different, if the paying banker would have paid a cheque whereon the signature of the drawer later transpires to be a forged one?

Give reasons for your answer in each case.

Solution

(a) In the cases where some person, other than the genuine payee, has forged the endorsement of the payee, and obtained the payment of the cheque, the paying banker will be discharged of his liabilities, and he can rightfully debit the account of its drawer with the amount of the cheque, provided the endorsement is *prima facie* (i.e. apparently, or on the face of it) in order (i.e. when it matches with the spelling of the name of the payee written on the instrument, word for word), and the payment has been made by the banker in due course. Such protection is available to the paying banker under Section 85. This is so because within the limited time available to the paying banker, it may not be possible for him to investigate all the endorsements, except as to their outward irregularity.

(b) The legal position will be diametrically different, if the paying banker would have paid a cheque whereon the signature of the drawer later transpires to be a forged one. This is so because, though the paying banker has been granted statutory (legal) protection, under **Section 85**, in the cases of forged endorsements, such protection will not be available to him in the cases where he happens to pay a cheque wherein the drawer's signature itself has been forged. The pertinent reasons is that, while it is well nigh impossible for the paying banker to verify the genuineness of all the endorsements within the limited time available to him, it is always expected of the paying banker to verify the signature of the drawer, as it is already instantaneously available in his records.

Problem 3

The name of the payee and the amount on a cheque were chemically erased. It was, thereafter, presented at the counter of the paying banker, and was paid by him. Will the paying banker get any legal protection in this case? Give reasons for your answer.

Solution

One may argue that, in case the impugned cheque (i.e. the cheque in question) would have been scrutinised under the ultraviolet ray lamp, the aforementioned material alteration made therein could have been detected. But, the paying banker would not be held to be guilty of negligence on the ground that the cheque was not put to such test (i.e. under the ultraviolet ray lamp). Sufficient authority was shown by the bank that if a cheque *prima facie* (i.e. on the fact of it) did not show that it was a forged one, and when it was presented for its payment, there were sufficient funds available in the drawer's account to honour the cheque in question, the payment, so made by the banker was a payment in due course, in view of the fact that its payment was made according to the apparent tenor of the cheque. Further, if it would be insisted that no cheque should be paid without a thorough enquiry as to its history, it would render the banking business impossible. The paying banker will, therefore, get the legal protection in this case. This contention is based on the decision of the Supreme Court delivered in a relatively recent case titled **Bank of Maharashtra vs Automotive Engineering Company (1993)**.

Problem 4

Ram Swarup, a clerk of a company, usually comes to the bank on the first working day of each month to take payment of open cheques drawn for a heavy amount, apparently comprising monthly salary of the staff. On 21st December 2008 also he had come to encash an open cheque for a heavy amount, which was paid to him by the paying banker in cash, as usual. Will the paying banker be discharged of his liability in the instant case? Give reasons for your answer.

Solution

The instant case must have definitely given a reasonable ground to the paying banker to suspect that Ram Swarup, the clerk of the company, who had come to the bank to take payment of the cheque, is not really entitled to receive its payment. This is so because, he had come to the bank on 21st December 2008, which apparently did not comprise the monthly salary of the staff, as the date did not coincide with the salary day, based on the bank's past experiences in such cases. Accordingly, the paying banker must have naturally got alerted and he must not have paid the cheque unless the drawer's confirmation was received in this regard, preferably in writing.

Problem 5

A paying banker had received a telegram from the drawer of a cheque to stop payment of a bearer cheque, quoting its number, date, name of the payee, and the amount mentioned therein. Believing that the telegraphic message, containing all the relevant particulars of the cheque, must be a genuine one, he had returned the cheque under the objection 'Payment stopped by drawer'. But when the payee of the cheque approached the drawer of the cheque that the cheque in question was returned unpaid by the bank under the aforementioned objection, the drawer of the cheque visited the bank to confront the banker that the telegram was not sent by him. The banker pleaded that in view of the fact that the telegram had contained all the relevant particulars of the cheque, he had considered it to be a genuine one. He had, therefore, rightly returned the cheque unpaid under the objection 'Payment stopped by drawer'.

(a) Do you think that the stand taken by the banker in this case is sustainable in the Court of law?
(b) What specific suggestions will you like to give to the paying banker when faced with such problems in the future?

Give reasons for your answer in each case.

Solution

(a) The stand taken by the banker in this case is not sustainable in the Court of law for the following reasons:
   (i) The paying banker should not have stopped payment of the cheque merely on the receipt of the telegram, which message, being unauthenticated, cannot be treated as a genuine one, in any case.
   (ii) Further, as per the banking practice, the bankers are required to act on the drawer's instruction to stop payment of a cheque only when such instruction has been received by him in writing, and duly signed by the drawer himself in strict conformity with his signature already on the bank's records.

(b) Under such circumstances, the paying banker is faced with a problem both ways; that is
   (i) If he pays the cheque, taking the information as unauthentic and, therefore, false; and
   (ii) If he does not pay the cheque, and returns it, instead, under the objection 'payment stopped by drawer', based on such message, though unauthenticated.

In the case (i) above, if he pays such cheque, and the message transpires to have actually been sent by or on behalf of the drawer, he may be held liable for having paid the cheque wrongfully. Thus, he may incur the following two liabilities, viz.,

- To refund the amount of the stopped cheque into the drawer's account for its wrongful payment; and

- To pay damages to the drawer of the cheque for wrongfully dishonouring any further cheque for insufficiency of funds in his account, caused by such wrongful payment of the stopped cheque, i.e. which could have been honoured if the stopped cheque would not have been paid.

As against this, in the case (ii) above, if the paying banker does not pay the cheque and, instead, returns it under the objection 'payment stopped by drawer', and the unauthenticated message later transpires to be a mischievous one, and not sent by the drawer, he (paying banker) will be held liable for paying damages to the drawer for having wrongfully dishonoured the cheque.

Keeping in view the aforementioned legal points of view, we will like to make the following suggestions to the paying banker when faced with such problems in the future:

(i) He must immediately make a precautionary noting in the ledger account of the respective drawer; so as to guard against an erroneous payment of the cheque, through an oversight, if it is presented for payment in cash or even through a banker;

(ii) He must simultaneously try to contact the drawer and advise him to send a letter duly signed by him to stop payment of the cheque, to enable him to note the 'stop payment' in the banks records, and act accordingly;

(iii) Further, if in the mean time, i.e. before receiving confirmation or otherwise from the drawer of the cheque, the paying banker must play safe and return the cheque under the objection 'drawer's confirmation required', instead of the objection 'Payment stopped by drawer'. This way the banker will neither be paying the cheque nor can he be held liable for having wrongfully dishonoured the cheque.

Problem 6

A paying banker had received a telegram from the drawer of a cheque to stop payment of a bearer cheque of a particular number. As the telegraphic message was not an authenticated one (i.e. it should have, instead, been sent by way of a letter duly signed by the drawer himself), he had ignored this message and had paid the cheque when it was presented for payment at the bank's cash counter. But when the drawer of the cheque visited the bank he was disgusted to find that the cheque, whose payment he had stopped by telegram, had already been paid by the bank.

(a) Do you think that the payment made by the banker in this case is a wrongful payment? If so, what specific penalties and/or damages will the paying banker incur in this regard?

(b) What specific suggestions will you like to give to the paying banker when faced with such problems in the future?

Give reasons for your answer

Solution

(a) The payment made by the banker in the instant case definitely falls in the category of a wrongful payment, because the telegram must have alerted the banker that the telegraphic message could as well be a genuine one, actually sent by the drawer. Therefore, he must have played safe, instead of ignoring the message and paying the cheque. He could have, instead, returned the cheque under the objection 'drawer's confirmation required', instead of the objection 'Payment stopped by drawer'. This way the banker will neither be paying the cheque nor can he be held liable for having wrongfully dishonoured the cheque.

Further, by wrongfully paying the cheque, payment whereof had already been duly stopped by the drawer; the paying banker will incur the following penalty and damage:

(i) He will have to refund the amount of the stopped cheque into the drawer's account for its wrongful payment; and

(ii) He will also have to pay damages to the drawer of the cheque for wrongfully dishonouring any further cheque for insufficiency of funds in his account, caused by such wrongful payment of the stopped cheque, i.e. which could have been honoured if the stopped cheque would not have been paid.

(b) Keeping in view the aforementioned legal points of view, we will like to make the following suggestions to the paying banker when faced with such problems in the future:

(i) He must immediately make a precautionary noting in the ledger account of the respective drawer; so as to guard against an erroneous payment of the cheque, through an oversight, if it is presented for payment in cash or even through a banker;

(ii) He must simultaneously try to contact the drawer and advise him to send a letter duly signed by him to stop payment of the cheque, to enable him to note the 'stop payment' in the bank's records, and act accordingly;

(iii) Further, if in the mean time, i.e. before receiving confirmation or otherwise from the drawer of the cheque, the paying banker must play safe and return the cheque under the objection 'drawer's confirmation required', instead of the objection 'Payment stopped by drawer'. This way the banker will neither be paying the cheque nor can he be held liable for having wrongfully dishonoured the cheque.

Problem 7

A banker had paid a cheque on 27th December 2008 drawn by Johnson. On 29th December 2008 he had received a letter from Johnson's son that, unfortunately, his father had expired on 25th December 2008. On receipt of this letter, the banker was very much perturbed that he had wrongfully paid a cheque by debiting the account of a deceased person. He has come to you to seek your expert opinion from you. What legal advice will you give to him? Give reasons for your answer.

Solution

We will advise him that he need not worry at all in this regard because, the payment made by him will not construe a wrongful payment. It will, instead, be considered as a rightful payment, as it had been paid by him before receiving the information about Johnson's death. This is so because, as provided in the Act, the paying banker must not make any payment from the account of his customer after he has received the notice regarding his (customer's) death. Conversely speaking, if the paying banker makes any payment on the account of the (deceased) customer, before having any knowledge of, or receiving the notice of, his customer's death, he will not be held liable for a wrongful payment. That is, all the payments made by the banker before receipt of such notice will be deemed to be a rightful payment.

Problem 8

A banker had paid a cheque on 5th January 2009 drawn by Robert. On 9th January 2009, he had received a letter from Robert's wife that, unfortunately, her husband had been admitted in a lunatic asylum on the 3rd January 2009. On receipt of this letter, the banker was very much perturbed that he had wrongfully paid a cheque by debiting the account of an insane person. He has come to you to seek your expert opinion from you. What legal advice will you give to him? Give reasons for your answer.

Solution

We will advise him that he need not feel perturbed at all in this regard because, the payment made by him will not construe a wrongful payment. It will, instead, be considered as a rightful payment, as it had been paid by him before receiving the information about the insanity of Robert. This is so because, as provided in the Act, the paying banker must not make any payment from the account of his customer after he has received the notice regarding his customer's insanity. Conversely speaking, if the paying banker makes any payment on the account of his insane customer, before having any knowledge of, or receiving the notice of, his customer's insanity, he will not be held liable for a wrongful payment. That is, all the payments made by the banker before receipt of such notice will be deemed to be a rightful payment.

Problem 9

A banker had paid a cheque on 19th January 2009 drawn by Remington. On 23rd January 2009 he had received a letter from the official receiver to the effect that Remington had been declared insolvent. Will the payment made by the paying banker, as aforesaid, be declared as a wrongful payment? Give reasons for your answer.

Solution

The payment made by the paying banker will not be declared as a wrongful one. It will, instead, be considered as a rightful payment, as it had been paid by him before receiving the notice of his insolvency. This is so because, as provided in the Act, the paying banker must not make any payment from the account of his customer after the receipt of the notice of the customer's insolvency. That is, the payments on his account must be stopped with immediate effect, after the receipt of such notice, but not earlier. This is so because, after a person is declared insolvent, all his properties, including his credit balances in his accounts with the various banks, are vested in the official receiver or assignee. Thus, such insolvent customer is no longer authorised to operate any of his accounts with the banks. But all the payments made by the banker before receipt of such notice will be deemed to be a rightful payment.

Problem 10

Waterman operates on a trust account with a bank by virtue of being one of the trustees thereof. He had deposited with the bank a cheque, drawn by him on the trust account, for credit of his savings bank account maintained at the same branch of the bank. The paying banker had accordingly, credited the amount of the cheque into his (Waterman's) savings bank account. Do you think the banker had done the right thing? Give reasons for your answer.

Solution

The banker had not done the right thing. This is so, because, Waterman was working as a trustee, and thus, he was operating in a fiduciary capacity. Further, if a trustee draws a cheque on the trust account to receive the payment apparently for his personal use, instead of for the use on behalf of the trust, it must give rise to a genuine doubt in the mind of the paying banker, and he should not make payment of such cheque by credit to the personal account of the trustee without making reasonable enquiry in this regard. Therefore, the paying banker should not have made payment of the cheque by credit to the personal account of Waterman, the trustee, without having satisfied himself beyond any doubt that the payment so requested by Waterman was a genuine payment actually meant for him personally.

Problem 11

A cheque had been presented to the paying banker after its usual banking hours. But when the banker was about to return the cheque under the objection 'cheques not duly presented', the payee of the cheque had requested the banker to pay the cheque as he was in an emergent need of money for the admission of his daughter in the school, and that day was the last date for paying the admission fees. The banker had developed some soft corner for the payee in difficulty, and accordingly, he had preferred to pay the cheque even after the business hours. But, just on the opening of the bank the very next day, the drawer of the cheque had come to the bank and had given a letter duly signed by him (containing all the relevant details of the cheque, like its date, name of the payee, and amount), requesting for stopping the payment of the cheque in question. When the banker informed him that the cheque had already been paid on the previous day, the drawer became furious and argued that the cheque had been issued by him late in the afternoon the previous day, well after the usual banking hours of the branch. Therefore, the banker could not plead that the cheque was paid during the usual banking hours of the branch. Will the paying banker get the protection granted under Section 85 in the instant case? Give reasons for your answer.

Solution

The paying banker will not get the protection granted under **Section 85** in the instant case, because the cheque had been paid after the bank's usual banking hours, whereby it will not constitute a payment in due course of business. Further, as the cheque had been paid to some person other than the drawer himself, outside the usual working hours of the bank, and the drawer had subsequently stopped the payment of the cheque, just at the opening of the bank on the next working day, the paying banker will be held liable for wrongful payment of the cheque, and may have to refund the amount of the cheque so paid, to the drawer, by crediting the amount back to the credit of his (drawer's) account.

Problem 12

Under what specific objection, in each case, may a paying banker return the following cheques which are presented for payment on 5th January 2009?

(a) A cheque dated 2nd January 2009 for Rs 10,000, when the credit balance in the account is Rs 9,000.
(b) A cheque dated 30th June 2008 for Rs 25,000, when the credit balance in the account is Rs 21,000.
(c) A cheque dated 9th January 2009 for Rs 1,000, when the credit balance in the account is Rs 900.
(d) A cheque is drawn by one of the operators on the joint account, which is to be operated by all the three account holders jointly.
(e) A cheque dated 3rd January 2009 for Rs 50,000, when the credit balance in the account is Rs 32,000, and some cheques and bills of exchange aggregating Rs 21,000 have already been sent by the bank on 30th December 2008 to some outstation for collection, the proceeds whereof, are yet to be realised.
(f) A cheque dated 3rd January 2009 wherein the name of the payee has been altered by the drawer himself from K.K. Banerji to read as S.K. Banerjee, but he has forgotten to sign under such alteration.
(g) A dividend warrant, crossed 'A/C Payee' and 'Not Negotiable', where the payee has forgotten to put his signature on the reverse of the instrument at the place specified for the purpose.
(h) On the cheque the amount payable is written in words as 'Rupees Seventy-five thousand' and in figures it is stated as 'Rs 65,000'.
(i) A cheque, crossed generally, is presented at the counter of the paying banker for payment in cash.
(j) A cheque, drawn on Allahabad Bank, Hazrat Ganj, Lucknow branch, is presented for payment at its Gomti Nagar, Lucknow branch.
(k) A cheque, where the drawer's signature on the cheque does not appear to be in strict conformity with the one already recorded with the bank.
(l) A cheque when its payment has been duly stopped (countermanded) by the drawer.
(m) Where the paying banker had come to know of the death of the drawer on 2nd January 2009.
(n) A cheque, made payable to Shusil, has been endorsed by the payee as 'Sushil'; this being the correct spelling of his name.

Solution

The paying banker may return the cheques which are presented for payment on 5th January 2009, under the following objections respectively:

(a) Under the objection like 'insufficient funds in the account', or 'no funds', or 'not arranged for', or 'refer to drawer'.
(b) Under the objection 'cheque is out of date' or 'cheque is outdated'. (In this case, the fact of there being insufficient funds in the drawer's account is immaterial, and will usually be avoided by the banker.).
(c) Under the objection 'cheque is post-dated'. (In this case, the fact of there being insufficient funds in the drawer's account is immaterial, and will usually be avoided by the banker.).
(d) Under the objection 'cheque must be drawn by all the account holders jointly' or 'signature of the remaining account holders also required'.
(e) Under the objection 'effects not yet cleared: please present again'.
(f) Under the objection 'alteration requires full signature' (as such alteration comes within the category of material alterations).
(g) Under the objection 'payee's separate discharge to the bank required'.
(h) Under the objection 'amount in words and figures differs'. (This is the practice generally being followed by the banks, despite the fact that Section 18 provides that in such cases the amount written in words shall be taken as the amount ordered or undertaken to be paid.
(i) Under the objection 'crossed cheque: must be presented through a bank.
(j) Under the objection 'not drawn on us', provided even one of its two branches is not covered under its internet banking system.

(k) Under the objection 'drawer's signature differs'.
(l) Under the objection 'payment stopped by the drawer'.
(m) Under the objection 'drawer is dead' or 'drawer deceased'.
(n) Under the objection 'Endorsement irregular', because the spelling of the name of the payee of the cheque does not exactly match with every letter of such name of the payee written on the cheque by the drawer.

Problem 13

(a) Wilson had issued a cheque for Rs 10, 000 in favour of William. But later he had found that on that day he had a sum of Rs 9,000 in his account. Therefore, to avoid the criminal penalties under Section 138, he had stopped payment of the cheque that very day. The cheque, when presented for payment, was, accordingly, returned unpaid by the paying banker under the objection 'payment stopped by drawer'. Will Wilson succeed in avoiding the criminal penalties under Section 138?
(b) Will it make any difference if the drawer of the cheque, instead of stopping the payment of the cheque, would have personally requested the payee not to present the cheque?
(c) What specific expert opinion will you give to the drawer of the cheque to do in the case (b) above, other than requesting the payee not to present the cheque?

Give reasons for your answer in each case.

Solution

(a) Wilson will not succeed in avoiding the criminal penalties under Section 138. This is so because, even in the case where the payment of a cheque has been subsequently stopped by the drawer, such stopped cheque will also be deemed to have been returned for want of funds, if such also happens to be the case. Thus, the act of stopping payment of the cheque on the part of the drawer, who had insufficient funds in his account that day, will also be deemed to have been returned for want of funds, and accordingly, the provisions of Section 138 will apply in the instant case.
(b) It will not make any difference even if the drawer of the cheque, instead of stopping the payment of the cheque, would have requested the payee not to present the cheque for payment. This is so because where the drawer of the cheque personally makes a request to its payee, not to present the cheque for payment; it will also be deemed to have been returned for want of funds, if such also be the case. This contention is based on the judgement in the case titled **Modi Cement Ltd vs Kuchil Kumar Nandi.**
(c) We will advise the drawer of the cheque not to issue any cheque in the future unless there are sufficient funds in his account to honour the cheque by the bank. Further, in the instant case at (b) above, we will advise the drawer of the cheque to issue a post-dated cheque, by which date he expects to receive funds from some known sources, instead of personally requesting the payee not to present the cheque for payment. This way he will be able to avoid the penalties stipulated under Section 138.

Problem 14

Krishna Electronics had filed a complaint under Section 138 on the ground that the cheque dated 21.10.2008 for Rs 25,550, was dishonoured on 27.10.2008. On such dishonour of the cheque, Krishna Electronics had issued a notice to the drawer on 23.11. 2008. Such notice was received by the drawer on 27.11.2008. On 10.12.2008 Krishna Electronics had filed the petition before the Court complaining of the offence committed by the drawer (petitioner) under Section 138 (c). The drawer of the cheque had pleaded that as the complaint had been filed in the Court after the time limit prescribed for the purpose had expired, the case is not sustainable in the Court. Do you agree? Give reasons for your answer.

Solution

When we closely analyse and calculate the period of limitation, we find that Krishna Electronics had issued a notice to the drawer on 23.11.2008 [i.e. within 30 days of the cause of action (dishonour of the cheque) arising on 27.10.2008]. Further, the notice was received by the drawer on 27.11.2008. Therefore, after 27. 11.2008, he

had the time to pay the amount of the cheque within 15 days. Thus, the limitation will start in this case from the date of expiry of 15 days from 27.11.2008, i.e. with effect from 12.12.2008, it being the 16th day counted from 27.11.2008. The complaint was filed in this case on 10.12.2008, that is, within the limitation period, which continues upto 11.12.2008 and expires only on 12.12.2008.

The 16th day from 27.11.2008 has been calculated in the following manner:

Step 1: The remaining days in the month of November, excluding the starting point (i.e. 27.11.2008) are 30 days less 27 days = 3 days;

Step 2: By taking 12 days from the month of December, to be added to the remaining 3 days in the month of November, so as to come to 15 days from 27.11.2008, we come to 12.12.2008.

Thus, the complaint filed upto 12.12.2008 will be deemed to have been filed within the limitation period; and the limitation will start from the following day of 12.12.2008. That is, the limitation period will start from 13.12.2008. Accordingly, the suit filed in the instant case on 10.12.2008 will be deemed to have been filed within the limitation period. Therefore, the plea of the drawer of the cheque that the complaint had been filed in the Court after the time limit prescribed for the purpose had expired is ill-conceived and miscalculated. This contention is based on the judgement given by the Andhra Pradesh High Court in the case titled **M/s Mahalakshmi Enterprises, Calicut, Kerala and Another vs M/s Sri Vishnu Trading Company and Others, AIR (1991) A.P. 74**.

Problem 15

Peter had issued a cheque for Rs 10,000 in favour of John, which was dishonoured by the paying banker under the objection 'Refer to drawer'. Thereafter, John had issued a notice to Peter to pay to him the amount of Rs 10,000 within 15 days from the receipt of the notice, but Peter had failed to do so. John, thereafter, had filed a complaint in the Court of law under Section 138. On realising the seriousness of the matter, Peter had sent a cheque for Rs 5,000 to John, in part payment of the amount of the dishonoured cheque for Rs 10,000, which john had encashed at the bank's cash counter. Peter thought that, this way, he had successfully avoided the penalties under Section 138. Do you agree with the contention of Peter?
Give reasons for your answer.

Solution

We do not agree with the contention of Peter in this case, for the following reasons:
Section 138 (b), *inter alia* (among other things) requires that, on dishonour of the cheque, the payee of the cheque shall make a demand from the drawer for the payment of the 'said amount of money', by giving a notice to the drawer in writing. The clause 'said amount of money' may be interpreted to mean the 'full amount mentioned in the cheque'. This clause, thus, makes it amply clear that, in this context, the drawer will have to pay the entire amount of money mentioned in the cheque in full. Conversely speaking, any part-payment of the cheque will not have any effect on the cause of action and legal right of such payee of the dishonoured cheque, to file a complaint in the Court under **Section 138**. That is, by making a part-payment of the amount of the dishonoured cheque, its drawer cannot avoid or evade the prosecution under this Section. This is so because, if part-payment could have protected the drawer of such dishonoured cheque from prosecution under this Section, it would prove to be a very easy and handy measure for any unscrupulous person to frustrate the very purpose of **Section 138**, and stipulating the punishment thereunder).

It may be further stressed here that, even if the drawer of such dishonoured cheque would have issued another cheque, in part-payment of the amount of the dishonoured cheque, and even if the payee of the dishonoured cheque would have even encashed such other cheque, after his having already filed the complaint in the Court, the earlier position will not get altered or even softened in any manner, whatsoever.

This point may be well asserted by taking the example of the criminal offence of theft, committed under the Indian Penal Code (IPC). If the thief, after being caught, returns all the goods stolen by him, he will still be convicted for his act of theft. Accordingly, the act of making of a part-payment by the defaulting drawer of the dishonoured cheque will not be of any effect and consequence in regard to the question of maintainability of the complaint in the Court.

Problem 16

During the course of a summary trial, after hearing the parties to the case, the Metropolitan Magistrate, trying the case under Section 138, felt that the nature of the offence in the case was such that the sentence of imprisonment for a term exceeding one year, and/or a fine exceeding Rs 5,000, may have to be passed to meet the ends of justice.

(a) What action the Metropolitan Magistrate will have to take in such cases?
(b) Can the Magistrate recall any of the witnesses who have already been examined, and thereafter, proceed to hear or even rehear the case in the manner provided under the Code of Criminal Procedure, 1973?

Solution

(a) In such a situation, the Metropolitan Magistrate will pass an order to the effect that the case should not be tried summarily, but otherwise, i.e. in the usual manner. Further, he will also have to record such order, in writing, in the case file.
(b) In such an event, the Metropolitan Magistrate can also recall any of the witnesses, who have already been examined, and thereafter, proceed to hear or even rehear the case in the manner provided under the Code of Criminal Procedure, 1973.

Chapter Twenty Three

The Collecting Banker

"*Money in the bank is like toothpaste in the tube. Easy to take out, hard to put back.*
Earl Wilson

There is a way of transferring funds that is even faster than electronic banking. It's called marriage.
Donald H. Mcgannon"

23.1 Who is the Collecting Banker?

One of the main functions of a bank is to work as a 'collecting agent' of its customers, i.e. to receive the negotiable instruments from its customers and to collect them on their behalf from the paying banker, and to credit the proceeds of the instrument so collected, to the account of its respective customer. Such banker is referred to as a 'collecting banker'. Further, the collecting banker is also considered to be a link between his customer and the 'paying banker', i.e. the banker on whom the instrument is drawn on, i.e. the drawee banker. Such instruments (cheques) may be drawn:

(a) On the branch of the collecting banker itself, or
(b) On a local branch of the same bank, or of another bank, or
(c) On an outstation branch of the same bank, or of another bank.

(a) Where the instrument (cheque) is drawn on the branch of the collecting banker itself, the proceeds of the instrument are credited to the customer's account the same day, as its amount is debited to the account of its drawer, which is also maintained at the same branch.
(b) Where the instrument (cheque) is drawn on a local branch of the same bank, or of another bank, it is sent to the drawee bank through the local clearing, and the proceeds of the cheque are usually credited to the customer's account on the third day.
(c) If the cheque is drawn on some outstation branch of the same bank, or of another bank, it is sent for collection to that outstation branch, and when the advice or amount of such payment is received from

the drawee outstation branch, the proceeds thereof is credited to the account of the respective customer of the collecting banker. Till the recent past, the payment of such outstation cheques was usually received by the collecting banker in about a fortnight or even in a month or so. But now-a-days, with the introduction of internet banking, the proceeds of the cheques, both local and outstation, if drawn on some specified branches of the same bank, are credited to the customers' accounts the same day instantaneously, as is the case with the cheques drawn on the branch of the collecting bank itself.

It may, however, be mentioned here that it is not obligatory on the part of the banker to necessarily and compulsorily work as a collecting banker. But then, as it has, as of now, become a common practice to mostly issue crossed cheques, the bankers cannot avoid to perform their function as a collecting agent of their customer, as otherwise the customers will be put to a great but avoidable hardship. Here, it may be pertinent to point out that, now-a-days, all the payments for Rs 2,500 and above are statutorily required to be made, not in cash but only by way of crossed cheques, and that too, mostly crossed as 'account payee'. It is, therefore, for this main reason that Sir John Peget in his book: 'Paget's Law of Banking', has observed that 'the collection of such (crossed) cheques must be regarded as an inherent part of a banker's business'.

In this connection, we must also remember that while collecting the cheques on behalf of its customers, the bankers act either

(a) As a holder for value, i.e. as a 'holder in due course', or
(b) Merely as a collecting agent of its customer, i.e. as a 'holder'.

Let us now discuss the material differences in regard to the legal position and rights enjoyed by the banker under these two different capacities.

23.2 Banker as a 'Holder for Value', i.e. as a 'Holder in Due Course'

A banker may be considered as a 'holder for value' under the following conditions:

(i) Where the banker pays the full amount of a cheque drawn on one of its own local or outstation braches, or some local or outstation branch of another bank, before actually receiving the advice about the payment of the amount payable thereon, he is deemed to be a holder (of the cheque) for value.

(ii) Similarly, the banker is deemed to be a holder (of the cheque) for value, where the customer deposits such a cheque with his banker, and the banker, expressly or impliedly, allows him to draw money against such cheque, even before its proceeds have actually been received by his banker and credited to his account [resulting in an overdraft (overdrawing) in his account]. In a case titled **A. L. Underwood Ltd vs Barclays Bank (1924),** Lord Atkin had observed: ' To constitute value, there must be, in such a case, a contract between banker and customer that the bank will, before receipt of the proceeds, honour cheques of the customer drawn against cheques.'

(iii) Further, where the banker allows a specific Demand Drafts Purchased (DDP) limit, against execution of the required agreement documents, to his customer for a certain amount, say, for Rs 50,000, the proceeds of the cheques deposited by the customer concerned for credit of his account is immediately credited to his account, of course, to the extent of the DDP limit, i.e. upto Rs 50,000 only. In such cases also the banker is deemed to be a holder (of the cheque) for value.

(iv) Besides, the banker may, in some genuine cases, agree to credit the proceeds of the cheques immediately on the same day when it is deposited by some of its known and valued customers, before receiving the proceeds of these cheques from the paying banker. This may be done by the banker as a special gesture even in the cases where there is no DDP limit already sanctioned in favour of such customer. This is usually done by the banker only in the cases where he knows for sure that if the cheque were to be returned unpaid, the customer concerned will definitely replenish his account with the amount of such cheques, returned unpaid. In such cases also, the baker will be deemed to be a holder (of the cheque) for value.

(v) Where the banker has noted a lien in the customer's account for the amount of the cheque, he is deemed to be a holder (of the cheque) for value, to the extent of the amount of such cheque. Thus, when the cheque, so deposited with the bank for collection, is returned unpaid, for some reason or the other, the banker, by virtue of having notes a lien on the account, can recover the same by debiting the customer's account with the amount of the cheque paid into the account earlier.

23.2.1 Privileges of a Banker for Value

The collecting banker, as a holder for value, enjoys a special position of privilege in the cases where the endorsements (and not the signatures of its drawers) on the cheques are forged. In the cases where the endorsement is a forged one, the collecting banker will also be held liable to the true owner the cheque, as is usually the case. But then, there is a difference in the sense that the banker, as holder for value, will be enjoying the legal right to recover the amount from the endorsers subsequent to the forged endorsement. In this connection, Sir John Paget has remarked that apart from the question of a forged instrument, if the customer has either no title to the cheque or his title is defective, the banker is a holder in due course, with good independent title against all the prior parties on the cheque.

(For a detailed discussion on the distinguishing features between a 'holder' and a 'holder in due course', please refer to Chapter 19, Section 19.9).

23.3 Banker as a Collecting Agent, i.e. as a 'Holder'

We have observed in the preceding paragraphs that, when the banker, on receipt of the cheques, deposited by his customer with him for their realisation from the paying banker, credits the proceeds of such cheques, even before the proceeds of the cheques are received by the collecting banker from the paying banker, such banker is known as a 'holder for value' in regard to such cheques. As against this, when the banker credits the proceeds of the cheques, deposited with him by the customer, in the account of the customer, not before but only after the actual realisation of the proceeds of the cheques from the paying banker, such banker is referred to as a collecting agent and just a 'holder' of the cheque.

Further, the banker, acting as a collecting agent (i.e. the holder), does not enjoy a better title to the cheque than the title of his customer. Accordingly, the banker, who collects the proceeds of a cheque on behalf of his customer, where the cheque actually belonged to another person, will be held liable for conversion of the amount received by him, unless he can prove to the following effects:

(i) That he had acted in good faith and without negligence; and
(ii) That the cheque was already crossed before he had received it from his customer.

23.4 Statutory Protections Enjoyed by a Collecting Banker

A collecting banker enjoys certain statutory protections under **Section 131,** which provides: 'A banker, who has in good faith and without negligence, received payment for a customer of a cheque crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.'

Let us now try to understand and appreciate the legal provisions of the operating clauses contained in **Section 131** a little more closely and analytically.

(i) Only for Crossed Cheques

As provided under **Section 131**, the protection to the colleting banker is available to him in respect of only such cheques which have been received by him duly crossed, generally or specially, well before it was deposited with him for the purpose of its collection. Conversely speaking, such protection will not be available to him in

respect of the cheques which were received by him for collection in an open (i.e. uncrossed) condition. Alternatively speaking, such protection will not be available to him (collecting banker) in respect of the cheque which, though received by him for collection in an open (i.e. uncrossed) condition, it was duly crossed by him (collecting banker) after its receipt from the customer.

It may be further noted here with due care that the crossing stamp of the collecting banker (bearing the name of the bank, between two transverse parallel lines), which is invariably affixed by him on all the cheques, including the open cheques, immediately on their receipt for collection, will not tantamount to convert an open cheque into a crossed one. The sole purpose of such crossing stamp is that in case it were lost and fallen in some unauthorised and unscrupulous hands, such person will not be able to encash such open cheque bearing the crossing stamp of the respective bank, unless it is presented through such bank or else only after getting its crossing stamp duly cancelled by an authorised officer of such bank on behalf of the bank and under his full signature above the bank's rubber stamp.

Our Comments

This may be so because it is not necessary to receive the amount of an open cheque only through a bank account. That is, an open cheque may be encashed over-the-counter of the paying banker, without it being compulsorily put through a bank account.

But then, how inconvenient will it be for the payee, residing in Lucknow, to receive payment of an open but outstation cheque, say, drawn on a bank in Hyderabad. Is he supposed to go all the way to Hyderabad to encash the cheque over-the-counter there? He will definitely find it far more convenient to get it collected through a banker.

It may be further noted with sufficient interest here that how would it be incontrovertibly proved that the cheque was not crossed at the time of its deposit with the collecting banker, but the collecting banker himself had crossed it after having received it in an open form when it was lodged with him.

Further, the conversion of an open (uncrossed) cheque does not amount to a material alteration. Therefore, any one can cross an uncrossed cheque. So, the rationale behind excluding only the collecting banker from doing so has not been understood by us.

However, leaving the aforementioned comments aside, it may be pertinent to mention here that the collecting banker, in such cases, may be well-advised to take more than ordinary care to request the payee of the cheque to first cross it and only thereafter to deposit it for collection, so that the protection granted under **Section 131** may become applicable even in such cases.

(ii) Only while Working as a Collecting Agent

Further, the protection under **Section 131** is available to the banker only when he has accepted the crossed cheque, as a collecting agent of the customer. Conversely speaking, such protection is not available to the collecting banker when he receives such cheques from his customer as a 'holder for value', i.e. when he credits the account of the customer immediately on its receipt, with or without a DD purchased limit sanctioned in his (customer's) favour, or in adjustment of an overdraft already existing on the account of the customer (which involves his own interest in realising his dues on such overdrawn account of his customer), or where he had a lien noted in the customer's account for the value of the such cheque. Thus, when the banker takes delivery of the cheque as its independent holder, i.e. where it is negotiated in his favour, he cannot be deemed to be collecting the cheque on behalf of his customer, but, instead, for receiving the amount of the cheque in his personal capacity. Accordingly, he cannot plead statutory protection under **Section 131**.

For a detailed discussion on the circumstances under which a banker may be considered as a 'holder for value', please refer to **Section 23.2** in this chapter.

(iii) In Good Faith and without Negligence

Further, the protection under **Section 131** is available to the collecting banker only when he has accepted and

received payment of the crossed cheque, as a collecting agent of the customer, in good faith and without negligence. Here, the onus (burden) of proving the fact that he has received the payment of the cheque 'in good faith' as also 'without negligence', squarely lies on the collecting banker alone, who is claiming the protection under **Section 131**. However, what factors will constitute the element of negligence on the part of the collecting banker will depend upon the facts, circumstances, and merit of each case.

Lord Dunedin in the case titled **Commissioner of Taxation vs English, Scottish, and Australian Bank Ltd.**, has tried to specify the presence of the following elements by way of the test of negligence:

'Where the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so out of the ordinary course that it ought to have aroused doubts in the banker's mind and caused them to make enquiry.' Thus, in such cases, which should ordinarily give rise to some doubt in the mind of the banker regarding the genuineness or otherwise of the payee or the holder of the cheque concerned, and despite such circumstances , he does not hold any enquiry in this regard, he will be held liable for having been negligent.

For example, where the payee or the holder of a cheque is operating in some fiduciary capacity – like the director of a company, or a partner of a partnership firm, or as the holder of a power of attorney for discharging some particular responsibilities on behalf of the principal – and he draws a cheque in his own favour and comes to the bank to deposit such cheque for credit to his own personal account, and not in the account of the company or the firm, etc., it must definitely give rise to some genuine doubts in the mind of the collecting banker (as also of the paying banker), and thus, making it obligatory on the part of the banker to make due enquiry in this regard. Further, the payment of such cheque, in cash or even through the credit of the account of such doubtful payee or holder of the cheque, should not be made unless he (banker) gets fully satisfied, beyond any doubt, about the genuineness of such transaction. If he (banker) fails to do so, he will be held liable for being negligent, and thus, will not get any protection under **Section 131**.

Let us now authenticate such observations by citing some case laws in this regards.

Example

In the case titled **A. L. Underwood Ltd vs Bank of Liverpool and Martins and Barclays Bank,** Underwood, was the only director of the company, and was holding all the shares of the company, except one single share. He had endorsed a large number of cheques, all of which were payable to the company or to its order, and had lodged all such cheques for credit of his own personal account with the bank, and not for the credit of the company's account. It was held that the bank had acted negligently in this case.

But the legal position is not as simple as it so appears.

It is so because of the following reasons:

While on the one hand, 'it is not to be expected that the officials of banks should also be amateur detectives' (as has been observed in the judgement delivered in the case titled **Lloyds Bank Ltd vs The Chartered Bank of India, Australia, and China**), on the other hand, he cannot be supposed to presume that all the persons who come to the bank are necessarily honest. That is to say that he must be discreet while taking decisions in such tricky matters.

It will, therefore, be pertinent to cite the facts of some illustrative Case Laws, which may help us in forming some relevant and useful ideas as to what would amount to negligence on the part of the bank.

23.5 Illustrations of Negligence by Banks through Some Case Laws

23.5.1 Failure to Obtain Proper Introduction

(i) Where a person, not already known to the bank, opens an account with it, on the basis of giving the reference of a stranger (i.e. a person unknown to the bank), and the banker opens the account, without

taking the necessary steps to verify the reference of such stranger referee, the banker will be held liable of negligence on his part.

The bank was held being negligent on the aforementioned ground in the case titled **Guardians of S. Johan's Hampstead vs Barclay's Ltd (1923).**

(ii) Further, in case a banker opens an account without obtaining a proper reference at all, he will be held liable of being negligent **(Landbroke vs Todd).**

(iii) Similarly, an introduction given by an authorised signatory of an account holder, and not by the account holder himself, cannot be considered as a proper introduction. Thus, by opening a new bank account on the basis of such introduction, the bank will be deemed to have acted negligently. **[Vysya Bank Ltd. vs Indian Bank, AIR (1988) 256 mad].**

23.5.1.1 However, these days the rules have become even more stringent for opening a new account in that, besides insisting for a reference from a person already known to the bank (by virtue of already maintaining an account with the bank, at the same branch or at another branch thereof, for the last six months or more), the person, intending to open a new account with the bank, is required to give the following documents, to prove his identity:

(i) Two copies of his recent passport size photograph (of all the joint account holders, while opening joint accounts),

(ii) A copy of any one of the following documents:
   (a) His (student's/employee's) identity card (ID card), issued by his academic institution or by his employer; as the case may be, or
   (b) His passport,
   (c) His voter identity card, or
   (d) His Permanent Account Number (PAN card);

(iii) The proof of his address by way of submitting a copy of any one of the following documents:
   (a) His latest-paid electricity bill,
   (b) His latest-paid water tax bill,
   (c) His latest-paid telephone bill,
   (d) His latest-paid LIC premium deposit receipt, or
   (e) Particulars of any credit card, or the like.

23.5.2 Failure to take due care while Opening a New Account

In the case titled **United Bank of India vs Bank of Baroda, AIR 1997 Mad. 23**, a forged instrument (demand draft) was collected by the bank on behalf of its customer, whose account was opened without due care (like getting and verifying reference, and so on), the collecting banker was held as being not entitled to claim protection under **Sections 131** and **131A**.

23.5.3 Verification of Endorsements

In the cases where there is some discrepancy in the endorsement, like where the mode of endorsement by the payee does not match, word for word, with the name of the payee written on the cheque, the collecting banker will be held by the Court as being negligent, as was done by the Court in the case titled **Babins Junior and Sims vs London and South-Western Bank Ltd (1910).**

As has been discussed in Chapter 20, in the cases where, on the instrument, made payable to order, the name and/or designation of the payee or the endorsee has been wrongly mentioned, or else where his name has been wrongly spelt, he is required under law to sign thereon in the same manner as has been mentioned in the instrument. This is so because one of the ingredients of a 'payment in due course' (and similarly, in the

case of an 'endorsement in due course') is that it must be made according to the apparent tenor of the instrument. But then, such payee or the endorsee has the option of writing his correct name and/or his designation also, under his correct (proper) signature (endorsement), if he so desires.

(***A detailed discussion on 'payment in due course of business', appears in Section 22.4 of the preceding Chapter 22 of this book.***)

23.5.4 Overlooking an Apparent (*Prima Facie*) Warning

The circumstances, under which an instrument may be said to be containing a *prime facie* warning, have been elaborated by Lord Wright in the case titled **E. B. Savory and Company vs Lloyds Bank (1933),** in the following words:

'The most obvious circumstances which should put the banker on his guard (apart from manifest irregularities in the endorsement and such like) are where the cheque bears on its face a warning that the customer may have misappropriated it, as for instance, where a customer known to be a servant or agent pays for collection a cheque drawn by a third party in favour of his employer or principal. Such a case carries even a clearer warning if the cheque is endorsed per pro, the employer or principal by the servant or agent.

A second type of case is where a servant steals cheques drawn by his employer and pays them or procures their payment into his own account.

In all these cases, the cheque, in itself, apart from knowledge possessed of the customer's position, indicates the possibility or even probability that the servant or agent may have misappropriated it and hence the bank may be converting it.'

In view of the aforementioned succinct remarks by Lord Wright, where a solicitor draws cheques on the account of his client on the strength of the power of attorney and pays them into his own personal account, the banker, who collects them for him, will be held liable and guilty of negligence. This observation is based on the judgement delivered in the case titled **Midland Bank Ltd vs Reckitt**, wherein it was held that, under such (aforementioned) circumstances, there was sufficient notice, on the face of the cheque itself, that the solicitor was applying the money of the plaintiff (the client of the solicitor) to his private purpose.

Likewise, where a cheque is drawn in favour of a partnership firm and is endorsed by one of the partners of the firm on behalf of the firm, and it is deposited with the bank for collection and crediting the proceeds thereof into the personal account of the partner (instead of into the firm's account), the collecting banker will be held negligent by the Court if he credits the proceeds of such cheque into the personal account of that partner. Such was the judgement declared in the case titled **Bevan vs National Bank Ltd. (1906).**

23.5.5 Per-pro Endorsement

If a person, like a branch manager, is authorised to draw per-pro cheques on behalf of a company, and he draws cheques payable to 'ourselves' (i.e. to the company) or in his own favour, and deposits these cheques with the bank for credit of the proceeds of such cheques to his personal account (instead of to the account of his company), and the bank credits the proceeds of such cheques into the account of such manager, it will be held by the Court that the bank had acted negligently. The decision delivered in the case titled **Moerson vs London County and Westminster Bank Ltd. (1914),** was based on the aforementioned legal principle and practice.

23.5.6 Unknown or Improper Endorsement

If a banker confirms the endorsement on a cheque, given in a language not known to him (banker), for example in Tamil, and such endorsement later transpires to be improper (e.g., not being in an strict conformity

with the endorsement, as written on the cheque), the collecting banker will be held as being negligent and thus, not entitled to claim protections given in **Section 131**.

23.5.7 Crediting Cheques Crossed 'A/C Payee' into a Third Party's Account

As we have discussed earlier in Chapter 19, a cheque crossed 'Account Payee' must be credited to the account of the payee only - such being the specific instruction given by the drawer in this regard, by crossing the cheque as such. Conversely speaking, the proceeds of an 'A/C Payee' cheque must not be credited to the account of any third party. Thus, in the case titled **House Property Company of London Ltd. vs London County and Westminster Bank Ltd. (1915),** wherein an 'A/C Payee' cheque was collected on behalf of a third party (other than the payee) and the amount thereof was credited to the account of such third party, without making any enquiry by the collecting banker in this regard, he (collecting banker) was held guilty of negligence, and thereby also liable for conversion of the amount.

23.5.7.1 'Not Negotiable' Crossing

But in the case of a 'Not Negotiable' crossing, Sir John Paget has so succinctly observed that 'the not negotiable crossing has nothing to do with the collecting banker, or he (collecting banker) with it (the 'Not Negotiable' crossing). It is because it would be an impossible burden on the banker to investigate titles prior to that of his customer.

23.6 Duties and Responsibilities of a Collecting Banker

23.6.1 Exercising Due Care and Diligence

The collecting banker, by virtue of being a collecting agent of his customer, is required to exercise due care and diligence, while collecting the cheques deposited with it by its customers for such purpose. Conversely speaking, if the collecting banker fails in his duty (of exercising due care and diligence), and his customer incurs some loss on this account, he (collection banker) will be held liable to compensate such loss sustained by his customer. This principle has been doubly confirmed by the judgement given in the case titled **Formen vs Bank of England.** The facts of the case are as follows:

A customer of the Bank of England had deposited a cheque for $ 500 drawn on a bank in Norwich, alternatively payable in London. But, in utter disregard to the usual banking practice, the collecting banker had got this cheque cleared through the local clearing. Thus, the amount of the cheque was debited to the customer's account the same day. In case the cheque would have been sent for collection to the bank's branch in Norwich, instead, as per the usual banking practice in such cases, it would have taken some more time when the cheque would have been cleared by its Norwich branch, by debit to the customer's account. On such presumption, the customer had issued another cheque, drawn on this branch itself. But, when the cheque was presented to that branch, the cheque was dishonoured by the bank due to insufficient funds in the customer's account, as the amount of the previous cheque had already been (wrongly) debited to the account, on being cleared through local clearing, instead of through the Norwich branch, which was against the prevalent banking practice in this regard. In this case, the Court had held the collecting banker liable for paying the damages to his customer.

23.6.2 When to Present Cheques Received for Collection?

The colleting bankers are required to present the cheques received for collection latest by the next working day, after the date of its receipt by them. However, in the cases where both the collecting banker and the

paying banker are located in the same city, the collecting bankers generally present such cheques for collection on the same day on which they are received, or latest on the very next working day. As against this, in the cases where the collecting banker and the paying banker are located in two different cities, the collecting banker is required to send the cheque to his own outstation branch on which the cheque is drawn, or else to his agent located in that city, either on the same day on which it is received, or latest on the very next working day.

23.6.3 When to Send Notice of Dishonour

The colleting banker is required to exercise due care and diligence in intimating his customer about the dishonour of the cheque deposited by him for collection, such that the customer may promptly proceed to recover the amount of such dishonoured cheque from its drawer or the other parties liable thereon. Besides, it must also be noted here that the same rules that are applicable in cases of collection of the cheques (as regards the time of sending them for collection), are equally applicable in the cases of sending the notices of dishonour of the cheques, too

23.7 Position of a Bank Acting Both as a Collecting Banker and as a Paying Banker

Let us now examine as to what will be the position of a banker who acts both as a 'Collecting Banker' as also as a 'Paying Banker' at the same time.

As we have seen in the preceding paragraphs, the collecting banker gets the protection under **Section 131**, when he acts without negligence.

Further, as discussed in Chapter 22, a paying banker gets the protection under **Section 85**, when he makes the payment in due course of business. Further, under **Section 10**, the term 'in due course of business' has been defined as the payment made 'in good faith and without negligence'.

Thus, we observe that in both the cases, i.e. when the banker is acting both as a 'Collecting Banker' as also as a 'Paying Banker' at the same time, the protection will be available to the banker only when he acts without negligence. Conversely speaking, the protection under the Act will not be available to the banker, in both the cases, when he acts with negligence. Thus, in both the cases, the protection under the Act will not be available to the banker if the element of negligence is present in both or any one of these two cases.

23.8 Provisions in English Law when a Bank Acts Both as a Collecting Banker and as a Paying Banker

Under **Section 60** of the Bills of Exchange Act, 1882, applicable in England, the protection is given to the banker if he pays a cheque 'in good faith and in the ordinary course of business'. Further, the term 'ordinary course of business' has been interpreted to mean that the payment is made in accordance with (and not contrary to), the established and prevalent practice or custom of the banks.

The payment will be considered to have been made contrary to the established and prevalent practice or custom of the banks in the following cases:

(i) When a crossed cheque, required to be credited to the account of its payee or its holder, and not to be paid in cash over the counter, is paid in cash over the counter;
(ii) When the payment is made after the usual banking hours of the bank concerned; and
(iii) Where a large sum of money has been paid to a person who looked suspicious.

In the aforementioned cases, the payment will not be considered to have been made in the ordinary course of business, and accordingly, the bank will not get any protection under **Section 60** of the Bills of Exchange Act, 1882, applicable in England.

Thus, it may be observed and inferred that the presence of the element of negligence on the part of the paying banker will not make him liable, and the payment will be considered to have been made in the ordinary course of business, if the same has been made in accordance with (and not contrary to), the established and prevalent practice or custom of the banks (notwithstanding the fact that the paying banker was negligent, in some way or the other).

It may, however, be remembered with care that in the aforementioned circumstances the paying banker will get discharged of his liabilities, if he had made the payment in due course, even if he had been negligent in making such payment. But, if the collecting banker (as against the paying banker) is found to be negligent, he will be held liable for a wrongful payment all the same. This view is based on the judgement delivered in the case titled **Worshipful Company of Carpenters vs British Mutual Banking Company Ltd., 1938.**

23.9 Position of Bankers Collecting Bills of Exchange

As we have observed, the protection under **Section 131** is available to the collecting banker only and exclusively in the cases of collection of cheques. Thus, conversely speaking, such protection is not available to the collecting banker in the cases of collection of bills of exchange. But then, as the business pertaining to the collection of bills comprises a large percentage of the banking transactions, no bank can afford to lose such business. But, in view of the extent of risks inherent in the business of collection of bills, the collecting banker will be well advised to exercise more than ordinary care while transacting such business, i.e. operating as a collecting banker of bills of exchange.

For example, he must examine the title of the depositor of the bill with more than ordinary care. This is so because, in the absence of the protection available under **Section 131,** in regard to collection of bills, the true owner of such bill can claim the amount of the bill from the collecting banker, if and when the title of the bank's customer to the bill in question is found to be defective. But then, the collecting banker, in turn, can recover the amount of the bill from his customer who had deposited the bill and obtained its payment, though his title to the bill was not in order.

But again, with a view to play safe now rather than to feel sorry later, the bank will do well if it will prefer to accept bills for collection only on behalf of well-known and trusted parties, having satisfactory dealings with the bank for quite some time. Further, in regard to new accounts, such business should normally be avoided, so as to avert avoidable risks; unless the new account has been opened with the reference given thereto by some well-known and trusted parties.

Let us Recapitulate

A 'collecting banker' is one who receives the negotiable instruments from its customers and to collect them on their behalf from the paying banker, and to credit the proceeds of the instrument so collected, to the account of its respective customer. He is also a link between his customer and the 'paying banker', i.e. the banker whom the instrument is drawn on, i.e. the drawee banker. Such instruments (cheques) may be drawn:

(a) On the branch of the collecting banker itself, in which case the proceeds of the instrument are credited to the customer's account the same day, as its amount is debited to the account of its drawer, which is also maintained at the same branch.

(b) On a local branch of the same bank, or of another bank, in which case it is sent to the drawee bank through the local clearing, and the proceeds of the cheque are usually credited to the customer's account on the third day.

(c) On an outstation branch of the same bank, or of another bank, in which case it is sent for collection to that outstation branch, and when the advice or amount of such payment is received from the drawee outstation branch, in about a fortnight or even in a month or so, the proceeds thereof is credited to the account of the respective customer of the collecting banker.

But, in the cases where both the other local branch or the outstation branch of the same bank are connected on line, the proceeds of the cheques are credited to the customer's account the same day.

The Collecting banker is considered as a **'Holder for Value',** i.e. as a **'Holder in Due Course'** under the following conditions:

(i) Where the banker pays the full amount of a cheque drawn on one of its own local or outstation braches, or some local or outstation branch of another bank, before actually receiving the advice about its payment.
(ii) Where the customer deposits such a cheque with his banker, and the banker, expressly or impliedly, allows him to draw money against such cheque, even before its proceeds have actually been received by his banker and credited to his account.
(iii) Where the banker sanctions a specific Demand Drafts Purchased (DDP) limit, against execution of the required agreement documents, to his customer for a certain amount, the proceeds of the cheques deposited by the customer concerned for credit of his account is immediately credited to his account to the extent of the DDP limit only.
(iv) In some genuine cases, the banker may agree to credit the proceeds of the cheques the same day in the accounts of its known and valued customers.
(v) Where the banker has noted a lien in the customer's account for the amount of the cheque.

The collecting banker, as a holder for value, enjoys a privileges position in the cases where the endorsements (and not the signatures of its drawers) on the cheques are forged.

When the banker credits the proceeds of the cheques, deposited with him by the customer, in the account of the customer, not before but only after the actual realisation of the proceeds of the cheques from the paying banker, such banker is referred to as a **collecting agent** and just a **'holder'** of the cheque.

Here, he does not enjoy a better title to the cheque than the title of his customer. Thus, he may be held liable for conversion of the amount received by him, unless he can prove to the following effects:

(a) That he had acted in good faith and without negligence;
(b) That the cheque was already crossed before he had received it from his customer, and
(c) That he was working as a collecting agent.

The collecting banker may be deemed to be negligent in the following cases:

(a) Where the payee or the holder of the cheque is operating in some fiduciary capacity - like the director of a company, or a partner of a partnership firm, or as the holder of a power of attorney for discharging some particular responsibilities on behalf of the principal – and he draws a cheque in his own favour and/or deposits such cheque for credit to his own personal account, it must give rise to some genuine doubts in the mind of the collecting banker, and despite this, the banker fails to make due enquiry in this regard;
(b) Where the bank opens an account without obtaining proper introduction. An introduction given by an authorised signatory of an account holder, and not by the account holder himself, cannot be considered as a proper introduction;*
(c) Where there is some discrepancy in the endorsement, like where the mode of endorsement by the payee does not match, word for word, with the name of the payee written on the cheque;

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* However, these days the banks insist on obtaining the following documents for opening any new account:
(i) A reference from a person already maintaining an account with the same branch of the bank, or at its another branch, for the last six months or more;
(ii) Two copies of his recent passport size photographs, or of all the joint account holders;
(iii) Proof of his identity: viz. copy of one of the documents like (student's/employee's) identity card (ID card), or passport, voter identity card, or Permanent Account Number (PAN card);
(iv) Proof of his address: viz. copy of one of the documents like the latest paid electricity bill, water tax bill, telephone bill. LIC premium deposit receipt, or particulars of any credit card.

(d) Where the banker overlooks an apparent (*prima facie*) warning, like the possibility that the servant, agent or a solicitor might have misappropriated the cheque of his master or principal; or where a cheque is drawn in favour of a partnership firm and is endorsed by one of the partners of the firm on behalf of the firm, and it is deposited with the bank for collection and crediting the proceeds into the personal account of the partner;

(e) If a person, like a branch manager, who is authorised to draw per-pro cheques on behalf of a company, draws cheques payable to 'ourselves' (i.e. to the company) or in his own favour, and deposits these cheques with the bank for credit to his personal account (instead of to the account of his company);

(f) If a banker confirms the endorsement on a cheque, given in a language not known to him and such endorsement later transpires to be improper (e.g., not being in strict conformity with the endorsement, as written on the cheque);

(g) Where he credits cheques crossed 'A/C Payee' into a third party's account:

But a 'not negotiable crossing' has nothing to do with the collecting banker, because it would be an impossible burden on him to investigate titles prior to that of his customer.

The collecting banker, being a collecting agent of his customer, must exercise due care and diligence, while collecting the cheques on behalf of his customers. He is required to present the local cheques received for collection the same day or latest by the next working day, after the date of its receipt. In the cases of outstation cheque, he is required to send it to his own outstation branch on which the cheque is drawn, or else to his agent located in that city, either on the same day, or latest on the very next working day.

He must exercise due care and diligence in promptly (i.e. the same day or latest by the next working day) intimating his customer about the dishonour of the cheque, deposited by him for collection, such that the customer may promptly proceed to recover the amount of such dishonoured cheque from its drawer or the other parties liable thereon.

The payment will not be considered to have been made according to the established and prevalent practice or custom of the banks in the following cases:

(i) When a crossed cheques, required to be credited to the account of its payee or its holder, is paid in cash over the counter;

(ii) When the payment is made after the usual banking hours of the bank concerned; and

(iii) Where a large sum of money has been paid to a person who looked suspicious.

We must note here that the protection under **Section 131** is available to the collecting banker only and exclusively in the cases of collection of cheques. That is, such protection is not available to him in the cases of collection of bills of exchange. But then, as the business pertaining to the collection of bills comprises a large percentage of the banking transactions, no bank can afford to lose such business. But, in view of the extent of risks inherent in the business of collection of bills, the collecting banker will be well advised to exercise more than ordinary care while collecting bills of exchange.

Questions for Reflection

1. (a) Who may be referred to as a collecting banker?
   (b) What are the main functions of a 'collecting banker'?
2. Though it is not obligatory on the part of a banker to work as a collecting banker, it has become an inherent part of a banker's business. Do you agree with this view? Give reasons for your answer.
3. What are the material differences in regard to the legal position and rights enjoyed by the banker under the following two different capacities?
   (a) Banker as a 'Holder for Value', i.e. as a 'Holder in Due Course'; and
   (b) Banker as a 'Collecting Agent', i.e. as a 'Holder'

4. Under what different conditions, a collecting banker may be considered as a 'holder for value', i.e. as a 'Holder in Due Course'?
5. What are the various privileges enjoyed by a banker as a 'Holder for Value', i.e. as a 'Holder in Due Course'
6. (a) Does the banker, acting as a collecting agent (i.e. the holder), enjoy a better title to the cheque than the title of his customer? Give reasons for your answer.
   (b) Under what special circumstances the banker may not be held liable for conversion of the amount received by him, when he collects the proceeds of a cheque on behalf of his customer, where the cheque actually belonged to another person?
7. Under what special circumstances can the collecting banker be held liable for negligence on his part? Give illustrative examples in each case.
8. What specific effect a 'Not Negotiable' crossing may have on the collecting banker? Give reasons for your answer.
9. What are the various duties and responsibilities of a collecting banker?
10. The legal protection under **Section 131** is available to the collecting banker only and exclusively in the cases of collection of cheques, and not in the cases of collection of bills of exchange. But then, all the banks undertake such business also on behalf of their customers.
    (a) Do you agree with this contention?
    (b) If you agree with this contention, what special and extra precautions you will advise the banker to take to protect his interest?

    Give reasons for your answer in each case.

Problems for Practice (With Suggested Solutions)

Problem 1

A collecting banker has received a cheque for credit of its full amount to the account of his customer the same day, under the Demand Draft Purchased (DDP) limit. But the endorsement on the cheque transpires to be a forged one.

(a) Will the collecting banker be held liable to the true owner the cheque?
(b) Will the collecting banker be enjoying the legal right to recover the amount from the endorsers subsequent to the forged endorsement?

Give reasons for your answer in each case.

Solution

(a) In the instant case, the collecting banker is a holder for value (holder in due course), as he has paid the full amount of the cheque by credit to the account of his customer the same day, well before receiving the proceeds of the cheque. But then, in the cases where the endorsement is a forged one, the collecting banker will also be held liable to the true owner of the cheque, as is usually the case.
(b) However, the banker, as a holder for value (holder in due course), will be enjoying the legal right to recover the amount from the endorsers subsequent to the forged endorsement.

Problem 2

(a) Will the statutory protection granted under Section 131 be available to the collecting banker in the case of the cheque which, though received by him for collection in an open (i.e. uncrossed) condition, it was duly crossed by him (collecting banker) after its receipt from the customer? Give reasons for your answer.
(b) What comments will you like to make regarding the provisions made under Section 131 in this regard?
(c) What special advice will you like to give to collecting banker when confronted with such cases?

Solution

(a) The statutory protection granted under Section 131 will not be available to the collecting banker in the case of the cheque which, though received by him for collection in an open (i.e. uncrossed) condition, it was duly crossed by him (collecting banker) after its receipt from the customer.

This is so because, the statutory protection granted under Section 131 is available to the collecting banker only in the case of such cheques which have been received by him duly crossed, generally or specially, well before it was deposited with him for the purpose of its collection. Conversely speaking, such protection will not be available to him in respect of the cheques which were received by him for collection in an open (i.e. uncrossed) condition. Alternatively speaking, such protection will not be available to him (collecting banker) in respect of the cheque which, though received by him for collection in an open (i.e. uncrossed) condition, it was duly crossed by him (collecting banker) after its receipt from the customer.

(b) Such provision might have been made in Section 131 because it is not necessary to receive the amount of an open cheque only through a bank account. That is, an open cheque may be encashed over-the-counter of the paying baker, without it being compulsorily put through a bank account.

But then, how inconvenient will it be for the payee, residing in Delhi, to receive payment of an open but outstation cheque, say, drawn on a bank in Kolkata. Is he supposed to go all the way to Kolkata to encash the cheque over-the-counter there? He will definitely find it far more convenient to get it collected through a banker.

It may be further argued that how would it be incontrovertibly proved that the cheque was not crossed at the time of its deposit with the collecting banker, but the collecting banker himself had crossed it after having received it in an open form when it was lodged with him. Further, the conversion of an open (uncrossed) cheque does not amount to a material alteration. Therefore, any one can cross an uncrossed cheque. So, the rationale behind excluding only the collecting banker from doing so has not been understood by us.

(c) However, leaving the aforementioned comments in this context, the collecting banker, in such cases, may be well advised to take more than ordinary care to request the payee of the cheque to first cross it and only thereafter to deposit it for collection, so that the protection granted under Section 131 may become applicable even in such cases.

Problem 3

Will the statutory protection granted under Section 131 be available to a banker in the case where he receives a cheque as a holder for value (holder in due course)? Give reasons for your answer.

Solution

The statutory protection granted under Section 131 will not be available to a banker in the case where he receives a cheque as a holder for value (i.e. holder in due course). This is so because, the protection under Section 131 is available to the banker only when he has accepted the crossed cheque, as a collecting agent of the customer. Conversely speaking, such protection is not available to the collecting banker when he receives such cheques from his customer as a holder for value (i.e. holder in due course)? The rationale behind such legal provision is that, in the cases where it is negotiated in his favour, the banker takes delivery of the cheque as its independent holder. Accordingly, he cannot be deemed to be collecting the cheque on behalf of his customer, but, instead, for receiving the amount of the cheque in his personal capacity. Accordingly, he cannot plead statutory protection under Section 131.

Problem 4

Paritosh holds a power of attorney for discharging some particular responsibilities on behalf of Raman, his principal. On his authority as the holder of such power of attorney, he draws a cheque in his own favour and deposits it with his the bank for credit to his own personal account. Keeping in view his (Paritosh's) authority as the holder of such power of attorney, the banker credits the proceeds of the cheque into the account of Paritosh. Will the collecting banker be entitled to claim the protection under Section 131?
Give reasons for your answer.

Solution

The collecting banker will not be entitled to claim the protection under Section 131. This is so because, in the instant case, Paritosh, the holder of a power of attorney for discharging some particular responsibilities on behalf of Raman, his principal, was operating in a fiduciary capacity. Therefore, his act of drawing a cheque in his own favour and depositing it with his banker for credit to his own personal account must have definitely given rise to some genuine doubts in the mind of the collecting banker (as also of the paying banker), and thereby, making it obligatory on the part of the banker to make due enquiry in this regard. Further, the payment of such cheque, in cash or even through the credit of the account of such doubtful payee or holder of the cheque, should not be made unless he (banker) gets fully satisfied, beyond any doubt, about the genuineness of such transaction. In this case, he has failed to do so. Therefore, he (banker) will be held liable for being negligent, and accordingly, will not get any protection under Section 131.

This observation is based on the judgement delivered in the case titled **Midland Bank Ltd. vs Reckitt**, wherein it was held that, under such circumstances, there was sufficient notice, on the face of the cheque itself, that the solicitor was applying the money of the plaintiff (the client of the solicitor) to his private purpose.

Problem 5

A banker had collected the proceeds of a forged demand draft on behalf of its customer, whose account was opened without getting and verifying the reference. Will the collecting banker be entitled to claim protection under Section 131? Give reasons for your answer.

Solution

In the instant case, the collecting banker had failed to take due care while opening a new account, like obtaining and verifying the reference. Under these circumstances, he will be charged of being negligent. Further, as the protection under Sections 131 is available to the collecting banker only in the cases where he has, *inter alia* (i.e. besides other conditions), acted in good faith and without negligence, he will not be entitled to claim protection under Sections 131. This contention is based on the case titled **United Bank of India vs Bank of Baroda, AIR 1997 Mad. 23**

Problem 6

Ajit had drawn an order cheque, crossed 'Account Payee', favouring Ms. Sujatha Ramana, whereas her correct name was Sujata Raman. Accordingly, the collecting banker had paid the amount of the cheque by credit of the proceeds of the cheque into the account of 'Sujata Raman', as it was correctly endorsed by the payee as 'Sujata Raman'. Will the collecting banker be discharged of his liabilities by paying the amount of the cheque by credit to the account of 'Sujata Raman'? Give reasons for your answer.

Solution

The collecting banker will not be discharged of his liabilities by paying the amount of the cheque by credit to the account of 'Sujata Raman'. This is so because, in this case there is a discrepancy in the endorsement, i.e. here the mode of endorsement by the payee does not match, word for word, with the name of the payee written on the cheque. Therefore, the collecting banker will be held liable of being negligent. In fact, under law, in the cases where, on the instrument, made payable to order, the name and/or designation of the payee or the endorsee has been wrongly mentioned, or else where his/her name has been wrongly spelt, he/she is required under law to sign thereon in the same manner as has been mentioned in the instrument. This contention is based on the case titled **Babins Junior and Sims vs London and South-Western Bank Ltd. (1910).**

Here, we may add that such payee or the endorsee has the option of writing his/her correct name and/or his designation also, under his correct (proper) signature (endorsement), if he/she so desires.

Problem 7

A cheque is drawn in favour of a partnership firm and is endorsed by one of the partners of the firm on behalf of the firm, and it is deposited with the bank for collection and crediting the proceeds thereof into the personal account of the partner concerned. Will the collecting banker be entitled to claim the protection under Section 131? Give reasons for your answer.

Solution

The collecting banker will not be entitled to claim the protection under Section 131. This is so because, in the instant case, the partner was operating in a fiduciary capacity. Therefore, his act of depositing the cheque drawn in favour of a partnership firm and endorsing it on behalf of the firm, and depositing it with the bank for collection and crediting the proceeds thereof into the personal account of the partner concerned, must have definitely given rise to some genuine doubts in the mind of the collecting banker and thereby, making it obligatory on the part of the banker to make due enquiry in this regard. Further, the payment of such cheque, in cash or even through the credit of the account of such doubtful payee or holder of the cheque, should not be made unless he (banker) gets fully satisfied, beyond any doubt, about the genuineness of such transaction. In this case, he has failed to do so. Therefore, he (banker) will be held liable for being negligent, and accordingly, will not get any protection under Section 131.

This observation is based on the judgement delivered in the case titled **Bevan vs National Bank Ltd. (1906)**, wherein the collecting banker was held negligent by the Court as he had credited the proceeds of such cheque into the personal account of that partner.

Problem 8

Purushottam, the branch manager, is authorised to draw per-pro cheques on behalf of a company. He was usually drawing cheques payable to 'ourselves' (i.e. to the company) or in his own favour. He had deposited one cheque, drawn in his own favour, with the bank, for credit of its proceeds to his personal account. The bank had credited the proceeds of such cheque into the account of such manager. Will the collecting banker be entitled to claim the protection under Section 131? Give reasons for your answer.

Solution

The collecting banker will not be entitled to claim the protection under Section 131. This is so because, the bank, by crediting the proceeds of the cheque into the personal account of such manager (who was drawing such cheques in a fiduciary capacity), had acted negligently. This contention is based on the judgement delivered by the Court in the case titled **Moerson vs London County and Westminster Bank Ltd. (1914).**

Problem 9

A collecting banker has confirmed the endorsement on a cheque, given in Malayalam, a language not known to him. Such endorsement later transpired to be improper, i.e. not being in strict conformity with the endorsement, as written on the cheque. Will the collecting banker be entitled to claim the protection under Section 131? Give reasons for your answer.

Solution

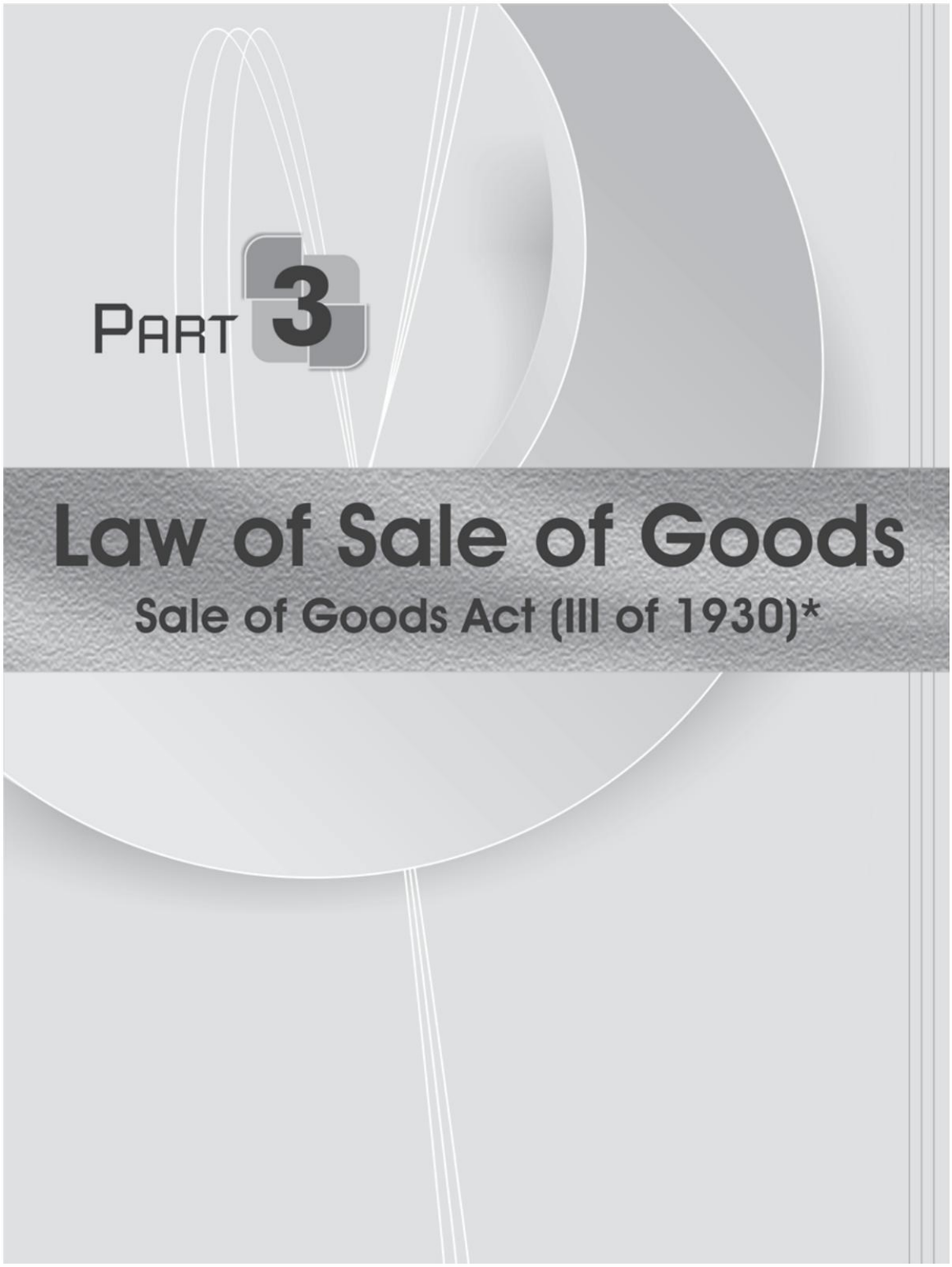
The collecting banker will not be entitled to claim the protection under Section 131. This is so because, the collecting banker will be held as being negligent, on the ground that despite not knowing Malayalam, he had been careless and negligent enough to the extent that he had dared to confirm the endorsement on a cheque, given in Malayalam, which language he did not know. The very fact that such endorsement had later transpired to be improper, i.e. not being in strict conformity with the endorsement, as written on the cheque, will be good enough to hold him to be negligent in his duty.

Problem 10

A collecting banker had collected an 'A/C Payee' cheque on behalf of a third party (other than the payee) and the amount thereof was credited to the account of such third party, without making any enquiry by him (collecting banker) in this regard. Will the collecting banker be entitled to claim the protection under Section 131? Give reasons for your answer.

Solution

The collecting banker will not be entitled to claim the protection under Section 131. This is so because, a cheque crossed 'Account Payee' must be credited to the account of the payee only, and not to the account of any third party - such being the specific instruction given by the drawer in this regard, by crossing the cheque as 'Account Payee'. Instead, he (collecting banker) will be held guilty of negligence, and thereby also liable for conversion of the amount. This contention is based on the judgement delivered by the Court in the case titled **House Property Company of London Ltd. vs London County and Westminster Bank Ltd. (1915).**



Law of Sale of Goods

Sale of Goods Act (III of 1930)*

Chapter Twenty Four

Contract of Sale of Goods

"*The sale begins when the customer says yes.*
Harvey Mackay

If eighty percent of your sales come from twenty percent of all of your items, just carry those twenty percent.
Stew Leonard

Nothing is more elegant than ready money!
French Proverb

If you can't pay for a thing, don't buy it. If you can't get paid for it, don't sell it.
Benjamin Franklin

Money makes a good servant, but a bad master.
Francis Bacon"

24.1 Background

The Sale of Goods Act, 1930, originally formed a part of the Indian Contract Act, 1872, as its Chapter VII. It was later repealed and was re-enacted as the Sale of Goods Act, III of 1930, which came into effect from 1st July 1930. The Indian Sale of Goods Act is largely based on the English Sale of Goods Act, 1893, which it largely follows. This Act expends to the whole of India except Jammu and Kashmir. Further, it does not affect the rights, interests, obligations, and titles acquired, or which had already accrued, before the enforcement of this Act.

24.2 Definition and Essential Ingredients of Contract of Sale of Goods

As defined under **Section 4**, 'A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for price'.

From the aforementioned definition, the following essential ingredients of the contract of sale of goods may emerge:

24.2.1 Existence of 'Minimum Two Parties'

In the cases of all the contracts, there must be at least two parties involved, because one single person cannot enter into a contract with himself. Accordingly, in the cases of contract of sale of goods also, there must be two parties because a sale can take place between two parties, viz. the buyer and the seller, who have to be necessarily two separate persons, as one can neither sell the property in goods to himself, nor buy his own property in goods. That is, the transfer of property in the goods in question is required to pass on from one person (seller) to the other person (buyer).

Example

Srinath is the owner of some goods. But he did not know that he owned those goods. Shahrukh poses himself to be the owner of those goods and accordingly, he sells them to Srinath himself. In this transaction, there is no sale effected, because Srinath cannot purchase the (property in) goods which happens to be his own. This contention is based on the case titled **Bell vs Lever Brothers Limited, 1932, A. C. 161.**

But, as provided under **Section 4**, a part-owner may sell to another person who also happens to be a part-owner of the same property. **For example,** a partner of a partnership firm may sell goods to his own firm, and again, even his own firm may sell goods to a partner of the firm.

As against this, the joint owners of certain goods cannot sell it to the joint owners of the property, as the joint owners of a property will be considered to be one and the same person, and one single person cannot be both the buyer and the seller of the property at the same time. This contention is based on the case titled **State of Gujarat vs Ramanlal S. & Company, AIR, 1965 Guj. 60.** The facts of the case, in brief, are that a partnership firm was dissolved and the surplus property (assets) of the firm, including some goods, was distributed among the partners of the firm *in specie*. The Sales Tax Officer of the State of Gujarat had imposed sales tax on such division of the property among the partners of the firm. The High Court of Gujarat had rejected the contention of the Sales Tax Officer of the State of Gujarat, demanding payment of sales tax on such division of the property among the partners of the firm. Justice Bhagwati in his judgement had observed that 'They (partners of the firm) were themselves the joint owners of the goods and they could not be both sellers and buyers. Moreover, no money consideration was promised or paid by any partner to the firm as consideration for the goods allotted to him'.

24.2.2 Transfer or Agreement to Transfer the 'Ownership' of Goods

In the case of pledge of goods, the ownership of the goods pledged, continues to remain with the borrower, who is the owner of the goods pledged. Here, only the possession of the goods pledged is transferred and not its ownership. As against this, in the case of the contract of sale of goods, the ownership of the goods sold itself is transferred in the sale, and not merely its possession, or a limited interest. Similarly, in the case of an agreement to sell, the ownership of the goods agreed to be sold itself is transferred, and not merely its possession or a limited interest.

24.2.3 The Subject Matter of the Contract must Necessarily be Some 'Goods'

The term 'goods', as defined under **Section 2 (7),** pertains to only movable property, and not to any immovable property like land, building, immovable items of machinery, and so on. The term 'property in goods', used in **Section 4**, connotes the title/ownership of (movable items of) goods. Further, the term 'property' should not be confused with house property or such other immovable items of immovable property like land, building, immovable items of machinery, and so on. Therefore, the sale of an immovable property is not covered under the Sale of Goods Act. Such sales (i.e. of immovable property) are, however, covered under the Transfer of Property Act, instead.

24.2.4 Consideration has to be in 'Price' (i.e. in Terms of Money)

In any contract of sale, the consideration has necessarily to be some 'price', i.e. in terms of 'money' (the legal tender) only, either in cash or by way of cheque or bank draft. Accordingly, a certain quantity of wheat exchanged for a certain quantity of rice, will not constitute a sale. It will, instead, be deemed as barter. Similarly, as in the case of a gift there is no consideration in terms of money, as it is given for free, it will not amount to a sale, either. Alternatively speaking, the transfer of ownership of any goods or property without any monetary consideration will tantamount to a gift and not a sale.

But then, we should note that in case of a sale of any (property in) goods, in consideration of a certain amount of money (cash or cheque, or bank draft), and such settled price is paid partly in terms of money and partly by way of some goods (i.e. in kind), such transaction will also be deemed to be a sale in the eye of law.

Examples

(i) Let us take the case law titled **Aldridge vs Johnson (26, L.J.Q.B., 296, 52),** as an illustrative example on this point. In this case, 52 bullocks were 'exchanged' at an agreed price of six (6) Pound Sterling each (i.e. aggregating 312 Pound Sterling). The term 'exchanged' has been deliberately used in the preceding sentence because the payment was to be settled partly against the delivery (exchange) of 100 quarters of barley at the rate of two (2) Pound Sterling, and the balance amount of 112 Pound Sterling was to be paid in cash. This agreement was declared by the Court as a valid agreement of sale.

(ii) Another illustrative example on this point is the case law titled **S. Australian Insurance Co. vs Randell [(1869) 3 PC 101]**. In this case, a certain quantity of corn was delivered to another person on the condition that, on demand, the other person will either pay the pre-settled price for the corn so delivered, or else he will return the same (equal) quantity of corn. This agreement was also held by the Court as a valid agreement of sale.

24.2.5 Contract of Sale may be Absolute or Conditional

Further, as provided under **Section 4,** the contract of sale of goods may be either absolute or conditional.

24.2.6 All other Elements of a Valid Contract must be Present

As the contract of sale of goods is also one of the species of contract, all the essential conditions required to make an agreement a valid contract must be present in the case of a contract of sale of goods also. For example, the parties to the contract must be competent to enter into a contract (i.e. none of them should be a minor, lunatic, or insolvent); there must be free consent, the object and consideration of the agreement must be legal, and so on.

24.3 Sale vs Agreement to Sell

24.3.1 Sale

As defined under **Section 4 (3)**, a 'sale' takes place where, under a contract of sale of goods, the property (title or ownership) in the goods in question is transferred from the seller to the buyer. Thus, in strict legal terms, a sale may be said to have taken place only when the property (title or ownership) in the goods in question is actually transferred from the seller to the buyer. Thus, a sale is an executed contract.

Example

Kartar sells his Maruti car to Avatar for a price of Rs 2, 00,000. This transaction will be deemed to be a sale as ownership or title to the car has been transferred from Kartar (seller) to Avatar (buyer).

In this context, it must be noted that the actual payment of the price at the time of the sale itself is not material or essential to effect the transfer of the property (title or ownership) in the goods (car in the instant case). In other words, in case the delivery of the car or the payment of its price, or even both, is postponed to some later date, the transaction will still be deemed to be a valid 'sale'. That is, it will not constitute 'an agreement to sell', which point has been discussed hereafter.

24.3.2 Agreement to Sell

As stipulated under **Section 4 (3)**, an 'agreement to sell' means that under such contract of sale, the transfer of the property (title or ownership) in the goods itself will take place at some future date or that it (i.e. the transfer of the property in the goods itself) will depend on some condition which could be fulfilled only thereafter.

Example

Prabhakar agrees to sell certain goods to Anil. But the goods are in the ship on the high sea on its way from Berlin (Germany) to Mumbai (India). This is a clear case of an 'agreement to sell', because the transfer of the property (title or ownership) in the goods itself (from the seller to the buyer of the goods) will take place only at some future date, i.e. when the goods will arrive at the port in Mumbai. The agreement in this case is subjected to a further condition that the ship arrives at the Mumbai port safely, and with the goods intact and in order. In other words, if the ship were to sink in the deep sea, and the goods therewith, the contract of sale will become void because of subsequent (or supervening) impossibility of the performance/execution of the contract, as per **Section 56 of the Indian Contract Act**.

The aforementioned distinctions between an actual 'sale' and an 'agreement to sell' are of vital importance, because the rights and obligations of the two parties involved under these two different conditions have different legal implications and ramifications. To recapitulate and re-emphasise the main points of distinction between the two, we may say that while in the case of an actual 'sale' there is a transfer of the property (title/ownership) in the goods in question from the buyer to the seller, there is no such transfer of the property (title/ownership) in the goods in question in the case of an 'agreement to sell'. In other words, in the case of an 'agreement to sell' there is only an agreement to transfer (and not an actual transfer of) the property in the goods in question from the buyer to the seller. The point is further clarified in the case law titled **Sales Tax Officer, Pilibhit vs Budh Prakash, Jai Prakash [(1954) S.C.J. 573],** wherein it was held that the liability to pay sales tax will arise only when there is a completed sale (whereby an actual transfer of the property in the goods takes place), and not in the case where there is only an 'agreement to sell' (whereby no actual transfer of the property in the goods takes place).

Some other distinguishing features between 'sale' and 'agreement to sell' have been summarised in **Table 24.1.**

Table 24.1 *Distinguishing Features between 'Sale' and 'Agreement to Sell'*

Sale	*Agreement to Sell*
(i) A 'Sale' is an executed contract.	(i) An 'Agreement to Sell' is an executory contract.
(ii) In the case of a sale, as the property in the goods has actually been transferred by the buyer to the seller, the seller has the right to sue the buyer for the realisation of the price of the goods sold.	(ii) In the case of an agreement to sell, in the event of a breach of the contract, the seller can sue the other party only for the damages, unless the price of the goods was to be paid on an agreed specific date.
(iii) A sale creates a right *in rem*.	(iii) An agreement to sell creates a right *personam*.
(iv) In the event of the loss of the goods sold, the loss will have to be borne by the buyer, even if the goods were still in the possession of the seller. This is based on the principle that the 'risk' is associated with the 'ownership'. And, in the case of an actual sale, the ownership gets immediately transferred from the seller to the buyer.	(iv) In the case of an agreement to sell, in the event of the loss of the goods agreed to be sold, the loss will have to be borne by the seller, even if the goods were in the possession of the (prospective) buyer. This is so because in the case of an agreement to sell, the ownership does not get transferred from the seller to the buyer, unless the sale is actually completed.
(v) If the buyer pays the price to the seller for the goods purchased by him, and thereafter the seller becomes insolvent, the buyer can claim the goods (purchased by him) from the Receiver or the Official Assignee.	(v) In the case of an agreement to sell, when the seller becomes insolvent, the buyer cannot claim the goods from the Receiver or the Official Assignee. He can only claim a rateable dividend for the money paid by him.
(vi) In the event of the buyer becoming insolvent, without paying the price to the seller for the goods purchased by him, the seller will have to deliver the goods in question to the Receiver or the Official Assignee, except where he has the lien over the goods so sold. This is so because the ownership of the goods involved has already passed on to the buyer, at the time of the sale.	(vi) In the case of an agreement to sell, when the seller becomes insolvent, the seller can refuse the delivery of the goods to the Receiver or the Official Assignee.

24.4 Sale vs Other Similar Transactions

24.4.1 'Sale of Goods' vs 'Hire Purchase Agreement'

A hire purchase agreement is an agreement for hire. It is different from sale, because it is only an agreement with an option to purchase, and not a purchase as such, at the time of entering into the agreement of hire purchase. Under such agreement, the hirer (hire purchaser) has to pay a certain pre-agreed amount every month by way of the monthly instalment. Further, if the hirer (hire purchaser) pays the monthly instalment regularly every month, he may become the owner of the goods involved immediately and automatically on payment of the last and final instalment, which tantamount to exercising his option to purchase the goods. But in case the hirer (hire purchaser) fails to pay any of the monthly instalments, the owner of the goods (hiree) has the option to terminate the contract and take away the goods, given on hire purchase terms. This is so because the ownership of the goods continues to remain with the (initial) owner (hiree) himself, till every instalment, including the last instalment, is finally and fully paid.

Thus, we observe that in the case of sale, the ownership of the goods passes on to the buyer immediately when the actual sale is completed, irrespective of the fact whether the price of the goods involved has been paid by the buyer in full or not. But in the case of hire purchase, the price is required to be paid by the hire purchaser in monthly instalments, and the ownership of the goods involved passes on to the hire purchaser only if he has been paying the monthly instalments regularly, and only after he has paid the last instalment in

full and final payment of the price of the goods involved, and not earlier, till when it constitutes only a bailment of the goods, and not a sale thereof. Thus, we may say that a hire purchase agreement is in the nature of bailment coupled with an agreement to sell. To ascertain the fact as to whether a particular transaction constitutes a sale or hire purchase, we must see whether the person (other than the owner) is merely a hirer, having only an option to purchase, or else he has purchased or agreed to purchase the goods involved.

24.4.2 'Sale of Goods' vs 'Work, Labour, and Materials'

In the case of a contract for the 'sale of goods', the delivery of the goods involved is a primary condition. As against this, in the case of a contract for the 'work**,** labour, and materials', the primary condition of the contract is the application of the labour or skill, and the delivery of the goods involved is just a secondary condition.

Examples

(i) Ramesh enters into a contract with M. F. Hussain, a renowned painter, to paint a picture for his office chamber for an agreed price. The required material was agreed to be supplier by Ramesh. This contract will be treated as a contract for 'work and labour', and not a contract for the 'sale of goods'. This contention is supported by the case law titled **Robinson vs Graves [(1935), I. K. B. 579].**

(ii) Similarly, when Ramesh delivers some gold biscuits to Sonkar, a goldsmith, for making some ornaments, this contract will also be in the nature of a contract for 'work and labour', and not that of the 'sale of goods'.

(iii) As against the aforementioned two examples, in the case where a dentist enters into an agreement with a person to prepare a set of dentures (artificial teeth) to fit into his (customer's) mouth, this contract will be deemed to be a contract for the 'sale of goods', and not a contract for 'work and labour'. This contention is based on the case law titled **Lee vs Griffin [(1861), L. J. Q. B. 252].**

24.4.3 'Sale of Goods' vs 'Barter of Goods'

In the case of a contract for the 'sale of goods', the delivery of the goods involved is made against a price (i.e. in terms of money, either in cash or by way of cheque/bank draft). As against this, in the case of a 'barter', the transfer of ownership of one thing (i.e. of a commodity, like rice, pulse, spice, and so on) takes place by way of the transfer of ownership of something else (i.e. some other commodity, like wheat or sugar, and so on). Thus, in the case of a 'barter', the transfer of ownership of the goods involved takes place not by way of payment of its price in terms of money (in cash or by cheque/bank draft), but by way of an exchange of some other goods of a similar value.

Let us Recapitulate

'A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for price' (**Section 4**).

(a) Existence of 'minimum two parties': buyer and seller. However, a part-owner may sell to another person who also happens to be a part-owner of the same property. **For example,** a partner of a partnership firm may sell goods to his own firm, and again, even his own firm may sell goods to a partner of the firm (**Section 4**).

But, the joint owners of certain goods cannot sell it to the joint owners of the property, as the joint owners of a property will be considered to be one and the same person, and one single person cannot be both the buyer and the seller of the property at the same time.

(b) Here, in the case of a sale or an agreement to sell, both the 'ownership' and the 'possession' of goods are transferred, as against in the case of pledge, wherein only the possession of the goods pledged is transferred, and not its ownership.

(c) Here, the subject matter of the contract must necessarily be some 'goods'. The term 'goods' as defined under **Section 2 (7),** pertains to only movable property, and not to any immovable property like land, building, immovable items of machinery, and so on.

(d) Consideration has to be in 'price', i.e. in terms of money only.

Accordingly, a certain quantity of wheat exchanged for a certain quantity of rice, will not constitute a sale. It will, instead, be deemed as barter. Similarly, as in the case of a gift there is no consideration in terms of money, as it is given for free, it will not amount to a sale, either.

(e) Contract of sale may be absolute or conditional.

(f) **All other elements of a valid contract must be present.** For example, the parties to the contract muse be competent to enter into a contract (i.e. none of them should be a minor, lunatic or insolvent), and there must be free consent, the object and consideration of the agreement must be legal, and so on.

Sale vs Agreement to Sell

(a) Sale

A 'sale' takes place where, under a contract of sale of goods, the property (title or ownership) in the goods in question is transferred from the seller to the buyer **[Section 4 (3)]**. Thus, a sale is an executed contract.

But, in case the delivery of the goods or the payment of their price, or even both, is postponed to some later date, the transaction will still be deemed to be a valid 'sale' and not 'an agreement to sell'.

(b) Agreement to sell

As against 'sale', an 'agreement to sell' means that under such contract of sale, the transfer of the property (title or ownership) in the goods itself will take place at some future date or that it (i.e. the transfer of the property in the goods itself) will depend on some condition which could be fulfilled only thereafter. **[Section 4 (3)]**.

We may thus, observe that, in the case of an actual 'sale' there is an actual transfer of the property (title/ ownership) in the goods in question from the buyer to the seller, whereas in the case of an 'agreement to sell' there is only an agreement to transfer (and not an actual transfer of) the property in the goods in question from the buyer to the seller, and that too, at a later date.

For some other distinguishing features between 'sale' and 'agreement to sell', please refer to **Table 24.1**.

'Sale of Goods' vs 'Hire Purchase Agreement'

In the case of sale, the ownership of the goods passes on to the buyer immediately when the actual sale is completed, irrespective of the fact whether the price of the goods involved has been paid by the buyer in full or not. But, in the case of hire purchase (where there is only an agreement for hire, and only an option with the hirer to purchase the goods, and not a purchase as such), the price is required to be paid by the hire purchaser in monthly instalments, and the ownership of the goods involved passes on to the hire purchaser only if he has been paying the monthly instalments regularly, and only after he has paid the last instalment in full and final payment of the price of the goods involved, and not earlier, and until that time (i.e. till the last instalment is paid in full and final payment of the price of the goods involved) it constitutes only a bailment of the goods, and not a sale thereof. Thus, we may say that a hire purchase agreement is in the nature of bailment, coupled with an agreement to sell.

'Sale of Goods' vs 'Work, Labour, and Materials'

In the case of a contract for the 'sale of goods', the delivery of the goods involved is a primary condition. As against this, in the case of a contract for the 'work**,** labour, and materials', the primary condition of the contract is the application of the labour or skill, and the delivery of the goods involved is just a secondary condition. **For example,** painting work by a specific painter, or delivery of gold biscuits to a goldsmith to make some ornaments.

But, in the case where a dentist enters into an agreement with a person to prepare a set of dentures (artificial teeth) to fit into his (customer's) mouth, this contract will be deemed to be a contract for the 'sale of goods', and not a contract for 'work and labour'.

'Sale of Goods' vs 'Barter of Goods'

In the case of a contract for the 'sale of goods', the delivery of the goods involved is made against a price (i.e. in terms of money, either in cash or by way of cheque/bank draft). As against this, in the case of a 'barter', the transfer of ownership of one thing (i.e. of a commodity, like rice, pulse, spice, and so on) takes place by way of the transfer of ownership of something else (i.e. some other commodity, like wheat or sugar, and so on).

Questions for Reflection

1. (a) What constitutes a contract of sale of goods, as defined under Section 4 of the Sale of Goods Act?
   (b) What are the various essential ingredients of the contract of sale of goods that emerge from the definition of the contract of sale of goods provided under Section 4 of the Sale of Goods Act?
2. Elucidate the following essential ingredients of the contract of sale of goods, by citing suitable illustrative examples in each case:
   (a) Existence of 'minimum two parties'.
   (b) Transfer or agreement to transfer the 'ownership' of goods.
   (c) The subject matter of the contract must necessarily be some 'goods'.
   (d) Consideration has to be in 'price' (i.e. in terms of money).
   (e) Contract of sale may be absolute or conditional.
   (f) All other elements of a valid contract must be present;

   (i.e. what are some of the other elements of a valid contract that must be present?)
3. What are the main distinguishing features of the following pairs of terms? Elucidate your points with the help of illustrative examples in each case.
   (a) 'Sale' vs 'Agreement to Sell'.
   (b) 'Sale of Goods' vs 'Hire Purchase Agreement'.
   (c) 'Sale of Goods' vs 'Work, Labour, and Materials'.
   (d) 'Sale of Goods' vs 'Barter of Goods'.
   (e) 'Sale of Goods' vs 'Pledge of Goods'.

Problems for Practice (With Suggested Solutions)

Problem 1

Smith is the owner of certain goods. But he did not know that he owned those goods. Shelly poses himself to be the owner of those goods and accordingly, he sells them to Smith. Shelly argues that in this transaction the sale has actually taken place. Do you think that the contention of Shelly is legally tenable? Give reasons for your answer.

Solution

The contention of Shelly is not legally tenable. This is so because Smith cannot purchase the (property in) goods which happen to be his own. This way, there is only one party in the instant case, i.e. the buyer, and in a contract of sale also, as in the cases of all other contracts, there must be at least two parties, viz., the buyer and the seller as distinct two parties. This contention is based on the case titled **Bell vs Lever Brothers Limited, 1932, A. C. 161.**

Problem 2

Anuradha, a partner in a firm, has sold certain goods to her own firm. Anuradha argues that in this transaction the sale has actually taken place. Do you think that the contention of Anuradha is legally tenable?

Give reasons for your answer.

Solution

The contention of Anuradha, in the instant case, is legally tenable. This is so because, as provided under Section 4 of the Sale of Goods Act, a part-owner may sell to another person who also happens to be a part-owner of the same property. Thus, Anuradha, a partner of a partnership firm, by virtue of being a part-owner of the same property, may sell goods to her own firm, which again is a part-owner of the same property.

Problem 3

A firm has sold certain goods to Anuradha, who happens to be a partner in the same firm. Anuradha argues that in this transaction the sale has not actually taken place. Do you think that the contention of Anuradha is legally tenable? Give reasons for your answer.

Solution

The contention of Anuradha, in the instant case, is not legally tenable. This is so because, as provided under Section 4 of the Sale of Goods Act, a part-owner may sell to another person who also happens to be a part-owner of the same property. Thus, Anuradha's firm, by virtue of being a part-owner of the same property, may sell goods to Anuradha, one of the partners of the same firm, who (Anuradha) again is a part-owner of the same property.

Problem 4

A partnership firm had been dissolved and the surplus property (assets) of the firm, including some goods, was distributed among the partners of the firm *in specie*. The Sales Tax Officer of the State had, however, imposed sales tax on such division of the property among the partners of the firm. Do you think that the contention of the Sales Tax Officer, demanding payment of sales tax on such division of the property among the partners of the firm legally tenable in the Court of law? Give reasons for your answer.

Solution

The contention of the Sales Tax Officer, demanding payment of sales tax in the instant case, is not legally tenable in the Court of law, and his claim will be rejected by the Court. This is so because, the partners of the firm were themselves the joint owners of the goods and they could not be both sellers and buyers. Moreover, no money consideration was promised or paid by any partner to the firm as consideration for the goods allotted to him. This contention is based on the observation made by Justice Bhagwati in his judgement given in a case on the same points titled **State of Gujarat vs Ramanlal S. & Company, AIR, 1965 Guj. 60**.

Problem 5

Ten horses were 'exchanged' at an agreed price of Rs 10,000 each (i.e. aggregating Rs 1,00,000). The payment, however, was to be settled partly against the delivery (exchange) of 4,000 kg of sugar at the rate of Rs 20 per kg, and the balance amount of Rs 20,000 was to be paid in cash. Do you think that this will be deemed to be a valid agreement of sale or a case of barter, as the payment is to be made not fully in terms of money but partly in terms of money and partly in kind (i.e. sugar in the instant case). Give reasons for your answer.

Solution

This will be deemed to be a valid agreement of sale (and not a case of barter) as the payment is to be made not fully in terms of exchange of goods but partly in terms of money and partly in kind (i.e. sugar in the instant case). This is so because, as per the provisions made in the Sale of Goods Act, in case of a sale of any (property in) goods, in consideration of a certain amount of money (cash or cheque or bank draft), and such settled price is paid partly in terms of money and partly by way of some goods (i.e. in kind), such transaction will also be deemed to be a valid sale in the eye of law.

Problem 6

A certain quantity of wheat was delivered to another person on the condition that, on demand, the other person will either pay the pre-settled price for the wheat so delivered, or else he will return the same (equal) quantity of wheat. Do you think that this agreement may be held by the Court as a valid agreement of sale or a case of barter? Give reasons for your answer.

Solution

This agreement will be held by the Court as a valid agreement of sale and not a case of barter. This is so because, as per the contract of sale of goods in the instant case, the settled price is to be paid wholly in terms of money or else in terms of the return the same (equal) quantity of the same goods (wheat in the instant case), and no commodity other than the wheat which was originally the subject matter of the sale. Accordingly, such transaction will be deemed to be a valid sale in the eye of law. This contention is based on the decision delivered in the case titled **S. Australian Insurance Co. vs Randell [(1869) 3 PC 101]**.

Problem 7

Krishna has sold his motorcycle to Gopal for a price of Rs 20,000. But Gopal has not made any payment for the price of the motorcycle to Krishna. Krishna contends that, as he (Gopal) has not paid the price of the motorcycle to him (Krishna), this transaction will be deemed to be only an agreement to sell (and not a sale), as the ownership or title to the motorcycle has not been transferred from Krishna (seller) to Gopal (buyer), due to the non-payment of the price of the motorcycle. Do you think that the contention of Krishna, in the instant case, is legally tenable? Give reasons for your answer.

Solution

The contention of Krishna, in the instant case, is not legally tenable. This is so because, in the cases of sale, the actual payment of the price at the time of the sale itself is not material or essential to effect the transfer of the property (title or ownership) in the goods (motorcycle in the instant case). In other words, in case the delivery of the motorcycle or the payment of its price, or even both, is postponed to some later date, the transaction will still be deemed to be a valid 'sale', and it will not constitute 'an agreement to sell'.

Problem 8

Govind has entered into an agreement with Prakash to sell certain goods to him (Prakash), which are already loaded in the ship and the ship is on the high sea on its way from London to Kolkata. Govind contends that, as he (Prakash) has not paid the price of the goods to him (Govind), this transaction will be deemed to be only an agreement to sell (and not a sale), as the ownership or title to the motorcycle has not been transferred from Govind (seller) to Prakash (buyer), due to the non-payment of the price of the goods. Do you think that the contention of Govind, in the instant case, is legally tenable? Give reasons for your answer.

Solution

The contention of Govind (seller), in the instant case, is legally tenable. This is so, not because the actual payment of the price at the time of the sale itself has not been made, but because this is a clear case of an 'agreement to sell' (and not a case of 'sale'), wherein the transfer of the property (title or ownership) in the goods itself (from the seller to the buyer of the goods) will take place only at some future date, i.e. when the goods will arrive at the port in Kolkata. The agreement in this case is subjected to a further condition that the ship arrives at the Kolkata port safely, and with the goods intact and in order. In other words, if the ship were to sink in the deep sea and the goods therewith, the contract of sale will become void because of subsequent (or supervening) impossibility of the performance/execution of the contract, as per Section 56 of the Indian Contract Act.

Here, we may re-emphasise that while in the case of an actual 'sale' there is a transfer of the property (title/ownership) in the goods in question from the buyer to the seller, there is no such transfer of the property (title/ownership) in the goods in question in the case of an 'agreement to sell'. In other words, in the case of an 'agreement to sell' there is only an agreement to transfer (and not an actual transfer of) the property in the goods in question from the buyer to the seller, at a later date.

Problem 9

(a) In Problem 7 above (i.e. in the case of a sale), whether the seller has the right to sue the buyer for the realisation of the price of the goods sold, or only for the damages?

(b) In Problem 8 above (i.e. in the case of an agreement to sell), whether the seller has the right to sue the buyer for the realisation of the price of the goods sold, or only for the damages?

Give reasons for your answer in both the cases.

Solution

(a) In Problem 7 above (i.e. in the case of a sale), as the property in the goods has actually been transferred by the buyer to the seller, the seller has the right to sue the buyer for the realisation of the price of the goods sold, and not for damages.

(b) In Problem 8 above (i.e. in the case of an agreement to sell), in the event of a breach of the contract, the seller can sue the buyer only for the damages, unless the price of the goods was to be paid on an agreed specific date. This is because the property in the goods has not actually been transferred by the buyer to the seller

Problem 10

Which one the two parties involved in the transaction (viz., buyer or seller), will have to bear the loss in the following cases?

(a) In the event of the loss of the goods sold, but the goods were still in the possession of the seller.

(b) In the case of an agreement to sell, in the event of the loss of the goods agreed to be sold, and the goods were in the possession of the (prospective) buyer.

Give reasons for your answer in both the cases.

Solution

(a) In the event of the loss of the goods sold, even if the goods were still in the possession of the seller, the loss will have to be borne by the buyer. This is based on the principle that the 'risk' is associated with the 'ownership'. And in the case of an actual sale, the ownership gets immediately transferred from the seller to the buyer.

(b) In the case of an agreement to sell, in the event of the loss of the goods agreed to be sold, the loss will have to be borne by the seller, even if the goods were in the possession of the (prospective) buyer. This is so because in the case of an agreement to sell, the ownership does not get transferred from the seller to the buyer, unless the sale is actually completed.

Problem 11

(a) In the cases where the buyer has already paid the price to the seller for the goods purchased by him, and thereafter the seller has become insolvent, can the buyer claim the goods (purchased by him) from the Receiver or the Official Assignee, or he can only claim a rateable dividend for the money paid by him?

(b) In the case of an agreement to sell, where the seller has subsequently become insolvent, can the buyer claim the goods from the Receiver or the Official Assignee or he can only claim a rateable dividend for the money paid by him?

Give reasons for your answer in both the cases.

Solution

(a) In the cases where the buyer has already paid the price to the seller for the goods purchased by him, and thereafter the seller has become insolvent, he (buyer) can claim the goods (purchased by him) from the Receiver or the Official Assignee, and not a rateable dividend for the money paid by him? This is so because in the case of an actual sale, the ownership gets immediately transferred from the seller to the buyer.

(b) In the case of an agreement to sell, where the seller has subsequently become insolvent, the buyer cannot claim the goods from the Receiver or the Official Assignee. He can only claim a rateable dividend for the money paid by him? This is so because, in the case of an agreement to sell, the ownership does not get transferred from the seller to the buyer, unless the sale is actually completed.

Problem 12

(a) The buyer has become insolvent, without paying the price to the seller for the goods purchased by him. Will the seller have to deliver the goods in question to the Receiver or the Official Assignee?
(b) Will the legal position be any different in the case where the seller had the lien over the goods so sold?
(c) In the case of an agreement to sell, when the seller becomes insolvent, can the seller refuse the delivery of the goods to the Receiver or the Official Assignee.

Solution

(a) In the case where the buyer has become insolvent, without paying the price to the seller for the goods purchased by him, the seller will have to deliver the goods in question to the Receiver or the Official Assignee. This is so because the ownership of the goods involved has already passed on to the buyer, at the time of the sale.
(b) The legal position will definitely be different in the case where the seller had the lien over the goods so sold, in that the seller will not have to deliver the goods in question to the Receiver or the Official Assignee, in such a case, because the seller has his lien over the goods so sold.
(c) In the case of an agreement to sell, when the seller becomes insolvent, the seller can refuse the delivery of the goods involved to the Receiver or the Official Assignee. This is so because the seller has already entered into an agreement to sell those goods, and if he will fail to do so, he may have to pay damages to the (prospective) buyer for the breach of the agreement.

Problem 13

(a) Akanksha has entered into a hire purchase agreement with a hirer to hire a ceiling fan. Under such agreement, Akanksha (hire purchaser) has agreed to pay a certain pre-agreed amount to him every month by way of the monthly instalment for 12 months. Akanksha (hire purchaser) has paid the monthly instalment regularly every month for 10 months, but she had stopped paying any instalment thereafter, despite receiving a notice from the hirer that if she will not pay the remaining two monthly instalments, he (hiree) will take away the ceiling fan from her possession. Is the hiree legally entitled to take away the ceiling fan from her (Akanksha) possession? Give reasons for your answer.
(b) What sound advice will you give to Akanksha in the instant case?

Solution

(a) Yes, the hiree is legally entitled to take away the ceiling fan from her (Akanksha) possession. This is so because, in case the hirer (Akanksha in the instant case) fails to pay any of the monthly instalments, the owner of the goods (hiree) has the option to terminate the contract and take away the goods, given on hire purchase terms. This is so because the ownership of the goods continues to remain with the (initial) owner (hiree) himself, till every instalment, including the last instalment, is finally and fully paid. This is so, because, till then, it constitutes only a bailment of the goods, and not a sale thereof.
(b) In the instant case, we will advise Akanksha to pay the remaining two monthly instalments to the hiree, because, by doing so she will become the owner of the ceiling fan immediately and automatically on payment of the last and final instalment, which tantamount to exercising her option to purchase the goods. Otherwise, she will lose the ceiling fan and also the amount of the 10 instalments already paid by her to the hiree.

Problem 14

(a) Meenakshi has entered into a contract with Ravi, a renowned painter, to paint a picture for her drawing room for an agreed price. The required material was agreed to be supplied by Meenakshi. Will this contract be treated as a contract for 'work and labour', or else as a contract for the 'sale of goods'?
(b) Mayuri has delivered some gold biscuits to a goldsmith, for making some ornaments. Will this contract be in the nature of a contract for 'work and labour', or that of the 'sale of goods'?

(c) A dentist enters into an agreement with Damodar to prepare a set of dentures (artificial teeth) to fit into his (Damodar's) mouth. Will this contract be deemed to be a contract for the 'sale of goods', or else as a contract for 'work and labour'?

Solution

(a) This contract will be treated as a contract for 'work and labour', and not as a contract for the 'sale of goods'. This contention is supported by the case law titled **Robinson vs Graves [(1935), I. K. B. 579]**.

(b) This contract will be deemed to be in the nature of a contract for 'work and labour', and not that of the 'sale of goods'.

(c) This contract will, however, be deemed to be a contract for the 'sale of goods', and not as a contract for 'work and labour'. This contention is based on the case law titled **Lee vs Griffin [(1861), L. J. Q. B. 252]**.

Chapter Twenty Five

Law of Sale of Goods; and Pricing of Goods

"*No sale is really complete until the product is worn out, and the customer is satisfied.*
L.L. Bean

I am the world's worst salesman; therefore, I must make it easy for people to buy.
F.W. Woolworth

Make a customer, not a sale.
Katherine Barchetti

What is a man if he is not a thief who openly charges as much as he can for the goods he sells?
Mahatma Gandhi

There is one rule for the industrialist and that is: Make the best quality of goods possible at the lowest cost possible, paying the highest wages possible.
Henry Ford

Cheat me in the price, but not in the goods.
English Proverb"

25.1 What is Meant by the Term 'Goods'?

'Goods' comprise all kinds of movable (and not immovable) property, other than the actionable claims and money. It, however, includes stocks and shares, growing crops, grass, and other things attached to or forming part of the land (and not the land itself, as it is an immovable property), which are agreed to be severed from

the land before the sale or under the contact of sale. In this context, the element of the agreement of severance from the land is of essence. Accordingly, the standing trees may as well be sold which may be cut and thereafter taken away by their purchaser. Such contract will also be deemed to be a contact of goods, by virtue of their becoming movable property after being severed from the land. It was so held in the case titled **Singh vs Saran [(1948) I. A. 396]**. Further, the items like goodwill, copyright, trademark, patents, water, gas, electricity also fall under the category of goods. This contention is based on the case law titled **Rash Behari vs Emperor [(1936) 41 CWN 225; A.I.R. 1936 Cal. 753], and [Commissioner of Sales Tax vs M.P. Electricity Board, A.I.R. 1970 SC 732].** Accordingly, these items may also form the subject matter of a contract of sale. But, under the English Law, the stocks and shares are not expressly included in the category of goods.

We have observed in the preceding paragraph, that money is expressly excluded from the category of 'goods'. This is so because the price in the transaction of every sale is paid in terms of money. Therefore, money itself cannot be the subject matter of a contract of sale. In this context, the term 'money' comprises only legal tenders (i.e. the Indian currency notes of the denominations of Rs 2 to Rs 1,000, under circulation in the home country alone), and not the coins. Therefore, the old coins can as well be sold and purchased, as this item falls within the category of 'goods'. Similarly, even foreign currency (notes) can be sold and purchased as 'goods', because these do not fall in the category of the legal tenders, which comprise only the currency notes under circulation within the home country only.

We have also observed in the preceding paragraph that even 'actionable claims' have been expressly excluded from the category of 'goods'. This is so because 'actionable claims' are not such things which a person can make any use of. It can, instead, be claimed by a person only through filing a legal case in the Court of law. Thus, the outstanding debts will fall under the category of 'actionable claims', which cannot be classified as 'goods'.

25.2 Documents of Title to Goods

A 'document of title to goods' is any document which is used as a proof of the possession or control of goods, authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive the goods represented thereby. The following documents are recognised as the 'documents of title to goods' under **Section 2 (4)**:

(i) Railway Receipt,
(ii) Warrant or Order for the delivery of goods,
(iii) Bill of Lading,
(iv) Dock Warrant,
(v) Warehouse Keeper's Certificate,
(vi) Wharfringer's Certificate, and
(vii) Any other document used in the ordinary course of business as a 'documents of title to goods'.

25.3 Classification of Goods

Goods may be classified under the following three broad categories:

(i) Existing Goods;
(ii) Future Goods; and
(iii) Contingent Goods.

Let us now discuss these three different categories of goods one after the other.

25.3.1 Existing Goods

As defined in **Section 6**, the goods that are owned or possessed by the seller at the time of the contract are referred to as the 'existing goods'. Here, we may clarify that the goods possessed but not owned refers to such goods which are in the possession of the agent of the owner of the goods, or are in the possession of the pledgee of the goods, who are only in the possession of the goods but none of them own them (goods).

The 'existing goods' may be further sub-divided into the following categories:

(i) Specific and Ascertained; and
(ii) Generic or Unascertained.

25.3.1.1 'Specific Goods'

'Specific goods', as defined under **Section 2 (14),** are such goods which are identified and agreed upon at the time of entering into a contract of sale itself.

'Ascertained goods' may also be generally understood as being a synonym of the 'specific goods'. But, the subtle difference between these two terms is that while the 'specific goods' are identified and agreed upon at the time of entering into a contract of sale itself, the 'ascertained goods' are such goods which have become ascertainable or are ascertained only after the contract of sale has already been entered into earlier. This contention is based on the observations made by Lord Atkin in the case titled **re Wait [(1927), 1, Ch. 606]** that the term 'ascertained goods' probably means the goods that are 'identified in accordance with the agreement after the time a contract of sale is made'.

25.3.1.2 'Generic or Unascertained Goods'

'Generic or unascertained goods' refer to such goods which are indicated by way of their description and which are not specifically identified, as against the case of the specific goods, where the goods involved are specifically identified at the time of entering into a contract of sale itself.

Example

Aruna Automobiles has 500 pieces of the Bajaj scooters on display in its showroom. It (firm) agrees to sell one of the 500 Bajaj scooters to Raghu, without specifying any particular piece to be sold to him. This contract is for the sale of uncertain goods as no specific (certain) piece of scooter, out of the 500 pieces of the Bajaj scooters, has been specified (ascertained) by the seller to be the subject matter of the sale at the time of entering into the contract of sale.

25.3.2 Future Goods

As defined under **Section 2(6)**, 'future goods' means such goods which is yet to be manufactured, produced or acquired by the seller after entering into the contract of sale.

Example

Where a person agrees to sell the future yield of mangoes in some particular trees in his farm house, or where a farmer agrees to sell the future crops of wheat or rice and so on, in his particular field, are the cases of agreements to sell the future goods.

25.3.3 Contingent Goods

As defined under **Section 6(2)**, the 'contingent goods' are such goods the acquisition whereof by the seller is dependent upon a certain contingency, which may happen or may not happen. Thus, 'contingent goods' may be said to be a part (kind) of the 'future goods'.

Example
Prakash agrees to sell the car of Onkar to Saurabh, provided Onkar, the present owner of the car, sells it to him (Prakash). Thus, the car of Onkar will fall into the category of the contingent goods.

25.4 What is a 'Price'?

The term 'Price' refers to the money (monetary) consideration for the sale of goods. Thus, the 'price', by virtue of its being the consideration, is an essential and integral part of any valid contract of sale (as 'consideration' is an essential part of any contract). Further, in case the price of the goods, being the subject matter of the sale, is not already fixed, or is not capable of being fixed, the contract of sale concerned will be treated as void *ab initio*, as any contract without consideration is declared as void *ab initio* under **Section 25 of the Indian Contract Act**, unless certain conditions, stipulated under the same **Section 25** are satisfied.

25.5 Rules for Fixing the Price

The rules and mode of fixing the price of goods have been provided under **Sections 9 and 10**.

Section 9 lays down the following rules and mode of fixing the price of goods:

(i) It may be fixed by way of the contract itself; or
(ii) It may be agreed to be fixed in a manner provided by the contract, for example by a valuer; or
(iii) It may be fixed (determined) by the course of dealings between the parties (i.e. seller and buyer). This contention is supported by the case titled **Browne vs Byrine [(1854), 118 E.R. 1304]**, wherein the usage of deducting the amount of discount in determining (fixing) the price was implied from the course of dealings.
(iv) In case the price of the goods is not capable of being fixed in any of the aforementioned ways, the borrower will be bound to pay a reasonable price for the goods purchased. The amount of the reasonable price will, however, differ from case to case. However, in case there is a market price of the goods involved available, the same (market) price will be treated as the reasonable price for the goods purchased.

Section 10 provides the following rules and mode of fixing the price of goods:

(i) If the price is to be fixed by the valuer, and the valuer concerned does not fix the price of the goods involved, the agreement of sale becomes void, except in regard to the part of the goods delivered to and accepted by the buyer. For such goods, which have been delivered to and accepted by the buyer, he (buyer) is legally bound to pay a reasonable price for the goods involved.
(ii) Further, if any one of the parties involved (i.e. either the seller or the buyer) happens to prevent the valuer from making the valuation of the goods involved, he will be liable to pay the damages to the other party to the contract.

Let us Recapitulate

- 'Goods' comprise all kinds of movable (and not immovable) property, other than the actionable claims and money. It, however, includes stocks and shares, growing crops, grass, and other things attached to or forming part of the land (and not the land itself, as it is an immovable property), which are agreed to be severed from the land before the sale or under the contact of sale. In this context, the element of the agreement of severance from the land is of essence. Accordingly, the standing trees may as well be sold which may be cut and thereafter taken away by their purchaser. Such contract will also be deemed to be a contact of goods, by virtue of their becoming movable property after being severed from the land.
- Money is expressly excluded from the category of 'goods', because the price in the transaction of every

sale is paid in terms of money. Further, as 'money' comprises only legal tenders (i.e. the Indian currency notes of the denominations of Rs 2 to Rs 1,000, under circulation in the home country alone), and not the coins, the old coins can as well be sold and purchased, as this item falls within the category of 'goods'.

- 'Actionable claims' have been expressly excluded from the category of 'goods', because 'actionable claims' are not such things which a person can make any use of. It can, instead, be claimed by a person only through filing a legal case in the Court of law. Thus, the outstanding debts will fall under the category of 'actionable claims', which cannot be classified as 'goods'.
- A 'document of title to goods' is any document which is used as a proof of the possession or control of goods, transferable by endorsement or by delivery' The following documents are recognised as the 'documents of title to goods' under **Section 2 (4)**:

  (i) Railway Receipt,
  (ii) Warrant or Order for the delivery of goods,
  (iii) Bill of Lading,
  (iv) Dock Warrant,
  (v) Warehouse Keeper's Certificate,
  (vi) Wharfringer's Certificate, and
  (vii) Any other document used in the ordinary course of business as a 'documents of title to goods'.

- Goods may be classified under the following three broad categories:

  (a) Existing Goods;
  (b) Future Goods; and
  (c) Contingent Goods.

  The 'existing goods' may be further sub-divided into the following categories:

  (i) Specific and Ascertained; and
  (ii) Generic or Unascertained.

  (i) 'Specific goods', as defined under **Section 2 (14),** are such goods which are identified and agreed upon at the time of entering into a contract of sale itself.

  'Ascertained goods', though generally understood as being a synonym of the 'specific goods', the subtle difference between these two terms is that while the 'specific goods' are identified and agreed upon at the time of entering into a contract of sale itself, the 'ascertained goods' are such goods which have become ascertainable or are ascertained only after the contract of sale has already been entered into earlier.

  (ii) 'Generic or unascertained goods' refer to such goods which are indicated by way of their description and which are not specifically identified, as against the case of the specific goods, where the goods involved are specifically identified at the time of entering into a contract of sale itself.

- The term **'Price'** refers to the money (monetary) consideration for the sale of goods. Thus, as 'consideration' is an essential part of any contract, 'price' is an integral part of every valid contract of sale also. Further, in case the price of the goods is not already fixed, or is not capable of being fixed, the contract of sale concerned will be treated as void *ab initio*, due to the absence of the element of consideration, as per **Section 25** of the Indian Contract, unless certain conditions, stipulated under the same **Section 25** are satisfied.
- The following are the **rules and mode** of fixing the price of goods:
  Section 9 provides that:

  (i) It may be fixed by way of the contract itself; or
  (ii) It may be agreed to be fixed in a manner provided by the contract, for example by a valuer; or
  (iii) It may be fixed (determined) by the course of dealings between the parties (i.e. seller and buyer).

(iv) In other cases, the borrower will be bound to pay a reasonable price for the goods purchased. The amount of the reasonable price will, however, differ from case to case. Generally, the market price will be treated as the reasonable price for the goods purchased.

- **Section 10** provides that:
  (i) If the price is to be fixed by the valuer, and the valuer does not fix the price of the goods involved, the agreement of sale becomes void, except in regard to the part of the goods delivered to and accepted by the buyer. For such goods, he (buyer) has to pay a reasonable price for the goods involved.
  (ii) Further, if any one of the parties involved (i.e. either the seller or the buyer) happens to prevent the valuer from making the valuation of the goods involved, such party will be liable to pay the damages to the other party to the contract.

Questions for Reflection

1. (a) What is meant by the term 'goods'?
   (b) Why are the 'actionable claims' and 'money' been expressly excluded from the category of goods?
2. Do the following items fall within the category of goods? Give reasons for your answer in each case.
   (i) House property;
   (ii) Stocks and share;
   (iii) Growing crops, grass, and other things attached to the land, but agreed to be severed from the land before the sale or under the contact of sale;
   (iv) Land;
   (v) Growing crops, grass, and other things attached to, but agreed not to be severed from the land before the sale or under the contact of sale;
   (vi) Standing teak trees attached to the land, but agreed to be severed from the land before the sale or under the contact of sale;
   (vii) Standing mango trees attached to the land, but agreed not to be severed from the land before the sale or under the contact of sale;
   (viii) Goodwill, copyright, trademark, patents, water, gas, and electricity
   (ix) Old coins;
   (x) Foreign currency notes;
   (xi) Future yield of mangoes in some particular trees;
   (xii) Current yield of mangoes in some particular trees; and
   (xiii) Current crop of wheat in the farm.
3. (a) Define the term 'documents of title to goods' as provided under Section 2 (4) of the Indian Contract Act.
   (b) Give the names of five documents which are recognised as the 'documents of title to goods' under Section 2 (4) of the Indian Contract Act.
4. (a) Under what three broad categories 'goods' can be classified? Name them.
   (b) Under what two broad categories the 'existing goods' may be further sub-divided? Name them.
5. What are the salient features of the following terms? Give illustrative examples in each case.
   (i) Existing Goods;
   (ii) Future Goods;
   (iii) Contingent Goods;
   (iv) Specific Goods;
   (v) Ascertained Goods;

(vi) Generic Goods;
(vii) Unascertained Goods;
(viii) Future Goods; and
(ix) Contingent Goods.

6. (a) Define the term 'price'.
   (b) Why is the 'price' regarded as an essential and integral part of any valid contract of sale?
7. (a) In case the 'price' of the goods is not already fixed, or is not capable of being fixed, will the contract of sale concerned be treated as void *ab initio*, or voidable?
   (b) If the contract will be considered voidable, at whose option will it be treated as voidable?
8. What are the various rules and modes of fixing the price of goods, as provided under Sections 9 and 10 of the Sale of Goods Act?
9. (a) If the price is to be fixed by the valuer, and the valuer concerned does not fix the price of the goods involved, will the agreement of sale be treated as void or voidable? Give reasons for your answer.
   (b) In the case of Question 9 (a) above, what will be the legal position of such goods, which have been delivered to and accepted by the buyer? That is, whether the buyer is legally bound to pay a reasonable price for the goods involved, or he can return such delivered and accepted goods to the seller?
10. In case any one of the parties involved (i.e. either the seller or the buyer) happens to prevent the valuer from making the valuation of the goods involved, what are the legal remedies available the other party to the contract?

Problems for Practice (With Suggested Solutions)

Problem 1

Rekha has agreed to purchase 10 standing teakwood trees from Vandana for use in her (Rekha's) house under construction. But later Rekha wants to back out on the ground that, under the Sale of Goods Act, only movable goods can be sold. Accordingly, as the standing teakwood trees of Vandana are in the nature of immovable property, as these (standing teakwood trees) are imbedded to the land of Vandana, these trees cannot become the subject matter of the sale. Do you think that the contention of Rekha is valid in the eye of law? Give reasons for your answer.

Solution

No, the contention of Rekha is not valid in the eye of law. This is so because standing teakwood trees, like the growing crops, grass, and other things attached to or forming part of the land (and not the land itself, as it is an immovable property), which are agreed to be severed from the land before the sale or under the contact of sale, can become the subject matter of sale, under the Sale of Goods Act, In this context, the element of the agreement of severance from the land is of essence. Accordingly, the standing trees may as well be sold which may be cut and thereafter taken away by their purchaser. Such contract will also be deemed to be a contact of goods, by virtue of their becoming movable property after being severed from the land. In this connection, as the teakwood trees are being purchased for use in her (Rekha's) house under construction, it is implied that she would cut the trees and thereafter take them away.

Problem 2

Goverdhan has agreed to purchase some old coins from Lakshman at a very high price. Later, Goverdhan had realised his mistake and therefore, wanted to back out from the deal on the ground that 'money' has expressly been excluded from the category of goods, to be the subject matter of sale under the Sale of Goods Act. Accordingly the old coins, being in the nature of money, cannot be the subject matter of sale. Do you think that the contention of Goverdhan is valid in the eye of law? Give reasons for your answer.

Solution

No, the contention of Goverdhan is not valid in the eye of law. This is so because, the term 'money' comprises only legal tenders (i.e. the Indian currency notes of the denominations of Rs 2 to Rs 1,000, under circulation in the home country alone), and not the coins. Therefore, the old coins can as well be sold and purchased, as this item falls within the category of 'goods', as per the Sale of Goods Act.

Problem 3

Bharat had agreed to purchase some US dollar currency (notes) from Shailendra, who had recently returned from the USA. Later, Bharat wanted to back out from the deal on the ground that 'money' has expressly been excluded from the category of goods, to be the subject matter of sale under the Sale of Goods Act. Accordingly, the US dollar currency (notes), being in the nature of money, cannot be the subject matter of sale. Do you think that the contention of Bharat is valid in the eye of law? Give reasons for your answer.

Solution

No, the contention of Bharat is not valid in the eye of law. This is so because, the term 'money' comprises only legal tenders (i.e. the Indian currency notes of the denominations of Rs 2 to Rs 1,000, under circulation in the home country alone), and not the foreign currency notes, which are not the legal tender to be in circulation in India. . Therefore, the US dollar currency notes (being the foreign currency notes) can as well be sold and purchased, as this item falls within the category of 'goods', as per the Sale of Goods Act, because these do not fall in the category of the legal tenders, which comprise only the currency notes under circulation within our home country (India) only.

Problem 4

Madhukar Motors has 100 pieces of Maruti 800 on display in its showroom. It (firm) agrees to sell one of the 100 pieces of Maruti 800 on display in its showroom to Ravindran, without specifying any particular piece to be sold to him. But Ravindran backs out on the ground that the firm had not specified a particular piece to be sold to him. Do you think that the contention of Ravindran is valid in the eye of law? Give reasons for your answer.

Solution

No, the contention of Ravindran is not valid in the eye of law. This is so because, in the instant case, there is a valid contract for the sale of uncertain goods, because no specific (certain) car, out of the 100 pieces of Maruti 800 on display in its showroom, has been specified (ascertained) by the seller to be the subject matter of the sale at the time of entering into the contract of sale. But the contract for the sale of uncertain goods is also valid as per the Indian Contract Act.

Problem 5

Robert had agreed to sell the car of John to Surendra, provided John, the present owner of the car, sells it to him (Robert). But Surendra later had backed out from the deal on the ground that it was a conditional and not an unconditional contract of sale of goods. Do you think that the contention of Surendra is valid in the eye of law? Give reasons for your answer.

Solution

No, the contention of Surendra is not valid in the eye of law. This is so because, the instant case is not a case of a conditional or an unconditional contract of sale of goods, but a case of the sale of 'contingent goods', instead; the car of John being the 'contingent goods' in the instant case. And, as the sale of 'contingent goods' is held valid under the Indian Contract Act, the contention of Surendra is not valid in the eye of law.

Problem 6

Subodh has agreed to sell certain goods to Basant. But the price of the goods has neither been fixed, nor is it capable of being fixed. Will this contract of sale be treated as void *ab initio*, or vioidable at the option of the buyer? Give reasons for your answer.

Solution

This contract of sale will be treated as void *ab initio* (and not vioidable at the option of the buyer). This is so because the term 'price' refers to the money (monetary) consideration for the sale of goods. Thus, the 'price',

by virtue of its being the consideration, is an essential and integral part of any valid contract of sale (as 'consideration' is an essential part of any contract). Further, in case the price of the goods, being the subject matter of the sale, is not already fixed, or is not capable of being fixed, the contract of sale concerned will be treated as void *ab initio*, as any contract without consideration is declared as void *ab initio* under Section 25 of the Indian Contract Act (unless certain conditions, stipulated under the same Section 25 are satisfied).

Problem 7

Suraj has agreed to sell certain goods to Bhagwat. But price of the goods so sold has neither been mentioned in the contract of sale of goods nor has the contract provided any method of fixing the price of the goods so sold. Its price cannot be fixed by the course of dealings between the parties (i.e. seller and buyer), either. Suraj and Bhagwat (seller and buyer respectively) have approached you for your expert legal opinion to suggest to them some way out. What will be your sound legal advice to them? Give reasons for your answer.

Solution

We will advise them that, as provided under Section 9 of the sale of Goods Act, in case the price of the goods is not capable of being fixed in any of the ways, as aforementioned in the question, the borrower will be bound to pay a reasonable price for the goods purchased. The amount of the reasonable price will, however, differ from case to case. However, in case there is a market price of the goods involved available, the same (market) price will be treated as the reasonable price for the goods purchased. We will, therefore, counsel them to settle the matter accordingly.

Problem 8

Samuel has agreed to sell certain goods to Browning, on the condition that the price of the goods so sold will be fixed by the valuer. Further, a part of the goods have already been delivered to and accepted by the buyer. The valuer concerned, however, has refused to fix the price of the goods involved.

(a) Will this agreement of sale become void *ab initio*, or will it be treated as being voidable at the option of either the seller or the buyer? Give reasons for your answer.
(b) What will be legal position in regard to the part of the goods already delivered to and accepted by the buyer?

Solution

(a) As provided under Section 10 of the sale of Goods Act, in case the price is to be fixed by the valuer, and the valuer concerned refuses to fix the price of the goods involved, the agreement of sale becomes void, *ab initio*, except in regard to the part of the goods delivered to and accepted by the buyer. Accordingly, this agreement of sale will become void *ab initio*. Thus, the question of it being treated voidable, at the option of either the seller or the buyer, does not arise at all.
(b) Further, for such goods, which have been delivered to and accepted by the buyer, he (buyer) is legally bound to pay a reasonable price for the goods involved.

Problem 9

Sajjad had agreed to sell certain goods to Ibrahim., on the condition that the price of the goods so sold will be fixed by the valuer. But Sajjad, the seller, had prevented the valuer from making the valuation of the goods involved. What are the legal remedies available to Ibrahim, the buyer, in the instant case?

Solution

As provided under Section 10 of the sale of Goods Act, in case any one of the parties involved (i.e. either the seller or the buyer) happens to prevent the valuer from making the valuation of the goods involved, he will be liable to pay the damages to the other party to the contract. Accordingly, in the instant case, as Sajjad, the seller, had prevented the valuer from making the valuation of the goods involved, he will have to pay the damages to the other party to the contract, i.e. to the buyer.

Chapter Twenty Six

Conditions and Warranties

"*Honesty prospers in every condition of life.*
J. F. Von Schiller

Peace is the one condition of survival in this nuclear age.
Adlai E. Stevenson

Variety is the condition of harmony.
Thomas Carlyle

The will to conquer is the first condition of victory.
Ferdinand Foch

Honour and shame from no condition rise;
Act well your part, there all the honour lies.
Alexander Pope"

26.1 'Condition' and 'Warranty' Defined

As defined under **Section 12 (2)**, a 'condition' is a 'stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated'. As against this, a 'warranty' has been defined under **Section 12 (3)**, as a 'stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated'.

Thus, a condition is the stipulation of certain terms and conditions in the contract of sale which are essential and primary (i.e. of a fundamental nature), to the main purpose of the contract of sale. As against this, a warranty is the stipulation of certain terms and conditions in the contract of sale, which are not essential and primary to the main purpose of the contract of sale, but only subsidiary and collateral (additional) to it (contract).

26.2 'Condition' and 'Warranty' Distinguished

An **example** of 'condition', which is of a primary and fundamental nature is the quality of the goods involved, the breach whereof will be regarded as the breach of the contract itself. It will, therefore, give a right to the aggrieved party to treat the contract as repudiated (cancelled). Accordingly, if the buyer has already paid the price of the goods so purchased, he can claim the refund of the price together with the damages for the breach of contract.

As against this, the time of payment of the price of the goods involved may be deemed to be a 'warranty', instead, because, though it is also intended by the parties to the contract of sale to be binding on them, it is not of a primary and fundamental nature, but only of a secondary and subsidiary nature. Accordingly, being in the nature of a warranty, a breach of such term and condition will not repudiate (cancel) the whole contract itself. It will, instead, make the party, who breaches the warranty, liable for damages. But the buyer cannot reject the goods so purchased by him.

It may, however, be clarified here that, as stipulated under **Section 12 (4)**, whether a stipulation in a contract of sale is to be treated as a 'condition' or 'warranty', will depend upon the construction of the contract of sale in each case. That is to say that a stipulation may be deemed to be in the nature of a 'condition', though it has been referred to as a 'warranty' in the contract of sale. However, a breach of 'warranty' may not be treated as a breach of 'condition' under any circumstances.

The following illustrative examples may further clarify the points of distinction between 'Condition' and 'Warranty'.

Examples

(i) Arvind selects a particular horse and buys it, as it is warranted as a quiet horse to ride and drive. But, if the horse later turns out to be not quiet but vicious, the remedy available to Arvind (buyer of the horse) will be only to claim damages, as this stipulation in the contract of sale will be treated as a 'warranty' and not a condition'.

(ii) As against this, if Arvind, instead of selecting and buying a particular horse, would have asked the seller of horses to sell to him a horse which is quiet to ride and drive, and the horse supplied to him would have later turned out to be not quiet but vicious, the stipulation in this case will be treated as a 'condition' and not a 'warranty'. Accordingly, Arvind (buyer of the horse) in this case, will have the option either to reject the horse and demand the refund of the price of the horse already paid by him, or he may keep the horse and sue the seller of the horse to claim damages.

The main distinctions between 'Condition' and 'Warranty' have been summarised in **Table 26.1**.

Table 26.1 *Distinguishing Features between 'Condition' and 'Warranty'*

Condition	*Warranty*
(i) A 'condition' is the stipulation in a contract of sale, which is essential to the main purpose of the contract.	(i) A 'warranty' is a stipulation in the contract of sale which is only collateral (additional) and subsidiary to the main purpose of the contract.
(ii) A breach of 'condition' entitles the aggrieved party (buyer in the case of a contract of sale),to the right to sue the other party (seller in the case of a contract of sale),for the damages as also the right to repudiate (cancel) the contract of sale itself.	(ii) A breach of 'warranty' in the contract of sale, however, gives only the right to sue for the damages. It does not give the right to repudiate (cancel) the contract of sale itself.
(iii) A breach of 'condition' may be treated as a breach of 'warranty' in certain circumstances, depending upon the construction of the contract of sale.	(iii) A breach of 'warranty', however, may not be treated as a breach of 'condition' under any circumstances.

26.3 When to Treat a 'Condition' as a 'Warranty'?

As stipulated under **Section 13**, in the following circumstances, a breach of condition will be treated as a breach of warranty, instead, whereby the buyer will lose his right to repudiate (cancel) the contract of sale:

26.3.1 Waiver of condition

In the cases where the contract of sale is subjected to any condition to be fulfilled by the seller, the buyer may (a) prefer to waive the condition or (b) elect to treat a breach of condition as a breach of warranty, instead.

26.3.2 Compulsory Treatment of a Breach of Condition as a Breach of Warranty, Instead

In the cases where the contract of sale is not severable (separable), and the buyer has accepted the entire goods or even a part of it, a breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, instead. But then, if the contract of sale provides otherwise (i.e. if the contract permits the repudiation of the contract in spite of the buyer accepting the entire goods or even a part of it), the buyer will remain entitled to his right to repudiate (cancel) the contract itself.

26.4 Express and Implied 'Conditions' and 'Warranties'

Express 'conditions' and 'warranties' are those where the terms stipulated in the contract of sale itself expressly provide for them (i.e. for the 'conditions' and 'warranties'). As against this, the implied 'conditions' and 'warranties' are those where, though the terms stipulated in the contract of sale itself do not expressly provide for them (i.e. for the 'conditions' and 'warranties'), the law deems their existence in the contract even without their actual mention in the contract of sale. But then, the implied 'conditions' and 'warranties' may be negated by express terms and conditions to the contrary, stipulated in the contract of sale. Thus, the provisions of **Section 62** are based on the maxims: (a) *'Expressum facit cessare tacitum'*, which means 'What is expressed makes what is implied to cease', and (b) *'Modus et conventio vincunt legem'*, which stands for 'Custom and conventions overrule law'.

26.4.1 Express 'Conditions' and 'Warranties'

There may be any type of express 'conditions' and 'warranties' to which the parties involved in a contract of sale (i.e. seller and buyer) may decide to agree upon. For example, it may be agreed that the buyer will not sell the goods purchased by him below a certain price, or that the delivery of the goods involved will be made by the seller or taken by the buyer on or before a specified date. Likewise, in a contract of sale of a car, express warranty may stipulate regarding its soundness.

26.4.2 Implied 'Conditions' and 'Warranties' (Sections 14 to 17)

Unless the terms and conditions stipulated in the agreement of sale of goods provide an intention to the contrary, the following implied 'conditions' and 'warranties' are presumed to have been incorporated in every contract of sale of goods:

26.4.2.1 Conditions as to Title

As provided under **Section 14 (a)**, in a contract of sale, unless the circumstances of the contract are such that show an intention to the contrary, there will be an implied condition on the part of the seller that in the case

of a sale, he already has the right to sell the goods. Further, in the case of an agreement to sell, it is implied and presumed that he (seller) will have the right to sell the goods at the time when the property (ownership) of the goods involved will be passed on from the seller to the buyer. Conversely speaking, in case the seller's title to the goods sold is found to be defective, the buyer of the goods will be entitled to reject the goods and claim the refund of the price, if paid, together with claiming the damages. The buyer will be entitled to both these rights even if he would have used the goods so supplied.

Examples

(i) The judgement delivered in the case titled **Rowland vs Duvall [(1923) 2 K.B.]** illustrates the point.

X had purchased a car from Y. But Y did not have a valid title to the car. X had used the car for several months. Thereafter, one day Z, the true owner of the car, spotted his car and demanded it back from X. It was held in the case that X was legally bound to hand over the car back to Z, the true owner of the car. It was further held that X could successfully sue Y, the seller who had sold the car without having a valid title thereto, for the recovery of the purchase price already paid by him to Y, despite the fact that X had driven the car for several months.

(ii) Again, in the case where the goods have been sold by infringement of a trademark, the buyer has the right to repudiate (cancel) the sale on the plea that there was a breach of condition as to the title to the goods so sold. This contention has been supported by the judgement in the case titled **Niblett vs Confectioners Materials Company Limited [(1921) 3 K.B. 387].** However, this condition may be neglected by an express term, as in the cases of sales by the custom authorities or by the Court.

26.4.2.2 Condition in the Sale by Description (Section 15)

In the case of a contract for the sale of goods by the description of the goods involved, there is an implied condition that the goods, supplied or to be supplied, shall be in conformity with (correspond to) the description of the goods agreed upon. Again, in the case of a contract for the sale of goods by the sample as also by the description of the goods involved, the goods should not only be in conformity with (correspond to) the sample of the goods, but should also be in conformity with the description of the goods agreed upon.

Examples

The following illustrative law cases may clarify the points still further:

(i) A ship was sold by description, saying 'copper-fastened vessel'. But it was actually found to be only a partly 'copper-fastened vessel'. It was held in the case titled **Shepherd vs Kain [(1821) 5 B. and Ald. 240]** that the goods did not correspond to the description thereof, and hence the buyer could return it. Alternatively, if the buyer had already taken the goods, he could claim damages for the breach of contract. The same will be the case even if the ship was sold subject to all faults and defects.

(ii) In another case, a car was sold as a 'new Singer car'. It was later found by the buyer that it was not a new car but an already used one. It was held in the case titled **Andrews Limited vs Singer and Company Limited [(1934) 1 K.B. 17]**, that the buyer may return the car or retain it and claim damages for the breach of contract.

(iii) In a case, 'foreign refined rape oil' was sold which was warranted to be corresponding with the sample. However, the sample itself was not a 'foreign refined rape oil' but a mixture of 'hemp oil', instead. It was, therefore, held in the case titled **Nichol vs Godts [(1854) 10 Ex. 19]**, that the buyer may reject the oil, though the bulk corresponded with the sample. This was so held because the sample itself did not correspond with the description of the goods agreed upon, i.e. 'foreign refined rape oil'.

(iv) A contract of sale of goods was entered into for the supply of 'English sainfoin seeds', exhibited by a sample. Though the bulk of goods supplied corresponded with the sample, the seeds actually supplied were not the 'English sainfoin seeds' but the 'giant sainfoin seeds', instead. It was, therefore, held in the case titled **Willis vs Pratt [(1911) A.C. 394]**, that there was a breach of condition pertaining to the description of the goods sold.

26.4.2.3 Conditions as to Quality or Fitness

The general rule is that a buyer is supposed to satisfy himself about the quality of goods he is purchasing. He is further responsible to satisfy himself that the goods that he is purchasing will be suitable for the purpose for which he was buying it. Accordingly, if the goods purchased by him are later found to be unsuitable for the purpose for which he had purchased them, the seller cannot be held responsible for it, and therefore, he (seller) cannot be asked by the buyer to compensate him (buyer). However, there are certain exceptions to such general rule. That is, only under certain exceptional circumstances there is an implied condition as to the quality or fitness of the goods. The various such exceptional circumstances have been discussed hereafter.

(a) In the cases where the buyer, expressly or impliedly, tells the seller the specific purpose for which he was buying the particular goods, he was thereby making the seller realise that he (buyer) was relying on the knowledge, skill and judgement of the seller of the goods. Further, the goods should be of such a description the supply whereof is in the seller's usual course of business, whether he manufactures or produces the goods under sale or not. Under such circumstances, there is an implied condition that the goods will be reasonably fit and suitable for the purpose for which it was being bought. We may thus, observe that for the operation of the exception all the following three conditions must be satisfied:

- **(i)** That the purpose for which the goods were being purchased must be made known to the seller, expressly or impliedly;
- **(ii)** That the buyer must have relied on the skill, knowledge or judgement of the seller; and
- **(iii)** That the selling of such goods must be the usual business of the seller.

Examples

The following illustrative law cases may clarify the points still further:

(i) A person was a draper, who did not have any special knowledge regarding hot water bottles. He had purchased a hot water bottle from a chemist. The bottle, however, burst and in the process his wife got injured. It was held in the case titled **Priest vs Last [(1903), 2 K.B. 148],** that the chemist had committed a breach as to the fitness of the condition of the hot water bottle. In the instant case, it seems to have been presumed that the purpose of buying a hot water bottle was obvious, that the buyer, being ignorant about hot water bottles, had relied upon the knowledge or judgement of the chemist (seller), who was supposed to be knowledgeable in regard to hot water bottles, and that selling the hot water bottles was the usual business of the seller, he being a chemist in the instant case.

(ii) X had sold a refrigerator to Y. The refrigerator performed all the required functions except that it failed to make ice. It was held in the case titled **Evens vs Stella Benjamin [(1950), A.I.R. Cal. 470]** that it amounted to a breach of an implied condition.

(iii) In the case titled **Frost vs Aylesbury Co. Ltd. [(1905) 1 K.B. 608]**, Aylesbury Co. Ltd. had supplied to Frost milk, which contained germs of typhoid. Unfortunately, Frost's wife consumed the milk and got infected with the germs of typhoid and finally she died of typhoid. It was held in the case that there was a breach of condition as to fitness, and accordingly, Aylesbury Co. Ltd. was liable to pay damages to Frost. This judgement is based on the fact that, in the case of food articles, an implied condition is there to the effect that the article is fit for human consumption.

(b) The aforementioned exception will not apply in the cases where the goods in question are sold under their patent or trade name.

Examples

(i) In a case titled **Chanter vs Hopkins [(1938) M. and W. 399]** a person ordered to buy a patent smoke-consuming furnace by its patent name for his brewery. But the furnace that was supplied was found to be unsuitable for the purpose for which it was purchased. It was held in the case that the buyer had no cause of action against the seller, as patented goods was purchased.

(ii) Where the goods are purchased by description from a seller, who deals in the goods of that description (whether he happens to be its manufacturer or producer or not), there is an implied condition that the goods will be of merchantable quality, which means that the goods will be free from latent defects, i.e. where the defects are such that they are not apparently visible or it is not possible to detect the defects by mere inspection. Thus, the exception will, apply only in such cases where:

(a) The goods are purchased by description; and
(b) The goods are purchased from a seller who deals in such goods.

In this context, it must be noted that, a condition pertaining to the fitness of a particular purpose or pertaining to its quality may also arise due to a custom of trade.

26.4.2.4 Merchantable Quality

Though it is rather difficult to exactly define the term 'merchantable quality', the definition which gives the closest description of the term is provided in the case titled **Gardener vs Grey [(1814) 4 Comp. 144]** which defines it as an article which 'must be saleable in the marker under the denomination mentioned'. Alternatively speaking, the quality of the article must be such that a reasonable person would accept the article as the performance of a promise.

Examples

(i) X had bought some black yarn from Y. The yarn was found to have been damaged by the white ants. It was held in the case that the condition in regard to the merchantability was broken.
(ii) In a similar case titled **Jones vs Just [(1867) L.R. 3. Q.B. 192]**, a contract of sale of Manila hemp was entered into. The hemp supplied was, of course, Manila hemp. But then, it was so much damaged by the sea water that no one would have accepted it in the market as Manila hemp. It was held that the condition in regard to the merchantability was broken in this case.

26.4.3 But then, in the cases where the buyer has himself examined the goods prior to the sale, there will be no implied condition as to the merchantability of the goods sold, in regard to the defects which such examination would have revealed.

Example

In a case titled **Thornett and Fehr vs Beers and Sons [(1919) 1 K.B. 436],** there was a sale of vegetable glue packed in casks. The buyer, instead of thoroughly and properly examining the goods, had just looked at the outside of the casks. Accordingly, the defects, which could have been detected by the buyer, if he would have properly and thoroughly examined the vegetable glue under sale, remained undetected. It was, therefore, held in the case that there was no implied condition as to the merchantability of the goods sold.

26.4.4 But then, in a case where, despite a proper and thorough examination by the buyer of the goods under sale, some latent defects in the goods were of such a nature that no examination could have detected (revealed), there will be implied condition as to the merchantability of the goods sold, in regard to the defects.

Example

In a case titled **Khoyee & Co. vs Garden Woodroff & Co. [(1937) Mad. 497]**, some 'skins of fair average quality' were purchased. The goods were thoroughly examined by the specialists on behalf of the buyer. But even such examination did not reveal any defect in the goods. However, when the skins so bought were processed, some defects were found therein. But, these defects were of such a nature that they were not visible and detectable in their dry condition. It was, therefore, held in the case that, as the defects were latent in nature, and therefore, were undetectable in their dry condition, there will be implied condition as to the merchantability of the goods sold.

26.4.5 However, the condition regarding the merchantability of the goods sold, must be reasonably construed, because the seller cannot be held responsible if certain facts were not disclosed to the seller; these were concealed from him, instead, which itself had given rise to the element of unsuitability of the goods so purchased.

Example

In a case titled **Griffiths vs Peter Convey Ltd. [(1939) 1 All. E.R. 685]**, a lady, who had an abnormally sensitive skin, had purchased a 'Harris Tweed Coat'. When she put on the coat, she developed rashes on her sensitive-skinned body. It was held in the case that no breach of condition was involved here, because the buyer had not disclosed the fact to the seller that her skin was abnormally sensitive. Conversely speaking, if she would have disclosed the fact to the seller that her skin was abnormally sensitive, the seller would have been held liable for the breach of condition as to the merchantability of the goods sold.

26.5 Sale by Sample (Section 17)

A contract of sale by sample is when there is a term in the contract of sale to this effect, whether in express or implied terms. It may, thus, be inferred that all contracts of sale, where a sample of the goods on sale is shown, will not necessarily be a sale by sample. It will be a contract of sale by sample only when one of the terms in the contract of sale is there to this effect. Alternatively speaking, if there is no term in the contract of sale to this effect, it will be presumed that the sample, though shown, it is not shown as a warranty, but only to facilitate the buyer to form a reasonable judgement about the nature, composition, quality, and so on, about the goods to be purchased.

26.5.1 Implied Conditions in the Case of a Sale by Sample

The following are the implied conditions in the case of a sale by sample:

(**a**) That the bulk of goods will correspond to the sample, in quality;
(**b**) That the buyer will have sufficient opportunity to compare the bulk of goods supplied with the sample; and
(**c**) That the goods supplied will be free from any defects which may render them non-merchantable, which may not be apparent on a reasonable examination of the sample.

Examples

(**i**) In a case, some shoes were sold by sample to French army personnel. These shoes were later found to be containing paper, which could not have been detected by an ordinary inspection. It was, accordingly, held in the case that the buyer was entitled to get the refund of the price already paid for the shoes, as also to claim damages.
(**ii**) In another case titled **Mody vs Gregson [(1968) L.R. 4 Ex. 49]**, in a contract of sale by sample of brandy, it was found that the brandy that was supplied had been coloured with a dye. It was held in the case that the buyer was not bound by the contract, though the bulk of brandy supplied had corresponded with the sample, because the aforementioned defect could not have been detected even on a reasonable examination of the sample.

26.6 Implied Warranties

There are the following two types of implied warranties:

(**i**) Warranty of Quiet Possession, and
(**ii**) Warranty of Freedom from Encumbrances.

We will now discuss each of them one after the other.

26.6.1 Warranty of Quiet Possession [Section 14 (b)]

In the case of a contract of sale, there is an implied warranty that the buyer will have, and will be able to enjoy, a quiet (peaceful and undisturbed) possession of the goods bought by him. Accordingly, if the buyer's right of enjoyment or possession of the goods is disturbed by the seller, or even by any other person, the buyer will have the legal right to sue the seller for the damages.

26.6.2 Warranty of Freedom from Encumbrances [Section 14 (c)]

Another warranty, that the buyer of the goods is entitled to, is that the goods being sold are free from any encumbrances or charge in favour of another person, which are neither known to, nor declared to, the buyer. Accordingly, this stipulation will not be operative in the cases where the buyer has already been informed of the encumbrances or charge, or where he had the notice of such prior encumbrances or charge.

Further, the claim under this warranty will be available to the buyer only where he discharges the amount of encumbrances. **[Collinge vs Heywood (1839) 9 A. and E. 633].**

Summary of 'Implied Conditions' and 'Implied Warranties'

'Implied Conditions'

(i) Conditions as to title;
(ii) Condition in the 'sale by description' is that the goods must correspond to the description;
(iii) Conditions as to quality or fitness, in some cases;
(iv) Condition that the goods must be of merchantable quality; and
(v) In case of sale by sample:
  (a) Bulk of goods must correspond with sample;
  (b) Buyer must have reasonable opportunity to compare the bulk of goods with the sample; and
  (c) Goods must be free from any defects which may render them as non-merchantable.

'Implied Warranties'

(i) Warranty of Quiet Possession, and
(ii) Warranty of Freedom from Encumbrances.

26.7 Principle of Caveat Emptor

The principle of 'Caveat Emptor' is the fundamental principle of law of sale of goods. The term *'caveat emptor'* means in English as 'let the buyer be ware' or simply as 'buyer be ware' or 'caution buyer'. In other words, it means that it is not the duty of the seller to disclose the defects in the goods, if any, that he is selling. Conversely speaking, it is the duty of the buyer to inspect and examine the goods he intends to buy, and to satisfy himself that they are free from any defects and that they will suit the purpose for which he is buying the goods in question.

For example, when we purchase an electric bulk, we must ask the buyer to show to you that it was not a fused one. Similarly, when we purchase an earthen pot, we must strike it softly with some coin to find out from the sound that it is not damaged and leaking. Alternatively, we may fill the pot with water to ensure that it was not leaking. If we will fail to do so before purchasing such goods and will later find that the bulb was fused or the earthen pot was leaking, we cannot hold the seller responsible and, therefore, we cannot ask the seller to exchange it. You can do so only before purchasing it, if it is found to be defective at the time of purchase itself.

In the case titled **Goddard vs Hobbs [(1878), 4 App. Cas. 13]**, some pigs were sold 'subject to all faults'. These pigs were infected with the germs of typhoid. Therefore, the other healthy pigs of the buyer also got the infection of typhoid from the infected pigs bought by him. It was held in the case that the seller was not legally

bound to disclose that the pigs under sale were unhealthy as they were infected with the germs of typhoid. This judgement was based on the fundamental principle of '*Caveat Emptor*'.

26.7.1 Exceptions to the Principle of *'Caveat Emptor'*

But then, there are the following exceptions to the fundamental principle (doctrine) of *'caveat emptor'*:

(i) In the case where the seller makes a false representation and the buyer relies thereon, the principle of 'caveat emptor' will not apply. Accordingly, the buyer will be entitled to the goods of that description, as was represented (though falsely) by the seller.

(ii) In the case where the seller actively conceals any defect in the goods being sold by him, so that the defect involved in the goods may not be detected even on a reasonable inspection and examination of the goods, the principle of *'caveat emptor'* will not apply.

(iii) As we have seen in **Sub-section 26.4.2.3** in this chapter, titled ' conditions as to quality or fitness', in the cases where the buyer, expressly or impliedly, tells the seller the specific purpose for which he was buying the particular goods, he was thereby making the seller realise that he (buyer) was relying on the knowledge, skill and judgement of the seller of the goods. Further, the goods should be of such a description the supply whereof is in the seller's usual course of business, whether he manufactures or produces the goods under sale or not. Under such circumstances, there is an implied condition that the goods will be reasonably fit and suitable for the purpose for which it was being bought. Accordingly, in such cases the principle of *'caveat emptor'* will not apply.

(iv) Similarly, as we have seen in **Sub-section 26.4.2.2** in this chapter, titled 'condition in the sale by description', where the goods are sold by description, there is an implied condition that the goods will be of merchantable quality. Accordingly, in such cases also the principle of *'caveat emptor'* will not apply.

(v) But, as already discussed in **Sub-section 26.4.3** in this chapter, in the cases where the buyer has himself examined the goods prior to the sale, there will be no implied condition as to the merchantability of the goods sold, in regard to the defects which such examination would have revealed. Accordingly, in such cases the principle of *'caveat emptor'* will apply.

(vi) However, as already discussed in **Sub-section 26.4.4** in this chapter, in a case where, despite a proper and thorough examination by the buyer of the goods under sale, some latent defects in the goods were of such a nature that no examination could have detected (revealed), there will be implied condition as to the merchantability of the goods sold, in regard to the defects. Accordingly, in such cases the principle of *'caveat emptor'* will not apply.

Let us Recapitulate

- A 'condition' is a stipulation essential to the main purpose of the contract (i.e. it is of a fundamental nature), e.g., quality of the goods, the breach of which gives rise to a right to treat the contract as repudiated, whereas a 'warranty' is a stipulation collateral to the main purpose of the contract (i.e. it is only subsidiary and additional to it), e.g., the time of payment of the price of the goods, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated. Further, the buyer cannot reject the goods so purchased by him.
- Further, a stipulation may be deemed to be in the nature of a 'condition', though it has been referred to as a 'warranty' in the contract of sale. However, a breach of 'warranty' may not be treated as a breach of 'condition' under any circumstances.

- When to Treat a Condition' as a 'Warranty'?
  (a) Waiver of condition.
  Where the contract of sale is subjected to any condition to be fulfilled by the seller, the buyer may (a) prefer to waive the condition or (b) elect to treat a breach of condition as a breach of warranty, instead.
  (b) Compulsory treatment of a breach of condition as a breach of warranty, instead.
  Where the contract of sale is not severable (separable), and the buyer has accepted the entire goods or even a part of it, a breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, but not if the contract of sale provides otherwise.
- **Express 'conditions' and 'warranties'** are those where the terms stipulated in the contract of sale itself expressly provide for them as such. The **implied 'conditions' and 'warranties'** are those where though the terms stipulated in the contract of sale itself do not expressly provide for them as such, the law deems their existence in the contract even without their actual mention in the contract of sale. But then, the implied 'conditions' and 'warranties' may be negated by express terms and conditions to the contrary, stipulated in the contract of sale.
- The following implied 'conditions' and 'warranties' are presumed where the terms and conditions stipulated in the agreement of sale of goods do not provide an intention to the contrary:
  (a) Conditions as to Title
    (i) That the seller already has the right (title) to sell the goods.
    (ii) In the case of an agreement to sell, it is implied that the seller will have the right to sell the goods at the time when the property (ownership) of the goods involved will be passed on from the seller to the buyer.
  (b) Condition in the Sale by Description
  In such cases, there is an implied condition that the goods, supplied or to be supplied, shall correspond to the description of the goods agreed upon.
  (c) Conditions as to Quality or Fitness
  The general rule is that a buyer is supposed to satisfy himself about the quality of goods he is purchasing, and that these will be suitable for the purpose for which he was buying it. However, only under some exceptional circumstances, where all the three following conditions are fulfilled, there is an implied condition as to the quality or fitness of the goods:
    (i) That the purpose for which the goods were being purchased must be made known to the seller, expressly or impliedly;
    (ii) That the buyer must have relied on the skill, knowledge, or judgement of the seller; and
    (iii) That the selling of such goods must be the usual business of the seller.

  But, the aforementioned exception will not apply in the cases where the goods in question are sold under their patent or trade name.
  (d) Merchantable Quality
  The term 'merchantable quality', may be defined as an article which must be such that a reasonable person would accept the article as the performance of a promise.
  However, the condition regarding the merchantability of the goods sold, must be reasonably construed, because the seller cannot be held responsible if certain facts were not disclosed to the seller; these were concealed from him, instead, which itself had given rise to the element of unsuitability of the goods so purchased.
- A contract of **sale by sample** is when there is a term in the contract of sale to this effect, whether in express or implied terms. The following are the implied conditions in the case of a sale by sample:
  (a) That the bulk of goods will correspond to the sample, in quality;

(**b**) That the buyer will have sufficient opportunity to compare the bulk of goods supplied with the sample; and

(**c**) That the goods supplied will be free from any defects which may render them non-merchantable, which may not be apparent on a reasonable examination of the sample.

- There are the following two types of implied warranties:

  (**a**) Warranty of quiet possession, and

  (**b**) Warranty of freedom from encumbrances, provided the encumbrances, if any, are neither known to, nor declared to, the buyer.

- In the **following cases** the fundamental principle of **'caveat emptor' will not apply**:

  (**i**) Where the seller makes a false representation and the buyer relies thereon.

  (**ii**) Where the seller actively conceals any defect in the goods being sold by him, so that the defect involved in the goods may not be detected even on a reasonable inspection and examination of the goods.

  (**iii**) Where the buyer, expressly or impliedly, tells the seller the specific purpose for which he was buying the particular goods, he was thereby making the seller realise that he (buyer) was relying on the knowledge, skill and judgement of the seller of the goods.

  (**iv**) Where the goods are sold by description, there is an implied condition that the goods will be of merchantable quality.

  (**v**) But, where the buyer has himself examined the goods prior to the sale, there will be no implied condition as to the merchantability of the goods sold, in regard to the defects which such examination would have revealed.

  (**vi**) However, where, despite a proper and though examination by the buyer of the goods under sale, some latent defects in the goods were of such a nature that no examination could have detected (revealed), there will be implied condition as to the merchantability of the goods sold, in regard to the defects.

Questions for Reflection

1. What are the main distinguishing features between 'Condition' and 'Warranty'? Give illustrative examples in each of the distinguishing features.
2. Under what specific circumstances can a breach of 'condition' be treated as a breach of warranty, whereby the buyer will lose his right to repudiate the contract of sale? Give illustrative examples in each case.
3. What are the main distinguishing features between 'Express' and 'Implied' 'Condition' and 'Warranty'? Give illustrative examples in each case.
4. What are the specific types of express 'conditions' and 'warranties' to which the parties to a contract of sale (i.e. seller and buyer) may decide to agree upon. Give illustrative examples in each case.
5. Unless the terms and conditions stipulated in the agreement of sale of goods provide an intention to the contrary, the following implied 'conditions' and 'warranties' are presumed to have been incorporated in every contract sale of goods. Do you agree with this statement?

   (a) If no, give reasons for your answer; and

   (b) If yes, explain each of the following implied 'conditions' and 'warranties' by giving suitable illustrative examples in each case.

      (i) Conditions as to Title, and

      (ii) In the case where the goods have been sold by infringement of a trademark.

   (c) Can the condition stated in item (b) (ii) above be neglected by an express term, in any specific case? Give at least one specific such case by way of an example.

6. (a) What is the main implied condition in the case of a contract for the sale of goods by the description of the goods involved?
   (b) What is the main implied condition in the case of a contract for the sale of goods by the sample as also by the description of the goods involved?
7. (a) The general rule is that a buyer is supposed to satisfy himself about the quality of goods he is purchasing. He is further responsible to satisfy himself that the goods that he is purchasing will be suitable for the purpose for which he was buying it. But then, under certain exceptional circumstances, there is an implied condition as to the quality or fitness of the goods. What are such exceptional circumstances? Discuss each of them by citing suitable illustrative examples in each case.
   (b) Will the legal position be any different in the cases where the goods in question are sold under their patent or trade name? Explain, by citing suitable illustrative examples.
8. (a) What will be the legal position in the cases where the goods are purchased by description from a seller, who deals in the goods of that description (whether he happens to be its manufacturer or producer or not), and the goods so sold are not found to be of merchantable quality?
   (b) What is actually meant by the following terms in this context?
      (i) Goods of 'merchantable quality', and
      (ii) Goods will be free from 'latent defects'.
9. (a) What will be the implied conditions as to the merchantability of the goods sold, in the cases where the buyer has himself examined the goods prior to the sale, in regard to the defects which such examination would have revealed.
   (b) Will the legal position be any different in regard to the implied condition as to the merchantability of the goods sold, in the cases where, despite a proper and thorough examination by the buyer of the goods under sale, some latent defects in the goods were of such a nature that no examination could have detected?
10. (a) In what specific cases of contracts of sale, where though a sample of the goods on sale is shown, it will not be treated a sale by sample?
    (b) In the case where a sample of the goods on sale is shown, and it is not treated a sale by sample, what will be the legal presumption in such case?
    Give reasons for your answer and also give some illustrative examples in each case.
11. What are the various implied conditions in the case of a sale by sample?
    Explain and also give some illustrative examples in each case.
12. Explain the following two types of implied warranties, and also give some illustrative examples in each case:
    (a) Warranty of Quiet Possession, and
    (b) Warranty of Freedom from Encumbrances.
13. (a) What do you understand by the principle of 'Caveat Emptor'? Explain and also give some illustrative examples.
    (b) What are the various exceptions to the principle of 'Caveat Emptor', that is, under what specific circumstances the principle of 'caveat emptor' will not apply?
14. Will the principle of 'caveat emptor' apply in the following specific circumstances?
    (a) Where the buyer has himself examined the goods prior to the sale, and such examination would have revealed the merchantability of the goods sold, in regard to the defects therein, if any, and
    (b) Where, despite a proper and though examination by the buyer of the goods under sale, some latent defects in the goods were of such a nature that no examination could have detected (revealed).

Problems for Practice (With Suggested Solutions)

Problem 1

Mohammad had selected a particular horse and had bought it, because it was warranted as a quiet horse to ride and drive. But, when Mohammad took the horse on a ride, it turned out to be not a quiet but a vicious horse, instead. Thereupon, Mohammad had filed a case in the Court for claming the damages from the seller of the horse as also for rejecting the horse so purchased by him and treat the contract as repudiated. What are the chances of Mohammad winning the case? Give reasons for your answer.

Solution

In the instant case, the stipulation to the effect that the horse under sale was a quiet horse to ride and drive is in the nature of a warranty and not a condition. This is so because the aforementioned stipulation is collateral to the main purpose of the contract (and therefore, constitutes only a 'warranty'), and it is not essential to the main purpose of the contract (which could have constituted a 'condition', instead). Therefore, Mohammad can only claim damages from the seller of the horse, but will not be entitled to reject the horse so purchased by him nor can he treat the contract as repudiated.

Problem 2

Will the legal position in Problem 1 above be any different, in case Mohammad, instead of himself selecting and buying a particular horse, would have asked the seller of the horses to sell to him a horse which is quiet to ride and drive, and the horse supplied to him by the seller would have later turned out to be not quiet but vicious? Give reasons for your answer.

Solution

The legal position in the given changed situation will be entirely different, because here, the stipulation by the buyer to the effect that the horse must be 'quiet to ride and drive' is in the nature of a condition (and not just a warranty) as it forms an essential part of the main purpose of the contract. Accordingly, Mohammad (buyer of the horse) in this case, will have the option either to reject the horse, and treat the contract as repudiated, and demand the refund of the price of the horse already paid by him, or else he may keep the horse and claim damages from the seller of the horse.

Problem 3

(a) Dwarka had purchased a motorcycle from Shailendra. Shailendra, however, did not have a valid title to the motorcycle. But, after Dwarka had used the motorcycle for several months, one day Tarun, the true owner of the motorcycle spotted his motorcycle and demanded it back from Dwarka. But Dwarka refused to hand over the motorcycle back to Tarun on the ground that he had purchased the motorcycle from Shailendra on full payment of its price and had also used the motorcycle for several months by then. Do you think that the contention of Dwarka is legally justified in the given circumstances? Give reasons for your answer.

(b) In case you think that the contention of Dwarka is legally unjustified in the given circumstances, do you think that Dwarka will be left with any legal remedy against Shailendra, the seller of the motorcycle, in view of the fact that Dwarka had used the motorcycle for several months by then? Give reasons for your answer.

Solution

(a) No; the contention of Dwarka is not legally justified in the given circumstances. Accordingly, he is legally bound to hand over the motorcycle back to Tarun, the true owner of the motorcycle. This is so because the seller, Shailendra, did not have a valid title to the motorcycle that he had sold to Dwarka. This contention is based on the judgement delivered in the case titled **Rowland vs Duvall [(1923) 2 K.B.].**

(b) However, Dwarka will be left with the legal remedy against Shailendra, the seller of the motorcycle, to successfully sue him (Shailendra), for the recovery of the purchase price already paid by him to Shailendra, together with claiming the damages, on the ground that he (Shailendra) had sold the motorcycle without having a valid title thereto, despite the fact that Dwarka had driven the motorcycle for several months by then. This is so because, based on the provisions made under Section 14 (a) of the Indian Partnership Act, in case the seller's title to the goods sold is found to be defective, the buyer of the goods will be entitled to reject the goods and claim the refund of the price, if paid, together with claiming the damages. The buyer will be entitled to both these rights even if he would have used the goods so supplied. This contention is also based on the judgement delivered in the case titled **Rowland vs Duvall [(1923) 2 K.B.].**

Problem 4

A generator was sold as a 'new Kirloskar generator'. It was later found by the buyer that it was not a new generator but an already used one. What legal remedies does the buyer have against the seller in the instant case? Give reasons for your answer.

Solution

In the instant case, the buyer has the following two legal options available to him to choose any one from:

(i) He may return the generator; or else
(ii) He may retain the generator and claim damages from the seller for the breach of contract.

This contention is based on the judgement delivered in the case titled **Andrews Limited vs Singer and Company Limited [(1934) 1 K.B. 17]**.

Problem 5

Two quintals of pure '*desi ghee* made out of cow milk' was sold. It was warranted to be corresponding with the sample. But then, though the *ghee* so supplied corresponded with the sample, the sample itself was later found to be not a '*desi ghee* made out of cow milk' but a '*desi ghee* made out of buffalo milk', instead. Accordingly, the buyer preferred to reject the *ghee* so supplied. The seller, thereupon, filed a case in the Court pleading that, as the bulk of the *ghee* supplied by him had corresponded with the sample, and that this was a case by sale by sample, the buyer must be directed to accept the goods sold, as it corresponded with the sample. Do you think that the contention of the seller, in the instant case, is legally justified? Give reasons for your answer.

Solution

No; the contention of the seller, in the instant case, is not legally justified? This is so because, though the bulk had corresponded with the sample, the sample itself did not correspond with the description of the goods agreed upon, i.e. '*desi ghee* made out of cow milk'. Accordingly, the buyer was legally entitled to reject the *ghee*, so supplied. This contention is based on the judgements delivered in the cases titled **Nichol vs Godts [(1854) 10 Ex. 19],** and **Willis vs Pratt [(1911) A.C. 394]**.

Problem 6

Purushottam was a hardware dealer. He had purchased a hot water bottle from a shop dealing in surgical instruments, including hot water bottles. But, being a hardware dealer, he (Purushottam) himself did not have any special knowledge regarding the proper use of hot water bottles. However, when he was using the bottle, filled with steaming hot water to the brim, it had burst and in the process he had got injured. Do you think that the seller is legally liable in any way in the instant case? Give reasons for your answer.

Solution

Yes; the seller is legally liable for having committed a breach of contract of sale of goods as to the fitness of the condition of the goods (hot water bottle). In the instant case, it seems to have been presumed that the purpose of buying a hot water bottle was obvious, and also that the buyer, being ignorant about hot water bottles, had relied upon the knowledge or judgement of the seller, who was supposed to be knowledgeable in regard to the proper use of hot water bottles, and that selling the hot water bottles was the usual business of the seller,

he being a dealer in surgical instruments, including hot water bottles, as is given in the instant case. Thus, we find that, under the given circumstances, all the following three implied conditions that the goods will be reasonably fit and suitable for the purpose for which it was being bought, have been satisfied for the operation of the exception to the general rule that a buyer is supposed to satisfy himself about the quality of goods he is purchasing, and also that the same will be suitable for the purpose for which he was buying it:

(i) That the purpose for which the goods were being purchased must be made known to the seller, expressly or impliedly;
(ii) That the buyer must have relied on the skill, knowledge or judgement of the seller; and
(iii) That the selling of such goods must be the usual business of the seller.

This contention is based on the judgement delivered in the case titled **Priest vs Last [(1903), 2 K.B. 148].**

Problem 7

Pravin had purchased a geyser from Shravan, a renowned dealer in geysers. But, it was found that the geyser so bought failed to heat water. Do you think that Shravan (seller) is legally liable in any manner in the instant case? Give reasons for your answer.

Solution

Yes; Shravan (seller) is legally liable for having committed a breach of an implied condition in the contract of sale of goods regarding the fitness of the condition of the goods (geyser) sold. This is so for the same reasons as are stated in the solution to Problem 6 above. This contention is based on the judgements delivered in the case titled **Evens vs Stella Benjamin [(1950), A.I.R. Cal. 470]**.

Problem 8

Hemant had bought fresh milk from a renowned milk dairy. But the milk contained some germs of tuberculosis. Thus, when Hemant consumed the milk, he got infected with the germs of tuberculosis and finally he died of the disease (tuberculosis). Do you think that dairy (seller) is legally liable in any manner in the instant case? Give reasons for your answer.

Solution

Yes; the milk dairy (seller) is legally liable for having committed a breach of an implied condition in the contract of sale of goods regarding the fitness of the condition of the goods (infected milk) sold. This is so for the same reasons as are stated in the solution to Problem 6 above. Further, it may also be pointed out in this context that in the case of food articles, an additional implied condition is there to the effect that the article is fit for human consumption. This contention is based on the judgement delivered in a similar case titled **Frost vs Aylesbury Co. Ltd [(1905) 1 K.B. 608]**.

Problem 9

Vasantraj had purchased a boiler for his factory, by its (boiler's) patent name. But the boiler that was supplied was found to be unsuitable for the purpose for which it was purchased. Do you think that the seller will be legally liable in any manner in the instant case? Give reasons for your answer.

Solution

No; the seller will not be held legally liable in any manner in the instant case. This is so because, in the cases, where the goods are purchased by their patent or trade name, the buyer had no cause of action against the seller. This contention is based on the judgement delivered in a similar case titled **Chanter vs Hopkins [(1938) M. and W. 399].**

Problem 10

William (seller) had entered into a contract of sale of calf leather with Shelly (buyer). The leather supplied was undoubtedly calf leather. But then, it was so much damaged by the rain water and dampness in the store house that no one would have accepted it in the market as calf leather. Do you think that William (seller) will be legally liable in any manner in the instant case? Give reasons for your answer.

Solution

Yes, William (seller) will be held legally liable in the instant case for the breach of the condition in regard to the merchantability of the goods. This contention is based on the judgement delivered in a similar case titled **Jones vs Just [(1867) L.R. 3. Q.B. 192]**.

Problem 11

Will the legal position be any different if, in Problem 10 above, Shelly (buyer) had himself examined the goods prior to the sale? But then, please also note that, instead of thoroughly and properly examining the goods, Shelly (buyer) had just looked at the outside of the box it was securely packed in. Give reasons for your answer.

Solution

The legal position will be distinctly different if, in Problem 10 above, Shelly (buyer) had himself examined the goods prior to the sale. That is, in that event William (seller) will not be held legally liable for the breach of the condition in regard to the merchantability of the goods, as in such cases there will be no implied condition as to the merchantability of the goods sold.

Further, the fact that, instead of thoroughly and properly examining the goods, Shelly (buyer) had just looked at the outside of the box, will not make any difference in the legally safe position of William (seller). This is so because, in the cases where the buyer has himself examined the goods prior to the sale, there will be no implied condition as to the merchantability of the goods sold, in regard to the defects which such (proper/thorough) examination would have revealed. Thus, as in the instant case, the defects in the goods were of such a nature that such (proper/thorough) examination would have revealed, if the goods were checked by Shelly (buyer) thoroughly and not superficially. Accordingly, the fault squarely lies on Shelly (buyer) himself and the William (seller) cannot be held responsible for the same. This contention is based on the judgement delivered in a similar case titled **Thornett and Fehr vs Beers and Sons [(1919) 1 K.B. 436].**

Problem 12

Will the legal position be any different in Problem 11 above, if Shelly (buyer) had himself thoroughly (and not superficially) examined the calf leather prior to the purchase, but even his such thorough examination had not revealed the inherent defects in the calf leather in the dry condition? Further, when the calf leather so bought was processed, some defects were found therein, which (defects) were of such a nature that they were not visible and detectable in their dry condition. Give reasons for your answer.

Solution

The legal position will definitely be different if, in Problem 11 above, Shelly (buyer) had himself thoroughly (and not superficially) examined the calf leather prior to the purchase, but even his such thorough examination had not revealed the inherent defects in the calf leather in the dry condition. This is so because, in that case the defects were latent in nature, and therefore, were undetectable in their dry condition even by a thorough examination. Therefore, in such a case, there will be an implied condition as to the merchantability of the goods sold in regard to the latent and inherent defects. This contention is based on the judgement delivered in a similar case title **Khoyee & Co. vs Garden Woodroff & Co. [(1937) Mad. 497].**

Problem 13

The skin of Raghunath was abnormally sensitive, so much so that he was allergic to artificial fabrics made up of materials like rayon or nylon. He had purchased a readymade full shirt made of such material. But when he had put on the shirt, he developed rashes on his sensitive skinned body. Do you think that in the instant case the breach of condition as to the merchantability of the goods sold will be involved? Give reasons for your answer.

Solution

No; the breach of condition as to the merchantability of the goods sold will not be involved in the instant case. This is so because, as it appears from the narration of the facts in the instant case, Raghunath (buyer) had not disclosed the fact to the seller that his skin was abnormally sensitive to artificial fabrics. This contention is

based on the judgement delivered in a similar case title **Griffiths vs Peter Convey Ltd [(1939) 1 All. E.R. 685]**.

Problem 14

Will the legal position be any different if in Problem 13 above, Raghunath (buyer) would have disclosed the fact to the seller that his skin was abnormally sensitive (allergic) to artificial fabrics made up of materials like rayon or nylon.? Give reasons for your answer.

Solution

Yes; in the changed situation the breach of condition as to the merchantability of the goods sold will definitely be involved in that case. This is so because, as it has been specifically mentioned in this case, Raghunath (buyer) had disclosed the fact to the seller that his skin was abnormally sensitive to artificial fabrics. Accordingly, the seller would be held liable for the breach of condition as to the merchantability of the goods sold. This contention is also based on the judgement delivered in a similar case title **Griffiths vs Peter Convey Ltd. [(1939) 1 All. E.R. 685]**.

Problem 15

Reshma had purchased 20 pairs of lady shoes sold to her by sample. This term (i.e. the sale involved was a sale by sample) was one of the terms in the contract of sale. All these shoes were later found to be containing paper, which could not have been detected by an ordinary inspection. Will Reshma (buyer) be entitled to get the refund of the price already paid to the seller for the shoes, or only to claim damages from the seller concerned, or both (i.e. to get the refund of the price already paid for the shoes, as also to claim damages)? Give reasons for your answer.

Solution

Yes; Reshma (buyer) will be entitled to get the refund of the price already paid to the seller for the shoes, as also to claim damages from the seller concerned. This is so because the fact, that the sale involved was a sale by sample, was also one of the terms specified in the contract of sale. Our aforementioned contention is based on the provisions of Section 17 of the Sale of Goods Act to the effect that a contract will be deemed to be a contract of sale by sample only when one of the terms in the contract of sale is there to this effect.

Problem 16

Will the legal position be any different if in Problem 15 above, the term that the sale involved was a sale by sample was not specifically mentioned as one of the terms in the contract of sale? Give reasons for your answer.

Solution

Yes; the legal position will surely be different if in Problem 15 above, the term that the sale involved was a sale by sample was not specifically mentioned as one of the terms in the contract of sale. This is so because, as per the provisions of Section 17 of the Sale of Goods Act, if there is no term in the contract of sale to this effect, it will be presumed that the sample, though shown, it is not shown as a warranty, but only to facilitate the buyer to form a reasonable judgement about nature, composition, quality, and so on, about the goods to be purchased. Therefore, Reshma (buyer) will not be entitled to get the refund of the price already paid to the seller for the shoes, nor will she be entitled to claim damages from the seller concerned.

Problem 17

Some cows were sold 'subject to all faults'. These cows were infected with the germs of tuberculosis. Therefore, the other healthy cows of the buyer also got the infection of tuberculosis from the infected cows bought by him. The buyer filed a suit in the Court claiming damages from the seller on the ground that his healthy cows were also got infected by the germs of tuberculosis and that the seller was legally duty bound to disclose that the cows under sale were unhealthy as they were infected with the germs of tuberculosis. What are the chances of the buyer of the infected cows winning the case? Give reasons for your answer.

Solution

There does not appear to be any chance of the buyer of the infected cows winning the case. This is so because, the seller was not legally bound to disclose that the cows under sale were unhealthy as they were infected with

the germs of tuberculosis. This contention is based on the fundamental principle of 'Caveat Emptor', which means that 'let the buyer be ware' or simply as 'buyer be ware' or 'caution buyer'. In other words, it means that it is not the duty of the seller to disclose the defects in the goods, if any, that he is selling. Conversely speaking, it is the duty of the buyer to inspect and examine the goods he intends to buy, and to satisfy himself that they are free from any defects, and that they will suit the purpose for which he is buying the goods in question. This contention is based on the judgement delivered in a similar case title **Goddard vs Hobbs [(1878), 4 App. Cas. 13]**.

Problem 18

What will be the legal position, regarding the application of the principle of 'caveat emptor' in the case where the seller has actively concealed some defect in the goods being sold by him, so that the defect involved in the goods may not be detected even on a reasonable inspection and examination of the goods by the buyer? Give reasons for your answer.

Solution

In such cases the principle of 'caveat emptor' will not apply. This is so because such cases where the seller actively conceals any defect in the goods being sold by him, so that the defect involved in the goods may not be detected even on a reasonable inspection and examination of the goods, are one of such cases of exceptions, which are exempt from the application of the principle of 'caveat emptor', i.e. in such cases the principle of 'caveat emptor' will not apply.

Chapter Twenty Seven

Transfer of Property (Title) in Goods

"*Knowledge conquered by labour becomes a possession—a property entirely our own.*
Samuel Smiles

Labour diligently to increase your property.
Horace

He that parts with his property before his death prepares himself for much suffering.
French Proverb

Riches do not consist in the possession of treasures, but in the use made of them.
Napoleon Bonaparte

Possession is nine-tenth of ownership
Proverb

A proverb is a short sentence based on long experience.
Miguel De Cervantes"

27.1 Meaning of Property in Goods

Simply put, the term 'property in goods' means 'ownership in goods'. But then, the 'property in goods' must not be confused with the 'possession of the goods' as these two terms have entirely different connotations. While the 'property' in the goods means having the 'ownership' of the goods, the 'possession' of goods simply means the 'custody' of the goods. Usually the same person may be in the possession of the goods as also may be the owner of the goods. But the person in possession of the goods will not necessarily be it owner as well.

For example, in the case of pledge of goods as security against loans from a bank, the bank, by virtue of it being a pledgee, will be in the possession of the goods pledged to it by the borrower, but the ownership of the pledged goods will continue to remain with the borrower concerned. Thus, we see that in a certain situation a person may be in the possession of the goods, but he may not be their owner, like the bank as a pledgee of the goods pledged by the borrower, as aforementioned. As against this, in another situation, a person may the owner of the goods but the goods may not be in his possession, like the borrower as the pledgor of the goods pledged to the bank, as aforementioned.

27.2 When will the Seller or Buyer Bear the Loss of Damaged or Lost Good?

When does the property in the goods get passed or transferred from the seller to the buyer is a very significant point in the contract of sale of goods. Therefore, it is very important to know the manner in which to determine the exact moment of the passing or transfer of the property in the goods from the seller to the buyer. It is important due to the following reasons:

(i) The general rule is that the risk follows the ownership. Accordingly, who will bear the loss (seller or buyer), when the goods are lost or damaged, will be decided on the fact of the case as to whether, at the actual time of the loss or damage of the goods, the ownership of the goods involved was still remaining with the seller, or else it had been passed on (transferred) to the buyer. Thus, if, at the actual time of the loss or damage of the goods, the ownership of the goods involved was still remaining with the seller, the seller will bear the loss. As against this, if, at the actual time of the loss or damage of the goods, the ownership of the goods involved had already passed on (transferred) to the buyer, the buyer will have to bear the loss, instead.

(ii) In case the goods are damaged by a third party, the owner (and not the prospective buyer) will be entitled to take action against such third party.

(iii) In case either the seller or the buyer is declared insolvent, whether the Receiver or the Official Assignee can claim the goods from the seller or the buyer will depend upon the fact whether, at the material time, the ownership of the goods involved was still remaining with the seller, or else it had been passed on (transferred) to the buyer. The same rule, as discussed in item (i) above, will prevail in this case as well.

27.3 Passing (Transfer) of Property in Goods from Seller to Buyer

We will now discuss the various rules provided under **Sections 18 to 25** to determine the actual time when the property (ownership) in the goods passes on (gets transferred) from the seller to the buyer, under different circumstances/cases.

27.3.1 In Specific (Ascertained) Goods

In the case of the sale of the specific or ascertained goods, the ownership of such goods is transferred from the seller to the buyer at such times when the parties to the contract (i.e. buyer and seller) intend the ownership of the goods to be transferred. The intention of parties to the contract (i.e. of the buyer and the seller) is ascertained from the following cases and circumstances:

(a) From the terms of the contract;
(b) From the conduct of the parties involved; and
(c) From the circumstances of the case.

Further, unless an intention appears to the contrary, the rules provided under **Sections 20 to 24** (discussed hereafter), will be applicable for ascertaining the intention of the parties involved in the contract of the sale of goods (i.e. the intention of the buyer and the seller).

27.4 Passing (Transfer) of Property in Goods from Seller to Buyer (Unless an Intention Appears to the Contrary)

We will now discuss the rules for ascertaining the intentions of the parties to the contract (i.e. of the buyer and the seller) in different cases and circumstances, unless an intention appears to the contrary.

27.4.1 Specific Goods in Deliverable State

As stipulated under **Section 20**, the property (ownership) in regard to the specific (ascertained) goods, which are in a deliverable state (stage/condition), passes on (gets transferred) at the time when an unconditional contract is entered into. Even where the delivery of the goods or the payment of the price of the goods, or both, is deferred to a future date, it will be immaterial and will not affect the transfer of the property in the goods from the seller to the buyer in any manner, whatsoever.

27.4.1.1 Deliverable State Defined

As stipulated under **Section 2(3)**, 'Goods are said to be in a deliverable state when they are in such state that the buyer would, under the contract, be bound to take delivery of them'.

The point may be further clarified with the help of the following examples:

Examples

(i) Pran makes an offer to Shakti to sell his motorcycle to him for a sum of Rs 25,000. Shakti accepts the offer unconditionally. In this case, the moment the offer of Pran is unconditionally accepted by Shakti, that is an unconditional contract is entered into between them, the property in the motorcycle passes on from Pran (seller) to Shakti (buyer). Here, it will be of no consequence even if the delivery of the motorcycle or the payment of its price of the goods (Rs 25,000), or both, is agreed to be made at a specified later date, or even if the motorcycle has been sold on credit. This is so because all the three following conditions, as stipulated under **Section 2(3)**, have been complied with in the instant case:

   (a) That the case relates to the specific goods, i.e. the motorcycle, in the instant case;
   (b) That the contract between the buyer and the seller is unconditional; and
   (c) That the goods involved (motorcycle) is in a deliverable state.

(ii) In a case titled **Tarling vs Barter [(1827) 6 B. and C., 360]** a person had agreed to sell his standing stock of hay to another person for a fixed price payable on 4th February next. The delivery of the goods (standing stock of hay) was to be made on 1st May next. It was held in this case that the buyer had become the owner of the goods sold immediately when the contract was entered into between him and the seller, in spite of the fact that both the price of the goods was to be paid and the goods were to be delivered at the specified and agreed dates, later.

27.4.1.2 Endorsement on a Railway Receipt vs Transfer of Ownership of the Goods Involved

In a case titled **Shamji vs N. W. Rly. [47, Bom. L.R. 608]**, a question was raised before the Bombay High Court as to whether the endorsement on a railway receipt will amount to the transfer of ownership of the goods represented thereby. It was held that the endorsement made on a railway receipt by the consignee in favour of another person will not, in itself, pass on the ownership of the goods, represented thereby, to the endorsee. Instead, it only amounts to making the endorsee as an agent of the consignee to take the delivery of the goods on his (consignee's) behalf. Accordingly, an endorsement on a railway receipt, in itself, will not make the endorsee either a *bona fide* pledgee or a transferee for value, of the goods, represented by the railway receipt.

27.4.2 Specific Goods Not in Deliverable State

As stipulated under **Section 21**, the property (ownership) in regard to the specific (ascertained) goods, which are not in a deliverable state (i.e. where something more remains to be done by the seller to put them in a deliverable state), passes on to the buyer only after the thing that was yet to be done on the goods under sale is completed, and the buyer receives the notice from the seller to this effect.

The following illustrative cases will clarify the points even further:

Examples

(i) In a case titled **Rugg vs Minett [(1809), 11 East 2.101]**, the entire contents of a cistern of oil were sold, but the seller had yet to fill the oil in casks, only whereafter he could deliver it to the buyer. It was held in the case that the property in the oil did not pass on from the seller to the buyer till the oil was actually put into the casks by the seller, and thereby he had made it deliverable to the buyer, and when the buyer had received the notice to this effect from the seller.

(ii) In another case titled **Underwood vs Burgh Castle Syndicate [(1922), I.K.B. 343]**, a condensing engine, which was fixed at a particular place, was agreed to be sold F.O.R (Free-on-Rail) at a certain price. But the engine got damaged on way to the railway (station). It was held in the case that the property in the engine had not passed on from the seller to the buyer as the seller, under the contract of sale, was still required, to put the engine on the rails only whereafter it could be deemed to be in a deliverable state.

27.4.3 Specific Goods in Deliverable State but yet to be Weighed, Measured, Tested, to ascertain Price

Let us take a case where some specific goods are in a deliverable state, but these are yet to be weighed, measured, tested, and something more is required be done by the seller on the goods under sale, to ascertain the price, which the seller is bound to do, as per the provisions made in the contract of sale of goods. Under **Section 22,** in such a case, the property in the goods does not pass on from the seller to the buyer until such act or thing, still required to be done by the seller on the goods, is done by him, and the buyer is notified by him to this effect. The following illustrative cases will clarify the points even further:

Example

(i) In a case titled **Zaguny vs Furnell [(1809), 2 Camp. 240]**, some stock of bark was sold at a price per tonne, as was agreed upon between the buyer and the seller. Further, as provided under the contract of sale of goods, the bark was required to be weighed by the agents of the buyer as also of the seller so as to ascertain the price, in terms of tonnes. However, a portion of the bark, after being weighed by the agents of the buyer as also of the seller, was taken away by the agent/servant of the buyer. But thereafter, the remaining stock of bark was swept away in the flood. It was held in the case that the resultant loss, caused by the flood, will have to be borne by the seller, as the property in the balance stock of bark had not yet passed on to the buyer. This was so because, these stocks were not weighed to ascertain the price per tonne, as was specifically provided in the contract of sale of goods.

(ii) It may thus, be observed that, as it was specifically provided in the contract of sale of goods (that the goods (bark) must be weighed by the agents of the buyer as also of the seller so as to ascertain the price, in terms of tonnes), the resultant loss by flood was to be borne by the seller. Conversely speaking, if such terms (to the effect that the seller had to do something more regarding the goods under sale) were not specifically incorporated in the contract of sale of goods, the loss may have to be suffered by the buyer, instead. Thus, if in the aforementioned case, the weighing etc. were to be done by the buyer himself, for his personal satisfaction, and not by the seller, the loss would have been suffered by the buyer, instead. This subtle point is based on the judgment delivered in the case titled **Turley vs Bates [(1863) H & C 200].**

27.4.4 Unascertained or Future Goods

27.4.4.1 As stipulated under **Section 18**, in the case of a contract of sale of 'unascertained or future goods', the property in the goods will not be transferred from the seller to the buyer unless the goods become ascertained.

Example

Samuel agrees to sell to Benson 100 quintals of sugar out of a huge quantity of sugar stored in his (Samuel's) godown. The price, however, was to be paid at a later date, as was specified under the contract of sale of goods. Under such circumstances, the property in the sugar will not pass on from the seller to the buyer unless and until the required quantity of sugar (i.e. 100 quintals) is segregated from the huge quantity of sugar stored in the seller's godown. This is so because it will be only then that the required quantity of sugar (i.e. 100 quintals) would be deemed to have been ascertained. Until then, it will remain in the nature of unascertained or future goods.

27.4.4.2 Further, as stipulated under **Section 23**, in the case of a sale of unascertained goods or future goods sold by description, the property in the goods under sale will pass on from the seller to the buyer only when the goods of the agreed description will be in a deliverable state, and when these goods 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.

When we closely analyse the various provisions of **Section 23**, as aforementioned, we find that, in such cases, the property in the goods under sale will pass on from the seller to the buyer only when the following conditions are fulfilled:

(a) That the goods, pertaining to the contract of sale by description, must be produced or procured (obtained);
(b) That the goods under sale must be in a deliverable state (condition), Further, as provided under **Section 2(3),** 'Goods are said to be in a deliverable state when they are in such state that the buyer would, under the contract, be bound to take delivery of them'. That is, when some chemical is required to be packed and labelled by the seller in a specified manner, the seller must have done accordingly, so that the provision of this Section could become operative and applicable, and not otherwise; and
(c) That the goods must be unconditionally appropriated to the contract. Let us clarify this point with the help of an illustrative case titled **General Paper Ltd. vs Pakkir Mohideen [(1968) A.I.R. Mad. 482]**. In this case, the sellers had neither segregated (separated) the goods, covered under the contract of sale thereof, from the general stocks lying with them (sellers), nor had they put the goods in the receptacle, which had been sent by the buyer for the purpose. It was, accordingly, held in this case that an inspection of the general stock by the prospective buyer and the approval by him of the quality of the goods, fixation of the price and the agreement regarding the payment of the tax and freight charges between the seller and the prospective buyer, were not considered sufficient for the passing on of the property in the goods involved from the buyer to the seller.

27.4.4.3 Unconditional Appropriation Explained

Unconditional appropriation may be made in the following manners:

27.4.4.3.1 By the Buyer with the Consent of the Seller

Generally the goods are appropriated by the seller. But, under the circumstances, where the goods are in the possession of the buyer on behalf of the seller, say, by virtue of he (the buyer) being the seller's warehouseman, the goods that he agrees to buy out of the stocks of the goods of the seller, stored in his warehouse, will be deemed to have been appropriated and the ownership in them will be deemed to have passed on from the seller to the buyer (warehouseman) only when the buyer (the seller's warehouseman in the instant case), has,

with the assent (consent) of the seller, selected and segregated the goods that he has agreed to buy from the stock of the goods that he possess in his warehouse on behalf of the seller.

Example

For example, if 1,000 tonnes of wheat are in the possession of the buyer on behalf of the seller, by virtue of his being the seller's warehouseman, and he agrees to buy only 500 tonnes of wheat out of the stock of 1,000 tonnes of wheat stored in his warehouse on behalf of the seller, the goods (500 tonnes of wheat) will be deemed to have been appropriated, and the ownership in them will be deemed to have passed on from the seller to the buyer (warehouseman), only when the buyer (the seller's warehouseman in the instant case), has, with the assent (consent) of the seller, selected the goods (500 tonnes of wheat) that he has agreed to buy, and has segregated the same (500 tonnes of wheat) that he wants to buy from the stock of the goods (i.e. 1,000 tonnes of wheat) he possess in his warehouse on behalf of the seller.

27.4.4.3.2 By the Seller with the Consent of the Buyer

In the cases where the seller appropriates the goods to the contract of sale, the property will pass on from the seller to the buyer only when the buyer has given his assent (consent) to the seller for the appropriation of the goods under the sale. Such assent (consent) of the buyer may, however be given by him to the seller before or even after the appropriation has taken place.

Example

For example, if 1,000 tonnes of wheat are in the possession of the seller in his godown, and the buyer agrees to buy only 500 tonnes of wheat out of the stock of 1,000 tonnes of wheat in the possession of the seller, the goods (500 tonnes of wheat) will be deemed to have been appropriated, and the ownership in them will be deemed to have passed on from the seller to the buyer, only when the seller, with the assent (consent) of the buyer, has selected and segregated the goods (500 tonnes of wheat) from the stock of the goods (i.e. 1,000 tonnes of wheat).

It may, thus, be noticed that, in the cases where the appropriation is made either by the buyer or by the seller, in both the cases the assent (consent) of the other party to the contract of the sale of goods must necessarily be sought and received. Conversely speaking, in the cases where the assent (consent) of the other party has not been sought and received, the ownership in the goods under the sale will not be deemed to have passed on from the seller to the buyer.

Example

In the case titled **Atkinson vs Bell [(1828) 108 E.R. 1046]**, a contract of sale of some machinery, manufactured by the seller, was entered into between him and the buyer. The seller had packed the machinery, and before despatching the same to the buyer, he had asked the buyer to specify the mode of transporting the machine to him. There was, however, no reply from the buyer. It was held in the case that there was no valid appropriation because the buyer concerned had not given his assent (consent) thereto.

27.4.4.4 Mode of Appropriation by the Seller

An appropriation by the seller may be done in the following ways:

(a) By putting the quantity of the goods contracted for sale in suitable receptacles, like putting the goods into gunny bags or boxes, or by putting the *ghee* or oil into bottles or such other suitable receptacles, and that too, with assent (consent) of the buyer.

(b) By delivering the goods, contracted for sale, to the transporters company or some other carrier (as a bailee only), for the sole purpose of transporting the goods to the buyer, without the carrier reserving the right to dispose off the goods.

However, in the cases where the goods are despatched by the seller to the buyer under the condition that the delivery of the goods will be made only against cash payment, the property in the goods will not be deemed to have passed from the seller to the buyer unless and until the payment is made by the buyer in cash.

Further, the fact, whether the seller has retained with himself the right of disposal of the goods under sale or not, even after delivering the goods to the carrier will depend upon the specific circumstances connected with the particular case. However, in the cases where the railway receipt (R/R) or the bill of lading (B/L) has been made out in the name of the buyer, or in the name of the agent of the buyer, it will be presumed that the seller had not retained the right of disposal of the goods. But then, even in such cases, the presumption that the seller had not retained the right of disposal of the goods can be refuted (disputed). As against this, in the cases where the railway receipt (R/R) or the bill of lading (B/L) has been made out in the name of the seller himself, or in the name of the agent of the seller, it will be presumed that the seller had retained with himself the right of disposal of the goods.

Further, under **Section 25 (3) 1,** in the cases where the seller of the goods under the contract of sale, draws a bill of exchange on the buyer for the amount of the price of the goods under sale, and sends it (bill of exchange) to the buyer direct, along with the relative railway receipt (R/R) or bill of lading (B/L), for the purpose of obtaining the buyer's acceptance (of the time bills of exchange) or the payment of the demand or the time bills of exchange, the buyer is legally bound to return the relative railway receipt (R/R) and bill of lading (B/L) to the seller, if he (buyer) does not accept the time bills of exchange or does not make the payment of the demand or the time bills of exchange. But then, if the buyer, instead of returning the relative railway receipt (R/R) or bill of lading (B/L) to the seller, retains the same, the property in the goods will not be deemed to have passed from the seller to the buyer.

27.5 Sale 'on Approval' or 'Sale or Return' Basis

In the cases, where the goods are delivered to the buyer 'on approval' or 'sale or return' basis, or even on such similar terms and conditions, the property in the goods under sale will pass on from the seller to the buyer when the buyer will signify his approval or acceptance of the goods to the seller.

The property in the goods under sale will also pass on from the seller to the buyer where the buyer does any act pertaining to the transaction, like when he (buyer) pledges the goods with a third party; or when he (buyer) retains the goods, without giving notice of rejection to the seller even beyond the time fixed for the return of the goods involved, or if no specific time is fixed, beyond a reasonable time.

27.5.1 'Sale or Return' vs 'Sale for Cash Only or Return'

As against the term 'Sale or Return', explained in the preceding paragraphs, in the case of 'Sale for cash only or Return', the property does not pass on to the buyer until the goods involved are paid for by the buyer. Further, in case the goods involved are not paid for by the buyer, and the buyer pledges the goods with a third party, such pledge (by a non-owner of the goods) will be treated as an invalid pledge, and accordingly, the seller will have the right to recover the goods from the pledgee.

27.6 General Rule Pertaining to Transfer of Title

As a general rule, only the owner of the goods can transfer a valid title in the goods. Further, no one can give a better title to the goods than the owner of the goods himself has. This principle is based on the dictum (maxim): '*Nemo dat quod non habet',* which, in the English language means 'No one can give what he himself has not'. Thus, if the seller has no title, or has a defective/invalid title, the buyer also will be deemed to be having no title to the goods sold by such seller, or else the title of buyer will also be deemed to be equally defective/invalid, depending upon the fact of the case where the seller of the goods had no title, or had a defective/invalid title to the goods. This rule will hold good even in the cases where the buyer is a *bona fide* buyer for value.

As stipulated under **Section 27**, 'subject to the provisions of the Act and of any other law at the time in force, where goods are sold by a person, who is not the owner thereof and who does not sell under the authority or with the consent of the owner, the buyer acquires no better title to the goods than what the seller had, unless the owner is precluded by his conduct from denying the seller's authority to sell' (precluded means prohibited or not permitted).

Examples

(i) Himanshu, a hirer of the goods, under a hire-purchase agreement, sells the same to Bhavna, a *bona fide* buyer for value. Bhavna, though a *bona fide* buyer for value, does not acquire any title in the goods as Himanshu, the seller did not have any title in the goods hired by him under a hire-purchase agreement. At best, Bhavna (buyer) will acquire an interest in the goods as the hirer (Himanshu) himself had.

(ii) Firdausi finds a gold necklace of Onkar on the roadside, and sells it to Chesterton, a third person. Chesterton buys the necklace for value and in good faith. In this case, the true owner (Onkar) can recover the necklace from Chesterton, even though he had bought the necklace for value and in good faith. This is so because Firdausi, just being a finder of the necklace, did not have any title thereto, and accordingly, could not pass any title even to any buyer for value and in good faith, like Chesterton, because he cannot give (any title) as he himself did not have any (title).

27.7 Exceptions to the General Rule Pertaining to Transfer of Title

In regard to the aforementioned general rule pertaining to transfer of title, **Sections 27 to 30** have stipulated several exceptions thereto, which are being discussed hereafter.

27.7.1 Sale by Mercantile Agent

As defined under **Section 2 (9)**, a 'mercantile agent' is an agent having, in the customary course of business as such agent, authority either to sell goods or to consign goods for the purpose of sale, or to buy goods , or to raise money on the security of goods.

In a case where a mercantile agent, who is in the possession of the goods, or the document to the title to the goods, sells them, with the consent of the owner of these goods, in the ordinary course of business as a mercantile agent, the buyer gets a valid (good) title to the goods, provided he (buyer) buys them in good faith and for value.

Further, a person who, in good faith and for value, buys the goods from a factor or auctioneer, he will get a valid title to the goods bought by him, even if such seller (factor or auctioneer) would have exceeded his authority or else, even if the authority of the factor or auctioneer was revoked by the true owner of the goods before these were sold by him (factor or auctioneer).

Examples

(a) In the cases titled **Oppenheimer vs Attenborough [(1908) I.K.B. 221]**, a mercantile agent had obtained some diamonds from their true owner by falsely pretending to him that he had a customer who was willing to purchase them, and thereafter, he fraudulently pledged the diamonds as security to obtain some loans for himself against them. It was held in this case that the owner of the diamonds was bound by the transaction of the pledge, created by the mercantile agent.

(b) In another case titled **Folkes vs King [(1923) K.I.B. 282]** an agent for the sale of motor cars had sold a car below the price that the owner of the car had authorised him to sell the car for, and had misappropriated the sale proceeds. It was held in this case that the innocent buyer had obtained a good title to the car purchased by him.

27.7.2 Sale by a Joint Owner

As stipulated under **Section 28**, where one of several joint-owners of goods, who has the sole possession thereof, with the consent of the other joint-owners sell such goods, any purchaser from such person, for value, without notice at the material time, of the seller's want of authority to sell, acquires a good title thereto against the other joint-owners.

But, in the case of sale by a co-owner, a good title in the goods can pass on to the purchaser only if the co-owner was in the possession of the goods with the consent of the other co-owners.

Example

Browning and Tennyson are the co-owners of a television. The television was in the possession of Browning. But Tennyson had secretly taken it away and had sold it to Shelly, a *bona fide* purchaser for value. Shelly cannot get a good title to the television. This is so because, though Tennyson was a co-owner, and was also in the possession of the television, he was not in its (television's) possession with the consent of the other co-owner, viz., Browning.

27.7.3 Sale by a Person in Possession under a Voidable Contract

As provided under **Section 29**, where a person has obtained the possession of the goods under a voidable contract, which is considered voidable due to fraud, coercion, misrepresentation, or undue influence, he can pass on a good title to the buyer, provided the sale has taken place before (and not after) the voidable contract is avoided.

Example

Avinash exercises coercion on Johnson and purchases his (Johnson's) car for a much lower price. Thereafter, Avinash sells the car to Rahim, an *innocent* purchaser. In this case, Rahim will get a valid title to the car, and Johnson cannot recover the car from him (Rahim), provided the voidable contract between Avinash and Johnson (by way of coercion) is avoided by Johnson after the sale has taken place, and not earlier.

27.7.4 Sale by the Seller in Possession of the Goods after Sale

As stipulated under **Section 30**, in the case where a seller has sold the goods, and even thereafter he continues to be in the possession of such already sold goods, or of the document to the title to such already sold goods, the delivery or transfer of such already sold goods, by such seller or by the seller's mercantile agent, acting on behalf of the seller, by way of a further sale, pledge or some other disposition of the already sold goods, such seller will pass on a valid (good) title to the goods to the transferee (*bona fide* buyer for value, or pledgee, and so on), if the transferee ((*bona fide* buyer for value, or pledgee, and so on), has acted in good faith and without the notice of the earlier sale of the same goods by the seller.

It may be noted here that the provisions of this Section will be applicable only where both the following conditions are fulfilled:

(a) First, that the seller must be in the possession of the goods (already sold by him earlier), only in the capacity of a seller of these goods, and not in any other capacity. Alternatively speaking, if the earlier buyer had left the goods, already purchased by him, with the seller, to keep them on his behalf as a bailee (the buyer being the bailer in such a case), the provisions of this Section will not be enforceable.

(b) Second, that the buyer must be a *bona fide* buyer and also for value.

Example

Prakash had sold 500 quintals of rice to Bhavya. But Bhavya had not immediately lifted the goods and had, instead, left them with the seller himself. In the mean time, Prakash (seller) had over again sold these 500 quintals of rice (though already sold to Bhavya), to another innocent buyer for value, Varsha. But Varsha did not have any notice of the earlier sale of the same goods to some one else. In this case, a valid (good) title will pass on to Varsha.

27.7.5 Sale by the Buyer in Possession of the Goods

As provided under **Section 30 (2)**, in the case where a person, after buying or after agreeing to buy certain goods, obtains the possession of such goods, or the possession of the document to the title to such goods, with the consent of the seller, the delivery or transfer of such goods or the document to the title to such goods, by way of sale or pledge or such other disposition of such goods, by such person, or by a mercantile agent acting on behalf of such person, will be effective and valid, provided the person receiving such goods, had acted in a *bona fide* manner and without the notice of the seller's lien, if any.

Example

In a case titled **Cohn vs Pockett's Bristol Channer Steam Packer Co. [(1899) I.Q.B. 643]**, a person (Arun) had sold to another person (Bhaskar) some copper and he (Arun) had delivered to him (Bhaskar) a bill of lading pertaining to the copper so sold, along with a bill of exchange for the price of the copper sold. The buyer (Bhaskar), after obtaining the bill of lading, had endorsed it in favour of another person (Dhoni), who had taken it. However, Dhoni did not have any notice to any objection or defect in Bhaskar's title of the goods (copper). The buyer (Bhaskar) had subsequently become insolvent without paying the price of the copper. It was held in this case that the transfer of the bill of lading by the buyer (Bhaskar) to the sub-buyer (Dhoni) was effective against the true owner (Arun). Accordingly, the true owner (Arun) could not stop the goods (copper) in transit.

But then, in case the person were in possession of the goods under a 'hire-purchase' agreement, which gives him the right only of an option to buy, will not be covered within this Section **[Section 30 (2)]**, unless and until it had amounted to a sale.

27.7.6 Sale by an Unpaid Seller

As provided under **Section 54 (3)**, an unpaid seller of the goods, who has exercised his right of lien or stoppage in transit, can resell the already sold goods and pass on a valid title thereto to another buyer, even if the ownership of such goods had already passed on to the original buyer, and no notice of the re-sale had been given to the original buyer.

27.7.7 Exceptions Provided in Some Other Acts

(a) As provided under **Section 169 of the Indian Contract Act**, the sale by the finder of some lost goods will be held valid under the following circumstances:
   (i) If the true owner of such lost goods cannot be found (traced) with reasonable diligence (efforts); or
   (ii) If the true owner of such lost goods is found, but he (true owner) refuses to pay to the finder of the lost goods the lawful charges; or
   (iii) If the so found goods are likely to perish or lose a greater part of their value; or
   (iv) If the lawful charges of the finder of the lost goods amounts to two-third of the value of the lost and found goods in question.

(b) Further, as per the provisions contained in **Section 176 of the Indian Contract Act**, the sale by the pawnee (pledgee) will also be held valid, if the sale is effected by the pawnee (pledgee) after meeting some other condition also, as provided in the Act in this regard, like giving a reasonable notice to the pawner (pledgor), and so on.

(c) Moreover, the sale by the Official Assignee or the Official Receiver, or the Liquidator of Companies will also be held valid.

27.8 Summary of the Sales by the Non-owners of the Goods

The various circumstances, under which the sales by the non-owners of the goods will be held to be valid, have been summarised hereafter.

Valid Sales by the non-owners of the goods

(i) Where the sale is effected by a 'Mercantile Agent' in the ordinary course of business.
(ii) Where the sale is effected by a joint owner, who is in the possession of the goods, with the consent of the other joint owners of the goods.
(iii) Where the sale is effected by a person, who is in the possession of the goods under a voidable contract, before it (voidable contract) is opted to be set aside.
(iv) Where the sale is effected by a seller who is in the possession of the goods after their sale, provided he (seller) does not hold the goods as a bailee of the buyer.
(v) Where the sale is effected by a buyer who is in the possession of the goods after the agreement of sale, but before the actual sale.
(vi) Where an unpaid seller is in possession of the goods, and the sale is effected by him in exercise of his right of (seller's) lien or the right of stoppage in transit.
(vii) Where the sale is effected by a finder of the lost goods under **Section 169 of the Indian Contract Act**.
(viii) Where the sale is effected by a pledge under **Section 176 of the Indian Contract Act**.
(ix) Where the sale is effected by the Official Assignee or the Official Receiver, or the Liquidator of Companies.

Let us Recapitulate

The term 'property in goods' means 'ownership in goods' and not just the 'possession of the goods'. While the 'property' in the goods means having the 'ownership' of the goods, the 'possession' of goods simply means the 'custody' of the goods. For example, in the case of pledge of goods, the bank (pledgee) is in possession of the goods, but the ownership of the pledged goods still remains with the borrower.

- **When will the seller or buyer bear the loss of damaged or lost goods)?**
  - **(i)** The general rule is that the risk follows the ownership. Accordingly if, at the actual time of the loss or damage of the goods, the ownership of the goods was still with the seller, the seller will bear the loss.
  - **(ii)** In case the goods are damaged by a third party, the owner (and not the prospective buyer) will be entitled to take action against such third party.
  - **(iii)** In case either the seller or buyer is declared insolvent, whether the Receiver or the Official Assignee can claim the goods from the seller or the buyer will depend upon the fact whether, at the material time, the ownership of the goods involved was still remaining with the seller, or else it had been passed on (transferred) to the buyer.
- **When the property (ownership) in the goods passes on from seller to buyer?**
  - **(i)** In the case of the sale of the specific or ascertained goods, the ownership of such goods is transferred from the seller to the buyer at such times when the parties to the contract (i.e. buyer and seller) intend the ownership of the goods to be transferred. The intention of parties to the contract is ascertained from the following cases and circumstances:
    - **(a)** From the terms of the contract;

(**b**) From the conduct of the parties involved; and
(**c**) From the circumstances of the case.

- **Passing (Transfer) of Property in Goods from seller to buyer (unless an intention appears in the contract to the contrary)**

(**i**) The property (ownership) in **specific goods in a deliverable state** (stage/condition), passes on at the time when an unconditional contract is entered into, even if the delivery of the goods or the payment of the price of the goods, or both, is deferred to a future date.

(**ii**) The property in **specific goods not in a deliverable state** (i.e. where something more remains to be done by the seller to put them in a deliverable state), passes on to the buyer only after the thing that was yet to be done on the goods under sale is completed, and the buyer receives the notice from the seller to this effect.

(**iii**) In the cases where the **specific goods are in a deliverable state but these are yet to be weighed, measured, tested, to ascertain price,** the property in such goods does not pass on from the seller to the buyer until the aforementioned act or thing, still required to be done by the seller on the goods, is done by him, and the buyer is notified by him to this effect.

(**iv**) In the case of a contract of sale of '**unascertained or future goods**', the property in the goods will not be transferred from the seller to the buyer unless the goods become ascertained.

(**v**) In the case of a sale of **unascertained goods or future goods sold by description**, the property in the goods under sale will pass on from the seller to the buyer only when the goods of the agreed description will be in a deliverable state, and when these goods are unconditionally appropriated (i.e. selected and segregated), either by the seller with the consent of the buyer, or by the buyer with the consent of the seller.

(**vi**) Further, in the cases where the delivery of the goods is to be made only against cash payment, the property in the goods will not be deemed to have passed from the seller to the buyer unless payment is made by the buyer in cash.

(**vii**) Where the goods are delivered to the buyer **'on approval' or 'sale or return' basis**, or even on such similar terms and conditions, the property in the goods under sale will pass on from the seller to the buyer when the buyer will signify his approval or acceptance of the goods to the seller, and also where the buyer does any act pertaining to the transaction, like when he (buyer) pledges the goods with a third party; or when he (buyer) retains the goods, without giving notice of rejection to the seller even beyond the time fixed for the return of the goods involved, or if no specific time is fixed, beyond a reasonable time.

As against the sale 'on approval' or 'sale or return', in the case of **'Sale for cash only or Return'**, the property does not pass on to the buyer until the goods involved are paid for by the buyer.

As a **general rule**, only the owner of the goods can transfer a valid title in the goods. Further, no one can give a better title to the goods than the owner of the goods himself has. This principle is based on the dictum (maxim): '*Nemo dat quod non habet',* which means 'No one can give what he himself has not'.

- **Exceptions to the General Rule Pertaining to Transfer of Title**

(**i**) **Sale by Mercantile Agent**
A 'mercantile agent' is an agent having, in the customary course of business as such agent, authority either to sell or to consign goods for the purpose of sale, or to buy goods , or to raise money on the security of goods.

(**ii**) **Sale by a Joint Owner**
Where one of several joint-owners of goods, who has the sole possession thereof, with the consent of the other joint-owners, sells such goods, any purchaser from such person, for value, without notice at the material time, of the seller's want of authority to sell, acquires a good title thereto against the other joint-owners.

(iii) Sale by a Person in Possession under a Voidable Contract
Where a person has obtained the possession of the goods under a voidable contract, which is considered voidable due to fraud, coercion, misrepresentation, or undue influence, he can pass on a good title to the buyer, provided the sale has taken place before (and not after) the voidable contract is avoided.

(iv) Sale by the Seller in Possession of the Goods after Sale
Where a seller has sold the goods, and even thereafter he continues to be in the possession of such already sold goods, or of the document to the title to such already sold goods, the delivery or transfer of such already sold goods, by such seller or by the seller's mercantile agent, acting on behalf of the seller, by way of a further sale, pledge, or some other disposition of the already sold goods, such seller will pass on a valid title to the goods to the transeferee (*bona fide* buyer for value, or pledgee, and so on), if the transeferee (*bona fide* buyer for value, or pledgee, and so on) has acted in good faith and without the notice of the earlier sale of the same goods by the seller. That is, the buyer must be a *bona fide* buyer and also for value.

(v) Sale by the Buyer in Possession of the Goods
Where a person, after buying or after agreeing to buy certain goods, obtains the possession of such goods, or the possession of the document to the title to such goods, with the consent of the seller, the delivery or transfer of such goods or the document to the title to such goods, by way of sale or pledge or such other disposition of such goods, by such person, or by a mercantile agent acting on behalf of such person, will be effective and valid, provided the person receiving such goods, had acted in a *bona fide* manner and without the notice of the seller's lien, if any.

(vi) Sale by an Unpaid Seller
An unpaid seller of the goods, who has exercised his right of lien or stoppage in transit, can resell the already sold goods and pass on a valid title thereto to another buyer, even if the ownership of such goods had already passed on to the original buyer, and no notice of the re-sale had been given to the original buyer.

- **Exceptions Provided in Some Other Acts**

(a) As provided under **Section 169 of the Indian Contract Act**, the sale by the finder of some lost goods will be held valid under the following circumstances:

(i) If the true owner of such lost goods cannot be found (traced) with reasonable diligence (efforts); or

(ii) If the true owner of such lost goods is found, but he (true owner) refuses to pay to the finder of the lost goods the lawful charges; or

(iii) If the so found goods are likely to perish or lose a greater part of their value; or

(iv) If the lawful charges of the finder of the lost goods amounts to two-third of the value of the lost and found goods in question.

(b) Further, as per the provisions contained in **Section 176 of the Indian Contract Act**, the sale by the pawnee (pledgee) will also be held valid, if the sale is effeted by the pawnee (pledgee) after meeting some other condition also, as provided in the Act in this regard, like giving a reasonable notice to the pawner (pledgor), and so on.

(c) Moreover, the sale by the Official Assignee or the Official Receiver, or the Liquidator of Companies will also be held valid.

Questions for Reflection

1. (a) What do you understand by the term 'property in goods'?
   (b) What are the main distinguishing features between the terms 'property in goods' and 'possession of goods'?

   Give illustrative examples in each case.
2. (a) Under what specific circumstances will the seller or buyer bear the loss of damaged or lost good?
   (b) Whether the seller or buyer will bear the loss of the damaged or lost good, in the following cases?
      (i) If, at the actual time of the loss or damage of the goods, the ownership of the goods involved was still remaining with the seller; and
      (ii) If, at the actual time of the loss or damage of the goods, the ownership of the goods involved had already passed on to the buyer.

   Give reasons for your answer in each case.
3. (a) In case the goods are damaged by a third party (i.e. other than the buyer and seller), whether the (owner) seller or the prospective buyer will be entitled to take action against such third party?
   (b) In case either the seller or the buyer is declared insolvent, under what specific circumstances the Receiver or the Official Assignee can claim the goods from the seller or the buyer, respectively?

   Give reasons for your answer.
4. (a) What do you understand by the term 'deliverable state' of goods?
   (b) When does the property in the specific goods, which are in a deliverable state, pass on from the seller to the buyer?
   (c) What difference, if any, will it make where the delivery of the specific goods in a deliverable state or the payment of the price of such goods, or both, is deferred to a future date?

   Explain with the help of some illustrative examples in each case.
5. (a) Will the endorsement on a railway receipt, made by the consignee in favour of another person, amount to the transfer of ownership of the goods represented thereby? Give reasons for your answer.
   (b) In case you think that it will not amount to the transfer of ownership of the goods represented by the railway receipt, in what other capacity, if any, the endorsee will be holding the railway receipt so endorsed?
6. (a) What do you understand by the term 'specific goods not in a deliverable state'?
   (b) When does the property in the specific goods not in a deliverable state, pass on from the seller to the buyer?
   (c) When does the property in the specific goods pass on from the seller to the buyer, in the case where, though such goods are in a deliverable state, these are yet to be weighed, measured, tested, and something more is required be done by the seller on the goods under sale?

   Explain with the help of some illustrative examples in each case.
7. (a) What do you understand by the term 'unascertained or future goods'?
   (b) When does the property in the unascertained or future goods pass on from the seller to the buyer?
   (c) When does the property in the unascertained or future goods sold by description pass on from the seller to the buyer?

   Explain with the help of some illustrative examples in each case.
8. (a) What do you understand by the term 'unconditional appropriation'?
   (b) In what manners the unconditional appropriation may be made in the following case:
      (i) By the buyer with the consent of the seller; and
      (ii) By the seller with the consent of the buyer.

(c) In the cases where the consent of the buyer has not been sought and received, will the ownership in the goods under the sale be deemed to have passed on from the seller to the buyer?

Explain with the help of some illustrative examples in each case.

9. (a) When does the property in the specific goods pass on from the seller to the buyer, in the case where the goods are delivered to the buyer 'on approval' or 'sale or return' basis, or on such similar terms?
   (b) When does the property in the specific goods pass on from the seller to the buyer, in the case where the goods are delivered to the buyer 'on approval' or 'sale or return' basis, and the buyer pledges the goods with a third party; or when he (buyer) retains the goods, without giving notice of rejection to the seller even beyond the time fixed for the return of the goods involved, or if no specific time is fixed, beyond a reasonable time.
   (c) When does the property in the specific goods pass on from the seller to the buyer, in the case where the goods are delivered to the buyer on the condition of 'sale for cash only or return'.

   Explain with the help of some illustrative examples in each case.
10. (a) What are the general rules pertaining to transfer of title to goods from the seller to the buyer?
    (b) On what dictum (maxim) is the general rule that 'no one can give a better title to the goods than the owner of the goods himself has' based on?
    (c) Will the general rule that 'no one can give a better title to the goods than the owner of the goods himself has' hold good even in the cases where the buyer happens to be a *bona fide* buyer for value?
11. (a) Do you think that the sales made by the non-owners of the goods are held valid in the following circumstances?
    (b) Explain each of the following circumstances with the help of suitable illustrative examples in each case.
        (i) Where the sale is effected by a 'Mercantile Agent' in the ordinary course of business.
        (ii) Where the sale is effected by a joint owner, who is in the possession of the goods, with the consent of the other joint owners of the goods.
        (iii) Where the sale is effected by a person, who is in the possession of the goods under a voidable contract, before it (voidable contract) is opted to be set aside.
        (iv) Where the sale is effected by a seller who is in the possession of the goods after their sale, provided he (seller) does not hold the goods as a bailee of the buyer.
        (v) Where the sale is effected by a buyer who is in the possession of the goods after the agreement of sale, but before the actual sale.
        (vi) Where an unpaid seller is in possession of the goods, and the sale is effected by him in exercise of his right of (seller's) lien or the right of stoppage in transit.
        (vii) Where the sale is effected by a finder of the lost goods.
        (viii) Where the sale is effected by a pledgee.
        (ix) Where the sale is effected by the Official Assignee or the Official Receiver, or the Liquidator of Companies.

Problems for Practice (With Suggested Solutions)

Problem 1

Surabhi has pledged some of her goods to a bank as a security against some loan taken by her from it. The bank claims that it is also the owner of the pledged goods as the same is in its possession. Do you think that the contention of the bank is legally valid? Give reasons for your answer.

Solution

No; the contention of the bank is not legally valid. In fact, in the case of pledge of goods as security against

loans from a bank, the bank, by virtue of it being a pledgee, will be in the possession of the goods pledged to it by the borrower, but the ownership of the pledged goods will continue to remain with the borrower concerned.

Problem 2

Sneha had made an offer to Prerna to sell her Maruti van to her for a sum of Rs 2,50,000. Prerna had accepted the offer unconditionally. But the delivery of the Maruti van as also the payment of the price of the Maruti van (Rs 2,50,000), was agreed between them to be made at a specified later date. But unfortunately, in the mean time, the Maruti van was stolen from the house of Sneha. Sneha, thereupon, asked Prerna on the specified date to make payment of the price of the Maruti van that was bought by her (Prerna). But Prerna argued that as the Maruti van had been stolen from the house of Sneha, she (Sneha) should bear the loss and she (Prena) should not be asked to pay the price of the Maruti van stolen. Thereafter, Sneha filed a suit in the Court against Prerna. What are the chances of Sneha winning the case? Give reasons for your answer.

Solution

Sneha has a very bright chance of winning the case. This is so for the following reasons:

(i) That, as per the provisions made in the Sale of Goods Act, in the instant case, the moment the offer of Sneha was unconditionally accepted by Prerna, an unconditional contract was entered into between them, and accordingly, the property in the Maruti van was passed on from Sneha (seller) to Prerna (buyer) at that time itself.

(ii) That, in such cases, it will be of no consequence even if the delivery of the Maruti van or the payment of its price of the Maruti van (Rs 2,50,000), or both is agreed to be made at a specified later date. This is so because all the three following conditions, as stipulated under Section 2(3) of the Sale of Goods Act, have been complied with in the instant case:

  (a) That, the case relates to the specific goods, i.e. the Maruti van, in the instant case;
  (b) That, the contract between the buyer and the seller is unconditional; and
  (c) That, the goods involved (Maruti van) is in a deliverable state.

(iii) Thus, the property in the Maruti van had already passed on from Sneha (seller) to Prerna (buyer), the very moment the unconditional contract was entered into between them. Further, the general rule is that the risk follows the ownership. Accordingly, as at the actual time of the theft of the Maruti van , the ownership of the Maruti van had already passed on (transferred) to Prerna (buyer), she herself will have to bear the loss, and not Sneha (seller).

Problem 3

The entire stock of wheat, stored in the godown of Shekhar, was purchased by Parashuram. But the socks of wheat were required to be delivered to Parashuram after being duly packed in the gunny bags, weighing 100 kg in each bag. But unfortunately, while the stocks of wheat were in the process of being packed in the gunny bags, the entire stock of wheat was destroyed by fire that had broken out in the godown of Shekhar.

Shekhar, thereupon, asked Parashuram to make payment of the price of the entire stock of wheat that was already bought by him (Parashuram). But Parashuram argued that as the entire stock of wheat had been destroyed by fire in the godown of Shekhar., he (Shekhar) should bear the loss and he (Parashuram) should not be asked to pay the price of the entire stock of wheat destroyed by fire. Thereafter, Shekhar filed a suit in the Court against Parashuram. What are the chances of Shekhar winning the case? Give reasons for your answer.

Solution

Shekhar (seller) has no chance of winning the case. This is so because, as per the provisions of the Sale of Goods Act, the property in the stock of wheat did not pass on from the seller to the buyer (Parashuram) till the stock of wheat was actually duly packed by the seller in the gunny bags, weighing 100 kg in each bag, and thereby he had made it deliverable to the buyer, and further, only when the buyer had received the notice to this effect from the seller. Thus, in the instant case, as the stocks of wheat were destroyed by fire while these

were still in the process of being packed in the gunny bags as required, and thus, these had not been made in the deliverable state, the title (ownership) of the stock of wheat had not passed on to the buyer, but it still continued to remain with the seller. Further, the general rule is that the risk follows the ownership. Accordingly, as, at the actual time of the fire in the godown of the seller, the ownership of the stocks of wheat had still continued to remain with the seller (Shekhar), he himself will have to bear the loss, and not Parashuram (buyer). This contention is based on the judgement delivered in a similar case titled **Rugg vs Minett [(1809), 11 East 2.101]**.

Problem 4

Sudarshan had agreed to sell to Bhavna a huge generating set, which was fixed at a particular place, on an F.O.R (Free-on-Rail) basis at a certain price. But unfortunately, the generating set got damaged on way to the railway (station). Both the parties to the contract (i.e. Sudarshan and Bhavna) have approached you for your expert legal opinion, as to who should bear the loss, that is, the cost for the repair of the damaged generating set? Give reasons for your answer.

Solution

We will advise them on the following lines:

(i) That the property (ownership) in the generating set, agreed to be sold by Sudarshan (seller) had not passed on from him to Bhavna (buyer) as the seller, under the contract of sale, was still required to put the generating set on the rails only whereafter it could be deemed to be in a deliverable state, as the sale was on an F.O.R (Free–on-Rail) basis.

(ii) Further, that the general rule is that the risk follows the ownership. Accordingly, as at the actual time of the damage of the generating set, the ownership of thereof had still continued to remain with the seller (Sudarshan), he himself will have to bear the loss, and not Bhavna (buyer).

(iii) We will still go further to doubly convince them that our aforementioned contention is based on the judgement delivered in a similar case titled **Underwood vs Burgh Castle Syndicate [(1922), I.K.B. 343]**,

Problem *5*

An agreement was entered into between the buyer and seller for the sale of some stock of paddy at a price per tonne. Further, as provided under the contract of sale of goods, the stock of paddy was required to be weighed by the agents of the buyer as also of the seller so as to ascertain the price, in terms of tonnes. A portion of the paddy, after being weighed by the agents of the buyer as also of the seller, was taken away by the agent/servant of the buyer. But thereafter, the remaining stock of paddy was destroyed by fire. Both the buyer and seller have approached you for your expert legal opinion, as to who should bear the loss of paddy destroyed by fire? Give reasons for your answer.

Solution

We will advise them on the following lines:

(i) That the property (ownership) in the balance stock of paddy, agreed to be sold, had not passed on from the seller to the buyer because, under the contract of sale, the stock of paddy was required to be weighed by the agents of the buyer as also of the seller so as to ascertain the price, in terms of tonnes. Further, as the weighing process was not yet completed, the ownership has still remained with the seller. Conversely speaking, only after the stock of paddy was weighed by the agents of the buyer as also of the seller, it could be deemed to be in a deliverable state, and only thereafter the property in the balance stock of paddy could be deemed to have passed on from the seller to the buyer.

(ii) Further, that the general rule is that the risk follows the ownership. Accordingly, because, at the actual time of the destruction of the remaining stock of paddy by fire, the ownership of thereof (remaining stock of paddy) had still continued to remain with the seller, he (seller) himself will have to bear the loss of the destroyed portion of the stock of paddy, and not the buyer.

(iii) But, because some portion of the stocks of paddy, after being weighed by the agents of the buyer as also of the seller, was already taken away by the agent/servant of the buyer, the property (ownership) in regard to that portion of paddy had already passed on the buyer. But, as no loss had taken place in regard to that portion of paddy, this aspect is not required to be discussed any further in the instant case.

(iv) We will still go further to doubly convince them (buyer and seller) that our aforementioned contention is based on the judgement delivered in a similar case titled **Zaguny vs Furnell [(1809), 2 Camp. 240]**,

Problem 6

Will it make any difference if, in the Problem 5 above, it was not provided under the contract of sale of goods, to the effect that the stock of paddy was required to be weighed by the agents of the buyer as also of the seller so as to ascertain the price, in terms of tonnes? Give reasons for your answer.

Solution

In the changed situation the legal position will be definitely changed. In that case, the loss will have to be suffered by the buyer, and not by the seller. This is so because, as provided under the Sale of Goods Act, if such terms (to the effect that the seller had to do something more regarding the goods under sale, like weighing etc.) were not specifically incorporated in the contract of sale of goods, the loss may have to be suffered by the buyer, instead.

Thus, if in the changed situation, the weighing etc., were to be done by the buyer himself, for his personal satisfaction, and not by the seller, the loss would have been suffered by the buyer, instead. This subtle point is based on the judgment delivered in the case titled **Turley vs Bates [(1863) H & C 200].**

Problem 7

Shatrugna has agreed to sell to Prasoon 500 quintals of rice out of a huge quantity of rice stored in his (Shatrugna's) godown. The price, however, was to be paid at a later date, as was specified under the contract of sale of goods. Under such circumstances, has the property in the rice passed on from the seller to the buyer at the time when the contract was entered into between them? Give reasons for your answer.

Solution

No; the property in the rice has not passed on from the seller to the buyer at the time when the contract was entered into between them. This is so because the property in the rice will be passed on from the seller to the buyer only after the required quantity of rice (i.e. 500 quintals) is segregated from the huge quantity of rice stored in the seller's godown. This is so because it will be only then that the required quantity of rice (i.e. 500 quintals) would be deemed to have been ascertained, and only thereafter the property in the rice will pass on from the seller to the buyer. Until then it will remain in the nature of unascertained or future goods, because, under Section 18 of the Sale of Goods Act, in the case of a contract of sale of 'unascertained or future goods', the property in the goods will not be transferred from the seller to the buyer unless the goods become ascertained.

Problem 8

The seller's warehouseman is in the possession of 10,000 quintals of red chillies on behalf of the seller. The warehouseman agrees to buy only 1,000 quintals of red chillies out of the stock of 10,000 quintals of red chillies stored in his warehouse on behalf of the seller. Under such circumstances, by virtue of the fact the entire stock of 10,000 quintals of red chillies are already in the possession of the buyer, by virtue of his being the warehouseman of the seller, will the ownership of 1,000 quintals of red chillies be deemed to have passed on from the seller to the buyer at the time when the contract was entered into between them? Give reasons for your answer.

Solution

No; the ownership of 1,000 quintals of red chillies will not be deemed to have passed on from the seller to the buyer at the time when the contract was entered into between them. Instead, the 1,000 quintals of red chillies will be deemed to have been appropriated, and the ownership in them will be deemed to have passed on from the seller to the buyer (warehouseman), only when the buyer (the seller's warehouseman in the instant case), has, with the assent (consent) of the seller, selected the goods (1,000 quintals of red chillies) that he has

agreed to buy, and has segregated the same (1,000 quintals of red chillies) that he wants to buy from the stock of the goods (i.e. 10,000 quintals of red chillies) he possessed in his warehouse on behalf of the seller.

Problem 9

A contract of sale of a lathe machine, manufactured by the seller, was entered into between him and the buyer. The seller had packed the lathe machine, and before despatching the same to the buyer, he had asked the buyer to specify the mode of transporting the machine to him. There was, however, no reply from the buyer. Will the ownership of the lathe machine be deemed to have passed on from the seller to the buyer at the time when the contract was entered into between them? Give reasons for your answer.

Solution

No; the ownership of the lathe machine will not be deemed to have passed on from the seller to the buyer at the time when the contract was entered into between them. In fact, in the instant case, there was no valid appropriation because the buyer concerned had not given his assent (consent) thereto. We say so because, as provided in the Sale of Goods Act, in the cases where the seller appropriates the goods to the contract of sale, the property will pass on from the seller to the buyer only when the buyer has given his assent (consent) to the seller for the appropriation of the goods under the sale. This contention is based on the case titled **Atkinson vs Bell [(1828) 108 E.R. 1046]**. Here, we may clarify that in the cases where the assent (consent) of any of the other party to the contract of sale (buyer or seller) has not been sought and received, the ownership in the goods under the sale will not be deemed to have passed on from the seller to the buyer.

Problem 10

The seller has despatched the goods to the buyer on the condition that the delivery of the goods will be made against cash payment. The goods have arrived at the workplace of the buyer but he did not have ready cash to make the payment of the price of the goods immediately. Will the property in the goods be deemed to have passed on from the seller to the buyer in view of the fact that the goods have already arrived at the workplace of the buyer? Give reasons for your answer.

Solution

No; the property in the goods will not be deemed to have passed on from the seller to the buyer just because the goods have already arrived at the workplace of the buyer. In fact, as per the provisions in the Sale of Goods Act, the property in the goods will not be deemed to have passed from the seller to the buyer unless and until the payment is made by the buyer in cash, as was specifically provided in the contract of the sale of the goods. Therefore, as in the instant case, the cash payment of the price of the goods has not been paid, and accordingly, the delivery of the goods would not have, obviously, been given to the buyer, the property in the goods will not be deemed to have passed on from the seller to the buyer.

Problem 11

Subhadra, the seller of the goods under the contract of sale, has drawn a time (usance) bill of exchange on Basanti (buyer) for the amount of the price of the goods under sale, and has sent it (bill of exchange) to Basanti (buyer) direct, along with the relative bill of lading (B/L) for the purpose of obtaining the acceptance of the time bills of exchange by her. But, as Basanti (buyer) had not accepted the bill of exchange, Subhadra (seller) had asked Basanti (buyer) to return it to her along with the relative bill of lading (B/L). But Basanti (buyer) flatly refused to return the documents to Subhadra (seller). Do you think that the act on the part of Basanti (buyer) is legally justified? Give reasons for your answer.

Solution

No; the act on the part of Basanti (buyer) in flatly refusing to return the documents (bill of exchange and bill of lading) to Subhadra (seller) is not at all legally justified. In fact, as per the provisions in the Sale of Goods Act, the buyer (Basanti in the instant case) is legally bound to return the relative bill of lading (B/L) to the seller (Subhadra in the instant case), if she (buyer) does not accept the time bills of exchange. The Act further provides that, if the buyer, instead of returning the relative bill of lading (B/L) to the seller, retains the same, the property in the goods covered by the relative bill of lading (B/L) will not be deemed to have passed on from the seller to the buyer.

Problem 12

Dinesh (seller) had delivered the goods to Prasanna (buyer) 'on approval' or 'sale or return' basis. However, the buyer had not signified his approval of the goods to the seller. But then, the buyer had pledged the goods with a bank as a security against some loan raised by him (Prasanna) from the bank. Do you think that the property in the goods under sale would have passed on from the seller to the buyer despite the fact that the buyer had not signified his approval of the goods to the seller? Give reasons for your answer.

Solution

Yes; the property in the goods under sale would have passed on from the seller to the buyer despite the fact that the buyer had not signified his approval of the goods to the seller. This is so because, as per the provisions in the Sale of Goods Act, the property in the goods under sale will also pass on from the seller to the buyer, when the buyer does any act pertaining to the transaction, like when he (buyer) pledges the goods with a third party (bank in the instant case). Thus, as in the instant case, the buyer had pledged the goods with a bank as a security against some loan raised by him (Prasanna) from the bank, the title to the goods will be deemed to have passed on from the seller to the buyer.

Problem 13

In Problem 12 above, would the legal position be any different, if the buyer would have retained the goods, without giving notice of rejection to the seller even beyond the stipulated time fixed for the return of the goods involved? Give reasons for your answer.

Solution

Even in such changed situation the legal position would have remained unchanged. That is, even in that case, the property in the goods under sale would have passed on from the seller to the buyer because of the fact that the buyer had not given the notice of his rejection of the goods to the seller even beyond the stipulated time fixed for the return of the goods involved. This is so because the Sale of Goods Act further provides that the property in the goods under sale will also pass on from the seller to the buyer when the buyer does not give the notice of his rejection of the goods to the seller even beyond the stipulated time fixed for the return of the goods involved.

Problem 14

In Problem 13 above, would the legal position be any different, if the buyer would have retained the goods for an unreasonably long time, without giving notice of rejection to the seller, on the ground that no time was fixed for the return of the goods involved? Give reasons for your answer.

Solution

Even in such changed situation the legal position would have remained unchanged. That is, even in that case, the property in the goods under sale would have been deemed to have been passed on from the seller to the buyer because of the fact that the buyer had retained the goods with himself for an unreasonably long time, instead of returning the goods involved to the seller within a reasonable time. This is so because the Sale of Goods Act further provides that the property in the goods under sale will also pass on from the seller to the buyer where the buyer does not return the goods to the seller within a reasonable time, in the cases where no specified time is fixed in the contract of sale of goods for the return of the goods involved.

Problem 15

Subhash had sold certain goods to Prashant on 'sale for cash only or return' basis. Prashant, however, neither made the payment of the price of the goods, nor returned the goods to Subhash, as was required under the contract of sale of goods. Instead, he (Prashant.) had pledged those goods with a bank as security against some loans raised from it. Thereupon, Subhash had approached the bank and demanded that the goods pledged to it by Prashant must be returned to him (Subhash) on the ground that the goods were not paid for by Prashant. The bank, in turn, declined to return the goods to Subhash on the plea that it had already advanced certain loan to Prashant against the security of the goods pledged by Prashant. Therefore, Subhash filed a suit in the Court against the bank for the recovery of the goods already pledged to it by Prashant. What are the chances of Subhash winning the case? Give reasons for your answer.

Solution

Subhash has a very bright chance of winning the case. We say for the following reasons:

(i) That, the Sale of Goods Act provides that, in the cases of sales on 'sale for cash only or return' basis, the property (ownership) in the goods so sold does not pass on from the seller to the buyer until the goods involved are paid for by the buyer.

(ii) That, the Sale of Goods Act further provides that, in case the goods involved are not paid for by the buyer, and the buyer pledges the goods with a third party (bank in the instant case), such pledge (by a non-owner of the goods) will be treated as an invalid pledge, and accordingly, the seller will have the right to recover the goods from the pledgee (bank in the instant case).

In view of the aforementioned circumstances, Subhash (the seller in the given case) will win the case; that is, he will have the right to recover the goods from the pledgee (bank in the instant case).

Problem 16

Harshit, a hirer of a refrigerator, who still has to pay some monthly instalments thereon, under a hire-purchase agreement, had sold the same to Daksha, a *bona fide* buyer for value. Will Daksha, by virtue of being a *bona fide* buyer for value, acquire a valid title to the refrigerator? Give reasons for your answer.

Solution

No; Daksha, though a *bona fide* buyer for value, will not be able to acquire a valid title to the refrigerator. This is so because, Harshit, the hirer of a refrigerator, and the seller in the instant case, did not have any title in the goods hired by him under a hire-purchase agreement, as he still had to pay some monthly instalments thereon. At best, Daksha (buyer) will acquire an interest in the refrigerator as the hirer (Harshit) himself had. Our aforementioned contention is based on the fact that, as a general rule, only the owner of the goods can transfer a valid title in the goods. Thus, Harshit, the hirer of a refrigerator, who still had to pay some monthly instalments thereon, under a hire-purchase agreement, will not become the owner of the refrigerator till such time he pays of the last and final instalment on the refrigerator hired by him. Further, no one can give a better title to the goods than the owner of the goods himself has. This principle is based on the dictum (maxim): '*Nemo dat quod non habet',* which means 'No one can give what he himself has not'. Thus, as the seller had no title in the instant case, the buyer also will be deemed to be having no title to the goods sold by such seller. Moreover, this rule holds good even in the cases where the buyer is a *bona fide* buyer for value.

Problem 17

Faiz had found a gold necklace of Gauri on the roadside and had sold it to Shaguna, who had bought it (necklace) for value and in good faith. One day Gauri found Shaguna wearing her necklace. Can Gauri recover the necklace from Shaguna, even though she (Shaguna) had bought the necklace for value and in good faith? Give reasons for your answer.

Solution

Yes, Gauri can recover the necklace from Shaguna, even though she (Shaguna) had bought the necklace for value and in good faith from Faiz. This is so because, Faiz, in the instant case, is only the finder of the necklace, and therefore, he did not have any title thereto, and accordingly, could not pass on any title even to any buyer for value and in good faith, like Faiz in the instant cvase, because he (Faiz) cannot give any title as he himself did not have any (title).

Problem 18

A mercantile agent had obtained some gold ornaments from their true owner by falsely pretending to him that he had a customer who was willing to purchase them, and thereafter, he fraudulently pledged the gold ornaments as security to obtain some loans for himself against them. Do you think that the owner of the gold ornaments was legally bound by the transaction of the pledge, created by his mercantile agent? Give reasons for your answer.

Solution

Yes, the owner of the gold ornaments was legally bound by the transaction of the pledge, created by his

mercantile agent. This is so because, as provided in the Sale of Goods Act, in a case where a mercantile agent, who is in the possession of the goods (or the document to the title to the goods), sells them, with the consent of the owner of these goods, in the ordinary course of business as a mercantile agent, the buyer gets a valid title to the goods, provided he (buyer) buys them in good faith and for value. This contention is also corroborated by the case titled **Oppenheimer vs Attenborough [(1908) I.K.B. 221]**.

Problem 19

An agent for the sale of automobiles had sold a motorcycle below the price that the owner of the motorcycle had authorised him to sell the motorcycle for, and had misappropriated the sale proceeds. Will the innocent buyer be able to obtain a good title to the motorcycle purchased by him? Give reasons for your answer.

Solution

Yes; the innocent buyer will be able to obtain a good title to the motorcycle purchased by him. This is so because, as provided in the Sale of Goods Act, a person who, in good faith and for value, buys the goods from the agent or mercantile agent of the owner of the goods, such buyer will get a valid title to the goods bought by him, even if such seller (agent or mercantile agent of the owner or even his factor or auctioneer) would have exceeded his authority or else, even if the authority of the agent or mercantile agent of the owner or even his factor or auctioneer was revoked by the true owner of the goods before these were sold by him (agent or mercantile agent of the owner or his factor or auctioneer). This contention is also corroborated by the case titled **Folkes vs King [(1923) K.I.B. 282].**

Problem 20

Vinod and Ajai are the co-owners of a car. The car was in the possession of Vinod. But Ajai had secretly taken it away and had sold it to Dilip, a *bona fide* purchaser for value. Can Dilip get a good title to the car so sold by Ajai to him? Give reasons for your answer.

Solution

No; Dilip cannot get a good title to the car so sold by Ajai to him. This is so because, though Ajai was a co-owner, and was also in the possession of the car at the time of the sale, he was not in its (car's) possession with the consent of the other co-owner, viz., Vinod. Our aforementioned contention is based on the provisions of the Sale of Goods Act, which stipulates that, in the case of sale by a co-owner, a good title in the goods can pass on to the purchaser only if the co-owner was in the possession of the goods with the consent of the other co-owners. In this context, the clause 'with the consent of the other co-owners' is of essence, which is obviously absent in the instant case.

Problem 21

Yasin had exercised undue influence on Zahir, and had purchases his (Zahir's) cycle rickshaw for a much lower price than it (cycle rickshaw) would have ordinarily fetched in the market. Thereafter, Yasin had sold the cycle rickshaw to Prakash, an *innocent* purchaser. Will Prakash get a valid title to the cycle rickshaw, or Zahir can recover the cycle rickshaw from Prakash? Give reasons for your answer.

Solution

This is a case of a voidable contract (due to the exercise of undue influence by the buyer on the owner), and the contract is voidable at the option of the owner of the cycle rickshaw on whom the undue influence was exercised, i.e. at the option of Zahir in the instant case. Further, as provided under Section 29 of the Sale of Goods Act, where a person has obtained the possession of the goods under a voidable contract, which is considered voidable due to fraud, coercion, misrepresentation, or undue influence, he can pass on a good title to the buyer, provided the sale has taken place before (and not after) the voidable contract is avoided.

But in the instant case, it has not been specifically mentioned whether the cycle rickshaw was sold by Yasin before or after the voidable contract was avoided. Therefore, we have the following observations to make:

(a) Prakash will get a valid title to the cycle rickshaw, and Zahir cannot recover the cycle rickshaw from him (Prakash), if the vioidable contract between him (Zahir) and Yasin (arrived by way of undue influence) had not been avoided by Zahir till the sale of the cycle rickshaw had taken place.

(b) As against this, Prakash will not get a valid title to the cycle rickshaw, and Zahir can recover the cycle rickshaw from him (Prakash), if the vioidable contract between him (Zahir) and Yasin (arrived by way of undue influence) had already been avoided by Zahir beforer the sale of the cycle rickshaw had taken place.

Problem 22

Pallav had sold 1,000 quintals of spice to Balwant. But Balwant had not immediately lifted the goods and had, instead, left them with Pallav (seller) himself. In the mean time, Pallav (seller) had over again sold these 1,000 quintals of spice (though already sold to Balwant), to another innocent buyer for value, Wasim. But Wasim did not have any notice of the earlier sale of the same goods to some one else. Will in this case, a valid title pass on to Wasim? Give reasons for your answer.

Solution

Yes, in this case, a valid title will pass on to Wasim. This is so because, as stipulated under Section 30 of the Sale of Goods Act, in the case where a seller has sold the goods, and even thereafter he continues to be in the possession of such already sold goods, the delivery of such already sold goods, by such seller by way of a further sale of the already sold goods, such seller will pass on a valid title of the goods to the transeferee (*bona fide* buyer for value), if the transeferee (*bona fide* buyer for value), has acted in good faith and without the notice of the earlier sale of the same goods by the seller to some other person.

Problem 23

Sandeep had sold to Bashir some colour T.V. sets and he (Sandeep) had delivered to him (Bashir) a bill of lading pertaining to the colour T.V. sets so sold, along with a bill of exchange for the price of the colour T.V. sets sold. The buyer (Bashir), after obtaining the bill of lading, had endorsed it in favour of another person (Ehsan), who had taken it. However, Ehsan did not have any notice to any objection or defect in Bashir's title of the goods (colour T.V. sets). The buyer (Bashir) had subsequently become insolvent without paying the price of the colour T.V. sets. Can the true owner (Sandeep) stop the goods (colour T.V. sets) in transit? Give reasons for your answer.

Solution

No; the true owner (Sandeep) cannot stop the goods (colour T.V. sets) in transit because the transfer of the bill of lading by the buyer (Bashir) to the sub-buyer (Ehsan) was effective against the true owner (Sandeep). Accordingly, the true owner (Sandeep) cannot stop the goods (colour T.V. sets) in transit. This contention is based on the provisions of Section 30 (2) of the Sale of Goods Act, which, *inter alia* stipulates that where a person, after buying the goods, obtains the possession of such goods, or the possession of the document to the title to such goods, with the consent of the seller, the delivery or transfer of such goods or the document to the title to such goods, by way of sale of such goods, by such person, will be effective and valid, provided the person receiving such goods, had acted in a *bona fide* manner and without the notice of the seller's lien, if any. This stand is further confirmed even in a case titled **Cohn vs Pockett's Bristol Channer Steam Packer Co. [(1899) I.Q.B. 643].**

Problem 24

Umesh, an unpaid seller of the goods, had sold some goods to Shakti. But he (Umesh) had exercised his right of stoppage in transit. However, he had resold such already sold goods to Awtar, though the ownership of such goods had already passed on to the original buyer, Shakti, and no notice of the re-sale had been given to the original buyer, Shakti. Can Umesh pass on a valid title to such goods to Awtar, another buyer, in the given circumstances? Give reasons for your answer.

Solution

Yes; Umesh can pass on a valid title to such goods to Awtar, another buyer, in the given circumstances. This is so because, as provided under Section 54 (3) of the Sale of Goods Act, an unpaid seller of the goods, who has exercised his right of stoppage in transit, can resell the already sold goods and pass on a valid title thereto to another buyer, even if the ownership of such goods had already passed on to the original buyer, and no notice of the re-sale had been given to the original buyer.

Chapter Twenty Eight

Performance of Contract of Sale

> *A total commitment is paramount to reaching the ultimate in performance.*
> **Tom Flores**

For the purpose of understanding the performance of a contract of sale, it is essential to first understand the duties of the seller and the buyer, as also as to what constitutes the delivery of the sold goods by the seller. We will, therefore, discuss these issues first.

28.1 Duties of the Seller and the Buyer

As provided under **Section 31**, the buyer's duty is to delver the goods sold by him, and the seller's duty is to accept the goods bought by him and also to pay the price of the same, in accordance with the terms of the contract of sale of goods. Thus, it is the duty of the seller to give the delivery of the goods to the buyer and, in turn, it is the duty of the buyer (**a**) to accept the delivery of the goods; (**b**) to pay the price for the goods; and, (**c**) to pay compensation to the seller in the event of his (buyer's) wrongfully refusing to accept the delivery of the goods.

Further, as provided under **Section 32**, the delivery of the sold goods and the payment of the price of the bought goods are concurrent conditions (i.e. which run simultaneously), unless agreed otherwise (i.e. to the contrary). Thus,

(**a**) Neither the seller is required to give the delivery of the goods sold by him to the buyer, if the buyer is not willing to pay the price for the goods purchased by him;
(**b**) Nor the buyer is required to pay the price for the goods bought by him, if the seller is not willing and ready to give the delivery of the bought goods to the buyer.

28.2 Delivery Defined

As defined under **Section 2 (2)**, the term 'delivery' constitutes an act as 'a voluntary transfer of possession from one person to another'.

Further, as provided under **Section 33**, the delivery of the goods sold may be effected by the seller by his doing something, which the parties to the contract of sale of goods (viz., both the seller and the buyer), have agreed to treat the same as an effective delivery of the goods, or which has the effect of placing the goods in the possession of the buyer concerned, or in the possession of any other person authorised by the buyer to hold the same on his (buyer's) behalf.

28.3 Types of Delivery

Thus, on a closer reading of the provisions under **Section 33**, we find that the delivery of the goods sold may be effected not only by giving the physical possession of the sold goods to the buyer concerned, but also in many other ways, to which the parties to the contract of sale of goods (viz., both the seller and the buyer), have agreed to treat the same as being equivalent to an effective delivery of the goods sold.

The delivery of the goods sold may be effected in the following different ways:

28.3.1 Physical or Actual Delivery

In the cases of a physical or actual delivery, the seller of the goods gives the physical (actual) possession of the goods sold, to the buyer thereof. For **example**, where the seller had sold 100 bags of wheat, he physically delivers those actual 100 bags of wheat to the buyer thereof.

28.3.2 Symbolic Delivery

As against the physical or actual delivery, in the case of a symbolic delivery, the seller, instead of giving a physical or actual delivery of the goods sold, delivers some symbol that signifies a real or actual possession of, or control over, the goods sold. For **example**, where the seller had sold a car, the delivery of the key thereof symbolises the real or actual possession thereof, given to the buyer. Similarly, in the cases of the sale of a railway receipt or bill of lading, the delivery of the duly endorsed railway receipt or bill of lading to the buyer thereof, signifies the delivery of the same to the buyer concerned.

28.3.3 Constructive Delivery

In the case of a constructive delivery, however, neither a physical delivery of the goods sold is involved, nor does any delivery of a symbol, signifying the possession or control of the goods sold, take place. Instead, there is only an acknowledgment by the person, who is already in the physical possession of the goods sold, to the effect that he (possessor) holds those goods on behalf the buyer.

Such constructive delivery may take place in the following different ways in different circumstances:

(a) Where the buyer, who happens to be already in the physical possession of the goods sold, in the capacity of a bailee of the seller concerned, acknowledges that he now holds such goods as his own;
(b) Where the seller of the goods, who happens to be already in the physical possession of the goods sold, holds them after the sale as a bailee of the buyer concerned; and
(c) Where a third person (i.e. a person other than the buyer and the seller involved), e.g., a warehouseman or a carrier, who was so far holding the goods in the capacity of a bailee of the seller concerned, agrees that he now holds them in the capacity of a bailee of the buyer, instead.

28.4 Rules of Delivery

28.4.1 As defined under **Section 34**, the delivery of a part of the goods sold may amount to the delivery of

the whole (entire) goods, provided it is so intended and agreed between the buyer and the seller. But in the cases, where only a part of the goods, out of the whole stock of goods stored in the seller's godown, is bought and such bought goods are intended and agreed between the buyer and the seller to be segregated (separated) from the whole (entire) stocks of the goods stored in the seller's godown, a part delivery of the goods, under such circumstances, will not amount to be the delivery of the entire portion of the goods bought and sold.

28.4.2 As provided under **Section 35**, unless agreed to the contrary, the seller is not bound to deliver the goods till the buyer applies for the delivery of the goods. Even in the cases where the goods sold are yet to be acquired by the seller, the seller's duty ends after he has notified to the buyer that the goods sold have since been acquired by him (seller).

28.4.3 Providing for the **place of delivery**, **Section 36 (1)**, stipulates that it entirely depends upon the terms (express or implied) of the contract of sale of goods entered into between the buyer and the seller, whether the goods are to be taken possession of by the buyer, or the seller is required to send the goods to the buyer. But, apart from any such contract, the goods sold are required to be delivered at the place where the goods are lying at the time of the sale. In the case of an agreement to sell, the goods are required to be delivered at the place where the goods are lying at the time of the agreement to sale had taken place. Further, in the cases where the goods are non-existent, the goods are required to be delivered at the place where the goods are manufactured or produced.

28.4.4 Stipulating for the **time of delivery**, **Section 36 (2)** provides that, in the cases where, in terms of the contract of sale of goods, the time of their delivery is fixed, the seller is bound to send the sold goods to the buyer on such specified time, but if no time for sending them to the buyer has been fixed (specified), the seller is legally bound to send them within a reasonable time.

28.4.5 Unless agreed otherwise, the expenses of, and incidental to, putting the goods under a deliverable state is required to be borne by the seller.

28.4.6 Further, the demand and delivery (tender) must be at a reasonable hour. But, what is a reasonable hour is a matter of fact, which may differ from case to case.

28.4.7 In regard to the **delivery of lesser quantity** of goods sold, **Section 37 (1)** provides that, in the cases where the seller has delivered the goods to the buyer in a quantity lesser than what was agreed upon between them (seller and buyer) in the contract of sale of goods, the buyer is entitled to reject or accept them (i.e. the goods supplied in a lesser quantity), at his own option. But then, if the buyer prefers to accept the goods, so delivered to him in a lesser quantity, he (buyer) will have to pay for the (lesser) quantity of the goods actually supplied to him.

28.4.8 In regard to the **delivery of larger quantity** of goods sold, **Section 37 (2)1** provides that, in the cases where the seller has delivered the goods to the buyer in a quantity larger than what was agreed upon between them (seller and buyer) in the contract of sale of goods, the buyer is entitled to exercise any of the following three options he is entitled to:

(i) To accept the goods only upto the quantity that was agreed upon, as per the contract, and reject the surplus (extra) goods so supplied by the seller; or

(ii) To accept the entire goods (i.e. the goods supplied even in a larger quantity than was agreed upon). However, in such case, the buyer will have to pay for the entire quantity of the goods accepted by him, but only at the contracted rate; or

(iii) To even reject the whole (entire) goods so supplied to him.

To elaborate the point further, we may say that:

(i) In the situation (i) above, he will have to pay only for the goods he had accepted upto the quantity that was agreed upon, as per the contract, and that too, at the already contracted rate. Further, he will not have to pay for the surplus (extra) goods he had rejected and returned to the seller.

(ii) Similarly, in the situation (ii) above, he will have to pay for the entire goods he had accepted (i.e. even for the goods supplied in a larger quantity than was agreed upon), but only at the contracted rate.

(iii) In the situation (iii) above, where the buyer has rejected the whole (entire) goods so supplied to him, he will not have to make any payment at all to the seller.

28.4.9 In regard to the **delivery of mixed up goods,** that is, where the goods of the description in the contract of sale of goods, are mixed up with some other goods, **Section 37 (3)** provides that, in such cases the buyer may accept the goods which conform to the description in the contract of sale of goods, and reject the rest of the goods (i.e. which do not conform to the description in the contract of sale of goods). Alternatively, he may even reject and return the entire lot of such mixed up goods supplied to him by the seller.

Example

In the case titled **Nicholson vs Bradford Union [(1866) L.R. 1 Q.B. 620],** where the coal supplied was partly in conformity with the description stipulated in the contract of sale of goods, and partly did not (conform to the description stipulated in the contract of sale of goods), it was held that the buyer was entitled to reject the entire lot of goods so supplied by the seller.

28.4.10 But then, we should read **Section 37 (3)** along with **Section 37 (4),** which **[Section 37 (4)]** stipulates that the provisions contained in **Section 37 (3)** are subject to any usage of the trade, special agreement entered into between the seller and the buyer, or the (usual) course of dealings between the parties (viz., buyer and seller).

28.4.11 Further, the buyer is not legally bound to accept the **delivery of the goods in instalments**, unless agreed otherwise.

Example

In the case titled **Renter vs Sala [(1879) 4 C.P.D. 239]**, a contract for sale of goods was entered into between the seller and the buyer, for the supply of 45 tonnes of pepper by 'October–November shipment'. The seller had, however, shipped 20 tonnes of pepper in November, and the balance 5 tonnes of pepper in December. It was held in this case that the buyer was entitled to reject and return the entire lot of pepper so supplied in lots.

28.4.12 Further, as provided under **Section 38**, in the cases where there is a contract for the sale of goods, to be delivered in the specified instalments, and that each of such instalments are to be paid for by the buyer separately, any breach of the contract, committed either by the seller or the buyer will depend on the terms of the contract and the circumstances in each case, whether such breach of contract will repudiate (reject or renounce) the whole contract in its entirety, or else, it will give to the defaulting party (seller or buyer, as the case may be) only the right to claim for the damages from the other party, where such breach of contract pertains to a separable (severable) branch (part) of the contact.

Usually, the failure on the part of the seller to deliver any one of the instalments to the buyer, or the failure on the part of the buyer to pay for any one of the instalments to the seller, does not amount to the repudiation of the contract as a whole. But in the cases where the breach is of such a nature that it could be reasonably inferred that a similar breach is most likely to be committed by the defaulting party (seller or buyer, as the case may be) even in the cases of future transactions (instalments), the other party will be entitled to treat the whole contract as repudiated (rejected or renounced).

Example

In the case titled **Robert A. Munso & Co. vs Meyer [(1930) 2 K.B 312]**, the seller had sold to the buyer 1,500 tonnes of bone meat of a specific quality, which was required, under the contract for sale of goods, to be shipped at 125 tonnes per month and in equal instalments each month. But after almost half of the total quantity of 1,500 tonnes of bone meat had been delivered to the buyer by the seller and was also paid for by the buyer, it was found by the buyer that the goods which were supplied to him were not of the agreed quality, and accordingly, he had refused to take any further delivery of the goods (bone meat). It was held in this case that the buyer was rightfully entitled to refuse to take any further delivery of the goods (bone meat), as he was not bound to take the risk of accepting any further delivery of the goods which did not conform to the quality of the goods that was contracted for.

28.4.13 Where the sold goods are **delivered to the carrier or the wharfinger** by the seller for the purpose of transporting the same to the buyer or to keep them in the safe custody on behalf of the seller, respectively, it is *prima facie* (on the face of it) deemed to be the delivery of the goods to the buyer concerned, unless the *jus disponendi* (the right of disposal) has been reserved by the seller of those goods. The seller, in such cases, is bound to make an agreement of carriage with the carrier to the effect that he will duly (properly) safeguard the interest of the buyer, except in the cases the contract for goods of sale provides to the contrary (otherwise). In case the seller fails to do so, he will be held liable for damages to the buyer, or else the buyer may refuse to treat the delivery to the carrier as the delivery to him (buyer). But, as regards the insurance of the goods sold, the seller is duty bound just to give sufficient notice to the buyer to enable him to arrange for the insurance of the goods unless the goods have been sent c.i.f. or ex-ship.

28.4.14 As provided under **Section 41**, in the cases where the goods have been deliver to the buyer, which goods he (buyer) has not properly examined, he (buyer) cannot be deemed to have accepted the goods, unless the seller has given sufficient (reasonable) opportunity to the buyer for examining them (goods) with a view to ascertaining whether the goods, so delivered by the seller, are in conformity with the contract entered into between them (seller and buyer). However, the provisions contained in this Section will not be applicable in the cases where the buyer and the seller have agreed otherwise (to the contrary).

Example

In the case titled **Isherwood vs Whatmore [11, M. & W.347]**, the seller had given a notice to the buyer that the goods sold to him, as per the contract for sale of goods, were lying in a certain storehouse, and that the goods were ready for delivery to him against payment of the price thereof. But then, when the buyer had gone to the storehouse, he was shown only two closed casks, which were said to be containing the contracted goods. It was held in this case that the seller had not given sufficient (reasonable) opportunity to the buyer for examining them (goods) with a view to ascertaining whether the goods, so delivered by the seller, are in conformity with the contract entered into between them (seller and buyer). Accordingly, there was no valid delivery of the goods by the seller to the buyer.

28.4.15 As provided under **Section 43**, unless otherwise agreed upon between the seller and the buyer, where the goods are delivered to the buyer on 'sale or return basis', and the buyer refuses to accept them, he (buyer) is not responsible (duty bound) to return such rejected goods to the seller. Instead, he is duty bound only to inform the seller, within a reasonable time, about his non-acceptance (refusal) of the goods concerned. But then, if the buyer fails to inform the seller, and that too, within a reasonable time, about his non-acceptance (refusal) of the goods concerned, he will be deemed to have accepted them (the goods).

28.4.16 As provided under **Section 44**, in the cases where the seller of the goods is ready and willing to deliver the sold goods to the buyer, and he requests the buyer to take delivery of those goods, and the buyer,

on his part, does not take delivery of the goods within a reasonable time, after the receipt of the aforementioned information from the seller of the goods, the buyer will be held liable to compensate the seller of any loss sustained by him due to such neglect or refusal to take delivery of the goods, on the part of the buyer. Moreover, the buyer will also be held liable to compensate the seller for a reasonable charge incurred by the seller for taking care and custody of the sold goods. Further, the aforementioned provisions of this Section do not, in any way, affect the rights of the seller to treat the refusal of the buyer or the neglect on his (buyer's) part, as repudiation (rejection or renouncement) of the whole contract.

Let us Recapitulate

Duties of the Seller and the Buyer

The buyer's duty is to delver the goods sold by him, and the seller's duty is **(a)** to accept the goods bought by him **(b)** to pay the price of the same, as per the terms of the contract of sale of goods, and **(c)** to pay compensation to the seller in the event of his (buyer's) wrongfully refusing to accept the delivery of the goods (**Section 31**).

- The term 'delivery' constitutes an act as 'a voluntary transfer of possession from one person to another' **[Section 2 (2)].**
- **Types of Delivery (Section 33)**

(a) Physical or Actual Delivery e.g., where the seller physically delivers the sold goods to the buyer.

(b) Symbolic Delivery, where the seller delivers some symbol that signifies a real or actual possession of, or control over, the goods sold. For example, where the seller had sold a car, the delivery of the key thereof symbolises the real or actual possession thereof, given to the buyer.

(c) Constructive Delivery

(i) Where the buyer, who happens to be already in the physical possession of the goods sold, in the capacity of a bailee of the seller concerned, acknowledges that he now holds such goods as his own;

(ii) Where the seller of the goods, who happens to be already in the physical possession of the goods sold, holds them after the sale as a bailee of the buyer concerned; and

(iii) Where a third person (i.e. a person other than the buyer and the seller involved), e.g., a warehouseman or a carrier, who was so far holding the goods in the capacity of a bailee of the seller concerned, agrees that he now holds them in the capacity of a bailee of the buyer, instead.

Rules of Delivery of Sold Goods

(a) The delivery of a part of the goods sold may amount to the delivery of the entire goods, provided it is so intended and agreed between the buyer and the seller. But in the cases, where only a part of the goods, out of the whole stock of goods stored in the seller's godown, is bought and such bought goods are intended and agreed between the buyer and the seller to be segregated (separated) from the whole (entire) stocks of the goods stored in the seller's godown, a part delivery of the goods will not amount to be the delivery of the entire portion of the goods bought and sold.

(b) Unless agreed to the contrary, the seller is not bound to deliver the goods till the buyer applies for the delivery of the goods. Further, where the goods are yet to be acquired by the seller, the seller's duty ends after he has notified to the buyer that the goods sold have since been acquired by him (seller) (**Section 35**).

(c) The place of delivery entirely depends upon the terms (express or implied) of the contract of sale of goods. Besides, the may be delivered at the place where the goods are lying at the time of the sale. Further, where the goods are non-existent, the goods are required to be delivered at the place where the goods are manufactured or produced.

(d) Where, the time of the delivery of the goods is fixed by the contract, the seller must send the sold goods to the buyer on such specified time; otherwise, the seller is legally bound to send them within a reasonable time.

(**e**) Unless agreed otherwise, the expenses of, and incidental to, putting the goods under a deliverable state is required to be borne by the seller.

(**f**) Further, the demand and delivery (tender) must be at a reasonable hour, depending upon each case.

(**g**) In the cases where the seller has delivered the goods to the buyer in a quantity lesser than what was agreed upon between them in the contract, the buyer is entitled to reject or accept them at his own option. But then, if the buyer prefers to accept the goods, so delivered to him in a lesser quantity, he (buyer) will have to pay for the (lesser) quantity of the goods actually supplied to him.

(**h**) Where the seller has delivered the goods to the buyer in a quantity larger than what was agreed upon between them, the buyer may exercise any of the following three options:

(**i**) To accept the goods only upto the quantity that was agreed upon, and to reject the surplus goods; or

(**ii**) To accept the entire goods (i.e. also the extra goods supplied). However, in such case, the buyer will have to pay for the entire quantity of the goods, but only at the contracted rate; or

(**iii**) To even reject the whole (entire) goods so supplied to him.

(**i**) Where the goods contracted for are mixed up with some other goods, the buyer may accept the goods which conform to the description in the contract, and reject the rest of the goods. Alternatively, he may even reject and return the entire lot of such mixed up goods so supplied.

(**j**) Further, the buyer is not bound to accept the delivery of the goods in instalments, unless agreed upon to the contrary.

(**k**) Where the goods are to be delivered in specified instalments, and each of such instalments are to be paid for separately, any breach of the contract, committed either by the seller or the buyer, it will depend on the terms of the contract and the circumstances in each case, whether such breach of contract will repudiate (reject or renounce) the whole contract in its entirety, or it will give to the defaulting party (seller or buyer, as the case may be) only the right to claim for the damages from the other party, where such breach of contract pertains to a separable part of the contact.

(**l**) Where the sold goods are delivered to the carrier or the wharfinger by the seller for the purpose of transporting the same to the buyer or to keep them in the safe custody on behalf of the seller, respectively, it is *prima facie* (on the face of it) deemed to be the delivery of the goods to the buyer concerned, unless the *jus disponendi* (the right of disposal) has been reserved by the seller of those goods.

(**m**) Where the goods have been deliver to the buyer, which goods he (buyer) has not properly examined, he (buyer) cannot be deemed to have accepted the goods, unless the seller has given sufficient (reasonable) opportunity to the buyer for examining them (goods) with a view to ascertaining whether the goods, so delivered by the seller, are in conformity with the contract entered into between them (**Section 41**).

(**n**) Unless otherwise agreed upon between the seller and the buyer, where the goods are delivered to the buyer on 'sale or return basis', and the buyer refuses to accept them, the buyer is not responsible (duty bound) to return such rejected goods to the seller. Instead, he is duty bound only to inform the seller, within a reasonable time, about his non-acceptance of the goods concerned.

(**o**) Where the seller is ready and willing to deliver the sold goods to the buyer, and he requests the buyer to take delivery of those goods, and the buyer does not take delivery of the goods within a reasonable time, after the receipt of the aforementioned information from the seller, the buyer will be held liable to compensate the seller of any loss sustained by him due to such neglect or refusal to take delivery of the goods by the buyer. Moreover, the buyer will also be held liable to compensate the seller for a reasonable charge incurred by the seller for taking care and custody of the sold goods (**Section 44**).

Questions for Reflection

1. What are the various duties of the buyer and the seller in regard to the acceptance and payment of the goods, and their delivery respectively? Give some illustrative examples in each case.

2. What do you understand by the provision made in Section 32 of the Sale of Goods Act to the effect that, the delivery of the sold goods and the payment of the price of the bought goods are concurrent conditions, unless agreed to the contrary? Explain by citing some illustrative examples in each case.
3. What do you understand by the term 'delivery', used in the Sale of Goods Act? Explain, with the help of some illustrative examples.
4. Explain each of the following different ways in which the delivery of the goods sold may be effected, with the help of some illustrative examples in each case:
   (i) Physical or actual delivery;
   (ii) Symbolic Delivery; and
   (iii) Constructive Delivery.
5. In what different ways and in different circumstances can a constructive delivery take place?
6. Do you think that the delivery of the goods will be deemed to have been completed by the seller to the buyer, in the following circumstances? Say only 'yes' or 'no' as your answer.
   (i) The delivery only of a part of the goods sold have been made, where it was intended and agreed between the buyer and the seller that such part-delivery will amount to the delivery of the whole goods;
   (ii) Where only a part of the goods, out of the whole stock of goods stored in the seller's godown, is bought and such bought goods are intended and agreed between the buyer and the seller to be separated from the whole stocks of the goods stored in the seller's godown, and a part-delivery of such non-separated goods have been made to the buyer;
   (iii) Where the goods sold were yet to be acquired by the seller, and the seller had subsequently notified to the buyer that the goods sold had since been acquired by him (seller);
   (iv) The goods sold are lying at the place where the goods were lying at the time of the sale;
   (v) The goods sold are lying at the place where the goods were lying at the time the agreement to sale had taken place;
   (vi) Where the goods were non-existent, and subsequently the goods were lying at the place where the goods were manufactured or produced;
   (vii) Where no time for sending the goods to the buyer had been fixed, and accordingly, the seller had unreasonably delayed the delivery of the goods;
   (viii) Where the buyer had asked the seller to delver the goods at 2 a.m; and
   (ix) Where the seller had taken the sold goods to the buyer for delivery of the goods to him at 2 a.m.
7. What are the various options available to the buyer of the goods in the following cases? Explain, with the help of illustrative examples in each case.
   (i) Where the seller has delivered the goods to the buyer in a quantity lesser than what was agreed upon between them in the contract of sale of goods;
   (ii) Where the seller has delivered the goods to the buyer in a quantity larger than what was agreed upon between them in the contract of sale of goods;
   (iii) Where the goods of the description in the contract of sale of goods, are mixed up with some other goods;
   (iv) Where the seller has delivered the goods to the buyer in instalments, though the buyer had not agreed to any delivery in instalment;
   (v) Where there is a contract for the sale of goods, to be delivered in the specified instalments, and that each of such instalment is to be paid for by the buyer separately, and the seller has breached the contract; and
   (vi) Where the breach of the contract by the seller in question (v) above is of such a nature that it could be reasonably inferred that a similar breach was most likely to be committed by the seller even in the cases of future transactions (instalments).

8. (a) Some goods were purchased by the buyer. But when these goods were delivered to him, he declined to accept these goods on the ground that they were not properly examined by him, as the seller had not given reasonable opportunity to him for examining them, with a view to ascertaining whether the goods, so delivered to him by the seller, were in conformity with the contract entered into between them. Do you think that the contention of the buyer in refusing to accept the goods so delivered by the seller to him, or else, such delivery of the goods by the seller to the buyer, will be held valid in the Court of law?
   (b) Will the legal position be any different if, in question (a) above, the buyer and the seller would have already agreed to the contrary?

   Give reasons for your answer in both the cases.
9. (a) Where the goods are delivered to the buyer on 'sale or return basis', and the buyer has refused to accept them, and has also informed the seller, the same day, about his non-acceptance (refusal) of the goods concerned, will the buyer be held duty bound to return such rejected goods to the seller?
   (b) Will the legal position be any different if, in question (a) above, the buyer would have failed to inform the seller within a reasonable time, about his non-acceptance of the goods concerned?

   Give reasons for your answer in both the cases.
10. (a) Where the seller of the goods is ready and willing to deliver the sold goods to the buyer, and he requests the buyer to take delivery of those goods, and the buyer, on his part, does not take delivery of the goods within a reasonable time, after the receipt of the aforementioned information from the seller of the goods, will the buyer be held liable to compensate the seller for any loss sustained by him due to such neglect or refusal to take delivery of the goods, on the part of the buyer?
    (b) In question (a) above, will the buyer be also held liable to compensate the seller for a reasonable charge incurred by the seller for taking care and custody of the sold goods?
    (c) Under the circumstances stated in question (a) above, will the seller be still entitled to treat the refusal of the buyer or the neglect on his (buyer's) part, as repudiation of the whole contract?

    Give reasons for your answer in all the three cases.

Problems for Practice (With Suggested Solutions)

Problem 1

Durga has sold some goods to Ishwar. But she finds that Ishwar is not willing to pay the price for the goods purchased by him. Under such circumstances, is Durga required to deliver the goods sold by her to Ishwar? Give reasons for your answer.

Solution

No; under such circumstances, Durga, the seller, is not required to give the delivery of the goods sold by her to Ishwar, the buyer, as he (Ishwar) is not willing to pay the price for the goods purchased by him. This is so because, under Section 32 of the Sale of Goods Act, the delivery of the sold goods and the payment of the price of the bought goods are concurrent conditions (i.e. which run simultaneously), unless agreed to the contrary.

Problem 2

Manmohan has sold some goods to Yashwant. But Yashwant finds that Manmohan is not willing and ready to give the delivery of the bought goods to him (Yashwant). Under such circumstances, is Yashwant (buyer) required to pay the price for the goods bought by him? Give reasons for your answer.

Solution

No; under such circumstances, Yashwant (buyer) is not required to pay the price for the goods bought by him as Manmohan, the seller, is not willing and ready to give the delivery of the bought goods to him, the buyer. This is so because under Section 32 of the Sale of Goods Act, the delivery of the sold goods and the payment

of the price of the bought goods are concurrent conditions (i.e. which run simultaneously), unless agreed to the contrary.

Problem 3

Suleman has sold his motorcycle to Bashir. But Suleman is not able to decide on how to deliver the motorcycle to Bashir, as Suleman finds it difficult to lift the motorcycle to make a physical delivery of the motorcycle to Bashir. Accordingly, Suleman has approached you for your expert legal opinion in the matter. What will be your expert legal opinion in the case? Give reasons for your answer.

Solution

We will advise Suleman that, instead of making a physical delivery of the motorcycle to Bashir, he should deliver the key of the motorcycle to Bashir, which will constitute a symbolic delivery of the motorcycle to Bashir. We will further convince Suleman that such symbolic delivery of the motorcycle is also considered as a valid delivery of the sold motorcycle, as per the provisions of the Sale of Goods Act.

Problem 4

In what different ways can the sold goods be deemed to have been effectively delivered by the seller to the buyer, in each of the following circumstances?

(a) Where the buyer, who happens to be already in the physical possession of the goods sold, in the capacity of the bailee of the seller concerned.
(b) Where the seller of the goods happens to be already in the physical possession of the goods sold.
(c) Where a carrier, who is holding the goods in the capacity of a bailee of the seller concerned.

Solution

(a) Where the buyer, who happens to be already in the physical possession of the goods sold, in the capacity of a bailee of the seller concerned, the sold goods will be deemed to have been effectively delivered by the seller to the buyer when the buyer concerned acknowledges that he now holds such goods as his own.
(b) Where the seller of the goods, who happens to be already in the physical possession of the goods sold, the sold goods will be deemed to have been effectively delivered by the seller to the buyer when the seller concerned acknowledges that he now holds such goods after the sale as a bailee of the buyer concerned.
(c) Where a carrier, who is holding the goods in the capacity of the bailee of the seller concerned, the sold goods will be deemed to have been effectively delivered by the seller to the buyer when the carrier concerned acknowledges that he now holds them in the capacity of the bailee of the buyer concerned, instead.

Problem *5*

Paras has bought only a part of the goods, out of the whole stock of goods stored in Subodh's godown, and such bought goods are intended and agreed between the buyer and the seller to be segregated from the whole stocks of the goods stored in Subodh's godown. But, before the part of the goods so bought, were segregated, from the whole stocks of the goods stored in Subodh's godown, a part delivery of the goods were made by Subodh to Paras. Will such part delivery of the goods be deemed to be the delivery of the entire portion of the goods bought by Paras and sold by Subodh? Give reasons for your answer.

Solution

No; such part delivery of the goods will not be deemed to be the delivery of the entire portion of the goods bought by Paras and sold by Subodh. This is so because, as provided under Section 32 of the Sale of Goods Act, in the cases, where only a part of the goods, out of the whole stock of goods stored in the seller's godown, is bought and such bought goods are intended and agreed between the buyer and the seller to be segregated from the whole stock of the goods stored in the seller's godown, a part delivery of the goods, under such circumstances, will not amount to be the delivery of the entire portion of the goods bought and sold.

Problem 6

What are the various options available to the buyer of the goods in the following circumstances?

(a) Where the seller has delivered the goods to the buyer in a quantity lesser than what was agreed upon between them in the contract of sale of goods;

(b) Where the seller has delivered the goods to the buyer in a quantity larger than what was agreed upon between them in the contract of sale of goods;

(c) Where the goods of the description in the contract of sale of goods, are mixed up with some other goods;

(d) Where the seller has delivered the goods to the buyer in instalments, though the buyer had not agreed to any delivery in instalment.

Solution

(a) Where the seller has delivered the goods to the buyer in a quantity lesser than what was agreed upon between them in the contract of sale of goods, the buyer is entitled to reject or accept them (i.e. the goods supplied in a lesser quantity), at his own option. But then, if the buyer prefers to accept the goods, so delivered to him in a lesser quantity, he (buyer) will have to pay for the (lesser) quantity of the goods actually supplied to him.

(b) Where the seller has delivered the goods to the buyer in a quantity larger than what was agreed upon between them in the contract of sale of goods, the buyer is entitled to exercise any of the following three options:

(i) To accept the goods only upto the quantity that was agreed upon, as per the contract, and reject the surplus (extra) goods so supplied by the seller; or

(ii) To accept the entire goods (i.e. the goods supplied even in a larger quantity than was agreed upon). However, in such case, the buyer will have to pay for the entire quantity of the goods accepted by him, but only at the contracted rate; or

(iii) To even reject the whole (entire) goods so supplied to him.

To elaborate the point further, we may say that:

(i) In the situation (i) above, he will have to pay only for the goods he had accepted upto the quantity that was agreed upon, as per the contract, and that too, at the already contracted rate. Further, he will not have to pay for the surplus (extra) goods he had rejected and returned to the seller.

(ii) Similarly, in the situation (ii) above, he will have to pay for the entire goods he had accepted (i.e. even for the goods supplied in a larger quantity than was agreed upon), but only at the contracted rate.

(iii) In the situation (iii) above, where the buyer has rejected the whole (entire) goods so supplied to him, he will not have to make any payment at all to the seller.

(c) Where the goods of the description in the contract of sale of goods, are mixed up with some other goods, the buyer may accept the goods which conform to the description in the contract of sale of goods, and reject the rest of the goods (i.e. which do not conform to the description in the contract of sale of goods). Alternatively, he may even reject and return the entire lot of such mixed up goods supplied to him by the seller. Our such contention is based on the judgement of the case titled **Nicholson vs Bradford Union [(1866) L.R. 1 Q.B. 620],** where the coal supplied was partly in conformity with the description stipulated in the contract of sale of goods, and partly did not (conform to the description stipulated in the contract of sale of goods), it was held that the buyer was entitled to reject the entire lot of goods so supplied by the seller.

(d) Where the seller has delivered the goods to the buyer in instalments, though the buyer had not agreed to any delivery in instalment, the buyer is not legally bound to accept the delivery of the goods in

instalments. In support of our aforementioned contention; we may cite the case titled **Renter vs Sala [(1879) 4 C.P.D. 239]**, wherein a contract for sale of goods was entered into between the seller and the buyer for the supply of 45 tonnes of pepper by 'October–November shipment'. The seller had, however, shipped 20 tonnes of pepper in November, and the balance 5 tonnes of pepper in December. It was held in this case that the buyer was entitled to reject and return the entire lot of pepper so supplied in lots.

Problem 7

The seller had sold to the buyer 1,000 tonnes of stainless steel sheets of a specific quality, which was required, under the contract for sale of goods, to be shipped at 100 tonnes per month and in equal instalments each month. But after 400 tonnes of the total quantity of 1,000 tonnes of stainless steel sheets had been delivered to the buyer by the seller and was also paid for by the buyer, it was found by the buyer that the goods which were supplied to him were not of the agreed quality, and accordingly, he had refused to take any further delivery of the goods (stainless steel sheets). Do you think that the buyer was rightfully entitled to refuse to take any further delivery of the goods (stainless steel sheets)? Give reasons for your answer.

Solution

Yes; the buyer was rightfully entitled to refuse to take any further delivery of the goods (stainless steel sheets), because he was not bound to take the risk of accepting any further delivery of the goods which did not conform to the quality of the goods that was contracted for. This is so because though, under the provisions of the Sale of Goods Act, usually, the failure on the part of the seller to deliver any one of the instalments to the buyer, or the failure on the part of the buyer to pay for any one of the instalments to the seller, does not amount to the repudiation of the contract as a whole, in the cases where the breach is of such a nature that it could be reasonably inferred that a similar breach is most likely to be committed by the defaulting party (seller or buyer, as the case may be) even in the cases of future transactions (instalments), the other party will be entitled to treat the whole contract as repudiated. This contention is also confirmed in a similar case titled **Robert A. Munso & Co. vs Meyer [(1930) 2 K.B 312]**.

Problem 8

The seller had given a notice to the buyer that the goods sold to him, as per the contract for sale of goods, were lying in a certain storehouse, and that the goods were ready for delivery to him against payment of the price thereof. But then, when the buyer had gone to the storehouse, he was shown only two closed boxes, which were said to be containing the contracted goods. Do you think that there was a valid delivery of the goods by the seller to the buyer? Give reasons for your answer.

Solution

No; there was no valid delivery of the goods by the seller to the buyer. This is so because, the seller had not given a reasonable opportunity to the buyer for examining the sold goods, with a view to ascertaining whether the goods, so delivered by the seller, are in conformity with the contract entered into between them. Accordingly, there was no valid delivery of the goods by the seller to the buyer, as per the provisions of Section 41 of the Sale of Goods Act. This contention is also confirmed in a similar case titled **Isherwood vs Whatmore [11, M. & W.347]**.

Problem 9

(a) The goods were delivered to the buyer on 'sale or return basis', and the buyer had refused to accept them. But then, somehow he (buyer) had forgotten to inform the seller, within a reasonable time, about his non-acceptance of the goods concerned. Do you think that, under the given circumstances, he (buyer) will be deemed to have accepted the goods?

(b) If your answer is in the affirmative, what will be the various liabilities incurred by the buyer in that event? Give reasons for your answer.

Solution

(a) Yes; under the given circumstances, the buyer will be deemed to have accepted the goods. This is so because, as provided under Section 43 of the Sale of Goods Act, in the cases where the seller of the goods is ready and willing to deliver the sold goods to the buyer, and he requests the buyer to take delivery of those goods, and the buyer, on his part, does not take delivery of the goods within a reasonable time, after the receipt of the aforementioned information from the seller of the goods, the buyer will be deemed to have accepted the goods.

(b) Further, the buyer will also be held liable to compensate the seller of any loss sustained by him due to such neglect or refusal to take delivery of the goods, on the part of the buyer. Moreover, the buyer will also be held liable to compensate the seller for a reasonable charge incurred by the seller for taking care and custody of the sold goods. This is so because, as provided under Section 44 of the Sale of Goods Act, in the cases where the seller of the goods is ready and willing to deliver the sold goods to the buyer, and he requests the buyer to take delivery of those goods, and the buyer, on his part, does not take delivery of the goods within a reasonable time, after the receipt of the aforementioned information from the seller of the goods, the buyer will be held liable to compensate the seller of any loss sustained by him due to such neglect or refusal to take delivery of the goods, on the part of the buyer. Moreover, the buyer will also be held liable to compensate the seller for a reasonable charge incurred by the seller for taking care and custody of the sold goods.

Chapter Twenty Nine

Rights of Unpaid Seller; and Sale by Auction

"*Rights that do not flow from duty well performed are not worth having.*
Mahatma Gandhi

Where there are no rights, there are no duties.
Henri Benjamin Rebecque

Be more aware of responsibility than you are of your rights.
Source Unknown

Zeal is very blind, or badly regulated, when it encroaches upon the rights of others.
Pasquier Quesnel

Few people have the virtue to withstand the highest bidder.
George Washington"

In any contract, there are necessarily two reciprocal promises made, one each made by both the parties involved therein. Accordingly, in a contact for sale of goods also the seller is duty bound to deliver the goods to the buyer thereof. Similarly, the buyer is obliged to pay the price of the goods (bought by him) to the seller thereof. Further, in case the buyer refuses to pay or fails to pay to the seller the price of the goods bought by him, the seller, by virtue of being an 'unpaid seller', will be entitled to certain legal rights as an 'unpaid seller'. We will, therefore, first define who is an 'unpaid seller', and thereafter we will go on to discuss the various legal rights of an 'unpaid seller'.

29.1 'Unpaid Seller's' Defined

As defined under **Section 45 (1)**, the seller of the goods is deemed to be an 'unpaid seller' (of goods) in the following conditions:

(a) If the whole of the price (of the goods sold) has not been paid or tendered to him (seller); and
(b) Where a bill of exchange or any other negotiable instrument has been received as a conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

Further, the term 'seller' includes any person who is in the position of a seller. Thus, an agent of the seller will also be treated as a seller.

29.2 Rights of an Unpaid Seller

An unpaid seller has the following two types of rights:

(i) Rights against the goods (sold); and
(ii) Rights against the buyer (in person).

29.2.1 Rights against the Goods (sold)

The seller's rights against the goods (sold) are:

(a) The right of 'lien' on the goods;
(b) The right of 'stoppage' of the goods in transit; and
(c) The right of re-sale of the goods.

29.2.2 Right of 'Unpaid Seller's Lien' on the Goods

In the present context the term 'lien' means 'to retain possession of' (the goods sold).
As provided under **Section 47**, an unpaid seller, who is (still) in the possession of the goods sold, has the legal right to retain them in his possession, but that too (only) till the time the payment or the tender of the price of the goods are made to him by the buyer, in the following cases:

(i) Where the goods have been sold without making any specific provision (stipulation) in regard to the credit (i.e. the sale being a credit sale);
(ii) Where the goods are sold on credit terms, but such specified term of credit has expired; and
(iii) Where the buyer has become insolvent.

Here, it must be noted that the unpaid seller can exercise his right of lien on the goods sold only in the cases where the price of the goods sold has not been paid to him by the buyer concerned. Conversely speaking, an unpaid seller cannot exercise his right of lien on the goods sold, in the cases of the no-payment of any other charges (i.e. other than the non-payment of the price of the goods sold), like for the non-payment of the storage or handling charges for the storage of the goods sold and so on, though these charges are also payable by the buyer.

Further, it must be stressed here that the unpaid seller's lien is in the nature of a 'particular lien' (and not a 'general lien', like that of a banker). The 'particular lien' also signifies that this right of lien, enjoyed by the seller, can be exercised only and exclusively by the seller alone, and not by his assignee or his creditor, and so on.

Moreover, the unpaid seller can exercise his right of lien on the goods sold, even in the cases where he (seller) happens to be in the possession of the goods sold, in the capacity of an agent or a bailee of the buyer.

Example
Prabhat had bought some goods from Tarun, and had agreed to pay the price of the goods bought by him at a later date. However, Prabhat had left the goods with the seller (Tarun), requesting him to send them to him (Prabhat) at a later date. In the mean time Prabhat had become insolvent. Under these circumstances, Tarun, the seller, will have the right to exercise his lien on the goods unpaid for.

Further, as provided under **Section 48**, the right of lien will be available to the unpaid seller even in the cases where a part delivery of the goods sold, has already been made by the unpaid seller. But, in the cases where such part delivery of the goods sold, has been made by the unpaid seller under such circumstances which go to indicate (show) that there was already an agreement between the buyer and the seller to the effect that the unpaid seller's lien will be waived by the seller; the right of lien will not be available to the unpaid seller.

29.3 Loss of the Right of 'Unpaid Seller's Lien' on the Goods

The rights of 'unpaid seller's lien' on the goods are lost by him (unpaid seller) in the following different ways/ circumstances:

(a) In the cases where the seller has delivered the sold goods to a carrier or some other bailee, for the purpose of transportation/transmission of the goods to the buyer concerned, provided the (seller) has not reserved his right of the disposal of the goods to himself. For example, when the seller takes-out the railway receipt (R/R) or the transport receipt (T/R) in the name of the buyer or his (buyer's) agent;
(b) Where the buyer or his agent lawfully obtains the possession of the goods sold;
(c) Where the seller waives his right of lien on the goods sold;
(d) Where the seller consents (assents) to a sub-sale by the buyer; and
(e) Where the seller takes a security from the buyer for the payment of the price of the goods sold, in lieu (place) of his (seller's) right of lien.

Further, as provided under **Section 49(2)**, the unpaid seller does not lose (forfeit) his right of lien only due to the fact that he has obtained a decree from the Court for the payment of the price of the sold goods from the buyer.

In this context, it must be noted that the unpaid seller's lien is in the nature of a promissory lien, which signifies that once the possession of the sold goods is lost by the seller, his right of lien is also lost therewith.

Example

In the case titled **Bharneha vs Wadilal [28Bom. L.R. 777 P.C.],** a person had sold some of his shares to another person (buyer), and had also delivered those share certificates to the buyer along with the share transfer deed duly signed by him. The payment was, however, made by the buyer by means of a cheque. Subsequently, before the cheque, representing the payment of the price of the shares, could be realised by the seller, the buyer had become insolvent. It was held in this case that the seller of the shares did not have any lien on the share certificates so sold and delivered to the buyer along with the share transfer deed duly signed by him, because his lien thereon (shares) had already ceased the moment he had delivered (transferred the possession of) the shares to the buyer.

29.4 Right of Stoppage-in-Transit

The right of stoppage-in-transit involves stopping of the sold goods from their being delivered to the buyer thereof, and regaining (resuming) their possession, while the sold goods are still in transit, and retaining those goods with himself till their price is paid or tendered to him by the buyer concerned. Further, the seller becomes entitled to exercise his right of stoppage-in-transit only when he loses to exercise his right of lien, and that too, only in the cases where he has lost his right to exercise his right of lien, on account of the buyer becoming insolvent after the sale of the goods.

As provided under **Section 50**, subject to the provisions of the Act, where the buyer of the goods becomes insolvent, the unpaid seller, who has parted with the possession of the goods sold, has the right of stopping them in transit, that is to say that he may resume the possession of the goods sold as long as they are in the course of transit, and may retain them until and unless the payment or tender of the price of the goods sold is

made to him by the seller concerned. Conversely speaking, the provisions of the Section will not be operative, once the goods are no longer in the course of transit, i.e. where the goods have already been delivered to the buyer of those goods, which delivery will tantamount to the transfer of the possession of the goods from the seller to the buyer.

29.5 Lien vs Stoppage-in-Transit

The main distinguishing features between 'lien' and 'stoppage-in-transit' have been presented in **Table 29.1.**

Table 29.1 *Distinguishing Features between 'Lien' and 'Stoppage-in-Transit'*

Lien	*Stoppage-in-Transit'*
(i) The 'lien' is available to the unpaid seller only so long the goods are in his (unpaid seller's) possession.	(i) A 'stoppage-in-transit' is available to the unpaid seller only after he has parted with the possession of the goods sold.
(ii) The 'lien' is available to the unpaid seller even in the cases where the buyer has not become insolvent.	(ii) A 'stoppage-in-transit' is available to the unpaid seller only in the cases where the buyer has become insolvent.

29.6 Duration and End of Transit

As we have seen, the right of stoppage of goods in transit can be exercised by the seller only during the period the goods sold are in the course of transit. That is, the right of stoppage of goods in transit cannot be exercised by the seller when the period of the goods sold being in the course of transit ends. Therefore, it is necessary for us to know as to how long the goods sold will be deemed to be in the course of transit, and the time when goods sold will cease to be treated as being in the course of transit.

29.6.1 Duration of Transit

As provided under **Section 51**, the goods sold will be treated as being in the course of transit from the time when these are delivered to the carrier, or to some other bailee, for the purpose of transportation/transmission of the goods to the buyer, and that too, only upto such time when the buyer or his agent (on his behalf) has not taken the delivery of the sold goods from the carrier, or some other bailee. In other words, when the buyer or his agent (on his behalf) has taken the delivery of the sold goods from the carrier, or some other bailee, the goods will cease to be treated as being in the course of transit. We will now discuss the various ways and circumstances when the period of transit will be deemed to have ended.

29.6.2 End of Transit

The period of transit will be deemed to have ended in the following ways and circumstances:

(a) When the goods have reached in the possession of the buyer or his agent or servant on his behalf;
(b) When the buyer or his agent or servant obtains the delivery of the goods before they reach their specified destination;
(c) When the goods have reached their specified destination, and the carrier or some other bailee of the goods acknowledges to the buyer or his agent that he (carrier or some other bailee) holds those goods on behalf of the buyer or his agent. In this context, it is immaterial that a further destination of the goods was specified by the contract; and
(d) When the carrier or some other bailee of the goods wrongfully refuses to deliver the goods to the buyer or his agent on his behalf.

(e) In the cases where the goods are sent by ship, and are delivered to (the Captain/Master of) the ship, the moot point to be considered in this case is that whether the goods shipped will be treated as being in the possession of the Captain/Master of the ship as a carrier or as an agent of the buyer. This significant point may have to be decided keeping in view the circumstances of each case. Thus, when the ship whereon the sold goods have been loaded, belongs to the buyer or else has been chartered by the buyer, the period of transit will be deemed to have ended the moment the sold goods are loaded on the ship, provided the seller had not reserved the right of the disposal of the goods. That is, where the seller had reserved the right of the disposal of the goods loaded on the ship, even if it belonged to the buyer or else had been chartered by the buyer, the period of transit will not be deemed to have ended in such cases.

Example

In the case titled **Schetmans vs Landshire and Yorkshire Railway Co. [(1867) L.R. 2 CH. App. 332]**, the goods were delivered on board the ship which belonged to the buyer himself. Further, as stated in the relative bill of lading (B/L), the goods were made to be delivered to the buyer or his agent. It was held in this case that such bill of lading (B/L) had amounted to a delivery of the goods to the buyer, and that these were no longer in the course of transit. Accordingly, the seller did not have the right of stoppage-in-transit in this case.

29.6.2.1 But then in the case where the buyer of the goods in transit has rejected the goods, and the carrier or some other bailee of the goods continues to hold those goods, the goods will still be treated as being in the course of transit; that is, the period of transit will not be deemed to have ended. The position will remain unchanged even if the seller of the goods has refused to take those goods back.

Example

In the case titled **James vs Griffin [(1837) 2 M&W 6231]**, the buyer P at Delhi had placed an order with the seller S at Kolkata for the purchase of certain goods. The seller S at Kolkata had transported the ordered goods to Delhi. Further, on arrival at Delhi, the carrier had taken the goods to the warehouse of the buyer P, and left them there. The buyer P, however, had refused to accept and take delivery of these goods, and had stopped payment of his cheque representing the price of the goods sold. It was held in this case that the goods will still be treated as being in transit, and the unpaid seller could take the goods back.

29.6.3 Effect of Change of Destination

In the cases where the buyer and the seller have agreed that the sold goods must be delivered at a certain place, say, at Mumbai, but subsequently the buyer has asked the seller that now the sold goods must be delivered at another place, say, at Pune, the goods will be treated to be still in transit until the goods are taken delivery of by the buyer, or his agent on that behalf, at the subsequently changed place (destination), i.e. Pune in the instant case.

29.6.4 Effect of Part-Delivery

In the cases where the seller has made only a part-delivery of the sold goods to the buyer, or to his agent on his (buyer's) behalf, the remaining quantity of the goods may be stopped in transit by the seller, unless such part-delivery of the goods has been made by the seller to the buyer under such circumstances, which may go to indicate (show) that there was an agreement between the seller and the buyer to the effect that the seller will pass on the possession of the entire goods to the buyer by way of even a part-delivery of the goods.

Further, even in the cases where the buyer of such goods has sold the goods or disposed of the goods in some other manner (like by way of pledge or otherwise), the unpaid seller's right of lien or his right of stoppage of the goods in transit, will not get adversely affected unless the seller had agreed to that effect.

29.7 Exercise of the Right of Stoppage-in-Transit

As provided under **Section 52**, the unpaid seller may exercise his right of stoppage in transit in the following manners:

(a) By taking the actual possession of the goods in transit; or
(b) By giving notice of his intention to claim and exercise his right of stoppage of the goods in transit to the carrier or the other bailee of the goods, who happens to be in the actual possession of the goods at the material time.

29.7.1 Whom to give Notice of Stoppage-in-Transit?

Notice of stoppage-in-transit can be given by the seller either to the person (carrier or the other bailee of the goods), who happens to be in the actual possession of the goods at the material time, or to his principal. In case the notice of stoppage-in-transit is given by the seller to the principal of the person, who happens to be in the actual possession of the goods at the material time, such notice to the principal will be deemed to effective if it is given by the seller at such a time and under such circumstances when the principal, by the exercise of reasonable diligence on his (principal's) part, may communicate (contents of) the notice to his agent or servant, so as to prevent the delivery of the goods to the buyer.

Further, on receipt of such notice from the seller, the person (carrier or the other bailee of the goods), who happens to be in the actual possession of the goods at the material time, is required to re-deliver the goods to the seller of the goods or as per the seller's direction, and realise the cost of such re-delivery of the goods from the seller.

29.8 Effect of Sub-Sale or Pledge by the Buyer

As per the general rule, the unpaid seller's right of lien on the goods sold, and his right of stoppage of the goods in transit, do not get affected by any sale by the buyer or by disposal of the goods by him (buyer) in some other manner (like by pledge), unless and until the seller had consented (assented) to that effect (**Section 53**).

Example

In the case **Knights vs Wiffen [(1870) L.R. 5 Q.B. 660]**, Asit had sold to Bhaskar 80 mounds of grains out of his (Asit's) stock, stored in his (Asit's) granary. Bhaskar, thereafter, had sold 60 mounds of grains, out of the stock of 80 mounds of grains, to Prasoon. After receiving the delivery order from Bhaskar, pertaining to the stock of 60 mounds of grains so sold to him (Prasoon) by Bhaskar, Prasoon had presented it to Asit (original seller). Asit (original seller) had advised Prasoon that the required 60 mounds of grains will be delivered to him (Prasoon) in due course. Thereafter, Bhaskar had become insolvent. It was held in this case that Asit's rights, of lien on the goods sold (as also his right of stoppage of the goods in transit), regarding the stock of 60 mounds of grains so sold to him (Prasoon) by Bhaskar, were lost (forfeited), on the ground that Asit (original seller) had recognised the title of Prasoon (the sub-seller), by way of advising Prasoon that the required 60 mounds of grains will be delivered to him (Prasoon) in due course.

29.8.1 Exceptions to the General Rule

There are the following exceptions to the aforementioned general rule:

(a) In the cases where the document to the title to the goods has been made out in the name of the buyer himself, or it has been lawfully transferred to any person as the buyer or owner of those goods, and where such person (as the buyer or owner of those goods) transfers such document to the title to the goods to another buyer , in good faith and for a valuable consideration, the unpaid seller's rights of lien

or stoppage in transit regarding those goods gets forfeited and lost. This point is confirmed in the case of **Dreyfus & Co. (1943), K.B. 40.**

(b) In the cases where the document to the title to the goods has been made out in the name of the buyer himself, or it has been lawfully transferred to the buyer, and where such buyer transfers such document to the title to the goods to another *bona fide* buyer for consideration, by way of pledge, the unpaid seller's rights of lien or stoppage in transit regarding those goods can be exercised by the unpaid seller, only subject to the right of the pledgee (pawnee).

29.9 Right of Re-Sale

As provided under **Section 54**, in the cases where the unpaid seller has retained the possession of the goods in exercise of his right of unpaid seller's lien, or where he has resumed (regained) the possession of the goods from the carrier, in the event of such buyer being declared insolvent, such unpaid seller can resell the goods involved, in the following circumstances:

(a) Where the goods so sold are perishable in nature, such unpaid seller can resell the goods involved, without giving any notice to the buyer. But, here, the term 'perishable' is not confined to only the physical deterioration of the goods. It also includes the goods which are commercially perishable in nature. That is, the goods which may deteriorate so as to make them non-merchantable. This contention is based on the judgement delivered in the case titled **Asfar vs Blundell [(1896) 1 Q.B. 123].**

(b) However, in other cases (i.e. where the goods so sold are not perishable in nature), such unpaid seller is required to ask (call upon) the buyer to pay or to tender the price of the goods so sold to him, within a reasonable time, and only in case the buyer fails to do so, such unpaid seller can resell the goods involved, and not otherwise.

(c) Further, as provided under **Section 54 (4)**, the right of unpaid seller to resell the goods is also available to him in the cases where, under the contract of the sale of goods, he (unpaid seller) has expressly retained (reserved) the right of resale of the goods, in the event of the buyer making a default. Thus, if the unpaid seller exercises his right to resell the goods under the provisions made in **Section 54 (4)**, the original contract gets rescinded (cancelled), but the unpaid seller still retains his right to claim damages from the original buyer for the breach of the contract.

But then, it is necessary for the unpaid seller to exercise his right of resale of the goods within a reasonable time. But again, what may be considered to be the 'reasonable time' will depend upon the facts of each case. However, in the case titled **Partha Sarithi vs Gopinath [48 Masd. 787]**, a period of eight months was held to be an unreasonable time.

29.9.1 Notice of Re-Sale, When Necessary?

We thus, observe that giving of a notice to the buyer is not required to be given by the unpaid seller only in the cases where the goods are of a perishable nature. Conversely speaking, in all the other cases (i.e. where the goods so sold are not perishable in nature), such unpaid seller is legally bound to give the required notice to the buyer as aforementioned. Thus, if such unpaid seller happens to resell the goods involved, without giving the required notice to the buyer in such other cases, he will not be able to recover any damages from the buyer for the loss, if any, sustained by the unpaid seller in the case of reselling the goods. Further, he (unpaid seller) will not be entitled to retain the profit, if any, accruing on the resale of such goods, either. That is, such profit, if any, the unpaid seller will have to pass on the buyer, instead.

As against this, if such unpaid seller happens to resell the goods involved, after giving the aforementioned required notice to the buyer in such other cases, he will be able to recover the damages from the buyer for the loss, if any, sustained by the unpaid seller in the case of reselling the goods. Further, he (unpaid seller) will also be entitled to retain the profit, if any, accruing on the resale of such goods. That is, such profit, if any, the

unpaid seller will not have to pass on the buyer. This is so because, in such an event taking place, the unpaid seller is not acting as an agent of the buyer concerned. This point has been validated in the case titled **Gobdindram vs Shamiji & Co. [(1961) A.I.R., I.S.C. 1285].**

29.9.2 Measure of Damages and Gains

In the cases where the notice of the resale of the goods was given, in the cases where such notice was required to be given by the unpaid seller, aforementioned, the damages in the case of the resale of the goods will be arrived at by subtracting the 'resale price realised', from the 'contracted price' of the goods involved, plus the 'related expenses of the resale'.

Examples

(i) In the case where the 'contracted price' is Rs 1,000 and the 'resale price realised' is Rs 900 and the 'related expenses of the resale' come to Rs 200, the total damages to be realised by the unpaid seller from the buyer will be [(Rs 1,000 less Rs 900) + Rs 200] = (Rs100 + Rs 200) = Rs 300.

(ii) In the case where the 'contracted price' is Rs 1,000 and the 'resale price realised' is higher than the 'contracted price', i.e. Rs 1,400, and the 'related expenses of the resale' come to Rs 200, the total gain earned by the unpaid seller on the resale will be the [(resale price realised) less (contracted price)] less (related expenses of the resale) = [(Rs 1,400 less Rs 1,000) less Rs 200] = (Rs 400 less Rs 200) = Rs 200. This amount of gain of Rs 200 will be retained by the unpaid seller and need not be passed on to the buyer.

But then, the buyer, who happens to buy the goods on the resale thereof, will acquire a valid title thereto, as against the original buyer, even in the cases where the unpaid seller had failed to give the notice of the resale of the goods to the original buyer, where such notice was required to be given by him (unpaid seller), as aforementioned.

29.10 Right against the Buyer Personally

Further, as provided under **Sections *55* and *56***, the unpaid seller, in addition to his various rights against the goods, also enjoys the following rights against the buyer personally:

(a) The right to sue the buyer for the price of the goods sold to him; and

(b) The right to sue the buyer for the damages for non-acceptance (of the goods).

29.10.1 Right to sue for the Price

As provided under **Section *55***, in the cases where, under the contract of the sale of goods, the property (ownership) in the goods sold, has passed on to the buyer, and the buyer wrongfully neglects or refuses to pay the price of the goods bought by him, the seller can sue the buyer for realisation of the price of the goods sold.

Further, in the cases where, under the contract of the sale of goods, the price of the goods sold is payable on a day fixed for payment, irrespective of the delivery of the goods to the buyer, and the buyer wrongfully neglects or refuses to pay the price of the goods bought by him, the seller may sue the buyer for realisation of the price of the goods sold, although the property (ownership) in the goods sold, has not passed on to the buyer, and the goods have not been appropriated to the contract.

29.10.2 Right to sue for the Damages

As provided under **Section *56***, in the cases where the buyer wrongfully neglects or refuses to accept of the goods and pay for the goods bought by him, the seller may sue the buyer for damages for non-acceptance of the goods sold.

Further, in the cases where the property (ownership) in the goods sold has not been passed on to the buyer, and the price of the goods sold was not payable without passing on the property (ownership) in the goods sold, the seller can sue the buyer only for the damages, and not for the realisation of the price of the goods sold.

As provided under **Section 64**, the following rules will apply in the cases of sale by auction:

29.11 Sale by Auction in Lots

In the cases where the goods have been put up for sale by auction in lots, each lot will be, *prima facie* (on the face of it), treated as the subject matter of a separate contract of sale by auction.

29.12 Completion of Sale by Auction

The sale at the auction will be deemed to have been completed when the auctioneer concerned announces the completion of the sale by auction, by the customary way of falling of the hammer, or even in some other customary manner. It is also the practice to say (i.e. to announce the completion of the sale) 'three times'.

Further, until the announcement of the completion of the sale is announced by the auctioneer concerned, as aforementioned, any bidder is permitted to withdraw his bid.

29.13 Right to Bid Reserved by the Seller

The right to bid may be reserved expressly by the seller or by some other person on his (seller's) behalf, and in the cases where such right is so reserved expressly [by the seller or by some other person on his (seller's) behalf], but not otherwise, the seller or some other person on his (seller's) behalf may also bid at the auction.

29.14 Right to Bid Not Reserved by the Seller

But in the cases where the sale by auction has not been expressly notified to be subject to the right to bid by or on behalf of the seller, it will be deemed to be unlawful for the seller to bid for himself or even to employ some other person to bid on his (seller's) behalf at such auction.

Similarly, if the auctioneer concerned knowingly takes any bid from the seller personally, or even from some other person employed by the seller for this purpose [i.e. for bidding at the auction on his (seller's) behalf at such auction], it will be deemed to be unlawful for the auctioneer as well.

Thus, any sale by auction in contravention of the aforementioned rule will be deemed (treated) as being fraudulent.

29.15 Reserved Minimum Price or Upset Price

The sale by auction may also be notified to be subject to a reserved or upset price (i.e. below this reserved minimum price the goods will not be sold by auction).

29.16 Pretended Bidding by the Seller to Raise the Price

Further, as was held in the case titled **Thornett vs Haines [(1846) 15 M&W 367]**, in the cases where the seller makes use of any pretended (feigned or false) bidding, with a view to raising the price of the goods under auction, such sale by auction will be treated as voidable at the option of the buyer thereof.

Let us Recapitulate

- The seller is an 'unpaid seller' (of goods) in the following conditions **[Section 45 (1)]**:
  - **(a)** If the whole of the price (of the goods sold) has not been paid or tendered to him (seller); and
  - **(b)** Where a bill of exchange or any other negotiable instrument has been received as a conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

    Further, the term 'seller' includes any person who is in the position of a seller, like an agent of the seller.
    - An unpaid seller has the following two types of rights:
      - **(i)** Rights against the goods (sold); and
      - **(ii)** Rights against the buyer (in person).
    - The seller's rights against the goods (sold) are:
      - **(a)** The right of 'lien' on the goods;
      - **(b)** The right of 'stoppage' of the goods in transit; and
      - **(c)** The right of re-sale of the goods.
- Right of 'Unpaid Seller's Lien' on the Goods
  - **(i)** Where the goods have been sold without making any specific provision in regard to the credit (i.e. the sale being a credit sale);
  - **(ii)** Where the goods are sold on credit terms, but such specified term of credit has expired; and
  - **(iii)** Where the buyer has become insolvent.
- **Loss of the Right of 'Unpaid Seller's Lien'** on the Goods takes place**:**
  - **(a)** Where the seller has delivered the sold goods to a carrier or some other bailee, for the purpose of transportation/transmission of the goods to the buyer concerned, provided the (seller) has not reserved his right of the disposal of the goods to himself;
  - **(b)** Where the buyer or his agent lawfully obtains the possession of the goods sold;
  - **(c)** Where the seller waives his right of lien on the goods sold;
  - **(d)** Where the seller consents to a sub-sale by the buyer; and
  - **(e)** Where the seller takes a security from the buyer for the payment of the price of the goods sold, in lieu of his (seller's) right of lien.
- **Duration of Transit**

  The sold goods are in the course of transit from the time when these are delivered to the carrier, or to some other bailee, for the purpose of transportation/transmission of the goods to the buyer, and that too, only upto such time when the buyer or his agent (on his behalf) has not taken the delivery of the sold goods from the carrier, or some other bailee.
- **Duration (Period) of Transit ends:**
  - **(a)** When the goods have reached in the possession of the buyer or his agent or servant on his behalf;
  - **(b)** When the buyer or his agent or servant obtains the delivery of the goods before they reach their specified destination;
  - **(c)** When the goods have reached their specified destination, and the carrier or some other bailee of the goods acknowledges to the buyer or his agent that he (carrier or some other bailee) holds those goods on behalf of the buyer or his agent. In this context, it is immaterial that a further destination of the goods was specified by the contract; and
  - **(d)** When the carrier or some other bailee of the goods wrongfully refuses to deliver the goods to the buyer or his agent on his behalf.
  - **(e)** When the ship whereon the sold goods have been loaded by the seller, belongs to the buyer or else has been chartered by the buyer, the period of transit will be deemed to have ended the moment

the sold goods are loaded on the ship, provided the seller had not reserved the right of the disposal of the goods.

- **Effect of Change of Destination**
  Where the buyer and the seller have agreed that the sold goods must be delivered at a certain place, say, at Delhi, but subsequently the buyer has asked the seller that now the sold goods must be delivered at another place, say, at Chandigarh, the goods will be treated to be still in transit until the goods are taken delivery of by the buyer, or his agent on that behalf, at the subsequently changed destination, i.e. Chandigarh.
- **Effect of Part-Delivery**
  In such cases, the remaining quantity of the goods may be stopped in transit by the seller, provided there was no agreement between the seller and the buyer that the seller will pass on the possession of the entire goods to the buyer by way of even a part-delivery of the goods.
- **Exercise of the Right of Stoppage in Transit (Section 52)** by way of:
  (**a**) Taking the actual possession of the goods in transit; or
  (**b**) Giving notice of his intention to claim and exercise his right of stoppage of the goods in transit to the carrier or the other bailee of the goods, who happens to be in the actual possession of the goods at the material time.
- **Whom to give Notice of Stoppage-in-Transit?**
  Notice of stoppage-in-transit can be given by the seller either to the person (carrier or the other bailee of the goods), who happens to be in the actual possession of the goods at the material time, or to his principal.
- **Effect of Sub-Sale or Pledge by the Buyer**
  As per the general rule, the unpaid seller's right of lien on the goods sold, and his right of stoppage of the goods in transit, do not get affected by any sale by the buyer or by disposal of the goods by him (buyer) in some other manner (like by pledge), unless and until the seller had consented to that effect (**Section 53**).
- **Exceptions to the General Rule,** as aforementioned:
  (**a**) Where the document to the title to the goods has been made out in the name of the buyer himself, or it has been lawfully transferred to any person as the buyer or owner of those goods, and where such person (as the buyer or owner of those goods) transfers such document to the title to the goods to another buyer, in good faith and for a valuable consideration, the unpaid seller's rights of lien or stoppage in transit regarding those goods gets forfeited and lost. **[Dreyfus & Co. (1943), K.B. 40].**
  (**b**) Where the document to the title to the goods has been made out in the name of the buyer himself, or it has been lawfully transferred to the buyer, and where such buyer transfers such document to the title to the goods to another *bona fide* buyer for consideration, by way of pledge, the unpaid seller's rights of lien or stoppage in transit regarding those goods can be exercised by the unpaid seller, only subject to the right of the pledgee (pawnee).
- **Right of Re-Sale (Section 54)**
  Where the unpaid seller has retained the possession of the goods in exercise of his right of unpaid seller's lien, or where he has resumed (regained) the possession of the goods from the carrier, in the event of such buyer being declared insolvent, such unpaid seller can resell the goods involved, in the following circumstances:
  (**a**) Where the goods so sold are perishable in nature, such unpaid seller can resell the goods involved, without giving any notice to the buyer. But, here, the term 'perishable' also includes the goods which are commercially perishable in nature, i.e. which may deteriorate so as to make them non-merchantable.

(**b**) However, where the goods so sold are not perishable in nature, such unpaid seller is required to ask the buyer to pay or to tender the price of the goods so sold to him, within a reasonable time, and only when the buyer fails to do so, such unpaid seller can resell the goods involved, and not otherwise.

(**c**) Further, such right is also available to him in the cases where, under the contract of the sale of goods, he has expressly retained the right of resale of the goods, in the event of the buyer making a default. Thus, the original contract gets cancelled, but the unpaid seller still retains his right to claim damages from the original buyer for the breach of the contract [**Section 54 (4)**]. But then, the unpaid seller must exercise his right of resale of the goods within a reasonable time, which will depend upon the facts of each case.

- **Notice of Re-Sale, When Necessary?**
  Such notice is necessary in all the cases except where the goods are of a perishable nature. Thus, if the unpaid seller resells the imperishable goods involved, without giving the required notice to the buyer, he will not be able to recover any damages from the buyer for the loss, if any, sustained by the unpaid seller in the case of reselling the goods. Further, he (unpaid seller) will not be entitled to retain the profit, if any, accruing on the resale of such goods, either.
- **Measure of Damages and Gains**
  The damages in the case of the resale of the goods will be arrived at by subtracting the 'resale price realised', from the 'contracted price' of the goods involved, plus the 'related expenses of the resale'
- **Right against the Buyer Personally**

  (**a**) **Right to sue for the Price**
  Where, under the contract, the property (ownership) in the goods sold has passed on to the buyer, and the buyer wrongfully neglects or refuses to pay the price of the goods bought by him, the seller can sue the buyer for realisation of the price of the goods sold (**Section *55***).

  (**b**) **Right to sue for the Damages**
  Where the buyer wrongfully neglects or refuses to accept of the goods and pay for the goods bought by him, the seller may sue the buyer for damages for non-acceptance of the goods sold.

  Further, in the cases where the property (ownership) in the goods sold has not been passed on to the buyer, and the price of the goods sold was not payable without passing on the property (ownership) in the goods sold, the seller can sue the buyer only for the damages, and not for the realisation of the price of the goods sold (**Section *56***).
- Where the goods have been put up for sale by auction in lots, each lot will be, *prima facie* (on the face of it), treated as the subject matter of a separate contract of sale by auction (**Section 64**).
- Sale at auction is deemed completed when the auctioneer announces its completion, customarily by way of falling of the hammer, or in some other customary manner. Usually the auctioneer announces the completion of the sale, 'three times'.
- Before such announcement of the completion of the sale by the auctioneer 'three times', any bidder can withdraw his bid.
- The right to bid may be reserved expressly by the seller or by some other person on his (seller's) behalf. Where such right is so reserved expressly, but not otherwise, the seller or some other person on his (seller's) behalf may also bid at the auction.
- But where it has not been expressly notified to be subject to the right to bid by or on behalf of the seller, it will be unlawful for the seller to bid for himself or even to employ some other parson to bid on his (seller's) behalf at such auction. Such auction will, accordingly, be treated as fraudulent.
- Similarly, if the auctioneer knowingly takes any bid from the seller personally, or even from some other person employed by the seller for this purpose, it will be deemed to be unlawful even for the auctioneer. Such auction will, accordingly, be treated as fraudulent.

- Sale by auction must be notified to be subject to a reserved or upset price (i.e. below this reserved minimum price the goods will not be sold by auction).
- Where the seller makes use of any pretended (feigned or false) bidding, so as to raise the price of the goods under auction, such sale by auction will be treated as voidable at the option of the buyer thereof. **[Thornett vs Haines (1846) 15 M.&W 367]**.

Questions for Reflection

1. (a) Under what specific conditions can the seller of the goods be deemed as an 'unpaid seller' of the sold goods?
   (b) What are the various persons/parties that are included in the term 'seller'?
   Illustrate your points by citing some appropriate examples in each case.
2. What are the various rights of an unpaid seller in the following cases?
   (a) Against the goods sold; and
   (b) Against the buyer (in person).
3. Explain each of the following rights of an unpaid seller against the goods sold:
   (a) The right of 'lien' on the goods;
   (b) The right of 'stoppage' of the goods in transit; and
   (c) The right of re-sale of the goods.
4. Can an unpaid seller exercise his right of lien on the goods sold, where the buyer has paid the price of the goods sold, but he still has to pay to seller some other charges like the storage or handling charges for the storage of the goods sold, because these charges are also payable by the buyer? Give reasons for your answer.
5. (a) Can the assignee or creditor of the unpaid seller exercise the right of the unpaid seller's lien on his (unpaid seller's) behalf?
   (b) Can the unpaid seller exercise his right of lien on the goods sold, even in the cases where he (seller) happens to be in the possession of the goods sold, in the capacity of an agent or a bailee of the buyer, and in the mean time, the buyer had become insolvent?
   (c) Will the right of lien be available to the unpaid seller in all the cases where a part delivery of the goods sold, has already been made by the unpaid seller? If not, under what specific circumstances the right of lien will not be available to the unpaid seller?
   Give reasons for your answer in all the cases.
6. Under what specific circumstances the right of the 'unpaid seller's Lien' on the goods is lost by him?
7. What is the legal ramification of the statement that 'the unpaid seller's lien is in the nature of a promissory lien'? Explain with the help of some illustrative examples.
8. (a) What does the unpaid seller's right of stoppage-in-transit signify?
   (b) Under what specific circumstances can the seller exercise his right of stoppage-in-transit?
   (c) Can the seller exercise his right of stoppage-in-transit where the goods have already been delivered to the buyer?
   Give reasons for your answer in all the cases.
9. Explain the main distinguishing features between 'lien' and 'stoppage-in-transit', with the help of some illustrative examples.
10. (a) Explain as to how long the goods sold will be deemed to be in the course of transit, and
    (b) When goods sold will cease to be treated as being in the course of transit?
    (c) When goods sold will cease to be treated as being in the course of transit where the goods are sent by ship?

11. (a) In the case where the buyer of the goods in transit has rejected the goods, and the carrier or some other bailee of the goods continues to hold those goods, will the goods be still treated as being in the course of transit?
    (b) Will the legal position be any different if the seller of the goods has refused to take those goods back?

    Give reasons for your answer in both the cases.
12. In the cases where the buyer and the seller have agreed that the sold goods must be delivered at a certain place, but subsequently, the buyer has asked the seller that now the sold goods must be delivered at another place, till what time will the goods be treated to be still in transit?
    Explain with the help of some illustrative example.
13. In the cases where the seller has made only a part-delivery of the sold goods to the buyer's agent on his (buyer's) behalf, under what specific circumstances can the remaining quantity of the goods be stopped in transit by the seller?
14. In the cases where the buyer has sold such partly delivered goods, under what specific circumstances will the unpaid seller lose his right of lien or his right of stoppage of the goods in transit?
15. In what specific manners can the unpaid seller exercise his right of stoppage in transit?
16. (a) When and to whom should the unpaid seller give the notice of stoppage-in-transit?
    (b) In case the notice of stoppage-in-transit is given by the seller to the principal of the carrier, who happens to be in the actual possession of the goods at the material time, under what specific conditions will such notice to the principal be deemed to effective?
    (c) Where the carrier re-delivers the goods to the seller of the goods or as per the seller's direction, from whom will the carrier realise the cost of such re-delivery of the goods, i.e. from the buyer or from the seller?
17. Does the unpaid seller's right of lien or stoppage in transit regarding the unpaid goods get forfeited and lost in the following cases? State 'yes' or 'no' in your answer.
    (a) Where the document to the title to the goods has been made out in the name of the buyer himself.
    (b) Where the document to the title to the goods has been lawfully transferred to any person as the buyer or owner of those goods, and where such person (as the buyer or owner of those goods) transfers such document to the title to the goods to another buyer, in good faith and for a valuable consideration,.
    (c) Where the document to the title to the goods has been made out in the name of the buyer himself, or it has been lawfully transferred to the buyer, and where such buyer transfers such document to the title to the goods to another *bona fide* buyer for consideration, by way of pledge.
18. Where the unpaid seller has retained the possession of the goods in exercise of his right of unpaid seller's lien, or where he has resumed (regained) the possession of the goods from the carrier, in the event of such buyer being declared insolvent, can such unpaid seller resell the goods involved, without giving any notice to the buyer, in the following circumstances:
    (a) Where the goods so sold are perishable in nature.
    (b) Where the goods so sold are not perishable in nature.
    (c) Where, under the contract of the sale of goods, the unpaid seller has expressly retained the right of resale of the goods, in the event of the buyer making a default in payment.
    (d) In the case stated at (c) above, will the unpaid seller still retain his right to claim damages from the original buyer for the breach of the contract, and if so, under what specific circumstances?
19. If an unpaid seller happens to resell the imperishable goods, without giving the required notice to the buyer, will he be able to recover any damages from the buyer for the loss, if any, sustained by the unpaid seller in the case of reselling the goods; and will he (unpaid seller) be able to retain the profit, if any, accruing on the resale of such goods? Give reasons for your answer.
20. (a) In what manner will the quantum of the damages to be recovered from the buyer be arrives at in the case of the resale of the goods?

(b) How will the quantum of the gains, if any, be arrives at in the case of the resale of the goods? Explain with the help of illustrative example in each case.

21. Will the buyer, who happens to buy the goods on the resale thereof, acquire a valid title thereto, as against the original buyer, even in the cases where the unpaid seller had failed to give the notice of the resale of the imperishable goods to the original buyer? Give reasons for your answer.
22. Explain the various rights enjoyed by the unpaid seller against the buyer personally.
23. Under what specific circumstances can the unpaid seller exercise his rights against the buyer personally?
    (a) The right to sue the buyer for the price of the goods sold to him; and
    (b) The right to sue the buyer for the damages for non-acceptance of the goods.
24. 'In the cases where the goods have been put up for sale by auction in lots, each lot will not be, *prima facie* treated as the subject matter of a separate contract of sale by auction.' Is this statement true or false?
25. What is the most customary way by which the sale at the auction is deemed to have been completed?
26. As per the practice, how many time(s) the auctioneer usually announces the completion of the sale?
27. Till what time is any bidder permitted to withdraw his bid?
28. Under what specific conditions the seller or some other person on his behalf can also bid at the auction?
29. Under what specific conditions can the bid by the seller for himself, or even by some other parson employed by the seller to bid on his behalf at an auction, such sale by auction will be deemed to be unlawful and fraudulent?
30. Under what specific conditions can the bid taken by the auctioneer concerned, the sale in such auction will be deemed to be unlawful and fraudulent for the auctioneer?
31. **'**Any sale by auction cannot be notified to be subject to a reserved or upset price.' Is this statement true or false?
32. 'In the cases where the seller makes use of any pretended (feigned or false) bidding, with a view to raising the price of the goods under auction, such sale by auction will be treated as voidable at the option of the seller thereof.' Is this statement true or false?

Problems for Practice (With Suggested Solutions)

Problem 1

Bhushan has bought some goods from Gopi. Bhushan has paid the price of the bought goods to Gopi, but he still has to make payment to Gopi of some other charges like for the storage and handling charges for the storage of the goods sold. Gopi has, therefore, exercised his unpaid seller's right of lien on the goods sold, on the ground that the storage and handling charges for the storage of the goods sold are yet to be paid by Bhushan. Do you think that the stand taken by Gopi is justifiable in the eye of law? Give reasons for your answer.

Solution

No; the stand taken by Gopi is not justifiable in the eye of law. This is so because, as per the provisions of the Sale of Goods Act, unpaid seller can exercise his right of lien on the goods sold only in the cases where the price of the goods sold has not been paid to him by the buyer concerned. Conversely speaking, an unpaid seller cannot exercise his right of lien on the goods sold, in the cases of the non-payment of any other charges (i.e. other than the non-payment of the price of the goods sold), like for the non-payment of the storage and handling charges, for the storage of the goods sold and so on, though these charges are also payable by the buyer.

Problem 2

In Problem 1, in case Bhushan would not have paid even the price of the goods to Gopi, can Gopi's assignee or his creditor exercise the unpaid seller's right of lien on the sold goods on behalf of Gopi? Give reasons for your answer.

Solution

No; Gopi's assignee or his creditor cannot exercise the unpaid seller's right of lien on the sold goods on behalf of Gopi. This is so because, as per the provisions of the Sale of Goods Act, the unpaid seller's lien is in the nature of a 'particular lien' (and not a 'general lien', like that of a banker). Further, the 'particular lien' also signifies that this right of lien, enjoyed by the seller, can be exercised only and exclusively by the seller alone, and not by his assignee or his creditor, and so on.

Problem 3

Varun had bought some goods from Salim, and had agreed to pay the price of the goods bought by him at a later date. However, Varun had left the goods with the seller (Salim), requesting him to send the goods to him (Varun) at a later date. In the mean time, Varun had become insolvent. Under these circumstances, will Salim, the seller, have the right to exercise his lien on the goods unpaid for? Give reasons for your answer.

Solution

Yes; under the given circumstances, Salim, the seller, will have the right to exercise his lien on the goods unpaid for. This is so because, as per the provisions of the Sale of Goods Act, the unpaid seller can exercise his right of lien on the goods sold, even in the cases where he (seller) happens to be in the possession of the goods sold, in the capacity of an agent or a bailee of the buyer. Thus, as in the instant case Salim, the seller happens to be in the possession of the goods sold, in the capacity of a bailee of the buyer, he (Salim), by virtue of being the unpaid seller, can exercise his right of lien on the goods sold.

Problem 4

Sulakshna (seller) has take-out the railway receipt (R/R) in the name of Vasant (buyer), who still has to pay the price of the bought goods to Sulakshna (seller). Can Sulakshna exercise her rights of 'unpaid seller's lien' on the goods covered by the railway receipt (R/R)? Give reasons for your answer.

Solution

No; Sulakshna cannot exercise her rights of 'unpaid seller's lien' on the goods covered by the railway receipt (R/R), taken out in the name of Vasant (buyer). This is so because, as per the provisions of the Sale of Goods Act, the rights of 'unpaid seller's lien' on the goods are lost by the unpaid seller in the cases where the seller has not reserved his/her right of the disposal of the goods to himself/herself. And, where the seller has taken-out a railway receipt (R/R) in the name of the buyer [or even in the name of his/her (buyer's) agent], such seller is not deemed to have reserved his/her right of the disposal of the goods to himself/herself. Thus, in the instant case, as Sulakshna (seller) has take-out the railway receipt (R/R) in the name of Vasant (buyer), she (Sulakshna) cannot be deemed to have reserved her right of the disposal of the goods to herself. Accordingly, Sulakshna cannot exercise her rights of 'unpaid seller's lien' on the goods covered by the railway receipt (R/R), taken out in the name of Vasant (buyer).

Problem 5

Sukumar has sold some goods to Benazir. But Benazir has not paid the price of the goods bought by her. Accordingly, Sukumar has, instead, taken some security from Benazir for the payment of the price of the goods sold, in lieu of his right of lien. But Benazir has failed to pay the price of the goods for an unreasonably long time. Can, in such circumstances, Sukumar exercise his rights of 'unpaid seller's lien' on the goods on the ground that Benazir had failed to pay the price of the goods for an unreasonably long time? Give reasons for your answer.

Solution

No; even in the given circumstances, where Benazir, the buyer, has failed to pay the price of the goods for an unreasonably long time, Sukumar cannot exercise his rights of 'unpaid seller's lien' on the goods. This is so because, as per the provisions of the Sale of Goods Act, the rights of 'unpaid seller's lien' on the goods are lost by the unpaid seller in the cases where the seller (Sukumar in the given case) has taken some security from the buyer (Benazir in the given case) for the payment of the price of the goods sold, in lieu of his right of lien.

Problem 6

Sudhanshu had sold some of his shares to Vishwanath, and had also delivered the respective share certificates to Vishwanath, along with the share transfer deed duly signed by him. The payment, however, was made by

Vishwanath (buyer) by means of a cheque. Subsequently, before the cheque, representing the payment of the price of the shares, could be realised by the seller, Vishwanath (buyer) had become insolvent. Can, in such circumstances, Sudhanshu exercise his rights of 'unpaid seller's lien' on the respective shares on the ground that the cheque, pertaining to the payment of the price of the goods sold by him to Vishwanath, had not by then been paid to him? Give reasons for your answer.

Solution

No; Sudhanshu cannot exercise his rights of 'unpaid seller's lien' on the respective shares on the ground that the cheque, pertaining to the payment of the price of the goods sold by him to Vishwanath, had not yet been realised by him (Sudhanshu). This is so because, as provided in the Sale of Goods Act, the unpaid seller's lien is in the nature of a particular and promissory lien, which signifies that once the possession of the sold goods is lost by the seller, his right of lien is also lost therewith. Likewise, in the instant case also, the rights of 'unpaid seller's lien' on the goods (shares in the instant case) are lost by the unpaid seller (Sudhanshu in the instant case), because he had delivered the respective share certificates to the buyer along with the share transfer deed duly signed by him. In fact, his (Sudhanshu's) rights of unpaid seller's lien on those shares had already ceased the moment he had delivered (transferred the possession of) those shares to Vishwanath, the buyer. This contention is based on the judgement delivered in the case titled **Bharneha vs Wadilal [28Bom. L.R. 777 P.C.].**

Problem 7

Sulekha had sold some goods to Vaishali. The payment, however, was made by Vaishali (buyer) by means of a cheque. Subsequently, before the cheque, representing the payment of the price of the sold goods, could be realised by Sulekha (seller), Vaishali (buyer) had become insolvent. Can, in such circumstances, Sulekha exercise her rights of 'unpaid seller's lien' on the respective goods, which were still in transit, on the ground that the cheque, pertaining to the payment of the price of the goods sold by her to Vaishali, had not yet been realised by Sulekha, the seller? Give reasons for your answer.

Solution

In the instant case, Sulekha cannot exercise her rights of 'unpaid seller's lien' on the respective goods. But then, by virtue of the fact that the goods were still in transit, she can exercise her right of stoppage-in-transit, instead. Here, we may stress that the stoppage-in-transit involves stopping of the sold goods from their being delivered to the buyer thereof, and regaining their possession, only while the sold goods are still in transit. Further, as provided in the Sale of Goods Act, the seller (Sulekha in the instant case) can retain those goods with herself till their price is paid or tendered to her by the buyer (Vaishali in the instant case). Further, the seller (Sulekha in the instant case) becomes entitled to exercise her right of stoppage-in-transit only when she loses her right to exercise her lien on the sold goods, and that too, only in the cases where she has lost her right to exercise her right of lien, on account of the buyer (Vaishali in the instant case), becoming insolvent after the sale of the goods.

Thus, as the sold goods are still in transit and the buyer (Vaishali in the instant case) has become insolvent (before the cheque could be encased by the seller (Sulekha in the instant case), Sulekha can exercise her right of stoppage-in-transit, though not the right of unpaid seller's lien. This is so because, as provided in the Sale of Goods Act, the seller becomes entitled to exercise his right of stoppage-in-transit only when he loses his right to exercise his right of lien, and that too, only in the cases where he has lost his right to exercise the right of lien, on account of the buyer becoming insolvent after the sale of the goods.

Problem 8

Will the legal position be any different in Problem 7, in case the goods were already delivered by Sulekha , the seller, to Vaishali, the buyer? Give reasons for your answer.

Solution

Yes; the legal position will decidedly be different in case the goods were already delivered by Sulekha, the seller, to Vaishali, the buyer. This is so because, as provided in the Sale of Goods Act, where the sold goods

have already been delivered to the buyer of those goods, such goods cannot be deemed to be in the course of their transit any longer. In fact, such delivery will tantamount to the transfer of the possession of the goods from the seller to the buyer. Thus, as the right of stoppage of goods in transit can be exercised by the seller only during the period the goods sold are in the course of transit, the right of stoppage of goods in transit cannot be exercised by the seller when the period of the goods sold being in the course of transit ends, i.e. when the goods have been delivered to the buyer.

Problem 9

Shahrukh had delivered the sold goods to the captain of the ship, which belonged to Vasco, the buyer himself. Further, as stated in the relative bill of lading (B/L), the goods were made to be delivered to the buyer or his agent. Will the seller (Shahrukh) be able to exercise his right of stoppage-in-transit in this case? Give reasons for your answer.

Solution

No; the seller (Shahrukh) will not be able to exercise his right of stoppage-in-transit in this case. This is so because, as provided in the Sale of Goods Act, such bill of lading (B/L), whereby the goods were made to be delivered to the buyer or his agent, and the captain of the ship, which belonged to the buyer (Vasco), can be deemed to be the agent of the buyer, such delivery had amounted to a delivery of the goods to the buyer, and that these were no longer in the course of transit. Accordingly, the seller (Shahrukh) did not have the right of stoppage-in-transit in this case. This contention is also based on the judgement delivered in the case titled **Schetmans vs Landshire and Yorkshire Railway Co. [(1867) L.R. 2 CH. App. 332]**.

Problem 10

Vasundhara, the buyer at Lucknow, had placed an order with the seller Shrawan at Bangalore for the purchase of certain goods. The seller Shrawan at Bangalore had transported the ordered goods to Lucknow. Further, on arrival at Lucknow, the carrier had taken the goods to the warehouse of the buyer Vasundhara, and had left them there. The buyer Vasundhara, however, had refused to accept and take delivery of these goods, and had stopped payment of her cheque representing the price of the goods sold. Will Shrawan be able to exercise his right of stoppage-in-transit in this case and take the goods back? Give reasons for your answer.

Solution

Yes; Shrawan will be able to exercise his right of stoppage-in-transit in this case and take the goods back because, as provided in the Sale of Goods Act, the goods will still be treated as being in transit. This contention is also based on the judgement delivered in the case titled **James vs Griffin [(1837) 2 M&W 6231]**.

Problem 11

Shobha and Prabha, the seller and buyer respectively, had agreed that the sold goods must be delivered at Chandigarh, but subsequently Prabha had asked Shobha that the sold goods must be delivered at Amritsar, instead. While the goods were on the way from Chandigarh to Amritsar, Shobha had exercised her right of stoppage-in-transit on the goods. Is Shobha legally justified in doing so? Give reasons for your answer.

Solution

Yes; Shobha is legally justified in exercising her right of stoppage-in-transit on the goods. This is so because, as provided in the Sale of Goods Act, the goods involved will be treated to be still in transit until the goods are taken delivery of by the buyer, or his agent on that behalf, at the subsequently changed destination i.e. Amritsar in the instant case.

Problem 12

Shailja, the seller, had given the notice of stoppage-in-transit to the principal of the carrier when the carrier concerned was in the actual possession of the goods. Immediately on receipt of such notice from the seller, the principal had exercised reasonable diligence on his (principal's) part, to communicate the contents of the notice to the carrier, so as to prevent the delivery of the goods to the buyer. But, well before the principal could communicate the contents of the notice to the carrier, the goods had already been duly delivered by the carrier to the buyer. Thereafter, Shailja, the seller, had filed a suit against the principal of the carrier for recovery of the damages from him (principal of the carrier) for non-compliance of her reasonable instructions in time. What are the chances of Shailja winning the case? Give reasons for your answer.

Solution

Shailja does not seem to be having even the slightest chance of winning the case. This is so because, as provided in the Sale of Goods Act, the notice of stoppage-in-transit can be given by the seller either to the person (carrier or some other bailee of the goods), who happens to be in the actual possession of the goods at the material time, or to his principal. But, when the notice of stoppage-in-transit is given by the seller to the principal of such person (carrier in the given case), such notice will be deemed to effective if it is given by the seller at such a time and under such circumstances when the principal, by the exercise of reasonable diligence on his (principal's) part, may communicate the contents of the notice to his agent (carrier in the given case), so as to prevent the delivery of the goods to the buyer. But in the instant case, as immediately on receipt of such notice from the seller, the principal had exercised reasonable diligence on his (principal's) part, to communicate the contents of the notice to the carrier, so as to prevent the delivery of the goods to the buyer, and before the principal could communicate the contents of the notice to the carrier, the goods had already been duly delivered by the carrier to the buyer, the notice given by the seller to the principal will not be deemed to effective under the aforementioned circumstances.

Problem 13

Suleman had sold to Baker 100 kg of almond out of his (Suleman's) stock, stored in his (Suleman's) godown. Baker, thereafter, had sold 50 kg of almond, out of the stock of 100 kg of almond, to Prashant. After receiving the delivery order from Baker, pertaining to the stock of 50 kg of almond so sold to him (Prashant) by Baker, Prashant had presented it to Suleman (original seller). Suleman (original seller) had advised Prashant that the required 50 kg of almond will be delivered to him (Prashant) in due course. Thereafter, Baker had become insolvent. Under the given circumstances, do you think that Suleman's rights of lien on the goods sold, as also his right of stoppage of the goods in transit, regarding the stock of 50 kg of almond so sold to Prashant by Baker, were lost? Give reasons for your answer.

Solution

Yes; as provided in the Sale of Goods Act, under the given circumstances, Suleman's rights of lien on the goods sold, as also his right of stoppage of the goods in transit, regarding the stock of 50 kg of almond so sold to Prashant by Baker, will be deemed to have been lost on the ground that Suleman (original seller) had recognised the title of Prasoon (the sub-seller), by way of advising Prashant that the required 50 kg of almond will be delivered to him (Prashant) in due course. This contention is also based on the judgement delivered in the case titled **Knights vs Wiffen [(1870) L.R. 5 Q.B. 660]**.

Problem 14

Firdausi, the unpaid seller, in the exercise of his right of unpaid seller's lien, had retained the possession of the goods, which were likely to deteriorate shortly, making them non-merchantable. But soon thereafter, Firdausi had come to know that the buyer (Niraj) had been declared insolvent. Accordingly, Firdausi sold those goods to Digvijai urgently, and in the process, he had forgotten to give any notice to Niraj, the original buyer. Thereafter, Niraj had filed a case against Firdausi for realisation of damages from Firdausi for not giving him (Niraj) the notice before selling the goods that were originally purchased by him from Firdausi. What are the chances of Niraj winning the case? Give reasons for your answer.

Solution

Niraj does not seem to be having even the slightest chance of winning the case. This is so because, as provided under Section 54 of the Sale of Goods Act, where the goods sold are perishable in nature, such unpaid seller can resell the goods involved, without giving any notice to the buyer. Further, the term 'perishable', besides signifying the physical deterioration of the goods, also includes the goods which may deteriorate so as to make them non-merchantable. This contention is based on the judgement delivered in the case titled **Asfar vs Blundell [(1896) 1 Q.B. 123].**

Problem 15

Will the legal position be any different in Problem 14, if the goods involved were not of perishable nature? Give reasons for your answer.

Solution

Yes; the legal position will be far different, if the goods involved were not of perishable nature, in that Niraj will have a very bright chance of winning the case. This is so because, as provided under Section 54 of the Sale of Goods Act, where the goods so sold are not perishable in nature, such unpaid seller is required to ask the buyer to pay or to tender the price of the goods so sold to him, within a reasonable time, and only in case the buyer fails to do so, such unpaid seller can resell the goods involved, and not otherwise.

Other legal ramifications in the instant case will be that the unpaid seller (Firdausi) will not be able to recover any damages from the buyer (Niraj) for the loss, if any, sustained by him (Firdausi) in the case of reselling the goods. Further, he (Firdausi) will not be entitled to retain the profit, if any, accruing on the resale of such goods, either. That is, such profit, if any, the unpaid seller will have to pass on the buyer, instead.

Problem 16

Will the legal position be any different in Problem 14, if the goods involved were not of perishable nature, and the unpaid seller (Firdausi) had also given the required notice to the buyer (Niraj) before actually selling the goods in question? Give reasons for your answer.

Solution

The legal position will be quite different under the aforementioned changed circumstances, in that Firdausi (unpaid seller) will be able to recover the damages from the buyer (Niraj) for the loss, if any, sustained by him (Firdausi, the unpaid seller) in the case of reselling the goods. Further, Firdausi, theunpaid seller, will also be entitled to retain the profit, if any, accruing on the resale of such goods. This is so because, in such an event taking place, the unpaid seller (Firdausi) will not be acting as an agent of the buyer concerned. This point has been validated in the case titled **Gobdindram vs Shamiji & Co. [(1961) A.I.R., I.S.C. 1285].**

Problem 17

In Problem 16, let us presume that the 'contracted price' is Rs 5,000 and the 'resale price realised' is Rs 4,500 and the 'related expenses of the resale' come to Rs 700. What will the amount of the totals damages that could be realised by the unpaid seller from the buyer? Give reasons for your answer.

Solution

The total damages to be realised by the unpaid seller (Firdausi) from the buyer (Niraj) in the given case will be [(Rs 5,000 less Rs 4,500) + Rs 700] = (Rs 500 + Rs 700) = Rs 1,200. This is so because, where the goods are resold at a price lesser than the contracted price, the damages in the case of the resale of the goods are arrived at by subtracting the 'resale price realised', from the 'contracted price' of the goods involved, plus the 'related expenses of the resale'.

Problem 18

In Problem 16, let us presume that the 'contracted price' is Rs 9,000 and the 'resale price realised' is Rs 11,000, and the 'related expenses of the resale' come to Rs 600. What will be the total gain earned by the unpaid seller on the resale. Give reasons for your answer.

Solution

The total gain earned by the unpaid seller on the resale will come to [(Rs 11,000 less Rs 9,000) less Rs 600] = (Rs 2,000 less Rs 600) = Rs 1,400. This is so because, where the goods are resold at a price higher than the contracted price, the gains are arrived at by a changed formula, i.e. [(resale price realised) less (contracted price)] less (related expenses of the resale) = net gain. Further, this amount of gain of Rs 1.400 will be retained by the unpaid seller and need not be passed on to the buyer.

Problem 19

Wilson has sold some goods to Yasmin, and the property in the goods sold, has already passed on to Yasmi. But, Yasmin has wrongfully neglected to pay the price of the goods bought by her. Can Wilson sue Yasmin for realisation of the price of the goods sold, though the property in the goods sold, has already passed on to her (Yasmin)? Give reasons for your answer.

Solution

Yes; Wilson can sue Yasmin for realisation of the price of the goods sold, though the property in the goods sold, has already passed on to her (Yasmin). This is so because, as provided under Section 55 of the Sale of Goods Act, in the cases where, under the contract of the sale of goods, the property in the goods sold, has passed on to the buyer, and the buyer wrongfully neglects (or refuses) to pay the price of the goods bought by the buyer (Yasmin in the instant case), the seller (Wilson in the instant case), can sue the buyer for realisation of the price of the goods sold.

Problem 20

Yuvraj has sold some goods to Sachin, but the delivery of the goods has not yet been made to Sachin. Further, the price of the goods sold was to be paid by Sachin to Yuvraj on 5th June 2009. But Sachin (buyer) had not paid the price of the goods bought by him till 5th June 2009. Can Yuvraj, the seller sue Sachin, the buyer, for the realisation of the price of the goods sold? Give reasons for your answer.

Solution

Yes; Yuvraj, the seller, can sue Sachin, the buyer, for realisation of the price of the goods sold, although the property in the goods sold, has not yet passed on to Sachin, the buyer, and the goods have not been appropriated to the contract. This is so because, as provided under Section 55 of the Sale of Goods Act, in the cases where, under the contract of the sale of goods, the price of the goods sold is payable on a day fixed for payment (5th June 2009 in the instant case), irrespective of the delivery of the goods to the buyer, and the buyer wrongfully neglects or refuses to pay the price of the goods bought by him on such fixed date, the seller may sue the buyer for realisation of the price of the goods sold, although the property in the goods sold, has not passed on to the buyer, and the goods have not been appropriated to the contract.

Problem 21

Johar had sold some goods to Karan. But the property in the goods sold had not been passed on to Karan, the buyer. Further, it was provided in the contract of sale that the price of the goods sold will not be payable without passing on the property in the goods sold. Can Johar, the seller, sue Karan, the buyer, for the damages, and also for the realisation of the price of the goods sold? Give reasons for your answer.

Solution

No; Johar, the seller, cannot sue Karan, the buyer, for the realisation of the price of the goods sold, as per the terms of the contract (i.e. the property in the goods sold had not been passed on to Karan, and the price of the goods sold were not to be paid without passing on the property in the goods sold). But then, as provided under Section 56 of the Sale of Goods Act, Johar, the seller, can definitely sue Karan, the buyer but only for the damages for the non-acceptance of the goods sold, but not for the realisation of the price of the goods sold.

Problem 22

In a sale at auction, the auctioneer concerned announces the completion of the sale by auction, by the customary way of falling of the hammer, not only once but two times? Will the auction be deemed to have been completed in the instant case? Give reasons for your answer.

Solution

No; such auction will not be deemed to have been completed in the instant case. This so because, in a sale at the auction, it will be deemed to have been completed when the auctioneer concerned announces the completion of the sale by auction, by the customary way of falling of the hammer, not just once or twice but 'three times', as per the usual practice in such cases.

Problem 23

A bidder at an auction wanted to withdraw his bid, but by the time he could announce his withdrawal of his bid, the auctioneer had quickly announced the completion of the sale by auction, by the customary way of falling of the hammer once. Accordingly, the auctioneer restrained the bidder from withdrawing his bid once he had already announced the completion of the sale by auction, by the customary way of falling of the hammer. Do you think that the contention of the auctioneer is legally valid? Give reasons for your answer.

Solution

No; the contention of the auctioneer is not legally valid in the instant case. This is so because, as per the provisions of the Sale of Goods Act, the bidder is permitted to withdraw his bid until the announcement of the completion of the sale is announced by the auctioneer concerned, by the customary way of falling of the hammer not just once, but three times, as per the usual practice in such cases. Thus, as the hammer of the auctioneer in the given case had fallen only once, the bidder still was legally entitled to withdraw his bid till the hammer of the auctioneer had fallen not just once or even twice but finally the third time.

Problem 24

Sunil, the seller, had employed Othello to bid on his (Sunil's) behalf at an auction. Accordingly, Othello bid at the auction on Sunil's behalf. However, such sale by auction had not been expressly notified to be subject to the right to bid by or on behalf of the seller. Do you think that such bid by Othello will be deemed to be unlawful and fraudulent in the eye of law? Give reasons for your answer.

Solution

Yes; such bid by Othello will be deemed to be unlawful and fraudulent in the eye of law. This is so because, as per the provisions of the Sale of Goods Act, in the cases where the sale by auction has not been expressly notified to be subject to the right to bid by or on behalf of the seller, it will be deemed to be unlawful for the seller to bid for himself or even to employ some other person to bid on his (seller's) behalf at such auction.

Problem 25

At an auction the seller had bid on his own behalf. However, such sale by auction had not been expressly notified to be subject to the right to bid by or on behalf of the seller. The auctioneer concerned was also aware of these facts. But he (auctioneer) had taken the bid from the seller at the auction. Do you think that such bid by the seller will be deemed to be unlawful and fraudulent in the eye of law even for the auctioneer? Give reasons for your answer.

Solution

Yes; such bid by the seller will be deemed to be unlawful and fraudulent in the eye of law even for the auctioneer. This is so because, as per the provisions of the Sale of Goods Act, if the auctioneer concerned knowingly takes any bid from the seller personally, at such auction and in the given circumstances (i.e. where such sale by auction had not been expressly notified to be subject to the right to bid by or on behalf of the seller), it will be deemed to be unlawful and fraudulent even for the auctioneer.

Problem 26

(a) In an auction, Zahid (seller) had adopted a winning strategy of making pretended (feigned or false) bidding, so as to raise the price of the goods under auction. Will such sale by auction be treated as valid, void or voidable?

(b) If you think that it will be treated as voidable, at whose option will it be treated as such, i.e. at the option of the seller or of the buyer of the goods under the auction?

Give reasons for your answer in both the cases.

Solution

(a) Under the given circumstances, such sale by auction will neither be deemed to be valid nor void but voidable. This is so because, as per the provisions of the Sale of Goods Act, in the cases where the seller makes use of any pretended (feigned or false bidding), with a view to raising the price of the goods under auction, such sale by auction will be treated as voidable at the option of the buyer thereof. This contention is also strengthened by the judgement delivered in the case titled **Thornett vs Haines [(1846) 15 M.&W 367].**

(b) Such sale by auction will be treated as voidable at the option of the buyer thereof. This is so because, as per the provisions of the Indian Contract Act, any voidable contract is deemed voidable at the option of the aggrieved party, i.e. the one who has been adversely affected by some fraud (coercion, undue influence, and so on). Thus, as in the given case, the buyer has been the victim of the fraud played by the seller (in artificially raising the bid by making false bids), the sale will be held voidable at the option of the buyer and not that of the seller.

Law of Partnership*

Chapter Thirty

Essential Elements of Partnership

> *Society is indeed a contract. It is a partnership in all science; a partnership in all art; a partnership in every virtue, and in all perfection.*
>
> **Edmund Burke**
>
> *It is probably not love that makes the world go around, but rather those mutually supportive alliances through which partners recognize their dependence on each other for the achievement of shared and private goals.*
>
> **Fred A. Allen**

The Indian Partnership Act, 1932 contains the comprehensive legislation pertaining to the partnerships in India. Earlier, it formed Chapter XI of the Indian Contract Act, 1872, since repealed.

30.1 What is a Partnership?

Section 4 of the Act defines a partnership as 'the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all'.

As defined by Sir F. Pollock, a partnership is 'the relation which subsists between persons who have agreed to share the profits of a business carried on by all, or any of them on behalf of all of them'.

But the English Partnership Act, 1890, however, has defined a partnership as 'the relation which subsists between persons carrying on business in common with a view of profit'.

30.2 Essential Ingredients of a Partnership

When we analyse the various clauses of **Section 4**, containing the definition, the following essential ingredients of a partnership may emerge:

30.2.1 A Partnership is an Association of Two or more Persons

This is so because an agreement of any nature, including the partnership agreement, cannot take place with one single person. That is, at least two persons are necessary to constitute a partnership. Further, as per **Section 11 of the Indian Companies Act 1956**, there can be maximum 10 persons in a partnership firm carrying on the business of banking, and maximum 20 persons in the other cases.

30.2.2 (i) A Partnership must Emerge Out of an Agreement

As a partnership emerges out of an agreement, as provided under **Section 5**, there must necessarily be at least two persons involved, because an agreement of any nature, including the partnership agreement, cannot take place with one single person. Thus, when two or more persons agree to constitute a partnership, a partnership agreement is entered into between them, and a 'Partnership Deed' is executed by them, containing the terms and conditions of the partnership. Further, after such agreement between two or more persons is entered into, a partnership is duly constituted, and these persons, thereafter, are referred to as the partners of the partnership firm.

Moreover, as a partnership is the product of an agreement, the partnership agreement must also comply with all the conditions specified for a valid and legally enforceable contract, as per the various provisions in this regard contained in the **Indian Contract Act, 1872**. Such contract, however, may be either an express contract or an implied one.

30.2.2 (ii) Minor Cannot be Member of a Partnership

A minor cannot become a partner in a new partnership firm, at the time of its constitution. This is so because, under **Section 11 of the Indian Contract Act**, a minor is not considered to be competent to enter into a valid contract, including the contract of partnership. He may, however, be admitted into an already existing partnership firm, but only to its benefits, and not for any losses incurred by the firm. A detailed discussion on this point appears at Section 31.15 of Chapter 31 of this book.

30.2.2 (iii) Partnership for a Fixed Period or for a Particular Project, i.e. 'Particular Partnership'

A partnership agreement may be entered into for a fixed period, or for executing a particular project, adventure or job. Further, as provided under **Section 8,** a partnership agreement, entered into just for executing a particular project, adventure or job, is known as a 'Particular Partnership'. Accordingly, a 'Particular Partnership' usually gets automatically dissolved on completion of the specified project, adventure or job. For example, a team of two or more auditors, engaged in the audit of the accounts of a particular company, may be regarded as partners in that particular audit, as was held in the case titled **Robinson vs Anderson.** And once this particular audit is over, and the final audit report is duly submitted to the management of the company, this partnership will automatically get dissolved.

30.2.2 (iv) HUF Business Concern is Not a Partnership

Furthermore, as a partnership must necessarily emerge out of an agreement, a Hindu Undivided Family (HUF) business concern, which carries on the family business (inherited from the ancestors), by the members of the Joint Hindu Family (known as coparceners), cannot be deemed to be a partnership. This is so because, a Hindu Undivided Family business venture generally does not emerge out of an agreement between the members of the Joint Hindu Family, but by virtue of their status, i.e. by way of its members being born in that family. However, the members of a Joint Hindu Family may also constitute a partnership by entering into an

agreement amongst them for carrying on the business as a partnership firm, and not as a Joint Hindu Family venture. But then, in such specific cases, they will have to prove that the partnership firm has emerged by way of a separate agreement between them to this effect, and not just by way of their status by virtue of their being born in that joint family. Similarly, it cannot emerge by way of the operation of law either, like in the case of co-ownership or joint acquisition of a property. Detailed discussions on the main distinguishing features between a partnership firm on the one side, and a Hindu Undivided Family (HUF) business concern and a co-ownership or joint acquisition of a property on the other, appear at points 30.6.1 and 30.6.2 in this chapter.

30.2.3 Partnership Agreement must be to Carry on Some Business

As explained in **Section 2, Clause (b),** the term 'business' here means any trade, occupation, or profession. Such business may be for a fixed period, involving several business transactions during the fixed period of time, or else, it may pertain only to the transaction in a 'Particular Partnership' (**Section 8**), as discussed above. But then, the most important and essential element involved in a partnership agreement is that it must be entered into for carrying on a business. Accordingly, a charitable society, a religious association, and so on, cannot be deemed to be partnerships under the Act. Based on such criterion, even a club does not constitute a partnership, as was held in the case titled **Caldecott vs Griffiths (1853) 8 Ex Re. 898.**

30.2.4 Partnership Agreement must be to Share the Profit of the Business

In this context, it may be stressed that just to carry on some business in itself is not good enough to constitute a partnership. Another essential ingredient for constituting a partnership is that there must be an agreement between its partners to share the profit of the business. Further, the sharing of such profit of the business also usually includes the sharing of the loss of the business, unless specifically agreed upon among the partners, to the contrary. That is, it may be agreed upon that one or more specified partners will share only the profit arising out of the business, and will not share the losses, if and when incurred by the partnership firm. We may, however, emphasise here that in the absence of an agreement to the contrary, it will be presumed that the agreement of partnership pertains to the sharing not only of its profits but also its losses. But then, the absence of the provision of the criteria for sharing of the loss, if any, incurred in the business does not constitute the essential element for constituting a partnership. As against this, the absence of the provision for sharing of profit of the business will have the adverse effect of nullifying the partnership itself. Alternatively speaking, while sharing of the profit of the business among the partners is absolutely essential and compulsory for constituting a valid partnership, the sharing of loss of the business among the partners is just optional, and thus, it does not adversely affect the constitution of a partnership.

Further, the sharing of such profit and loss of the business among the partners, may be either in equal proportion or otherwise, i.e. in the specified percentage of the profit, to be payable to the respective partners, as per the partnership agreement (partnership deed). In case no provision has been made in the partnership agreement (partnership deed) in regard to the sharing of the firm's profit, all the partners of the firm will share the profit of the firm in equal proportions amongst themselves [**Section 13 (b)**].

30.2.5 Partnership Business may be Carried out by all the Partners or by any of them Acting for all, i.e. Active Partners and Sleeping (Dormant) Partners

A partnership business may be carried out by all the partners or by any of them acting for all. That is, it is not necessary that all the partners must necessarily look after the business of the firm. It is quite possible that while only one or some of the partners of the firm may actively participate in the management and control of the business of the firm, the other partner or partners may prefer to be dormant or sleeping partners, instead.

30.2.6 Partners as 'Agents' or 'Principal' of other Partners, in Different Situations

As a partnership is based upon the principle of 'mutual agency', the law of partnership is said to be a branch of the law of principal and agent. Accordingly, each and every partner of the firm assumes the two respective and different roles (viz. the role of an agent and the role of a principal), in the following two different circumstances:

(i) In one case, each partner assumes the role of an agent, performing on behalf of the other partners of the firm, being his principals. This way, such partner binds all the remaining partners by his own act, as the agent binds his principal by his own actions.

(ii) Similarly, in the other situation, each partner is, instead, considered to be the principal of the other partners of the firm. Thus, under such opposite condition, he is, in turn, bound by the action of the other partner, working as his agent, from time to time.

Sections 19 and 22 have laid down that, unless provided to the contrary in the partnership deed, every partner has the implied authority to bind every other partner for his act done in the name of the firm, provided such act falls within the ordinary course of business of the firm, and is done in a usual manner.

30.3 The terms, 'Partners', 'Firm', and 'Name of the Firm' Defined

A partnership emerges out of an agreement among two or more persons. Such persons involved in the agreement of partnership, in their respective individual capacity, are referred to as partners. Further, these persons collectively constitute a partnership. And the name, under which a partnership firm carries on its business, is referred to as its (partnership firm's) name.

For example, when Amar, Akbar, and Anthony enter into an agreement to constitute a partnership, they are individually known as partners, and collectively as a partnership firm. And, if they conduct the business of the partnership firm as 'Three Aces', it (Three Aces) will be referred to as its name.

30.3.1 Restrictions in Naming a Firm

Here, we must clarify that while the partners of a firm are free to choose any name for their firm, they must take care to see to it that such name does not infringe upon the trade name and/or goodwill of any other existing firm or company, whose same, or very similar name, might have already been registered. In other words, the name should not be such which may mislead and confuse the members of the public with some other well reputed companies, enjoying valuable goodwill in the market.

This reminds me of the advertisement of 'CIBACA', flashed on the T.V. for quite some time, where the alphabets contained in the word 'BINACA' (the brand make toothpaste of a Swiss company), were being dismantled and gathered in a different order to read as 'CIBACA', with the punch line being ' Every thing is the same, except the name'. But, by the time the Swiss company had realised and objected to such advertisement, and it was taken off the T V screen, the damage had already been done.

Further, as provided under **Section 58 (3)**, the name of a firm should not contain any of the words like 'Crown', 'Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or such other words, which may express or imply the sanction, approval or patronage of the government. This can, however, be done in exceptional cases, but invariably with the written and specific consent of the government.

30.4 Partnership has No Legal Significance or Existence

We must, however, bear in mind that the term 'partnership firm' is just a convenient and generally used term

in the context of two or more persons constituting a 'partnership firm'. That is, it does not have any legal significance or existence, in its own right, other than the persons constituting it jointly (**Indian Cotton Company vs Raghunath**)**.** Further, in the case of the aforementioned partnership firm named 'Three Aces', the firm in itself does not mean anything other than Amar, Akbar, and Anthony taken together.

As against partnership firm, a joint stock company is a legal entity, a body incorporate. Thus, it can enter into an agreement, it can borrow and lend money, it can own property, it can sue and be sued, and so on, in its own name, which a partnership cannot do in its own name. In fact, the rights and duties enjoyed and owed by each of the partners are enjoyed and owed by him against the remaining partners individually, and not against the firm as such. Accordingly, if a partner prefers to initiate some legal action to enforce his rights and duties against all or some of the other (remaining) partners, he will have to file a suit against the respective partners in their personal capacity, and not against the firm, as it (firm) is considered in law to be non-existent and, therefore, a non-entity.

30.5 Persons Sharing Profit not Necessarily Partners (Section 6)

We may, however, reiterate here that just because a person is being given a portion of the profit earned in the business of the partnership firm, in itself, does not necessarily make him a partner of such firm. Let us understand the point more clearly with the help of an illustrative example.

Example

A partnership firm was getting the supplies of its raw materials from several suppliers on credit. But, as the firm was facing some financial problems, its dues to them (its suppliers of raw materials) had accumulated to a substantial amount over a period of time. Thereupon, an agreement was reached between the partnership firm and its various suppliers (creditors) to the effect that the firm will pay its dues to its creditors out of the profit it would earn from time to time. It was further agreed upon that the firm's business will now be run under the supervision of the creditors. Under the aforementioned arrangement, the various creditors of the firm will not be deemed to be the partners of the firm in any manner, despite the fact that they were being paid their dues by the firm out of its profits. Such contention is based on the judgement delivered by the House of Lords in the case titled **Cox vs Hickman (1860) 8 HLC, 268**.

In a similar vein (manner), **Section 6** also stipulates that the following persons will not be deemed to be the partners of the firm, just because they are paid out of the profit earned by the firm:

(a) The creditors, who supply goods to the firm on credit, or the bankers, who lend money to the firm to carry on (or to commence) its business, who are paid out of the profit earned by the firm;
(b) The employees, officers, servants, or agents, who receive their remunerations by way of a share in the firm's profit;
(c) The widow or child of a deceased partner; who is paid as an annuity, out of the profit earned by the firm; and
(d) The previous owner or part-owner of the firm's business, who is paid out of the profit earned by the firm, in consideration of the sale of goodwill or share thereof, to the firm.

This is so because the aforementioned persons [mentioned in (a) to (d) above] do not have any say in the management and control of the partnership, and, thus, the element of agency is missing in such cases. Moreover, as was held in the case titled **Cox vs Hickman**, cited earlier, the true test of partnership is not the sharing of profit but the presence of the element of agency.

Thus, **Section 6** has amply clarified that none of the persons will be deemed to be the partners of the firm, just because they are being paid out of the profit earned by the firm. We may, therefore, fairly conclude that though the sharing of profit in the business of the partnership firm is one of the most essential elements, which must be present to call a group of persons as partnership, this alone is not an exhaustive and conclusive proof

to pass such group as a partnership. Alternatively speaking, we may say that, in addition to the element of profit-sharing, the various other essential ingredients of a partnership (as discussed in Section 30.2 above) must also be present, to enable us to consider such group of persons as a partnership. Conversely speaking, if even a single essential ingredient of a partnership will be found to be missing, such group of persons will fail the test of partnership; that is, it cannot be declared as a partnership.

It will augur well if we will provide the summary of the various essential ingredients of a partnership (as shown in **Figure 30.1**), at one place, which must be present together, so as to pass the group of persons as a partnership, failing which it will not be considered as a partnership.

(a) Partnership is an association of two or more persons;
(b) Partnership must emerge out of an agreement between two or more persons;
(c) Partnership agreement must be to carry on some business;
(d) Partnership agreement must be to share the profit of the business;
(e) Partnership business may be carried out by all the partners or by any of them acting for all.
(f) Partners as 'agents' or 'principal' of other partners, in different situations

Figure 30.1 Essential Ingredients of a Partnership

30.6 Partnership vs Some Similar Organisations

30.6.1 Partnership vs Hindu Undivided Family (HUF) Business

As already discussed in Section 30.2.2 (iv), a Hindu Undivided Family (HUF) business concern, which carries on the family business (inherited from the ancestors), by the members of the Joint Hindu Family cannot be deemed to be a partnership. This is so because, while a partnership must necessarily emerge out of an agreement, a Hindu Undivided Family business venture generally does not emerge out of an agreement between the members of the Joint Hindu Family, but by virtue of their status, i.e. by way of its members being born in that family (**Section 5**). However, the members of a Joint Hindu Family may also constitute a partnership, but by way of entering into a separate specific agreement for carrying on the business as a partnership firm, and not as a Joint Hindu Family venture.

The main distinguishing features of a 'Partnership' and a 'Hindu Undivided Family (HUF) Business have been presented in **Table 30.1.**

Table 30.1 *Distinguishing Features of Partnership and Hindu Undivided Family (HUF) Business*

Partnership	*Hindu Undivided Family (HUF) Business*
(i) It arises out of a contract among two or more persons.	(i) It does not arise out of any contract. It, instead, arises out of the status, i.e. by virtue of being born in the same family, and thereby inheriting the family business.But the members of a HUF can constitute a partnership by way of entering into a separate contract to this effect.
(ii) Here, a new partner may be admitted to the partnership only with the unanimous consent of all the existing members of the partnership.	(ii) Here, a male child (and not a female child) becomes a member of the HUF business, automatically, right from his birth in the family.
(iii) Here, a female member can also join a partnership firm as its full-fledged partner, just like the male partners.	(iii) Here, a female member of the family cannot become a member of the HUF business.

(*Contd.*)

(*Contd.*)

(iv) Here, a minor cannot become a partner in a new partnership firm, at the time of its constitution. He or she may, however, be admitted into an already existing partnership firm, but only to its benefits, and not for any losses incurred by the firm.	(iv) Here, all the male minor members of the family, including a baby boy right from his birth, automatically become members of the HUF business.
(v) Here, a partnership firm automatically gets dissolved, immediately on the death of any of its partners, unless otherwise agreed upon among its members.	(v) Here, the HUF firm does not get dissolved, and remains unaffected, even after the death of any of its members.
(vi) Here, each and every partner of the firm mutually performs the role of an agent of the other partners, and thereby all his acts bind the firm itself.That is, here the arrangement of a mutual agency operates amongst the partners.	(vi) Here, the *'Karta'* of the HUF firm alone is authorised to enter into any agreement on behalf of the HUF firm, so as to bind it by his acts. Conversely speaking, none of the members of the HUF (known as coparceners), other than the *'Karta'* of the HUF firm, are authorised to do so. That is, here the arrangement of a mutual agency does not operate amongst the members of the HUF firm.
(vii) Here, the liability of each and every partner of the firm is unlimited. That is, the own personal assets of the partners are also liable for the settlement of the debt of the partnership.	(vii) Here, the liability of the *'Karta'* of the HUF firm alone is unlimited. Conversely speaking, the liabilities of the other members of the HUF firm are limited only to the extent of their share in the profit of the business of the HUF firm. But then, if the other member of the HUF firm had also taken part in any specific act or transaction, together with the *'Karta'* of the HUF firm, they will also be held liable thereto.

30.6.2 Partnership vs Co-ownership

Co-ownership or joint ownership arises where a particular property, like a house, is owned by two or more persons jointly. Thus, they may let out the house on rent, and may agree to share the monthly rent (profit) in proportion to their investment in the house. But then, such arrangement between them will not constitute a partnership. This is so, because the element of agency (i.e. the representation of one co-owner by another) is missing in such arrangement. And, the true test of partnership is not the sharing of profit but the presence of the element of agency (**Cox vs Hickman**, cited earlier). Thus, it remains only the case of a co-ownership, and not that of a partnership.

Similarly, Mohan, Rohan, and Sohan may inherit a house after the death of their father. They are thus, co-owners of the house property, but not out of any contract but by way of status, that is, by virtue of being born as brothers in the same family.

The main distinguishing features of a 'Partnership' and a 'Co-Ownership' have been presented in **Table 30.2**.

Table 30.2 *Distinguishing Features of Partnership and Co-ownership*

Partnership	*Co-ownership*
(i) Here, it arises out of contract among two or more persons.	(i) Here, it may, or even may not, arise out of contract among two or more persons. That is, in the case of inheritance of a property, it arises out of status, i.e. of being born in the same family.
(ii) It invariably carries on some business.	(ii) It may, or even may not, carry on some business.

(*Contd.*)

(*Contd.*)

(iii) Here, the element of sharing of profit and losses is invariably present.	(iii) Here, the element of sharing of profit and losses may, or even may not, be present. This is so because, it may exist even without carrying out any business.
(iv) Here, every partner operates as an agent on behalf of the other partner(s).	(iv) Here, no co-owner operates as an agent on behalf of the other co-owner(s).
(v) Here, no partner can transfer his interest in the firm to any third party, without the consent of the remaining partner(s).	(v) Here, every co-owner can transfer his interest in the property to any third party, without the consent of any of the remaining co-owner(s).
(vi) A partner can claim a share in the surplus assets of the firm, but he cannot claim any share in the properties of the firm *in specie.*	(vi) A co-owner can even claim division of the joint property *in specie.*

30.6.3 Partnership vs Club

Unlike a partnership, a club is an association of persons, who join together, not for carrying on any gainful business for earning any profit, but with the objective of promotion of some beneficial or social services, like promotion of health, literacy, women's rights, providing some recreational facilities to its members, and so on. Further, while the liability of each and every partner of the firm is unlimited, a member of the club is not liable to the creditors of the club, except to the extent of his being a party to a particular contract, which gave rise to such liability **[In re St. James's Club (1862), 2 De G. Mac. 6, 383].**

The main distinguishing features of a 'Partnership' and a 'Club' have been presented in **Table 30.3**.

Table 30.3 *Distinguishing Features of Partnership and Club*

Partnership	*Club*
(i) A partnership firm invariably carries out some business.	(i) A club is formed, not for carrying on any gainful business for earning any profit, but with the objective of promotion of some beneficial or social services.
(ii) Here, the element of sharing of profit and losses is invariably present.	(ii) As a club usually does not carry on any gainful business, the element of sharing of profit and losses is invariably absent.
(iii) Here, the liability of each and every partner of the firm is unlimited. That is, the own personal assets of the partners are also liable for the settlement of the debt of the partnership.	(iii) Here, no member of the club is liable to the creditors of the club, except to the extent of his being a party to a particular contract, which gave rise to such liability to the club.

30.6.4 Partnership vs Company

As against a partnership firm, a company is a separate legal entity, distinct from its shareholders (**Solomon vs Soloman & Co. Ltd**). Further, the shareholders of a company do not act as an agent to the other shareholders. Moreover, the liabilities of the shareholders of a limited (liability) company are limited to the extent of their own holding of the shares in the company, or to the extent of the amount which remains unpaid on the holding of their own shares in the company, or to the extent of the amount of guarantee, as stated in the Memorandum of Association of the company. However, in the case of an unlimited (liability) company, the liabilities of its shareholders are unlimited, i.e. not confined only upto the aforementioned extent. This is mainly for this very reason that the unlimited liability companies have now become rather extinct.

Further, a shareholder can freely transfer his own shares in favour of any other person, in the stock exchanges through a broker, or even privately to his relatives or friends, and so on. But such transfer will be subject to

the restrictions specified in the Article of Association of the company concerned. Here, it must be stated that the shares of a private limited company cannot be transferred without a specific approval of the remaining shareholders thereof. Furthermore, the company does not necessarily get dissolved with the death of any of its members or shareholders, nor in the event of any of its members or shareholders retiring or being declared insolvent. This is so because, a company is a separate legal entity, distinct from its shareholders. Moreover, in the case of a private company, the number of its shareholders must be minimum 2 and maximum 50. In the case of a public company, however, while the minimum number of its shareholders has been specified to be minimum 7, there is no maximum limit prescribed by the Indian Companies Act, 1956, in the case of a public company. That is, a public company can afford to have its shareholder upto an unlimited extent. As regards the audit of the accounts of a company, it is a statutory obligation on the part of a company to gets its account audited at least annually, by a certified Chartered Account, or by a team of certified Chartered Accounts. Besides, the companies are also required to publish, in some daily newspapers of repute, their unaudited Balance Sheets at quarterly intervals (earlier it was at half-yearly intervals). Besides, all the companies are compulsorily required to get themselves registered with the Registrar of Company of the State where their head office happens to be located.

The main distinguishing features of a 'Partnership' and a 'Company' have been presented in **Table 30.4**.

Table 30.4 *Distinguishing Features of Partnership and Company*

Partnership	*Company*
(i) A partnership firm does not have any legal significance or existence, in its own right, other than the persons constituting it jointly.	(i) A company is a separate legal entity, distinct from its shareholders.
(ii) Here, every partner operates as an agent on behalf of the other partner(s).	(ii) Here, no member or shareholder of the company operates as an agent on behalf of the other members or shareholders of the company.
(iii) Here, the liability of each and every partner of the firm is unlimited. That is, the own personal assets of the partners are also liable for the settlement of the debt of the partnership.	(iii) Here, the liabilities of the shareholders of a limited (liability) company are limited to the extent of their own holding of the shares in the company, or to the extent of the amount which remains unpaid on the holding of their own shares in the company, or to the extent of the amount of guarantee, as stated in the Memorandum of Association of the company.
(iv) Here, no partner can transfer his interest in the firm to any third party, without the consent of the remaining partner(s).	(iv) Here, a shareholder can freely transfer his own shares in favour of any other person. But such transfer will be subject to the restrictions specified in the Article of Association of the company concerned. The shares of a private limited company, however, cannot be transferred without a specific approval of the remaining shareholders thereof.
(v) Here, a partnership firm automatically gets dissolved, immediately on the death, retirement, or insolvency of any of its partners, unless otherwise agreed upon among its members.	(v) Here, the company does not necessarily get dissolved with the death of any of its members or shareholders, or in the event of any of its members, or shareholders retiring or being declared insolvent.
(vi) A partnership firm can be constituted with a minimum number of its partners as 2.	(vi) **(a)** A private company can be constituted with a minimum number of its shareholders as 2. **(b)** A public company can be constituted with a minimum number of its shareholders as 7.

(*Contd.*)

(*Contd.*)

(vii) There can be maximum 10 persons in a partnership firm carrying on the business of banking, and maximum 20 persons in the other cases.	(vii) **(a)** A private company can have the maximum number of its shareholders as 50. **(b)** A public company, however, has no limit (ceiling) on the number of its shareholders.
(viii) It is not a statutory obligation on the part of a partnership firm to gets its account audited at least annually, by certified Chartered Account(s).	(viii) It is a statutory obligation on the part of a company to gets its account audited at least annually, by certified Chartered Account(s). Besides, the companies are also required to publish, in some daily newspapers of repute, their unaudited Balance Sheets at quarterly intervals (earlier it was at half-yearly intervals).
(ix) Registration of a partnership firm is optional, and not compulsory. However, non - registration of a partnership firm involves certain disadvantages.	(ix) All the companies are compulsorily required to get themselves registered with the Registrar of Company of the State where their head office happens to be located.

Let us Recapitulate

Section 4 of the Act defines a partnership as 'the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all'.

Essential Ingredients of a Partnership

(a) It is an association of two or more persons.

(b) **(i)** As it must emerge out of an agreement (**Section 5**), there must be at least two persons involved.

(ii) A minor cannot become a partner in a new partnership firm, at the time of its constitution, because, he is not considered to be competent to enter into a valid contract, including the contract of partnership.

(iii) Partnership for a fixed period or for a particular project, i.e. 'Particular Partnership'
A partnership agreement may be entered into for a fixed period or for executing a particular project, adventure or job, in which case it is known as a 'Particular Partnership' (**Section 8**).

(iv) Furthermore, as a partnership must necessarily emerge out of an agreement, a Hindu Undivided Family (HUF) business concern, which carries on the family business (inherited from the ancestors), by the members of the Joint Hindu Family (known as coparceners), cannot be deemed to be a partnership, because it generally does not emerge out of an agreement between the coparceners but by virtue of their status, i.e. by way of their being born in that family.

(c) Partnership agreement must be to carry on some business, like trade, occupation or profession **[Section 2, Clause (b)],** and that too, for earning some profit as also for sharing it (profit).

(d) While sharing of the profit of the business (in equal proportion or in the specified percentage of the profit), is compulsory, the sharing of loss of the business among the partners is just optional, and thus, it does not adversely affect the constitution of a partnership.

(e) Partnership business may be carried out by all the partners or by any of them acting for all. They are known as 'active partners' and the non-active partners are known as 'sleeping (dormant) partners'.

(f) Partners act as 'agent' or 'principal' of other partners, in different situations. This way, each partner binds all the remaining partners by his own act, as the agent binds his principal by his own actions.

The terms, 'Partners', 'Firm', and 'Name of the Firm' Defined

Two or more persons, involved in the agreement of partnership, in their respective individual capacity, are referred to as partners. Further, these persons collectively constitute a partnership. And the name, under which a partnership firm carries on its business, is referred to as its (partnership firm's) name.

Further, a partnership has no legal significance or existence. The term 'partnership firm' is just a convenient and generally used term in the context of two or more persons constituting a 'partnership firm'. As against partnership firm, a joint stock company is a legal entity. However, all the persons sharing the firm's profit are not necessarily its partners **(Section 6).**

For example, the following persons will not be deemed to be the partners of the firm, just because they are paid out of the profit earned by the firm:

(a) The creditors, who supply goods to the firm on credit, or the bankers, who lend money to the firm to carry on (or to commence) its business, who are paid out of the profit earned by the firm;
(b) The employees, officers, servants or agents, who receive their remunerations by way of a share in the firm's profit;
(c) The widow or child of a deceased partner; who is paid as an annuity, out of the profit earned by the firm; and
(d) The previous owner or part-owner of the firm's business, who is paid out of the profit earned by the firm, in consideration of the sale of goodwill or share thereof to the firm.

Main Features on which Some Similar Organisations Differ from Partnership

(a) Hindu Undivided Family (HUF) Business (**Section** *5*)

(i) A Hindu Undivided Family (HUF) business concern, cannot be deemed to be a partnership, because, a HUF business venture does not emerge out of an agreement between the members of the Joint Hindu Family, but by virtue of their status, i.e. by way of its members being born in that family.
(ii) All the male minor members of the family, including a baby boy right from his birth, automatically become members of the HUF business.
(iii) Thus, all the male minor members of the family, including a baby boy right from his birth, automatically become members of the HUF business.
(iv) But, a female child, born in the same family, cannot become a member of the HUF business.
(v) HUF firm does not get dissolved, and remains unaffected, even after the death of any of its members.
(vi) Here, usually only the *'Karta'* of the HUF firm is authorised to enter into any agreement on behalf of the HUF firm, so as to bind it by his acts. That is, here the arrangement of a mutual agency does not operate amongst the members of the HUF firm.
(vii) Here, the liability of the *'Karta'* of the HUF firm alone is unlimited. That is, the liabilities of the other members of the HUF firm are limited only to the extent of their share in the profit of the business of the HUF firm.

(b) Co-ownership or Joint ownership

(i) Co-ownership or joint ownership of a particular property, like a house property, though arising out of a contract between two or more persons, cannot constitute a partnership, because the element of agency (i.e. the representation of one co-owner by another) is missing in such arrangement.
(ii) Similarly, two or more real brothers may inherit a house after the death of their father. They are thus, co-owners of the house property, but not out of any contract but by way of status, that is, by virtue of being born as brothers in the same family.
(iii) Here, the joint owners and co-owners may, or even may not, carry on some business. Accordingly, the element of sharing of profit and losses may, or even may not, be present in such cases.
(iv) Here, no co-owner or joint owners can operate as an agent on behalf of the other co-owner(s).or joint owner(s).
(v) Here, every co-owner or joint owners can transfer his interest in the property to any third party, without the consent of any of the remaining co-owner(s) or joint owner(s).

A co-owner can even claim division of the joint property *in specie.*

(c) Club

(i) A club is an association of persons, who join together, not for carrying on any gainful business for earning any profit, but with the objective of promotion of some beneficial or social services.

(ii) Further, a member of the club is not liable to the creditors of the club, except to the extent of his being a party to a particular contract, which gave rise to such liability.

(d) Joint Stock Company

(i) A company is a separate legal entity, distinct from its shareholders.

(ii) The shareholders of a company do not act as agent to the other shareholders.

(iii) The liabilities of the shareholders of a limited (liability) company are limited to the extent of their own holding of the shares in the company, or to the extent of the amount which remains unpaid on the holding of their own shares in the company, or to the extent of the amount of guarantee, as stated in the Memorandum of Association of the company.

(iv) A shareholder can freely transfer his own shares in favour of any other person, in the stock exchanges through a broker, or even privately to his relatives or friends, and so on. But such transfer will be subject to the restrictions specified in the Article of Association of the company concerned.

(v) A company does not necessarily get dissolved with the death of any of its members or shareholders, nor in the event of any of its members or shareholders retiring or being declared insolvent, because, a company is a separate legal entity, distinct from its shareholders.

(vi) (a) A private company can be constituted with a minimum number of its shareholders as 2.
(b) A public company can be constituted with a minimum number of its shareholders as 7.

(vii) (a) A private company can have the maximum number of its shareholders as 50.
(b) A public company, however, has no limit (ceiling) on the number of its shareholders.

(viii) It is a statutory obligation on the part of a company to gets its account audited at least annually, by a certified Chartered Account, or by a team of certified Chartered Accounts. Besides, the companies are also required to publish, in some daily newspapers of repute, their unaudited Balance Sheets at quarterly intervals (earlier it was at half-yearly intervals).

(ix) All the companies are compulsorily required to get themselves registered with the Registrar of Company of the State where their head office happens to be located.

Questions for Reflection

1. (a) Define a 'Partnership', quoting the number of the Section of the Indian Partnership Act that defines it.
   (b) Analyse the various clauses contained in the respective Section of the Indian Partnership Act that defines a 'Partnership'.
2. (a) Can a partnership be formed by one single person? Give reasons for your answer.
   (b) What is the maximum number of persons fixed for constituting a legal partnership firm in the following case?
      (i) A firm carrying on the business of banking, and
      (ii) A firm carrying on a non-banking business.
3. (a) Can a minor become a partner in a new partnership firm, at the time of its constitution?
   (b) Can a minor be admitted into an already existing partnership firm? If so, will he share its benefits, as also its losses?

   Give reasons for your answer in each case.
4. What is a 'Particular Partnership'? Explain with the help of suitable illustrative examples.
5. Can a Hindu Undivided Family (HUF) business venture be called a partnership? Give reasons for your answer.

6. Can a charitable society, a religious association, or a club, established by two or more persons, with the objectives other than carrying on some business for profit, be deemed to be partnerships under the Indian Partnership Act? Give reasons for your answer.
7. Do you think that the absence of the provisions in the partnership agreement regarding the sharing of the profit as also the losses of the business will have the adverse effect of nullifying the partnership itself?
   Give reasons for your answer.
8. What do you understand by the terms 'Active Partners' and 'Sleeping (Dormant) Partners'?
   Explain with the help of suitable illustrative examples in each case..
9. 'Each and every partner of a partnership firm assumes the two respective and different roles (viz. the role of an agent and the role of a principal), in two different circumstances'. Explain, by citing suitable illustrative examples in each case.
10. (a) Explain the terms 'Partners', 'Firm', and 'Name of the Firm'.
    Explain with the help of suitable illustrative examples in each case.
    (b) What are the various restrictions that must be taken care of while selecting the name of a partnership firm?
11. 'The presence of the element of 'sharing of the profit of the business of a partnership firm' is one of the most essential ingredients of a partnership. Therefore, all the persons, sharing the profit of the business of a partnership firm, are necessarily its partners.' Do you agree with the above statement?
    Give reasons for your answer.
12. 'Like a joint stock company, a partnership firm is also a legal entity.' Do you agree?
    Give reasons for your answer. Also cite suitable illustrative examples to elucidate your points.
13. Will the following persons be deemed to be the partners of the firm?
    Give reasons for your answer in each case.
    (i) The creditors, who supply goods to the firm on credit, who are paid out of the profit of the firm;
    (ii) The employees, officers, servants or agents, who receive their remunerations by way of a share in the firm's profit;
    (iii) The bankers, who lend money to the firm to carry on (or to commence) its business, who are paid out of the profit earned by the firm;
    (iv) The widow or child of a deceased partner; who is paid as an annuity, out of the profit earned by the firm; and
    (v) The previous owner or part-owner of the firm's business, who is paid out of the profit earned by the firm, in consideration of the sale of goodwill or share thereof, to the firm.
14. What are the main distinguishing features that exist between the following?
    (i) 'Partnership' and 'Hindu Undivided Family (HUF) Business';
    (ii) 'Partnership' and 'Co-ownership';
    (iii) 'Partnership' and 'Club'; and
    (iv) 'Partnership' and 'Company'.

Problems for Practice (With Suggested Solutions)

Problem 1

A partnership, named 'Modern Garments' has been constituted with the following persons as its partners:

(i) Harsh, aged 55 years;
(ii) Behari, aged 51 years;
(iii) Purushottam, aged 15 years;

(iv) Hanuman, aged 21 years; and
(v) Narayan, aged 17 years.

Can this firm be regarded as a legal firm? Give reasons for your answer.

Solution

No, this firm cannot be regarded as a legal partnership, because Purushottam, aged 15 years, and Narayan, aged 17 years are minors, and accordingly, they are not considered competent to enter into a contract, including a contract of partnership, as per **Section 11 of the Indian Contract Act**. This is so because, the partnership is a product of an agreement, and accordingly, only the persons competent to enter into a contract (i.e. only major persons) can constitute a partnership.

However, both of them may be admitted into an already existing partnership firm, with consent of all the partners, and that too, only to the benefits, and not for any losses incurred by the firm.

Problem 2

Ram and Shyam, Chartered Accountants, have entered into an agreement of partnership on 18th September 2008, to jointly conduct and complete the annual statutory audit of a company. The audit was completed by them and the final report had been submitted to the management of the company on 29th November 2008. What shall be the legal standing of this partnership thereafter? Give reasons for your answer.

Solution

As in the instant case, the partnership agreement had been entered into between the two auditors, Ram and Shyam, for the specific purpose of executing a particular job, i.e. to jointly conduct and complete the annual statutory audit of a company; this partnership is in the nature of a 'Particular Partnership' (**Section 8**). Therefore, as a 'Particular Partnership' usually automatically gets dissolved on completion of the specified project, this partnership will also get automatically dissolved likewise.

Problem 3

Can the following persons be deemed to be the members of a Join Hindu Family business?

(i) Gautam, aged 75 years (male);
(ii) Basanti, aged 31 years (female);
(iii) Purushottam, aged 10 years (male);
(iv) Shobha, aged 2 years (female);
(v) Narayan, aged one month (male); and
(vi) Parmeshwar, the just born son of Basanti, aged 31 years (female), mentioned at number (ii) above.;

Give reasons for your answer.

Solution

As per the Partnership Act, only the male members of a Hindu Undivided Family (HUF), including even a baby boy right from his birth, automatically become members of the HUF business, and any of the female member of the family (major or minor), cannot become a member of the HUF business. Therefore, Basanti, aged 31 years (female major), and Shobha, aged 2 years (female minor), cannot be deemed to be the members of the HUF business–only the sex of the persons (females in the instant case) and not their age being material in such cases. Conversely speaking, Gautam, aged 75 years (male major), Purushottam, aged 10 years (male minor), Narayan, aged one month (male minor) and Parmeshwar, the just-born baby boy (male minor) born to Basanti of the same HUF, will be deemed to be the members of the HUF business–only the sex of the persons (males in the instant case) and not their age being of essence in such cases.

Problem 4

Will the following persons be deemed to be the partners of the firm, on the ground that they are paid out of the profit earned by the firm?

(a) The creditors, who supply goods to the firm on credit, or the bankers, who lend money to the firm to carry on (or to commence) its business, who are paid out of the profit earned by the firm;

(b) The employees, officers, servants, or agents, who receive their remunerations by way of a share in the firm's profit;
(c) The widow or child of a deceased partner; who is paid as an annuity, out of the profit earned by the firm; and
(d) The previous owner or part-owner of the firm's business, who is paid out of the profit earned by the firm, in consideration of the sale of goodwill or share thereof, to the firm.

Give reasons for your answer.

Solution

None of the persons, mentioned in the question from items (a) to (d) will be deemed to be the partners of the firm, on the ground that they are paid out of the profit earned by the firm. This is so because, the persons of such categories have been specifically denied of their right to become partners of the firm, just on the ground that they are paid out of the profit earned by the firm, **under Section 6**.

Problem *5*

Fancy Furniture, a partnership firm, was getting the supplies of its finished goods from Saharanpur from several suppliers on credit. But, after some time, the firm started facing some financial problems, and thereby its dues to its suppliers had accumulated to a substantial amount over a period of time. Thereupon, an agreement was reached between the partnership firm and its various suppliers (creditors) to the effect that the firm will pay its dues to its creditors out of the profit it would earn from time to time. It was further agreed upon that the firm's business from now onwards will be run under the supervision of the creditors, till such time all their dues were fully paid.

Do you think that, under the aforementioned arrangement, the various creditors of the firm will now be deemed to be the partners of the firm on the ground that they were being paid their dues by the firm out of its profits. Give reasons for your answer.

Solution

Under the aforementioned arrangement, the various creditors of the firm will not be deemed to be the partners of the firm in any manner, despite the fact that they were now being paid their dues by the firm out of its profits. This is so because, **Section 6** has amply clarified that, though the sharing of profit in the business of the partnership firm happens to be one of the most essential elements in any partnership firm, none of the persons will be deemed to be the partners of the firm, just because they are being paid out of the profit earned by the firm. That is, in addition to the element of profit-sharing, the various other essential ingredients of a partnership must also be present, to consider such group of persons as a partnership. Such contention is based on the judgement delivered by the House of Lords in the case titled **Cox vs Hickman (1860) 8 HLC, 268**.

Problem 6

Ashish, Ashwin, and Akash are partners in a firm named 'Three Aces'. Ashish, without the knowledge or consent of Ashwin and Akash, the other two partners in the firm, had borrowed a sum of Rs 1,50,000 from Kishore, one of the customers of the firm, in the name of the firm. Thereafter, Ashish had purchased some ornaments for his wife out of such borrowed amount. On coming to know of the aforementioned fact, Ashwin and Akash had taken the plea that the amount of the loan must be paid by Ashish only, because the loan amount had been used by him for his personal use, and not for the purpose of the firm. Do you think that the contention of Ashwin and Akash are justified in the eye of law? Give reasons for your answer.

Solution

No; the contention of Ashwin and Akash are not justified in the eye of law. This is so because each partner of a firm also acts as an agent of other partners. This way, each partner has the implied right to legally bind all the remaining partners by his own act, as an agent can bind his principal by his own actions.

Further, **Sections 19 and 22** have laid down that, unless provided to the contrary in the partnership deed, every partner has the implied authority to bind every other partner for his act done in the name of the firm, provided such act falls within the ordinary course of business of the firm, and is done in a usual manner.

Accordingly, if the aforementioned conditions are fulfilled in the given case, Ashwin and Akash will also be held liable, along with Ashish, to repay the amount of the loan taken by Ashish in the name of the firm.

Chapter Thirty One

Essential Elements of Partnership

"*Friendship is essentially a partnership.*
Aristotle

Every business is built on friendship.
James Cash Penny

Treat employees like partners, and they act like partners.
Fred A. Allen

Treat your customers like lifetime partners.
Michael LeBoeuf

The poor man who enters into a partnership with one who is rich makes a risky venture.
Titus Maccius Plautus

We have to distrust each other. It is our only defence against betrayal.
Tennessee William"

31.1 Illegal Partnership

A partnership will be considered as illegal under the following two conditions:

(a) In the cases where the number of its partners exceeds the maximum limit prescribed under **Section 11 of the Indian Companies Act 1956**. That is, where there are more than 10 persons in a partnership firm carrying on the business of banking, and more than 20 persons in the other cases, such partnership firm will be considered as illegal.

Such partnership firms (constituted for the purpose of carrying on the respective banking or non-banking business, with the objective of earning some profit), can, however, be regularised and legalised

only if they get them registered under the Indian Companies Act, 1956, or under any other law. Under the Indian Companies Act, 1956, they are required to be registered with the Registrar of Companies, established in the State where the head office of the partnership firm is located.

(b) Further, a partnership firm is also considered to be illegal, if it is constituted for carrying on some illegal business, like for carrying on the business of manufacturing illicit liquor, long knives, guns, bombs, or for carrying on a gambling den, and so on.

Such illegal partnership firm can, however, be sued against [**Bhahmaya vs Hamiah, 43, Mad.141**]. But then, any person, who enters into a contract with such partnership firm, with the full knowledge of its illegal nature, cannot file a suit pertaining to such contract. This is so because, as per **Section 24 of the Indian Contract Act**, any contract entered into with any unlawful consideration and/or unlawful object, is considered to be void and thus, unenforceable in law.

31.2 Partnership-at-Will

As provided under **Section 7**, a partnership is referred to as a 'Partnership-at-Will', under the following two conditions:

(a) In the cases where the partnership is not constituted for a fixed period of time; and
(b) In the cases where no specific provision has been made in the Partnership Deed to the effect as to when and how will the partnership firm come to an end. Thus, a 'Partnership-at-Will' can be dissolved at any time, if any of the partners of the firm will give a notice, expressing his willingness to wind up the firm.

31.3 Particular Partnership

A partnership agreement may be entered into for a fixed period or for executing a particular project, adventure or job. Further, as provided under **Section 8,** a partnership agreement, entered into just for executing a particular project, adventure or job, is known as a 'Particular Partnership'. Accordingly, a 'Particular Partnership' is usually automatically dissolved on completion of the specified project, adventure or job. For example, a team of two or more auditors, engaged in the audit of the accounts of a particular company, may be regarded as partners in that particular audit, as was held in the case titled **Robinson vs Anderson.** And, once this particular audit is over, and the final audit report is duly submitted to the management of the company, this partnership will automatically get dissolved.

31.4 Registered Partnership Firm

A 'Registered Partnership Firm' is one which is duly registered with the Registrar of Firms, in accordance with the procedure laid down under **Section 58.**

31.4.1 Procedure for Registration of Partnership Firm

As provided under **Section 58**, the following procedure is required to be followed for the registration of a partnership firm:

(a) A partnership firm must be registered, any time, with the Registrar of Firms of the area where the business of the firm is situated, or is proposed to be situated.
(b) A detailed statement must be sent to the Registrar of Firms of the respective area on a form, prescribed for the purpose, along with the amount of the fee, prescribed for registration.
(c) The prescribed form contains, *inter alia*, the following particulars pertaining to the firm:
    (i) The name of the firm;

(ii) The place or the principal place of business of the firm;
(iii) The name(s) of any other place(s) where the firm carries on its business;
(iv) The date(s) on which each partner has joined the firm;
(v) The names in full, as also the complete address of each partner; and
(vi) The duration of the firm.

(d) This statement must be signed by all the partners personally, or by their agents on their behalf, specifically authorised for the purpose.
(e) All such signatures (i.e. of the partners or of their agents), must be verified as well.
(f) Such statement may be sent by post or may be delivered personally to the Registrar of Firms concerned.
(g) When any alteration is made in the name of the firm, and/or in the name of the place where its principal business is located, the Registrar of Firms concerned must be suitably informed accordingly (**Section 60**).

31.4.2 Entry in the 'Register of Firms'

On being fully satisfied to the effect that all the provisions, laid down in **Section 58,** have been duly complied with by the firm, the Registrar of Firms will register the firm in his records, by making an entry of the statement in the register, known as the 'Register of Firms'. He will, thus, file the statement. (**Section 59**).

31.4.3 Recording of Alteration(s) in the Firm's Name and its Principal Place of Business (Section 60)

Whenever any alteration takes place in the name of the firm, or in the principal place of business of the firm, such information must be sent to the Registrar of Firms, for his records.

31.5 Unregistered Partnership Firm

As against a 'Registered Partnership Firm', an 'Unregistered Partnership Firm' is the one which is not duly registered with the Registrar of Firms. Here, we may mention that, while a large number of registered partnership firms are carrying on their the business, there are some unregistered partnership firms also, who are operating, side by side, without their registration with the Registrar of Firms.

This is so because, it is not compulsory on the part of the partnership firms, to get them registered with the Registrar of Firms. That is, the registration of a firm is only optional. Thus, a firm may like to get registered or not to get registered with the Registrar of Firms, at its own sweet will. But then, all the partnership firms will be well advised to get them registered with the Registrar of Firms, because non-registration of the firms involves several avoidable business risks.

31.6 Disadvantages of Non-Registration of Firms

Section 69 has stipulated the following adverse consequences of non-registration of a partnership firm:

(a) Any of the partners of an unregistered partnership firm cannot file a suit against the firm or against any of the other partners of the firm for enforcing his rights in the following cases:
   (i) For enforcing his rights arising out of the contract of partnership'; and
   (ii) For enforcing his rights conferred under the Partnership Act.

   Accordingly, in case a partner of an unregistered partnership has not been paid his rightful share in the profit of the firm, he cannot claim it by filing a suit in the Court of law.

(b) Further, even an unregistered partnership firm itself cannot file a suit against any third party so as to enforce its rights arising out of the contract entered into with such third party.

Thus, an unregistered partnership firm cannot file a suit against any third party for recovery of its dues outstanding against the supply of goods on credit to him. Such a situation will be to a great disadvantage, and substantial financial losses connected therewith, to any unregistered partnership firm, in view of the fact that, in the buyers' market (which is mostly the case), a major portion of the sale of goods are effected on credit basis, as against a very small percentage of sales against cash payments. Accordingly, all or most of the unscrupulous parties, who get their supplies from an unregistered partnership firm on credit, may usually refuse to make the payment to the firm, if they happen to come to know that the supplier firm is an unregistered partnership firm.

(c) Further, even the 'right of set-off' is not available to an unregistered partnership firm.

Let us now explain what is meant by the term 'right of set-off', with the help of an illustrative example.

Example

Kohinoor & Brothers, an unregistered partnership firm, had supplied certain goods worth Rs 60,000 to Rahman on credit. Later, Kohinoor & Brothers had borrowed a sum of Rs 75,000 from Rahman. This being the final position of accounts, Kohinoor & Brothers had proposed to Rahman to finally settle the accounts between them by accepting the balance amount of Rs 15,000, which is the net amount payable by Kohinoor & Brothers to Rahman after deducting the amount of goods supplied to Rahman on credit (i.e.Rs 75,000 less Rs 60,000 = Rs 15,000).

In case Kohinoor & Brothers had been a registered partnership firm, instead, it could have legally forced Rahman to accept the payment of Rs 15,000 in final settlement of the accounts between them. Such right is called the right of set-off. But then, because Kohinoor & Brothers happened to be an unregistered partnership firm, it cannot exercise the aforementioned right of set-off, and force Rahman to settle the issue in the manner suggested by it (firm).

31.7 What Rights of an Unregistered Partnership Firm are Not Affected?

All the rights of an unregistered partnership firm will, however, remain intact and unaffected in the following conditions / circumstances:

(i) As we have observed earlier, an unregistered partnership firm is deprived of enforcing any of its rights, which arise out of any contract entered into between the firm and the third party. Conversely speaking, all the rights of an unregistered partnership firm, which do not arise out of any contract, but in some other manner, will remain intact and unaffected.

For example, if some one will infringe upon the trademark of an unregistered partnership firm, its right to file a case against such party will remain intact and unaffected.

This is so because the trademark of the firm does not arise out of any contract.

(ii) Similarly, its right to file a suit for the dissolution of a firm, or its right to ask for the accounts of a dissolved firm, or its right or power to realise the property of a dissolved firm, will also remain intact and unaffected, as these rights do not arise out of any contract, either.

(iii) Further, powers of an Official Assignee or Receiver or Court, under the Presidency Towns Insolvency Act, or the Provincial Insolvency Act, to realise the property of an insolvent partner (of the unregistered partnership firm) also remain intact and unaffected.

(iv) Moreover, the rights of an unregistered partnership firm will also remain intact and unaffected, in the cases where it des not have any place of business in the territories to which the Indian Partnership Act extends (applies).

(v) Besides, its rights will also remain intact and unaffected in any suit or claim of set-off, not exceeding Rs 100 in value, provided the suit is of such a nature that it will have to be filed in the Small Causes Courts. In such cases, the proceedings, incidental to such suits, like the execution of the decree, are also allowed.

31.8 Partner by Holding out or by Estoppel

Like the different types of partnerships, there are various types of partners of the firm also, which we are going to discuss hereafter.

The principle of agency by estoppel has been extended in the case of partnership also, by way of the provisions of **Section 28 (1),** which stipulates as follows:

'Anyone who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm, whether the person represented to be a partner does or does not know that the representation has reached the person so giving credit.' Such partner is referred to as a 'partner by holding out', and is also called as a 'partner by estoppel'.

Examples

(i) Raghunandan had retired from the firm named R. K. Brothers. But he had not given the notice of his retirement. In the aforementioned circumstances, Raghunandan will still be deemed to be a 'partner by holding out' or a 'partner by estoppel', by his conduct, that is by not so far giving the notice of his retirement from the firm.

(ii) Amir induces Bhushan to believe that he (Amir) is a partner in the firm named Roshan & Sons. Bhushan, based on the belief that Amir is a partner in the firm named Roshan & Sons, gives credit to the firm. In the instant case, Amir will have to compensate Bhushan by virtue of being a 'partner by holding out', also referred to as a 'partner by estoppel'. Accordingly, Amir cannot be allowed to plead that, in fact, he was not a partner in the firm named Roshan & Sons.

On a closer analysis of the provisions made under **Section 28**, we may summarise that a person may be deemed to be a 'partner by holding out', also referred to as a 'partner by estoppel', only if the following conditions are satisfied:

(a) That he had represented himself, or had knowingly permitted himself to be represented, to be a partner of the firm;

(b) That such representation was made by him by words spoken (i.e.verbally) or in writing, or by his conduct; and

(c) That the other party had given the credit to the firm, based on the faith of such representation.

Here, we must carefully note that the liability, based on the principle of estoppel, covers only the amount of the credit so given to the firm, and it does not get extended to cover the liabilities pertaining to torts or civic wrongs, committed on behalf of the firm. This contention is based on the decision given in the case titled **Smith vs Bailey [2, Q. B. 423].**

We may further clarify that a 'partner by holding out' (also referred to as a 'partner by estoppel'), can be held liable only to the person who has given the credit to the firm, or he may have to make good the loss suffered by the creditor. But then, by his so doing, he does not acquire any claim on the firm.

31.9 Sleeping Partner, or Dormant Partner

Section 4 of the Act defines a partnership as 'the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all'. Accordingly, it is not necessary that all the partners must necessarily look after the business of the firm. Conversely speaking, one or some of the partners of the firm may prefer not actively participate in the management and control of the firm's business. Such partners (i.e.who do not take active part in the management and control of the firm's business), are known as the 'Sleeping Partners' (also referred to as the 'Dormant Partners') of the firm.

But then, by not taking any active part in the business of the firm, they do not, in any way, get absolved of their responsibilities as the partners of the firm. In other words, the sleeping partners (or the dormant partners)

of the firm are also held liable in the same manner as all the other active partners of the firm are held liable. The position of the sleeping (or dormant) partner may be compared with the position of an 'undisclosed principal'. Thus, as an 'undisclosed principal' is made liable the moment he is discovered to be the principal, the sleeping (or dormant) partner can also be made liable the moment he is discovered to be a partner of the firm.

Further, like the other active and known partners, even the sleeping (or dormant) partners are not required to give notice so as to absolve themselves from the liabilities of the acts of the other partners, after they cease to be partners in that firm. Moreover, the firm does not get dissolved when a sleeping (or dormant) partner becomes insane.

31.10 Nominal Partner

In the cases where, in fact, a person is not a partner in the firm, but only his name is being used, as if he were also a partner of the firm, such person is referred to as a 'Nominal Partner'. Thus, a nominal partner is a partner only for the name sake, i.e.only in name. But a nominal partner, though not entitled to share the profit of the firm, he is held liable for all the acts of the firm, as if he were one of the actual (real) partners of the firm.

31.11 Sub-Partner

In the cases where one of the partners of the firm agrees to share his own portion of the profit of the firm with a stranger to the firm (i.e. not being a partner of the firm), such stranger is referred to as the 'Sub-Partner'. A sub-partner, however, is not deemed to be a partner of the firm in eye of law. Accordingly, he neither has any right, as against the firm, nor can he be held liable for any debt of the firm.

31.12 Working Partner

In the cases where a partner, by virtue of his specialised technical or professional qualifications, knowledge, or experience, is assigned the overall responsibility of the management and control of the affairs of the firm, such partner is referred to as a 'Working Partner'. Usually, a working partner receives a fixed amount as his salary, as also a share in the profit of the firm, in addition thereto (i.e. his salary). But then, all the other members of the firm continue to be held liable to the third parties for all his (working partner's) acts.

31.13 Incoming Partner

For the admission or introduction of a new person into a firm as its partner, the consent of all the existing partners of the firm is necessary and compulsory. Thus, where a person is admitted or introduced into an already existing firm as its new partner, with the consent of all the existing partners of the firm, is referred to as an 'Incoming Partner'. Further, as it is most logical and reasonable, such incoming partner, who has joined the firm as a partner midway, cannot be held liable for any of the acts of the firm pertaining to the period prior to his joining the firm. But then, if the incoming partner, on his own, specifically agrees to bear and share even the past liabilities of the firm, he will also be held liable for such liabilities to all the already existing partners of the firm. However, any of the third parties, cannot hold him liable for any of the acts of the firm pertaining to the period prior to his joining the firm. This is so because, there is no privity of contract between the new partner and the creditors of the firm pertaining to the debt or other liabilities incurred by the firm during the period prior to his (incoming partner's) joining the firm.

31.14 Outgoing Partner (or Retired Partner)

As against the incoming partner, an 'Outgoing Partner' (also referred to as a Retired Partner), is that (existing) partner of the firm who leaves the firm, but the remaining (existing) partners of the firm keep carrying on the business of that firm.

A partner of a firm may leave or retire from the firm under the following conditions:

(a) He may leave with the consent of all the remaining partners of the firm;
(b) He may leave in accordance with an express agreement by the partners; and
(c) In the case of a partnership–at-will, he may leave by giving notice in writing to all the remaining partners of the firm regarding his intention of retiring from the firm [**Section 32 (1)**].

Further, a public notice is also required to be given regarding the retirement of the particular partner of the firm. Such notice can be given either by the retiring partner himself or by any of the remaining partners of the (reconstituted) firm. It must, however, be noted that, till such time such public notice about his retirement is given, the retiring partner will continue to be held liable to the third parties for all the acts done by the firm. Moreover, the firm gets reconstituted on the retirement of the partner.

However, as it is most logical and reasonable, such outgoing partner will continue to be held liable for the debts or other obligations of the firm pertaining to the period prior to his retirement. Moreover, the retiring partner will also continue to be liable to the third parties for all the transactions of the firm already begun during the period of his partnership, and still remains unfinished at the time of his retirement.

But then, a retiring partner may be discharged from any of his liabilities to any third party for the act of the firm done prior to his retirement, provided it is so agreed with the third party and the partners of the reconstituted firm. Such agreement may, however, be expressed or may even be implied from the course of the dealings between the firm and the third parties, after having the knowledge of the retirement of that partner.

We may further point out that, while a partner may voluntarily retire on his own will, he cannot be expelled from the partnership unless such power has been conferred by way of a contract between the partners, and provided such power is exercised in good faith (**Section 33**).

Moreover, a retiring partner continues to be entitles to receive his share in the profit of the firm, earned even after his retirement from the firm, till such time his accounts are finally settled **(Section 37).**

31.15 Admission of a Minor into an Existing Partnership

A minor cannot become a partner in a new partnership firm, at the time of its constitution. This is so because, under **Section 11 of the Indian Contract Act**, a minor is not considered to be competent to enter into a valid contract, including the contract of partnership. Thus, as a contract with or by a minor is considered to be void, *ab initio*, he may only be admitted into an already existing partnership firm, but only for his benefits (i.e.only to share the profits of the firm), and not for any losses incurred by the firm. But then, he cannot even be admitted into an already existing partnership firm, unless all the partners of the firm agree to his (minor's) admission into the firm.

Section 30 has stipulated the following rights and liabilities of such minor member (not partner) of the firm:

(i) Minor has the right to such share of the firm's property and profit as the partners of the firm may agree upon among themselves.
(ii) Minor has the right to access, inspect and copy any of the accounts of the firm.
(iii) He is not personally liable for any of the acts of the firm. However, his share in the firm's property and profit is liable for any of the acts of the firm.

(iv) He is not entitled to file a suit against the other partners of the firm for the accounts or for payment of his share in the firm's profit or property, but only during the period he continues to be a member of the firm. That is, he can do so but only when he desires to break his connections with the firm.

(v) Further, when he will file a suit for severing (breaking) his connection with the firm, his share in the firm's profit or property will be determined by valuation, as per the principles laid down under **Section 48**, for the purpose of making accounts of a dissolved partnership firm.

(vi) Further, any time, within six months of his attaining majority, or of his having the knowledge that he had been admitted to the benefits of the firm, whichever date happens to be later, he may give public notice to the effect that he has decided to become or not to become a partner of the firm.

(vii) But then, if he takes a decision to become a partner of the firm, he would become liable for the debts of the firm taken since the time he was admitted to the benefits of the partnership firm. The same will be the position in the case where he would elect (decide) not to become a partner, but will fail to give public notice to such effect.

The provisions in the English Law on this point, however, are different on the following two counts:

(a) The minor becomes liable for the debts of the firm taken not since the time he was admitted to the benefits of the partnership firm, but only from the date he had attained majority.

(b) Second, the public notice is required to be given, not within six months, but within a reasonable time.

31.16 Mode of Giving Public Notice

Section 72 has prescribed the following mode for giving a public notice**:**

(a) In the case of a registered partnership firm the following procedure is to be followed:

  (i) A copy of the notice is required to be sent to the Registrar of Firms, and

  (ii) A copy of the notice must be published in the local Official Gazette, and at least in one vernacular newspaper circulating in the district, where the firm has its place or its principal place of business located.

(b) In the case of an unregistered partnership firm, however, the following procedure is to be followed:

A copy of the notice must be published in the local Official Gazette, and at least in one vernacular newspaper circulating in the district, where the firm has its place or its principal place of business located. That is, in this case, a copy of the notice is not required to be sent to the Registrar of Firms, because it is not registered with him. Alternatively speaking, only the procedure at (ii) mentioned in the case of registered firm is to be followed, and not the procedure mentioned at (i) therein.

Let us Recapitulate

Illegal Partnership:

(a) Where the number of its partners exceeds the maximum prescribed limit. That is, where there are more than 10 persons in a partnership firm carrying on the business of banking, and more than 20 persons in the other cases. In such cases, it is required to be registered with the Registrar of Companies, established in the State where the head office of the partnership firm is located.

(b) Where it is constituted for carrying on some illegal business, like for carrying on the business of manufacturing illicit liquor, long knives, guns, bombs, or for carrying on a gambling den, and so on.

Such illegal partnership firm can, however, be sued against by the third parties, except by those persons who enter into a contract with such partnership firm, with the full knowledge of its illegal nature. This is so

because, as per **Section 24 of the Indian Contract Act**, any contract entered into with any unlawful consideration and/or unlawful object, is considered to be void and thus, unenforceable in law.

Partnership-at-Will (**Section 7**):

(**a**) Where the partnership is not constituted for a fixed period of time; and
(**b**) Where no specific provision has been made in the Partnership Deed as to when and how will the partnership firm come to an end. Thus, it can be dissolved at any time, if any of the partners of the firm will give a notice, expressing his willingness to wind up the firm.

Particular Partnership (**Section 8**): Where the partnership agreement is for a fixed period or for executing a particular project, adventure or job. Such firm usually automatically gets dissolved on completion of the specified project, adventure or job, like when the job of audit of the accounts of a particular company is completed.

Registered Partnership Firm: Where it is duly registered with the Registrar of Firms, in accordance with the procedure laid down under **Section 58.**

That is (**a**) Where it is registered, any time, with the Registrar of Firms of the area where the business of the firm is situated, or is proposed to be situated, and

(**b**) A detailed statement is sent to the respective Registrar of Firms, on the prescribed form, along with the amount of the fee, prescribed for registration.

(**c**) The prescribed form contains, *inter alia*, the following particulars pertaining to the firm:

(**i**) The name of the firm;
(**ii**) The place or the principal place of business of the firm;
(**iii**) The name(s) of any other place(s) where the firm carries on its business;
(**iv**) The date(s) on which each partner has joined the firm;
(**v**) The names in full, as also the complete address of each partner; and
(**vi**) The duration of the firm.

Unregistered Partnership Firm: It is not duly registered with the Registrar of Firms, because, such registration is not compulsory on the part of the partnership firms.

Disadvantages of Non-Registration of Firms (**Section 69**)

(**a**) It cannot file a suit against the firm or against any of the other partners of the firm for enforcing his rights (**i**) arising out of the contract of partnership', and (**ii**) the rights conferred under the Partnership Act.
(**b**) Further, even such firm cannot file a suit against any third party so as to enforce its rights arising out of the contract entered into with such third party, like for payments of the goods supplied on credit.
(**c**) Moreover, even the right of set-off is not available to an unregistered partnership firm.

Rights of an unregistered partnership firm are not affected

(**i**) All its rights, which do not arise out of any contract, but in some other manner, like where its trademark is infringed upon;
(**ii**) All its right to file a suit for the dissolution of a firm, or its right to ask for the accounts of a dissolved firm, or its right or power to realise the property of a dissolved firm;
(**iii**) Powers of an Official Assignee or Receiver or Court, under the Presidency Towns Insolvency Act, or the Provincial Insolvency Act, to realise the property of an insolvent partner (of the unregistered firm);
(**iv**) In the cases where it des not have any place of business in the territories to which the Indian Partnership Act extends (applies); and
(**v**) In any suit or claim of set-off, not exceeding Rs 100 in value, provided the suit is of such a nature that it will have to be filed in the Small Causes Courts.

Partner by Holding out or by Estoppel

The principle of agency by estoppel has been extended in the case of partnership also. As provided under **Section 28 (1)**, a person may be deemed to be a 'partner by holding out', also referred to as a 'partner by estoppel', if the following conditions are satisfied:

(**a**) That, he had represented himself, or had knowingly permitted himself to be represented, to be a partner of the firm;
(**b**) That, such representation was made by him by words spoken (i.e.verbally) or in writing, or by his conduct; and
(**c**) That, the other party had given the credit to the firm, based on the faith of such representation.

Sleeping Partner or Dormant Partner

It is not necessary that all the partners must necessarily look after the business of the firm. Thus, such partners, who do not take active part in the management and control of the firm's business, are known as the 'Sleeping Partners' (also referred to as the 'Dormant Partners') of the firm. But, even then, they will continue to be held liable in the same manner as all the other active partners of the firm will be held liable. That is, like an 'undisclosed principal', the sleeping (or dormant) partner can also be made liable the moment he is discovered to be a partner of the firm.

Nominal Partner: He is one who is not a partner in the firm, but only his name is being used, as if he were also a partner of the firm. Thus, he is a partner only in name. But a nominal partner, though not entitled to share the profit of the firm, he is held liable for all the acts of the firm, as if he were one of the actual partners of the firm.

Sub-Partner: Where one of the partners of the firm agrees to share his own portion of the profit of the firm with a stranger to the firm (i.e.not being a partner of the firm), such stranger is referred to as the 'Sub-Partner'. A sub-partner, however, is not deemed to be a partner of the firm in eye of law. Accordingly, he neither has any right, as against the firm, nor can be held liable for any debt of the firm.

Working Partner: When a partner, by virtue of his specialised technical or professional qualifications, knowledge or experience, is assigned the overall responsibility of the management and control of the affairs of the firm, such partner is referred to as a 'Working Partner'.

Incoming Partner: Where a person is admitted into an already existing firm as its new partner, with the consent of all the existing partners of the firm, he is referred to as an 'Incoming Partner'.

Outgoing Partner (or Retired Partner): He is such existing partner of the firm who leaves the firm, but the remaining (existing) partners of the firm keep carrying on the business of that firm.

A partner of a firm may leave or retire from the firm under the following conditions:

(**a**) He may leave with the consent of all the remaining partners of the firm;
(**b**) He may leave in accordance with an express agreement by the partners; and
(**c**) In the case of a partnership–at-will, he may leave by giving notice in writing to all the remaining partners of the firm regarding his intention of retiring from the firm.

Admission of a Minor into an Existing Partnership: A minor cannot become a partner in a new partnership firm, at the time of its constitution, as he is not considered to be competent to enter into a valid contract, including the contract of partnership. He may only be admitted into an already existing partnership firm, with the consent of all the partners of the firm, but only for his benefits (i.e.only to share the profits of the firm), and not for any losses incurred by the firm.

A minor member has the following rights and liabilities:

(**i**) Right to such share of the firm's property and profit as the partners of the firm may agree to give him.
(**ii**) Right to access, inspect and copy any of the accounts of the firm.
(**iii**) He is not personally liable for any of the acts of the firm. But, his share in the firm's property and profit is liable for any of the acts of the firm.

(iv) He is not entitled to file a suit against the other partners of the firm for the accounts or for payment of his share in the firm's profit or property, but only during the period he continues to be a member of the firm. That is, he can do so but only when he desires to break his connections with the firm.

(v) Further, any time, within six months of his attaining majority, or of his having the knowledge that he had been admitted to the benefits of the firm, whichever date happens to be later, he may give public notice to the effect that he has decided to become or not to become a partner of the firm.

(vi) But then, if he takes a decision to become a partner of the firm, he would become liable for the debts of the firm taken since the time he was admitted to the benefits of the partnership firm. The same will be the position in the case where he would elect (decide) not to become a partner, but will fail to give public notice to such effect.

Mode of Giving Public Notice:

(a) In the case of a registered partnership firm

(i) A copy of the notice is required to be sent to the Registrar of Firms, and

(ii) A copy of the notice must be published in the local Official Gazette, and at least one vernacular newspaper circulating in the district, where the firm has its place or its principal place of business located.

(b) In the case of an unregistered partnership firm, item (a) (ii) only is required.

Questions for Reflection

1. Write short notes on the following types of a partnership firm:
   (a) Illegal Partnership;
   (b) Partnership-at-Will;
   (c) Particular Partnership; and
   (d) Registered Partnership Firm.
2. What is the detailed procedure for the registration of a partnership firm, as provided under Section 58 of the Partnership Act?
3. What are the various particulars pertaining to the firm that are required to be furnished in the form prescribed for the purpose of registration of a firm?
4. What are the various disadvantages of non-registration of a partnership firms as provided under Section 69 of the Partnership Act?
5. What are the various rights of an unregistered partnership firm, which do not get affected due to its non-registration?
6. Who may be called as the following types of partners of a firm?
   (i) 'Partner by Holding Out' or 'Partner by Estoppel'
   (ii) 'Sleeping Partner' or 'Dormant Partner'
   (iii) 'Sub-Partner'
   (iv) 'Working Partner'
   (v) 'Incoming Partner'
   (vi) 'Outgoing Partner' or 'Retired Partner'
7. (a) Can a minor become a partner in a new partnership firm, at the time of its constitution? Give reasons for your answer.
   (b) Can a minor be admitted into an already existing partnership firm? If so, under what specific conditions can he be admitted into an already existing partnership firm?
8. What are the various rights and liabilities of a minor member of the firm admitted into an already existing partnership firm?

9. (a) Can a minor member of the firm, admitted into an already existing partnership firm, become a partner of the firm on his attaining the age of majority, if he so decides? If your answer is in the affirmative, when and how can he become a partner of the firm?
   (b) If a minor, on attaining majority, takes a decision to become a partner of the firm, what would be his liabilities in respect of the debts of the firm?
   (c) What will be the position if a minor, on attaining majority, takes a decision not to become a partner of the firm, but fails to give public notice to such effect?
10. What is the mode for giving a public notice by a firm in the following two cases?
   (a) In the case of a registered partnership firm, and
   (b) In the case of an unregistered partnership firm.

Problems for Practice (With Suggested Solutions)

Problem 1

(a) A non-banking partnership firm has been constituted with 25 members. Is it a legal partnership firm? Give reasons for your answer.
(b) If it is an illegal partnership firm, is there any way out to make it a legal firm?

Solution

(a) It is an illegal partnership firm, because the maximum limit prescribed for a non-banking partnership firm, under Section 11 of the Indian Companies Act 1956, is 20 only. Thus, as the firm, in the instant case, has crossed the maximum limit of 20 (its partners being 25), it is an illegal partnership firm.
(b) The position of this illegal firm can be regularised and legalised by getting it registered under the Indian Companies Act, 1956, or under any other law. Under the Indian Companies Act, it will have to be registered with the Registrar of Companies, established in the State where the head office of the partnership firm is located.

Problem 2

(a) A partnership firm is constituted for carrying on the business of manufacturing illicit liquor. Is it a legal partnership firm?
(b) If it is an illegal partnership firm, is there any way out to make it a legal firm?
(c) Can this firm be sued against by all the third parties without any exception, whatsoever?

Give reasons for your answer in each case.

Solution

(a) The partnership firm, constituted for carrying on the business of manufacturing illicit liquor is illegal, because it is carrying on an unlawful business.
(b) This illegal partnership firm cannot be legalised so long as it continues to carry on the unlawful business of manufacturing illicit liquor.
(c) Such illegal partnership firm can be sued against by all the third parties, except by any person, who enters into a contract with such partnership firm, with the full knowledge of its illegal nature. This is so because, as per **Section 24 of the Indian Contract Act**, any contract entered into with any unlawful consideration and/or unlawful object, is considered to be void and thus, unenforceable in law.

Problem 3

Solomon had joined a partnership firm where no specific provision had been made in the Partnership Deed to the effect as to when and how will the partnership firm come to an end. After a couple of years, Solomon had given a notice, expressing his willingness to wind up the firm. But the other partners of the firm were not willing to do so. Can this firm be dissolved under the aforementioned circumstances? Give reasons for your answer.

Solution

As there is no specific provision made in the Partnership Deed to the effect as to when and how will the partnership firm come to an end, it is in the nature of a 'Partnership-at-Will'. Therefore, it can be dissolved at any time, whenever any of the partners of the firm will give a notice, expressing his willingness to wind up the firm. Therefore, the firm will have to be wound up. However, it may be reconstitutes, if the remaining partners will so desire.

Problem 4

A team of five auditors had entered into an agreement to audit of the annual accounts of Krishna Udyog Limited. On 15th October 2008, they had completed the audit of Krishna Udyog Limited and had duly submitted the final audit report to the management of the company. What will be the legal position of this firm thereafter? Give reasons for your answer.

Solution

As the five auditors had entered into an agreement to audit of the accounts of a particular company, Krishna Udyog Limited, they will be regarded as partners of a 'particular partnership', i.e. only for the purpose of that particular audit only. Thus, once this particular audit is over, and the final audit report is duly submitted to the management of the company on 15th October 2008, this particular partnership will automatically get dissolved immediately thereafter. This contention is based on the decision delivered in the case titled **Robinson vs Anderson.**

Problem 5

George, a partner of an unregistered partnership, has not been paid his rightful share in the profit of the firm. Can he claim it by filing a suit in the Court of law? Give reasons for your answer.

Solution

No; George, who has not been paid his rightful share in the profit of the firm, cannot claim it by filing a suit in the Court of law, because he is a partner in an unregistered partnership. This is so because, under Section 69 of the Indian Partnership Act, a partner in an unregistered partnership firm cannot enforce his rights conferred under the Indian Partnership Act.

Problem 6

(a) Kapoors & Bhatias, an unregistered partnership firm, had supplied five pieces of colour T.Vs worth Rs 1,50,000 to Madhurima on credit. Later, Kapoors & Bhatias had borrowed a sum of Rs 2,00,000 from Madhurima. After some time, Madhurima approached Kapoors & Bhatias, the unregistered partnership firm, for repayment of the loan amount of Rs 2,00,000. Thereupon, Kapoors & Bhatias, had proposed to Madhurima to finally settle the accounts between them by accepting the balance amount of Rs 50,000, being the net amount payable by Kapoors & Bhatias, to Madhurima, after deducting the amount of the five colour T.Vs, supplied to Madhurima on credit (i.e. Rs 2,00,000 less Rs 1,50,000 = Rs 50,000).This proposal of the firm was not acceptable to Madhurima. Can the firm legally force Madhurima to accept the payment of Rs 50,000 in final settlement of the accounts between them? Give reasons for your answer.

(b) What would be the legal position, if Kapoors & Bhatias were a registered partnership firm, instead?

Give reasons for your answer in each case.

Solution

(a) No; Kapoors & Bhatias cannot legally force Madhurima to accept the payment of Rs 50,000 in final settlement of the accounts between them, because it is an unregistered partnership firm. This is so because, the proposed manner of settlement of the account happens to be in the nature of exercising the right of set-off, which right an unregistered partnership firm cannot exercise. On this ground, the aforementioned right of set-off, contained in the firm's proposal, cannot be enforced by the firm to settle the accounts in the manner suggested by it, because it is an unregistered partnership firm.

(b) The legal position would have been decidedly different, if Kapoors & Bhatias were a registered partnership firm, instead of being an unregistered partnership firm. This is so, because a registered partnership firm can legally force its right of set-off. Accordingly, the aforementioned right of set-off, contained in the firm's proposal, can be enforced by the firm to settle the accounts in the manner, as and when suggested by it, because of it being a registered partnership firm, instead.

Problem 7

(a) Xpert Solutions, an unregistered partnership firm, has found that another firm has infringed upon its trademark. The partners of the firm were much worried, as they had come to know that, under the provisions of the Indian Partnership Act, an unregistered partnership firm cannot file a suit against any third party. Therefore, the partners of the firm have now approached you to arrange for the registration of the firm so that it (firm) could file a suit against the firm for the infringement upon its trademark. What specific legal advice would you give to the partners of the firm?

Would you suggest them to first get their firm registered with the Registrar of Firms, to enable their firm to file a suit against the other firm for the infringement upon the trademark of their firm, Xpert Solutions?

(b) Alternatively, would you suggest to them to first file a suit against the other firm for the infringement upon the trademark of their firm, Xpert Solutions, and thereafter to get their firm registered with the Registrar of Firms?

Give reasons for your answer in each case.

Solution

(a) We would suggest to them that it is not necessary that the firm should, at first, be got registered with the Registrar of Firms. We would, instead, convince them on the legal point that an unregistered partnership firm is deprived of enforcing only such of its rights, which arise out of any contract entered into between the firm and the third party. Conversely speaking, all the rights even of an unregistered partnership firm, which do not arise out of any contract entered into between the firm and the third party, but in some other manner, will remain intact and unaffected. Further, as we know, the issue, pertaining to the infringement upon the trademark of unregistered partnership firms, does not arise out of any contract entered into between the firm and the third party. Accordingly, the legal rights of Xpert Solutions, to file a suit against the other party for the infringement upon its trademark will remain intact and unaffected. Thus, the firm Xpert Solutions can file the suit against the other firm for the infringement upon its trademark, it being an unregistered partnership firm, notwithstanding.

(b) Yes; we would definitely suggest to them to first file a suit against the other firm for the infringement upon the trademark of their firm, Xpert Solutions, on the ground that all the rights even of an unregistered partnership firm, which do not arise out of any contract entered into between the firm and the third party, but in some other manner, will remain intact and unaffected. But, at the same time, we would also suggest to them that soon thereafter they must definitely proceed to get their firm registered with the Registrar of Firms as well. In this context, we will like to convince them on the legal point that though all the rights even of an unregistered partnership firm, which do not arise out of any contract entered into between the firm and the third party, and even some other rights, will remain intact and unaffected, there are several avoidable business risks and adverse consequences of non-registration of a partnership firm, as stipulated in Section 69 of the Indian Partnership Act. Therefore, all the partnerships may be well advised to get them registered with the Registrar of Firms, sooner the better.

Problem 8

Asif had introduced Bismil to Kabir as a partner in his firm named Asif and Friends. But, in fact, Bismil was not a partner in the firm named Asif and Friends. However, despite not being a partner in the firm, Bismil had not contradicted the aforementioned statement of Asif, and had preferred to keep quiet, instead. After a

couple of days, Kabir had given a loan to the firm amounting to Rs 75,000. But, as the firm was not paying back the loan amount, Kabir had approached Bismil for repayment of the loan. At this point in time, Bismil refused to repay the loan on the ground that he was never a partner in the firm, and therefore, he cannot be held responsible for the repayment of the loan given not to him but to the firm of Asif. Do you think that the contention of Bismil in the instant case is legally justified? Give reasons or your answer.

Solution

No; the contention of Bismil in the instant case is not legally justified. This is so because, Bismil, in the instant case, will be considered as partner of the firm by virtue of being a 'partner by holding out', also referred to as a 'partner by estoppel', as per the provisions of Section 28, based on the following circumstances of the case:

(a) That, Bismil had knowingly permitted himself to be represented, to be a partner of the firm;
(b) That, such representation was made by him by his conduct; and
(c) That, the other party had given the credit to the firm, based on the faith of such representation.

Accordingly, Bismil cannot be allowed to plead that, in fact, he was not a partner in the firm named Asif and Friends. Instead, he will have to compensate Kabir by virtue of his being a 'partner by holding out', also referred to as a 'partner by estoppel'.

Problem 9

Ashok had retired from the firm named Prakash Traders. But he had not so far given the notice of his retirement from the firm. Do you think that Ashok will still be deemed to be a partner in the firm? Give reasons or your answer.

Solution

Yes; in the aforementioned circumstances, Ashok will still be deemed to be a partner 'by holding out' or a 'partner by estoppel', as per the provisions of Section 28, because he had knowingly permitted himself to be still deemed as a partner of the firm by his conduct, that is by not so far giving the notice of his retirement from the firm.

Problem 10

(a) Ram, Onkar, and Kabir are the partners in a firm named 'ROK & Sons'. While Onkar and Kabir take active part in the management and control of the firm's business, Ram had preferred not to actively participate in the management and control of the firm's business. Accordingly, he was under the impression that, by virtue of his not taking any active part in the business of the firm, he will not be held liable for the actions taken by Onkar and Kabir in the management and control of the firm's business. Do you think that the contention of Ram is legally tenable? Give reasons for your answer.
(b) Will the firm get automatically dissolved in the event of Ram becoming insane?

Solution

(a) No; the contention of Ram is not legally tenable. This is so because, under the given circumstances, Ram will be considered to be a sleeping or dormant partner of the firm. Further, as the sleeping or dormant partners of any firm are also held liable in the same manner as all the other active partners of the firm are held liable, Ram will also be held liable in the same manner as Onkar and Kabir will be held liable.

Here, we may add that the position of the sleeping (or dormant) partner is similar to the position of an 'undisclosed principal'. That is, as an 'undisclosed principal' is made liable the moment he is discovered to be the principal, the sleeping (or dormant) partner (Ram in the given case) will also be held liable the moment he will be discovered to be a partner of the firm, he being a sleeping (or dormant) partner, notwithstanding.

(b) No; the firm will not get automatically dissolved in the event of Ram becoming insane. This is so because, in the instant case, Ram will be considered to be a sleeping or dormant partner of the firm. Further, as any firm does not get dissolved when its sleeping (or dormant) partner becomes insane, the

firm named 'ROK & Sons' will not get automatically dissolved, either, in the event of Ram [the sleeping (or dormant) partner of the firm] becoming insane.

Problem 11

Shankar was a famous cricketer of in Ludhiana. His friends, Tarun and Mukesh, had been planning to constitute a firm for manufacturing cricket bats and balls of international standard. Tarun and Mukesh had approached Shankar to join them as the third partner of the firm. But Shankar, due to his busy schedule of playing international cricket matches, expressed his inability to accept their offer. Thereupon, Tarun and Mukesh suggested him to join their firm only in the name, as his name could be used to promote the firm in the international market. As Shankar found it difficult to refuse the alternative suggestion of his two good friends, he agreed that his name could be used as if he were a partner in the firm. The firm had done a good business in its initial years, and the profits of the firm were equally shared between Tarun and Mukesh. In the seventh year, the firm incurred substantial losses. Therefore, Tarun and Mukesh approached Shankar to share the losses suffered by the firm, he (Shankar) flatly refused on the following two forceful grounds:

(i) That, he was, in fact, not a partner in the firm; only his name was being used as if he were a partner in the firm, and

(ii) That, he had , so far, never been paid any share in the profit of the firm.

Tarun and Mukesh have now approached you for an expert legal advice in the matter.

What advice will you give to them, and on what legal grounds?

Solution

We will suggest to Tarun and Mukesh on the following lines:

(i) That, in the instant case, Shankar will be deemed to be a 'Nominal Partner' because, in fact, he is not a partner in the firm, but only his name is being used, as if he were also a partner of the firm.

(ii) That, a nominal partner, is not entitled to any share in the profit of the firm. However, though not entitled to share the profit of the firm, a nominal partner will still be held liable for all the acts of the firm, as if he were one of the actual (real) partners of the firm.

Based on the aforementioned legal points, we will advise Tarun and Mukesh that they can legally hold Shankar, the nominal partner of the firm, liable for their acts and, accordingly, to share the loss of the business of the firm.

Problem 12

(a) On 31st December 2008, Johnson had been admitted into a firm, established since 1st January 2006, as its new partner, with the consent of all the existing partners of the firm. After some time, Johnson was asked by all the other old partners of the firm to share the liabilities of the firm arising out of their actions taken from time to time, since its inception on 1st January 2006 till date. Upon this, Johnson reacted sharply on the ground that he cannot be held liable for any of the acts of the firm pertaining to the period prior to his joining the firm. Do you think that this contention of Johnson will be held valid under all the circumstances, or else, there may be some exceptions also to this stand under certain specific circumstances?
[*Note:* If you find that there are some vital legal points missing in the instant case, you may presume such missing points, but do not forget to specify them in your answer.]

(b) Can any of the third parties hold him liable for any of the acts of the firm pertaining to the period prior to his (Johnson's) joining the firm, under any circumstances?

Give reasons for your answer in each case.

Solution

(a) In the instant case, we find that it has not been stated whether, Johnson, on his own, had specifically agreed to bear and share even the past liabilities of the firm or not. In such two different cases, our response will also be different as follows:

(i) In case Johnson, on his own, had not specifically agreed to bear and share even the past liabilities of the firm, the aforementioned contention of Johnson will be held as reasonable, logical and accordingly, valid.

(ii) As against this, in case Johnson, on his own, had specifically agreed to bear and share even the past liabilities of the firm, the aforementioned contention of Johnson will be held as invalid. That is, he (Johnson) will also be held liable for such liabilities to all the already existing partners of the firm.

(b) But then, none of the third parties can hold him (Johnson) liable for any of the acts of the firm pertaining to the period prior to his (Johnson's) joining the firm, under any circumstances. This is so because there is no privity of contract between the new (in-coming) partner (Johnson in the instant case), and the creditors of the firm, pertaining to the debt or other liabilities incurred by the firm during the period prior to his (Johnson's) joining the firm.

Problem 13

(a) Narottam is a partner in a partnership-at-will. He has given a notice, in writing, to all the remaining partners of the firm, regarding his intention of retiring from the firm. Will he still continue to be held liable to the third parties for all the acts done by the firm? Give reasons for your answer.
[*Note:* If you find that there are some vital legal points missing in the instant case, you may presume such missing points, but do not forget to specify them in your answer.]

(b) Will Narottam continue to be held liable for the debts or other obligations of the firm pertaining to the period prior to his retirement? Say 'Yes' or 'No'.

(c) Will Narottam continue to be held liable to the third parties for all the transactions of the firm already begun during the period of his partnership, but still remains unfinished at the time of his retirement? Say 'Yes' or 'No'.

(d) Will Narottam continue to be entitled to receive his share in the profit of the firm, earned even after his retirement from the firm? If your answer is in the affirmative, specify the period upto which he will be entitled to receive his share in the profit of the firm.

Solution

(a) In the instant case, we find that it has not been stated whether Narottam, or any of the remaining partners of the firm, had given a public notice regarding the retirement of Narottam from the firm. We say so because, in the case of a partnership–at-will, in addition to the retiring partner giving a notice in writing to all the remaining partners of the firm regarding his intention of retiring from the firm, he, or any of the remaining partners of the firm, must also give a public notice regarding the retirement of the particular partner of the firm (Narottam in the instant case).
In such two different cases, our response will also be different as follows:

(a) (i) If Narottam, or any of the remaining partners of the firm, had not given a public notice regarding the retirement of Narottam, he (Narottam) will continue to be held liable to the third parties for all the acts done by the firm, till such time the required public notice about his retirement is given.

(ii) As against this, if Narottam, or any of the remaining partners of the firm, had given a public notice regarding the retirement of Narottam, he (Narottam) will cease to be held liable to the third parties for all the acts done by the firm, immediately after giving the required public notice about his retirement.

(b) Yes.

(c) Yes.

(d) Yes; Narottam will continue to be entitled to receive his share in the profit of the firm, earned even after his retirement from the firm, till such time his accounts are finally settled (Section 37).

Problem 14

(a) Robert & Sisters, a registered partnership firm, has published a copy of a public notice in the local official gazette, and in only one vernacular newspaper circulating in the district, where the firm has its principal place of business located.

(b) Uttam & Brothers, an unregistered partnership firm, has published a copy of a public notice in the local official gazette, and in only two vernacular newspapers circulating in the district, where the firm has its principal place of business located.

Do you think that both the aforementioned public notices will be deemed to have been given in compliance of all the procedures, laid down in the Indian Partnership Act? Give reasons for your answer in each case.

Solution

(a) In the case of Robert & Sisters, a registered partnership firm, another essential procedure, i.e.of sending a copy of the notice to the Registrar of Firms, has not been complied with. The publication of a copy of a public notice in the local official gazette, and in just one vernacular newspaper is in order, because under Section 72, the words used are 'at least in one vernacular newspaper'.

(b) As against this, the procedures adopted by Uttam & Brothers, an unregistered partnership firm, are complete and in order, because in the case of an unregistered partnership firm, no copy of the notice is required to be sent to any of the Registrar of Firms, as it is not registered with any of them. Further, as the publication of the notice is required to be published in 'at least in one vernacular newspaper', its publication in two of them is also all right.

Chapter Thirty Two

Rights, Duties, and Liabilities of Partners

"*Right is its own defence.*
Bertolt Brecht

If only the people who worry about their liabilities would think about the riches they do possess, they would stop worrying.
Dale Carnegie

The welfare of each is bound up in the welfare of all.
Helen Keller"

32.1 Rights of a Partner

Unless provided to the contrary in the contract among the partners of the firm [contained in the partnership agreement (partnership deed), or even otherwise], each and every partner of the firm will be entitled to the following rights:

(i) Right to take part in the conduct of the business of the firm. [**Section 12 (a)**].
(ii) Right to share equally in the profits of the firm. [**Section 12 (b)**].
(iii) Right to express his opinion on any matter.

However, in the cases of differences regarding the ordinary matters of the firm's business, the decisions of the majority will prevail, which all the partners will have to agree to.

But then, in regard to bringing out any change in the nature of the business of the firm, a unanimous agreement of all the partners of the firm will be required on this count. [**Section 12 (c)**].

(iv) Right to access to, and to inspect and copy from any of the books of the firm. [**Section 12 (d)**].
(v) Right to be the joint owner of the property of the firm.

The term 'property of the firm' here includes all the property and rights and interests in the property, originally brought into the stocks of the firm, or acquired by purchase or otherwise, by or for the firm,

or for the purpose and in the course of the business of the firm. The term 'property of the firm' also includes the goodwill of the firm's business.

(vi) Right to take, in an emergency, all such actions as are reasonably necessary to protect the firm from any loss.

(vii) Right to claim interest at the rate of 6 per cent per annum on any amount advanced to the firm over and above (i.e. beyond) the amount of his capital that he has agreed to subscribe. [**Section 13 (c)**].

(viii) Right to be indemnified by the firm in respect of the liabilities incurred by him in the ordinary course of business. [**Section 13 (e)**].

(ix) Right not to be expelled.

However, a partner may be expelled under the following two circumstances:

(a) If a power to expel a partner has been conferred upon the partners, and
(b) Such power, if conferred upon the partners, is exercised in a *bonafide* manner by a majority of the partners of the firm.

(x) Right to resist the introduction or admission of a new partner in the partnership. [**Section 31 (1)**].

Alternatively speaking, no new partner can be introduced or admitted into the firm without a unanimous consent of all the partners.

(xi) Right to retire.

A partner may retire from the firm under the following conditions:

(a) With the consent of all the remaining (other) partners;
(b) In terms of an express agreement by the partners; or
(c) In case of a partnership-at-will, but by giving notice in writing to all the other partners of the firm, about his intention to retire from the firm. [**Section 32 (1)**].

(xii) Right to carry on a competing business, but only after retirement from the firm.

Every retiring (outgoing) partner has the right to carry on a competing business. But then, he cannot use the name of the firm from which he has retired, because, in that case, it will amount to the infringement on the trade mark of that firm. Further, he can neither solicit the customer of the firm from where he has retired, nor he can, in any way, represent himself as carrying on the business of that firm.

But then, he will not have any right to carry on a competing business, even after his retirement from the firm, if he has been restrained by a reasonable agreement, from carry on a similar (competing) business, for a specified period of time, within the specified local limits. [**Section 36 (1)**].

(xiii) Right as an outgoing (retiring) partner to share subsequent profit of the firm, under certain circumstances **(Section 37).**

For the convenience of the readers, we provide the summary of the various rights of a partner of a partnership firm, at one place in **Figure 32.1**.

32.1.1 Express and Implied Authority of a Partner

The authority of a partner may be either express or implied. When it is defined by way of an agreement between the partners, it is said to be the express authority. It may be either written or even verbal. It, however, is said to be the implied when the law impliedly gives certain powers to a partner; that is, when in law, it is presumed that each partner (impliedly) has the authority to do certain things, unless an express agreement provides to the contrary. **Sections 19 and 22** have stipulated the implied authority of a partner.

32.2 Duties of a Partner

All partners of the firm have the following duties, as provided under the various Sections of the Act:

(a) Under **Section 9**, the general duties of the partners include:

Unless provided to the contrary in the contract among the partners of the firm [contained in the partnership agreement (partnership deed), or even otherwise], each and every partner of the firm will be entitled to the following rights:

(i) Right to take part in the conduct of the business of the firm [**Section 12 (a)**].
(ii) Right to share equally in the profits of the firm [**Section 12 (b)**].
(iii) Right to express his opinion on any matter.
(iv) Right to access to, and to inspect and copy from any of the books of the firm [**Section 12 (d)**].
(v) Right to be the joint owner of the property of the firm.
(vi) Right to take, in an emergency, all such actions as are reasonably necessary to protect the firm from any loss.
(vii) Right to claim interest at the rate of 6 per cent per annum on any amount advanced to the firm over and above (i.e. beyond) the amount of his capital that he has agreed to subscribe [**Section 13 (c)**].
(viii) Right to be indemnified by the firm in respect of the liabilities incurred by him in the ordinary course of business [**Section 13 (e)**].
(ix) Right not to be expelled.
(x) Right to resist the introduction or admission of a new partner in the partnership [**Section 31 (1)**]. Alternatively speaking, no new partner can be introduced or admitted into the firm without a unanimous consent of all the partners.
(xi) Right to retire.
(xii) Right to carry on a competing business, but only after retirement from the firm.
(xiii) Right as an outgoing (retiring) partner to share subsequent profit of the firm, under certain circumstances.

Figure 32.1 Rights of a Partner

(i) To carry on the business of the firm in the highest common interest and advantage of all the partners;
(ii) To be just and faithful to all the other partners; and
(iii) To give, to any partner or his legal representatives, true accounts and complete information of every thing affecting the firm.

(b) Under **Section 10**, it is the duty of each partner to indemnify the firm for the losses caused to it due to the fraud committed by him during the conduct of the firm's business.
(c) As stipulated under **Section 11 (2)**, partner is duty-bound not to carry on any business other than the firm's own business, so long as he continues to be a partner of that firm, if he is restrained by an agreement to this effect with the other partners.
(d) As stipulated under **Section 13,** it is the partner's duty to indemnify the firm for any losses suffered by it, due to his wilful negligence in the conduct of the firm's business.
(e) Under **Section 13 (a)**, it is the duty of each partner to attend to his duties in the conduct of the firm's business diligently, and that too, without any remuneration.
(f) As stipulated under **Section 16 (a)**, a partner is duty-bound to account for all the profits that he makes, even secretly, from any transaction of the firm, or from the use of any of the properties of the firm, or the business connections of the firm, or even by using the name of the firm.
(g) As per **Section 16 (b)**, in case a partner happens to carry on some business that competes with the firm's own business, he will have to account for and pay to the firm all the profits made by him in that competing business.
(h) A partner is duty-bound not to assign his own share to some outside party. If he fails in such duty, i.e. if he assigns his own share to some outside party, the partnership itself may be dissolved.
(i) As per duty, all the partners are required to contribute to the losses of the firm in equal proportion, unless otherwise agreed upon between the partners.

For the convenience of the readers, we provide the following summary of the various duties of a partner of a partnership firm, at one place in **Figure 32.2**.

All the partners have been assigned the following duties under law:

(a) By way of general duties, all the partners are duty-bound,
  (i) To carry on the business of the firm in the highest common interest and advantage of all the partners;
  (ii) To be just and faithful to all the other partners; and
  (iii) To give, to any partner or his legal representatives, true accounts and complete information of every thing affecting the firm.

(b) To indemnify the firm for the losses caused to it due to the fraud committed by him during the conduct of the firm's business.

(c) Not to carry on any business other than the firm's own business, so long as he continues to be a partner of that firm, if he is restrained by an agreement to this effect with the other partners.

(d) To indemnify the firm for any losses suffered by it, due to his wilful negligence in the conduct of the firm's business.

(e) To attend to his duties in the conduct of the firm's business diligently, and that too, without any remuneration.

(f) To account for all the profits that he makes, even secretly, from any transaction of the firm, or from the use of any of the properties of the firm, or the business connections of the firm, or even by using the name of the firm.

(g) In case a partner carries on some business that competes with the firm's own business, he will have to account for and pay to the firm all the profits made by him in that competing business.

(h) Not to assign his own share to some outside party. If he fails in such duty, i.e. if he assigns his own share to some outside party, the partnership itself may be dissolved.

(i) To contribute to the losses of the firm in equal proportion, unless otherwise agreed upon between the partners.

Figure 32.2 Duties of a Partner

32.3 Liabilities of a Partner

32.3.1 Liabilities of a Partner by not Performing his Duties Provided in the Act

The liabilities of a partner constitute such acts on the part of the partner, when he does not perform his duties, as stipulated under the Partnership Act. Alternatively speaking, when a partner acts in contravention of his duties, as stipulated under the Partnership Act, he is held liable for such acts. Thus, all partners of the firm have the following duties, as provided under various Sections of the Act:

(a) In view of **Section 9**, the general liabilities of partners arise in the following circumstances:
  (i) When he fails to carry on the business of the firm in the highest common interest and advantage of all the partners;
  (ii) When he fails to be just and faithful to all the other partners; and
  (iii) When he fails to give, to any partner or his legal representatives, true accounts and complete information of every thing affecting the firm.

(b) In view of **Section 10**, each partner will be liable to indemnify the firm for the losses caused to it due to the fraud committed by him during the conduct of the firm's business.

(c) In view of **Section 13,** every partner is liable to indemnify the firm for any losses suffered by it, due to his wilful negligence in the conduct of the firm's business.

(d) In view of **Section 16 (a)**, a partner is liable to account for all the profits that he makes, even secretly, from any transaction of the firm, or from the use of any of the properties of the firm, or the business connections of the firm, or even by using the name of the firm.

(e) In view of **Section 16 (b)**, in case a partner carries on some business that competes with the firm's own business, he will be liable to account for and pay to the firm all the profits made by him in that competing business.

(f) All partners are liable to contribute to the losses of the firm in equal proportion, unless otherwise agreed upon between the partners.

For the convenience of the readers, we provide the following summary of the various liabilities of a partner of a partnership firm, at one place in **Figure 32.3**.

All the partners have been assigned the following liabilities under law:

(a) The general liabilities of a partners arise in the following circumstances:
  (i) When he fails to carry on the business of the firm in the highest common interest and advantage of all the partners;
  (ii) When he fails to be just and faithful to all the other partners; and
  (iii) When he fails to give, to any partner or his legal representatives, true accounts and complete information of every thing affecting the firm.

(b) Each partner will be liable to indemnify the firm for the losses caused to it due to the fraud committed by him during the conduct of the firm's business.

(c) Every partner is liable to indemnify the firm for any losses suffered by it, due to his wilful negligence in the conduct of the firm's business.

(d) A partner is liable to account for all the profits that he makes, even secretly, from any transaction of the firm, or from the use of any of the properties of the firm, or the business connections of the firm, or even by using the name of the firm.

(e) In case a partner carries on some business that competes with the firm's own business, he will be liable to account for and pay to the firm all the profits made by him in that competing business.

(f) All partners are liable to contribute to the losses of the firm in equal proportion, unless otherwise agreed upon between the partners.

Some more liabilities of partners are discussed in Points 32.3.2, 32.3.3,and 32.4 hereafter.

Figure 32.3 Liabilities of a Partner

32.3.2 As stipulated under **Section 25**, all the partners are liable jointly along with all the other partners of the firm, as also severally (separately) for all the acts of the firm done by any of the partners while he continues to be a partner of the firm. Further, an act of the firm has been defined under **Section 2 (a)** as 'any act or omission by all the partners, or by any partner or agent of the firm, which gives rise to a right enforceable by or against the firm'.

As against such provisions in the Indian Partnership Act, in English Law the liabilities of a partner for the debts and obligations of the firm are only joint, and not several. However, even under the English law, the liabilities of a partner for the debts and obligations of the firm also are several (separate), but only under the following conditions:

(a) Where any wrongs have been committed by a partner in the ordinary course of business of the firm, or with the authority of the remaining co-partners causing loss or injury to the third persons, and

(b) Where a partner is guilty of misappropriation of money or property received by him while acting within the scope of his authority or while they are in the custody of the firm in the ordinary course of its business.

32.3.3 Further, there is no difference between an active and a dormant (inactive) partner in regard to his unlimited liabilities to the third parties. In other words, even a dormant (inactive) partner is liable to an unlimited extent for all the debts of the firm.

Moreover, where the implied authority of a partner is curtailed by an agreement between himself and his remaining co-partners, an act of the firm within his implied authority, but beyond his actual authority, would be binding upon the firm, unless the third party knows of the curtailment of his implied authority.

32.4 Liability of a Firm for Wrongful Acts of a Partner

Under the provisions contained in **Sections 26 and 27**, where, by any wrongful act or omission of a partner, acting in the ordinary course of business of the firm, or with the authority of his other partners, loss or injury is caused to any third party or any penalty is incurred, the firm is liable for that, to the same extent as the partners.

Further, the firm is also liable to make good the loss in the following cases:

(a) Where a partner, acting within his apparent authority, receives money or property from a third party, and misappropriates (misapplies) it; or

(b) Where a firm, in the course of its business, receives money or property from a third party, and such money or property is misappropriated (misapplied) by any of the partners, while it is in the custody of the firm.

Let us Recapitulate

Rights of a Partner: Unless provided to the contrary in the contract among the partners of the firm [contained in the partnership agreement (partnership deed), or even otherwise], each and every partner of the firm will be entitled to various rights. These are: (i) Right to take part in the conduct of the business of the firm [**Section 12 (a)**]; (ii) Right to share equally in the profits of the firm [**Section 12 (b)**]; (iii) Right to express his opinion on any matter; (iv) Right to access to, and to inspect and copy from any of the books of the firm. [**Section 12 (d)**]; (v) Right to be the joint owner of the property of the firm; (vi) Right to take, in an emergency, all such actions as are reasonably necessary to protect the firm from any loss; (vii) Right to claim interest at the rate of 6 per cent per annum on any amount advanced to the firm over and above (i.e. beyond) the amount of his capital that he has agreed to subscribe [**Section 13 (c)**]; (viii) Right to be indemnified by the firm in respect of the liabilities incurred by him in the ordinary course of business [**Section 13 (e)**]; (ix) Right not to be expelled; (x) Right to resist the introduction or admission of a new partner in the partnership [**Section 31 (1)**]; (xi) Right to retire; (xii) Right to carry on a competing business, but only after retirement from the firm; (xiii) Right as an outgoing (retiring) partner to share subsequent profit of the firm, under certain circumstances.

Express and Implied Authority of a Partner: When it is defined by way of an agreement between the partners, it is said to be the express authority. It may be either written or even verbal. The implied authorities are those when the law impliedly gives certain powers to a partner; that is, when in law, it is presumed that each partner (impliedly) has the authority to do certain things, unless an express agreement provides to the contrary (**Sections 19 and 22).**

Duties of a Partner: Every partner of the firm has various duties also. These are: (a) General duties which include (i) To carry on the business of the firm in the highest common interest and advantage of all the partners; (ii) To be just and faithful to all the other partners; and (iii) To give, to any partner or his legal representatives, true accounts and complete information of every thing affecting the firm (**Section 9**); (b) To indemnify the firm for the losses caused to it due to the fraud committed by him during the conduct of the firm's business (**Section 10);** (c) **N**ot to carry on any business other than the firm's own business, so long as he continues to be a partner of that firm, if he is restrained by an agreement to this effect with the other partners [**Section11 (2)**]; (d) To indemnify the firm for any losses suffered by it, due to his wilful negligence in the conduct of the firm's business (**Section13**); (e) To attend to his duties in the conduct of the firm's business diligently, and that too, without any remuneration [**Section 13 (a)];** (f) To account for all the profits that he makes, even secretly, from any transaction of the firm, or from the use of any of the properties of the firm, or the business connections of the firm, or even by using the name of the firm [**Section16 (a);** (g) In case a partner happens to carry on some business that competes with the firm's own business, he will have to account for and pay to the firm all the profits made by him in that competing business [**Section16 (b)];** (h) Not

to assign his own share to some outside party (otherwise the partnership itself may be dissolved); (i) To contribute to the losses of the firm in equal proportion, unless otherwise agreed upon between the partners.

Liabilities of a Partner: Every partner of the firm incurs various liabilities by not performing his duties provided in the Act. Thus, his liabilities emerge out of non-performance of his duties as stipulated under various Sections, as mentioned above. Thus (a) His general liabilities are: (i) When he fails to carry on the business of the firm in the highest common interest and advantage of all the partners; (ii) When he fails to be just and faithful to all the other partners; and (iii) When he fails to give, to any partner or his legal representatives, true accounts and complete information of every thing affecting the firm. (b) Each partner will be liable to indemnify the firm for the losses caused to it due to the fraud committed by him during the conduct of the firm's business. (c) Every partner is liable to indemnify the firm for any losses suffered by it, due to his wilful negligence in the conduct of the firm's business. (d) A partner is liable to account for all the profits that he makes, even secretly, from any transaction of the firm, or from the use of any of the properties of the firm, or the business connections of the firm, or even by using the name of the firm. (e) In case a partner carries on some business that competes with the firm's own business, he will be liable to account for and pay to the firm all the profits made by him in that competing business. (f) All partners are liable to contribute to the losses of the firm in equal proportion, unless otherwise agreed upon between the partners. (g) Further, all the partners are jointly and severally (separately) liable for all the acts of the firm done by any of the partners while he continues to be a partner of the firm. (h) Moreover, both the active and dormant (inactive) partners are liable to an unlimited extent for all the debts of the firm. (i) Where the implied authority of a partner is curtailed by an agreement between himself and his remaining co-partners, an act of the firm within his implied authority, but beyond his actual authority, would be binding upon the firm, unless the third party knows of the curtailment of his implied authority.

Liability of a Firm for Wrongful Acts of a Partner

Where, by any wrongful act or omission of a partner, acting in the ordinary course of business of the firm, or with the authority of his other partners, loss or injury is caused to any third party or any penalty is incurred, the firm is liable for it, to the same extent as the partners. (**Sections 26 and 27).**

Questions for Reflection

1. What are the various rights of the partners of a partnership firm?
2. (a) What is the difference between express and implied authorities of a partner of a partnership firm?
   (b) Is it necessary that the express authorities of a partner of a partnership firm must invariably be in writing?
3. (a) What are the various 'general duties' of the partners of a partnership firm?
   (b) What are the various other duties of the partner of a partnership firm?
4. (a) What are the various 'general liabilities' of the partners of a partnership firm?
   (b) What are the various other liabilities of the partner of a partnership firm?
5. (a) As stipulated under Section 25 of the Indian Partnership Act, all the partners of a partnership firm are 'jointly and severally' liable for all the acts of the firm done by any of the partners while he continues to be a partner of the firm. Explain.
   (b) In what specific respects the provisions regarding the 'joint and several' liabilities in the Indian Partnership Act are different from the provisions made in the English Law in this regard?
   (c) How has an act of the firm been defined under Section 2 (a) of the Indian Partnership Act?
6. (a) Is there any differences between an active and a dormant (inactive) partner of a firm in regard to their unlimited liabilities to the third parties?
   (b) Is the firm liable to make good the loss where a partner, acting within his apparent authority, receives money or property from a third party, and misappropriates (misapplies) it?

(c) Is the firm liable to make good the loss where it (firm), in the course of its business, receives money or property from a third party, and such money or property is misappropriated (misapplied) by any of the partners, while it is in the custody of the firm?
Write only 'YES' or 'NO' as your answer, as the case may be.

Problems for Practice (With Suggested Solutions)

Problem 1

John, Jenny, Johnson, and Jacob are the four partners of a firm, established on 1st January 2008. They have contributed Rs 1,00,000, Rs 2,00,000, Rs 3,00,000, and Rs 4,00,000 respectively, in the partnership business. The firm has earned a net profit of Rs 1,50,000 as at the end of the first year on 31st December 2008. Jacob, who had contributed the highest sum of Rs 4,00,000 in the firm's business insisted that the net profit of the firm must be shared among all the partners in proportion to their respective contributions in the firm's business. But the other three partners were arguing that the profit of the firm must be shared equally among them. All the four partners of the firm have finally approached you to settle this contentious issue in a judicious manner. How will you decide this issue to the entire satisfaction of all the four partners, citing the relevant provisions contained in the Indian Partnership Act? Give reasons for your decision in the matter.

Solution

At the very outset, we will ask the partners whether there is an agreement entered into among all the four partners of the firm, i.e. in the partnership agreement (partnership deed), or even otherwise, regarding the manner of sharing the profit of the firm's business. If their reply will be in the affirmative, we will advise them to share the firm's profit accordingly, as already agreed upon among them. However, if their response will be in the negative, we will advise them that the firm's profit must be shared by them equally. We will further convince them that, as provided under Section 12 (b) of the Indian Partnership Act, in the absence of any provision contained in the contract among the partners of the firm to the contrary, all the partners will be entitled to share the profit of the firm equally, i.e. the partner will get Rs 37,500 each (i.e. 1,50,000 divided by 4 = Rs 37,500).

Problem 2

Wilson, Wasim, Warsi, and Varun are the partners of a partnership firm. A clear majority of the partners of the firm, viz., Wilson, Wasim, and Warsi are agreeable to admit Vaishali as a new partner in the firm. But Varun is not in favour of admitting Vaishali as a new partner in the firm. The other three partners of the firm have taken an instance that the decision of the majority should prevail. All the four partners of the firm have approached you to advise them on the legal points involved in this dispute. Give reasons for your contention in this case.

Solution

As provided under **Section 31 (1)** of the Indian Partnership Act, every partner of the firm has the right to resist the introduction or admission of a new partner in the partnership. That is, each partner has a veto power. That is to say that no new partner can be introduced or admitted into the firm without a unanimous consent of all the partners. Therefore, in the instant case the unanimous agreement of all the partners is necessary, and the majority decision will not serve any useful legal purpose. Accordingly, we will advise all the partners of the firm that Vaishali cannot be introduced or admitted into the firm unless and until Varun also agrees to allow it.

Problem 3

Wordsworth, Tennyson, and Browning are the partners of a partnership-at-will. Tennyson wants to retire from the firm and intends to carry on a competing business after his retirement from the firm. Accordingly, he has given notice in writing to Wordsworth and Browning about his intention to retire from the firm. While Wordsworth has agreed, Browning has resisted his retirement, and contends that Tennyson can neither retire

nor carry on a competing business, unless all the remaining partners of the firm unanimously agree to it (retirement of Tennyson). Wordsworth, Tennyson, and Browning have come to you to seek your expert legal opinion in the matter. What will be your considered legal opinion in the matter? Give reasons for your answer, citing the relevant Section(s) of the Indian Partnership Act operative in such cases.

Solution

As provided under Section 32 (1) of the Indian Partnership Act, in case of a partnership-at-will, any partner of the firm enjoys the right to retire by giving notice in writing to all the other partners of the firm about his intention to retire from the firm. It is only in the cases of partnerships, other than in the case of a partnership-at-will, that a partner can retire only with the consent of all the remaining (other) partners, and not so in the case of a partnership-at-will. Accordingly, as Tennyson is a partner in a partnership-at-will, and as he has given notice in writing to all the remaining partners of the firm, viz., Wordsworth and Browning, about his intention to retire from the firm, he cannot be stopped from retiring from the firm. Therefore, Tennyson will retire after he has given notice in writing to all the remaining partners of the firm, and the resistance on the part of Browning will not be of any legal consequence in the instant case.

The Act further provides that a partner has the right to carry on a competing business, after his retirement from the firm. Accordingly, Tennyson is within his legal rights to carry on a competing business after his retirement from the firm. But he cannot use the name of the firm from which he has retired, because, in that case it will amount to the infringement on the trade mark of that firm. Further, he can neither solicit the customer of the firm from where he has retired, nor he can, in any way, represent himself as carrying on the business of that firm.

Problem 4

Sujata, Priya, and Ankita are the partners of Paridhan Traders, a partnership firm. All the three partners were attending to their duties in the conduct of the firm's business diligently. At the time of the annual closing of the firm, Priya and Ankita wanted a reasonable remuneration for rendering their services for the conduct of the firm's business diligently, all the year round, in addition to their respective share in the profit of the firm. But Sujata objected to their claims regarding payment of any remuneration to them for rendering their services for the conduct of the firm's business diligently all the year round. In your considered opinion, whether the claims of Priya and Ankita for payment of the remuneration to them, or Sujata's objection to their aforementioned claims, are valid in the eye of law.

Give reasons for your answer, by citing the relevant Section(s) of the Indian Partnership Act.

Solution

As provided under Section 13 (a) of the Indian Partnership Act, it is the duty of each partner to attend to his duties in the conduct of the firm's business diligently, and that too, without any remuneration. Accordingly, the claims of Priya and Ankita, for payment of the remuneration to them for rendering their services for the conduct of the firm's business diligently all the year round, is not legally justifiable. Conversely speaking, Sujata's objection to their aforementioned claims is legally justified under the stipulations made under Section 13 (a) of the Indian Partnership Act. All the partners will, thus, be entitled to receive only their respective share in the profit of the firm, and no amount by way of any remuneration for rendering their services for the conduct of the firm's business diligently all the year round, which is required from all the partners of the firm as a part of their legal duty, and that too, without any remuneration, whatsoever.

Problem 5

Amit, Prashant, and Abhishek are the partners of 'APA Traders', a partnership firm. Amit had made some profits secretly from a transaction of the firm, which the other partners of the firm did not know at the material time. In your considered opinion, is it necessary for Amit to disclose the profits made by him secretly, which the other partners of the firm are not likely to come to know at any later stage? Give reasons for your answer, by citing the relevant Section(s) of the Indian Partnership Act applicable in such cases.

Solution

Section16 (a) of the Indian Partnership Act, *inter alia* (among other things) provides that if a partner of a partnership firm makes some profits, even secretly, from a transaction of the firm, it is his bounden-duty to account for all such profits, including those that he had made even secretly. Accordingly, it is one of Amit's duties as a partner of the firm, to disclose and account for all such profits, including those that he had made even secretly, to all the other partners of the firm, whether they are likely to come to know of it at any later stage or not. Accordingly, if he fails in this duty as a partner of the firm, he may be proceeded against by the other partners of the firm for violation of one of his legal duties as provided under the aforementioned Section of the Act.

Problem 6

Paul, Peter, and Philip are the partners of a partnership firm. After some time, Peter and Philip found that Paul was carrying on some business that competed with the firm's own business. Accordingly, they approached Paul, and asked him to account for and pay to the firm all the profits made by him in that competing business. But Paul flatly refused to comply with their aforementioned request on the ground that there is no such provision in the Indian Partnership Act. Do you think that the contention of Paul is legally justified? Give reasons for your answer, by citing the relevant Section(s) of the Indian Partnership Act, if any, which is/are applicable in such cases.

Solution

The contention of Paul, that there is no such provision in the Indian Partnership Act, is not legally justified. In fact, it is factually incorrect because, Section16 (b) of the Act specifically stipulates that, in case a partner happens to carry on some business that competes with the firm's own business, it is his legal duty as a partner of the firm, to account for and pay to the firm all the profits made by him in that competing business. Accordingly, if he will fail in this duty as a partner of the firm, he may be proceeded against by the other partners of the firm for violation of one of his legal duties as provided under the aforementioned Section of the Act.

Problem 7

Ashok, Alok, and Akash are the partners of a partnership firm. While Ashok and Alok are the active partners of the firm, Akash has preferred to remain as an inactive (dormant) partner. When a question arose regarding limited or unlimited liabilities of the partners of the firm, in regard to the debts of the firm, Ashok and Alok pleaded that the liabilities of all the partners of the firm are unlimited, whether he happens to be an active or inactive (dormant) partner of the firm. But Akash contended that, in view of the fact that he was only an inactive (dormant) partner of the firm, his liability cannot be unlimited; it will, instead, be only limited. In your considered opinion whether the plea of Ashok and Alok are legally valid or else the contention of Akash is legally justifiable? Give reasons for your answer.

Solution

The contention of Akash is not legally justified, because the Indian Partnership Act has specifically stipulated that there is no difference between an active and a dormant (inactive) partner in regard to his unlimited liabilities to the third parties, for all the debts of the firm. In other words, even a dormant (inactive) partner is liable to an unlimited extent for all the debts of the firm. Therefore, the stand taken by Ashok and Alok are legally valid and the contention of Akash is not legally justifiable.

Chapter Thirty Three

Dissolution of Partnership

"*You can close more business in two months by becoming interested in other people than you can in two years by trying to get people interested in you.*
Dale Carnegie

Every institution not only carries within it the seeds of its own dissolution, but prepares the way for its most hated rival.
Dean William R. Inge"

33.1 Meaning of Dissolution of a Partnership Firm

As stipulated under **Section 39**, the dissolution of a partnership firm means the discontinuance of the legal relationship between all the partners of the firm. Accordingly, the dissolution of a partnership firm means the break-up of the legal relationship of partnership between all the partners of the firm.

33.2 Distinction between Dissolution and Reconstitution of a Partnership Firm

There is a clear distinction between dissolution and reconstitution of a partnership firm.
Reconstitution of a partnership firm necessarily takes place in the event of the retirement, death, or insolvency of a partner of the firm. In other words, under such conditions, the firm has got to be reconstituted (i.e. constituted over again) with the remaining partners of the firm. But then, even in the event of the retirement, death, or insolvency of a partner of the firm, the firm may not necessarily get dissolved; that is, it may still continue, provided the partnership deed provides to such effect. [**Keshavlal Patel vs B. Naranda, AIR (1968) Guj. 157].** But though the partnership may continue as aforesaid, the firm will have to be reconstituted any way. Alternatively speaking, in the event of the retirement, death, or insolvency of a partner of the firm,

a new partnership emerges, which is known as the reconstituted firm. When a new partner is admitted into an existing partnership firm, it also involves reconstitution of the firm. Further, while the reconstitution of a firm involves only a change in the relationship of the partners of the firm, in the case of the dissolution of the firm, there is a complete severance (discontinuation) in the relationship of the partners of the firm.

Examples

(a) John, Johnson, and Joseph have constituted a partnership firm named Jay's and Company. Unfortunately, John retires or dies, or becomes insolvent. But the partnership deed provides that, in the event of the retirement, death, or insolvency of any partner of the firm, the firm may still continue. In such a case, the firm, with the remaining partners, Johnson and Joseph, will be called a reconstituted firm. Here, the relationship between Johnson and Joseph will not remain the same as it was earlier with John, Johnson, and Joseph, i.e. when John was also a partner of the firm.

(b) John, Johnson, and Joseph have constituted a partnership firm named Jay's and Company. After some time, Jagdish has been introduced (admitted) as a new partner in the firm. Here again, the relation between John, Johnson, Joseph, and Jagdish will be different from the relationship that earlier existed between John, Johnson, and Joseph. In this case also the firm, with John, Johnson, Joseph, and Jagdish as partners, will be called a reconstituted firm.

33.3 Modes of Dissolution of a Partnership Firm

A partnership firm may be dissolved in the following different ways:

(a) By mutual agreement;
(b) By notice of dissolution;
(c) By operation of law;
(d) By the happening of certain contingencies; and
(e) By a decree of the Court.

We will now discuss each of these five different modes of dissolution of a partnership firm, one after the other.

33.3.1 By Mutual Agreement

As provided under **Section 40**, a partnership firm may be dissolved any time, with the mutual consent of the partners, in accordance with a contract between the partners.

33.3.2 By Notice of Dissolution

As per **Section 43**, a 'partnership-at-will', however, may be dissolved by giving a notice, in writing, to the other partners of the firm, of the intention of the partner concerned to dissolve the firm. Such notice (i) must contain the intention to dissolve the firm, and (ii) it must be given in writing. The firm will be deemed to have been dissolved with effect from the date mentioned in the notice as the specific date of dissolution. However, if no such specific date is mentioned in the notice, the firm will be deemed to have been dissolved with effect from the date of communication of the notice. Here, it must be noted carefully that the filing of a suit for the dissolution of the firm is not considered to be a notice, as required under **Section 43**. In such a case, however, the effective date of dissolution of the firm will be the date of passing of the preliminary decree by the Court for the dissolution of the firm. **[Banarsi Das vs Kanshi Ram, AIR (1963), S.C. 1165].**

33.3.3 By Operation of Law

The dissolution of a partnership firm by operation of law is also referred to as a compulsory dissolution of the

firm. As provided under **Section 41,** the dissolution of a partnership firm by operation of law can take place under the following two circumstances:

(i) If all the partners of the firm, or if all but one of the partners of the firm, are adjudicated as insolvent, or
(ii) By the happening of an event which makes the carrying on the firm's business, or the continued existence of the firm, as unlawful.

But then, if the partnership firm relates to more than one undertaking, the illegality of one or more of them will not prevent the firm from carrying on its other lawful undertakings.

Section 41 also covers the cases of partnership between persons, some of whom may become alien (foreigner) enemies, by the declaration of war subsequently. This is so because, trading with alien (foreigner) enemies is against public policy, as provided in the Indian Contract Act. It may be noted here that the term 'alien enemy' includes a person of any nationality voluntarily residing in any enemy country.

33.3.4 By the Happening of Certain Contingencies

As per **Section 42**, unless otherwise agreed between the partners of a firm, the partnership will stand dissolved on the happening of any of the following events:

(i) If the firm has been constituted for a fixed term, it will automatically get dissolved on the expiry of that term.
(ii) On completion of one or more projects, if the partnership was constituted only for such specific purpose.
(iii) In the event of the death of a partner.
(iv) In the event of the adjudication of a partner as insolvent.

The dissolution of a firm by the happening of any of the aforementioned circumstances is also referred to as 'optional dissolution' because the partnership firm could still continue if the partnership agreement (deed) would have made such provisions.

33.3.5 By a decree of the Court

Under the provisions of **Section 44**, in the event of any of the partners of the firm filing a suit, the Court may dissolve a firm under the following circumstances:

(i) Where a partner of the firm becomes insane (i.e. of unsound mind), any of the partners of the firm or the next friend of the insane partner, can file a petition in the Court for the dissolution of the firm, and the Court may pass the order for the dissolution of the firm. However, in case a dormant (inactive) partner of the firm becomes insane (i.e. of unsound mind), the Court will not pass the order for the dissolution of the firm, unless a very special case is made out for the dissolution of the partnership firm.
(ii) Where a partner of the firm becomes permanently incapable of performing his duties as a partner of the firm, the Court may pass the order for the dissolution of the firm. Here the word 'permanently' is of essence. Thus, in case a partner is suffering from paralysis, which, on evidence, is found to be curable, it cannot be termed as a 'permanent' incapacitation, and therefore, in such cases, the Court will not pass the order for the dissolution of the firm. This contention is strengthened by the case titled **Whitwell vs Arthur, 35 Beav. 140**. Here, it must be noted that in such a case the application cannot be made by the incapacitated partner himself, but only by any of the other partners of the firm.
(iii) Where a partner is found guilty of the conduct, which is likely to prejudicially affect the carrying of the business of the firm, the Court may pass the order for the dissolution of the firm.

33.3.5.1 Some Illustrative Case Laws

(i) **In Pearce vs Foster, 17 B.D.536**, the act of a partner of a mercantile firm, for his making speculations in the price of cotton, was considered to be such an act, and accordingly, the Court had dissolved the partnership firm.

(ii) **In Carmichael vs Evans, 1940, 1 Ch. 486**, wherein a partner of a solicitors' firm was convicted for his act of travelling in a railway compartment without ticket, with the intention of defrauding the **undertaking**, it was considered to be such an act, and accordingly, the Court had dissolved the partnership firm.

(iii) In an English case titled **Essel vs Hayward, 30, Beav. 158**, wherein a partner of the firm was convicted for an offence under moral turpitude, the English Court had passed the order for the dissolution of the firm. In some other English cases, the act of misappropriation of money of a client by a solicitor, the act of adultery by a doctor, have also been found by the English Courts to fall under the category of such acts, justifying dissolution of the firm concerned.

But, it must be carefully noted here that, in such cases, the suit can be filed only by the other partners of the firm, and not by any one else.

(iv) The Court may order dissolution of a firm in the case where a partner wilfully and persistently commits breach of the partnership agreement regarding management, or otherwise conducts himself in such a manner that it is not reasonably practicable for the other partners of the firm to carry on the business of the partnership with him. Continuous refusal by a partner to attend his duties in the business of the firm, and the existence of hostility between the partners of the firm such that any cooperation between the partners becomes impossible, are some of the conditions which have been held to be sufficiently reasonable grounds for ordering dissolution of the firm by the Court.

(v) The Court may also order dissolution of a firm in the case where a partner is found to have transferred in any manner (like by sale, mortgage or charge), his entire interest in the partnership to a third party (i.e. to an outsider), or to have allowed his share to be charged for the execution of a decree against him (under Rule 49 of Order XXI of the First Schedule of the Code of Civil Procedure, 1908), or to have allowed the same to be sold for arrears of land revenue, or for charges recoverable as land revenue. But then, as was held in the case titled **Cassels vs Stewart 6 App. Cas. 64**), a partner can transfer even his entire (whole) share in the partnership firm to a co-partner of the firm, because in such an event no new partner gets admitted or introduced to the firm.

Here, it must be carefully noted that this legal provision will be applicable only in such cases where the partner transfers his whole (entire) share in the business, and not only a part thereof, to an outside party. Further, as regards the transfer of a part of the share in the firm to an outsider, a partner can do so, but with the unanimous consent of all the other partners. Alternatively speaking, a partner of a firm cannot transfer even a part of his share in the firm to an outsider, without a unanimous consent of all the other partners.

(vi) In the case of a loss-making firm, the Court can pass an order for the dissolution of a partnership firm, where its business cannot be run except at a loss. In such cases, the Court can dissolve a partnership firm even if it was established for a fixed period. Such was the Court decision in the case titled **Rehmat-un-nisa vs Price, 42 Bom. 380.**

(vii) The Court can also pass the order for the dissolution of the firm on any other ground which, in the Court's opinion, is a fit ground for the dissolution of a partnership firm. To cite a few such instances, where the Court, in its opinion, had found a fit ground for the dissolution of a partnership firm are: (**a**) where there was a deadlock in the management, where the substratum (the very basis or foundation) of the business had disappeared, or (**b**) where the partners were not on speaking terms with each other.

For the convenience of the readers, we provide the following summary of the various grounds for the dissolution of a partnership firm by the Court, at one place in **Figure 33.1**.

The Court may dissolve a partnership firm on any of the following grounds
(a) When a partner becomes insane (of unsound mind).
(b) Where a partner becomes permanently incapable of performing his duties as a partner.
(c) Where a partner is guilty of misconduct, prejudicially affecting the firm's business.
(d) Where a partner wilfully and persistently commits breach of the partnership agreement.
(e) Where a partner transfers his entire interest or share in the partnership to a third party.
(f) When its business cannot be run except at a loss.
(g) On any other justifiable grounds, like when there is a deadlock in the management; where the very basis of the firm's business has disappeared; or where the partners are not on speaking terms with each other.

Figure 33.1 Grounds for Dissolution by Court

33.4 Consequences of Dissolution

The dissolution of a partnership firm has the following consequences (effects) on the firm:

(a) After dissolution of a partnership firm, it is necessary to wind up all the affairs of the firm. **For example**, all its assets have to be realised, all its liabilities are to be paid off, and the surplus (the remaining balance), if any, is to be distributed among the partners or their representatives as per their respective rights in the firm.

(b) As stipulated under **Section 46**, on the dissolution of a partnership firm, any of the partners or his representative has the following rights against the other partners:
   (i) To have the property of the firm applied in the payment of the debts of the firm; and
   (ii) To have the surplus distributed amongst the partners of the firm or their representatives in accordance with their respective rights.

   The rights of the partner is usually referred to as the 'partner's lien'. Here, the word 'lien' is used not in its technical sense, as it is used in the context of the 'unpaid seller's lien'. It is only used as a convenient way of referring to the rights of the partner. This view was held in the case titled **Babu vs Gokuldas, 1930 Mad. 393**.

(c) After the dissolution of a partnership firm, a partner cannot bind the firm in any case, except under the following circumstances:
   (i) Where it may be necessary to wind up the affairs of the firm; and
   (ii) For the purpose of completing the transaction already begun but not completed, till the time of the dissolution of the partnership firm.

   Further, as provided under **Section 47**, a partner, who has been adjudged as an insolvent, cannot bind the firm in any case after the passing of the adjudication.

(d) As provided under **Section 50**, in case any of the partners earns any profit from any transaction connected with the firm, after its dissolution, he is required to share such profit with the other partners of the firm, and the legal representatives of the deceased partner of the firm.

33.5 Return of Premium on Premature Dissolution

As stipulated under **Section 51**, in case a partner had paid a premium on his entry into the partnership firm for a fixed term, and the firm has been dissolved before the expiry of such term, he will be entitled to get the refund (repayment) of the premium paid by him earlier, or such part thereof as may be reasonable (keeping in view the term and length of the time during which he was a partner). But then, he will not be entitled to receive the refund of the premium paid by him earlier, under the following circumstances:

(i) If the dissolution of the partnership firm has been caused by the death of a partner; or

(ii) If the dissolution of the partnership firm has taken place due to his own misconduct; or
(iii) If the dissolution of the partnership firm is in pursuance of an agreement containing no provision regarding the refund of the premium or any part thereof.

33.6 Restraint of Trade by the Buyer of Goodwill

As provided under **Section 27 of the Indian Contract Act,** 'Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.' In simpler words, every agreement in restraint of trade has been expressly declared as void. However, an exception has been made under **Section 54** of the Indian Partnership Act in the case of restraint of trade by the buyer of goodwill, but with certain conditions stipulated in this connection. Under this Section, upon actual dissolution, or in anticipation of the dissolution of the partnership firm, they (partners of the firm) may enter into an agreement with the buyer of the goodwill of the firm, to the effect that some or all of them (partners), will not carry on a business similar to the business of the firm within a specified period or within the specified local limits. Further, if the restrictions imposed in this regard are found to be unreasonable, the agreement will be treated as void. Conversely speaking, the agreement will be treated as valid only if the restrictions imposed in this regard are found to be reasonable. To sum up, we may say that the trade restrictions will be valid only if the following five conditions are fulfilled:

(a) Only upon actual dissolution, or in anticipation of the dissolution of the partnership firm;
(b) In respect of only such business which are similar to the business of the firm, and not on any other business;
(c) Only within a specified period;
(d) Or only within the specified local limits,
(e) And only if the restrictions imposed in this regard are found to be reasonable, and not unreasonable.

33.7 Settlement of Accounts

Generally, the accounting clause is provided in the 'Deed of Partnership' in accordance with which the final accounts of the partners of the firm are settled. But in case such provisions are missing in the partnership deed, the provisions made under S**ection 48** will apply. This Section has the following provisions:

(a) Losses, including the losses on capital (i.e. amount invested by the partners in the firm), must be paid first of all from the profit of the firm, and only thereafter out of the capital (i.e. amount already invested by the partners in the firm), and at the end, if there happens to be some more loss still to be met, such balance loss will be met by contribution of each partner in proportion to his share in the profit.
(b) Further, the assets of the firm (including the amount contributed by the partners of the firm for making up the deficiency in the capital of the firm), will be applied in the following order:
    (i) First, in paying the debts of the firm to the outsiders;
    (ii) Next, in paying each partner, rateably, for the advances made by him to the firm, in addition to and different from the capital contributed by him in the firm;
    (iii) Thereafter, in paying each partner, rateably, amount due for capital contribution;
    (iv) And finally, the balance amount, if any, will be applied for paying each partner according to his share in the profit of the firm.

However, if a partner becomes insolvent, or he is even otherwise not in a position to pay his share of his contribution, the remaining solvent partners must rateably share the available assets of the firm (including their own contribution in the capital deficiency of the firm). In other words, the available assets of the firm will be distributed in proportion to their original capital in the firm. This rule is referred to as the rule in ***Garner vs Murray (1904, 1 chapter 57).***

33.7.1 Limitation Period

The limitation period for filing a case in the Court, in regard to the settlement of the firm's account on its dissolution, is three years. Thus, in case a partner fails to file such case against even one partner within this period of three years, the whole claim gets barred against the other remaining partners of the firm as well.

33.8 Payment of Partnership Debt

As stipulated under **Section 49**, in the cases where there are joint debts due from the firm, and also separate debts due from any of the partners, the property of the firm shall be applied first in the payment of the debts of the firm. And in case there is still some surplus (property/assets of the firm) available, the share of each partner shall be applied in payment of his separate debts, or else it will be paid to him direct. Further, the separate property of any partner shall be applied first in the payment of his separate debts. And in case there is still some surplus (property/assets of the partners) available, the same shall be applied in the payment of the debts of the firm.

33.9 Sale of Goodwill after Dissolution

As stipulated under **Section *55***, while settling of the final accounts of a partnership firm after its dissolution, the goodwill of the firm shall (in accordance with the terms of the contract between the partners), be included in the assets of the firm, and it may be sold either separately or along with the other property (assets) of the firm.

After the sale of the goodwill of the firm on its dissolution, a partner of the dissolved firm may carry on a business, competing with the business of the buyer of the goodwill of the dissolved firm, and he may also advertise such business. But, subject to the agreement between him (the partner of the dissolved firm) and the buyer of the goodwill of the dissolved firm, he (the partner of the dissolved firm) may not do the following things:

(i) He may not use the name of the firm;
(ii) He may not represent himself as carrying on the business of the firm; or
(iii) He may not solicit the customers, who were dealing with the firm before it was dissolved.

Further, as already stated in Section 33.6 above, after the sale of the goodwill of the firm, any partners of the firm may enter into an agreement with the buyer of the goodwill of the firm to the effect that he (such partner of the firm), will not carry on a business similar to the business of the firm within a specified period or within the specified local limits. But such agreement will be valid only when the restrictions imposed in this regard are found to be reasonable. Conversely speaking, such agreement will be treated as void, if the restrictions imposed in this regard are found to be unreasonable

Let us Recapitulate

As stipulated under **Section 39**, the dissolution of a partnership firm means the discontinuance (break-up) of the legal relationship between all the partners of the firm.

The distinction between dissolution and reconstitution of a partnership firm are that, while reconstitution of a partnership firm necessarily takes place in the event of the retirement, death, or insolvency of a partner of the firm, in the cases of such eventualities (i.e. of the retirement, death, or insolvency of a partner of the firm), the firm may not necessarily get dissolved, provided the partnership deed provides to such effect. But then, the firm has got to be reconstituted with the remaining partners of the firm, which is known as the reconstituted firm.

A partnership firm may be dissolved in various different ways. These are: (a) By mutual agreement; (b) By notice of dissolution; (c) By operation of law; (d) By the happening of certain contingencies; and (e) By a decree of the Court.

(a) **By mutual agreement:** As provided under **Section 40**, a partnership firm may be dissolved any time, with the mutual consent of the partners, in accordance with the contract between them.

(b) **By notice of dissolution:** As per **Section 43**, a partnership–at-will, however, may be dissolved by giving a notice, in writing, to the other partners of the firm, of the intention of the partner concerned to dissolve the firm.

(c) **By operation of law:** As provided under **Section 41,** the dissolution of a partnership firm by operation of law (i.e. a compulsory dissolution) can take place:

  (i) If all the partners of the firm, or if all but one of the partners of the firm are adjudicated as insolvent, or

  (ii) By the happening of an event which makes the carrying on the firm's business, or the continued existence of the firm, as unlawful.

(d) **By the Happening of Certain Contingencies:** As per **Section 42**, unless otherwise agreed between the partners of a firm, the partnership will stand dissolved on the happening of any of the events like (i) If the firm has been constituted for a fixed term, it will automatically get dissolved on the expiry of that term. (ii) On completion of one or more projects, if the partnership was constituted only for such specific purpose. (iii) In the event of the death of a partner. (iv) In the event of the adjudication of a partner as insolvent.

(e) **By a decree of the Court:** Under the provisions of **Section 44**, in the event of any of the partners of the firm filing a suit, the Court may dissolve a firm under the following circumstances:

  (i) Where a partner of the firm becomes insane (i.e. of unsound mind), any of the partners of the firm or the next friend of the insane partner, can file a petition in the Court for the dissolution of the firm, and the Court may pass the order for the dissolution of the firm.

  (ii) Where a partner of the firm becomes 'permanently' incapable of performing his duties as a partner of the firm, the Court may pass the order for the dissolution of the firm.

  (iii) Where a partner is found guilty of the conduct, which is likely to prejudicially affect the carrying of the business of the firm, the Court may pass the order for the dissolution of the firm. The misconduct includes speculating the price of commodities like cotton, sugar, etc., conviction for travelling in a railway compartment without ticket, with the intention of defrauding the railway undertaking, or convicted for an offence under moral turpitude, and so on.

  (iv) Where a partner wilfully and persistently commits breach of the partnership agreement regarding management, or otherwise conducts himself in such a manner that it is not reasonably practicable for the other partners of the firm to carry on the business of the partnership with him.

  (v) Where a partner is found to have transferred in any manner (like by sale, mortgage, or charge), his entire interest in the partnership to a third party (i.e. to an outsider), or to have allowed his share to be charged for the execution of a decree against him or to have allowed the same to be sold for arrears of land revenue, or for charges recoverable as land revenue.

  (vi) In the case of a loss-making firm, the Court can pass an order for the dissolution of a partnership firm, where its business cannot be run except at a loss. In such cases, the Court can dissolve a partnership firm even if it was established for a fixed period.

  (vii) The Court can also pass the order for the dissolution of the firm on any other ground which, in the Court's opinion, is a fit ground for the dissolution of a partnership firm.

Consequences of Dissolution: As the consequences of dissolution of a firm: (a) It is necessary to wind up all the affairs of the firm. For example, all its assets have to be realised, all its liabilities are to be paid off, and the surplus (the remaining balance), if any, is to be distributed among the partners or their representatives as per

their respective rights in the firm. (b) As stipulated under **Section 46**, any of the partners or his representative has some rights against the other partners like (i) To have the property of the firm applied in the payment of the debts of the firm; and (ii) To have the surplus distributed amongst the partners of the firm or their representatives in accordance with their respective rights. The rights of the partner is usually referred to as the 'partner's lien', though the word 'lien' is used not in its technical sense, as it is used in the context of the 'unpaid seller's lien'. (c) After the dissolution of a partnership firm, a partner cannot bind the firm in any case, except under certain circumstances like: (i) Where it may be necessary to wind up the affairs of the firm; and (ii) For the purpose of completing the transaction already begun but not completed, till the time of the dissolution of the partnership firm. Further, as provided under **Section 47**, a partner, who has been adjudged as an insolvent, cannot bind the firm in any case after the passing of the adjudication. (d) As provided under **Section 50**, in case any of the partners earns any profit from any transaction connected with the firm, after its dissolution, he is required to share such profit with the other partners of the firm, and the legal representatives of the deceased partner of the firm.

Return of Premium on Premature Dissolution:

As stipulated under **Section 51**, in case a partner had paid a premium on his entry into the partnership firm for a fixed term, and the firm has been dissolved before the expiry of such term, he will be entitled to get the refund (repayment) of the premium paid by him earlier, or such part thereof as may be reasonable (keeping in view the term and length of the time during which he was a partner). But he will not be entitled to receive the refund of the premium paid by him earlier, (i) If the dissolution of the partnership firm has been caused by the death of a partner; or (ii) If the dissolution of the partnership firm has taken place due to his own misconduct; or (iii) If the dissolution of the partnership firm is in pursuance of an agreement containing no provision regarding the refund of the premium or any part thereof.

Restraint of Trade by the Buyer of Goodwill: Under **Section 54**, upon actual dissolution, or in anticipation of the dissolution of the partnership firm, the partners of the firm may enter into an agreement with the buyer of the goodwill of the firm that some or all of them (partners), will not carry on a business similar to the business of the firm within a specified period or within the specified local limits. Such trade restrictions, however, must be reasonable; otherwise the agreement will be treated as void.

Settlement of Accounts: If the accounting clause is not provided in the 'Deed of Partnership' as to how the final accounts of the partners of the firm will be settled, the provisions made under **Section 48** will apply, which proves that: (a) Losses, including the losses on capital (i.e. amount invested by the partners in the firm), must be paid first of all from the profit of the firm, and only thereafter out of the capital, and at the end, any further loss still remaining, it will be met by contribution of each partner in proportion to his share in the profit. (b) Further, the assets of the firm (including the amount contributed by the partners of the firm for making up the deficiency in the capital of the firm), will be applied in certain order like: (i) First, in paying the debts of the firm to the outsiders; (ii) Next, in paying each partner, rateably, for the advances made by him to the firm, in addition to and different from the capital contributed by him in the firm; (iii) Thereafter, in paying each partner, rateably, amount due for capital contribution; and (iv) finally, the balance amount, if any, will be applied for paying each partner according to his share in the profit of the firm.

Limitation Period for filing a case in the Court, in regard to the settlement of the firm's account on its dissolution, is three years. Thus, in case a partner fails to file such case against even one partner within this period of three years, the whole claim gets barred against the other remaining partners of the firm as well.

Payment of Partnership Debt: As stipulated under **Section 49**, the property of the firm shall be applied first in the payment of the debts of the firm. And in case there is still some surplus (property/assets of the firm) available, the share of each partner shall be applied in payment of his separate debts, or else it will be paid to him direct.

Sale of Goodwill after Dissolution: As stipulated under **Section 55**, while settling the final accounts of a partnership firm after its dissolution, the goodwill of the firm shall, (in accordance with the terms of the

contract between the partners), be included in the assets of the firm, and it may be sold either separately or along with the other property (assets) of the firm.

After the sale of the goodwill of the firm on its dissolution, a partner of the dissolved firm may carry on a business, competing with the business of the buyer of the goodwill of the dissolved firm, and he may also advertise such business. But, subject to the agreement between him (partner) and the buyer of the goodwill of the dissolved firm, he (partner) may not do the some things like: (i) He may not use the name of the firm; (ii) He may not represent himself as carrying on the business of the firm; or (iii) He may not solicit the customers who were dealing with the firm before it was dissolved.

Questions for Reflection

1. What do you mean by the 'dissolution of a partnership firm'? Explain.
2. What are the main distinctions between dissolution and reconstitution of a partnership firm? Explain.
3. Under what specific circumstances can the reconstitution of a partnership firm necessarily take place?
4. Is the reconstitution of a firm necessary, when a new partner is admitted into an existing partnership firm? Give reasons for your answer.
5. Explain the main features of the following modes of the dissolution of a Partnership Firm:
   (a) By mutual agreement;
   (b) By notice of dissolution;
   (c) By operation of law; and
   (d) By the happening of certain contingencies.
6. Explain the main features of the dissolution of a Partnership Firm by a decree of the Court.
7. What are the various consequences of the dissolution of a partnership firm? Explain.
8. What are the various rights that any of the partners or his representative has, as against the other partners of the firm, on its dissolution? Explain.
9. What are the specific circumstances under which, even after the dissolution of a partnership firm, a partner can bind the firm?
10. (a) Can a partner, who has been adjudged as an insolvent, bind the firm in any case after the passing of the adjudication?
    (b) In case any of the partners earns any profit from any transaction connected with the firm, after its dissolution, is he required to share such profit with the other partners of the firm, and the legal representatives of the deceased partner of the firm?

    Write only 'YES' or 'NO' as your answers to the above questions.
11. Will a partner, who had paid a premium on his entry into the partnership firm for a fixed term, and the firm had been dissolved before the expiry of such term, be entitled to get the refund (repayment) of the premium paid by him earlier, under the following circumstances:
    (i) If the dissolution of the partnership firm has been caused by the death of a partner; or
    (ii) If the dissolution of the partnership firm has taken place due to his own misconduct; or
    (iii) If the dissolution of the partnership firm is in pursuance of an agreement containing no provision regarding the refund of the premium or any part thereof.

    Write only 'YES' or 'NO' as your answers to the above questions.
12. (a) As provided under Section 27 of the Indian Contract Act, 'Every agreement by which any one is restrained from exercising a lawful profession, trade, or business of any kind, is to that extent void.' Accordingly, upon actual dissolution, or in anticipation of the dissolution of the partnership firm, the partners of the firm should not be allowed to enter into an agreement with the buyer of its goodwill to the effect that some or all of them (partners), will not carry on a business similar to the business of the firm. Do you agree with the statement? Give reasons for your answer.

(b) In case you do not agree with this statement, what conditions must be satisfied to hold such contract in restraint of trade as valid?

13. (a) In case the accounting clause is not provided in the 'Deed of Partnership', in what specific manner the accounts of the firm will be finally settled under the provisions of Section 48 of the Indian Partnership Act?
    (b) Will it make any difference if a partner becomes insolvent, or he is even otherwise not in a position to pay his share of his contribution?
14. (a) What is the limitation period for filing a case in the Court, in regard to the settlement of the firm's account on its dissolution?
    (b) In case a partner fails to file such case against even one partner within the specified limitation period, will the whole claim gets barred against the other remaining partners of the firm as well? Write only 'YES' or "NO' as your answer.
15. (a) In the cases where there are joint debts due from the firm, and also separate debts due from any of the partners, in what specific order of preference/priority the property of the firm shall be applied, in the repayment of the debts of the firm, and in the repayment of the separate debts of the partners?
    (b) In the cases where there are joint debts due from the firm, and also separate debts due from any of the partners, in what specific order of preference/priority the separate property of any partner will be applied in the repayment of his separate debts and the debts of the firm?

Problems for Practice (With Suggested Solutions)

Problem 1

Ashraf, Ahmed, and Abdul are the partners of a 'partnership-at-will'. Abdul had given a notice in writing, dated 9th December 2008, and on the same day, he had delivered it personally to Ashraf and Ahmed, of his intention to dissolve the firm. But in his notice, he had forgotten to mention any specific date for the dissolution of the firm. Ashraf and Ahmed had not dissolved the firm till 21st December 2008, on the ground that Abdul had not mentioned any specific date from which the dissolution of the firm will be effective. Do you think that the stand taken by Ashraf and Ahmed are legally justified? Give reasons for your answer.

Solution

No; the stand taken by Ashraf and Ahmed is not legally justified for the following reasons:

(i) As per Section 43 of the Indian Partnership Act, a 'partnership–at-will' may be dissolved by giving a notice, in writing, to the other partners of the firm, of the intention of the partner concerned to dissolve the firm. Such notice, in writing dated 9th December 2008 had already been given by Abdul to Ashraf and Ahmed, the other partners of the firm, the same day, i.e. on 9th December 2008.

(ii) This Section further provides that, in case no specific date is mentioned in the notice, the firm will be deemed to have been dissolved with effect from the date of the communication of the notice. And we find that, in the instant case, the required notice in writing dated 9th December 2008 had already been given by Abdul to Ashraf and Ahmed, the other partners of the firm, the same day, i.e. on 9th December 2008. Accordingly, the firm will be deemed to have been dissolved with effect from 9th December 2008, this being the date of the communication of the notice to Ashraf and Ahmed, the other partners of the firm.

Problem 2

In Problem 1 above, in case Abdul, instead of giving the notice in writing to Ashraf and Ahmed on 9th December 2008, of his intention to dissolve the firm, would have preferred to file a suit in the Court on 9th December 2008, for the dissolution of the firm, will the firm be deemed to have been dissolved with effect from 9th December 2008. Give reasons for your answer.

Solution

No; the firm will not be deemed to have been dissolved with effect from 9th December 2008, for the following reasons:

(i) First, the filing of a suit for the dissolution of the firm is not considered to be a notice, as required under **Section 43.** Therefore, the firm cannot be deemed to have been dissolved with effect from 9th December 2008, as was the case in Problem 1 above.

(ii) Further, in the case where a suit has been filed in the Court of law, for the dissolution of the firm, the effective date of dissolution of the firm will be the date of passing of the preliminary decree by the Court for the dissolution of the firm**.** This contention is based on the judgement delivered in the case titled **Banarsi Das vs Kanshi Ram, AIR (1963), S.C. 1165**.

In view of the foregoing provisions of law, the firm will not be deemed to have been dissolved with effect from 9th December 2008, but only from the date the Court will later pass the preliminary decree for the dissolution of the firm.

Problem 3

Akbar, Abraham, Akash, and Amarjit are the partners of a partnership firm. But as only Akbar still continues to be solvent, he wants to continue the business of the firm. Can Akbar be legally permitted to continue the business of the firm? Give reasons for your answer.

Solution

No; Akbar cannot be legally permitted to continue the business of the firm, because, as provided under Section 41 of the Indian Partnership Act, if all the partners of the firm, or if all but one of the partners of the firm, are adjudicated as insolvent, the dissolution of a partnership firm will compulsorily take by the operation of law. That is why it is also referred to as a compulsory dissolution of the firm. This is so because of the following reasons:

(i) Insolvent persons cannot enter into a valid contract, including the contract of partnership, as provided in the Indian Contract Act. They can do so only after obtaining a certificate of discharge.

(ii) As a contract can be entered into between minimum two persons involved in it, a singe partner, viz. Akbar, who is otherwise competent to contract, cannot enter into a contract by himself alone.

In view of the foregoing provisions of law, this partnership firm will be compulsorily dissolved by the operation of law, as out of the four partners of the firm, three of them have been adjudicated as insolvent, and only one of the partners of the firm has not been adjudicated as insolvent, viz. Akbar. Thus, as the firm will be compulsorily dissolved, the question of Akbar continuing the business of the firm does not arise at all.

Problem 4

Will the position in Problem 3 above be any different in case only Abraham would have been adjudicated as insolvent? Give reasons for your answer.

Solution

The position will be decidedly different because, in that case, the firm will not get automatically and compulsorily dissolved invariably in all cases. That is to say that it could still continue to function, unless the partnership agreement (deed) would have already provided that the firm will get dissolved in the event of adjudication of a partner as insolvent. Thus, if the remaining (solvent) partners of the firm will opt and decide that the firm should not be dissolved but it should still continue to do its usual business (there being no provision in the Partnership Deed to the contrary), their such decision will prevail.

We say so on the basis of the provisions made under Section 42 of the Indian Partnership Act, which stipulates that, unless otherwise agreed upon between the partners of a firm, the partnership will stand dissolved on the happening of certain events, including the event of adjudication of a partner as insolvent.

That is why it is also referred to as 'optional dissolution', in contrast with the 'compulsory dissolution'.

Problem 5

George, Ganesh, and Qasim are the partners of a partnership firm. George has become insane (i.e. of unsound mind). Ganesh has filed a petition in the Court for the dissolution of the firm on this ground. Will the Court pass the order for the dissolution of the firm? Give reasons for your answer.

Solution

Yes; the Court will pass the order for the dissolution of the firm, because, as provided under Section 44 of the Indian Partnership Act, where a partner of the firm becomes insane (i.e. of unsound mind), any of the partners of the firm or (the next friend of the insane partner), can file a petition in the Court for the dissolution of the firm, and the Court may pass the order for the dissolution of the firm. In the instant case, George, one of the partners of the firm, has become insane (i.e. of unsound mind), and another partner of the firm viz., Ganesh has filed a petition in the Court for the dissolution of the firm on this ground.

Problem 6

Will the position in Problem 5 above be any different in case George, who has become insane (i.e. of unsound mind), would have been an inactive (dormant partner) of the firm? Give reasons for your answer.

Solution

Yes; the position will be different in case George, who has become insane (i.e. of unsound mind), would have been an inactive (dormant) partner of the firm. This is so because, as provided under Section 44 of the Indian Partnership Act, where an inactive (dormant) partner of the firm becomes insane (i.e. of unsound mind), the Court will not pass the order for the dissolution of the firm, unless a very special case is made out for the dissolution of the partnership firm. In the instant case, it is not mentioned whether a very special case has been made out for the dissolution of the partnership firm. We, therefore, presume that no such very special case has been made out for the dissolution of the partnership firm in the instant case. Therefore, based on such presumption, we have concluded that the Court will not pass the order for the dissolution of the firm.

Problem 7

Bharat, Ram, and Raghubir are the partners of a partnership firm. Raghubir, unfortunately, had a severe attack of paralysis whereby the left part his body had got completely paralysed. He was referred to an expert panel of specialist doctors, who, after a thorough examination, found that there was a great chance of his gaining full recovery, though it will naturally take somewhat long time for him to attain full recovery. Bharat and Ram were in no mood to wait that long, and therefore, they had filed a suit in the Court for dissolution of the firm. Will the Court pass the order for the dissolution of the firm? Give reasons for your answer.

Solution

No; the Court will not pass the order for the dissolution of the firm on the following grounds:

(i) Section 44 of the Indian Partnership Act provides that where a partner of the firm becomes permanently incapable of performing his duties as a partner of the firm, the Court may pass the order for the dissolution of the firm.

(ii) Here, the word 'permanently' is of essence. Thus, as in the instant case, Raghubir, a partner of the firm, though suffering from paralysis, has, on medical evidence, been found to be curable, it cannot be termed as a 'permanent' incapacitation of Raghubir, and therefore, in this case the Court will not pass the order for the dissolution of the firm. This contention is strengthened by the case titled **Whitwell vs Arthur, 35 Beav. 140.**

Problem 8

Wasim, Akram, and Kabir are the partners of a partnership firm. On 23rd October 2008, Wasim was travelling from Lucknow to Delhi by train without ticket. He was caught and was convicted for his act of travelling in a railway compartment without ticket, with the intention of defrauding the railway undertaking. Kabir had filed a petition in the Court for the dissolution of the firm on this ground. Will the Court pass the order for the dissolution of the firm? Give reasons for your answer.

Solution

Yes; the Court will pass the order for the dissolution of the firm in the instant case. This is so because, Section 44 of the Indian Partnership Act provides that where a partner of the firm is found guilty of the conduct, which is likely to prejudicially affect the carrying of the business of the firm, the Court may pass the order for the dissolution of the firm.

In the case titled **Carmichael vs Evans, 1940, 1 Ch.** 486, the act mentioned in the case in question (i.e. conviction of a partner for his act of travelling in a railway compartment without ticket, with the intention of defrauding the railway undertaking) was considered to be such an act (which was likely to prejudicially affect the carrying of the business of the firm), and accordingly, the Court had dissolved that partnership firm.

Problem 9

Arun, Sachin, and Dhoni are the partners of a partnership firm. The partners were carrying on the firm's business with full cooperation among themselves. But after a couple of years, Arun had started conducing himself in such a manner that it was not reasonably practicable for Sachin and Dhoni, the other partners of the firm, to carry on the business of the partnership with him. Therefore, Dhoni had filed a suit in the Court for dissolution of the firm. Will the Court pass the order for the dissolution of the firm? Give reasons for your answer.

Solution

Yes; the Court will pass the order for the dissolution of the firm, because Section 44 of the Indian Partnership Act provides that where a partner of the firm conducts himself in such a manner that it is not reasonably practicable for the other partners of the firm to carry on the business of the partnership with him, the Court may dissolve the firm.

Problem 10

Dhruv, Dron, and Gautam are the partners of a partnership firm. Gautam had sold his entire interest in the partnership to a third party (i.e. to an outsider). Will the Court pass the order for the dissolution of the firm? Give reasons for your answer.

Solution

Yes; the Court will pass the order for the dissolution of the firm, because Section 44 of the Indian Partnership Act provides that where a partner of the firm is found to have transferred in any manner (like by sale, mortgage or charge), his entire interest in the partnership to a third party (i.e. to an outsider), the Court may dissolve a firm

Problem 11

Will the position in Problem 10 above be any different if Gautam would have sold his entire interest in the partnership to Dhruv, instead? Give reasons for your answer.

Solution

Yes; the position will be different if Gautam would have sold his entire interest in the partnership to Dhruv, instead. This is so because, in that case the transfer of the entire (whole) share of Gautam in the partnership firm would have been transferred to a co-partner of the firm, viz. Dhruv, whereby the admission or introduction of any new partner to the firm would not have been involved. Accordingly, the Court will not pass the order for the dissolution of the firm in this case. This contention is based on the judgement of the case titled **Cassels vs Stewart 6 App. Cas. 64.**

Problem 12

Fashion Traders is a partnership firm. For the last couple of years, it was making steep losses, and its financial condition had been going from bad to worse, so much so that there was no hope or even any remote chance of its running on profit at any time in the near future. Accordingly, one of the partners of the firm had filed a suit in the Court for the dissolution of the firm. Will the Court pass the order for the dissolution of the firm? Give reasons for your answer.

Solution

Yes; the Court will pass the order for the dissolution of the firm, because Section 44 of the Indian Partnership Act provides that in the case of a loss-making firm, the Court can pass an order for the dissolution of a partnership firm, where its business cannot be run except at a loss.

Problem 13

Will the position in Problem 12 above be any different if the partnership firm was established for a fixed period? Give reasons for your answer.

Solution

No; there will no change of the position even in that case because, Section 44 of the Indian Partnership Act provides that, in the case of a loss-making firm, the Court can pass an order for the dissolution of a partnership firm, where its business cannot be run except at a loss, even if it was established for a fixed period. This contention is strengthened by the judgement of the case titled **Rehmat-un-nisa vs Price, 42 Bom. 380.**

Problem 14

After the dissolution of a partnership firm, William, one of the partners of the dissolved firm, had earned a substantial profit from the transactions connected with the firm. When the other partners came to know of this fact, they all insisted that William must share such profit with all the other partners of the dissolved firm. But William argued that, as he had earned the profit after the dissolution of the firm, he is not required to share the aforesaid profit with the other partners of the firm. Do you think that the aforementioned contention of William is legally tenable? Give reasons for your answer.

Solution

The contention of William is not legally tenable, because, as provided under **Section 50** of the Indian Partnership Act, in case any of the partners earns any profit from any transaction connected with the firm, after its dissolution, he is required to share such profit with the other partners of the firm, and the legal representatives of the deceased partner of the firm.

Problem 15

Yashwant, Yasin, Yaqub, and Yudhishthir are the partners of a firm named 'Three Wise'. It was established for a fixed period. Yudhishthir had paid a premium on his entry into the firm. It had, however, been dissolved before the expiry of the term, due to the premature death of Yaqub. Will Yudhishthir be entitled to get the refund (repayment) of the premium paid by him earlier? Give reasons for your answer.

Solution

No; Yudhishthir will not be entitled to get the refund (repayment) of the premium paid by him earlier, because, as provided under Section 51 of the Indian Partnership Act, such partner will not be entitled to receive the refund of the premium paid by him earlier, if the dissolution of the partnership firm is caused under certain circumstances which, *inter alia*, includes the death of a partner of the firm. Thus, as in the instant case, the dissolution of the partnership firm has been caused due to the death of Yaqub, one of the partners of the firm, before expiry of the fixed term of the partnership firm. Yudhishthir will not be entitled to get the refund (repayment) of the premium paid by him earlier.

Problem 16

Will the legal position be any different in Problem 15 above, in case the dissolution of the partnership firm would have taken place due to the own misconduct of Yudhishthir, instead? Give reasons for your answer.

Solution

No; the legal position will not be any different even in this case, because, as provided under Section 51 of the Indian Partnership Act, such partner will not be entitled to receive the refund of the premium paid by him earlier, if the dissolution of the partnership firm is caused under certain circumstances which, *inter alia*, includes the own misconduct of such partner of the firm himself. Thus, as in the instant case, the dissolution of the partnership firm has been caused due to the own misconduct of such partner of the firm, viz. Yudhishthir himself, he will not be entitled to get the refund (repayment) of the premium paid by him earlier.

Problem 17

As provided under Section 27 of the Indian Contract Act, every agreement in restraint of trade has been expressly declared as void. But, upon actual dissolution, the partners of the firm have enter into an agreement with the buyer of the goodwill of the firm, to the effect that some or all of them (partners), will not carry on a business similar to the business of the firm within a period of one year within the local limits of Lucknow. Do you think that such agreement will be declared as void, under the provisions of Section 27 of the Indian Contract Act, as aforementioned? Give reasons for your answer.

Solution

No; this agreement will not be declared as void, under the provisions of Section 27 of the Indian Contract Act, because an exception has been made under Section 54 of the Indian Partnership Act in the case of restraint of trade by the buyer of goodwill, but with certain conditions stipulated in this connection. Under this Section, upon actual dissolution, or in anticipation of the dissolution of the partnership firm, they (partners of the firm) may enter into an agreement with the buyer of the goodwill of the firm, to the effect that some or all of them (partners), will not carry on a business similar to the business of the firm within a specified period or within the specified local limits. And we find that all the aforementioned conditions specified under Section 54 of the Indian Partnership Act have been fulfilled in the instant case; that is;

(a) The firm has been actually dissolved;
(b) The restrictions have been made in respect of only such business which are similar to the business of the dissolved firm, and not on any other business;
(c) The restrictions have been made in respect of only within a specified period, i.e. only for one year;
(d) The restrictions have been made in respect of only within the specified local limits, i.e. Lucknow.
(e) Further, all the aforementioned restrictions imposed in this regard are found to be reasonable, and none of them are unreasonable.

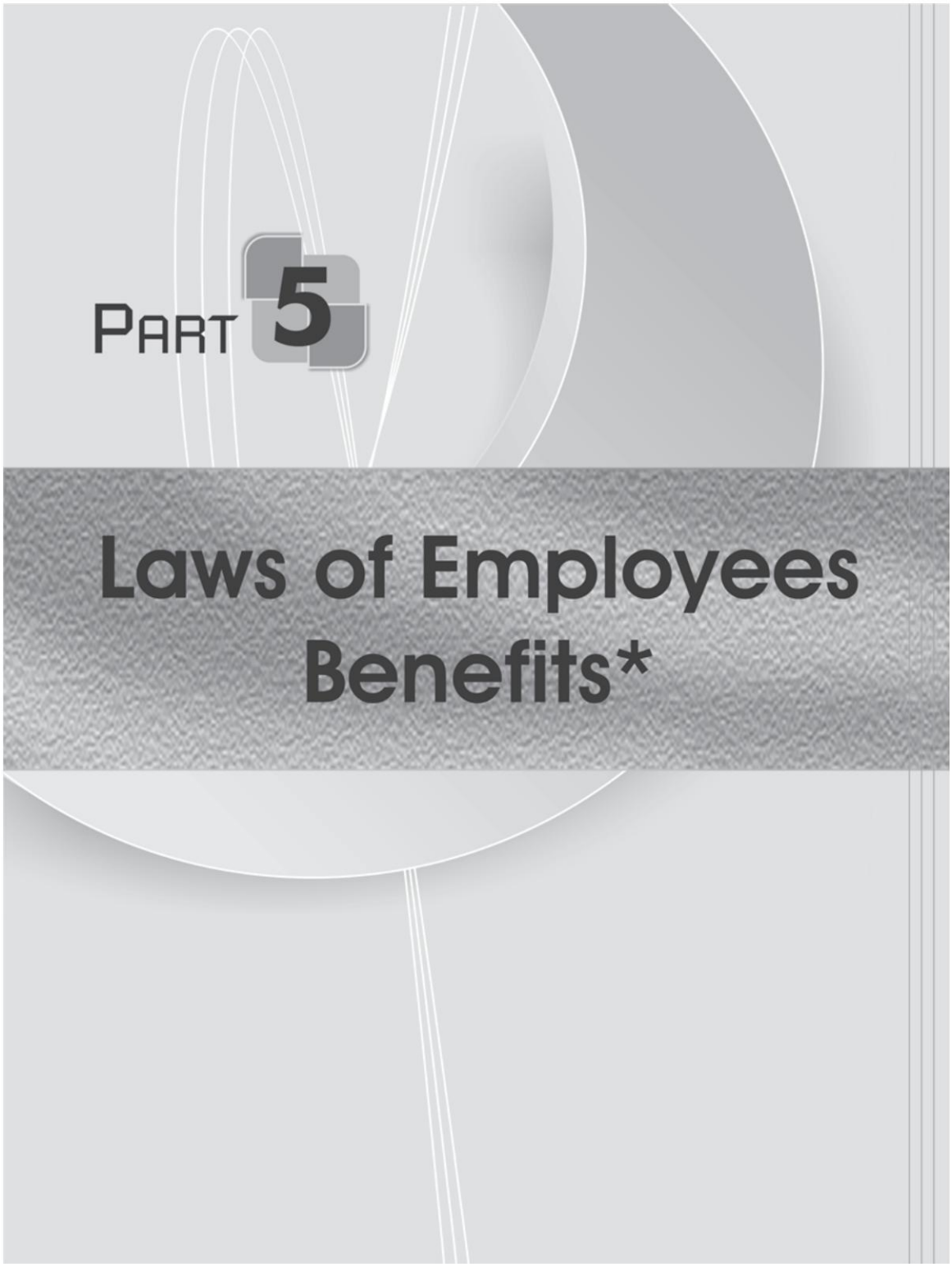
Accordingly, this agreement will not be declared as void

Problem 18

Bhavna, Benazir, and Basanti are the three partners of a partnership firm named 'Three Bees'. On the dissolution of the firm, it has been found that there are some joint debts due from the firm, and also some separate debts due from each of the three partners of the firm. But none of the three partners know as to how and in what order of priority/preference the property of the firm and the separate property of each of the partners of the firm will be applied in the settlement of the joint debts due from the firm, and the separate debts due from each of the three partners of the firm. They have, therefore, come to you to give them your expert legal opinion in this case. What will be your advice to them as a legal expert?

Solution

Our legal advice to them will be based on the provisions of Section 49 of the Indian Partnership Act. That is: The property of the firm shall be applied first in the payment of the debts of the firm. And in case there is still some surplus (property/assets of the firm) available, the share of each partner shall be applied in payment of her separate debts, or else it will be paid to her direct. Further, the separate property of any partner shall be applied first in the payment of her separate debts. And in case there is still some surplus (property/assets of the partners) available, the same shall be applied in the payment of the debts of the firm.


PART 5
Laws of Employees Benefits*

Chapter Thirty Four

Law of Payment of Bonus

"*Benefits should be conferred gradually; and in that way they will taste better.*
Niccolo Machiavelli

Write your injuries in dust, your benefits in marble.
Benjamin Franklin

Companies that give excellent service reward employees for providing it.
Source Unknown

Treat employees like partners, and they act like partners.
Fred A. Allen

A wage hike is very hard to take away, but bonuses and profit-sharing can disappear very quickly in hard times...More people are realizing that bonuses look like raises, but really aren't.
Al Bauman"

34.1 Object of the Act

The object of the Payment of Bonus Act is to provide for the payment of bonus to the persons employed in certain specified establishments and for the matters connected with the same. As observed by Justice Shah in the case titled **Jalan Trading Company (Private) Limited vs Mill Mazdoor Sabha [(1967) AIR SC 691]**, the object of the Act is to maintain peace and harmony between labour and capital by allowing the employees

to share the prosperity of the establishment and to prescribe the maximum and minimum rates of bonus together with the scheme of 'set-off' and 'set-on', which not only secures the right of the labour to share in the profits (of the establishments), but also ensures a reasonable degree of uniformity (in `the payment of bonus).

34.2 Scope and Application of the Act

The Act extends to the whole of India. Further, unless provided in the Act otherwise, it shall apply to the following establishments:

(i) To every factory (as defined under the Factories Act, 1948), and

(ii) To every other establishment wherein 20 or more persons are employed even on any day during an accounting year. That is, if even on a single day during an accounting year the number of the employees happens to be 20 or more, the provision of the Act will become applicable in that establishment.

Moreover, while calculating the number of the employees employed in any other establishment, even the casual labour will have to be included in such counting.

Conversely speaking, the provisions of the Act will not be applicable to any other establishment (other than the factories, as defined under the Factories Act, 1948) wherein less than 20 persons (including the casual labour) are employed on all the days during an accounting year.

Further, it must be noted carefully that the restriction in respect of number of employees pertains only to the other establishments (i.e. other than the factories, as defined under the Factories Act, 1948). Conversely speaking, the provisions of the Act will be applicable to all the factories (as defined under the Factories Act, 1948), irrespective of the fact whether the total number of persons employed in the factory (including the casual labour) happens to be even less than 20.

34.2.1 Power of Respective Government

Further, it has also been provided in the Act, that the respective appropriate Government could apply the provisions of the Act to any establishment or class of establishment even employing less than 20 persons (i.e. 10 or more persons but less than 20 persons), and that too, with effect from any accounting year, as may be notified in the Official Gazette.

34.2.2 Once the Act is Applied, it Continues to be Applicable

It will be interesting and important to note in this context that, as provided under **Section 1, Sub-section (5),** once the provisions of the Act is made applicable to any establishment, as per the aforementioned provisions in regard to the number of employees employed therein, the provisions of the Act will continue to be applicable to such establishment even in case the number of the employees employed therein happens to drop below 20, or even below 10 in certain cases (as aforementioned).

34.3 Where the Act is Not Applicable?

As provided under **Section 32**, some of the categories of employees have been excluded from the application of the Act. A list of such categories of employees has been presented in **Appendix 34.1**, at the end of the chapter.

34.3.1 Power of Respective Government to Exempt Some Other Establishments

In addition to the aforementioned rule regarding exemptions granted to some of the categories of employees from the application of the Act (vide Appendix 34.1); the appropriate Government has also been empowered,

under **Section 36** of the Act, to exempt any other specific establishment or even a class of establishments from the application of all or any of the provisions of the Act, of course, keeping in view its financial position and such other relevant circumstances. Thus, if it (Government) is of a considered opinion that it would not be in the public interest to apply all or any of the provisions of the Act in the case of such particular establishment or even a class of establishments, it may exempt such other specific establishment or even a class of establishments from the application of all or any of the provisions of the Act. However, the appropriate Government may impose such conditions while according such exemption, as it may consider fit.

34.4 Accounting Year [Section 2 (1)]

The term 'accounting year', as defined under **[Section 2 (1)]**, differs with the nature of the respective organisations, as has been discussed hereafter.

(**a**) When used in regard to a **corporation**, it (accounting year) means the year ending on the day on which the books and accounts of the corporation are to be closed and balanced.

(**b**) As against this, when used in regard to a **company**, it (accounting year) means the period in respect of which any profit and loss account, prepared by the company, is put up before the company in its annual general meeting, irrespective of the fact whether such period is full one year (12 months) or even less or more than full year (12 months).

In this context, it may be noted that while the accounting period of the companies are also usually one year (12 months), sometimes some companies prefer to change their accounting period from one year (12 months) to 9 months or 15 months or the like, under their own managerial judgments. But then, they also, after a couple of years or so, come back to their usual accounting period of one year (12 months).

(**c**) In any **other cases,** it (accounting year) means:

(i) The year commencing on the first day of April (and closing on the 31st day of March) each year, or

(ii) If the accounts of an establishment, maintained by its employer, are closed and balanced on any day other than the 31st day of March, in such cases the year ending on the day on which its accounts are so closed and balanced, at the option of the employer, will be its accounting year.

But then, once an option has been exercised by the employer concerned, such option cannot be exercised by the employer over again, except with the prior written permission of the prescribed authority, who may subject it (permission) to such conditions as it may think fit.

34.5 Corporation, Company, and Establishment

(a) Corporation [Section 2 (11)]

A corporation means any body corporate established by or under any Central, Provincial or State Act, but it does not include a company or a cooperative society.

(b) Company [Section 2 (9)]

As against this, a company means any company as defined under Section 3 of the Companies' Act, 1956, but it also includes a foreign company within the meaning of Section 591of the Act (Companies' Act, 1956).

(c) Establishment (Section 3)

Where an establishment consists of departments or undertakings, or has its branches, irrespective of the fact whether they are located in the same place or in different places, all such departments, undertakings, or branches, will be treated as a part of the same establishment for the purpose of computation of bonus under the Act.

Further if, for any accounting year, a separate balance sheet and profit and loss account are prepared and maintained in respect of any such departments, undertakings, or branches, such department, undertaking, or

branch, will be treated as separate establishments for the purpose of computation of bonus for that accounting year, unless such department, undertaking or branch, immediately before the commencement of that accounting year, were treated as a part of the same establishment for the purpose of computation of bonus under the Act.

34.6 Gross Profit [Section 2 (18)]

The term 'gross profit' stands for the gross profit, derived by an employer for the establishment for the respective year, which is to be calculated in the following manner, as per the provisions of **Section 4**:

(a) In the case of a banking company, the gross profit is required to be calculated in the manner as specified in the First Schedule.
(b) In any other case, it (gross profit) is required to be calculated in the manner as specified in the Second Schedule.

34.7 Available Surplus [Section 2 (6)]

The term 'available surplus' means the 'available surplus', as computed under **Section 5** in the following manner:

In any accounting year, the available surplus = gross profit of that year (less) the sum total of certain items as specified under **Section 6**. These items have been specified under Section 34.7.1 hereafter.

34.7.1 Sums Deductible from Gross Profit (Section 6)

After calculating the amount of gross profit as per **Section 4**, the sum of the following items is required to be deducted from the gross profit, as prior charges:

(a) Any amount by way of depreciation, admissible under Section 32 (1) of the Income Tax Act, or under the provisions of the Agriculture Income Tax Law;
(b) Any amount by way of development rebate, investment allowance or development allowance, which the employer is entitled to deduct from his income under the Income Tax Act;
(c) Subject to the provisions of **Section 7**, any direct tax, which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year; and
(d) Such further sums as are specified in the Third Schedule.

34.7.2 Simply put, in any accounting year, the available surplus = [gross profit of that year (less) {depreciation + (development rebate or investment allowance or development allowance) + (any direct tax payable by the employer during that accounting year, Subject to the provisions of **Section 7**) + (such further sums as specified in the Third Schedule of the Act)}].

34.7.3 Further, an amount equal to the saving made in income tax in the preceding accounting year because of the payment of the bonus in that year, should be added back to the amount arrived at as per Sub-section 34.7.2 above, or to the amount of gross profit at the initial stage itself.

34.8 Allocable Surplus [Section 2 (4)]

The term 'allocable Surplus' in two different cases means the following, as described under **Section 5:**

(a) In the case where a company (other than a banking company) is an employer, the term 'allocable surplus' means 67 per cent of the available surplus in an accounting year, where such company has not made the arrangements, as prescribed under the Income Tax Act, for the declaration and payments of

the dividends within India, payable out of its profits in accordance with the provisions of **Section 194 of the Income Tax Act**.

(b) In any other case, the term 'allocable surplus' means 60 per cent (instead of 67 per cent) of the available surplus **[Section 2 (4)].**

34.9 Appropriate Government [Section 2 (5)]

(a) In the case of an establishment where, under the 'Industrial Disputes Act, 1947', the 'appropriate' Government is the Central Government, in regard to the 'Payment of Bonus Act' as well the 'appropriate' Government will mean the Central Government itself. **[Section 2 (5)].**

(b) But in regard to any other establishment, the term 'appropriate' Government will mean the Government of the respective State wherein establishment concerned is located.

34.10 Award [Section 2 (7)]

The term 'award' stands for an interim or a final determination of any industrial dispute or any question relating thereto by any Labour Court, Industrial Tribunal or National Tribunal, constituted under the **Industrial Disputes Act, 1947**, or by any other authority constituted under any corresponding law, relating to investigation and settlement of industrial dispute in force in the State and includes an arbitration award made under Section **IOA** of that Act or under that law.

34.11 Direct Tax [Section 2 (12)]

As defined under **Section 2 (12),** the term 'direct tax', stands for the following:

(a) Any tax chargeable under the following Acts/Law:
  (i) Income Tax Act;
  (ii) Super Profits Tax, 1963;
  (iii) Companies (Profits) Surtax Act, 1964; and
  (iv) Agricultural Income Tax Law.

(b) Further, any other tax which, having regard to its nature of incidence*, may be declared by the Central Government, by notification in the Official Gazette, to be a direct tax for the purpose of this Act (Payment of Bonus Act).

34.12 Employee [Section 2 (13)]

The term 'employee' includes any person, other than an apprentice, employed on a salary or wage not exceeding Rs 3,500 (effective from 10th July 1995) per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical, or clerical work, for hire or reward, whether the terms of employment be expressed or implied.

*The meaning of the word 'incidence', in the present context, means the burden or liability (to pay the tax). Accordingly, the term 'nature of incidence' means, as to on which person or party the burden or liability (to pay the tax) finally lies. Alternatively speaking, it means as to which person or party finally ends up bearing the burden or liability of paying the tax concerned; that is, who finally and actually is made to pay the tax.

Thus, a tax is said to be in the nature of a direct tax, where the person or party on whom the tax is levied is required to pay the tax himself. Accordingly, the income tax is in the nature of a direct tax, because the income tax payee concerned is required to finally end up in paying the tax to the Government, which tax he cannot shift to any other party or person in any manner.

(*Contd*)

34.13 Employer [Section 2 (14)]

The term 'employer' includes the following:

(a) In respect of an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as a manager of the factory under **Section 7 of the Factories Act**, the person so named; and

(b) In respect of any other establishment, the person who, or the authority which, has the ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager or managing director, such manager or managing director.

34.14 Salary or Wage [Section 2 (21)]

The term 'salary or wage' includes the following:

(a) All remuneration capable of being expressed in terms of money, which would, if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment or of work done in such employment.

(b) Further, the term 'wage' also includes the dearness allowance (DA), i.e. all cash payments by whatever name called, paid to an employee on account of a rise in the cost of living.

34.14.1 Items Excluded from the Term 'Wage'

But the term 'wage' does not include the following items:

(i) Overtime wage;

(ii) Any allowance, other than the dearness allowance (DA), which the employee for the time being is entitled to;

(iii) The value of any house accommodation or of supply of light, water, medical attendance, or other articles;

(iv) Any travelling concession;

(v) Any contribution paid or payable by the employer to any pension fund or for the benefit of the employee under any law for the time being in force;

(vi) Any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him; and

(vii) Any commission payable to the employee.

However, where the employee is given, in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such (free) food allowance or the value of such (free) food shall be deemed to form part of the salary or wage for such employee.

(*Contd*)

As against the direct taxes, the taxes, like the sales tax, service tax, excise duty or customs duty, are in the nature of indirect taxes. This is so because, though the person or party concerned is required to pay such taxes to the Government direct in the first place, the parties or persons concerned, in turn, realise the amount of such taxes paid by them by way of proportionately increasing the price of the goods manufactured and/or sold by such persons or parties (manufacturing or distributing companies/firms and the like). This way, such taxes and duties are actually paid by the other parties/consumers, though indirectly (and not directly), by way of paying a higher or lower price for the goods depending on the fact whether the rates of the aforementioned taxes/duties have been increased or reduced by the Central or the State Governments concerned.

34.15 Words Not Defined in the Act [Section 2 (22)]

Further, as per **Section 2 (22),** the words and expressions used but not defined in the Payment of Bonus Act, but defined in the **Industrial Disputes Act**, shall have the same meaning respectively assigned to them in that Act (i.e. in the Industrial Disputes Act).

34.16 Calculation of Direct Tax (Section 7)

Any direct tax payable by the employer for any accounting year shall be calculated at the rates applicable to the income of the employer for that year, subject to the following provisions:

(a) While calculating the direct tax, the following matters will not be taken into account:
  (i) Any loss incurred by the employer in respect of any previous accounting year and carried forward under any law for the time being in force relating to direct tax;
  (ii) Any arrears of depreciation which the employer is entitled to add to the amount of the allowance for depreciation for any following accounting year or years, under **Section 32 (2) of the Income Tax Act**; and
  (iii) Any exemption conferred on the employer under **Section 80 of the Income Tax Act**.

(b) Where the employer is a religious or charitable institution, to which Section 32 of the Income Tax Act does not apply, and the whole or part of its income is exempt from tax under the Income Tax Act, with respect to the income so exempted, such institution shall be treated as if it were a company in which the public are substantially interested within the meaning of the Income Tax Act.

(c) Where the employer is an individual or a Hindu Undivided Family (HUF), the tax payable by such employer under the Income Tax Act shall be computed on the basis that the income derived by him from the establishment is his only income.

(d) Where the income of the employer includes any profits and gains derived from the export of any goods or merchandise, and any rebate on such income is allowed under any law for the time being in force, pertaining to the direct taxes, such rebate will not be taken into account, in this regard.

(e) No account shall be taken of any rebate (other than the development rebate, investment allowance or development allowance) or any credit, relief, or deduction (not hereinbefore mentioned) in the payment of any direct tax allowed under any law for the time being in force relating to the direct taxes or under the relevant annual Finance Act for the development of any industry.

34.17 Who is Eligible to Receive Bonus (Section 8)

(a) Employees

Every employee* shall be entitled to be paid bonus by his employer in any accounting year, according to the provisions of the Act, provided he has worked in the establishment for not less than 30 working days in that (accounting) year. That is, the holidays, Sundays, and/or any other non-working days are to be excluded for counting 30 working days in this context.

(b) Working Days

For the purpose of calculating the working days, an employee shall be deemed to have worked in an establishment in any accounting year also on the day on which:

(i) He has been laid off under an agreement or as permitted by the Standing Order under the Industrial Employment (Standing Order) Act, 1946, or under the Industrial Disputes Act, 1947, or under any other law applicable to the establishment;

* The term 'employee' in this context means the employee, as defined under **Section 2(13)**.

(ii) He has been on leave with salary or wage;
(iii) He has been absent due to temporary disablement caused by accident arising out of, and in the course of, his employment; and
(iv) The employee has been on maternity leave with salary or wage during the accounting year (**Section 14**).

34.18 Calculation of Bonus (Section 12)

Where the salary or wage of an employee exceeds Rs 3,500 per month, the bonus payable to such employee under **Section 10**, or as the case may be under **Section 11**, shall be calculated as if his salary or wage were Rs 3,500 per month.

Accordingly, if an employee's salary is Rs 5,000 per month and the bonus declared by the employer is 15 per cent, he will be entitled to the amount of the bonus of Rs 6,300, calculated in the following manner:

$$\text{Rs } 3{,}500 \times 0.15 \times 12 = \text{Rs } 6{,}300$$

$$\text{Or } \frac{\text{Rs } 3{,}500 \times 15 \times 12}{100} = \text{Rs } 6{,}300$$

34.19 Disqualification for Bonus (Section 9)

An employee will be disqualified from receiving bonus under **Section 9**, in case he is dismissed from service for any of the following reasons:

(i) Fraud;
(ii) Riotous or violent behaviour while on the premises of the establishment; or
(iii) Theft, misappropriation or sabotage of any property of the establishment.

But, we must note with care that the disqualification from the payment of the bonus to the employee will be applicable only if the employee was dismissed from his service. Alternatively speaking, the dismissal from service is a pre-requisite for the application of the disqualification, as aforementioned.

34.20 Minimum Bonus (Section 10)

Subject to the other provisions of the Act, every employer shall be bound to pay to every employee in respect of every accounting year, a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or Rs 100, whichever is higher, whether the employer has any allocable surplus in the accounting year or not. But, if the employee has not completed 15 years of age at the beginning of the accounting year, he will be entitled to a minimum bonus which shall be 8.33 per cent of the salary or wage during the accounting year or Rs 60, whichever is higher.

34.21 Maximum Bonus (Section 11)

Where, in respect of any accounting year, referred to in **Section 10**, the allocable surplus exceeds the amount of minimum bonus payable to the employee under **Section 10**, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year, bonus, which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year, subject to a maximum of 20 per cent of such salary or wage.

Further, while calculating the allocable surplus, under the aforementioned provisions, the amount 'set on' or the amount 'set off', as provided under **Section 15**, shall be taken into account, in accordance with the provisions of **Section 15**.

34.22 Proportionate Reduction in Bonus (Section 13)

Where an employee has not worked for all the working days [vide Section 34.20 of this chapter], in an accounting year, the minimum bonus of Rs 100 or of Rs 60 (where the employee has not completed 15 years of age), as the case may be, and if such bonus is higher than 8.33 per cent of his salary or wage of the days he has worked in that accounting year, it shall be proportionately reduced.

34.23 'Set on' and 'Set off' of Allocable Surplus

34.23.1 'Set on'

Where, for any accounting year, the allocable surplus exceeds the amount of maximum bonus payable to the employee in the establishment under **Section 11**, the excess amount, subject to a limit of 20 per cent of the total salary or wage of the employee employed in the establishment in that accounting year, shall be carried forward for being 'set on' in the succeeding accounting year and so on, upto and inclusive of the fourth accounting year. Such excess amount is to be utilised for the purpose of payment of bonus, in the manner illustrated in the Fourth Schedule.

34.23.2 'Set off'

There may be cases where there is no allocable surplus, or where the allocable surplus falls short of the amount of minimum bonus payable to the employee in the establishment under **Section 10**, and there is no amount or sufficient amount carried forward and set on under the aforementioned provisions of the Act, which could be utilised for the purpose of payment of the minimum bonus. In such cases, the minimum amount or the deficiency, as the case may be, shall be carried forward for being 'set off' in the succeeding accounting year and so on, upto and inclusive of the fourth accounting year, in the manner illustrated in the Fourth Schedule.

Further, the principle of 'Set on' and 'Set off', as illustrated in the Fourth Schedule, shall be applicable in all other cases covered under **Sub-Sections (1)** or **(2)** for the purpose of payment of bonus covered under the Act. **[Section 15 (3)].**

Moreover, where in any accounting year, any amount has been carried forward, and 'set on' or 'set off', under this Section, the amount of 'set on' or 'set off' carried forward from the earliest accounting year, shall be taken into account while calculating the bonus for the succeeding accounting year. **[Section 15 (4)].**

34.24 Provisions Regarding New Establishments (Section 16)

In the cases of the establishments, which have been newly set-up, the employees of such establishments shall be entitled to be paid bonus as per the provisions of **Sub-Sections (IA) (IB), and (IC) (Section 1).**

Here, it must be noted that an (already set-up) establishment shall not be deemed to be newly established merely because of a change in its name, location, management or ownership.

The provisions made under **Sub-Sections (IA) (IB), and (IC)** have been discussed hereafter, one after the other.

34.24.1 First Five Accounting Years [Sub-Sections (IA)]

In the case of a newly set-up establishment, in the first five accounting years, following the accounting year in which the employer sells the goods produced or manufactured by him or renders the services, as the case may be, the bonus shall be payable by such establishments only in respect of the accounting year in which the employer earns profits from such newly set-up establishment. Such bonus shall be calculated as per the provisions of the Act relating to that year but without applying the provisions of **Section 15**; that is, no set on or set off of the allocable surplus shall be made. **[Sub-Sections (IA)].**

In this context, it must be noted that the employer shall not be deemed to have earned any profit from the new establishment in an accounting year unless:

(i) He (employer) has made provisions for depreciation for that year, which he is entitled to, under the Income Tax Act or the Agricultural Income Tax Law, as the case may be; and

(ii) The arrears of such depreciation and losses incurred by, or in respect of, the establishment for previous accounting years, have been fully set off against his (employer's) profits.

34.24.2 Sixth and Seventh Accounting Years [Sub-Sections (IB)]

However, in the sixth and seventh accounting years, the provisions of **Section 15** (regarding the principles of set on or set off of the allocable surplus) shall apply, subject to the following modifications:

(i) For the sixth accounting year, the set on or set off, as the case may be, shall be made, in the manner illustrated in the Fourth Schedule, taking into account the surplus or deficit, if any, as the case may be, of the allocable surplus set on or set off in respect of the fifth and sixth accounting years.

(ii) For the seventh accounting year, the same principle will be followed but the surplus or deficit, if any, of the allocable surplus, set on or set off in respect of the fifth, sixth and seventh accounting years, will have to be taken into account. **[Sub-Sections (IB)].**

34.24.3 Eighth Accounting Year [Sub-Sections (IC)]

From the eighth accounting years, following the accounting year in which the employer sells the goods produced or manufactured by him, or renders the services (as the case may be), from such establishment, the provisions of **Section 15** will apply in respect of such establishments also as they apply in respect of any other establishment. **[Sub-Sections (IC)].**

34.24.4 Implication of the Words 'Sell the Goods Produced or Manufactured'

It may be carefully noted that, in the context of **Sub-Sections (IA), (IB), and (IC)**, the sale of goods produced or manufactured by the employer during the course of the trial-run of any factory, or the prospecting stage of any mine or oil-field, shall not be taken into account.

Further, in the event of any question arising with regard to such production or manufacture, the decision made by the appropriate Government, after giving reasonable opportunity to the parties concerned for representing their case, shall be final. Moreover, such decision, made by the appropriate Government, shall not be called into question by any Court or other authority.

34.25 Adjustment of Customary or Interim Bonus (Section 17)

If in any accounting year, an employer has paid any *puja* bonus or any other customary bonus to any employee, the employer shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under the Act, in respect of that accounting year. Thus, the employee shall be entitled to receive only the balance amount of bonus payable to him. The employer can do the same thing even in a

case where he has paid the amount of bonus payable to an employee under the Act before the date on which such bonus had become payable.

34.25.1 Deduction from Bonus Amount (Section 17)

If in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, the employer shall be legally entitled to deduct the amount of such loss from the amount of bonus payable by him to the employee under the Act in respect of that accounting year only. In such cases, the employee shall be legally entitled to receive only the balance amount, if any.

34.26 Bonus Linked with Production or Productivity (Section 31 A)

In some cases, there may be an agreement or settlement by the employees with their employer before the commencement of the Payment of Bonus (Amendment) Act, 1975, for payment of an annual bonus linked with production or productivity, instead of the bonus based on profits, payable under this Act (Payment of Bonus Act).

In other cases, there may be a similar agreement or settlement between the employees with their employer to the same effect, after such commencement, as aforementioned. In both the cases, the employee shall be legally entitled to receive the bonus due to him under such agreement or settlement, as the case may be. However, these provisions will be applicable, subject to the provisions pertaining to the minimum and maximum amount of bonus.

Further, such agreement or settlement, whereby the employees relinquish their right to receive the minimum bonus, as per **Section 10**, such agreement or settlement shall be considered as null and void, insofar as it purports to deprive the employees of such right. It has been further provided that such employees shall not be entitled to claim such bonus in excess of 20 per cent of the salary or wage earned by them during the relevant accounting year.

34.27 Time Limit for Payment of Bonus

All amounts, payable to an employee by his employer by way of bonus under the Act, must be paid in cash. Further, the amount of bonus must be paid in the following manner in respect of the relevant cases:

(a) In the cases, where a dispute regarding the payment of bonus is pending before any authority under **Section 22**, the amount of bonus must be paid within one month from the date on which the award becomes enforceable, or the settlement comes into operation, in respect of such dispute.

(b) In other cases, however, the amount of bonus must be paid within a period of eight months from the close of the respective accounting year.

However, upon an application made to the appropriate Government, by the employer, and for sufficient reasons, it (appropriate Government) may extend the aforementioned period of eight months to such further period or periods (from time to time), as it may think fit. But then, the total of such extended period must not exceed the period of two years in any case.

34.28 Application in the Public Sector (Section 20)

34.28.1 Meaning of Establishments in Public Sector [(Section 2 (16)]

An establishment in the public sector means an establishment owned, controlled, or managed by any of the following:

(i) A Government company, as defined under **Section 617 of the Companies Act, 1956**;
(ii) A corporation wherein not less than 40 per cent of its capital is held, either singly or taken together, by the following:
   (1) By the Government; or
   (2) By the Reserve Bank of India; or
   (3) By a corporation owned by the Government or the Reserve Bank of India.

34.28.2 Application of the Act in the Public Sector

The provisions of the Act (Payment of the Bonus Act) will apply to the establishments in the public sector only when the following conditions are satisfied:

(i) The establishment is engaged during an accounting year in the sale of any goods produced or manufactured by it, or in the rendering the services by it, in competition with an establishment in the private sector.
(ii) The income generated from the aforementioned sale or services, or both taken together, is not less than 20 per cent of the gross income of the establishment.

34.29 Recovery of Bonus due from the Employer (Section 21)

In the cases where any amount is due to an employee from his employer by way of bonus under an agreement, a settlement or an award, the employee himself or any other person authorised by him in this behalf, or in the case of the employee's death, his assignee or heirs may make an application to the appropriate Government for the recovery of the amount of bonus due to him.

If the appropriate Government or such authority, as the appropriate Government may specify in this behalf, is satisfied that any amount of bonus is due to him from his employer, it shall issue a certificate for the amount to the Collector, who shall proceed to recover the same in the same manner as an arrear of land revenue is recovered.

But such application has to be made within one year from the date the amount of bonus has become due. However, the application may be entertained even at a later date than one year, if the appropriate Government is satisfied that the applicant (employee) had sufficient reason for not making the application within the aforementioned period (i.e. within one year).

In this context and purpose, the term 'employee' includes a person who is entitled to the payment of bonus under the Act, but who is no longer in the employment of the employer concerned.

34.30 Reference of Disputes (Section 22)

In the cases where there is any dispute between the employer and his employees in regard to the bonus payable under the Act, or in regard to the application of the Act, to an establishment in the public sector, such dispute shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947, or any corresponding law relating to the investigation and settlement of the industrial disputes in force in a State, and the provisions of that Act, or such law, as the case may be, shall apply accordingly, except provided to the contrary (otherwise).

Let us Recapitulate

- **Object of the Act**
  The object of the Act is to provide for the payment of bonus to the persons employed in certain specified establishments and for the matters connected therewith.

As observed by Justice Shah in a case, the object of the Act is to maintain peace and harmony between labour and capital by allowing the employees to share the prosperity of the establishment and to prescribe the maximum and minimum rates of bonus together with the scheme of 'set-off' and 'set-on' which not only secures the right of the labour to share in the profits (of the establishments) but also ensures a reasonable degree of uniformity (in `the payment of bonus).

- **Scope and Application of the Act**

The Act extends to the whole of India. Further, unless provided in the Act otherwise, it shall apply to the following establishments:

(**i**) To Every factory (as defined under the Factories Act, 1948), irrespective of number of employees; and

(**ii**) To Every other establishment wherein 20 or more persons, including the casual labour, are employed even on any day during an accounting year.

- **Powers of the Appropriate Government**

However, the respective appropriate Government could apply the provisions of the Act to any establishment even employing less than 20 persons, but not less than 10 persons, with effect from any accounting year, as may be notified in the Official Gazette.

Most of the definitions of the terms have been provided under **different Sub-Sections of Section 2.**

- **Accounting Year**

(**a**) When used in regard to a **corporation**, it means the year ending on the day on which the books and accounts of the corporation are to be closed and balanced.

(**b**) But, when used in regard to a **company**, it means the period in respect of which any profit and loss account, prepared by the company, is put up before the company in its annual general meeting, irrespective of the fact whether such period is full one year (12 months) or even less or more than one full year (12 months).

(**c**) In any **other cases,** it means:

(**i**) The year commencing on the first day of April (and closing on the 31st day of March) each year, or

(**ii**) If the accounts of an establishment are closed and balanced on any day other than 31st March, it will mean the year ending on the day on which its accounts are so closed and balanced, at the option of the employer. But once an option has been exercised by the employer it cannot be changed, except with the prior written permission of the prescribed authority, who may subject it (permission) to such conditions as it may think fit.

- **Corporation, Company, and Establishment**

(**a**) **Corporation** means any body corporate established by or under any Central or State Act, but it does not include a company or a cooperative society.

(**b**) **Company** means any company as defined under **Section 3 of the Companies' Act, 1956**, but it also includes a foreign company within the meaning of **Section 591 of the Act (Companies' Act, 1956)**.

(**c**) **Establishment**

Where an establishment consists of departments or undertakings, or has its branches, located in the same place or in different places, all these will be treated as a part of the same establishment for the purpose of computation of bonus.

Gross Profit (Section 4)

(**a**) In the case of a banking company, it is calculated in the manner as specified in the First Schedule.

(**b**) In any other case, it is required to be calculated in the manner as specified in the Second Schedule.

- **Available Surplus (Sections 5 and 6)**

In any accounting year, it is = [gross profit of that year (less) {depreciation + (development rebate or investment allowance or development allowance) + (any direct tax payable by the employer during

that accounting year, Subject to the provisions of **Section 7**) + (such further sums as specified in the Third Schedule of the Act)].

- **Allocable Surplus**
  - (**a**) In the case where a company (other than a banking company) is an employer, it means 67 per cent of the available surplus in an accounting year, where such company has not made the arrangements, as prescribed under the Income Tax Act, for the declaration and payments of the dividends within India, payable out of its profits in accordance with the provisions of **Section 194 of the Income Tax Act**.
  - (**b**) In any other case, it means 60 per cent (instead of 67 per cent) of the available surplus.
- **Appropriate Government**
  - (**a**) In the case of an establishment where, under the 'Industrial Disputes Act, 1947', the 'appropriate' Government is the Central Government, in regard to the 'Payment of Bonus Act' also, it will mean the Central Government itself.
  - (**b**) In regard to any other establishment, it will mean the Government of the respective State wherein establishment concerned is located.
- **Award**
  It stands for an interim or a final determination of any industrial dispute or any question relating thereto, by any Labour Court, Industrial Tribunal or National Tribunal constituted under the **Industrial Disputes Act**, 1947, or by any other authority constituted under any corresponding law, relating to investigation and settlement of industrial dispute in force in the State and includes an arbitration award made under **Section IOA** of that Act or under that law.
- **Direct Tax**
  It stands for the following:
  - (**a**) Any tax chargeable under the following Acts/Law:
    - (i) Income Tax Act;
    - (ii) Super Profits Tax, 1963;
    - (iii) Companies (Profits) Surtax Act, 1964; and
    - (iv) Agricultural Income Tax Law.
  - (**b**) Further, any other tax which, having regard to its nature of incidence, may be declared by the Central Government, by notification in the Official Gazette, to be a direct tax for the purpose of this Act.
- **Employee**
  It includes any person, other than an apprentice, employed on a salary or wage not exceeding Rs 3,500 (effective from 10 July 1995) per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical, or clerical work, for hire or reward, whether the terms of employment be expressed or implied.
- **Employer**
  - (**a**) In respect of an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as a manager of the factory under **Section 7 of the Factories Act**, the person so named; and
  - (**b**) In respect of any other establishment, the person who, or the authority which, has the ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager or managing director, such manager or managing director.
- **Salary or Wage**
  - (**a**) It includes all remuneration capable of being expressed in terms of money, which would, if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment or of work done in such employment.

(b) Further, the term 'wage' also includes the dearness allowance (DA), i.e. all cash payments by whatever name called, paid to an employee on account of a rise in the cost of living.

- **Items excluded from the term 'wage'**
  (i) Overtime wage;
  (ii) Any allowance, other than the DA, which the employee for the time being is entitled to;
  (iii) The value of any house accommodation or of supply of light, water, medical attendance or other articles;
  (iv) Any travelling concession;
  (v) Any contribution paid or payable by the employer to any pension fund or for the benefit of the employee under any law for the time being in force;
  (vi) Any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him; and
  (vii) Any commission payable to the employee.
- **Words not defined in the Act**
  These words shall have the same meaning as are assigned to them in the **Industrial Disputes Act**.
  - Any direct tax payable by the employer shall be calculated at the rates applicable to his income without taking into account any loss incurred by him in the previous accounting year, any arrears of depreciation, any exemption under **Section 80 of the Income Tax Act**, any rebate available on exports, and any rebate (other than the development rebate, investment allowance or development allowance) or any credit, relief or deduction (not hereinbefore mentioned) in the payment of any direct tax.
  - Every employee shall be entitled to bonus provided he has worked for not less than 30 working days in that (accounting) year; i.e. holidays, Sundays, and/or any other non-working days are to be excluded.
  - The days the employee has been laid off, or was on leave with salary and wages, or was absent due to temporary disablement caused by accident in the course of his employment; and when on maternity leave with salary or wage during the accounting year.
  - Where the salary or wage of an employee exceeds Rs 3,500 the bonus shall be calculated as if his salary or wage were Rs 3,500 per month.
    Accordingly, if an employee's salary is Rs 5,000 per month and the bonus declared by the employer is 15 per cent he will be entitled the amount of the bonus of Rs 6,300, calculated in the following manner:

$$\text{Rs } 3{,}500 \times 0.15 \times 12 = \text{Rs } 6{,}300; \text{ Or } \frac{\text{Rs } 3{,}500 \times 15 \times 12}{100} = \text{Rs } 6{,}300$$

  - (**i**) Fraud; (**ii**) Riotous or violent behaviour while on the premises of the establishment; or (**iii**) Theft, misappropriation or sabotage of any property of the establishment, disqualifies the employee from payment of bonus, provided the employee was dismissed from his service for the same.
  - A minimum bonus shall be paid at 8.33 per cent of the salary or wage earned by the employee or Rs 100, whichever is higher, whether the employer has any allocable surplus in the accounting year or not. But, if the employee has not completed 15 years of age at the beginning of the accounting year, he will be entitled to a minimum bonus which shall be 8.33 per cent of the salary or wage during the accounting year or Rs 60, whichever is higher.
  - Where the allocable surplus exceeds the amount of minimum bonus payable, the employer shall be bound to pay bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year, subject to a maximum of 20 per cent of such salary or wage.
  - Where an employee has not worked for all the working days, the minimum bonus of Rs 100 or of Rs 60 (where the employee has not completed 15 years of age), and if such bonus is higher than

8.33 per cent of his salary or wage of the days he has worked in that accounting year, it shall be proportionately reduced.

- For 'Set on' and 'Set off' of Allocable Surplus, please refer to the text (Section 34.23).
- For provisions regarding new establishments please refer to the text (Section 34.24).
- Any interim bonus, like *puja* bonus, paid earlier than the due date, shall be deductible from the final bonus payable.
- If in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, the amount of such loss is deductible from the amount of bonus payable to the employee for that accounting year only.
- Bonus linked with production or productivity will, however, be subject to the provisions pertaining to the minimum and maximum amount of bonus.
- For the time limit for payment of bonus, please refer to the text (Section 34.27).
- For application in the Act in the public sector , please refer to the text (Section 34.28).
- Bonus due from the employer can be recovered by the employee himself, or by any other person authorised by him, or by his assignee or legal heirs after making an application to the appropriate Government for the recovery of the amount of bonus due.
- The appropriate Government or such specified authority, on being satisfied, shall issue a certificate for the amount to the Collector, who shall proceed to recover the same as an arrear of land revenue.
- But such application has to be made within one year from the date the amount of bonus has become due. However, the period may be extended if there were sufficient reason for the delayed application.

In this context and purpose, the term 'Employee' includes a person who is entitled to the Payment of Bonus Under the Act, but who is no longer in the employment of the employer concerned.

Questions for Reflection

1. Explain the object of the Payment of Bonus Act.
2. Write whether the following statements are true or false:
   (i) The Payment of Bonus Act extends to the whole of India, except to the State of Jammu and Kashmir.
   (ii) The Payment of Bonus Act extends to every factory, wherein 20 or more persons are employed on all the working days during an accounting year.
   (iii) The Payment of Bonus Act extends to the whole of India, including the State of Jammu and Kashmir.
   (iv) The Payment of Bonus Act extends to every factory, wherein 20 or more persons are employed, excluding the casual labour, even on any day during an accounting year.
   (v) The Payment of Bonus Act extends to every factory, irrespective of the number of employees employed even on any day during an accounting year.
   (vi) The Payment of Bonus Act extends to the whole of India.
   (vii) The Payment of Bonus Act extends to every establishment, other than factories, wherein 20 or more persons are employed, including the casual labour, even on any day during an accounting year.
   (viii) The provisions of the Act will not be applicable to any other establishment (other than the factories) wherein less than 20 persons (excluding the casual labour) are employed on all the working days during an accounting year.
   (ix) The provisions of the Act will not be applicable to any other establishment (other than the factories), wherein less than 20 persons (excluding the casual labour) are employed on all the days during an accounting year.

(x) The provisions of the Act will be applicable to all the factories, irrespective of the fact whether the total number of persons employed in the factory (excluding the casual labour) happens to be even less than 20.

(xi) The Payment of Bonus Act extends to every establishment, other than factories, wherein 20 or more persons are employed, excluding the casual labour, even on any day during an accounting year.

3. Write whether the following statements are true or false:
   (i) The appropriate Government can apply the provisions of the Act to any establishment or class of establishment, even employing less than 20 persons (i.e. 10 or more persons but less than 20 persons), with effect from any accounting year, as may be notified in the Official Gazette.
   (ii) Once the provisions of the Act is made applicable to any establishment, as per the provisions [as stated in question (i) above], in regard to the number of employees employed therein, the provisions of the Act will cease to be applicable to such establishment in case the number of the employees employed therein happens to drop below 20, or even below 10 in certain cases.
   (iii) The appropriate Government can apply the provisions of the Act to any establishment or class of establishment even employing 10 or lesser number of persons, with effect from any accounting year, as may be notified in the Official Gazette.
   (iv) Once the provisions of the Act is made applicable to any establishment, as per the provisions [as stated in question (i) above], in regard to the number of employees employed therein, the provisions of the Act will continue to be applicable to such establishment even in case the number of the employees employed therein happens to drop below 20, or even below 10 in certain cases.
4. (a) Write the names of five categories of the employees who have been excluded from the application of the Act.
   (b) Write the names of five of the notified institutions, the employees whereof have been excluded from the application of the Act.
5. (a) Under what specific conditions and considerations can the appropriate Government exempt any other specific establishment or even a class of establishments, from the application of all or any of the provisions of the Act?
   (b) Whether such exemption accorded by the appropriate Government will be unconditional?
6. Define the following terms, as provided in the Payment of Bonus Act:
   (i) 'Accounting Year':
      (a) When used in regard to a corporation,
      (b) When used in regard to a company, and
      (c) When used in regard to any other cases (i.e. other than a corporation and company);
   (ii) 'Corporation', 'Company', and 'Establishment';
   (iii) Gross Profit:
      (a) In the case of a banking company, and
      (b) In other cases;
   (iv) Available Surplus;
   (v) Various items the sums whereof is required to be deducted from Gross Profit;
   (vi) Allocable Surplus:
      (a) In the case where a company (other than a banking company) is an employer, and
      (b) In any other case;
7. In what specific case of an establishment, as provided in the Payment of Bonus Act, the term 'Appropriate Government' will mean the following?
      (a) The Central Government, and
      (b) The Government of the respective State wherein establishment concerned is located.

8. What is the meaning of the following terms, as provided in the Payment of Bonus Act?
   (a) Award,
   (b) Direct Tax;
   (c) Employee;
   (d) Employer; and
   (e) Salary or Wage.
9. Specify the various items:
   (a) Which are included, for calculation of salary and wage, and
   (b) Which are excluded, for calculation of salary and wage.
10. What meaning will the words and expressions have, which have been used, but not defined, in the Payment of Bonus Act?
11. In what specific manner should the direct tax, payable by the employer for any accounting year, be calculated, in regard to payment of bonus?
12. What are the various criteria prescribed for the eligibility of the employees for payment of bonus?
13. For what specific reasons can an employee, dismissed from service, be disqualified from payment of bonus?
14. What are the legal provisions laid down for payment of minimum bonus?
15. What are the legal provisions laid down for payment of maximum bonus?
16. Specify the provisions made in regard to the proportionate reduction in bonus where an employee has not worked for all the working days in the following cases?
   (a) Where the employee has completed 15 years of age, and
   (b) Where the employee has not completed 15 years of age.
17. Explain the various legal provisions stipulated in the Payment of Bonus Act regarding 'Set on' and 'Set off' of Allocable Surplus?
18. What are the various provisions regarding new establishments for payment of bonus under the Payment of Bonus Act, in the following cases?
   (a) During the first five accounting years;
   (b) During the sixth and seventh accounting years' and
   (c) During the eighth accounting year.
19. What are the various legal implications of the words 'sell the goods produced or manufactured' in the cases (a) (b) and (c), in question no. 18 above?
20. Explain the provisions pertaining to the adjustment of customary or interim bonus.
21. Under what circumstances can the amount of bonus be deducted from the amount of bonus payable to the employee during the current year?
22. Explain the various legal provisions stipulated in the Payment of Bonus Act regarding bonus linked with production or productivity.
23. What are the time limits stipulated for payment of bonus under different circumstance?
24. What is the meaning of establishments in the public sector, as stipulated in the Payment of Bonus Act?
25. 'The provisions of the Payment of the Bonus Act will apply to the establishments in the public sector only when certain conditions are satisfied'. Explain the various conditions.
26. What are the conditions, ways, and time period within which the amount of bonus due from the employer can be recovered from him by the employee, who is no longer in the service of the employer:
   (a) During his life time and
   (b) After his death?
27. In question no.16 above, can the time limit be extended, and if so, under what circumstances and by which authority?
28. What are the provisions for referring any dispute between the employer and his employees in regard to the bonus payable under the Act, or in regard to the application of the Act, to an establishment in the public sector?

Problems for Practice (With Suggested Solutions)

Problem 1

Wasim, the chairman and managing director of 'Kashmir Carpets', located in Shrinagar, has not paid any bonus to its employees, numbering 9 permanent employees and 15 casual labours, for the current accounting year, on the plea that the provisions of the Payment of Bonus Act does not extend to the State of Jammu and Kashmir. Do you think that the contention of Wasim is legally tenable? Give reasons for your answer.

Solution

No**;** the contention of Wasim is not legally tenable, because the provisions of the Payment of Bonus Act extend to the whole of India, including the state of Jammu and Kashmir.

Problem 2

In Problem 1 above, let us presume that Wasim had, instead, taken the plea that the provisions of the Payment of Bonus Act would not apply to his company on the ground that it (his company) was employing only 9 permanent employees, which falls short of the minimum 20 employees, as stipulated in the Payment of Bonus Act. Do you think that this contention of Wasim would have been legally tenable in the changed situation? Give reasons for your answer.

Solution

No; the contention of Wasim would not have been legally tenable even in the changed situation. This is so, because, the provisions of the Act do not apply to any other establishment (other than the factories, as defined under the Factories Act, 1948), wherein less than 20 persons (including, and not excluding the casual labour) are employed on all the days during an accounting year.

In the instant case, the number of total persons employed in Wasim's company, including the 15 casual labours, comes to 24 (i.e. 9 permanent employees plus 15 casual labours). Wasim might have been under the wrong impression that while calculating the minimum number of employees in his company, the number of casual labour is not to be included, whereas, as per the provisions of the Act, the number of casual labour is not to be excluded, but included, instead.

Problem 3

Patiala Pharmaceuticals, a factory (as defined under the Factories Act, 1948), has fully automated plants and machinery and computerised production system, so much so that it employs only 14 permanent employees and 5 casual labours. It, however, has not paid any bonus to its employees even for the current accounting year, on the plea that the provisions of the Payment of Bonus Act does not apply to it as only 19 persons (including the casual labour) are employed on all the days during any accounting year. Do you think that the contention of the company is legally tenable? Give reasons for your answer.

Solution

No; the contention of the company is not legally tenable. This is so, because the provisions of the Act do not apply only to the other establishments (other than the factories, as defined under the Factories Act, 1948), wherein less than 20 persons (including the casual labour) are employed on all the days during an accounting year. Alternatively speaking, the restriction in respect of number of employees pertains only to the other establishments (i.e. other than the factories, as defined under the Factories Act, 1948). Conversely speaking, the provisions of the Act will be applicable to all the factories (as defined under the Factories Act, 1948), irrespective of the fact whether the total number of persons employed in the factory (including the casual labour) happens to be even less than 20. Accordingly, the company will have to pay the bonus for all the previous accounting years also, as it may be payable to the employees of the company, as per the provisions of the Act.

Problem 4

Only 14 permanent employees and 5 casual labours were employed by a company during all the previous accounting years. Accordingly, it had not paid bonus to any of its employees so far. Supriya, however, had

joined the company as the 15th permanent employees on 29th March 2009. The employer had denied payment of bonus to all its employees for this accounting year also on the plea that Supriya had worked in the company only for three days and thereby the number of the total employees working in the company, including casual labour, had had gone up from 19 to 20 for only three days in this accounting year, and for the rest of the days in this accounting year, i.e. from 1st April to 31st March 2009, the total number of the employees working in the company, including casual labour, had remained only 19, i.e. less than 20. Do you think that the contention of the company is legally tenable? Give reasons for your answer.

Solution

No; the contention of the company is not legally tenable. This is so, because, the provisions of the Act become applicable in any establishment, if even on a single day during an accounting year, the number of the employees happened to be 20 or more. Accordingly, the provision of the Act will become applicable in this establishment as for three days during the accounting year, from 1st April to 31st March 2009, the number of employees employed in this company happened to be 20.

Problem 5

The respective appropriate Government had applied the provisions of the Act to a company employing 12 persons with effect from the accounting year from 1st April to 31st March 2008, and had notified the same in the Official Gazette. But in the following account year, i.e. from 1st April to 31st March 2009, the number of the employees employed therein had dropped to 9. Accordingly, the company had taken a considered decision not to pay the dividend for the accounting year, from 1st April to 31st March 2009. Do you think that the decision taken by the company is legally tenable? Give reasons for your answer.

Solution

No; the decision taken by the company is not legally tenable. This is so, because, once the provisions of the Act is made applicable to any establishment, or class of establishment, by the respective appropriate Government, even employing less than 20 persons (i.e. 10 or more persons but less than 20 persons), the provisions of the Act will continue to be applicable to such establishment even in case the number of the employees employed therein happens to drop below 20, or even below 10 in certain cases.

Thus, though in the following account year, i.e. from 1st April to 31st March 2009, the number of the employees employed in the company had dropped to 9 (i.e. even below 10), as the provisions of the Act has once been made applicable to this company by the respective appropriate Government, the provisions of the Act will continue to be applicable to this company even when the number of the employees employed therein had droped below 10, in the instant case.

Problem 6

A company, employing 50 persons, has been incurring losses right from the commencement of its business. Accordingly, it has made an application to the appropriate Government to exempt it from the application of all the provisions of the Payment of Bonus Act. Do you think that the appropriate Government will exempt it from the application of all the provisions of the Payment of Bonus Act, and if so, on what grounds? Give reasons for your answer.

Solution

Yes; as per the provisions of Section 36 of the Payment of Bonus Act, the appropriate Government may exempt this company from the application of all or any of the provisions of the Act, keeping in view its financial position, and provided it is of considered opinion that it would not be in the public interest to apply all or any of the provisions of the Act in the case of this establishment. Thus, the very fact that this company has been incurring losses right from the commencement of its business, goes to indicate that its financial position is weak enough, and accordingly, the appropriate Government is most likely to consider that it would be in the public interest to exempt this company from the application of all or any of the provisions of the Act. However, the appropriate Government, while according such exemption, may impose such conditions on the company, as it may consider fit.

Problem 7

Some relevant data of a non-banking company are as follows:

(a)	Gross Profit:	Rs 90,000
(b)	Amount of Depreciation available under Income Tax Act and Agricultural Income Tax Act:	Rs 11,000
(c)	Development rebate, investment allowance, and development allowance, deductible under the Income Tax Act;	Rs 15,000
(d)	Direct tax, which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year:	Rs 14,000
(e)	Further sums as specified in the Third Schedule of the Act:	Rs 16,000
(f)	Saving made in income tax in the preceding accounting year because of the payment of the bonus in that year	Rs 12,000

It may be further noted that the company has not made the arrangements, as prescribed under the Income Tax Act, for the declaration and payments of the dividends within India, payable out of its profits.

Compute the amounts of:

(i) Available Surplus; and
(ii) Allocable Surplus.

Solution

In any accounting year, the available surplus = gross profit of that year (less) the sum total of certain items deductible from the gross profit as per Section 6 of the Payment of Bonus Act. These are:

(a) Depreciation available under Income Tax Act and Agricultural Income Tax Act;
(b) Development rebate, investment allowance or development allowance, deductible under the Income Tax Act;
(c) Direct tax, which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year; and
(d) Such further sums as are specified in the Third Schedule.
(e) Amount equal to the saving made in income tax in the preceding accounting year because of the payment of the bonus in that year should be added to the total of the amount so arrived at.

Simply put, in any accounting year, the available surplus = [gross profit of that year (less) {depreciation + (development rebate or investment allowance or development allowance) + (any direct tax payable by the employer during that accounting year, subject to the provisions of Section 7) + (such further sums as specified in the Third Schedule of the Act)].

(f) Further, to such sum total, we should add back the amount of the saving made in income tax in the preceding accounting year because of the payment of the bonus in that year, so as to arrive at the amount of available surplus.

Thus, the amount of available surplus will be equal to

[{a} (less) {b + c + d+ e}] + (f).

Now, by computing the values of these items, as given in the problem we will get the available surplus as

		(a) Rs 90,000
(b)	Rs 11,000	
(c)	Rs 15,000	
(d)	Rs 14,000	
(e)	Rs 16,000	
	Rs 56,000 (less)	Rs 56,000
		Rs 34,000
	Add back (f) (+)	Rs 12,000

(i) Thus, Available Surplus (=) Rs 46,000

As in the given case the company is other than a banking company, and such company has not made the arrangements, as prescribed under the Income Tax Act, for the declaration and payments of the dividends within India, payable out of its profits, the 'allocable surplus' will be 67 per cent of the available surplus in an accounting year.

(ii) Thus, the allocable surplus will be 67 per cent of Rs 46, 000 , which comes to Rs. 30,820.

Problem 8

In the Problem 7 above, if the company would have been a banking company, instead (all other data remaining unchanged), would there be any difference in regard to the following:

(i) Available Surplus; and
(ii) Allocable Surplus.

Solution

(i) As regards the amount of **available surplus**, there will be no change and, thus, in this case also it will remain the same, i.e. **Rs 46,000.**
(ii) The 'allocable surplus', however, in the case of a banking company will be 60 per cent (instead of 67 per cent) of the available surplus in an accounting year.
(iii) **Thus, the allocable surplus will be 60 per cent of Rs 46, 000, which comes to Rs. 27,600.**

Problem 9

The following categories of officers and employees are working in a company and are paid the amount of monthly salary etc. as noted against each of them:

(i) Officers drawing 3,500 p.m. + Dearness Allowance Rs 500 + free food allowance valued at Rs 1,000 p.m. as a part of salary.
(ii) Officers drawing 3,000 p.m. + Dearness Allowance Rs 600 + free food allowance valued at Rs 900 p.m. as a part of salary.
(iii) Officers drawing 2,100 p.m. + Dearness Allowance Rs 700 + free food allowance valued at Rs 700 p.m. as a part of salary.
(iv) Officers drawing 1,200 p.m. + Dearness Allowance Rs 600 + free food allowance valued at Rs 600 p.m. as a part of salary.
(v) Supervisors drawing 1,200 p.m. + Dearness Allowance Rs 500 and overtime on an average of Rs 1,000 per month + free food allowance valued at Rs 500 p.m. as a part of salary.
(vi) Workers drawing 900 p.m. + Dearness Allowance Rs 700 and overtime on an average of Rs 900 per month + free food allowance valued at Rs 400 p.m.
(vii) Apprentices drawing 700 p.m. + Dearness Allowance Rs 400 and overtime on an average of Rs 500 per month + free food allowance valued at Rs 400 p.m.

Further, except the apprentices, all the employees are given house accommodation, supply of light, water, and medical attendance; and travelling concession amounting to Rs 1,000 p.m.

To compute the quantum of bonus payable to each of them, what amount will be taken as the salary in each case?

Solution

The term 'salary or wage' includes:

(**a**) All remuneration capable of being expressed in terms of money and (**b**) the dearness allowance (DA).

But the term 'wage', *inter alia*, does not include (i) overtime wage; (ii) value of any house accommodation or of supply of light, water, medical attendance or other articles, or (iii) travelling concession;

However, where the employee is given, in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such (free) food allowance or the value of such (free) food shall be deemed to form part of the salary or wage for such employee.

In view of the foregoing provisions, only the following items will be included as the salary and wages payable to the employee:

(a) Amount of salary
(b) Dearness allowance
(c) Free food allowance

That is so because (i) overtime wage; (ii) value of any house accommodation or of supply of light, water, medical attendance or other articles, and (iii) travelling concession are not taken into account for the purpose.

But in the cases where the salary or wage of an employee exceeds Rs 3,500 per month, the bonus payable to such employee shall be calculated as if his salary or wage were Rs 3,500 per month (Sections 10 and 11 of the Payment of Bonus Act).

Now, when we total the amount of the three relevant items, as aforementioned, i.e. salary, DA and free food allowance, in respect of the various categories of staff of the company, we find the following facts:

(i) Officers drawing 3,500 p.m. + Dearness Allowance Rs 500 + free food allowance valued at Rs 1,000 p.m. as a part of salary, the sum total of these three items at Rs 5, 000 exceeds the ceiling of Rs 3,500. Therefore, the bonus payable to such employees shall be calculated as if their salary or wage were Rs 3,500 per month.

(ii) Officers drawing 3,000 p.m. + Dearness Allowance Rs 600 + free food allowance valued at Rs 900 p.m. as a part of salary, the sum total of these three items at Rs 4,500 exceeds the ceiling of Rs 3,500. Therefore, the bonus payable to such employees shall be calculated as if his salary or wage were Rs 3,500 per month.

(iii) Officers drawing 2,100 p.m. + Dearness Allowance Rs 700 + free food allowance valued at Rs 700 p.m. as a part of salary, the sum total of these three items at Rs 3,500 is within the prescribed ceiling of Rs 3,500. Therefore, the bonus payable to such employees shall be calculated on the basis of their salary or wage at Rs 3,500 per month.

(iv) Officers drawing 1,200 p.m. + Dearness Allowance Rs 600 + free food allowance valued at Rs 600 p.m. as a part of salary, the sum total of these three items at Rs 2,400 is within the prescribed ceiling of Rs 3,500.
Therefore, the bonus payable to such employees shall be calculated on the basis of their salary or wage at Rs 2,400 per month.

(v) Supervisors drawing 1,200 p.m. + Dearness Allowance Rs 500 + free food allowance valued at Rs 500 p.m. as a part of salary, the sum total of these three items at Rs 2,200 is within the prescribed ceiling of Rs 3,500. Therefore, the bonus payable to such employees shall be calculated on the basis of their salary or wage at Rs 2,200 per month.

(vi) Workers drawing 900 p.m. + Dearness Allowance Rs 700 + free food allowance valued at Rs 400 p.m. as a part of salary, the sum total of these three items at Rs 2,000 is within the prescribed ceiling of Rs 3,500. Therefore, the bonus payable to such employees shall be calculated on the basis of their salary or wage at Rs 2,000 per month.

(vii) Apprentices drawing 700 p.m. + Dearness Allowance Rs 400 + free food allowance valued at Rs 400 p.m. as a part of salary are not found eligible for payment of bonus, as they have been specifically declared as ineligible under the Act, though the sum total of the three items at Rs 1,500 is within the prescribed ceiling of Rs 3,500.

Problem 10

Paramita had worked in an establishment for 100 working days in a particular accounting year. However, she was laid off under an agreement for 15 working days, and was on leave with salary or wage for another 16 working days. She was also absent due to temporary disablement caused by accident arising out of, and in the course of, her employment for 19 working days; and had been on maternity leave with salary or wage for another 30 working days during the accounting year. The employer had refused payment of bonus to her on the ground that she had worked in the establishment only for 20 days [100 days (less) {15 +16+19 +30}, which was less than the minimum 30 working days to make her eligible for the payment of bonus under the Payment of Bonus Act.. Do you think that the contention of the employer is legally tenable in the aforementioned circumstances? Give reasons for your answer.

Solution

The contention of the employer is not legally tenable in the aforementioned circumstances for the following reasons:

It is true that every employee shall be entitled to be paid bonus by his or her employer in any accounting year, according to the provisions of the Act, provided he or she has worked in the establishment for not less than 30 working days in that (accounting) year. That is, the holidays, Sundays, and/or any other non-working days are to be excluded for counting 30 working days in this context.

It has been further provided in the Act that for the purpose of calculating the working days, an employee shall be deemed to have worked in an establishment in any accounting year also on the day on which:

(i) He or she has been laid off under an agreement or as permitted by the Standing Order under the Industrial Employment (Standing Order) Act, 1946, or under the Industrial Disputes Act, 1947, or under any other law applicable to the establishment;

(ii) He or she has been on leave with salary or wage;

(iii) He or she has been absent due to temporary disablement caused by accident arising out of, and in the course of, his/her employment; and

(iv) The employee has been on maternity leave with salary or wage during the accounting year.

In view of the aforementioned provisions of law, Paramita will be eligible for bonus as she had, in fact, worked in the establishment for 100 working days and not for just 20 working days, as all the 80 days for which she was laid off and was on leave, will be not excluded for calculating the working days, she will be legally deemed to have worked in the organisation.

Therefore, the contention of the employer is not legally tenable in the aforementioned circumstances.

Problem 11

An employee's salary is Rs 9,000 per month and the bonus declared by the employer is 20 per cent for a particular accounting year. What amount of bonus will he be entitled to receive? Give reasons for your answer.

Solution

He will be entitled to receive the amount of bonus of Rs 8,400, calculated in the following manner:

$$\text{Rs } 3{,}500 \times 0.20 \times 12 = \text{Rs } 8{,}400$$

$$\text{Or } \frac{\text{Rs } 3{,}500 \times 20 \times 12}{100} = \text{Rs } 8{,}400$$

This is so because, where the salary or wage of an employee exceeds Rs 3,500 per month, the bonus payable to such employee shall be calculated as if his salary or wage were Rs 3,500 per month.

Problem 12

An employee's salary is Rs 3,000 per month and the bonus declared by the employer is 25 per cent for a particular accounting year. What amount of bonus will he be entitled to receive? Give reasons for your answer.

Solution

He will be entitled to receive the amount of bonus of Rs 9,000, calculated in the following manner:

$$\text{Rs } 3{,}000 \times 0.25 \times 12 = \text{Rs } 9{,}000$$

$$\text{Or } \frac{\text{Rs } 3{,}000 \times 25 \times 12}{100} = \text{Rs } 9{,}000$$

This is so because, where the salary or wage of an employee does not exceed Rs 3,500 per month, the bonus payable to such employee shall be calculated on the basis of the actual salary or wage paid to him, i.e. Rs 3,000 p.m., in the instant case.

Problem 13

An employee has been dismissed from service for committing fraud. His salary, however, is Rs 9,000 per month and the bonus declared by the employer is 20 per cent for a particular accounting year. What amount of bonus will he be entitled to receive? Give reasons for your answer.

Solution

He will not be entitled to receive any bonus as, due to having committed fraud, and thereafter being dismissed also on this account, he will be disqualified for receiving any bonus.

Problem 14

An employee has been charge-sheeted for his riotous or violent behaviour while on the premises of the establishment. He has been put under suspension pending decision for his dismissal or otherwise. His salary, however, is Rs 3,000 per month and the bonus declared by the employer is 20 per cent for a particular accounting year. What amount of bonus will he be entitled to receive? Give reasons for your answer.

Solution

The employee has been put under suspension pending decision for his dismissal or otherwise. Thus, it may be safely inferred that he has not yet been dismissed from his service. Therefore, he will not be disqualified from receiving the bonus due to having committed the offence in question, because he has not so far been dismissed also on this account. This is so because, the disqualification from the payment of the bonus to the employee will be applicable only if the employee has already been dismissed from his service. Alternatively speaking, the dismissal from service is a pre-requisite for the application of the disqualification, as aforementioned.

Therefore, he will be entitled to receive the amount of bonus of Rs 7,200, calculated in the following manner:

$$\text{Rs } 3{,}000 \times 0.20 \times 12 = \text{Rs } 7{,}200$$

$$\text{Or } \frac{\text{Rs } 3{,}000 \times 20 \times 12}{100} = \text{Rs } 7{,}200$$

This is so because, where the salary or wage of an employee does not exceed Rs 3,500 per month, the bonus payable to such employee shall be calculated on the basis of the actual salary or wage paid to him, i.e. Rs 3,000 p.m., in the instant case.

Problem 15

An employee's salary is Rs 3,300 per month but the employer has no allocable surplus for that particular accounting year. His age is 18 years. What amount of bonus will he be entitled to receive? Give reasons for your answer.

Solution

Subject to the other provisions of the Act, every employer shall be bound to pay to every employee in respect of every accounting year, a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or Rs 100, whichever is higher, whether the employer has any allocable surplus in the accounting year or not. But this will be position if the employee has completed 15 years of age at the beginning of the accounting year. Thus, as the employee had completed 15 years of age at the beginning of the accounting year (as he is already 18 years of age), he will be eligible for a minimum bonus at the rate of 8.33 per cent of the salary or wage earned by the employee during the accounting year (i.e. 8.33 per cent or 25/3 per cent of Rs 2,100), which comes to Rs 175, which is more than the minimum entitled amount of Rs 100, This is so because the higher amount between 175 and minimum entitled amount of Rs 100 will be payable to him.

Problem 16

An employee's salary is Rs 600 per month but the employer has no allocable surplus for that particular accounting year. His age is 14 years. What amount of bonus will he be entitled to receive? Give reasons for your answer.

Solution

Subject to the other provisions of the Act, every employer shall be bound to pay to every employee in respect of every accounting year, a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or Rs 60, whichever is higher, whether the employer has any allocable surplus in the accounting year or not. But this will be the position if the employee has not completed 15 years of age at the beginning of the accounting year. Thus, as the employee had not completed 15 years of age at the beginning of the accounting year (as he is even now 14 years of age), he will be eligible for a minimum bonus at the rate of 8.33 per cent of the salary or wage earned by the employee during the accounting year (i.e. 8.33 per cent or 25/3 per cent of Rs 600), which comes to Rs 50, which is less than the minimum entitled amount of Rs 60. Therefore, he will be paid the bonus amount of minimum entitled amount of Rs 60. This is so because, the higher amount between 50 and minimum Rs 60 will be payable to him.

Problem 17

Will the position be any different if, in question 16 above, the allocable surplus would have exceeded the amount of minimum bonus payable to the employee? Give reasons for your answer.

Solution

Under the changed circumstances, the employer shall, in lieu of such minimum bonus (of Rs 60), be bound to pay to every employee in respect of that accounting year, bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year, subject to a maximum of 20 per cent of such salary or wage. Thus, the employee will be paid a maximum bonus at the rate of 20 per cent of Rs 600, which comes to Rs 120, instead of Rs 60 only. But then this will be maximum bonus he will be entitled to. That is, if the allocable surplus is at a lower level, such entitled bonus will be propionately reduced in the case of the employee concerned, as also in respect of all the other employees.

Problem 18

Will the position be any different if, in question 15 above, the allocable surplus would have exceeded the amount of minimum bonus payable to the employee? Give reasons for your answer.

Solution

Under the changed circumstances, the employer shall, in lieu of such minimum bonus (of Rs 100), be bound to pay to every employee in respect of that accounting year, bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year, subject to a maximum of 20 per cent of such salary or wage. Thus, the employee will be paid a maximum bonus at the rate of 20 per cent of Rs 3,300, which comes to Rs 660, instead of Rs 100 only. But then this will be maximum bonus he will be entitled to. That is, if the allocable surplus is at a lower level, such entitled bonus will be proportionately reduced in the case of the employee concerned, as also in respect of all the other employees.

Problem 19

In an accounting year, the employer has paid a *puja* bonus to an employee. Will the employer be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee in respect of that accounting year? Give reasons for your answer.

Solution

Yes, the employer will be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under the Act in respect of that accounting year. Thus, the employee shall be entitled to receive only the balance amount of bonus payable to him. The employer can do the same thing even in a case where he has paid the amount of bonus payable to an employee under the Act before the date on which such bonus had become payable.

Problem 20

In an accounting year, an employee has been found guilty of misconduct causing financial loss to the employer to the extent of Rs 1,000. Will the employer be legally entitled to deduct the amount of such loss of Rs 1,000 from the amount of bonus payable by him to the employee? Give reasons for your answer.

Solution

Yes, the employer will be legally entitled to deduct the amount of such loss of Rs 1,000 from the amount of bonus payable by him to the employee, but in respect of that accounting year only, and not in the subsequent accounting years. Accordingly, the employee shall be legally entitled to receive only the balance amount, if any, but in respect of that accounting year only.

Appendix 34.1

List of the categories of the employees, excluded from the application of the Act.

(i) Employees employed by the Life Insurance Corporation of India (LIC);
(ii) Seamen, as defined under Section 3 (42) of the Merchant Shipping Act, 1958;
(iii) Employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948, and employed by the registered or listed employers;
(iv) Employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a local authority;
(v) Employees employed by:
  (a) The Indian Red Cross Society, or any other institution of a like nature (including its branches), and
  (b) Institutions (including hospitals, chambers of commerce, and social welfare institutions) established not for the purposes of profit;
(vi) Employees employed through contractors on building operations;
(vii) Employees employed by the Reserve Bank of India (RBI);
(viii) Employees employed by inland water transport establishment operating on routes passing through any other country; and
(ix) Employees employed by the **notified institutions**.

The notified institutions include the following:

(a) Industrial Financial Corporation of India (IFCI);
(b) Any financial corporation established under Section 3 or any joint financial corporation established under Section 3 A of the State Financial Corporation Act, 1951;
(c) Deposit Insurance Corporation (DIC);
(d) Agricultural Refinance Corporation (ARC);
(e) Unit Trust of India (UTI);
(f) Industrial Development Bank of India (IDBI)
(g) Any other financial institution (other than a banking company) being an establishment in the public sector, which the Central Government may, by notification in the Official Gazette, may notify.

Chapter Thirty Five

Law of Payment of Gratuity

"*A long dispute means that both parties are wrong.*
Voltaire

Talk is over-rated as a means of settling disputes.
Tom Cruise

At a round table there is no dispute about place.
Alas! How deeply painful is all payment!
Lord Byron

Cash-payment is not the sole nexus of man with man.
Thomas Carlyle Nominee

I cannot think of any need in childhood as strong as the need for a father's protection.
Sigmund Freud"

35.1 Introduction

The Act aims at providing for a scheme for the payment of gratuity to the employees engaged in factories, mines, oil-fields, plantation, ports, railway companies, shops or other establishments, and for the matters pertaining or incidental thereto. The Act became enforceable with effect from 21st August 1972. Under **Section 1**, it extends to the whole of India. But then, in regard to plantations or ports, it will not be enforceable in the State of Jammu and Kashmir.

The Act applies to the following:

(a) All factories, mines, oil-fields, plantation, ports, and railway companies,

(b) All shops or other establishments within the meaning of any law, for the time being in force, in relation to shops and establishments in a State, wherein 10 or more persons are employed or were employed on any day of the preceding 12 months, and
(c) Such other establishments or class of establishments wherein 10 or more persons are employed or were employed on any day of the preceding 12 months, as the central Government may, by notification, specify in this regard.

35.2 Definitions

35.2.1 Appropriate Government [(Section 2 (a)]

This Section provides that in regard to any of the following establishments, the appropriate Government will mean the Central Government:

(a) An establishment belonging to, or under the control of, the Central Government,
(b) An establishment having its branches in more than one State,
(c) An establishment of a factory belonging to, or under the control of, the Central Government,
(d) An establishment of a major port, mine, oil-field or railway company.

In all other cases, the appropriate Government will mean the State Government.

35.2.2 Continuous Service [(Section 2 (c)]

Under **Section 2 (c)**, read with **Section 2A,** the continuous service means uninterrupted service, including the service interrupted by sickness, accident, leave, absence from duty without leave, lay off, strike, or lock-out or cessation of work without any fault on the part of the employee concerned.

In case the service of an employee is interrupted by the causes other than those specified above, the service will be deemed to have been interrupted and, accordingly, such service will not fall within the definition of continuous service. **[Dalmia Magnesite Corporation, Salem vs R.L. Commissioner, Madras (1982)].**

If an employee does not have uninterrupted service for (a) one year or (b) six months, he shall be deemed to be in the continuous service under the following circumstances:

(a) In the case of the aforementioned one-year period, if the employee during the period of 12 calendar months, preceding the date with reference to which the calculation is required to be made , has actually worked with the employer for not less than:
  (i) 190 days, if the employee is engaged below the ground in a mine, or in an establishment which works for less than six days in a week; or
  (ii) 240 days, in the other cases.
(b) In the case of the aforementioned six-month period, if the employee during the period of six calendar months, preceding the date with reference to which the calculation is required to be made, has actually worked with the employer for not less than:
  (i) 95 days, if the employee is engaged below the ground in a mine, or in an establishment which works for less than six days in a week; or
  (ii) 120 days, in the other cases.

However, an employee, working in a seasonal establishment, shall be deemed to be in continuous service, if he has actually worked for not less than 75 per cent of the number of days on which the establishment was in operation during such period.

35.2.3 Controlling Authority [(Section 2 (d)]

Controlling Authority means an authority appointed by the appropriate Government under **Section 3.** As

provided under this Section, the appropriate Government may, by notification in the Official Gazette, appoint any officer to be a Controlling Authority, who shall be responsible for the administration of the Act. Further, different Controlling Authorities may be appointed for different States.

35.2.4 Employee [(Section 2 (e)]

The term 'employee' means any person (other than an apprentice) employed in any establishment, factory, mine, oilfield, plantation, port, railway company, or shop. He may be employed to do any skilled, semi-skilled or unskilled, manual, supervisory, technical, or clerical work. Further, his term of employment may be express or implied.

The term 'employee' also includes any such person who is employed in a managerial or administrative capacity. But, the term does not include any such person who holds a post under the Central Government or a State Government, and is governed by any other Act or rules pertaining to the payment of gratuity to him.

It may, however, be noted in this context that the monetary ceiling of Rs 3,500 per month, as the salary or wage of an employee, for his being covered under Act, has since been abolished under the Payment of Gratuity (Amendment) Act, 1994. Thus, all the employees of the specified establishments, except the apprentices, are now entitled to be paid the gratuity under the Act.

35.2.5 Employer [(Section 2 (f)]

The term 'employer' has been defined as follows:

Pertaining to any establishment, factory, mine, oilfield, plantation, port, railway company, or shop, belonging to or under the control of the Central Government or a State Government, the term 'employer' means a person or authority, appointed by the appropriate Government for the supervision and control of the employees. Where no person or authority has been so appointed, the term 'employer' means the head of the Ministry or the Department concerned.

In the case of any of the aforementioned establishments belonging to, or under the control of, any of the local authorities, the term 'employer' means the person appointed by such authority for the supervision and control of the employees. Where no person has been so appointed, the term 'employer' will mean the Chief Executive Officer of the local authority.

In any other case, the term 'employer' will mean the person or authority, who or which has the ultimate control over the affairs of the establishments, factory, mine, oilfield, plantation, port, railway company or shop. However, where the control of the affairs of the aforementioned establishments are entrusted to any other person, the term 'employer' will mean such other person, whether called a manager, managing director, or by any other name.

35.2.6 Factory [(Section 2 (g)]

The term 'factory' in relation to this Act, has the same meaning as has been assigned to the term under **Clause (m) of Section 2 of the Factories Act**.

35.2.7 Family [(Section 2 (h)]

The term 'family' differs in the cases of the male and female employees. In the case of a male employee, the term 'family' will be considered to be consisting of himself, his wife, and his children (whether married or unmarried), his dependent parents and the dependent parents of his wife, and the widow and children of his pre-deceased son, if any.

Likewise, in the case of a female employee, the term 'family' will be considered to be consisting of herself, her husband, her children (whether married or unmarried), her dependent parents, and the dependent parents of her husband and the widow and children of her pre-deceased son, if any.

Further, where the personal law of an employee permits the adoption of a child by him, any child legally adopted by him shall be considered to be included in his family. Similarly, any child of the employee, legally adopted by any other person, shall be excluded from the family of the employee.

35.2.8 Retirement [(Section 2 (q)]

The term 'retirement' means termination of service of an employee otherwise than on superannuation.

35.2.9 Superannuation [(Section 2 (r)]

The term 'superannuation', in relation to the employee, means the following:

(a) The attainment of such age by the employee as is fixed in the contract or conditions of service as the age on the attainment whereof the employee shall vacate the employment, and

(b) In any other case, on the attainment of age of 58 years (now 60 years) by the employee. Thus, we may observe that the term 'superannuation' means retirement of an employee on attaining a certain age.

It may, however, be noted here that, in the case of an employee, entitled to the benefit of payment of gratuity under the Act, no age of superannuation 'has been fixed, either by a contract or any condition of service, if the employer unilaterally fixes 58 years of age as the age of superannuation' of the employee, it will not be held valid, because the age of superannuation' has now been raised to the age of 60 years, which has since been fixed by the Parliament. This has been clarified in the judgement in the case titled **Baidyanath Ayurved Bhawan Ltd, Naini, Allahabad vs Lalta Prasad.**

35.2.10 Wages [(Section 2 (s)]

The term 'wages' has been defined as all emoluments , which are earned by the employee while on duty or on leave in accordance with the terms and conditions of his employment, and which are paid or are payable to him in cash. It also includes the dearness allowance (DA). However, it does not include any bonus, commission, house rent allowance, overtime wages and any other allowance.

Further, as the amount to be included for the computation of payment of gratuity is only the amount which is payable to the employee in cash, the value of the food supplied by the employer to the employee cannot be taken into account because, the supply of free food cannot be considered as the part of his cash salary. This point has been clarified in the case titled **Ambika Saw Mill vs Assistant Labour Commissioner (1986) Lab. I.C. 1828 (Ori)**.

35.3 Application for Payment of Gratuity

An employee, who is eligible for the payment of gratuity under the Act, or any person authorised in writing, to act on his (employee's) behalf, is required to send a written application to the employer concerned, for payment of the amount of gratuity, usually within 30 days from the date on which the amount of gratuity had become payable. The method of determining gratuity has been stipulated under **Section 7**.

However, in the cases where the date of superannuation or retirement of an employee is already known, the employee may apply to the employer before 30 days of the date of his such superannuation or retirement. Further, the application may also be made by the nominee of the employee or by his legal heir, within the prescribed time limit, i.e. within 30 days in the case of the nominee, and one year in the case of the legal heir.

35.4 Determining Amount of Gratuity

When the gratuity becomes payable to the employee, the employer should determine the amount of gratuity

and should give notice, in writing, to the employee to whom the amount of gratuity is payable. A notice is required to be given to the Controlling Authority also, specifying therein the amount of gratuity so determined by the employer. Such notices are required to be given by the employer irrespective of the fact whether the required application for the payment of the amount of gratuity has been made by the employee to the employer or not.

The employer is required to make the payment of the amount of gratuity to the employee to whom it is payable within thirty days from the date it has become payable. If the amount of gratuity so payable is not paid by the employer within the specified period of 30 days, as mentioned in **Sub-Section 3**, the employer shall have to pay simple interest on the amount so payable, at such rate, not exceeding the rate specified and notified by the Central Government from time to time, for payment of long-term deposits. The amount of interest so computed will be payable from the date on which the amount of gratuity had become payable to the date it has actually been paid. Such rate of interest is currently specified at 10 per cent per annum.

But then, no such interest will be payable to the employee, if the delay in the payment of the amount of gratuity is on account of any fault on the part of the employee, and the employer has obtained permission, in writing, from the Controlling Authority, for the delayed payment of the amount of gratuity on this account (basis, ground).

35.5 Dispute Regarding Amount of Gratuity

In regard to any dispute regarding the amount of gratuity payable to an employee, or regarding the person entitled to receive the amount of the gratuity, the employer is required to deposit such amount, as he admits to be payable to the employee, with the Controlling Authority. In regard to a dispute regarding any matter, the employee may make an application to the Controlling Authority. The Controlling Authority, in his turn, is required to hold an enquiry after allowing a reasonable opportunity to the parties involved in the dispute, for being heard, and thereafter, he will determine the actual amount of gratuity payable to the employee concerned.

Further, if after the enquiry, it is found that the employer is required to pay more amount than he had earlier deposited with the Controlling Authority, it shall direct the employer to pay the balance amount to the employee concerned.

35.6 Enforcing the Attendance of any Person

For the purpose of conducting an enquiry, the Controlling Authority shall have the same powers as are vested in a Court, while trying a suit under the Code of Civil Procedure in respect of the following matters:

(a) Enforcing the attendance of any person or his examination on oath;
(b) Requiring the discovery or production of documents;
(c) Receiving the evidence of affidavits; and
(d) Issuing commissions for examination of witnesses.

The appropriate government or the Appellant Authority, as the case may be, may, after giving to the appellant a reasonable opportunity of being heard, confirm or reverse the decision of the Controlling Authority.

35.7 Gratuity Payable on Termination of Employment

The circumstances under which the amount of gratuity may be paid to an employee, and when it may be forfeited, have been discussed under **Section 4**. These provisions have been discussed hereafter:

Under this Section, the amount of gratuity may be paid to an employee, on the termination of his employment, after he has rendered continuous service for not less than five years, and under the following cases:

(a) On his attaining the age of superannuation;
(b) On his retirement or resignation; or
(c) On his death or disablement due accident or disease.

But then, the amount of gratuity cannot be payable to an employee who has not rendered continuous service for the required minimum period of five years. But then, the amount of gratuity will not be payable to an employee who has been discharged from his service before he had rendered continuous service for the required minimum period of five years. In such case, no liability will fall on the employer to pay the amount of gratuity to such employee. This point has been clarified in the case titled **May & Baker (India) Ltd vs their Workmen**.

In this context, it may be noted that the completion of the continuous service for the required minimum period of five years shall not be necessary where the termination of his employment is caused due to his death or disablement. In the case of his death, the amount of gratuity will be payable to his nominee. Or, if no nomination has been made, the amount of gratuity will be payable to his legal heirs. Further, if such nominee or the legal heir happens to be a minor, the share of such minor will be deposited with the Controlling Authority, who is required to invest the amount for the benefit of such minor in such bank or some other financial institution, as may be stipulated, till the time such minor attains his age of majority.

35.8 Rate of Gratuity

The amount of gratuity will be payable at the rate of 15 days' wages for every completed year of service or part thereof exceeding six months. The wages last drawn will be taken into account.

Further, a month will be counted as a period of 30 days, inclusive of the period of rest and holidays, if the wages have to be computed at monthly rate. Accordingly, 15 days' wages would be what an employee would earn within a period of 15 days, and not in 15 working days. This point has been clarified in the case titled **Swami vs Controlling Authority, Hyderabad.** Incorporating this spirit, an explanation has been added in the Amendment Act 1987 to the following effect:

In the case of an employee, who is paid his wages or salary on a monthly basis (a monthly rated employee), the 15 days' wages will be calculated by multiplying the monthly rate of wages last drawn by him by 15 and the number of years of service rendered by him, and dividing the resultant figure by 26. Let us explain this provision with the help of an example

Example

If the last drawn wage of an employee is Rs 6,000 and he has worked for 13 years, his gratuity will come to

$$\frac{\text{Rs } 6,000 \times 15 \times 13}{26} = \text{Rs } 45,000.$$

However, in the case of a piece rated employee, the daily wages will be computed on the basis of average of the total wages received by him for the period of three months immediately preceding the termination of his employment. In this connection, the wages paid for any overtime work will not be taken into account.

But then, in the case of an employee employed in a seasonal establishment, he will be paid the gratuity at the rate of seven days' wages per season.

35.9 Maximum Gratuity

As per the Amendment Act 1998, with effect from 22nd June 1998, the maximum amount of gratuity payable to any employee has been fixed at Rs 3, 50,000.

35.10 Better Term of Gratuity

Sometimes, under any award or agreement or contract with the employer, an employee may be entitled to some better terms for payment of gratuity to him. In such cases he will continue to be paid by the employer on such better terms thereof, and the provisions under **Section 4** will not in any way adversely affect the same, i.e. the payment of gratuity to him on such better terms.

35.11 Mode of Payment of Gratuity

The amount of gratuity payable to the employee under the Act should be paid to him in cash, or by means of a demand draft or a banker's cheque, if so desired by the payee concerned, to the eligible employee or to his nominee or his legal heir, as the case may be. [**Rule 9 of the Payment of Gratuity (Central) Rules, 1972**]. Further, if the eligible employee or his nominee or his legal heir, as the case may be, so desires, and the amount of gratuity so payable is less than Rs 1,000, the payment may even be made by postal money order after deducting the amount of commission paid on such postal money order from the amount payable to the payee concerned.

35.12 Nomination within 30 days

Under **Section 6**, every employee, who has completed one year of service, is required to make a nomination within 30 days of his completing of one year of service.

35.13 Distribution of Gratuity Amount

An employee has the right to distribute the amount of gratuity payable to him under the Act among more than one nominee.

35.14 Nominee in Favour of Family Members

In case an employee has his family at the time of making a nomination, the nomination is required to be made in favour of one or more of his family members. With a view to protecting the interest of the members of the family of the employee, it has been specifically provided in the Act that, if the employee has his family at the time of making a nomination, any nomination made by such employee in favour of any outsider, i.e. any person other than his own family members, such nomination, if made by him (employee), will be considered to be void (i.e. not valid in law).

But then, in case an employee does not have his family at the time of making a nomination, the nomination may be made by the employee in favour of any person of his choice. But then, if the employee acquires his family at a later date, such nomination made in favour of any person (outside his family) will be considered as void forthwith. And, therefore, the employee must make a fresh nomination in favour of one or more of his family members, and that too, within 90 days of his acquiring his family.

35.15 Modification in Nomination

The employee may modify his nomination, made by him earlier, at any time, after giving a notice, in writing, to his employer regarding his intention to do so.

35.16 Death of Nominee

In case of the death of the nominee before (the death of) the employee, the employee is required to make a fresh nomination.

35.17 Date of Operation of Nomination

A nomination becomes operative (effective) with effect from the date it is received by the employer concerned.

35.18 Safe Custody of Nomination

The employee is required to send the nomination to the employer, and the employer, in turn, is required keep in his safe custody every nomination, fresh nomination, or alteration of the nomination, as the case may be.

35.19 Deduction and Forfeiture of Gratuity

Under Section 4 (6), the gratuity of an employee shall be forfeited, if his services have been terminated by any act, wilful omission, or negligence, which has caused damage to the property, belonging to the employer. But, such deduction will be limited to the extent of the damage or loss so caused by him to the employer's property.

Further, even in the case where a workman (employee) is dismissed for his misconduct, he cannot be altogether deprived of the benefit of the entire amount of gratuity payable to him, which he has earned by virtue of his services rendered by him during the period in the past. Instead, he is required to be paid his dues after deducting the amount of loss, if any, caused to the employer due to his misconduct. This point has been clarified in the case titled **Hindustan Times Ltd vs Their Workmen.**

But then, the amount of gratuity payable to an employee may be wholly or partly forfeited, if the services of such employee have been terminated for the following reasons:

(a) For his riotous or disorderly conduct, or any other act of violence on his part, or
(b) For his any act, which constitutes an offence involving moral turpitude, provided such offence has been committed by him during the course of his employment.

As held by the Supreme Court in the case titled **Delhi Cloth and General Mills Co. Ltd vs Their Workmen**, if a workman is guilty of a serious misconduct, such as acts of violence against the management or other employees, or riotous or disorderly behaviour in or near the place of employment which, though not indirectly causing damage, is conducive to great indiscipline, the entire amount of gratuity payable to him can be forfeited This ruling seems to be conducive to the industrial harmony and is in conformity with the public policy.

In a case where a workman was found to be guilty of serious misconduct for assaulting a supervisor inside the factory premises, it was held by the Court that he was not entitled to the amount of gratuity earned by him. **[Tournamulla Estate vs Their Workmen].**

In the same way, in the case titled **Bhurath Gold Mines Ltd vs Regional Labour Commissioner (1986),** where the services of an employee were terminated for committing theft during the course of his employment, the amount of gratuity payable to him under the Act was ordered to be wholly forfeited. This was so held because, under **Section 4 (6) (b) (ii),** theft is an offence involving moral turpitude.

35.20 Protection of Gratuity

The amount of gratuity payable to an employee under the Act, and the amount of gratuity payable to an employee in any establishment, factory, mine, oilfield, plantation, port, railway company, or shop, exempted under **Section 5**, shall not be liable to attachment in execution of any decree or order issued by any Civil, Revenue, or Criminal Court.

35.21 Recovery of Gratuity

Under **Section 8**, if the employer fails to pay the amount of gratuity within the prescribed time limit laid down for the purpose, to the person entitled thereto, the Controlling Authorities are authorised to issue a certificate to the Collector to recover the amount as the arrears of land revenue. Such amount will carry compound interest at such rate as the Central Government may specify from time to time, by notification, from the date of expiry of the prescribed time limit. The present rate of compound interest, however, is 10 per cent.

It has been further provided that the amount of compound interest so payable shall in no case exceed the amount of gratuity payable to the payee under the Act.

35.22 Compulsory Insurance

A new **Section 4A** has been inserted by the (Amendment) Act of 1987. This new Section provides for a compulsory insurance of the employer's liability to make payment of the gratuity to his employees under the Act. Further, this Section also permits an alternative to set up an approved Gratuity Fund by the establishments employing one hundred or more employees. It also provides for compulsory registration of all the establishments covered under the Act with the respective Controlling Authorities, appointed by the appropriate Governments. Besides, this Section authorises the Central Government to make rules for prescribing the insurers, other than the Life Insurance Corporation of India (LICI), as also the manner in which the employer shall get the insurance cover, the manner in which the Gratuity Trust Fund will be created, the conditions subject to which the exemption from taking a compulsory insurance shall be granted, the composition of the Board of Trustees of the Gratuity Trust Fund, and for the time and manner in which the establishment shall be registered with the Controlling Authority.

Further, this new Section authorises the appropriate Government to exempt the following from the operation of the provisions of the Act:

(a) Any establishment, factory, mine, oilfield, plantation, port, railway company, or shop to which this act applies, if, in its opinion, there exists a scheme of gratuity or pensionary benefits, not less favourable than the benefits granted under the Act.

(b) Any employee or class of employees, in any of the establishments aforementioned in (a) above if, in its opinion, such employee or class of employees are in receipt of gratuity or pensionary benefits, not less favourable than the benefits granted under the Act.

But then, a notification in regard to (a) and (b), as aforementioned, may be issued retrospectively, but not with effect from a date earlier than the date of commencement of the Act. No such notification shall be issued so as to adversely (prejudicially) affect the interest of any person.

Let us Recapitulate

- The Act aims at providing for a scheme for the payment of gratuity to the employees engaged in factories, mines, oil-fields, plantation, ports, railway companies, shops, or other establishments, and for

the matters pertaining or incidental thereto. The act became enforceable with effect from 21August 1972, and it extends to the whole of India. But then, in regard to plantations or ports, it will not be enforceable in the State of Jammu and Kashmir.

- **Section 2 (a)** provides that in regard to any of the following establishments, the appropriate Government will mean the Central Government:
  (a) An establishment belonging to, or under the control of, the Central Government,
  (b) An establishment having its branches in more than one State,
  (c) An establishment of a factory belonging to, or under the control of, the Central Government,
  (d) An establishment of a major port, mine, oil-field or railway company.

  In all other cases, the appropriate Government will mean the State Government.
- Under **Section 2 (c)**, read with **Section 2A,** the continuous service means uninterrupted service, including the service interrupted by sickness, accident, leave, absence from duty without leave, lay off, strike or lock-out or cessation of work without any fault on the part of the employee.
- In case the service of an employee is interrupted by the causes other than those specified above, the service will be deemed to have been interrupted and, accordingly, such service will not fall within the definition of continuous service.
- If an employee does not have uninterrupted service for (a) one year or (b) six months, he shall be deemed to be in the continuous service under the following circumstances:
  (a) In the case of the aforementioned one-year period, if the employee during the period of 12 calendar months, preceding the date with reference to which the calculation is required to be made , has actually worked with the employer for not less than:
    (i) 190 days, if the employee is engaged below the ground in a mine, or in an establishment which works for less than six days in a week; or
    (ii) 240 days, in the other cases.
  (b) In the case of the aforementioned six-month period, if the employee during the period of six calendar months, preceding the date with reference to which the calculation is required to be made, has actually worked with the employer for not less than:
    (i) 95 days, if the employee is engaged below the ground in a mine, or in an establishment which works for less than six days in a week; or
    (ii) 120 days, in the other cases.

  However, an employee, working in a seasonal establishment, shall be deemed to be in continuous service, if he has actually worked for not less than 75 per cent of the number of days on which the establishment was in operation during such period.
  - Controlling Authority means an authority appointed by the appropriate Government under **Section 3.** As provided under this Section, the appropriate Government may, by notification in the Official Gazette, appoint any officer to be a Controlling Authority, who shall be responsible for the administration of the Act.
  - The term 'employee' means any person (other than an apprentice) employed in any establishment, factory, mine, oilfield, plantation, port, railway company, or shop. He may be employed to do any skilled, semi-skilled or unskilled, manual, supervisory, technical or clerical work.
  - The term 'employee' also includes any such person who is employed in a managerial or administrative capacity. But, the term does not include any such person who holds a post under the Central Government or a State Government, and is governed by any other Act or rules pertaining to the payment of gratuity to him.
  - Further, the monetary ceiling of Rs 3,500 per month, as the salary or wage of an employee, for his being covered under Act, has since been abolished under the Payment of Gratuity (Amendment) Act, 1994.

- The term 'employer' has been defined as follows:
  Pertaining to any establishment, factory, mine, oilfield, plantation, port, railway company or shop, belonging to or under the control of the Central Government or a State Government, the term 'employer' means a person or authority, appointed by the appropriate Government for the supervision and control of the employees. Where no person or authority has been so appointed, the term 'employer' means the head of the Ministry or the Department concerned.
- In the case of any of the aforementioned establishments belonging to, or under the control of, any of the local authorities, the term 'employer' means the person appointed by such authority for the supervision and control of the employees. Where no person has been so appointed, the term 'employer' will mean the Chief Executive Officer of the local authority.

In any other case, the term 'employer' will mean the person or authority, who or which has the ultimate control over the affairs of the establishments, factory, mine, oilfield, plantation, port, railway company or shop.

The term 'factory', in relation to this Act, has the same meaning as has been assigned to the term under **Clause (m) of Section 2 of the Factories Act**.

- The term 'family' differs in the cases of the male and female employees. In the case of a male employee, the term 'family' will be considered to be consisting of himself, his wife, and his children (whether married or unmarried), his dependent parents and the dependent parents of his wife, and the widow and children of his pre-deceased son, if any.
- Likewise, in the case of a female employee, the term 'family' will be considered to be consisting of herself, her husband, her children (whether married or unmarried), her dependent parents and the dependent parents of her husband and the widow and children of her pre-deceased son, if any.
- The term 'retirement' means termination of service of an employee otherwise than on superannuation.
- The term 'superannuation', in relation to the employee, means the following:
  (a) The attainment of such age by the employee as is fixed in the contract or conditions of service as the age on the attainment whereof the employee shall vacate the employment, and
  (b) In any other case, on the attainment of age of 58 years (now 60 years) by the employee. Thus, we may observe that the term 'superannuation' means retirement of an employee on attaining a certain age.
- The term 'wages' has been defined as all emoluments , which are earned by the employee while on duty or on leave in accordance with the terms and conditions of his employment, and which are paid or are payable to him in cash. It also includes the dearness allowance (DA). However, it does not include any bonus, commission, house rent allowance, overtime wages and any other allowance.
- An employee, who is eligible for the payment of gratuity under the Act, or any person authorised in writing, to act on his (employee's) behalf, is required to send a written application to the employer concerned, for payment of the amount of gratuity, usually within 30 days from the date on which the amount of gratuity had become payable.
- When the gratuity becomes payable to the employee, the employer should determine the amount of gratuity and should give notice, in writing, to the employee to whom the amount of gratuity is payable.
- The employer must make payment of the amount of gratuity to the employee within thirty days from the date it has become payable, failing which the employer shall have to pay simple interest on the amount so payable, at such rate, not exceeding the rate specified and notified by the Central Government from time to time, for payment of long-term deposits.
- But, no such interest will be payable to the employee, if the delay in the payment of the amount of gratuity is on account of any fault on the part of the employee, and the employer has obtained

permission, in writing, from the Controlling Authority, for the delayed payment of the amount of gratuity on this account.

- In regard to any dispute regarding the amount of gratuity payable to an employee, or regarding the person entitled to receive the amount of the gratuity, the employer is required to deposit such amount, as he admits to be payable to the employee, with the Controlling Authority.
- Further, if after the enquiry, it is found that the employer is required to pay more amount than he had earlier deposited with the Controlling Authority, it shall direct the employer to pay the balance amount to the employee concerned.
- For the purpose of conducting an enquiry, the Controlling Authority shall have the same powers as are vested in a Court, while trying a suit under the Code of Civil Procedure in respect of the following matters:
  (a) Enforcing the attendance of any person or his examination on oath;
  (b) Requiring the discovery or production of documents;
  (c) Receiving the evidence of affidavits; and
  (d) Issuing commissions for examination of witnesses.
- The appropriate government or the Appellant Authority, as the case may be, may, after giving to the appellant a reasonable opportunity of being heard, confirm or reverse the decision of the Controlling Authority
- Under **Section 4**, the amount of gratuity may be paid to an employee, on the termination of his employment, after he has rendered continuous service for not less than five years, and under the following cases:
  (a) On his attaining the age of superannuation;
  (b) On his retirement or resignation; or
  (c) On his death or disablement due accident or disease.

But then, the amount of gratuity will not be payable to an employee who has been discharged from his service before he had rendered continuous service for the required minimum period of five years.

- But the completion of the continuous service for the required minimum period of five years shall not be necessary where the termination of his employment is caused due to his death or disablement.
- In the case of his death, the amount of gratuity will be payable to his nominee. Or, if no nomination has been made, the amount of gratuity will be payable to his legal heirs.
- Further, if such nominee or the legal heir happens to be a minor, the share of such minor will be deposited with the Controlling Authority, who is required to invest the amount for the benefit of such minor in such bank or some other financial institution, as may be stipulated, till the time such minor attains his age of majority.
- The amount of gratuity is payable at the rate of 15 days' wages for every completed year of service or part thereof exceeding six months. The wages last drawn will be taken into account.

If an employee, who is paid his wages or salary on a monthly basis (a monthly rated employee), the 15 days' wages will be calculated by multiplying the monthly rate of wages last drawn by him by 15 and the number of years of service rendered by him, and dividing the resultant figure by 26.

- In the case of a piece rated employee, the daily wages will be computed on the basis of average of the total wages received by him for the period of three months immediately preceding the termination of his employment. In this connection the wages paid for any overtime work will not be taken into account.
- In the case of an employee employed in a seasonal establishment, he will be paid the gratuity at the rate of seven days' wages per season.
- The maximum amount of gratuity payable to any employee has been fixed at Rs 3, 50,000.

- If, under any award or agreement or contract with the employer, an employee is entitled to some better terms for payment of gratuity to him, he will continue to be paid by the employer on such better terms thereof.
- The amount of gratuity payable to the employee under the Act should be paid to him in cash, or by means of a demand draft or a banker's cheque, if so desired by the payee concerned, to the eligible employee or to his nominee or his legal heir, as the case may be.
- If the eligible employee or his nominee or his legal heir, as the case may be, so desires, and the amount of gratuity so payable is less than Rs 1,000, the payment may even be made by postal money order after deducting the amount of commission paid on such postal money order from the amount payable to the payee concerned.
- Every employee, who has completed one year of service, is required to make a nomination within 30 days of his completing of one year of service.
- An employee has the right to distribute the amount of gratuity payable to him under the Act among more than one nominee.
- In case an employee has his family at the time of making a nomination, the nomination is required to be made in favour of one or more of his family members.
- If the employee has his family at the time of making a nomination, any nomination made by such employee in favour of any outsider, i.e. any person other than his own family members, such nomination, if made by him (employee), will be considered to be void.
- In case an employee does not have his family at the time of making a nomination, the nomination may be made by the employee in favour of any person of his choice.
- The employee may modify his nomination, made by him earlier, at any time, after giving a notice, in writing, to his employer regarding his intention to do so.
- In case of the death of the nominee before (the death of) the employee, the employee is required to make a fresh nomination.
- A nomination becomes operative (effective) with effect from the date it is received by the employer concerned.
- The employee is required to send the nomination to the employer, and the employer, in turn, is required to keep in his safe custody every nomination–fresh nomination, or alteration of the nomination, as the case may be.
- The gratuity of an employee shall be forfeited, if his services have been terminated by any act, wilful omission or negligence, which has caused damage to the property, belonging to the employer.
- In the case where a workman (employee) is dismissed for his misconduct, he cannot be altogether deprived of the benefit of the entire amount of gratuity payable to him. Instead, he is required to be paid his dues after deducting the amount of loss, if any, caused to the employer due to his misconduct.
- But then, the amount of gratuity payable to an employee may be wholly or partly forfeited, if the services of such employee have been terminated for the following reasons:
  (a) For his riotous or disorderly conduct, or any other act of violence on his part, or
  (b) For his any act, which constitutes an offence involving moral turpitude, provided such offence has been committed by him during the course of his employment.
- If a workman is guilty of a serious misconduct, such as acts of violence against the management or other employees, or riotous or disorderly behaviour in or near the place of employment which, though not indirectly causing damage, is conducive to great indiscipline, the entire amount of gratuity payable to him can be forfeited.
- The amount of gratuity payable to an employee shall not be liable to attachment in execution of any decree or order issued by any Civil, Revenue or Criminal Court.

- If the employer fails to pay the amount of gratuity within the prescribed time limit laid down for the purpose, to the person entitled thereto, the Controlling Authorities are authorised to issue a certificate to the Collector to recover the amount as the arrears of land revenue. Such amount will carry compound interest at such rate as the Central Government may specify from time to time, by notification, from the date of expiry of the prescribed time limit. The present rate of compound interest, however, is 10 per cent.
- It has been further provided that the amount of compound interest so payable shall in no case exceed the amount of gratuity payable to the payee under the Act.
- A new **Section 4A** provides for a compulsory insurance of the employer's liability to make payment of the gratuity to his employees under the Act. Further, this Section also permits an alternative to set up an approved Gratuity Fund by the establishments employing one hundred or more employees.
- Further, this new Section authorises the appropriate Government to exempt the following from the operation of the provisions of the Act:
  (a) Any establishment, factory, mine, oilfield, plantation, port, railway company or shop to which this act applies, if, in its opinion, there exists a scheme of gratuity or pensionary benefits, not less favourable than the benefits granted under the Act.
  (b) Any employee or class of employees, in any of the establishments aforementioned in (a) above if, in its opinion, such employee or class of employees are in receipt of gratuity or pensionary benefits, not less favourable than the benefits granted under the Act.

But then, a notification in regard to (a) and (b), as aforementioned, may be issued retrospectively, but not with effect from a date earlier than the date of commencement of the act. No such notification shall be issued so as to adversely (prejudicially) affect the interest of any person.

Questions for Reflection

1. What are the various establishments to which the Payment of Gratuity Act, 1972 applies?
2. Define the following terms as per the Payment of Gratuity Act, 1972:
   (a) Appropriate Government;
   (b) Continuous service;
   (c) Controlling Authority;
   (d) Employee;
   (e) Employer;
   (f) Factory;
   (g) Family, in the cases of the male and female employees;
   (h) Retirement
   (i) Superannuation; and
   (j) Wages
3. (a) If an employee does not have uninterrupted service for (i) one year or (ii) six months, under what different circumstances shall he be deemed to be in the continuous service?
   (b) If an employee, working in a seasonal establishment, does not have uninterrupted service for (i) one year or (ii) six months, under what different circumstances shall he be deemed to be in the continuous service?
4. (a) 'In the case of any establishments belonging to, or under the control of, any of the local authorities, the term 'employer' means the person appointed by such authority for the supervision and control of the employees.' Do you agree with this statement? Write 'Yes' or 'No' for your answer.
   (b) In the case (a) above, where no person has been so appointed by the local authorities, which Officer of the local authorities, the term 'employer' will mean ? Name him.

5. (a) 'Where the personal law of an employee permits the adoption of a child by him, any child legally adopted by him shall be considered to be included in his family.
   (b) Any child of the employee, legally adopted by any other person, shall not be excluded from the family of the employee.' Do you agree with these two statements or only one of them? Write 'Yes' or 'No' for your answer separately for these two statements, in (a) and (b) above.
6. What are the methods and procedures for making an application by an employee, who is eligible for the payment of gratuity under the Act, for the payment of gratuity, in the following cases?
   (a) In the cases where the date of superannuation or retirement of an employee is already known, and in other case;
   (b) Where the application is to be made by the nominee of the employee or by his legal heir.

   Specify the time limit prescribed in each case.
7. What are the methods and procedures for determining the amount of gratuity?
8. (a) If the amount of gratuity payable is not paid by the employer within the specified period of 30 days, at what rate the employer shall have to pay the interest on the amount so payable, and from which date to which date.
   (b) What is the present rate of interest in this regard?
   (c) Under what specific circumstances, no such interest will be payable to the employee?
9. (a) What are the methods and procedures for settlement of any dispute regarding the amount of gratuity payable to an employee, or regarding the person entitled to receive the amount of the gratuity?
   (b) What are the steps an employer is required to take in this regard?
   (c) What are the steps the Controlling Authority is required to take for conducting the enquiry, and thereafter, in this regard?
10. Specify the powers the Controlling Authority enjoys for the purpose of conducting an enquiry, besides enforcing the attendance of any person or his examination on oath?
11. Discuss the circumstances under which the amount of gratuity may be paid to an employee.
12. Discuss the circumstances under which the amount of gratuity may not be payable to an employee.
13. Discuss the circumstances when the amount of gratuity may be forfeited
14. Discuss the circumstances when the completion of the continuous service for the required minimum period of five years shall not be necessary.
15. To whom will the amount of gratuity be payable where the termination of the employment of the employee is caused due to his death or disablement, if no nomination has been made?
16. How will the share of a minor nominee or legal heir should be disposed of as per the Act?
17. At what rate will the amount of gratuity be payable to the employee? Explain with the help of an illustrative example.
18. For how many days will a month be counted, inclusive of the period of rest and holidays, if the wages have to be computed at monthly rate?
19. In the case of an employee, who is paid his wages or salary on a monthly basis, how should the 15 days' wages be calculated? Explain with the help of an illustrative example.
20. (a) In what manner will the daily wages be computed, in the case of a piece-rated employee?
   (b) In this connection, will the wages paid for any overtime work be taken into account?
21. 'In the case of an employee employed in a seasonal establishment, he will be paid the gratuity at the rate of 15 days' wages per season.' Do you agree with this statement? Give reasons for your answer.
22. What is the maximum amount of gratuity payable to any employee?
23. Sometimes, under any award or agreement or contract with the employer, an employee may be entitled to some better terms for payment of gratuity to him. In such cases, will he continue to be paid by the employer on such better terms thereof? Write 'Yes' or 'No; as your answer.

24. What should be the mode of payment of gratuity in the following case?
    (a) When the amount involved is more than Rs 1,000.
    (b) When the amount involved is less than Rs 1,000.
25. Every employee is required to make a nomination within how many days, and after what period of completion of his service?
26. An employee has the right to distribute the amount of gratuity payable to him under the Act among more than one nominee, or just in favour of one single nominee?
27. If an employee has his family at the time of making a nomination, any nomination made by such employee in favour of any outsider, i.e. any person other than his own family members, such nomination, if made by him (employee), will be considered to be void or valid? Give reasons for the justification of the correct provision made in the Act.
28. In case an employee does not have his family at the time of making a nomination, will the nomination made by the employee in favour of any person of his choice be held valid or void?
29. (a) If the employee has already made a nomination in favour of a person of his choice, and thereafter he acquires his family, will such nomination made in favour of any person (outside his family) be considered as valid or void forthwith?
    (b) Is the employee required to make a fresh nomination in favour of one or more of his family members, if you consider that the nomination made by him in the circumstances stated in (a) above, is void? If so, within how many days of his acquiring his family, he is required to make a fresh nomination in favour of one or more of his family members?
30. (a) Can an employee modify his nomination, made by him earlier, at any time, and if so what further steps he must take to do so?
    (b) In the case of the death of the nominee before (the death of) the employee, what step the employee is required to take in regard to nomination?
    (c) A nomination becomes operative (effective) with effect from which date?
31. What care and precaution should the employer take, in regard to the nomination, fresh nomination, and amendments, if any, made by the employee in his earlier nomination, once he receives such nomination, fresh nomination, or amendment thereto?
32. (a) Under what specific circumstances, can a part of the gratuity of an employee be forfeited?
    (b) Such deduction will be limited to what extent?
33. (a) In the case where a workman is dismissed for his misconduct, can he be altogether deprived of the benefit of the entire amount of gratuity payable to him, which he has earned by virtue of his services rendered by him during the period in the past?
    (b) If only a part of the amount of gratuity is required to be deducted, in the circumstances stated at (a) above, upto what extent such amount may be deducted?

Problems for Practice (With Suggested Solutions)

Problem 1

(a) 'An employee, who is eligible for the payment of gratuity under the Act, or any person authorised in writing, to act on his (employee's) behalf, is required to send a written application to the employer concerned, for payment of the amount of gratuity, usually within 90 days from the date on which the amount of gratuity had become payable.' Do you agree with this statement? Give reasons for your answer.

(b) Within what time period should such application be made by his legal heir?

Solution

(a) No. Because such persons are required to send a written application to the employer concerned, for payment of the amount of gratuity, usually within 30 days (and not 90 days) from the date on which the amount of gratuity had become payable.

(b) Within one year.

Problem 2

Can the appropriate government or the Appellant Authority, as the case may be, after giving to the appellant a reasonable opportunity of being heard, confirm or reverse the decision of the Controlling Authority? Write 'Yes' or 'No' for your answer.

Solution

Yes.

Problem 3

'The employer is required to make the payment of the amount of gratuity to the employee, to whom it is payable, within 60 days from the date it has become payable.' Do you agree with this statement? Give reasons for your answer.

Solution

No; because the employer is required to make the payment of the amount of gratuity to the employee, to whom it is payable, within 30 days from the date it has become payable to the employee, and not 60 days.

Problem 4

Will any interest be payable to the employee, if the delay in the payment of the amount of gratuity is on account of any fault on the part of the employee, and the employer has obtained permission, in writing, from the Controlling Authority for the delayed payment of the amount of gratuity on this account? Write 'Yes' or 'No' for your answer.

Solution

No

Problem 5

If the last drawn wage of an employee is Rs 13,000 and he has worked for 20 years, what amount will be payable to him as gratuity?

Solution

His gratuity amount will come to $\frac{\text{Rs}\,13,000 \times 15 \times 20}{26} = \text{Rs}\,1{,}50{,}000.$

Thus, as the amount of Rs 1,50,000 does not exceeds the maximum fixed limit of Rs 3, 50,000, the employee will get Rs 1,50,000 as the amount of his gratuity.

Problem 6

If the last drawn wage of an employee is Rs 39,000 and he has worked for 30 years, what amount will be payable to him as gratuity?

Solution

His gratuity amount will come to $\frac{\text{Rs}\,39,000 \times 15 \times 20}{26} = \text{Rs}\,4{,}50{,}000.$

But, the maximum amount of gratuity payable to any employee has been fixed at Rs 3, 50,000.

Thus, as the amount of Rs 4,50,000 exceeds the maximum fixed limit of Rs 3, 50,000., the employee will paid Rs 4,50,000 only, as the amount of his gratuity.

Problem 7

An eligible employee is to receive a small sum of Rs 900 as his gratuity. He lives in a remote village in Assam, where there is no bank in operation till date. He cannot come to the place of his work to receive the amount in cash, either. How can the amount be paid to him?

Solution

As the amount of gratuity payable is less than Rs 1,000, the payment may be made by postal money order after deducting the amount of commission paid on such postal money order from the amount payable to the payee concerned.

Problem 8

'Every employee, who has completed two years of service, is required to make a nomination within 60 days of his completing two years of service.' Do you agree with this statement? Give reasons for your answer.

Solution

No. The correct statement should, instead , read as 'every employee, who has completed one year of service, is required to make a nomination within 30 days of his completing of one year of service'.

Problem 9

'An employee has the right to distribute the amount of gratuity payable to him under the Act among more than one nominee.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 10

'If a workman is guilty of a serious misconduct, such as acts of violence against the management or other employees, or riotous or disorderly behaviour in or near the place of employment which, though not indirectly causing damage, is conducive to great indiscipline, the entire amount of gratuity payable to him can be forfeited.' Do you agree with this statement? Write 'Yes' or 'No' as your answer. Also give reasons for your answer.

Solution

Yes. As held by the Supreme Court in the case titled **Delhi Cloth and General Mills Co. Ltd vs Their Workmen**, if a workman is guilty of a serious misconduct, such as acts of violence against the management or other employees, or riotous or disorderly behaviour in or near the place of employment which, though not indirectly causing damage, is conducive to great indiscipline, the entire amount of gratuity payable to him can be forfeited This ruling seems to be conducive to the industrial harmony and is in conformity with the public policy.

Problem 11

In case a workman is found to be guilty of serious misconduct for assaulting a supervisor inside the factory premises, will he be entitled to the amount of gratuity earned by him? Write 'Yes' or 'No' as your answer. Also give reasons for your answer.

Solution

Yes, because it was held by the Court in the case titled **Tournamulla Estate vs Their Workmen** that he was not entitled to the amount of gratuity earned by him.

Problem 12

In case the services of an employee are terminated for committing theft during the course of his employment, can the amount of gratuity payable to him under the Act be wholly forfeited? Write 'Yes' or 'No' as your answer. Also give reasons for your answer.

Solution

Yes, because in the case titled **Bhurath Gold Mines Ltd vs Regional Labour Commissioner (1986),** where the services of an employee were terminated for committing theft during the course of his employment, the amount of gratuity payable to him under the Act was ordered to be wholly forfeited. This was so held because, theft is an offence involving moral turpitude.

Problem 13

'The amount of gratuity payable to an employee under the Act, shall not be liable to attachment in execution of any decree or order issued by any Civil, Revenue or Criminal Court.' Write 'Yes' or 'No' as your answer.

Solution
Yes.

Problem 14
'If the employer fails to pay the amount of gratuity within the prescribed time limit laid down for the purpose, to the person entitled thereto, the Controlling Authorities are authorised to issue a certificate to the Collector to recover the amount as the arrears of land revenue.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.

Solution
Yes.

Chapter Thirty Six

Law of Minimum Wages

"*Rightly defined philosophy is simply the love of wisdom.*
Marcus T. Cicero

A fair day's wages for a fair day's work.
Thomas Carlyle

A computer won't clean up the errors in your manual of procedures.
Sheila M. Eby

Get me inside any boardroom and I'll get any decision I want.
Alan Bond

In judging others, folks will work overtime for no pay.
Charles Edwin Caruthers"

36.1 Introduction

The Minimum Wages Act is aimed at the prevention of exploitation of labour in industries, based on the Geneva Convention 1928, International Labour Code (Articles 223 to 228). The fundamental principles and policy of the Act, in the Indian context, have been succinctly put by the Supreme Court of India in the case **Uichoyi vs State of Kerala, AIR 1962, SC, 12,** in the following terms:

'In an undeveloped country that faces the problem of unemployment on a very large scale, it is not unlikely that labour may offer to work even on starvation wages. The policy of the Act is to prevent the employment of such sweated labour in the interest of general public and so in prescribing the minimum rates, the capacity of the employer need not be considered. What is being prescribed is minimum wage rates which a welfare State assumes every employer must pay before he employs labour.'

The Act applies to the whole of India. It authorises the Central and State Governments to fix minimum rates of wages payable to the employees in a select number of sweated industries.

36.2 Definitions

36.2.1 Appropriate Government [Section 2(b)]

In the cases of any scheduled employment carried on by or under the authority of the central or a railway administration, or in relation to a mine, oilfield or major port or any corporation established by a Central Act, the Central Government is the appropriate government.

In the cases of any other scheduled employment, however, the State Government is the appropriate government.

36.2.2 Scheduled Employment [Section 2(g)]

Scheduled employment means an employment specified in the Schedule or any process or branch of work forming part of such employment.

36.2.3 Employee [Section 2(i)]

Employee means any person who is employed for hire or reward to do any work, skilled or unskilled, manual, or clerical, in a scheduled employment in respect of which the minimum rates of wages have been fixed. The term 'employee' also includes an outside worker to whom any articles or materials are given by another person to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted, or otherwise processed for sale for the purpose of trade or business of other person, where the process is to be carried out either in the home of the outside worker or in some other premises, not being the premises under the control and management of that person. It further includes an employee, declared to be an employee by the appropriate government (State or Central Government, as the case may be). The term 'employee', however, does not include any member of the Armed Forces of the Union (Central Government).

36.2.4 Wages [Section 2(h)]

The term 'wages' comprises all remuneration, payable to the employee, which can be expressed in terms of money. It also includes house rent allowance. But it does not include the following:

(a) The value of any house accommodation, supply of light, water, medical attendance, or any other amenity or any service excluded by general or specific order of the appropriate government.
(b) Any contribution by the employee to any pension fund or provident fund or any scheme of social insurance.
(c) Any travelling allowance or the value of any travelling concession,
(d) Any sum paid to the person employed to defray social expenses entailed on him by the nature of his employment.
(e) Any gratuity payable on discharge.

36.2.5 Employer [Section 2(e)]

Employer means any person who employs, whether directly or indirectly, for himself or for any other person, one or more persons in any scheduled employment in respect of which minimum wages have been fixed under the Act. It includes the following:

(a) Any person named under **Section 7 (1) (f) of the Factories Act, 1948**, as the manager of the factory.
(b) The person or authority appointed by the appropriate government for the supervision and control of the employees, and where no person or authority is so appointed, the Head of the Department.
(c) The person appointed by the local authority for the supervision and control of the employees, and where no person or authority is so appointed, the chief executive officer of the local authority.
(d) Any person responsible to the owner for the supervision and control of the employees, or for the payment of the wages.

36.3 Fixation of Minimum Wages [Section 3 (1)(a)]

The appropriate government shall fix the minimum rates of wages, payable to the employees specified in Part I and Part II of the Schedule, and in an employment added to either of the two parts, by notification in the Official Gazette under **Section 27.**

The appropriate government may, in respect of the employees, employed in an employment specified in Part II of the Schedule, instead of fixing the minimum rates of wages for the entire State, may fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof. The appropriate government should also review at such intervals, not exceeding five years, the minimum rates of wages so fixed and should revise the minimum rates of wages, if necessary.

36.4 Minimum Time Rate, Minimum Piece Rate, Guaranteed Time Rate, and Overtime Rate of Wages

36.4.1 Minimum time rate is the minimum rate of wages for the timely work; i.e. for completion of the work within the scheduled time, which is lesser than the time usually taken for the completion of the specific work.

36.4.2 Minimum piece rate is the minimum rate of wages for piece-work.

36.4.3 Guaranteed time rate is the minimum rate of remuneration to apply in the cases of such employees employed on piece work for the purpose of securing such employees a minimum rate of wages on a time work basis

36.4.4 Overtime rate is the minimum rate (whether a time rate or a piece rate) to apply in substitution of the minimum rate, which would otherwise be applicable in respect of the overtime work done by the employees.

36.5 Different Minimum Rates for Different Classes of Employees [Section3 (3)]

Different minimum rates of wages can be fixed for the employees in the following different classes of employment:

(a) Employees in scheduled employment,
(b) Employees in different classes of work in the same scheduled employment, and
(c) Employees in different localities.

Moreover, for fixing or revising the minimum rates of wages, the following wage periods may be considered:

(a) By the hour,
(b) By the day,
(c) By the month, and
(d) For other such larger wage period as may be prescribed.

36.6 Different Types of Wages (Minimum Wages, Fair Wages and Living Wages)

36.6.1 Statutory Minimum Wage

Statutory minimum wage refers to a wage rate, determined by the employer in accordance with the prescribed procedure and the relevant provisions of the Act. The employer is obliged to pay such wage rate to the employees for the services rendered by them. Thus, we may see that the statutory minimum wage is fixed in order to avoid the possibility of labour exploitation.

36.6.2 Minimum Wage or Bare Wage

Minimum wages (or bare minimum wages) refers to the lowest possible level of wages. That is, it comes somewhere between the 'living wages' and the 'fair wages'. Alternatively speaking, the minimum wages are higher than the 'fair wages' and lower than the 'living wages'. These two wages ('fair wages' and 'living wages') have been discussed hereafter. The Committee of Fair Wages 1948 has defined the minimum wage as 'the wage which must provide not only for the bare sustenance of life, but for the preservation of the efficiency of the worker. For this purpose, the minimum wage must provide for some measure of education, medical requirements and amenities'. This way, a minimum wage provides for the sustenance not only for the employee but for his family, too, i.e. for education, medical care and other basic amenities for his entire family.

36.6.3 Fair Wage

The Committee of Fair Wages has defined the fair wage as 'the wage which is above the minimum wage and below the living wage'. Accordingly, it may become very difficult to set the minimum wage because the cost of living and the living conditions differ from place to place. Therefore, the fixed standard of living cannot be determined in precise, exact, and uniform terms for all the places. That is why, the living wages must be determined by taking into account the national income and the capacity of the industry to pay. Accordingly, a way out has been evolved in that while fixing the fair wages, the following factors need to be taken into account:

(a) The productivity of the labour,
(b) The nature and place of the industry in the economy,
(c) The prevailing rates of wages in similar industries,
(d) The prevailing rates of wages, in similar and equivalent (i.e. at par) society, and
(e) The level of national income.

36.6.4 Living Wage

The Committee of Fair Wages has defined the living wage as 'the wage that enables the earner to provide for himself and his family not only the basic essentials of food, clothing and shelter, but a measure of frugal comfort, including education for his children, protection against ill health, requirements of essential social needs and a measure of insurance against the more important misfortunes, including the old age'. Thus, we see that the living wage is the highest remuneration provided to the employee to enable him

(a) To maintain a reasonably good standard of living,
(b) To ensure good health for the employee as also for his family,
(c) To educate his children, and
(d) To protect the family against misfortunes and solve the old age financial problems of the employee.

36.7 Objectives and Procedures (Section 5)

The following are the two methods of fixing and revising the minimum rate of wages:

(a) Appointment of a Committee, and
(b) Publication in the Official Gazette.

The objective of both the aforementioned methods is to enable the respective appropriate Government (Central and State Governments, as the case may be) to arrive at a balanced consensus in respect of fixing or revising the minimum wage rate.

Under the method of appointment of a committee, the appropriate Government shall appoint committees and as many sub-committees as it may consider necessary, to hold enquiries and advise the appropriate Government concerned accordingly, in regard to the fixation or revision of the minimum rate of wages.

Under the method of publication (notification) in the Official Gazette, however, the appropriate Government shall, by notification in the Official Gazette, make its proposals public for the information of the persons likely to be affected by the fixation or revision of the minimum rates of wages. The date on and from which such proposal will become effective should also be specified therein.

Thereafter, on consideration of the recommendations and advice of the committee or all the representations made in respect thereof, the appropriate Government shall, by notification in the Official Gazette, fix or revise the minimum rates of wages in respect of each scheduled employment. Such fixation or revision of the minimum rates of wages shall become effective on expiry of three months from the date of the issue (publication) of the notification in the Official Gazette, unless the notification provides otherwise.

But then, if the appropriate Government proposes to revise the minimum rates of wages, through the method of notification (the second aforementioned method), it should consult the Advisory Board (discussed hereafter). It may be noted here that the appropriate Government is not bound to accept the recommendations of the committees appointed by it under the appointment of Committee method (the first aforementioned method), as these are only recommendatory and advisory in nature. That is, it is not obligatory and compulsory on the part of the Government to necessarily accept all the recommendations of the Committees in all the cases. This stand was taken by the Court in the case titled **Management of all Tea Estates in Assam vs Indian National Trade Union Congress (INTUC), AIR 1957, SC 206.**

It was also observed in another case titled **Tourist Hotel vs State of Andhra Pradesh (AP), 1975, 1 LLJ 2.1.1**, that, irrespective of the fact whether the Committee advises or does not advise the appropriate Government concerned, it (appropriate Government concerned) will have its own powers to fix or revise the minimum rates of wages under **Section 5**.

36.8 Advisory Board (Section 7)

As per **Section 7**, the Advisory Board is constituted by the appropriate Government for the purpose of coordinating the work of the committees and sub-committees, appointed under **Section 5**, and advising the respective Governments in the matter pertaining to the fixation and revision of the minimum rates of wages.

36.8.1 Central Advisory Board

The Central Government appoints a Central Advisory Board for advising the Central and State Governments in the matters of fixation and revision of the minimum rates of wages and the other matters in the Act, as also for coordinating the work of the Advisory Boards. The Central Advisory Board comprises (consists of) the persons nominated by the Central Government representing the employees and the employers in the scheduled appointment. Such persons (representing the employees and the employers) should be equal in number as also independent persons, and should not exceed one third of its total number of its members. Further, one of the independent persons is appointed by the Central Government as the Chairman/Chairperson of the Board.

Moreover, the Central Government reserves the right to prescribe the term of office of the members of the Board, the method of voting, the procedure to be followed, the manner of filling up the casual vacancies in the membership, and the quorum necessary for transacting the business of the Central Advisory Board.

36.9 Wages of a Worker who Works for Less than the Normal Working Days (Section 15)

If any worker works for less than the normal working days, and the wages have been fixed for a day, he shall be entitled to receive his wages for that day, as if he had worked for a full normal working day. It has been further provided that he shall not receive wages for the full normal working days in the following circumstances:

(a) If his failure to work is caused by his own unwillingness to work, and not by the failure of the employer to provide him work, and
(b) Such other cases and circumstances as may be prescribed.

36.10 Wages for Overtime (Section 14)

An employee, whose minimum rate of wages has been fixed under the Act for the number of hours, days or any longer wage period as may be prescribed, works on any day in excess of the number of hours constituting a normal working day, the employer will pay to him for every hour or part thereof in excess of his so working, at the overtime rate fixed under the Act or under any other law of the appropriate Government concerned, for the time being in force, whichever is higher. Thus, it may be inferred that an employee who works for standard hours or days, is likely to receive the standard wages plus overtime wages.

Let us Recapitulate

- The Minimum Wages Act is aimed at the prevention of exploitation of labour in industries, based on the Geneva Convention 1928, International Labour Code (Articles 223 to 228).

  The Act applies to the whole of India. It authorises the Central and State Governments to fix minimum rates of wages payable to the employees in a select number of sweated industries.
- In the cases of any scheduled employment carried on by or under the authority of the central or a railway administration, or in relation to a mine, oilfield or major port or any corporation established by a Central Act, the Central Government is the appropriate government.

  Scheduled employment means an employment specified in the Schedule or any process or branch of work forming part of such employment.
- Employee means any person who is employed for hire or reward to do any work, skilled or unskilled, manual, or clerical, in a scheduled employment in respect of which the minimum rates of wages have been fixed. The term 'employee' also includes an outside (job) worker.
- The term 'wages' comprises all remuneration, payable to the employee, which can be expressed in terms of money. It also includes house rent allowance. But it does not include the following:
  (a) The value of any house accommodation, supply of light, water, medical attendance, or any other amenity or any service excluded by general or specific order of the appropriate government.
  (b) Any contribution by the employee to any pension fund or provident fund or any scheme of social insurance.
  (c) Any travelling allowance or the value of any travelling concession,
  (d) Any sum paid to the person employed to defray social expenses entailed on him by the nature of his employment.
  (e) Any gratuity payable on discharge.

- Employer means any person who employs, whether directly or indirectly, for himself or for any other person, one or more persons in any scheduled employment in respect of which minimum wages have been fixed under the Act.
- The appropriate government shall fix the minimum rates of wages, payable to the employees specified in Part I and Part II of the Schedule, and in an employment added to either of the two parts, by notification in the Official Gazette under **Section 27.**
- The appropriate government may, in respect of the employees, employed in an employment specified in Part II of the Schedule, instead of fixing the minimum rates of wages for the entire State, may fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof. The appropriate government should also review at such intervals, not exceeding five years, the minimum rates of wages so fixed and should revise the minimum rates of wages, if necessary.
- Minimum time rate is the minimum rate of wages for the timely work.
- Minimum piece rate is the minimum rate of wages for piece-work.
- Guaranteed time rate is the minimum rate of remuneration to apply in the cases of such employees employed on piece work for the purpose of securing such employees a minimum rate of wages on a time work basis
- Overtime rate is the minimum rate (whether a time rate or a piece rate) to apply in substitution of the minimum rate, which would otherwise be applicable in respect of the overtime work done by the employees.
- Different minimum rates of wages can be fixed for the employees in the following different classes of employment:

  (a) Employees in scheduled employment,
  (b) Employees in different classes of work in the same scheduled employment, and
  (c) Employees in different localities.

  Moreover, for fixing or revising the minimum rates of wages, the following wage periods may be considered:

  (a) By the hour,
  (b) By the day,
  (c) By the month, and
  (d) For other such larger wage period as may be prescribed.

- Statutory minimum wage refers to a wage rate, determined by the employer in accordance with the prescribed procedure and the relevant provisions of the Act. The employer is obliged to pay such wage rate to the employees. This provision aims at avoiding the possibility of labour exploitation.
- Minimum wages (or bare minimum wages) refers to the lowest possible level of wages. That is, it comes somewhere between the 'living wages' and the 'fair wages'. The Committee of Fair Wages 1948 has defined the minimum wage as 'the wage which must provide not only for the bare sustenance of life, but also for the preservation of the efficiency of the worker.
- The Committee of Fair Wages has defined the fair wage as 'the wage which is above the minimum wage and below the living wage'. It is, thus, very difficult to set the minimum wage because the cost of living and the living conditions differ from place to place. Accordingly, a way out has been evolved in that while fixing the fair wages, the following factors need to be taken into account:

  (a) The productivity of the labour,
  (b) The nature and place of the industry in the economy,
  (c) The prevailing rates of wages in similar industries,
  (e) The prevailing rates of wages, in similar and equivalent (i.e. at par) society, and
  (f) The level of national income.

- The Committee of Fair Wages has defined the living wage as 'the wage that enables the earner to provide for himself and his family not only the basic essentials of food, clothing and shelter, but a measure of frugal comfort, including education for his children, protection against ill health, requirements of essential social needs and a measure of insurance against the more important misfortunes, including the old age'.

  Thus, we see that the living wage is the highest remuneration provided to the employee to enable him

  (a) To maintain a reasonably good standard of living,
  (b) To ensure good health for the employee as also for his family,
  (c) To educate his children, and
  (d) To protect the family against misfortunes and solve the old age financial problems of the employee.
- The two methods of fixing and revising the minimum rate of wages are:

  (a) Appointment of a Committee, and
  (b) Publication in the Official Gazette.
- The objective of these methods is to enable the appropriate Government to arrive at a balanced consensus in respect of fixing or revising the minimum wage rate.
- Under the method of appointment of a Committee, the appropriate Government appoints committees and as many sub-committees as it may consider necessary, to hold enquiries and advise the appropriate Government concerned accordingly in regard to the fixation or revision of the minimum rate of wages.
- Under the method of publication (notification) in the Official Gazette, however, the appropriate Government shall, by notification in the Official Gazette, make its proposals public for the information of the persons likely to be affected by the fixation or revision of the minimum rates of wages.
- Thereafter, on consideration of the recommendations and advice of the committee or all the representations made in respect thereof, the appropriate Government shall, by notification in the Official Gazette, fix or revise the minimum rates of wages in respect of each scheduled employment.
- But then, in this case, if the appropriate Government proposes to revise the minimum rates of wages, it should consult the Advisory Board. But the appropriate Government is not bound to accept the recommendations of the committees as these are only recommendatory in nature.
- As per **Section 7**, the Advisory Board is constituted by the appropriate Government for the purpose of coordinating the work of the Committees and Sub-committees, appointed under **Section 5**, and advising the respective Governments in the matter pertaining to the fixation and revision of the minimum rates of wages.
- The Central Government appoints a Central Advisory Board for advising the Central and State Governments in the matters of fixation and revision of the minimum rates of wages and the other matters in the Act, as also for coordinating the work of the Advisory Boards.

  It consists of the persons nominated by the Central Government representing the employees and the employers in the scheduled appointment. Such persons (representing the employees and the employers) should be equal in number as also independent persons, and should not exceed one third of its total number of its members.
- If any worker works for less than the normal working days, and the wages have been fixed for a day, he shall be entitled to receive his wages for that day, as if he had worked for a full normal working day. But he shall not receive wages for the full normal working days in the following circumstances:

  (a) If his failure to work is caused by his own unwillingness to work, and not by the failure of the employer to provide him work, and
  (b) Such other cases and circumstances as may be prescribed.

- An employee, whose minimum rate of wages has been fixed under the Act for the number of hours, days or any longer wage period as may be prescribed, works on any day in excess of the number of hours constituting a normal working day, he will be paid for every hour or part thereof in excess of his so working, at the overtime rate fixed under the Act or under any other law of the appropriate Government concerned, for the time being in force, whichever is higher.

Questions for Reflection

1. What are the main aims and objectives of the Minimum Wages Act?
2. Explain the following terms in the context of the Minimum Wages Act:
   (a) Appropriate Government,
   (b) Scheduled employment,
   (c) Employee,
   (d) Wages, and
   (e) Employer
3. Which authority can fix the minimum rates of wages, payable to the scheduled employees?
4. Bring out the main distinguishing features between the following terms:
   (a) Minimum Time Rate and Minimum Piece Rate of wages;
   (b) Guaranteed Time Rate and Overtime Rate of Wages
5. What are the various different wage periods that may be considered for fixing or revising the minimum rates of wages?
6. Bring out the main distinguishing features between the following terms:
   (a) Minimum Wage and Statutory Minimum Wage,
   (b) Minimum Wage and Fair Wage,
   (c) Living Wage and Fair Wage.
7. What are the various factors that are taken into account while fixing the following different rates of wages?
   (a) Statutory minimum wage,
   (b) Fair Wage, and
   (c) Living Wage.
8. Explain the following two methods of fixing and revising the minimum rate of wages, and the procedures involved in each of the methods:
   (a) Appointment of a Committee, and
   (b) Publication in the Official Gazette.
9. What are the main objectives of each of the two methods, referred to in question 8 above?
10. Which authority can constitute the Advisory Board and with what main purposes?
11. Which authority can constitute the Central Advisory Board and with what main purposes?
12. (a) What is the method, prescribed under the Minimum wages Act, for the composition of the Central Advisory Board and its Chairman/Chairperson?
    (b) What are other rights reserved by the Central Government in this regard?
13. If any worker works for less than the normal working days, and the wages have been fixed for a day, at what rate will he be entitled to receive his wages for that day?
14. In question 13 above, under what circumstances will he not be entitled to receive the wages for the full normal working days?

Problems for Practice (With Suggested Solutions)

Problem 1

'The appropriate government may, in respect of the employees, employed in any scheduled employment, instead of fixing the minimum rates of wages for the entire State, may fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof.' Do you agree with this statement? Say 'Yes' or 'No' as your answer

Solution

Yes.

Problem 2

Should the appropriate government review periodically the minimum rates of wages so fixed and should revise the minimum rates of wages, if necessary? Say 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 3

'The appropriate government should review at such intervals, not exceeding six years, the minimum rates of wages so fixed.' Do you agree with this statement? Say 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

No. Such interval should not exceed five years, instead.

Problem 4

'Different minimum rates of wages cannot be fixed for the employees in the following different classes of employment:

(a) Employees in scheduled employment,
(b) Employees in different classes of work in the same scheduled employment, and
(c) Employees in different localities.

Do you agree with this statement? Say 'Yes' or 'No' as your answer.

Solution

No.

Problem 5

'The appropriate Government shall, by notification in the Official Gazette, fix or revise the minimum rates of wages in respect of each scheduled employment. Such fixation or revision of the minimum rates of wages shall become effective on expiry of six months from the date of the issue (publication) of the notification in the Official Gazette, unless the notification provides otherwise'. Do you agree with this statement? Say 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

No. The statement should read as three months and not six months.

Problem 6

'The appropriate Government is bound to accept the recommendations of the committees appointed by it.' Do you agree with this statement? Say 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

No. Because, these are only recommendatory and advisory in nature.

Problem 7

'An employee, whose minimum rate of wages has been fixed under the Act for the number of hours, days or any longer wage period, works on any day in excess of the number of hours constituting a normal working

day, will the employer pay to him for every hour or part thereof in excess of his so working, at the overtime rate fixed under the Act or under any other law of the appropriate Government concerned, for the time being in force, whichever is lower.'. Do you agree with this statement? Say 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

No. Because, the last clause should read as 'whichever is higher', instead of 'whichever is lower.'

Problem 8

'If any worker works for less than the normal working days, and the wages have been fixed for a day, he shall be entitled to receive his wages for that day, as if he had worked for a full normal working day. But he shall not receive wages for the full normal working days in the following circumstances:

> If his failure to work is caused by his own unwillingness to work, and not by the failure of the employer to provide him work.

Do you agree with this statement? Say 'Yes' or 'No' as your answer.

Solution

Yes.

PART 6

Law of Consumers' Protection

(Consumer Protection Act, 1986)*

Chapter Thirty Seven

Definitions and Rights & Protection of Consumers

"

The beginning of wisdom is a definition of terms.
Socrates

The magic formula that successful businesses have discovered is to treat customers like guests and employees like people.
Thomas J. Peters

When you judge another, you do not define them, you define yourself.
Wayne Dyer

A leader has been defined as one who knows the way, goes the way, and shows the way.
Source Unknown

A consumer is a shopper who is sore about something.
Harold Coffin

Consumers are statistics. Customers are people.
Stanley Marcus

"

37.1 Objectives

The objectives of the Act are the following:

(**a**) To provide for better protection of the interest of the consumers;
(**b**) To provide for the establishment of Consumer Councils and other authorities with a view to meeting these objectives; and

(c) To empower the Consumer Councils and other authorities to settle costumers' disputes and the matters connected therewith.

The Act extends to the whole of India except to the State of Jammu and Kashmir.

37.2 Definitions

37.2.1 Appropriate Laboratory [Section 2 (1) (a)]

Appropriate laboratory or organisation means the following:

(a) Laboratory or organisation, which is recognised by the Central Government;
(b) Laboratory or organisation, which is recognised by a State Government, subject to such guidance as may be prescribed by the Central Government on this behalf; or
(c) Any such laboratory or organisation, established by, or under the law, for the time being in force, which is maintained, financed, or aided by the Central Government or a State Government for carrying out the analysis or test of any goods for the purpose of determining whether such goods suffer from any defect.

37.2.2 Branch Office [Section 2 (1) (aa)]

A Branch Office means the following:

(a) Any establishment described by the opposite party as its branch, or
(b) Any establishment carrying on either the same business or substantially the same activity as those carried on by the Head Office of the establishment.

37.2.3 Complainant [Section 2 (1) (b)]

A Complainant means any of the following persons or authorities who have made the complaint:

(a) A consumer; or
(b) Any voluntary consumer association, which is registered under the Companies Act 1956, or under any other law, for the time being in force, or
(c) The Central Government or any State Government, or
(d) One or more consumers where there are numerous consumers having the same interest, or
(e) In the case of the death of a consumer, his legal heir or representative.

37.2.4 Complaint [Section 2 (1) (c)]

A complaint means any allegation made by a complainant, in writing, to the effect that:

(a) An unfair trade practice or a restrictive trade practice has been resorted to (adopted) by any trader or service provider,
(b) The goods purchased by him, or agreed to be purchased by him, suffer from one or more defects.
(c) The services hired, or availed of, or agreed to be hired or availed of, by him suffer from deficiency in any respect.
(d) A trader or a service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price, in excess of the price:
    (i) Fixed by or under any law for the time being in force,
    (ii) Displayed on the goods or on any package containing such goods,
    (iii) Displayed on the price list, exhibited by him, by or under any law for the time being in force, or
    (iv) Agreed between the parties.

(e) Goods, which will be hazardous to life and safety, when consumed (used), are being offered for sale to the public:
  (i) In contravention of any standards regarding the safety of such goods, as required to be complied with by or under any law for the time being in force,
  (ii) If the trader could have known with due diligence that the goods so offered by him are unsafe to be used by the public.

(f) Services, which are hazardous, or are likely to be hazardous, to the life and safety of the public, when used, are being offered by the service provider, which such person could have known with due diligence to be injurious to the life and safety, with a view to obtaining any relief provided by or under this Act.

In the cases where the price of any article (goods) is not fixed by any law or is not displayed on the goods, or is not displayed on the package containing the goods, the Act does not contemplate any complaint being filed in regard to the price charged, on the plea that the price so charged is excessive. This view has been confirmed in the case titled **Manager, Milk Chilling Centre vs Mahaboobnagar Citizen's Council (1990).**

37.2.5 Consumer [Section 2 (1) (d)]

The consumer means any of the following persons:

(a) A person who purchases any goods for consideration, which has been paid or partly paid, or which has been promised to be paid or partly paid, or which has been purchased under any system of deferred payment (i.e. pertaining to hire–purchase transactions). The term 'consumer' includes any other user of such goods, when such use is made with the consent (approval) of the purchaser. But then, the term, 'consumer' does not include such person who obtains such goods for resale or for any commercial purpose. Moreover, the term 'commercial purpose' does not include use of the goods by a consumer of goods purchased and used by him, and the services availed of by him, exclusively for the purpose of earning his living, by way of self-employment. [Explanation **to Section 2 (1) (d)].**

(b) A person who hires or avails of any services for consideration, which has been paid or partly paid, or which has been promised to be paid or partly paid, or which has been purchased under any system of deferred payment. The term 'consumer' includes any other beneficiary of such services, when such use is made with the consent (approval) of the original purchaser. But then, the term, 'consumer' does not include such person who avails of such services for any commercial purpose.

37.2.5.1 The following Persons fall within the Category of the Term 'Consumer':

(a) A person becomes a consumer of the liquid pressed gas (LPG), immediately when he registers for an LPG connection. **[Mohindra Gas Enterprises vs Jagdish Poswal, 1992].**

(b) Warranty of free service makes the buyer a consumer.

Example

A printing machine was sold to a person with a warranty of free service for one year. The seller of the machine had contended that, as the services for the maintenance of the machine for one year under the warranty were rendered free, the buyer did not fall in the category of the consumer under the Act, insofar as the warranty was concerned.

It was, however, held that the warranty was an integral part of the composite contract for the supply of the machine, and the maintenance of the machine for one year was not, in fact, free, as the price of such free services for one year under the warranty was already included in the original price of the printing machine. In fact, there cannot be an agreement of sale, including warranty, without consideration (pertaining to both the machine and the free warranty). **[Vishwa Jyoti Printers vs Molins of India, 1992]**.

(c) Passengers travelling by a train are consumers.
It was held that the passengers travelling by trains, on payment of the stipulated fare, charged for the ticket are consumers, and the facility of transportation by rail provided by the railway administration is a 'service' rendered for consideration, as per the Act. **[General Manager vs Anand Prasad Sinha, 1989].**

(d) Subscribers of telephones are consumers under the Act. Therefore, they are entitled to apply for relief to the Consumer Forum whenever necessary. **[District Manager, Telephones, Patna vs Lalit Kumar Bajla, 1989].**

(e) User of electricity is a consumer. Accordingly, he can approach the Consumer Forum for the redressal of his complaint for inflated bills, for not changing defective electric meter, and so on.

(f) Alottee of a flat as a nominee of the Government is a consumer as per the Act.

(g) User of sewerage system laid by the Municipal Corporation is a consumer.
It was held in the case titled **Prakashwati vs Municipality, Bhatinda, 1995], CCJ 354]** that the payment of water and sewerage charges to the Municipality tantamount to hiring these services and, accordingly, user thereof is a consumer.

(h) Purchaser of equipment using it by himself in the practice of a profession himself is a consumer, like the ultrasonic scanner, or ECG equipment or stethoscope by a physician, or the dental surgery equipments by a dental surgeon.

(i) Parents of an infant patient are the consumers.
This is so because the parents have paid the fees in consideration of the treatment of the child. The Supreme Court has held in the case titled **Spring Meadows Hospital vs Harjit Ahaluwalia, 1998(2), SCALE 456]** that a consumer would mean a person who hires or avails of any service and it includes any beneficiary. Thus, when a young child is taken to a hospital by his parents and the child is treated by the doctor, his parents would come within the definition of the consumer having hired the services, and the child would also become a consumer under the inclusive definition of **Section 2 (1) (d)** of the Act, by virtue of being a beneficiary.

(j) Subscriber to a Provident Fund is a consumer.
The Supreme Court has held that the administration of the Provident Fund by the Provident Fund Commissioner is a service and that every member of the Provident Fund Scheme is a consumer. **[Provident Fund Commissioner vs Shivkumar Joshi, 1999, AIR, SCW 4456].**

37.2.5.2 The following Persons do Not Fall within the Category of the Term 'Consumer':

(a) A winner of the lottery does not fall within the category of the term 'Consumer'.

Example

A person had purchased a car and had also won a lucky lottery draw for two tickets from New Delhi to New York and back, as was advertised by the motor company. His claim for payment of the value of the air fares was disallowed by the motor company on some ground. His complaint, on this count, was also turned down on the ground that he was a consumer only of the car; and as there was no defect in the car reported by him, the complaint was not maintainable. Further, it was held that the matter regarding winning the lottery did not bring the person within the category of the term 'consumer'. **[Byford vs S. S. Srivastava, 1993].**

The complainant's claim that the matter pertaining to the lottery in this case comes within the category of unfair trade practice was also rejected.

(b) Person buying goods either for resale, or for use in a large-scale profit-making activity, is not a consumer, entitled to protection under the Act. **[Raj Kumar vs S. C. Verma, 2001, 1 CPR 437].**

(c) Insurance company is not a consumer. Accordingly, the consumer complaint by an insurance company is not maintainable **[Savani Road Lines vs Sundaram Textiles Ltd, AIR, 2001, SC 2630]**.

37.2.6 Consumer Dispute [Section 2 (1) (e)]

Consumer dispute means a dispute where the person against whom the complaint has been made, denies or disputes the allegations contained in the complaint.

37.2.7 Defect [Section 2 (1) (f)]

A defect means any fault, imperfection, or shortcoming in the quality, quantity, potency, purity, or standard which is required to be maintained by or under any law for the time being in force, or under any contract, express or implied, or as is claimed by the trader in any manner whatsoever, in relation to any goods.

37.2.8 Deficiency [Section 2 (1) (g)]

Like the 'defect' pertaining to the goods, 'deficiency' pertains to services.
Thus, a deficiency means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force, or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

Deficiency of Service

(a) Non-delivery of any article by the courier, which causes some serious hardship and inconvenience to the consignee (addressee) is a case of negligence in performance and deficiency of service by the Courier concerned.

Examples

(i) In a case titled S**kypack Couriers Private Ltd and Another vs Ms. Anupama Bagla (1992)**, the non-delivery of a video cassette by the courier service company, which had resulted in the loss of admission of the complainant in the desired college, was held to be a case of deficiency in service, as it had put the complainant to serious hardship and the aforementioned loss of admission due to the negligence on the part of the courier concerned. Accordingly, the complainant was awarded a compensation of Rs 10,000.

(ii) In another case titled **Skypack Couriers Private Ltd vs CERS and Others (1992),** a compensation of Rs 1,000 was awarded to the complainant for non-delivery of a packet, containing the passport, visa and air tickets, and so on, to the complainant.

(b) Settlement of a claim by a life insurance company after an undue delay of filing of a claim is held to be a case of high negligence in performance of service by the life insurance company.

Example

In the case titled **Naina Devi Bairalia vs Life Insurance Corporation of India**, the widow had filed a claim with the LICI after the death of her husband after a sudden illness, when the second premium on a policy of Rs 50,000 had fallen due. This claim was not settled for as long as 14 years, and that too, after her aforementioned misery was published in a news paper and some M.P. had raised the matter in the Parliament. Thereafter, she was sent a cheque for Rs 50, 310.

The National Commission had held that the LICI had been highly negligent in performance of its service and had awarded payment of interest at the rate of 12 per cent per annum with effect from the expiry of three months of the death of the assured upto the date of payment of the cheque. Additionally, an order was passed by the National Commission on 11 May 1993 directing the LICI to pay her a compensation of Rs 15, 000 on account her mental torture, loss and harassment.

(c) Non-payment of a demand draft on invalid grounds, change of the names of the joint payee into a single payee on a Term Deposit Receipt (TDR) account at the request of only one of the joint payees, and so on, will be considered to be the cases of deficiency in service on the part of the bank concerned.

Examples

(i) In the case titled **State Bank of India vs N. Raveendran Nair**, the payment of a demand draft for Rs 98,000, drawn by a branch of the State Bank of Travancore on the State Bank of India, Surat, was refused on the (invalid) ground that under the signature of one of the signatories to the draft, his designation (Accountant) was not mentioned.

It was held in the case, decided on 3 August 1992, that such refusal amounted to deficiency in service and that the bank should be held liable for the inconvenience and the loss, caused to the payee concerned, resulting from such wrongful dishonour.

(ii) In the case titled **Satish Mehra vs Punjab and Sind Bank [(1997), CCJ 1252 (Delhi)]**, the State Commission had held that the conversion of a joint fixed deposit account into an individual account of only one of the joint account holders, without such requests from both the joint account holders, tantamount to deficiency of service on the part of the bank.

37.2.9 District Forum [Section 2 (1) (h)]

The District Forum means a Consumer Disputes Redressal Forum established under **Section 9 (a)**. This Section provides as follows:

There shall be established a Consumer Disputes Redressal Forum, to be named as 'District Forum'. It will be established by the State Government concerned in each of its districts, by notification. The State Government may establish more than one District Forum in a district, if it considers it fit.

37.2.10 Goods [Section 2 (1) (i)]

The term 'goods', under the Act shall have the same meaning as it has been assigned to the term under **Section 2 (7) of the Sale of Goods Act, 1930**.

Thus, the term 'goods' means every type of movable property, other than the actionable claims and money. It includes stocks 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.

But then, the shares, before these are allotted cannot be termed as goods as these do not exist till they are allotted. **[Morgan Stanley Mutual Fund vs Kartick Das (1994), 4, Supreme Court Cases (SCC)225]**.

37.2.11 Manufacturer [Section 2 (1) (j)]

The term 'manufacturer' means the following:

(a) A person who makes or manufactures any goods or part thereof,

(b) A person who does not make or manufacture any goods, but assembles parts thereof made or manufactured by others, but claims the end-product to be the goods manufactured by him.

But then, in the cases where the manufacturer despatches any goods or part thereof to any branch office, maintained by him, such branch office shall not be deemed to be the manufacturer, even though the parts so despatched to it (branch office) are assembled at such branch office and are sold or distributed from such branch office.

(c) A person who puts, or causes to be put, his own mark on any goods made or manufactured by any other manufacturer, and claims such goods to be the goods made or manufactured by himself. **For example** the Bajaj , Bata Shoe Company, Carona, Colgate, and so on, get their goods manufactured by some other parties but put their own seals on the goods, as if these were made or manufactured by themselves.

37.2.12 Member [Section 2 (1) (jj)]

The term 'member' has bee added to the Act subsequently by the Amendment Act 1993. This term includes the President and a member of the National Commission, a State Commission or a District Forum, as the case may be.

37.2.13 National Commission [Section 2 (1) (k)]

National Commission means the National Consumer Disputes Redressal Commission established under **Section 9 (c)**. This Section provides that there shall be established, for the purpose of the Act, a National Consumer Disputes Redressal Commission by the Central Government, by notification. Thus, based on the provisions of this Section, a National Commission was established by the Central Government in 1987.

37.2.14 Notification [Section 2 (1) (l)]

The term 'notification' means a notification published in the Official Gazette.

37.2.15 Person [Section 2 (1) (m)]

The term 'person', in the Act, includes the following:

(a) A firm, whether registered or not,
(b) A Hindu Undivided family (HUF),
(c) A cooperative society, and
(d) Every other association of persons, whether registered under Societies Registration Act, or not.

37.2.16 Prescribed [Section 2 (1) (n)]

The term 'prescribed', means prescribed by rules made by the Central Government or the State Government, as the case may be, under the Act.

37.2.17 Restrictive Trade Practice [Section 2 (1) (nn)]

The definition of the term 'Restrictive Trade Practice' has been inserted in the Act by the Amendment 1993. It, however, is limited in its scope, as it covers only the tie-up sales and excludes other restrictive trade practices covered under the MRTP Act.

37.2.18 Service [Section 2 (1) (o)]

The term 'service' means service of any description which is made available to the potential users and includes, but is not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical and other energy, boarding or lodging or both, housing construction, entertainment, amusement, or the purveying of news or other information. It, however, does not include the rendering of any service free of charge, or under a contract of personal service.

Thus, the services rendered by the Government hospital, being rendered free of charge, cannot be treated as service under the Act, unless the required amendment is inserted in the Act by the legislature. Similarly, the patient, receiving the treatment in a Government hospital, cannot be treated as a consumer, as he does not hire the services of the hospital, it being rendered free of charge.

As against this, the services rendered by the doctors in private hospitals for consideration (i.e. after payment of charges) would come within the meaning of service, as it is not rendered free of any charge. This point has been clarified in the case titled **Cosmopolitan Hospital vs Smt. Vasantha P. Nair, 1992.**

As regards the points relating to the contract of personal service, a subtle distinction has been brought out between the terms 'contract on personal service' and 'contract **for** personal service'. That is, the services rendered by the doctors in private hospitals for consideration (i.e. after payment of charges) would come within the meaning of service. But, where the hirer of the service is not in a position to exercise any type of control or supervision over the work of the person rendering the service, there would not be any 'personal service'.

37.2.19 Spurious Goods and Services [Section 2 (1) (oo)]

The term 'spurious goods and services' means that the goods and services in question, that are claimed to be genuine, are, in fact, not genuine.

37.2.20 State Commission [Section 2 (1) (p)]

State Commission means a Consumer Disputes Redressal Commission established in a State under **Section 9 (b)**. This Section provides that there shall be established, for the purpose of the Act, a Consumer Disputes Redressal Commission by the State Government concerned in the respective State, by notification in the official gazette. This Commission will be known as the State Commission

37.2.21 Trader [Section 2 (1) (q)]

A 'trader', in relation to any goods, means a person who sells or distributes any goods for sale and includes the manufacturer thereof. Further, where such goods are sold or distributed in a package form, the term 'trader' will include the packer of the goods, too.

37.2.22 Unfair Trade Practice [Section 2 (1) (r)]

'Unfair trade practice' means a trade practice which, for the purpose of promoting the sale, use or supply of any goods, or for the provision of any services, adopts any unfair method or unfair or deceptive practice including any of the following practice:

(a) Misleading advertisement and false representation.

Example

Acupressure Therapy Health Centre, manufacturing acupressure sandals, had claimed that with the use of the sandals for walking for eight minutes every day, morning and evening before meals, wearing the sandals, will improve the person's blood circulation, and he will be healthy. But, as there was no proven medical evidence regarding the aforementioned claim, the MRTP Commission had held that the claim was false and misleading. Accordingly, it had issued injunction restraining the company from issuing such advertisement, as it contained misleading facts.

(b) Claiming false affiliation or collaboration.

Example

In the case of Kelvinator of India Ltd and Expo Machinery Ltd, they had claimed that the Avanti scooters manufactured by them were being produced in technical collaboration with Garelli of Italy. But, on enquiry, it was revealed that no such collaboration existed. The companies were, therefore, directed by the Commission to remove such misleading facts from all their future advertisements.

(c) Non-fulfilling of warranty/guarantee and non-rendering of satisfactory after-sale service and warranty claims'

Example

A person had purchased an electric typewriter machine from Logic System Private Ltd, New Delhi, with a warranty of one year. But the machine had developed serious defects after one and half month

itself. The company, however, did not respond to any of the several complaints lodged with it by the purchaser. On enquiry, it was found that the company was supplying defective machines to its customers (consumers), and was not rendering satisfactory after-sale service, either. But the machine had developed serious defects after one and half month itself, though the machine was sold under the warranty of one year period. Even the repairs or replacements of the machine did not work efficiently. The company was, therefore, found by the commission to have indulged in unfair trade practice.

37.2.22.1 Bargain Sale

Bargain price means the following:

(i) A price that is stated in any advertisement, whether in a newspaper or otherwise, to be a bargain price with reference to an ordinary price or otherwise, or

(ii) A price that a person, who reads or hears or sees the advertisement, would reasonably believe it to be a bargain price, i.e. lesser than the usual price of the products on sale.

Examples

(i) The **Snow White Clothes** had advertised a 50 per cent discount. The Commission had held that the advertisements were misleading as the normal price was not shown in the advertisement. Further, the bargain sale period was also vaguely shown as 'till stocks last'.

(ii) In another case, **Panama Textiles, Mumbai,** the dealer was found to have sold spurious/sub-standard products, like suiting and so on, under the brand names like Raymonds, Bombay Dyeing, and Grasim products, in the name of bargain sale. It was held that the trader had indulged in an unfair trade practice.

37.2.22.2 Offering Gifts, Prizes, etc., and Considering Contents or Lottery

The offering of gifts, prizes, etc., or other items or lotteries, or lottery with the intention of not providing these, as offered, or creating an impression that something is being given or offered free of charge, when, in fact, it is fully or partly covered by the amount charged in the transaction as a whole, also come within the ambit of unfair trade practice.

37.2.22.3 Not Conforming to the Prescribed Standard

The sale of goods which do not conform to the prescribed standard will amount to indulging in unfair trade practice.

Example

The sale of helmets, without ISI certification, will amount to indulging in unfair trade practice.

37.2.22.4 Hoarding or Destruction of Goods

Hoarding or destruction of goods, with the intention of artificially raising their prices, and thereafter, to sell them at a higher profit, also amount to indulging in unfair trade practice.

37.3 Rights of Consumers

The following rights of the consumers have been recognised for the first time in India under **Section 6** of the Act:

(a) Right to safety

This right pertains to the right of the consumer to be protected against the marketing of goods and services, which are hazardous to life and property.

(b) Right to be informed
The consumer has been granted the right to be informed about the quality, quantity, potency, purity, standard, and price of goods or services, as the case may be, with a view to protecting the interest of the consumer against any type of unfair trade practices.

(c) Right to choose
The consumer has the right to choose, i.e. to be assured, wherever possible, access to a variety of goods and services at competitive prices. In the case of monopolies, like railways, and so on, it means the right to be assured of satisfactory quality and services at a fair price.

(d) Right to be heard
Under this right, the interests of the consumers will receive due consideration at the appropriate forum. It also includes the right to be represented in different forums formed for the consideration of the welfare of the consumers.

(e) Right to redressal
This right pertains to the right of the consumer to seek redressal against unfair practices or restrictive trade practices, or unscrupulous exploitation of the consumers. It also includes the right to a fair settlement of the genuine grievances of the consumers.

(f) Right to consumer education
This right confers the right to the consumers to acquire the knowledge and skill to become an informed consumer.

37.4 Consumer Protection Councils

The Act, as amended by the (Amendment) Act 2002, provides for the constitution of consumer protection councils at the Central, State, and District levels.

37.4.1 Central Consumer Protection Council (Sections 4 to 6)

37.4.1.1 Establishment

Under **Section 4**, the Central Government **shall** (since changed from the word '**may**') establish, by notification, a Council, to be known as the Central Consumer Protection Council, usually referred to as the Central Council.

37.4.2 Membership

The Central Council shall comprise (consist of) the following members:

(a) The Minister in charge of Consumer Affairs, in the Central Government, who shall be the Chairman,
(b) Such number of other official or non-official members representing such interest, as may be prescribed.

The term of the Council will be for three years.

37.4.3 Procedure for Meetings of the Central Council (Section 5)

The Central Council shall meet as and when necessary, but at least once every year.

37.4.4 Objects of the Central Council (Section 6)

The objects of the Central Council shall be to promote and protect all the six rights of the consumers, as mentioned in Section 37.3 above, i.e. as mentioned in **Section 6 (a) to (f) of the Act.**

37.4.5 Wide Publicity by the Central Council

The Central Council shall give wide publicity to the rights of the consumers and the consumer dispute redressal agencies, and the procedure for filing the complaints therein, through television, radio, newspapers and magazines so as to give a boost (impetus) to the consumer movement in the country.

37.4.6 State Consumer Protection Councils (Sections 7 and 8)

37.4.6.1 Establishment

Under **Section 7**, the State Government **shall** (since changed from the word '**may**'), by notification, establish, with effect from such date as it may specify in such notification, a Council to be known as the Consumer Protection Council, usually referred to as the State Council.

37.4.6.2 Membership

The State Council shall comprise (consist of) the following members:

(a) The Minister in charge of Consumers' Affairs, in the State Government, who shall be the Chairman,
(b) Such number of other official or non-official members representing such interests, as may be prescribed by the State Government, and
(c) Such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

37.4.6.3 Procedure for meetings of the State Council

The State Council shall meet as and when necessary, but at least twice every year.

37.4.6.4 Objects of the State Council (Section 8)

The objects of every State Council shall be to promote and protect, within the State, all the six rights of the consumers, as mentioned in 37.3 above, i.e. as mentioned in **Section 6 (a) to (f) of the Act.**

37.4.7 District Consumer Protection Councils (Section 8A)

37.4.7.1 Establishment

The State Government **shall** (since changed from the word '**may**'), establish for every District, by notification, a Council to be known as the District Consumer Protection Council, usually referred to as the District Council, with effect from such date as it may specify in such notification

37.4.7.2 Membership

The District Consumer Protection Council, usually referred to as the District Council, shall comprise (consist of) the following members:

(a) The Collector of the district (by whatever name called), who shall be its Chairman, and
(b) Such number of other official or non-official members representing such interests, as may be prescribed by the State Government.

37.4.7.3 Objects of the District Council (Section 8B)

The objects of every District Council shall be to promote and protect, within the District, all the six rights of the consumers, as mentioned in 37.3 above, , i.e. as mentioned in **Section 6 (a) to (f) of the Act.**

Let us Recapitulate

- The objects of the Act are the following:
  (**a**) To provide for better protection of the interest of the consumers;
  (**b**) To provide for the establishment of Consumer Councils and other authorities with a view to meeting these objectives; and
  (**c**) To empower the Consumer Councils and other authorities to settle costumers' disputes and the matters connected therewith.
- The Act extends to the whole of India except to the State of Jammu and Kashmir
- Definitions
  The remaining portion of this chapter mainly pertains to 'definitions' of various terms used in the Act. Further, such definitions are legally too technical, in its nature and wording. Thus, any attempt to reproduce them in a synoptic manner may distort their accurate contents. Accordingly, no attempt is made here to present a summary of the definition portion of the chapter.
- The following rights of the consumers have been recognised for the first time in India

  (**a**) **Right to safety**
  This right pertains to the right of the consumer to be protected against the marketing of goods and services, which are hazardous to life and property.

  (**b**) **Right to be informed**
  The consumer has been granted the right to be informed about the quality, quantity, potency, purity, standard, and price of goods or services, as the case may be, with a view to protecting the interest of the consumer against any type of unfair trade practices.

  (**c**) **Right to choose**
  The consumer has the right to choose, i.e. to be assured, wherever possible, access to a variety of goods and services at competitive prices. In the case of monopolies, like railways, and so on, it means the right to be assured of satisfactory quality and services at a fair price.

  (**d**) **Right to be heard**
  Under this right, the interests of the consumers will receive due consideration at the appropriate forum. It also includes the right to be represented in different forums formed for the consideration of the welfare of the consumers.

  (**e**) **Right to redressal**
  This right pertains to the right of the consumer to seek redressal against unfair practices or restrictive trade practices, or unscrupulous exploitation of the consumers. It also includes the right to a fair settlement of the genuine grievances of the consumers.

  (**f**) **Right to consumer education**
  This right confers the right to the consumers to acquire the knowledge and skill to become an informed consumer.
- **Central Consumer Protection Council (Sections 4 to 6)**

  Establishment
  The Central Government **shall** (since changed from the word '**may**') establish, by notification, a Council, to be known as the Central Consumer Protection Council, usually referred to as the Central Council.

  Membership
  The Central Council shall consist of) the following members:
  (**a**) The Minister in charge of Consumer Affairs, in the Central Government, who shall be the Chairman,
  (**b**) Such number of other official or non-official members representing such interest, as may be prescribed.

The **term of the Council** will be for three years.
Procedure for meetings of the Central Council
The Central Council shall meet as and when necessary, but at least once every year.
Objects of the Central Council
The objects of the Central Council shall be to promote and protect all the six rights of the consumers, as aforementioned. **[Section 6(a) to (f) of the Act]**.

- **Wide publicity by the Central Council**
  The Central Council shall give wide publicity to the rights of the consumers and the consumer dispute redressal agencies, and the procedure for filing the complaints therein, through television, radio, newspapers and magazines, so as to give a boost (impetus) to the consumer movement in the country.
- **State Consumer Protection Councils**
  Establishment
  Tthe State Government **shall** (since changed from the word '**may**'), by notification, establish, with effect from such date as it may specify in such notification, a Council to be known as the Consumer Protection Council, usually referred to as the State Council.
- **Membership**
  The State Council shall comprise (consist of) the following members:
  (**a**) The Minister in charge of Consumers' Affairs, in the State Government, who shall be the Chairman,
  (**b**) Such number of other official or non-official members representing such interests, as may be prescribed by the State Government.
  (**c**) Such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.
- **Procedure for meetings of the State Council**
  The State Council shall meet as and when necessary, but at least twice every year.
- **Objects of the State Council (Section 8)**
  The objects of every State Council shall be to promote and protect, within the State, all the six rights of the consumers, as aforementioned **[Section 6 (a) to (f) of the Act]**.
- **District Consumer Protection Councils (Section 8A)**
- **Establishment**
  The State Government **shall** (since changed from the word '**may**'), establish for every District, by notification, a Council to be known as the District Consumer Protection Council, usually referred to as the District Council, with effect from such date as it may specify in such notification.
- **Membership**
  The District Consumer Protection Council, usually referred to as the District Council, shall comprise (consist of) the following members:
  (**a**) The Collector of the district (by whatever name called), who shall be its Chairman, and
  (**b**) Such number of other official or non-official members representing such interests, as may be prescribed by the State Government.
- **Objects of the District Council (Section 8B)**
  The objects of every district council shall be to promote and protect, within the district, all the six rights of the consumers as mentioned in Section 6 (a) to (f) of the Act.

Questions for Reflection

1. What are the various objects of the Consumer Protection Act, 1986? Explain.
2. Does the Consumer Protection Act, 1986, extend to the whole of India? Give reasons for your answer.
3. Define the following terms as per the Consumer Protection Act, 1986:

(a) Appropriate Laboratory or Organisation;
(b) Branch Office;
(c) Complainant;
(d) Complaint;
(e) Consumer;
(f) Consumer Dispute;
(g) Defect in goods;
(h) Deficiency in service;
(i) District Forum;
(j) Goods;
(k) Manufacturer;
(l) Member;
(m) National Commission;
(n) Notification;
(o) Person;
(p) Prescribed;
(q) Restrictive Trade Practice;
(r) Service;
(s) Spurious Goods and Services;
(t) State Commission;
(u) Trader;
(v) Unfair Trade Practice;
(w) Bargain Sale;
(x) Offering Gifts, Prizes, etc.;
(y) Not conforming to the Prescribed Standard; and
(z) Hoarding or Destruction of Goods.

4. Explain the following rights of the consumers:
   (a) Right to safety;
   (b) Right to be informed;
   (c) Right to choose;
   (d) Right to be heard;
   (e) Right to redressal; and
   (f) Right to consumer education.
5. Write a short note on the Central Council referring to its establishment, membership, period of its term of office, periodicity of its meetings, and its objects.
6. Write a short note on the State Council referring to its establishment, membership, periodicity of its meetings, and its objects.
7. Write a short note on the District Forum referring to its establishment, membership, and its objects.

Problems for Practice (With Suggested Solutions)

Problem 1

Do the following persons fall within the category of the term 'Consumer'? Write 'Yes' or 'No' as your answer.

(a) A customer using the liquid pressed gas (LPG),
(b) Passengers travelling by a train,
(c) Subscribers of telephones,
(d) User of electricity,

(e) Allottee of a flat as a nominee of the Government,
(f) User of sewerage system laid by the Municipal Corporation,
(g) Purchaser of equipment using it by himself in the practice of a profession himself,
(h) Parents of an infant patient,
(i) Subscriber to a Provident Fund,
(j) A winner of the lottery
(k) Person buying goods either for resale or for use in a large-scale profit-making activity,
(l) Insurance company.

Solution

The answer to questions at serial numbers (a) to (i) is 'Yes'.

But, the answer to questions at serial numbers (j) to (l) is 'No'.

Problem 2

'The Act extends to the whole of India.' Do you agree with this statement? Give reasons for your answer.

Solution

No. The correct statement is 'The Act extends to the whole of India except to the State of Jammu and Kashmir'.

Problem 3

A Television (T.V.) was sold to a person with a warranty of free service for two years. The seller of the T.V. had contended that, as the services for the maintenance of the machine for two years under the warranty were rendered free, the buyer did not fall in the category of the consumer under the Act, insofar as the warranty was concerned. Do you agree with this stand of the seller? Give reasons for your answer.

Solution

No. The stand of the seller is not legally tenable. In fact, the warranty is considered to be an integral part of the composite contract for the supply of the T.V., and its maintenance for two years was not, in fact, free, as the price of such free services for two years under the warranty was already included in the original price of the T.V. In fact, there cannot be an agreement of sale, including warranty, without consideration (pertaining to both the T.V and the free warranty). **[Vishwa Jyoti Printers vs Molins of India, 1992].**

Problem 4

Are the passengers travelling by train consumers? Give reasons for your answer.

Solution

Yes, the passengers travelling by trains, on payment of the stipulated fare, charged for the ticket, are consumers, and the facility of transportation by rail, provided by the railway administration, is a 'service' rendered for consideration, as per the Act. **[General Manager vs Anand Prasad Sinha, 1989].**

Problem 5

Are the subscribers of telephones consumers? Are they entitled to apply for relief to the Consumer Forum whenever necessary? Give reasons for your answer.

Solution

Yes, the subscribers of telephones are consumers under the Act. Therefore, they are entitled to apply for relief to the Consumer Forum whenever necessary. **[District Manager, Telephones, Patna vs Lalit Kumar Bajla, 1989].**

Problem 6

Are the users of sewerage system laid by the Municipal Corporation consumers? Give reasons for your answer.

Solution

Yes, because it was held in the case titled **Prakashwati vs Municipality, Bhatinda, 1995], CCJ 354** that the payment of water and sewerage charges to the Municipality tantamount to hiring these services and, accordingly, the users thereof are consumers.

Problem 7

Are the parents of an infant patient the consumers? Give reasons for your answer.

Solution

Yes. This is so because the parents have paid the fees in consideration of the treatment of the child. The Supreme Court has held in the case titled **Spring Meadows Hospital vs Harjit Ahaluwalia, 1998(2), SCALE 456** that a consumer would mean a person who hires or avails of any service and it includes any beneficiary. Thus, when a young child is taken to a hospital by his parents and the child is treated by the doctor, his parents would come within the definition of the consumer having hired the services, and the child would also become a consumer under the inclusive definition of **Section 2 (1) (d)** of the Act, by virtue of being a beneficiary.

Problem 8

Are the subscribers to a Provident Fund consumers? Give reasons for your answer.

Solution

Yes. The Supreme Court has held that the administration of the Provident Fund by the Provident Fund Commissioner is a service and that every member of the Provident Fund Scheme is a consumer. **[Provident Fund Commissioner vs Shivkumar Joshi, 1999, AIR, SCW 4456].**

Problem 9

A person had purchased a scooter and had also won a lucky lottery draw for two tickets from New Delhi to Mumbai and back, as was advertised by the scooter company. His claim for payment of the value of the air fares was disallowed by the scooter company on some ground. His complaint, on this count, was also turned down on the ground that he was a consumer only of the scooter; and as there was no defect in the scooter reported by him, the complaint was not justified. Do you consider the stand of the scooter company valid in law? Give reasons for your answer

Solution

Yes; we consider the stand of the scooter company valid in law. We have taken this stand on the basis of a case wherein the Court had decided that the matter regarding winning the lottery did not bring the person within the category of the term 'consumer' **[Byford vs S. S. Srivastava, 1993].**

Problem 10

Raghu had booked a packet through a courier. It was not delivered to the consignee (addressee) by the courier as a result of which the person had lost his admission in the desired college. Can the courier be proceeded against for negligence and for rendering inefficient service provided by him (courier)? Give reasons for your answer.

Solution

Yes; the courier can be proceeded against for negligence and for rendering of inefficient service by him. This is so because, the non-delivery of any article by the courier, which causes some serious hardship and inconvenience to the consignee (addressee) is a case of negligence in performance and deficiency of service by the courier concerned. [S**kypack Couriers Private Ltd and Another vs Ms. Anupama Bagla (1992)].**

Problem 11

Nalini, the widow of Mangal, had filed a claim with the LICI after the death of her husband due to a sudden illness, when the second premium on a policy of Rs 50,000 had fallen due. This claim was not settled for as long as 12 years, and that too, after her aforementioned misery was published in a news paper and some M.P. had raised the matter in the Parliament. Thereafter, she was sent a cheque for Rs 2, 03.550. Is Nalini entitled to some additional relief for the financial hardship and mental agony caused to her due to the inordinate delay in settling her claim by the LICI? Give reasons for your answer.

Solution

Yes. This stand is based on the decision of the National Commission wherein it was held that the LICI had been highly negligent in performance of its service and the Commission had awarded payment of interest at

the rate of 12 per cent per annum, with effect from the expiry of three months of the death of the assured upto the date of payment of the cheque. Additionally, an order was passed by the National Commission on 11th May 1993 directing the LICI to pay her a compensation of Rs 15, 000 on account her mental torture, loss and harassment.

Problem 12

National Bank, Lucknow, had refused payment of a demand draft for Rs 55,000, drawn by its branch at Allahabad, under the objection that under the signature of one of the signatories to the draft, his designation (Manager) was not mentioned. Do you think that the stand taken by the bank is justified? Give reasons for your answer.

Solution

No**.** The stand taken by the bank is not justified. It, instead, amounts to deficiency in service on the part of the bank. Accordingly, the bank would be held liable for the inconvenience and the loss, caused to the payee concerned, resulting from such wrongful dishonour. This stand is based on the judgement of the case, decided on 3rd August 1992, titled **State Bank of India vs N. Raveendran Nair**.

Problem 13

Hindustan Bank, Lucknow, had converted a joint fixed deposit account into an individual account of only one of the joint account holders, without such request being made from both the joint account holders. Does the act, on the part of the bank, tantamount to deficiency of service? Give reasons for your answer.

Solution

Yes. The aforementioned act, on the part of the bank, amounts to deficiency of service. This stand is based on the judgement of the State Commission delivered in a similar case titled **Satish Mehra vs Punjab and Sind Bank [(1997), CCJ 1252 (Delhi)]**'.

Problem 14

Can the shares, before these are allotted, be termed as goods? Give reasons for your answer.

Solution

No. The shares, before these are allotted, cannot be termed as goods? This is so, because these do not exist till they are allotted. **[Morgan Stanley Mutual Fund vs Kartick Das (1994), 4, Supreme Court Cases (SCC) 225].**

Problem 15

Can the services rendered by Government hospitals, being rendered free of charge, be treated as service under the Act? Give reasons for your answer.

Solution

No. The services, rendered by the Government hospital, cannot be treated as service under the Act, as these are being rendered free of charge.

Problem 16

Can the patient, receiving the treatment in a Government hospital, free of charge, be treated as a customer? Give reasons for your answer.

Solution

No. The patient, receiving the treatment in a Government hospital, cannot be treated as a consumer, as he does not hire the services of the hospital, it being rendered free of charge.

Problem 17

Will the services, rendered by the doctors in private hospitals for consideration (i.e. after payment of charges), come within the meaning of service'? Give reasons for your answer.

Solution

Yes, the services rendered by the doctors in private hospitals for consideration (i.e. after payment of charges) would come within the meaning of service. This is so because such service is not rendered free of any charge. This point has been clarified in the case titled **Cosmopolitan Hospital vs Smt. Vasantha P. Nair, 1992.**

Problem 18

A company, manufacturing acupressure shoes, had claimed in an advertisement that with the use of the sandals for walking for ten minutes every day, morning and evening before meals, wearing the shoes, will improve the person's blood circulation, and he will be healthy. However, there was no proven medical evidence regarding the aforementioned claim. Do you think that the advertisement is valid and the company can continue with such advertisement? Give reasons for your answer.

Solution

No. the advertisement is not valid and the company cannot continue with such advertisement. This is so because, the claim is false and misleading. This stand is based on the contention of the MRTP Commission, which had held that the claim was false and misleading. Accordingly, it had issued injunction, restraining the company from issuing such advertisement, as it contained misleading facts.

Problem 19

A company, manufacturing cars, had claimed in the advertisement that the cars manufactured by them were being produced in technical collaboration with Ford of the USA. But, on enquiry, it was revealed that no such collaboration existed. Under the aforementioned circumstances, can the company be directed to remove such misleading facts from all their future advertisements? Give reasons for your answer.

Solution

Yes. The company would be directed to remove such misleading facts from all their future advertisements. This stand is taken on the basis of the decision given to this effect in a similar cases filed against **Kelvinator of India Ltd., and Expo Machinery Ltd.**

Problem 20

A person had purchased a computer machine from a company, with a warranty of two years. But the machine had developed serious defects after six months. The company, however, did not respond to any of the several complaints lodged with it by the purchaser. On enquiry, it was found that the company was supplying defective machines to its customers, and was not rendering satisfactory after-sale service, either. Do you consider that the company was indulging in unfair trade practice, in view of the aforementioned circumstances? Give reasons for your answer.

Solution

Yes. The company was indulging in unfair trade practice, in view of the aforementioned circumstances. This stand is based on a similar case filed against **Logic System Private Ltd., New Delhi**, wherein the Commission had observed that the company had indulged in an unfair trade practice.

Problem 21

A company had advertised to the effect that 60 per cent discount have been allowed on the displayed goods, which will be available till the stocks last. The normal prices of the goods, were, however, not shown in the advertisement. Do you think that the advertisements were misleading? Give reasons for your answer.

Solution

Yes. The advertisements were misleading in view of the fact that the normal price of the goods on sale was not shown in the advertisement. Further, the bargain sale period was also vaguely shown as 'till stocks last'. This stand is based on a similar case filed against **Snow White Clothes,** where such decision was handed out by the Commission.

Problem 22

A dealer was found to have sold spurious/sub-standard products, like shoes and so on, under the brand names like Bata, Liberty, Carona, and so on, in the name of bargain sale. Do you think that the trader had indulged in an unfair trade practice? Give reasons for your answer.

Solution

Yes. The trader had indulged in an unfair trade practice, as he had sold spurious/sub-standard products, under the false brand names like Bata, Liberty, Carona, and so on. This stand is based on a similar case filed against **Panama Textiles, Mumbai,** where such decision was handed out by the Commission.

Problem 23

A shopkeeper was selling helmets, without ISI certification. Will this act on his part amount to indulging in unfair trade practice? Give reasons for your answer.

Solution

Yes. This act on the part of the shopkeeper concerned would amount to indulging in unfair trade practice. This is so because the sale of goods which do not conform to the prescribed standard will amount to indulgence in unfair trade practice.

Problem 24

A wholesale trader had hoarded a huge stock of sugar, with the intention of artificially raising its prices, and thereafter to sell it at a higher profit. Will it amount to indulging in unfair trade practice? Give reasons for your answer.

Solution

Yes. This is so because, hoarding or destruction of goods, with the intention of artificially raising their prices, and thereafter, to sell them at a higher profit, amounts to indulging in unfair trade practice.

Problem 25

Do you agree with the following statement? Give reasons for your answer.

'The Central Council shall meet as and when necessary, but at least once in two years.'

Solution

No. Because the correct statement is that 'The Central Council shall meet as and when necessary, but at least once every year'.

Problem 26

Do you agree with the following statement? Give reasons for your answer.

'The State Council shall meet as and when necessary, but at least once in two years.'

Solution

No. Because the correct statement is that 'The State Council shall meet as and when necessary, but at least twice every year'.

Problem 27

Do you agree with the following statement? Write 'Yes' or 'No' as your answer.

'The Minister, in charge of Consumers' Affairs, in the State Government, shall be the Chairman of the State Council'.

Solution

Yes.

Problem 28

Do you agree with the following statement? Give reasons for your answer.

'Commissioner of the Division (by whatever name called), shall be the Chairman of the District Forum of the Districts within the Division'.

Solution

No. because the correct statement should be that the 'Collector of the district (by whatever name called), shall be the Chairman of the District Forum'.

Chapter Thirty Eight

Remedies and Relief Available to Consumers

"

Don't find fault, find a remedy.
Henry Ford

Force is not a remedy.
John Bright

Everyone suffers wrongs for which there is no remedy.
Edgar Watson Howe

A patient mind is the best remedy for trouble.
Plaut

For suffering and enduring there is no remedy, but striving and doing.
Thomas Carlyle

When thought becomes excessively painful, action is the finest remedy.
Salman Rushdie

A desperate disease requires a dangerous remedy.
Guy Fawkes

"

38.1 Nature and Scope of Remedies

The nature and scope of remedies, as stipulated in the Act, are to provide simple, speedy, and inexpensive redressal of the grievances of the consumers. With this end in view, a three-tier quasi-judicial machinery has been provided under the Act at the National, State, and District levels. At the national level, there is a National Consumer Disputes Redressal Commission, which is known as the National Commission.

Likewise, at the State level, there is to be similar Consumer Disputes Redressal Commissions, which is known as the State Commission.

Similarly, at the district level, there are to be District Forums, as the redressal forums. The State Government may, if it deems fit, establish more than one District Forums in a district.

38.2 Who may File a Complaint? (Section 12)

Any of the following persons may file a complaint:

(a) The 'consumer' (as defined in the Act as per **Section 2 (1) (d)**,
Thus, the consumer means any of the following persons:
  (i) A person who purchases any goods for consideration, which has been paid or partly paid, or which has been promised to be paid or partly paid, or which has been purchased under any system of deferred payment (i.e. pertaining to hire–purchase transactions). The term 'consumer' includes any other user of such goods, when such use is made with the consent (approval) of the purchaser. But then, the term, 'consumer' does not include such person who obtains such goods for resale or for any commercial purpose. Moreover, the term 'commercial purpose' does not include use of the goods by a consumer of goods purchased and used by him, and the services availed of by him, exclusively for the purpose of earning his living, by way of self-employment **[Explanation to Section 2 (1) (d)]**
  (ii) A **person who hires or avails of any services** for consideration, which has been paid or partly paid, or which has been promised to be paid or partly paid, or which has been purchased under any system of deferred payment. The term 'consumer' includes any other beneficiary of such services, when such use is made with the consent (approval) of the original purchaser. But then, the term, 'consumer' does not include such person who avails of such services for any commercial purpose.

(b) Any recognised consumer association, viz. any voluntary consumer association, registered under the Companies Act 1956, or under any other law, for the time being in force. Further, it is not necessary for the complainant to be a member of such association.

(c) One or more consumers, in the cases where there are several consumers having the same interest, with the permission of the District Forum, on behalf of, or for the benefit of, all the consumers so interested.

(d) The Central or the State Government, as the case may be, either in its individual (personal) capacity, or as a representative of the interest of he consumers, in general.

38.3 What Ttype of Complaint may be Filed?

Under **Section 2 (1) (c),** a complaint may pertain to one or more of the following:

(a) An unfair trade practice or a restrictive trade practice has been resorted to (adopted) by any trader or service provider,

(b) The goods purchased by him, or agreed to be purchased by him, suffer from one or more defects.

(c) The services hired or availed of, or agreed to be hired or availed of, by him suffer from deficiency in any respect.

(d) A trader or a service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price, in excess of the price:
  (i) Fixed by or under any law for the time being in force,
  (ii) Displayed on the goods or on any package containing such goods,
  (iii) Displayed on the price list, exhibited by him, by or under any law for the time being in force, or
  (iv) Agreed between the parties.

(e) Goods, which will be hazardous to life and safety, when consumed (used), are being offered for sale to the public:
   (i) In contravention of any standards regarding the safety of such goods, as required to be complied with by or under any law for the time being in force,
   (ii) If the trader could have known with due diligence that the goods so offered by him are unsafe to be used by the public.

(f) Services, which are hazardous, or are likely to be hazardous, to the life and safety of the public, when used, are being offered by the service provider, which such person could have known with due diligence to be injurious to the life and safety, with a view to obtaining any relief provided by or under this Act.

In the cases where the price of any article (goods) is not fixed by any law or is not displayed on the goods, or is not displayed on the package containing the goods, the Act does not contemplate any complaint being filed in regard to the price charged, on the plea that the price so charged is excessive. This view has been confirmed in the case titled **Manager, Milk Chilling Centre vs Mahaboobnagar Citizen's Council (1990).**

38.4 Where the Complaint may be Filed?

(a) As per **Section 11**, in the cases where the value of the goods or services, and the compensation, if any, claimed, does not exceed Rs 20 lakh, the complaint may be filed in the District Forum, which falls within the local limits of the jurisdiction, the opposite party (i.e. the party against whom the complaint has been filed), actually resides, or carries on the business, or has a branch office, or personally works for gains, or where the cause of action wholly or partly arises.

(b) As per **Section 17**, in the cases where the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 20 lakh, but does not exceed Rs 1 crore, the complaint may be filed in the State Commission of the respective State.

(c) However, in the cases where a joint petition has been filed, on behalf of a large number of complainants (victims), it will be the total amount of the compensation, claimed in the complaint, and not the single (individual) claims, which will be taken into account for deciding the appropriate jurisdiction, viz. State Council or the District Forum, as the case may be. Thus, if the total amount of compensation, claimed in the complaint, exceeds Rs 20 lakh, but does not exceed Rs 1 crore, the complaint may be filed in the State Commission of the respective State.

(d) Further, under **Section 17,** the appeal against the verdict of the District Councils within the State may be heard by the respective State Commission.

(e) As per **Section 21**, in the cases where the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 1 crore, the complaint may be filed with the National Commission.
the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 20 lakh, but does not exceed Rs 1 crore, the complaint may be filed in the State Commission of the respective State.

Further, under **Section 21,** the appeal against the verdict of any of the State Commission may also be heard by the National Commission.

38.5 How to File a Complaint?

The complaint may be filed with the appropriate Commission or Forum by the complainant or his authorised agent, in person, or it may even be sent by post to the appropriate Commission or Forum, as the case may be.

The complaint must, however, be addressed to the Chairman of the appropriate Commission or Forum, as the case may be.

The complaint must contain the following information:

(a) The name, description, and the address of the complainant,
(b) The name, description, and the address of the opposite party (i.e. against whom the complaint has been made), or the parties, as the case may be, as far as these can be ascertained,
(c) The facts pertaining to the complaint(s), and as to when and where the complaint arose,
(d) Documents, if any, in support of the allegations (complaints) contained in the complaint, and
(e) The relief that the complainant is seeking.

The complaint is required to be signed by the complainant, or by his authorised agent. A minimum of four copies of the complaint are required to be filed with the appropriate authorities concerned.

38.6 Procedure on Receipt of the Complaint (Section 13)

38.6.1 In Regard to the Goods, where the Defects Alleged, Does Not Require any Testing or Analysis

(i) In this connection, the complainant is required to send a copy of the complaint to the opposite party mentioned in the complaint, within a period of 21 days from the date of its admission by the appropriate authority, directing him (opposite party) to give his version of the case within a period of 30 days or within such extended period, not exceeding 15days, as may be granted by the District Forum or the State Commission.

It has further been observed by the National Commission that the aforementioned period is a mandatory requirement of the law. Accordingly, the disposal of any complaint before the expiry of the aforementioned period shall be contrary to law, and hence will be declared as void. (**Signet Corporation vs Commissioner of Municipal Corporation of Delhi (decided on 19 May 1997)**.

(ii) If the opposite party, on receipt of the complaint referred (sent) to him by the complainant, as aforementioned in (i) above, denies or disputes the allegation contained in the complaint, or omits or fails to take any action to represent his case within the aforementioned time period of 30 days and the extended period not exceeding 15 days, granted by the District Forum or the State Commission, the appropriate authority will proceed to settle the dispute of the consumer (complainant) in the manner specified in **Clauses (c) to (g),** mentioned under the next heading at 38.6.2 below, in regard to the goods where the defects alleged require any testing or analysis.

38.6.2 In Regard to the Goods where the Defects Alleged Require any Testing or Analysis

(i) In the cases where the complainant alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, the District Forum shall obtain a sample of the goods from the complainant, seal it and authenticate it in the prescribed manner. Such sample, so sealed and authenticated, shall then be sent to the appropriate laboratory, along with a direction to it, to the effect that such laboratory should make an analysis or test, whichever may be necessary, so as to find out whether such goods suffer from any defect alleged in the complaint, or from any other defect. Thereafter, the laboratory is required to report its finding thereon to the District Forum within a period of 45 days from the receipt of the sample, or within such extended period as may be granted by the District Forum. **[Clause (c)].**

(ii) Before referring any sample of the goods, under **Clause (c)** referred to above, to the appropriate laboratory, the District Forum may require the complainant to deposit, to the credit of the Forum, such

fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test pertaining to the goods in question. **[Clause (d)].**

(iii) The District Forum will remit such amount, so deposited to its credit, as aforementioned, to the appropriate laboratory, to enable it to carry out the required analysis or test, as stated above. After receiving such report from the appropriate laboratory, the District Forum shall forward a copy of such report, along with such remarks as it (District Forum) may consider appropriate, to the opposite party **[Clause (e)].**

(iv) In case any of the two parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the method of the analysis or test adopted by the appropriate laboratory, the District Forum shall require the opposite party or the complainant, as the case may be, to submit his objection in writing, pertaining to the report made by the appropriate laboratory. **[Clause (f)].**

(v) Thereafter, the District Forum shall give a reasonable opportunity to the complainant and the opposite party for being heard as to the correctness or otherwise of the report made by the appropriate laboratory as also as to the objection made in relation thereto under **Clause (f)**, as aforementioned. Thereupon, the District Forum shall issue an appropriate order under **Section 14 [Clause (g)]**.

38.6.3 Procedure where the Complaint Pertains to the Goods in Respect of which the Aforementioned Procedures cannot be Followed, or if the Complaint Relates to any Services

In such cases, the District Forum, after following the procedures laid down under **Section 13 (1) and (b)**, as aforementioned, shall proceed to settle the disputes of the customers, in the following manner:

(a) On the basis of the evidences that are brought to its notice by the complainant, the opposite party, where the opposite party denies or disputes the allegations contained in the complaint. Or

(b) On the basis of the evidences that are brought to its notice by the complainant, where the opposite party omits or fails to take any action to represent his case within the time given by the District Forum.

38.6.4 No proceedings, complying with the procedure of the aforesaid provisions of the Act, shall be called in questioning in any Court on the ground that the principle of natural justice has not been complied with.

38.7 Powers of the District Forum [Section 13 (4)]

The District Forum shall have the same powers as are vested in the Civil Court under the Code of Civil Procedure.

For the purpose of conducting an enquiry, the District Forum shall have the same powers as are vested in a Court, while trying a suit under the Code of Civil Procedure, 1908, in respect of the following matters:

(a) For summoning and enforcing the attendance of any person (defendant or witness) for his examination on oath;

(b) Requiring the discovery or production of documents, or other material or object as producible evidence;

(c) Receiving the evidence of affidavits; and

(d) Requisitioning the report of the analysis or test concerned from the appropriate laboratory, or from any other relevant source;

(e) Issuing of any warrant, conferring authority, for the examination of any witness; and

(f) Any other matter which may be prescribed.

Every procedure before the District Forum shall be deemed to be a judicial proceeding within the meaning of **Sections 193 and 228 of the Indian Penal Code (IPC)**. Further, the District Forum shall be deemed to be a Civil Court, for the purpose of **Section 195 and Chapter XXVI of the Code of Criminal Procedure (CRPC)**, 1973.

38.8 Relief Available to Consumers (Section 14)

If after the proceedings conducted under **Section 13**, the District Forum is satisfied that the goods complained against suffer from any defects specified in the complaint, or that any of the allegations contained in the complaint about the services rendered, are proved, it shall issue an order to the opposite party directing him to do one or more of the following things:

(a) To remove the defects, pointed out by the appropriate laboratory, from the goods in question.
(b) To replace the goods with new goods of similar description, that shall be free from defects.
(c) To return to the complainant the price or the charges, as the case may be, paid by the complainant.
(d) To pay such amount as it has awarded as compensation to the complainant (consumer) for any loss or injury suffered by him (consumer) on account of the negligence of the opposite party. The District Forum shall also have punitive power to grant (punitive) damages in such circumstances as it (District Forum) may deem suitable (fit).
(e) To remove the defects or deficiencies in the services rendered in question.
(f) To discontinue the unfair trade practice or the restricted trade practice, or not to repeat them.
(g) Not to offer the hazardous goods for sale.
(h) To withdraw the hazardous goods from being for sale.
(i) To stop the manufacturing of hazardous goods, and to desist from offering services that are hazardous in nature.
(j) To pay such amount as may be fixed by it (District Forum), if in its opinion, the loss or injury has been suffered by a large number of consumers who are not identifiable conveniently. The sum so payable shall not be less than five per cent of the value of such defective goods sold, or the services rendered, as the case may be, to such consumers. The amount so obtained shall be credited to such persons and will be utilised in such manner as may be prescribed.
(k) To issue corrective advertisement so as to neutralise the effect of the misleading advertisement. The cost of such corrective advertisement shall be payable by the opposite party, who has been responsible for issuing such misleading advertisement.
(l) To pay (provide) for adequate costs to the parties concerned.

38.9 Time-frame for Decision of Consumer Courts

The Redressal Forum (District Forum) is required to decide the complaint, as far as possible, within a time-period of three months from the date of the notice received by the opposite party, in the cases where the complaint does not require any analysis or testing of the goods. In the cases where the complaint requires any analysis or testing of the goods, the time-period for the purpose has been fixed at within five months, instead of three months, as far as possible.

38.10 Appeal to the State Commission

Any person aggrieved by an order of the District Forum can go in for the appeal against such order of the District Forum to the State Commission, within a period of 30 days from the date of such order. However, the State Commission may even entertain the appeal, if it is filed after the time-period of 30 days, provided it (State Commission) is satisfied that there was sufficient reason for not filing the appeal within the specified time-period of 30 days.

But then, in the cases where the person is required to pay any amount, as per the order passed by the District forum, no appeal shall be entertained by the State Commission, unless at least 50 per cent of such amount, or a sum of Rs 25, 000, whichever is lesser, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the State Commission.

38.11 Transfer of Cases (Section 17A)

On the application of the complainant, or on its own action (volition), the State Commission, at any stage of the proceedings, may transfer any complaint pending before the District Forum to any other District Forum within the State , if the interest of justice so demands.

38.12 Circuit Branches (Section 17B)

The State Commission shall generally function in the State Capital, but it may even function at any other place as the State Government may, in consultation with the State Commission, notify in the Official Gazette from time to time.

38.13 Procedure Applicable to State Commission (Section 18)

The provisions made under **Sections 12 to 14**, discussed above, under the procedures applicable to the District Forum, and the rules made in that regard for the disposal of the complaints by the District Forum, shall be applicable to the disposal of the disputes by the State Commission, and with such modifications as may be considered necessary.

38.14 Appeal to the National Commission (Section 19)

Any person aggrieved by an order of the State Commission can go in for the appeal against such order of the State Commission to the National Commission, within a period of 30 days from the date of such order. However, the National Commission may even entertain the appeal if it is filed after the time-period of 30 days, provided it (National Commission) is satisfied that there was sufficient reason for not filing the appeal within the specified time-period of 30 days.

But then, in the cases where the person is required to pay any amount, as per the order passed by the State Commission, no appeal shall be entertained by the National Commission, unless at least 50 per cent of such amount, or a sum of Rs 35, 000, whichever is lesser, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the National Commission.

38.15 Hearing of Appeal (Section 19A)

An appeal filed with the State Commission or the National Commission shall be heard as expeditiously as possible, and efforts will be made to finally dispose of the appeal within a period of 90 days from the date of its admission.

It has been further provided in this regard that ordinarily no adjournment of the appeal shall be granted by the State Commission or the National Commission, as the case may be, unless sufficient reason is shown and the reason to grant the adjournment of the appeal, and the reason for the grant of adjournment of the appeal, have been recorded in writing by the respective State Commission or the National Commission.

It has also been provided in this regard that the State Commission or the National Commission, as the case may be, shall make such orders as to the cost of the adjournment of the appeal so caused, as may be provided in the regulation made under the Act.

It has again been provided in this regard that in the case of an appeal being disposed of, after the period specified by the State Commission or the National Commission, as the case may be, shall record the reason for the same in writing, while (at the time of) disposing of the appeal concerned.

38.16 Power of and Procedure Applicable to National Commission (Section 22)

The National Commission, in disposal of any complaint or any proceedings before it, shall have the following powers:

(a) The powers of a Civil Court as specified in **Section 13, Sub-Sections (4) to (6)**; and

(b) The powers to issue an order to the opposite party directing him to do any one or more of the things referred to in **Section 14 (1), Clauses (a) to (i)**.

Further, the National Commission shall follow such procedure as may be prescribed by the Central Government.

38.17 No Power to Grant Interim Stay (Temporary Injunction) to the Consumer Forums

The Supreme Court has held that the Consumer Forums do not have any power to pass an interim order. The Supreme Court has ruled that under **Section 14**, the relief by way of ad-interim stay (temporary injunction) was not at all contemplated under the Act. Therefore, the Forums granting any stay by way of an interim order would be acting beyond their jurisdiction under the Act **[Morgan Stanley Mutual Fund vs Kartick Das; and Dr Arvind Gupta vs SEBI and others (11 1994 CPJ 7)].**

38.18 Appeal to the Supreme Court Against the Orders of National Commission (Section 23)

Any person aggrieved by an order of the National Commission can go in for the appeal against such order of the National Commission to the Supreme Court, within a period of 30 days from the date of such order. However, the Supreme Court may even entertain the appeal if it is filed after the time-period of 30 days, provided it (Supreme Court) is satisfied that there was sufficient reason for not filing the appeal within the specified time-period of 30 days.

But then, in the cases where the person is required to pay any amount, as per the order passed by the National Commission, no appeal shall be entertained by the Supreme Court, unless at least 50 per cent of such amount, or a sum of Rs 50, 000, whichever is lesser, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the Supreme Court.

38.19 Finality of Order (Section 24)

Every order passed by the District Forum, State Commission or the National Commission shall be final, if no appeal has been preferred against such order under the provisions of the Act.

38.20 Limitation Period (Section 24A)

The District Forum, State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

However, a complaint may even be entertained after the specified time-period of two years, provided the complainant satisfies the District Forum, the State Commission, or the National Commission, as the case may be, that he had sufficient reason for not filing the complaint within the specified time-period of two years. But no such complaint shall be entertained by the District Forum, the State Commission, or the National Commission, as the case may be, unless they (District Forum, State Commission or National Commission, as the case may be) record their reasons for condoning such delay.

38.21 Vacancies or Defects in the Appointment will not Invalidate the Order (Section 29A)

No action 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.

Let us Recapitulate

- The nature and scope of remedies are to provide simple, speedy, and inexpensive redressal of the grievances of the consumers. With this end in view, three-tier quasi-judicial machinery has been provided under the Act at the National, State, and District levels. At the national level, there is a National Consumer Disputes Redressal Commission, which is known as the National Commission.
- Any of the following persons may file a complaint:
  (a) The 'consumer'
  The consumer means any of the following persons:
    (i) A person who purchases any goods for consideration, which has been paid or partly paid, or which has been promised to be paid or partly paid, or which has been purchased under any system of deferred payment (i.e. pertaining to hire–purchase transactions).
    (ii) A person who hires or avails of any services for consideration, which has been paid or partly paid, or which has been promised to be paid or partly paid, or which has been purchased under any system of deferred payment.
  (b) Any recognised consumer association. Further, it is not necessary for the complainant to be a member of such association.
  (c) One or more consumers, in the cases where there are several consumers having the same interest, with the permission of the District Forum, on behalf of, or for the benefit of, all the consumers so interested.
  (d) The Central or the State Government, as the case may be, either in its individual (personal) capacity, or as a representative of the interest of the consumers, in general.
- A complaint may pertain to one or more of the following:
  (a) An unfair trade practice or a restrictive trade practice has been resorted to (adopted) by any trader or service provider.
  (b) The goods purchased by him, or agreed to be purchased by him, suffer from one or more defects.
  (c) The services hired or availed of, or agreed to be hired or availed of, by him suffer from deficiency in any respect.
  (d) A trader or a service provider has charged for the goods or for the services mentioned in the complaint, a price, in excess of the price:
    (i) Fixed by or under any law for the time being in force,
    (ii) Displayed on the goods or on any package containing such goods,
    (iii) Displayed on the price list, exhibited by him, by or under any law for the time being in force, or
    (iv) Agreed between the parties.
  (e) Goods, which will be hazardous to life and safety, when consumed (used), are being offered for sale to the public:
    (i) In contravention of any standards regarding the safety of such goods, as required to be complied with by or under any law for the time being in force,

(ii) If the trader could have known with due diligence that the goods so offered by him are unsafe to be used by the public.

(f) Services, which are hazardous, or are likely to be hazardous, to the life and safety of the public, when used, are being offered by the service provider, which such person could have known with due diligence to be injurious to the life and safety, with a view to obtaining any relief provided by or under this Act.

In the cases where the price of any article (goods) is not fixed by any law or is not displayed on the goods, or is not displayed on the package containing the goods, the Act does not contemplate any complaint being filed in regard to the price charged, on the plea that the price so charged is excessive.

- In the cases where the value of the goods or services, and the compensation, if any, claimed, does not exceed Rs 20 lakh, the complaint may be filed in the District Forum.
- In the cases where the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 20 lakh, but does not exceed Rs 1 crore, the complaint may be filed in the State Commission of the respective State.
- However, in the cases where a joint petition has been filed, on behalf of a large number of complainants (victims), it will be the total amount of the compensation, claimed in the complaint, and not the single (individual) claims, which will be taken into account for deciding the appropriate jurisdiction.
- The appeal against the verdict of the District Councils within the State may be heard by the respective State Commission.
- In the cases where the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 1 crore, the complaint may be filed with the National Commission.
- The appeal against the verdict of any of the State Commission may also be heard by the National Commission.
- The complaint may be filed with the appropriate Commission or Forum by the complainant or his authorised agent, in person, or it may even be sent by post to the appropriate authority.
- The complaint must contain the following information:
  - **(a)** The name, description, and the address of the complainant,
  - **(b)** The name, description, and the address of the opposite party or the parties, as far as these can be ascertained,
  - **(c)** The facts pertaining to the complaint(s), and as to when and where the complaint arose,
  - **(d)** Documents, if any, in support of the allegations (complaints) contained in the complaint, and
  - **(e)** The relief that the complainant is seeking.
- The complaint is required to be signed by the complainant, or by his authorised agent.
- In regard to the goods, where the defects alleged, do not require any testing or analysis, the complainant is required to send a copy of the complaint to the opposite party mentioned in the complaint, within a period of 21 days from the date of its admission by the appropriate authority, directing him (opposite party) to give his version of the case within a period of 30 days or within such extended period, not exceeding 15 days, as may be granted by the District Forum or the State Commission.
- If the opposite party, on receipt of the complaint referred (sent) to him by the complainant, denies or disputes the allegation contained in the complaint, or omits or fails to take any action to represent his case within the aforementioned time period of 30 days and the extended period not exceeding 15 days, granted by the District Forum or the State Commission, the appropriate authority will proceed to settle the dispute of the consumer (complainant) in the manner specified.
- In regard to the goods where the defects alleged require any testing or analysis, various other procedures are followed, like collecting the sample, sending the same to the appropriate laboratory,

sending the report of the laboratory to the opposite party, settlement of the dispute due to the report being defective in its methodology, and so on.

- In the cases where the complaint pertains to the goods in respect of which the aforementioned procedures cannot be followed, or if the complaint relates to any services, the District Forum, after following the laid down procedures, shall proceed to settle the disputes of the customers, in the following manner:
  (a) On the basis of the evidences that are brought to its notice by the complainant, the opposite party, where the opposite party denies or disputes the allegations contained in the complaint. Or
  (b) On the basis of the evidences that are brought to its notice by the complainant, where the opposite party omits or fails to take any action to represent his case within the time given by the District Forum.
- No proceedings, complying with the procedure of the aforesaid provisions of the Act, shall be called in question in any Court on the ground that the principle of natural justice has not been complied with.
- The District Forum shall have the same powers as are vested in the Civil Court under the Code of Civil Procedure for the purpose of conducting an enquiry, the District Forum shall have the same powers as are vested in a Court, while trying a suit under the Code of Civil Procedure, 1908, in respect of the following matters:
  (a) For summoning and enforcing the attendance of any person (defendant or witness) for his examination on oath;
  (b) Requiring the discovery or production of documents, or other material or object as producible evidence;
  (c) Receiving the evidence of affidavits; and
  (d) Requisitioning the report of the analysis or test concerned from the appropriate laboratory, or from any other relevant source;
  (e) Issuing of any warrant, conferring authority, for the examination of any witness; and
  (f) Any other matter which may be prescribed.

  Every procedure before the District Forum shall be deemed to be a judicial proceeding.
- If, after the proceeding conducted, the District Forum is satisfied that the goods complained against suffer from any defects specified in the complaint, or that any of the allegations contained in the complaint about the services rendered, are proved, it shall issue an order to the opposite party directing him to do one or more of the following things:
  (a) To remove the defects, pointed out by the appropriate laboratory, from the goods in question.
  (b) To replace the goods with new goods of similar description, which shall be free from defects.
  (c) To return to the complainant the price or the charges, as the case may be, paid by the complainant.
  (d) To pay such amount as it has awarded as compensation to the complainant (consumer) for any loss or injury suffered by him (consumer) on account of the negligence of the opposite party.
  (e) To remove the defects or deficiencies in the services rendered in question.
  (f) To discontinue the unfair trade practice or the restricted trade practice, or not to repeat them.
  (g) Not to offer the hazardous goods for sale.
  (h) To withdraw the hazardous goods from being for sale'
  (i) To stop the manufacturing of hazardous goods, and to desist from offering services that are hazardous in nature.
  (j) To pay such amount as may be fixed by it (District Forum), if in its opinion, the loss or injury has been suffered by a large number of consumers who are not identifiable conveniently.

(k) To issue corrective advertisement so as to neutralise the effect of the misleading advertisement.
(l) To pay (provide) for adequate costs to the parties concerned.

- The District Forum is required to decide the complaint, as far as possible, within a time-period of three months from the date of the notice received by the opposite party, in the cases where the complaint does not require any analysis or testing of the goods..
- Any person aggrieved by an order of the District Forum can go in for the appeal to the State Commission, within a period of 30 days from the date of such order.
- But then, in the cases where the person is required to pay any amount, as per the order passed by the District forum, no appeal shall be entertained by the State Commission, unless at least 50 per cent of such amount, or a sum of Rs 25, 000, whichever is lesser, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the State Commission. However, under such circumstances, in the cases of an appeal to the National Commission, or to the Supreme Court of India, the amount required to be so deposited, is at least 50 per cent of such amount, or a sum of Rs 35,000 and Rs 50,000, respectively, whichever is lesser.
- On the application of the complainant, or on its own action, the State Commission, at any stage of the proceedings, may transfer any complaint pending before the District Forum to any other District Forum within the State , if the interest of justice so demands.
- The State Commission shall generally function in the State Capital, but it may even function at any other place as the State Government may, in consultation with the State Commission, notify in the Official Gazette from time to time.
- Any person aggrieved by an order of the State Commission can go in for the appeal against such order of the State Commission to the National Commission, within a period of 30 days from the date of such order.
- An appeal filed with the State Commission or the National Commission shall be heard as expeditiously as possible, and efforts will be made to finally dispose of the appeal within a period of 90 days from the date of its admission.
- Ordinarily no adjournment of the appeal shall be granted by the State Commission or the National Commission unless sufficient reason is shown and the reason to grant the adjournment of the appeal, and the reason for the grant of adjournment of the appeal, have been recorded in writing by the respective State Commission or the National Commission.

The State Commission or the National Commission, shall make such orders as to the cost of the adjournment of the appeal so caused.

- The National Commission, shall have the following powers:
- The powers of a Civil Court, and
- The powers to issue an order to the opposite party directing him to do any one or more of the things referred to in **Section 14 (1), Clauses (a) to (i) .**
- Further, the National Commission shall follow such procedure as may be prescribed by the Central Government.
- The Supreme Court has held that the Consumer Forums do not have any power to pass an interim order.
- Any person aggrieved by an order of the National Commission can go in for the appeal to the Supreme Court, within a period of 30 days from the date of such order.
- Every order passed by the District Forum, State Commission or the National Commission shall be final, if no appeal has been preferred against such order under the provisions of the Act.
- The District Forum, State Commission, or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.
- No action 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.

Questions for Reflection

1. What are the nature and scope of remedies available to the consumers against their grievances under the Consumer Protection Act?
2. Name the three-tier quasi-judicial machinery that has been provided under the Act at the National, State, and District levels.
3. Who are the various persons that may file a complaint against the defects and deficiency in the goods and services?
4. Who are the various persons / associations that come within the term 'consumer' under the Consumer Protection Act?
5. What are the various types of Complaints that may be filed in the District Forum, State Commission, and the National Commission?
6. Name the authorities with whom the following types of complaints /appeal may be filed?
   (a) In the cases where the value of the goods or services, and the compensation, if any, claimed, does not exceed Rs 20 lakh,
   (b) In the cases where the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 20 lakh, but does not exceed Rs one crore, and
   (c) In the cases where a joint petition has been filed, on behalf of a large number of complainants (victims), and the total amount of compensation, claimed in the complaint, exceeds Rs 20 lakh, but does not exceed Rs 1 crore.
   (d) In the cases where the value of the goods or services, and the compensation, if any, claimed, exceeds Rs 1 crore,
   (e) The appeal against the verdict of the District Councils within the State,
   (f) The appeal against the verdict of any of the State Commission, and
   (g) The appeal against the verdict of the National Commission.
7. (a) Discuss the procedure for filing of a complaint to the appropriate Commission or Forum, as the case may be.
   (b) To whom should such complaint be addressed in the cases of the appropriate Commission or Forum, as the case may be?
8. (a) What various relevant particulars should such complaint contain?
   (b) How many minimum copies of the complaint are required to be filed with the appropriate authorities concerned?
9. What procedure should the appropriate authorities concerned follow on receipt of the complaint in the following cases?
   (a) In regard to the goods, where the defects alleged, does not require any testing or analysis:
   (b) In regard to the goods where the defects alleged require any testing or analysis, and
   (c) Where the complaint pertains to the goods in respect of which the aforementioned procedures cannot be followed, or if the complaint relates to any services.
10. What powers do the following authorities enjoy?
    (a) District Forum,
    (b) State Commission, and
    (c) National Commission.
11. What types of relief are available to the consumers, and what order can be passed by the District Forum, if, after conducting the proceeding, it (District Forum) is satisfied that the goods complained against suffer from any defects specified in the complaint, or that any of the allegations contained in the complaint about the services rendered, are proved?
12. What is the specific time-frame for decision provided for the following authorities?
    (a) District Forum,

(b) State Commission, and
(c) National Commission

13. (a) Can any person aggrieved by an order of the District Forum go in for the appeal against such order of the District Forum to the State Commission, and if so, within how many days?
    (b) Can the State Commission entertain the appeal if it is filed after the time-period, and if so, under what specific circumstances?
14. Do the Consumer Forums have any power to pass an interim order? Write 'Yes' or 'No' as your answer.
15. 'Every order passed by the District Forum, State Commission or the National Commission shall be final, if no appeal has been preferred against such order under the provisions of the Act.' Write 'Yes' or 'No' as your answer.
16. What is the limitation period in respect of the District Forum, State Commission and the National Commission for admitting a complaint?
17. Can the vacancies or defects in the appointment invalidate the order of the District Forum, the State Commission, or the National Commission?
18. Can the proceedings, complying with the procedure as provided in the Consumer Protection Act, be called in question in any Court on the ground that the principle of natural justice had not been complied with? Write 'Yes' or 'No' as your answer.

Problems for Practice (With Suggested Solutions)

Problem 1

Fill in the blanks in the following statement correctly:

In the cases where the person is required to pay any amount, as per the order passed by the District forum, no appeal shall be entertained by the State Commission, unless at least _____ per cent of such amount, or a sum of Rs _____, whichever is _____, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the State Commission.

Solution

In the cases where the person is required to pay any amount, as per the order passed by the District forum, no appeal shall be entertained by the State Commission, unless at least **50** per cent of such amount, or a sum of Rs **25,000** whichever is **lower**, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the State Commission.

Problem 2

Fill in the blanks in the following statement correctly:

Any person aggrieved by an order of the State Commission can go in for the appeal against such order of the State Commission to the National Commission, within a period of _____ days from the date of such order. However, the National Commission may even entertain the appeal if it is filed after the time-period, provided it is satisfied that there was _____ _____ for not filing the appeal within the specified time-period.

But then, in the cases, where the person is required to pay any amount, as per the order passed by the State Commission, no appeal shall be entertained by the National Commission, unless at least _____ per cent of such amount, or a sum of Rs _____, whichever is _____, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the National Commission.

Solution

Any person aggrieved by an order of the State Commission can go in for the appeal against such order of the State Commission to the National Commission, within a period of **30** days from the date of such order. However, the National Commission may even entertain the appeal if it is filed after the time-period, provided it is satisfied that there was **sufficient reason** for not filing the appeal within the specified time-period.

But then, in the cases, where the person is required to pay any amount, as per the order passed by the State Commission, no appeal shall be entertained by the National Commission, unless at least **50** per cent of such amount, or a sum of Rs **35,000,** whichever is **lesser**, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the National Commission.

Problem 3

Fill in the blanks in the following statement correctly:

Any person aggrieved by an order of the National Commission can go in for the appeal against such order of the National Commission to the _____ _____, within a period of _____ days from the date of such order. However, the _____ _____ may even entertain the appeal if it is filed after the time-period, provided it is satisfied that there was sufficient reason for not filing the appeal within the specified time-period.

But then, in the cases where the person is required to pay any amount, as per the order passed by the National Commission, no appeal shall be entertained by the _____ _____, unless at least _____ per cent of such amount, or a sum of Rs _____, whichever is _____, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to _____ _____.

Solution

Any person aggrieved by an order of the National Commission can go in for the appeal against such order of the National Commission to the **Supreme Court** within a period of **30** days from the date of such order. However, the **Supreme Court** may even entertain the appeal if it is filed after the time-period, provided it is satisfied that there was sufficient reason for not filing the appeal within the specified time-period.

But then, in the cases where the person is required to pay any amount, as per the order passed by the National Commission, no appeal shall be entertained by the **Supreme Court,**unless at least **50** per cent of such amount, or a sum of Rs **50, 000**, whichever is **lesser**, has been deposited by the appellant, in the prescribed manner, if such person goes in for the appeal to the **Supreme Court.**

Problem 4

Can the State Commission, at any stage of the proceedings, transfer any complaint pending before the District Forum to any other District Forum within the State, if the interest of justice so demands? Write 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 5

'The State Commission generally functions in the State Capital, but it may even function at any other place as the State Government may, in consultation with the State Commission, notify in the Official Gazette from time to time.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 6

Fill in the blanks in the following statement correctly:

An appeal, filed with the State Commission or the National Commission, shall be heard as expeditiously as possible, and efforts will be made to finally dispose of the appeal within a period of _____ days from the date of its _____.

Solution

An appeal, filed with the State Commission or the National Commission, shall be heard as expeditiously as possible, and efforts will be made to finally dispose of the appeal within a period of **90** days from the date of its **admission**.

Law of Companies

(Companies Act, 1956)*

Chapter Thirty Nine

Nature of Companies: Their Types and Formation

"*Make every decision as if you owned the whole company.*
Robert Townsend

It is human nature to think wisely and act foolishly.
Anatole France

The public do not know enough to be experts, but know enough to decide between them.
Samuel Butler

The first mistake in public business is going into it.
Benjamin Franklin

The public must and will be served.
William Penn

A man grows most tired while standing still.
Chinese Proverb"

39.1 Definition

As per **Section 3** of the Act, the company means a company formed and registered under the Act, or an existing company formed and registered under any of the previous Company Laws. Further, **Section 12** allows the formation of various types of companies as follows:

(**a**) Companies limited by shares;
(**b**) Companies limited by guarantees; and
(**c**) Unlimited companies.

Most of the companies in India are the companies limited by shares. This is naturally so because, in the cases of such companies, the liability of the shareholders of such companies are limited only up to the extent of their holdings. That is, their other assets will not be held liable to meet the liabilities of the company, if any, beyond the total holding of their shares in the company. That is why, the banks insist that the Directors of the borrowal company must additionally furnish their personal guarantees towards the loans and advances granted to the company by the bank. This way, the directors of the company will be liable to meet the total outstanding liabilities of the company to the bank even beyond the amount of their share-holdings, out of their personal assets as well. This way, the banks want to doubly ensure that the Directors of the company will endeavour, at all times, to conduct the financial affairs of the company in a careful, professional and efficient manner.

39.2 Main Characteristic Features of a Company

The following are the main characteristic features of a company:

39.2.1 An Incorporated Association

A company is required to be incorporated or registered under the Companies Act.

(a) Under **Section 12**, for incorporating a public company, the minimum number of seven is required. However, in such cases, no upper limit of the number is stipulated. Thus, a public company may have unlimited number of its shareholders (members).
(b) In the case of private company, however, the minimum number of two and a maximum number of 50 is prescribed in the Act.
(c) But, under **Section 11**, if an association of more than 10 persons in the case of a banking business, and more than 20 in case of any other business, which are not registered as a company under the Companies Act or under any other law for the time being in force, shall be deemed to be an illegal association.

39.2.2 An Artificial Person

As a company is incorporated under the sanction of law, it is not a human being like us. But then, it can sue and be sued in its own name, as we all can. That is why, it is known as an artificial person and not a real one.

39.2.3 Common Seal

Further, as the company is an artificial person, it cannot sign on its own. The common seal of a company is, therefore, known as its official signature on the documents. And its such Directors, who are authorised on this behalf by its Board, affix the common seal on its behalf, under their own signatures, too, which means the documents are, in fact, signed by the company. That is why, the banks, creditors, and others insist on the common seal of the company to be affixed on the documents, which also must be submitted along with the respective resolution of the Board, authorising the Directors concerned to affix the common seal of the company on the documents, which, too, is kept along with the documents under a safe custody.

The common seal may be affixed on the documents like the shares and debentures of the company, power of attorney, sale deed, lease deed, debenture trust deed, deed of mortgage, agreement of pledge, hypothecation and guarantee, all documents which attract stamp duty, and so on.

In the case the company has its offices in foreign countries (i.e. outside India), it is required to keep the exact copies (reproduction) of its common seal (i.e. replica of the common seal) at such places for the purpose of affixing the same. The place(s) where it may be used should be specified, under the respective powers conferred under the Articles of the company. Further, the seal may be affixed in a foreign country even by a holder of the power of attorney, issued on this behalf, under the common seal of the company.

39.2.4 A Separate legal Entity

A company is an artificial person; it is so by virtue of being a separate legal entity. As against a partnership firm, a company is a separate person in its own right, distinct from the persons who constitute it. As per **Section 34 (2)**, on registration, the association of persons becomes a body corporate, by the name contained in the Memorandum. **[Soloman vs Soloman and Company (1877) AC 22].**

39.2.5 Limited Liability

In a limited company, limited by shares, the liabilities of the shareholders are limited only upto the extent of their respective shares in the company; and their other assets cannot be acquired to pay the debts of the company, if such debt exceeds the total value of their shareholdings. In the case of an unlimited company the position will be otherwise, i.e. the liabilities of the shareholders are not limited only upto the extent of their respective shares in the company; and accordingly, their other assets can also be acquired to pay the debts of the company, if such debt exceeds the total value of their shareholdings.

39.2.6 A Separate Property

In the eye of law, the shareholders cannot be deemed to be the part owners of the property of the company. The Supreme Court has held that the shareholder is not the part owner of the company, nor of the property of the company. He is only given certain rights by law, like 'to vote or attend meetings, to receive the dividends periodically, and so on. [**Bacha F. Guzdar vs The Commissioner of Income Tax, Bombay (Supa)**].

39.2.7 Transferability of Shares

As the property and business of a company is separate from its members, the shares of a public company may be transferred any number of times from one person to another, without any restrictions in this regard, as per the provisions in the Articles of the company. (**Section 82**). However, in the case of private companies, there are some restrictions, which have been discussed a little later. But then, the transferability of even its shares have not been restricted absolutely, provided it is transferred as per the provisions in the Articles of the company.

39.2.8 Perpetual Existence (Company Never Dies)

'King is dead; long live the king', so goes the adage. In a similar vein, we may say that the 'Company never dies; it lives for ever', unless wound up voluntarily or either with the intervention and order of the Court. This is so because, the company is an artificial person, and accordingly, it cannot fall ill or get incapacitated or die ever, even if all its shareholders (members) happen to die. It has its own distinct separate legal entity and lives for ever, and never dies, as aforementioned.

39.2.9 May Sue and be Sued in its Own Name

As a company is incorporated under the sanction of law, it is not a human being like us. But then, it may sue and be sued in its own name, as we all can, as it has a separate entity of its own, recognised by law. Thus, if a case is filed in the Court, not by the company as the plaintiff, but by its directors, such suit will not be maintainable in the Court. **[Rajendra Nath Dutta vs Shibendra Nath Mukherjee (1982) 52 Comp. Cas. 293 Cal.].**

Further, it can open a bank account, can enter into an agreement, and can exercise all the powers pertaining to the attainment of its objects given in its Memorandum of Association.

39.2.10 Nationality and Domicile

A company being a person (though not a natural person but only an artificial person) has a nationality and a domicile.

39.2.11 No Fundamental Rights

But a company does not enjoy any fundamental rights, under the Constitution of India, as a natural person (human being) enjoys, as it is not a real person or citizen. **[Tata E. and L. Company Ltd vs State of Bihar (1965) SCJ 605].**

39.2.12 Lifting of a Corporate Veil

In the case of a dishonest and fraudulent use of the facility of incorporation, the corporate veil is lifted by law, and the law identifies the person (member) who is behind such dishonest and fraudulent use of the facility of incorporation. [**Cotton Corporation of India Ltd vs G. C. Odusumathd (1999)22 SCL 228 (Karn.), decided by Karnataka High Court**].

39.3 Main Types of Companies

Under **Section 12**, the liabilities of the shareholders (members) of the company may be limited or unlimited. Further, it may be limited by shares or by guarantees, or both, i.e. by shares and also by guarantees.

39.3.1 Company Limited by Shares

It is a registered company wherein the liability of its shareholders is limited by its Memorandum of Association upto the maximum amount of the paid up shares, or upto the extent of the amount of unpaid shares, if any, held by them. The unpaid amount on the shares may be called up at any time during the lifetime of the company, or at the time of its winding up. But then, if, after receiving the final notice, which is generally sent by registered post, for the payment of the unpaid amount on the share, such shares may be forfeited by the company, if it is not still paid, and such partly paid share holder will not be entitled to any rights on these partly paid shares, including the amount of the share which is forfeited. No dividend is payable to such partly paid shareholders, either. Such company is known as the **'share company'**.

39.3.2 Company Limited by Guarantees

It is a registered company, wherein the liability of its shareholders is limited by its Memorandum of Association upto such amount as the members will respectively undertake to the Memorandum to contribute to the assets of the company in the event of its being wound up. Such company is known as the **'guarantee company'**. Here, the liability of the members of the guarantee company is limited to the extent of the specific sum stipulated in the Memorandum. The amount so guaranteed may be called up by the company from the members only at the time of the winding up of the company, and that, too, if the liability of the company exceeds its assets.

Further, a 'guarantee company' does not have any share capital. Instead, the working funds, if required, are raised from different sources like the fees, charges, donations, subsidies, endowments, grants, subscriptions, and so on. Such a company is generally established for promoting art, science, culture, charity, sport, commerce, or, for such other similar purposes.

39.3.3 Company Limited by Shares as also by Guarantees

It is a synthesis (hybrid) form of company with the combined elements of both the shares and the guarantees companies. Such company raises its initial capital from the shareholders, while the normal working fund is provided from other sources like the fees, charges, donations, subsidies, endowments, grants, subscriptions, and so on, as aforementioned. Every member of such company is subjected to twin (two-fold) liabilities, i.e. initial shares as also the respective amount of guarantees, as aforementioned.

39.3.4 Unlimited Company

The liabilities of the shareholders of such companies are not limited upto the share capital only, as is the case with limited liability companies. Instead, in this case, the liabilities of the shareholders are unlimited. In the case of winding up of the company, the members of such companies are liable to the full extent of their total assets, to meet the liability of the company.

However, the shareholders are not liable to the creditors of the company. The company is liable to the creditors, instead. This is so because, the company is a distinct (legal) entity and the members are not co-owners of its property. But then, if the creditors cannot obtain their payment from the company, they may approach the Court to file a petition for the winding up of the company. Thereafter, the official liquidator will ask the members (shareholders) of the company to contribute to the assets of the company without any limitation on their liability for the repayment of the debts of the company. That is why, the unlimited liability companies are very rare in India, and for that matter, all over the world.

39.4 Distinguishing Features of Public and Private Companies

Main distinguishing features of 'Public' and 'Private' limited companies are given hereunder in **Table 39.1.**

Table 39.1 *Distinguishing Features of Public and Private Limited Companies*

Public Limited Companies	*Private Limited Companies*
(i) Here, the minimum number of shareholders must be seven, and there is no upper limit stipulated for its shareholders.	(i) Here, the minimum number of shareholders should be two and maximum number should be 50.
(ii) A public company may be formed with a minimum paid up capital of Rs 5 lakh.	(ii) A private company may be formed with a minimum paid up capital of Rs 1 lakh.
(iii) Here, the shares are freely transferable	(iii) Here, there are certain restrictions imposed on the transferability of its shares
(iv) It is required to issue prospectus to the general public to invite subscriptions to its public issue of shares and/or debentures.	(iv) Here, no such prospectus is required to be issued, as its maximum number of shareholders is limited to 50 only.
(v) It can accept term deposits (referred to as public deposits) from the public under **Sections 58 A, 58 AA, and 58 AAA.**	(v) It cannot accept public deposits from the members of the public.
(vi) It cannot commence business until it receives the certificate to commence business from the respective Registrar of Companies. Only receipt of certification of incorporation is not enough in this case.	(vi) It can commence its business immediately after receiving the certificate of incorporation from the respective Registrar of Companies., as it is not required to obtain any certificate for commencement of its business.
(vii) It is required to hold a statutory meeting and file a statutory report to the respective Registrar of Companies	(vii) It is not required to hold any statutory meeting.

(*Contd*)

(*Contd*)

(viii) Here, the directors are required to file with the Registrar of Companies, their written consent to act as directors of the company and must sign the Memorandum and must also enter into a contract for their qualifying shares of the company.	(viii) Here, the directors are not required to do any of such things.
(ix) Here, the directors of the company may not be appointed by a single resolution.	(ix) Here, the directors of the company may be appointed by a single resolution.
(x) Here, at least two-third of the directors are required to retire by rotation. But being eligible may be appointed over again as the director.	(x) Here, the directors are not required to retire by rotation.
(xi) Here, if the number of the directors is to go above 12, the specific permission of the Central Government will be necessary.	(xi) Here, the number of the directors may be increased to any number, without seeking any permission from the Central Government.
(xii) Here, five members of the board, actually present, may complete the quorum.	(xii) Here, even two members of the board, actually present, may complete the quorum.
(xiii) Here, there are certain restrictions on the managerial remuneration.	(xiii) Here, there are no restrictions on the managerial remuneration.
(xiv) It does not enjoy any special privileges, in addition to the above provisions.	(xiv) It enjoys some special privileges, in addition to the above provisions.
(xv) It can issue share warrants.	(xv) It cannot issue share warrants.

39.5 Conversion of a Private Company into a Public Company

Under **Section 44**, a private company may be converted into a Public Company in the following manner:

(a) In a general meeting, the company must pass a special resolution altering its Article in such a manner that they no longer include the provisions of **Section 3 (1) (iii),** which are required to be included in the Articles in the case of a private company. On the date such resolution is passed, the company ceases to be a private company, and it, thereafter, becomes a public company.

(b) In case the number of the members of a private company happens to be less than seven, steps must be taken to increase such number to at least seven. This is so because, a public company is required to have a minimum number of seven members.

Further, the number of its directors should also be increased to at least three, if it was having only two directors earlier, as was required in the case while it was a private company. This should be done within six months.

(c) The word 'Private' appearing before the word 'Limited' in its name must be deleted. Thus, the names of Garden Silk (Private) Limited, and Nirma Detergent (Private) Limited, on their conversion from private companies into public companies respectively were changed to Garden Silk Limited, and Nirma Detergent Limited, instead. Thereafter, both these companies had come out with public issues at a high premium with success.

(d) Within 30 days of the passing of the special resolution altering the Articles, as aforementioned, the company is required to file with the respective Registrar of Companies the following documents:
   (i) A printed or type-written copy of the special resolution, and
   (ii) A prospectus or a statement in lieu of the prospectus.

39.6 Conversion of a Public Company into a Private Company

There is no specific, direct or express provision for the conversion of a public company into a private company

in the Act, except with reference to the provisions of **Section 31 (1)**.

A public company may be converted into a private company by following the procedures as follows:

(a) In a general meeting, the company must pass a special resolution for altering its Articles so as to include therein the required restrictions, limitations and prohibitions, as also to delete any provisions that may be inconsistent with the restrictions. For example, a private company has to impose certain restrictions in regard to the transferability of its shares.
(b) The word 'Private' should be added before the word 'Limited' in its name.
(c) The company is required to obtain the approval of the Central Government to the alteration in the Article for the purpose of converting the public company into a private company.
(d) Within a period of one month from the date of the receipt of the order of approval from the Central Government, a printed copy of the altered articles must be filed with the Registrar of Companies concerned.
(e) Further, within 30 days of the passing of the special resolution, a printed or type-written copy of the special resolution must be filed with the Registrar of Companies concerned.

39.7 A Holding Company and a Subsidiary Company

In the cases, where a company holds control over the other company, it is known as the holding company. And the company, over which it has the control, is referred to as its subsidiary company.
A company is deemed to be under the control of another company in the following circumstances:

(a) If that other company controls the composition of the Board of Directors, or
(b) (i) If that other company holds more than half in the nominal (face) value of its equity share capital.
    (ii) But, in the case of the company, having preference shareholders, before the commencement of this Act, enjoying voting rights with that of the equity shareholders, for the purpose of the control of the company, the holding company must enjoy more than half of such total voting rights (power).
(c) If it happens to be a subsidiary company, under the control of (another) third company, which itself is the subsidiary of the holding (controlling) company, then the company will be the subsidiary company of the holding company.

For example, let us presume that company A is the holding company and the company B is the subsidiary company of company A. Then, if C is the subsidiary company of company B, the company C will also be the subsidiary company of company A. Likewise, if the company D is the subsidiary company of company C, then the company D will also be the subsidiary company of company C and company B. Further, as the company B and company C are the subsidiary companies of company A, company D will as well be the subsidiary company of company A. And so on.

39.8 One-Man Company

'One-Man Company' is the company wherein one person alone owns almost all the shares (almost the entire share capital) of the company and just say, only very few shares are given to a very few other persons in very little quantity. This may be the case in both private and public companies. Solomon and Solomon Company Limited is a very popular and famous example of a 'One-Man Company'. In this company, Solomon alone owned almost the entire shares of the company and just one share each was given to just two other persons, who, in fact, were just the dummies in the company, only for the purpose of meeting the legal requirements in regard to the minimum number of the membership required by law.

The entire procedures of formation of a company may be broadly divided into the following three main steps:

(a) Promotion,

(b) Registration, and
(c) Floatation.

39.9 Promotion

The term 'promotion' pertains to the preliminary steps that are taken for the registration and floatation of the company. The persons who take the charge and responsibility of promoting the company are referred to as the promoters of the company. The promoter may be an individual, association, syndicate, partnership, or company.

39.9.1 Who may be called a Promoter?

The term 'promoter' has not been defined in the Act, though it has been used in various Sections of the Act. The Chief Justice Cockburns has defined a promoter in the case titled **Twycross vs Grant** as the 'one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose'. A promoter is in a fiduciary relationship (a relationship of trust and confidence) with the company. He is required to make a full disclosure of all the material facts pertaining to the formation of the company. He is required not to make any secret profit at the expense of the company that he promotes, without the knowledge and consent of the company. And if he does so, he may be compelled by the company to account for it to the company. The death of a promoter does not relieve his estate from the liability arising out of the abuse of his fiduciary position.

39.10 Registration (Sections 12 and 33)

As stipulated under **Section 12**, any seven or more persons in the case of a public company, and any two or more persons (not exceeding 50 members) in the case of a private company, associated for any lawful purpose may, by subscribing their names to a Memorandum of Association, and otherwise complying with requirements of the Act in respect of registration, form an incorporated company, with or without limited liability.

As provided in **Section 33**, the following three documents are required to be submitted to the Registrar of Companies of the State in which the registered office of the company is to be situated (located) for the purpose of the registration of the company:

(a) Memorandum of the company;
(b) Articles of the company, if any; and
(c) The agreement, if any, which the company proposes to enter into with any individual for the appointment as its managing or whole time director or manger.

The documents, mentioned at (a) and (b) above, are to be signed by any seven or more persons in the case of a public company, and any two or more persons (not exceeding 50 members) in the case of a private company. However, certain types of companies are not required to frame their own Articles of Association. In such cases, the 'Regulations for Management of a Company Limited by Shares (given in Table A of schedule 1 to the Companies Act 1956), may be adopted.

Section 33 further requires that a declaration must be filed with the Registrar of companies along with the Memorandum and Articles. This is referred to as the 'Statutory Declaration of Compliance'.

Section 20 provides that a company cannot be registered with a name which, in the opinion of the Central Government, is undesirable.

For examples

(i) If the name is identical with, or it too nearly resembles, the name by which a company is already registered [**Section 20 (2)**]. The names under which some reputed firms, companies, and other bodies, are doing business, are also considered undesirable for a new company.

(ii) If the proposed name differs from the name of an existing company simply in the addition or subtraction of the word like New, Modern, Nav, and so on. Thus, the names like 'Modern Reliance Industries Limited', or 'Nav Bharat Bijlee', or 'New Infosis' or 'Modern WIPRO' will also be undesirable.

(iii) If the proposed name closely resembles the popular or abbreviated version of, or the nick names of, any well known and reputed company, such as RIL (Reliance Industries Limited), Telco (now Tata Motors), TISCO (now Tata Steel), SAIL (Steel Authority of India), and so on, are also unacceptable. Such words cannot be allowed even if such names have not been registered as trade marks.

(iv) If it connotes the Government participation or patronage, unless circumstances justify it; for **example,** National, Union, Central, President, Rashtrapati, and so on.

Therefore, the promoters will be well advised to first ascertain from the Registrar of Companies regarding the availability (suitability) of the proposed name of the company. For this purpose, three names, in order of priority, must be filed with the Registrar of Companies.

Though not required for the Registration of the company, the following two documents are also submitted with the Registrar of Companies, along with the aforementioned other documents:

(a) Address of the registered office of the company (**Section 146**), and

(b) Particulars regarding the directors, manager, and secretary, if any. (**Section 303**).

These two documents are required to be submitted within 30 days of the registration of the company.

39.11 Certificate of Incorporation and its Consequences

After the aforementioned documents have been filed with the Registrar of Companies, and the required fees have been deposited in his office (Office of the Registrar of Companies), the Registrar will, if he is satisfied, enter the name of the company in the Register of Companies, maintained by him for the purpose. (**Section 33**). Thereafter, he will issue a Certificate of Incorporation under his signature in proof (token) of the registration of the company on the date noted thereon. (**Section 34**). This Certificate of Incorporation serves the same purpose in the case of a company, as the birth certificate does in the case of a natural person (human being).

Immediately on registration of the company, the company comes into existence as a legal person, different (distinct) from the members of the company who constitute it. It comes into existence with effect from the earliest moment of the day of incorporation mentioned in the Certificate of Incorporation. It has all the rights and liabilities from that very moment as is the case with the natural person, competent to enter into a contract. (**Section 34**).

Such Certificate of Incorporation is considered to be a conclusive proof (evidence) to the effect that all the requirements of the Act, in regard to the registration and of the matters precedent and incidental thereto, have been complied with.

39.12 Floatation

After the company has been registered with the Registrar of Companies, and it (company) has received the Certificate of Incorporation, it is now ready to initiate the process of its formation. That is, it can proceed with the process of raising of the capital, sufficient to commence its business, and to carry it on in a satisfactory manner. A public company can raise the share capital from the public, after issuing the prospectus. But a private company cannot raise its share capital from the public, and accordingly, it is not required to issue any prospectus, either. It must, instead, approach its friends and relatives for raising the share capital by personal approach and arrangement.

In the case of a public company also, it is not obligatory on the part of the promoters of the company to raise the capital necessarily from the public at the very outset. It can also approach its friends and relatives for raising the share capital by personal approach and arrangement, in the initial stage. Such companies prefer to

register as a public company, instead of a private company, so as to raise the capital from an unlimited large number of the public at a later stage, as and when the need may arise. They thus, also avail of the rights in regard to the unrestricted transferability of its shares. But in fact, most of the companies prefer to raise the share capital from a large number of the members of the public by issuing the required prospectus.

Further, under **Section 70**, it is obligatory on the part of the public companies to take either of the following two steps:

(a) To issue a 'prospectus' in case the members of the public are to be invited to subscribe to its share capital, or

(b) To file a 'statement in lieu of the prospectus' with the Registrar of Companies, in the cases where the capital has been raised from friends and relatives by private arrangement. This must, however, be done at least three days before the allotment of the shares.

39.13 Certificate to Commence Business

Section 149 exempts the private companies from obtaining the Certificate to Commence Business. Thus, it can commence its business immediately on obtaining the Certificate of Incorporation from the Registrar of Companies. But then, it is compulsory for the public companies to obtain the Certificate to Commence Business before it can commence its business. This certificate can be obtained from the Registrar of Companies only after the floatation of the company.

Let us Recapitulate

- As per **Section 3** of the Act, the company means a company formed and registered under the Act, or an existing company formed and registered under any of the previous Company Laws.
- Various types of companies as follows:

  (a) Companies limited by shares;
  (b) Companies limited by guarantees; and
  (c) Unlimited companies.

  Most of the companies in India are the companies limited by shares, wherein the liabilities of the shareholders are limited only up to the extent of their holdings.
- **Main characteristic features of a company**:
- **An Incorporated Association**
  (a) For incorporating a public company, the minimum number of seven is required, with no upper limit stipulated.
  (b) In the case of private company, however, the minimum number of two and a maximum number of 50 is prescribed in the Act.
  (c) But, if an association of more than 10 persons in the case of a banking business, and more than 20 in case of any other business, which are not registered as a company under Act or under any other law for the time being in force, shall be deemed to be an illegal association.
- **An Artificial Person**
  As a company is incorporated under the sanction of law, it is not a human being like us. But then, it can sue and be sued in its own name, as we all can. That is why, it is known as an artificial person and not a real one.
- **Common Seal**
  Further, as the company is an artificial person, it cannot sign on its own. The common seal of a company is, therefore, known as its official signature on the documents. And its such Directors, who are authorised on this behalf by its Board, affix the common seal on its behalf, under their own signatures, too, which means the documents are, in fact, signed by the company.

- **A Separate legal Entity**
  A company is an artificial person; it is so by virtue of being a separate legal entity.
- **Limited Liability**
  In a limited company, limited by shares, the liabilities of the shareholders are limited only upto the extent of their respective shares in the company; and their other assets cannot be acquired to pay the debts of the company, if such debt exceeds the total value of their shareholdings. In the case of an unlimited company, the position will be otherwise.
- **A Separate Property**
  In the eye of law, the shareholders cannot be deemed to be the part owners of the property of the company. He is only given certain rights by law, like 'to vote or attend meetings, to receive the dividends periodically', and so on.
- **Transferability of Shares**
  As the property and business of a company is separate from its members, the shares of a public company may be transferred any number of times from one person to another, without any restrictions in this regard, as per the provisions in the Articles of the company.
- **Perpetual Existence (Company never dies)**
  Company never dies; it lives for ever; unless wound up voluntarily, or with the intervention and order of the Court.
- **May sue and be sued in its own name**
  As a company is incorporated under the sanction of law, it is not a human being like us. But then, it may sue and be sued in its own name, as we all can, as it has a separate entity of its own, recognised by law.
- **Nationality and Domicile**
  A company being a person (though not a natural person but only an artificial person) has a nationality and a domicile.
- **No Fundamental Rights**
  But a company does not enjoy any fundamental rights, under the Constitution of India, as a natural person (human being) enjoys, as it is not a real person or citizen.
- **Lifting of a Corporate Veil**
  In the case of a dishonest and fraudulent use of the facility of incorporation, the corporate veil is lifted by law, and the law identifies the person (member) who is behind such dishonest and fraudulent use of the facility of incorporation.
  - A Company, Limited by Shares, is a registered company wherein the liability of its shareholders is limited by its Memorandum of Association upto the maximum amount of the paid up shares, or upto the extent of the amount of unpaid shares, if any, held by them.
  - A company, limited by guarantees, is a registered company wherein the liability of its shareholders is limited by its Memorandum of Association upto such amount as the members will respectively undertake to the Memorandum to contribute to the assets of the company in the event of its being wound up. Such company is known as the **'guarantee company'**.
- A company, limited by shares as also by guarantees, is a synthesis (hybrid) form of company, with the combined elements of both the shares and the guarantees companies.

  In an unlimited company, the liabilities of the shareholders of such companies are not limited upto the share capital only, as is the case with limited liability companies. Instead, in this case, the liabilities of the shareholders are unlimited.
- Main distinguishing features of a 'Public' and 'Private' limited companies are given in **Table 39.1**.
- A private company may be converted into a public company in the following manner:

  (a) In a general meeting, the company must pass a special resolution altering its Articles in such a manner that they no longer include the provisions of **Section 3 (1) (iii),** which are required to be included in the Articles in the case of a private company. On the date such resolution is passed, the company ceases to be a private company, and it, thereafter, becomes a public company.

(**b**) In case the number of the members of a private company happens to be less than seven, steps must be taken to increase such number to at least seven. This is so because, a public company is required to have a minimum number of seven members.
(**c**) The word 'Private' appearing before the word 'Limited' in its name must be deleted.
(**d**) Within 30 days of the passing of the special resolution altering the Articles, the company is required to file with the respective Registrar of Companies the following documents:
(i) A printed or type-written copy of the special resolution, and
(ii) A prospectus or a statement in lieu of the prospectus.

- There is no specific, direct or express provision for the conversion of a public company into a private company in the Act, except with reference to the provisions of **Section 31 (1)**.
  A public company may be converted into a private company by following the procedures as follows:
  (**a**) In a general meeting, the company must pass a special resolution for altering its Articles so as to include therein the required restrictions, limitations and prohibitions, as also to delete any provisions that may be inconsistent with the restrictions.
  (**b**) The word 'Private' should be added before the word 'Limited' in its name.
  (**c**) The company is required to obtain the approval of the Central Government to the alteration in the Article for the purpose of converting the public company into a private company.
  (**d**) Within a period of one month from the date of the receipt of the order of approval from the Central Government, a printed copy of the altered Articles must be filed with the Registrar of Companies concerned.
  (**e**) Further, within 30 days of the passing of the special resolution, a printed or type-written copy of the special resolution must be filed with the Registrar of Companies concerned.
- In the cases where a company holds control over the other company, it is known as the holding company of such other company. And the company over which it has the control is referred to as its subsidiary company.
  A company is deemed to be under the control of another company in the following circumstances:
  (**a**) If that other company controls the composition of its Board of Directors, or
  (**b**) (**i**) If that other company holds more than half in the nominal (face) value of its equity share capital.
  (**ii**) But, in the case of the Company which had preference shareholders, before the commencement of this Act, enjoying voting rights with that of the equity shareholders, for the purpose of the control of the company, the holding company must enjoy more than half of such total voting rights (power).
  (**c**) If it happens to be a subsidiary company, under the control of (another) third company, which itself is the subsidiary of the holding (controlling) company, then the company will be the subsidiary company of the holding company.
- '**One-Man Company**' is the company wherein one person alone owns almost all the shares (almost the entire share capital) of the company, and just say, only very few shares are given to a very few other persons in very little quantity. This may be the case in both private and public companies. Solomon and Solomon Company Limited is a very popular and famous example of a 'One-Man Company'.
- The entire procedures of formation of a company may be broadly divided into the following three main steps:
  (**a**) Promotion,
  (**b**) Registration, and
  (**c**) Floatation.
- The term 'promotion' pertains to the preliminary steps that are taken for the registration and floatation of the company.

- Any seven or more persons in the case of a public company, and any two or more persons (not exceeding 50 members) in the case of a private company, associated for any lawful purpose may, by subscribing their names to a Memorandum of Association, and otherwise complying with the requirements of the Act in respect of registration, form an incorporated company, with or without limited liability.
- The following three documents are required to be submitted to the Registrar of Companies of the State in which the registered office of the Company is to be situated for the purpose of the registration:
  - **(a)** Memorandum of the company;
  - **(b)** Articles of the company, if any; and
  - **(c)** The agreement, if any, which the company proposes to enter into with any individual for the appointment as its managing or whole time director or manger.
- The documents mentioned at (a) and (b) above, are to be signed by any seven or more persons in the case of a public company, and by any two or more persons (not exceeding 50 members) in the case of a private company.
- A declaration must be filed with the Registrar of Companies along with the Memorandum and Articles. This is referred to as the 'Statutory Declaration of Compliance'.
- A company cannot be registered with a name which, in the opinion of the Central Government, is undesirable.

  For examples
  - **(i)** If the name is identical with, or it too nearly resembles the name by which a company is already registered.
  - **(ii)** If the proposed name differs from the name of an existing company simply in the addition or subtraction of the word like New, Modern, Nav, and so on.
  - **(iii)** If the proposed name closely resembles the popular or abbreviated version of or the nick names of, any well known and reputed company, such as RIL, SAIL', and so on.
  - **(iv)** If it connotes the Government participation or patronage, unless circumstances justify it; for **example** National, Union, Central, President, Rashtrapati, and so on.
- Therefore, the promoters will be well advised to first ascertain from the Registrar of Companies regarding the availability (suitability) of the proposed name of the company. For this purpose, three names, in order of priority, must be filed with the Registrar of Companies.
- Though not required for the Registration of the company, the following two documents are also submitted with the Registrar of Companies, along with the aforementioned other documents:
  - **(a)** Address of the registered office of the company, and
  - **(b)** Particulars regarding the directors, manager and secretary, if any.

  These two documents are required to be submitted within 30 days of the registration of the company.
- After the aforementioned documents have been filed with the Registrar of Companies, and the required fees have been deposited in his office, the Registrar will, if he is satisfied, enter the name of the company in the Register of Companies, maintained by him for the purpose.
- Immediately on registration of the company, the company comes into existence as a legal person, different (distinct) from the members of the company who constitute it. It comes into existence with effect from the earliest moment of the day of incorporation mentioned in the Certificate of Incorporation.
- After the company has been registered with the Registrar of Companies, and it has received the Certificate of Incorporation, it is now ready to initiate the process of its formation.
- Further, it is obligatory on the part of the public companies to take either of the following two steps:
  - **(a)** To issue a 'prospectus' in case the members of the public are to be invited to subscribe to its share capital, or

(b) To file a 'statement in lieu of the prospectus' with the Registrar of Companies, in the cases where the capital has been raised from friends and relatives by private arrangement. This must, however, be done at least three days before the allotment of the shares.

- Certificate to Commence Business
  The Act exempts the private companies from obtaining the Certificate to Commence Business. Thus, it can commence its business immediately on obtaining the Certificate of Incorporation from the Registrar of Companies. But then, it is compulsory for the public Companies to obtain the Certificate to Commence Business, before it can commence its business. This certificate can be obtained from the Registrar of Companies only after the floatation of the company.

Questions for Reflection

1. Write short notes on the following:
   (a) Companies limited by shares;
   (b) Companies limited by guarantees; and
   (c) Unlimited companies.
2. Why are most of the companies in India limited by shares? What are the specific advantages of a company being limited by shares?
3. Write your brief comments on each of the following main characteristics of a company:
   (a) An Incorporated Association
   (b) An Artificial Person
   (c) Common Seal
   (d) A Separate legal Entity
   (e) Limited Liability
   (f) A Separate Property
   (g) Transferability of Shares
   (h) Perpetual Existence (Company never dies)
   (i) May sue and be sued in its own name
   (j) Nationality and Domicile
   (k) No Fundamental Rights
4. What are the main distinguishing features of a public company and a private company limited by shares?
5. Write a brief note on the concept of 'Lifting of a Corporate Veil'.
6. Distinguish between the main (distinguishing) features of the following:
   (a) Company Limited by Shares,
   (b) Company Limited by Guarantees, and
   (c) Company Unlimited by Shares.
7. What are the main distinguishing features of a 'Public' and 'Private' limited companies?
8. In what manners a Private Company may be converted into a Public Company?
9. In what manners a Public Company may be converted into a Private Company?
10. Distinguish between a holding Company and a Subsidiary Company.
11. Write a short note on concept of 'One-Man Company'.
12. Write short notes on the following:
    (a) Promotion of a company,
    (b) Registration of a company, and
    (c) Floatation of a company.

13. 'A company cannot be registered with a name which, in the opinion of the Central Government, is undesirable.' Discuss this statement by citing suitable examples in each case.
14. What is meant by the document known as the 'Certificate of Incorporation' and what are its consequences?
15. Is a private company required to obtain a 'Certificate of Incorporation' from the Registrar of Companies? Give reasons for your answer.

Problems for Practise (With Suggested Solutions)

Problem 1

Can a company sue and be sued in its own name? Write 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

Yes; because it has a separate entity of its own, recognised by law. Thus, if a case is filed in the Court, not by the company as the plaintiff, but by its directors, such suit will not be maintainable in the Court.

Problem 2

Can a company open a bank account, enter into an agreement, and exercise all the powers pertaining to the attainment of its objects given in its Memorandum of Association**?** Write 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

Yes; because it has a separate entity of its own, recognised by law.

Problem 3

Does a company have a nationality and a domicile? Write 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

Yes; because it has a separate entity of its own, recognised by law.

Problem 4

Does a company enjoy the fundamental rights granted under the Constitution of India?? Write 'Yes' or 'No' as your answer. Give reasons for your answer.

Solution

No; because, though it has a separate entity of its own, recognised by law, it does not enjoy any fundamental rights, under the Constitution of India, as a natural person (human being) enjoys, as it is not a real person or citizen.

Problem 5

'In a public company the minimum number of shareholders must be nine, and there is no upper limit stipulated for its shareholders, but in a private company the minimum number of shareholders should be seven and maximum number should be 100.' Do you agree with this statement? Give reasons for your answer.

Solution

No. The correct statement should be that ' In a public company the minimum number of shareholders must be seven, and there is no upper limit stipulated for its shareholders, but in a private company the minimum number of shareholders should be two and maximum number should be 50'.

Problem 6

(a) A public company may be formed with a minimum paid up capital of Rs 50 lakh.
(b) A private company may be formed with a minimum paid up capital of Rs 10 lakh.
(c) In a public company there are certain restrictions imposed on the transferability of its shares.
(d) In a private company there are no restrictions imposed on the transferability of its shares.

Do you agree with the aforementioned statements? Give reasons for your answer.

Solution

No. The correct statements should be that:

(a) A public company may be formed with a minimum paid up capital of Rs 5 lakh.
(b) A private company may be formed with a minimum paid up capital of Rs 1 lakh.
(c) In a public company there are no restrictions imposed on the transferability of its shares.
(d) In a private company there are certain restrictions imposed on the transferability of its shares.

Problem 7

Do you agree with the following statements? Give reasons for your answer.

(a) A private limited company cannot commence business, just after receiving the certificate of incorporation from the respective Registrar of Companies, until it also receives the certificate to commence its business from the respective Registrar of Companies. Only receipt of certificate of incorporation is not enough in the case of a private company.
(b) A public limited company can commence its business immediately after receiving the certificate of incorporation from the respective Registrar of Companies, as it is not required to obtain a certificate for commencement of its business from the respective Registrar of Companies.

Solution

No. The correct statements should be that:

(a) A public limited company can very well commence its business immediately after receiving the certificate of incorporation from the respective Registrar of Companies, as it is not required to obtain a certificate for commencement of its business from the respective Registrar of Companies, which on the other hand, is required in the case of only public limited companies. Only receipt of certificate of incorporation is good enough in the case of a private limited company.
(b) A public limited company cannot commence its business immediately after receiving only the certificate of incorporation from the respective Registrar of Companies, as it is required, as per law, to obtain a certificate for commencement of its business also from the respective Registrar of Companies, well before it can legally commence its business. The exemption, of obtaining the certificate for commencement of its business from respective Registrar of Companies, is applicable in the cases of private limited companies only, not so in the cases of public limited companies.

Problem 8

(a) Can a private company be converted into a public company? Write 'Yes' or 'No' as your answer.
(b) Can a public company be converted into a private company? Write 'Yes' or 'No' as your answer.

Solution

(a) Yes.
(b) Yes.

Problem 9

(a) Company A is the holding company and the company B is the subsidiary company of company A. Then, if C is the subsidiary company of company B, will the company C also be the subsidiary company of company A.
(b) Further, if the company D is the subsidiary company of company C, then will the company D also be the subsidiary company of company C and company B. Further, as the company B and company C are the subsidiary companies of company A, will company D as well be the subsidiary company of company A.
Write 'Yes' or 'No' as your answer.

Solution

(a) Yes.
(b) Yes.

Problem 10

In a private company, Modern Garments, Karim alone owned almost the entire shares of the company and just one share each was given to just other two other persons, who, in fact, were just the dummies in the company, only for the purpose of meeting the legal requirements in regard to the required minimum number of the membership. Can this company be referred to as a 'one man company'? Write 'Yes' or 'No; as your answer.

Solution

Yes.

Problem 11

A company named 'Raghav and Indu Limited' has applied to the Registrar of Companies for the registration of its name as 'RIL'. Will the Registrar of Companies register the name as applied for? Give reasons for your answer.

Solution

No. The Registrar of Companies will not register the name as applied for, because it is identical with the acronym of the name of a very reputed company, viz. Reliance Industries Limited, popularly known as RIL. Because, the Companies Act specifically provides that if the proposed name closely resembles the popular or abbreviated version of, or the nick names of, any well known and reputed company, such names are unacceptable. Such words cannot be allowed even if such names have not been registered as trade marks.

Problem 12

A public limited company has obtained the certificate of incorporation from the Registrar of Companies but its certificate to commence business is still awaited. Can the company commence its business in anticipation of the receipt of the certificate to commence its business? Write 'Yes' or 'No' as your answer'. Give reasons for your answer.

Solution

No. Because, a public company cannot commence its business without actually receiving the certificate to commence its business from the Registrar of Companies.

Problem 13

A private limited company has obtained the certificate of incorporation from the Registrar of Companies but not the certificate to commence business Can the company commence its business? Write 'Yes' or 'No' as your answer'. Give reasons for your answer.

Solution

Yes. Because, a private company can commence its business immediately on receipt of the certificate of incorporation. In fact, the certificate to commence business, is not issued by the Registrar of Companies in the cases of private companies.

Chapter Forty

Memorandum and Articles of Association

"*A memorandum is not written to inform the reader, but to protect the writer.*
Dean Acheson

A man is known by the company he organizes.
Ambrose Bierce

Management's job is to see the company not as it is... but as it can become.
John W. Teets

Prospect is often better than possession.
Thomas Fuller"

40.1 Meaning and Purpose of Memorandum of Association

Memorandum of Association of a company is its Charter. It contains the fundamental conditions upon which alone the company can be incorporated. It contains its objects of the formation of the company and the maximum possible scope of its operation beyond which it cannot act or operate. Thus, it defines as also restricts (confines) the power of the company. Accordingly, if any thing is done beyond these powers, that will be declared *ultra vires* (i.e. beyond the powers of) the company and, thus, void. Thus, the Memorandum of Association of a company enables the shareholders, creditors and suppliers, and so on, to know whether the company is acting within the powers granted by its Memorandum of Association, or it is indulging in some activities which are *ultra vires* (i.e. beyond its powers).

40.2 Form and Content

Under **Section 14**, the Memorandum of Association of a company should be in one of the Forms provided in

Tables B, C, D, and E, in Schedule 1 to the Act, as may be applicable in the case of the company, or in the Forms, as near the Form provided in the Act, as the circumstances may require (accept or admit).

Section 15 stipulates that the Memorandum of Association of a company should be printed or legibly or type-written, or computer printed. Further, it must be divided into paragraphs, which must be serially numbered consecutively, and signed by at least seven persons in the case of a public company, and by at least two persons in the case of a private company. They must sign the Memorandum of Association of the company in the presence of at least one witness, who will attest their signatures. Each of such members must take at least one share and write against his name the number of shares so taken.

As provided under **Section 13**, the Memorandum of Association of a limited company is required to contain the following:

(a) The name of the company with the word 'limited' as the last word in the case of a public company, and 'private limited' as the last words in the case of a private company,
(b) The name of the State wherein the registered office of the company is to be located (situated),
(c) The objects of the company classified separately as the 'main objects' and 'other objects',
(d) The declaration to the effect that the liability of its members is limited, and
(e) The amount of the authorised share capital, divided into shares of the specified (fixed) amounts.

These contents of the Memorandum of Association are called the compulsory clauses.

40.3 Alteration in Memorandum of Association

Section 16 provides that the company cannot change the conditions contained in the Memorandum of Association except in the cases and in the mode and to the extent the express provisions have been made in the Act. Thus, a company can change its name, change its registered office, change its objects clause, and change its capital clause, by following the procedures laid down in these regards.

A company, limited by shares, can increase its authorised share capital by passing an ordinary resolution, if its Articles of association so authorises.

Within 30 days of the passing of the resolution for the increase in the authorised capital, the company is required to file a notice in this regard with the Registrar of Companies. After receiving the notice, the Registrar of Companies shall record the increase and also make any alterations that may be necessary in the company's **Memorandum of Association** or **Article of Association,** or in **both**.

40.4 Consolidation and Sub-Division (Splitting) of Shares

(a) Combination of shares means combing a specified number of shares of smaller face value (denominations), resulting in the higher face value of each share and the resultant lesser number of total shares. **For example**, when the total number of shares of the company is 1 crore, comprising 1 crore shares of Rs 10 each, aggregating Rs 10 crore, and its 10 shares of Rs 10 face value are combined into one share of Rs 100 face value, the amount (face value) of one share goes up from Rs 10 to Rs 100 and the number of shares goes down from 1 crore to 10 lakh shares of Rs 100 each, aggregating the same Rs 10 crore. In such case, the total capital of the company has remained unchanged. Only the number of shares has gone down to one tenth of the previous number of shares.
(b) Sub-Division (Splitting) of Shares means the opposite. **For example**, when the total number of shares of the company is 1 crore, comprising 1 crore share of Rs 10 each, aggregating Rs 10 crore, and its one share of Rs 10 face value is sub-divided (split) into ten shares of Re 1 face value, the amount (face value) of one share goes down from Rs 10 to Re 1 and the number of shares goes up from 1 crore to 10 crore shares of Re 1 each, aggregating the same Rs 10 crore. In such cases also, the total capital of the company

has remained unchanged. Only the number of shares has gone up by ten times of the previous number of shares.

40.5 Meaning and Purpose of Articles of Association

As we have seen in the preceding paragraphs, the Memorandum of Association spells out the scope and powers of the company. As against this, the Articles of Association governs the ways in which the objects of the company are required to be carried out and achieved. Further, alteration in the Memorandum of Association involves a detailed and lengthy procedure whereas the Articles of Association can be formed and altered by the members of the company by passing a special resolution. Besides, the Memorandum of Association lays down the area beyond which the action of the company cannot go. Thus, within such boundary line (*Lakshman Rekha*) specified by the Memorandum of Association, the shareholders may make such regulations for their own governance as they may deem fit. However, the Articles of Association must not be inconsistent with any of the provisions in the Memorandum of Association. Further, like in the case of Memorandum of Association, the Articles of Association also must not contain any thing which goes against or is repugnant to the provisions of the Act (**Section 9**).

Thus, we see that the Articles of Association of the company and its by-laws are the regulations which govern the management of the internal affairs and carrying on of the business of the company. These define the duties, rights, powers, and authority of the shareholders and the directors in their respective capacities, as also of the company, and the mode and form in which the business of the company is to be conducted (carried out).

Further, the Articles of Association of the company have a contractual force between the company and its members as also between the members *inter se*, in relation to their rights as such members. [**Ramakrishna Industries (P) Ltd. and others vs P. R. Ramakrishna and others (1988) 64 Comp. Cas. 425**].

In other words, the Articles of Association of a company are subordinate to and, thus, are controlled by the Memorandum of Association. Therefore, the Articles of Association cannot supersede the objects as laid down in the Memorandum of Association. [**Birds Investments Ltd vs C.I.T. (1965) 35 Comp. Cas. 147 Cal.].**

40.6 Registration of Articles of Association

As provided under **Section 26**, a public company, limited by shares, may register its Articles of Association, signed by the subscribers to the Memorandum of Association. However, if it does not register its own Articles of Association, the Articles of Association, given in Table A of Schedule 1 of the Act, will automatically become applicable.

If a member of the company so requires, the company shall send to him a copy of the Articles of Association, within seven days of the requirement, on payment of Re 1. Further, if the company fails to do so, the company, and every officer of the company responsible for such lapse, shall be punishable with a fine upto Rs 50. (**Section 39**).

40.7 Alteration of Articles of Association

Under **Section 31,** subject to the provisions of the Act, as also to the conditions laid down in the Memorandum of Association, a company may, by special resolution, alter or make additions to its Articles of Association. A printed or type-written copy of every special resolution of the company, making alterations in the Articles of Association, must be filed with the Registrar of Companies within 30 days of the passing of such special resolution.

40.8 Restrictions on Power for Alteration of Articles of Association

(a) Such alterations or additions in the Articles of Association, must not exceed the powers given by the Memorandum of Association, or should not be in conflict with the other provisions of the Memorandum of Association.
(b) Moreover, such alterations or additions in the Articles of Association must not be inconsistent with any of the provisions of the Act or any other law (statute).
(c) Further, such alterations or additions in the Articles of Association, must not include anything which may be illegal, or against the public policy.
(d) Above all, such alterations or additions in the Articles of Association must be *bona fide* and in the interest of the company as a whole. However, such alterations or additions in the Articles of Association will not be considered bad merely because it inflicts hardship on any of the shareholders.

40.9 Doctrine of Indoor Management

The 'doctrine of constructive notice' imposes the burden on the people, outside the company, entering into a contract with the company, that they are presumed to have read the documents, though, in fact, they might not have read them. As against the 'doctrine of constructive notice', the 'doctrine of indoor management' allows all those who deal with the company to assume that the provisions of the Articles of Association have been observed by the officers of the company. Alternatively speaking, they are not bound to enquire into the regularity or otherwise of the internal proceedings. That is, an outsider is not supposed to see that the company carries out the internal proceedings, in the required manner.

40.10 Issuance of Shares in Public Companies

As we have seen in the previous chapter, a public company, limited by shares, generally issues shares to the public for raising its capital. For this purpose, it is required to issue a document, known as 'Prospectus'. In this respect, it has to follow the following procedures:

After the certificate of incorporation is received, the affairs of the company are taken over by the first directors appointed in accordance with law. They then select one of the directors as the chairman of the Board of Directors, if no person has been named in the Articles of Association.

The Board attends to the following issues:

(a) Appointment of various expert agencies, such as bankers, auditors, secretary, and so on;
(b) Entering into the underwriting contracts/brokerage contracts with the underwriters/brokers;
(c) Making arrangements for the listing of its shares in the stock exchange(s); and
(d) Drafting a prospectus for issuing it to the public.
(e) Appointment of banker(s) is necessary, with whose specified branches the members of he public will submit their applications for the allotment of shares on the prescribed and serially numbered application forms, and deposit the cash or cheque or bank draft for the amount of the application money.
(f) Appointment of the first auditor is within the powers of the Board of Directors. It is necessary that an auditor is appointed before the prospectus is issued.
(g) The appointment of the company secretary is obligatory in the case of the companies, which have the prescribed paid up share capital (presently Rs 50 lakh or more). In the cases of even other companies, the appointment of the company secretary is desirable, though not compulsory.

40.11 Underwriting

The Board of Directors enters into underwriting contracts with the underwriters. Simply put, the term 'underwriting' consists of an undertaking by some person or persons to the effect that if the public does not subscribe to the public issue in full, he or they (underwriter or underwriters, as the case may be) will meet the amount of the balance, which remains unsubscribed by the general public. Thus, it involves great risks, on the part of the underwriters, to pay a huge balance amount, if the public issue gets highly undersubscribed. Therefore, the underwriters prefer to play safe, and undertake the risk of underwriting the undersubscribed balance only upto a certain amount, as agreed by them with the company. For undertaking such risks, the company enters into contracts with the underwriters to pay a reasonable amount of underwriting commission to them (underwriters). Thus, to meet the total amount of the public issue, the company may have to enter into separate contracts with several underwriters to get the total amount of the public issue underwritten by the various underwriters, taken together. The total amount of commission must be reasonable and should not exceed 5 per cent of the issued price in the case of the public issue of the shares, and 2 ½ per cent of the issued price in the case of the public issue of the debentures. Further, in case the issue is fully subscribed, the underwriters do not have to pay any amount to the company to take up any of its shares. But then, in such a mutually happy situation, the underwriters are entitled to receive their underwriting commission, all the same.

It has been further provided in **Section 69**, that a company must receive applications for issue of the shares from the general public equivalent to the minimum subscription, as it has been mentioned in the prospectus, failing which the company is required to refund the application money in full to the applicants (subscribers). At present, at least 90 per cent of the total issue is required to be subscribed, failing which the company is required to refund the application money in full to the applicants (subscribers).

But, in the cases where the entire issue has been underwritten by the underwriters, the company rests assured that it will not have to refund any application money, in view of the fact that, even if the public issue is not fully subscribed, the balance unsubscribed amount shall be paid by the underwriters in exchange of the shares equivalent to the agreed underwritten amount. Such shares are to be taken up by the underwriters at the issue price and not at any discounted price. This way, the underwriters act as a sort of insurer against the risk of under-subscription, if any.

40.12 Sub-Underwriting

As the financial risks are high, the underwriters prefer to underwrite the shares only upto a certain limit, depending upon their capability and risk-taking intention (appetite). To reduce (spread) their risk even further, they prefer to share their burden with some other persons, who in turn, are known as the 'Sub-Underwriters'. Such 'sub-underwriters' agree to take a certain number of shares, for which they accept the responsibility. For taking such risk, they are paid the underwriters' commission, out of the total underwriters' commission received by their main (principal) underwriters from the company. The difference (surplus) between the commission paid by the company to the main (principal) underwriters and the commission paid by the principal underwriters to their respective sub-underwriters is known as the **'overriding commission'.**

40.13 Brokerage Contracts

Besides the underwriters, a company may also enter into brokerage contracts with the brokers. The broker is a person who undertakes to place shares, that is, to locate (find) persons who will buy the shares of the company, in consideration of an agreed amount of brokerage. But even if he fails to place any of the shares, he cannot be held personally liable to take them (as against the underwriters), nor he is entitled to claim any

brokerage in regard to the shares not placed. He will, however, be paid his brokerage (commission) on the shares he has been able to place.

Further, under **Section 76**, there must be the authority given in the Articles of Association to pay the brokerage, and such brokerage paid must be reasonable, too. Such brokerage must also be disclosed in the prospectus, or in the statement in lieu of the prospectus, as the case may be.

40.14 Listing of Shares in the Stock Exchange(s)

Under **Section 73**, it is necessary for every public company, before issuing shares or debentures, for the subscription by the public by issue of a prospectus, to make an application for the listing of the securities (shares and debentures) in one or more of the recognised stock exchanges. This is known as the listing of shares. This is the way to transfer the shares and debentures of a listed company in an unrestricted manner any number of time. The true fact to the effect that the permission has been obtained from particular stock exchange(s), or that the application for getting permission has been made or will be made to particular stock exchange(s), may be mentioned in the prospectus.

40.15 Issuance of Public Deposit

Public deposit is the deposit received by the companies from the public for a certain period of time, with certain restrictions, discussed hereafter.

(a) A company is required to publish an advertisement for inviting or accepting any deposit, specifying therein the financial position, management structure, and other specific particulars of the company. Further, the 'renewals' of the public deposits are included in the 'acceptance' of the deposits.
(b) A company cannot accept or renew any deposits which are repayable on demand. That is, it can accept or renew only such deposits which are repayable after the expiry of a certain specified period of time.
(c) Further, a company cannot accept or renew any deposits which are repayable within (before) six months of its deposit. But then, such deposits of less than six months can be accepted provided such deposits do not exceed 10 per cent of the paid up capital and free reserves of the company taken together.
(d) Moreover, a company cannot accept deposits for less than three months and for more than 36 months.
(e) A company can accept deposits only within the following limits:
    (i) 10 per cent of the paid up capital and free reserves of the company taken together, in the cases of the deposits in the form of any deposit against unsecured debentures, deposits from the shareholders, or any deposits guaranteed by the directors of the company.
    (ii) Any other deposits, not exceeding 25 per cent of the total paid up capital and free reserves of the company taken together.
(f) No Government company can accept any public deposit more than 35 per cent of the paid up capital and free reserves of the company taken together

Let us Recapitulate

- Memorandum of Association of a company is its Charter. It contains the fundamental conditions upon which alone the company can be incorporated. It contains its objects of the formation of the company and the maximum possible scope of its operation beyond which it cannot act or operate.
- The Memorandum of Association of a company should be in one of the Forms provided in Tables B, C, D, and E, in Schedule 1 to the Act, as may be applicable in the case of the company, or in the Forms, as near the Form provided in the Act, as the circumstances may require (accept or admit).

- The Memorandum of Association of a company should be printed or legibly type-written or computer printed. Further, it must be divided into paragraphs, which must be serially numbered consecutively, and signed by at least seven persons in the case of a public company, and by at least two persons in the case of a private company.
- The Memorandum of Association of a limited company must contain the following:
  - (**a**) The name of the company with the word 'limited' as the last word in the case of a public company, and 'private limited' as the last words in the case of a private company,
  - (**b**) The name of the State wherein the registered office of the company is to be located (situated),
  - (**c**) The objects of the company classified separately as the 'main objects' and 'other objects',
  - (**d**) The declaration to the effect that the liability of its members is limited, and
  - (**e**) The amount of the authorised share capital, divided into shares of the specified (fixed) amounts.
- A company can change its name, change in its registered office, change its objects clause, and change its capital clause, by following the procedures laid down in these regards.
- A company, limited by shares, can increase its authorised share capital by passing an ordinary resolution, if its Articles of association so authorises.
  Within 30 days of the passing of the resolution for the increase in the authorised capital, the company is required to file a notice in this regard with the Registrar of Companies.
  Consolidation and Sub-Division (Splitting) of Shares
  - (**a**) Combination of shares means combing a specified number of shares of smaller face value (denominations), resulting in the higher face value of each share and the resultant lesser number of total shares.
  - (**b**) Sub-Division (Splitting) of Shares means the opposite.
  - (**c**) The Articles of Association governs the ways in which the objects of the company are required to be carried out and achieved. The Articles of Association can be formed and altered by the members of the company by passing a special resolution. Besides, the Memorandum of Association lays down the area beyond which the action of the company cannot go.
- **Registration of Articles of Association**
  As provided under **Section 26**, a public company, limited by shares, may register its Articles of Association, signed by the subscribers to the Memorandum of Association.
  - Subject to the provisions of the Act, as also to the conditions laid down in the Memorandum of Association, a company may, by special resolution, alter or make additions to its Articles of Association. A printed or type-written copy of every special resolution of the company making alterations in the Articles of Association must be filed with the Registrar of Companies within 30 days of the passing of such special resolution.
  - (**d**) Above all, such alterations or additions in the Articles of Association must be *bona fide* and in the interest of the company as a whole. However, such alterations or additions in the Articles of Association will not be considered bad merely because it inflicts hardship on any of the shareholders.
- The 'doctrine of constructive notice' imposes the burden on the people, outside the company, entering into a contract with the company, that they are presumed to have read the documents, though, in fact, they might not have read them. As against the 'doctrine of constructive notice', the 'doctrine of indoor management' allows all those who deal with the company to assume that the provisions of the Articles of Association have been observed by the officers of the company.
- A public company, limited by shares, generally issue shares to the public for raising its capital. For this purpose, it is required to issue a document, known as 'Prospectus'. In this respect, it has to follow the following procedures:
  After the certificate of incorporation is received, the affairs of the company are taken over by the first directors appointed in accordance with law. They then select one of the directors as the chairman of the Board of Directors, if no person has been named in the Articles of Association.

The Board attends to the following issues:

(**a**) Appointment of various expert agencies, such as bankers, auditors, secretary, and so on;
(**b**) Entering into the underwriting contracts/brokerage contracts with the underwriters/brokers;
(**c**) Making arrangements for the listing of its shares in the stock exchange(s); and
(**d**) Drafting a prospectus for issuing it to the public.
(**e**) Appointment of banker(s) is necessary, with whose specified branches, where the members of he public will submit their applications for the allotment of shares on the prescribed and serially numbered application forms, and deposit the cash or cheque or bank draft for the amount of the application money.
(**f**) Appointment of the first auditor is within the powers of the Board of Directors. It is necessary that an auditor is appointed before the prospectus is issued.
(**g**) The appointment of the company secretary is obligatory in the case of the companies, which have the prescribed paid up share capital (presently Rs 50 lakh or more). In the cases of even other companies, the appointment of the company secretary is desirable, though not compulsory.

- The Board of Directors enters into underwriting contracts with the underwriters. Simply put, the term 'underwriting' consists of an undertaking by some person or persons to the effect that if the public does not subscribe to the public issue in full, he or they (underwriter or underwriters, as the case may be) will meet the amount of the balance, which remains unsubscribed by the general public. Thus, it involves great risks, on the part of the underwriters, to pay a huge balance amount if the public issue gets highly undersubscribed. For undertaking such risks, the company enters into contracts with the underwriters to pay a reasonable amount of underwriting commission to them.
- A company must receive applications for issue of the shares from the general public equivalent to the minimum subscription, as it has been mentioned in the prospectus, failing which the company is required to refund the application money in full to the applicants (subscribers).
- But, in the cases where the entire issue has been underwritten by the underwriters, the company rests assured that it will not have to refund any application money, in view of the fact that, even if the public issue is not fully subscribed, the balance unsubscribed amount shall be paid by the underwriters in exchange of the shares equivalent to the agreed underwritten amount.
- As the financial risks are high, the underwriters prefer to underwrite the shares only upto a certain limit, depending upon their capability and risk-taking intention (appetite). To reduce (spread) their risk even further, they prefer to share their burden with some other persons, who in turn, are known as the 'Sub-Underwriters'.
- Besides the underwriters, a company may also enter into brokerage contracts with the brokers. The broker is a person who undertakes to place shares, that is, to locate (find) persons who will buy the shares of the company, in consideration of an agreed amount of brokerage. But even if he fails to place any of the shares, he cannot be held personally liable to take them (as against the underwriters), nor he is entitled to claim any brokerage in regard to the shares not placed.
- There must be the authority given in the Articles of Association to pay the brokerage, and such brokerage paid must be reasonable, too. Such brokerage must also be disclosed in the prospectus, or in the statement in lieu of the prospectus, as the case may be.
- It is necessary for every public company, before issuing shares or debentures, for the subscription by the public by issue of a prospectus, to make an application for the listing of the securities (shares and debentures) in one or more of the recognised stock exchanges. This is known as the listing of shares.
- Public deposit is the deposit received by the companies from the public for a certain period of time, with certain restrictions.

(**a**) A company is required to publish an advertisement for inviting or accepting any deposit, specifying therein the financial position, management structure, and other specific particulars of the company.

(b) A company cannot accept or renew any deposits which are repayable on demand. That is, it can accept or renew only such deposits which are repayable after the expiry of a certain specified period of time.

(c) Further, a company cannot accept or renew any deposits which are repayable within (before) six months of its deposit. But then, such deposits of less than six months can be accepted provided such deposits do not exceed 10 per cent of the paid up capital and free reserves of the company taken together.

(d) Moreover, a company cannot accept deposits for less than three months and for more than 36 months.

(e) A company can accept deposits only within the following limits:

(i) 10 per cent of the paid up capital and free reserves of the company taken together, in the cases of the deposits in the form of any deposit against unsecured debentures, deposits from the shareholders, or any deposits guaranteed by the directors of the company.

(ii) Any other deposits, not exceeding 25 per cent of the total paid up capital and free reserves of the company taken together.

(f) No Government company can accept any public deposit more than 35 per cent of the paid up capital and free reserves of the company taken together

Questions for Reflection

1. What are the main distinguishing features between the Memorandum of Association of a company and the Articles of Association of a company?
2. What are the specific particulars that can be altered in a Memorandum of Association?
3. What do you understand by the terms 'Consolidation' and 'Sub-Division (Splitting) of Shares'? Explain with the help of suitable examples in each case.
4. (a) How can the Memorandum of Association of a company be altered and within what restrictions?
5. What do you understand by the terms, 'Doctrine of Constructive Notice', and 'Doctrine of Indoor Management'? Explain.
6. Discuss the procedures that are required to be followed by a public company, limited by shares, to issue shares to the public for raising its capital.
7. Write short notes on the following terms:
   (a) Underwriting
   (b) Sub-Underwriting
   (c) Brokerage Contracts
8. What are the main distinguishing features of the following:
   (a) Underwriting
   (b) Sub-Underwriting
   (c) Brokerage Contracts
9. (a) What do you understand by the term 'Listing of Shares in the Stock Exchange(s)'
   (b) What are the advantages of 'Listing of Shares in the Stock Exchange(s)'?
10. What is a Public Deposit?
11. What are the specific restrictions stipulated in regard to the Public Deposit?

Problems for Practice (With Suggested Solutions)

Problem 1

Fill in the blanks with appropriate numbers:

(**a**) The total number of shares of a company is 10 crore, comprising 10 crore shares of Rs 10 each, aggregating Rs _____ crore, and its ten shares of Rs 10 face value are combined into one share of Rs 100 face value, the amount (fae value) of one share goes up from Rs _____ to Rs _____ and the number of shares comes down from _____ crore to _____ crore shares of Rs 100 each, aggregating Rs _____ crore.

(**b**) The total number of shares of the company is 10 crore, comprising 10 crore shares of Rs 10 each aggregating Rs _____, and its one share of Rs 10 face value is sub-divided (split) into ten shares of Re 1 face value, the amount (face value) of one share comes down from Rs _____ to Rs _____ and the number of shares goes up from _____ crore to _____ crore shares of Rs _____ each, aggregating Rs _____ crore

Solution

(**a**) The total number of shares of a company is 10 crore, comprising 10 crore shares of Rs 10 each, aggregating Rs **100** crore, and its ten shares of Rs 10 face value are combined into one share of Rs 100 face value, the amount (face value) of one share goes up from Rs **10** to Rs **100** and the number of shares goes down from **10** crore to **1** crore shares of Rs 100 each, aggregating Rs **100** crore.

(**b**) The total number of shares of the company is 100 crore, comprising 10 crore share of Rs 10 each, aggregaing Rs **100** crore, and its one share of Rs 10 face value is sub-divided (split) into ten shares of Re 1 face value, the amount (face value) of one share goes down from Rs **10** to Re **1** and the number of shares goes up from **10** crore to **100** crore shares of Re **1** each, aggregating Rs **100** crore.

Problem 2

'The doctrine of indoor management allows all those who deal with the company to assume that the provisions of the Articles of Association have been observed by the officers of the company. They are not bound to enquire into the regularity or otherwise of the internal proceedings. That is, an outsider is not supposed to see that the company carries out the internal proceedings, in the required manner.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 3

'A company must receive applications for issue of the shares from the general public equivalent to the minimum subscription, as it has been mentioned in the prospectus, failing which the company is required to refund the application money in full to the applicants. At present, at least 75 per cent of the total issue is required to be subscribed, failing which the company is required to refund the application money in full to the applicants'. Do you agree with this statement? Give reasons for your answer.

Solution

No. The correct statement should read as 'A company must receive applications for issue of the shares from the general public equivalent to the minimum subscription, as it has been mentioned in the prospectus, failing which the company is required to refund the application money in full to the applicants (subscribers). At present, at least **90** per cent of the total issue is required to be subscribed, failing which the company is required to refund the application money in full to the applicants (subscribers).'

Problem 4

Fill in the blanks with appropriate words:

As the financial risks are high, the underwriters prefer to underwrite the shares only upto a certain limit, depending upon their capability and risk-taking intention. To spread their risk even further, they prefer to

share their burden with some other persons, who in turn, are known as the _____. Such _____ agree to take a certain number of shares, for which they accept the responsibility. For taking such risk, they are paid the _____ commission, out of the total underwriters' commission received by their main underwriters from the company. The difference (surplus) between the commission paid by the company to the main underwriters and the commission paid by the principal underwriters to their respective sub-underwriters is known as the '_____ commission'.

Solution

As the financial risks are high, the underwriters prefer to underwrite the shares only upto a certain limit, depending upon their capability and risk-taking intention. To spread their risk even further, they prefer to share their burden with some other persons, who, in turn, are known as the '**Sub-Underwriters**'. Such '**sub-underwriters**' agree to take a certain number of shares, for which they accept the responsibility. For taking such risk, they are paid the **underwriters**' commission, out of the total underwriters' commission received by their main underwriters from the company. The difference (surplus) between the commission paid by the company to the main underwriters and the commission paid by the principal underwriters to their respective sub-underwriters is known as the **overriding** commission.

Chapter Forty One

Share Capital and Debentures, Equitable Mortgage, and Registration of Charges

"

"A large income is the best recipe for happiness, I ever heard of."
Jane Austen, Northanger Abbey

When a person has no need to borrow, they find multitudes willing to lend.
Oliver Goldsmith

Quick to borrow is always slow to pay.

Proverb

Who goes a borrowing, goes a sorrowing.
Proverb

Loans and debts, make worry and frets.
Saying

Clouds come floating into my life, no longer to carry rain or usher storm, but to add colour to my sunset sky.
Rabindranath Tagore

"

41.1 Shares

As defined under **Section 2 (46)**, a share is 'a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied'. A share signifies the interest of

a shareholder in the company, the right to receive dividends, to attend its meetings and vote at the meeting, and to have share in the surplus assets of the company, if any, in the event of the company being wound up.

41.2 Shares vs Share Certificates

As provided under **Sections 82 and 84**, while the term 'share' represents the property, the term 'share certificate', on the other hand, represents the evidence of the title of the member to such property.

41.3 Shares vs Stocks

The share capital of a company is divided into a number of indivisible units of a specified amount. And each of such units is referred to as a 'share'. Thus, if the share capital of a company is Rs 10 crore divided into 1 crore units of Rs 10 each, each unit of Rs 10 will be referred to as a 'share' of the company. Accordingly, the term 'stock' may be described as the aggregate (total) of the entire fully paid up shares of a company, owned by an individual, merged into one fund of the equal value. That is, it represents the set of the entire shares of the company, owned by an individual, put in one single bundle.

Further, the stock is expressed in terms of money, and not in terms of so many shares. The stock may, thus, be divided into fractions of any amount and such fraction of the amount may be transferred like shares. Such fractions, unlike the shares, bear no distinctive numbers. But a company cannot make an original issue of its stocks.

41.4 Different Types of Shares

Share Capital

Share capital comprises two types of shares:

(a) Equity Shares (these are also known as Ordinary Shares), and
(b) Preference Shares

There are the following types of equity shares:

(i) With voting rights;
(ii) Without voting rights; and
(iii) With differential rights regarding the payment of dividend, voting or otherwise, according to such rules, and subjects to such conditions, as may be prescribed. Shares with differential voting rights, including non-voting shares, cannot exceed 25 per cent of the total issued share capital.

Equity Share (Ordinary Share) Capital

The equity (or ordinary) shareholders of a company are virtually (or notionally) the owners of the company. (The debenture holders, however, are the creditors to the company).

41.5 Some Terminologies

41.5.1 Authorised Capital

Authorised capital is the maximum amount up to the face value of which the company concerned has been authorised to issue shares (including both the equity and preference shares). While computing the amount of the authorised capital, only the face value of the shares is to be taken into account, and not the amount of the premium at which the shares had been issued. Further, the amount (only the face value) of the bonus shares issued, by capitalising the general reserves, will also be taken into account.

41.5.2 Issued Capital

Issued capital is the amount of the aggregate face value of the company's shares, for which the shares have been issued (that is, offered) for subscription by the general public, or by private placement.

41.5.3 Subscribed Capital

The amount, up to which the shares have been actually applied for by the investors, is known as the subscribed capital.

41.5.4 Paid-up Capital

Paid up capital is the amount paid along with the application (known as application money) and/or subsequently by way of call money on first, second, and final calls.

41.6 Some Other Terminologies

Par Value (Also known as Face Value)
Par Value is the amount written on the face of the share scrip, also known as the face value.

Book Value
Book value of the shares is the value of each share, plus the aggregate amount of the entire Reserves and Surpluses, as per the books of the company, as all these belong exclusively to the equity shareholders, alone. Thus, the book value of each share, in percentage terms, would be equal to:

$$\frac{\text{(Fully Paid-up) Equity Share Capital + Reserves + Surpluses}}{\text{Aggregate face value of such Shares}} \times 100$$

Issue Price
The amount at which the shares are offered to the public, to subscribe thereto, is known as the issue price. Usually, the new companies come out with their first public issue at par value or face value.

Issue at Par Value
The shares are said to have been issued at par when the subscribers to the shares of the company are required to pay only the amount equivalent to the nominal value (face value) of the shares issued. **For example,** the HDFC bank had issued its shares in its Initial Public Offer (IPO) at par (i.e. its Rs 10 face value shares were issued for Rs 10 only, though its present price is far higher than Rs 10. (Rs 1,184.75 as on 15 May 2009). As per the SEBI guideline, the face value of the share has to be minimum Re 1 and in multiples of Re 1. The face value of most of the shares in India are Rs 10, but there are some shares of the face value of Re1, Rs 2, Rs 5, Rs 20, Rs 50, Rs 100 and so on.

Issue at Premium
The shares are said to have been issued at a premium, when the subscribers to the shares of the company are required to pay the amount higher than the nominal value (face value) of the shares issued. **For example,** the State Bank of India (SBI) had issued its shares in its Public Offer at a premium (i.e. its Rs 10 face value shares were issued for Rs 100, though its present price is far higher than Rs 10. (Rs 1,312.25 as on 15 May 2009). The face value of these shares at the rate of Rs 10 per share so collected were credited to the share capital account and the premium of Rs 90 (Rs 100 less Rs 10) were credited to the Share Premium Account of the company.

The Act does not stipulate any restrictions or conditions on the issue of shares by the company at a premium. But the Act has imposed the following restrictions on the use of the premium amount so collected:

(i) The amount of premium cannot to accounted for as the profit of the company. Accordingly, it cannot be distributed as dividends.

(ii) The amount of premium received should be kept in a separate bank account termed as the Share Premium Account or the Securities Premium Account of the company. Here, it must be noted that the Amendment Act 1999 has since substitute the words 'Share Premium Account' with the words 'Securities Premium Account'.
(iii) The amount of securities premium should be kept with the same sanctity as the share capital is kept.
(iv) The amount credited to the Securities Premium Account cannot be treated as the free reserves of the company, as it is in the nature of a capital reserve.

Issue at a Discount

The shares are said to have been issued at a discount, when the subscribers to the shares of the company are required to pay the amount lesser than the nominal value (face value) of the shares issued. **For example,** if a company has issued its shares of Rs 10 face value for Rs 6, it is said to have been issued or sold at a discount of Rs 4. However, for the issue of shares at a discount certain conditions have been stipulated under **Section 79** of the Act.

Issue of Sweat Equity (Section 79 A)

Sweat equity share means the equity shares issued by the company to its employees or directors at a discount or for consideration other than cash. Sweat equity shares may also be issued for providing know-how or making available intellectual property rights (like patents) or value additions, by whatever name called. **Section 79** allows the companies to issue sweat equity shares, but subject to certain conditions.

Employee Stock Option Plan (ESOP)

'Employee stock option' means the option given to the whole-time directors, officers, or employees of the company, giving them the rights or benefits to purchase or subscribe to the shares, at a future date, offered by the company at a predetermined price **[Section 2 (15 A)].**

Employee Stock Purchase Scheme (ESPS)

(a) Eligibility to Participate in the Scheme (ESPS)

An employee shall be eligible to participate in the scheme (**ESPS**).

(aa) Non-Eligibility to Participate in the Scheme (ESPS)

(i) An employee, who is a promoter or who belongs to the promoter group, shall not be eligible to participate in the scheme (**ESPS**).
(ii) A director who, either by himself or through his relatives or through any body corporate, directly or indirectly, holds more than 10 per cent of the outstanding equity shares of the company, shall not be eligible to participate in the scheme (ESPS).

(b) Approval of Shareholders

(i) The company is required to obtain the approval of its shareholders, by passing a special resolution in the general body meeting of the shareholders, before the ESPS could be offered to the employees of the company.
(ii) The explanatory statement to the notice of the meeting, issued by the company, should specify the following:
  (a) The price of the share as also the number of shares to be offered to each of the employees, and
  (b) The appraisal process for determining the eligibility of the employee for the ESPS.
(iii) The number of such shares offered may be different for the different categories of the employees.
(iv) The special resolution shall state that the company shall conform to the specified accounting policies.

(c) Pricing and Lock-in Period

(i) The company shall have the freedom to determine the price of the shares to be issued to the employees under the ESPS.
(ii) Shares issued to the employees under the ESPS shall have a minimum lock-in period of one year from the date of allotment.

(iii) If the shares to be issued to the employees under the ESPS is a part of the public issue, and the shares are issued to the employees at the same price as the public issue, the shares issued to the employees, pursuant to (as a result of) the shares to be issued to the employees under the ESPS, shall not be subjected to any lock-in period.

(d) Disclosure and Accounting Policy

The Directors' Report or Annexure thereto shall contain, *inter alia*, the following disclosures:

(a) The details of the number of shares issued under ESPS.

(b) The price at which such shares are issued.

(c) Employee-wise details of the shares issued to the following:

(i) Senior managerial personnel.

(ii) Any other employee who has been issued shares in any one year amounting to 5 per cent or more shares issued during that year.

(iii) Identified employees who were issued shares during any one year equal to or exceeding 1 per cent of the issued capital of the company at the time of issuing the shares.

(e) Diluted earnings per share (EPS) pursuant to (as a result of) the issuance of the shares under the ESPS, and

(f) The **consideration received** against the issuance of the shares under the ESPS.

Bonus Shares

A company may, if so provided in its Articles of Association, capitalise its profits by issuing fully paid up shares to the members (shareholders), and thereby transferring the sums capitalised from the company's Profit and Loss Account or its General Reserve Account, to its share capital [**Section 205 (3)**]. Such shares are referred to as bonus shares. These are issued to the existing shareholders of the company whose names appear in the Register of the company on the record date, as announced earlier to the actual issue of the bonus shares. If the authorised capital of a company falls short of the total amount of shares, after the issue of the bonus shares, it may announce the ratio of the bonus shares as also the record date, but the actual allotment of the bonus shares will be kept pending by the company till the date the authorised capital of the company is raised to the sufficient higher amount.

Let us explain this concept with the help of a **live example** of Burrows Wellcom. The company had an authorised capital of Rs 5 crore, and its fully paid up equity shares stood at Rs 3 crore. It had, in the long past, issued bonus shares in the ratio of 1:1 (i.e. one share for every share held by the shareholders). This way, its total paid up share capital would have gone up from Rs 3 crore to Rs 6 crore. As the company had an authorised capital only of Rs 5 crore, and it had announced the bonus shares, it had not allotted the bonus shares until it had got its authorised capital duly raised from Rs 5 crore to Rs 10 crore, though its raising of the authorised capital even up to 6 crore would have been sufficient for the purpose.

We may also observe that, on the issuance of the bonus shares, the amount of share capital, reserves and surplus taken together, does remain the same and unaltered. Let us explain the concept with the help of an **Example**.

Let us presume the following data of a company:

Share Capital	Rs 100 crore
Reserves and Surplus	Rs 400 crore
Total	**Rs 500 crore**

Let us further presume that the company has issued bonus shares in the ratio of 1:1 (i.e. one share for every share held by the shareholders).

Thus, after the issue of the bonus shares, the capital structure of the company will change in the following manner:

Share Capital	Rs 200 crore (changed from Rs 100 crore as Rs 100 crore bonus has now been added);

Reserves and Surplus	Rs 300 crore (changed from Rs 400 crore as Rs 100 crore bonus has now been subtracted, which has been transferred to the share capital above);
Total	**Rs 500 crore** (It has remained unchanged).

Market Value

The price at which a share is quoted and traded in the stock exchanges (BSE, NSE, etc.) is known as its market value. But, such market price may be said to be reliable enough, only if the shares are being actually traded daily, or at least frequently, as also in reasonably large volumes.

Public Issue

The issue of shares to the members of the public through a prospectus is known as the public issue.

Private Placement

The sale of shares to only a few investors is known as private placement. Such issues do not require the issuance of the formal prospectus nor any underwriting arrangements. Besides, the terms of the issue are also determined through negotiation between the parties, viz. the issuing Company and the investing Company (ies) or individuals.

Rights Issue

The fresh share issued only and exclusively to the existing shareholders of the Company (as per its register, as on a specified record date) on the rights basis, is known as the rights issue.

The existing shareholders are given the right to apply for a specified number of shares, in proportion to their existing holdings of shares, on pro-rata basis. They also have the option of applying for additional number of shares, over and above the number of shares offered to them on the rights basis.

The composite application form comprises four pages, divided into four segments, marked Parts A, B, C, and D, on one separate page each.

PART A: is meant for accepting and applying for the shares offered on rights basis, by the existing shareholders only. They may also apply for some additional shares, provided they have applied for the entire number of shares offered to them on the rights basis.

PART B: is meant for renouncing the rights by the existing shareholder in favour of some other person, known as the renouncee.

PART C: is to be used for application by the renouncee, i.e. in whose favour the existing shareholder has renounced his rights, by executing the Part-B, as aforesaid.

PART D: is in the nature of a split form which is required to be sent to the issuing company within a stipulated time, with a request to send fresh application forms in the cases where the original allotee (existing shareholder) wants to apply for some shares on rights basis as also wants to sell the remaining portion of the rights offer in the secondary market. But, in such cases, as the original allotee is not applying for the full number of the rights shares offered, he or she is not entitled to apply for any additional shares.

Primary Market and Secondary Market

When the shares are issued by way of public issue, rights issue or on private placement basis, and the shares applied for are allotted by the issuing company to the investors, it is know to have been purchased or obtained from the primary market.

And later, when such original primary investors want to sell their shares to some one else, in the stock exchange, through a broker (or even on personal basis to their friends and/or relatives, etc.) such sales and purchases are known to have been transacted in the secondary market.

Preference Share Capital

Preference share capital can well be said to be a "two-in-one" instrument, a synthesis of the main features of both the equity shares and debentures.

Types of Preference Shares

(a) Cumulative and Non-Cumulative:
In the case of cumulative preference shares, if the amount of dividend payable, remains due, in full or in part, in any of the years, such balance amount gets carried over to the next successive years, till the entire outstandings are cleared, up to date.

In the case of non-cumulative preference shares, however, if no dividend or some lesser amount has been paid, the balance amount would not be automatically carried over. This would, instead, lapse that very year.

(b) Callable and Non-Callable:
Where the amount could be called (i.e. paid back) in full or in part, at any time, but at the discretion of the issuing company, of course, at the price, as per such call features stipulated by the company at the time of the offer/issue of such shares, is known as callable preference shares. As against this, the Non-callable preference shares cannot be paid back in full, or even in part, before the due dates.

(c) Convertible and Non-Convertible:
Convertible preference shares are such shares where the holders enjoy the right., at their option, to get their shares converted into equity shares, after the lapse of a certain specified period (say, after two years) in the pre-settled ratio (say, 1:1, 1:2, etc.), but within a specified period thereafter (say, within a period of three months).

As against this, non-convertible preference shares do not get converted into equity shares at any point in time.

(d) **Redeemable and Non-Redeemable**
Redeemable preference shares are such shares, which are stipulated to be redeemed (repaid or retired) after the lapse of a specified maturity period (say, 10 years, etc.) after the date of allotment, as specified in the issue documents.

In the case of non-redeemable preference shares, however, these are supposed to be perpetual in nature, not to be redeemed (repaid or retired) at any point in time, till the existence of the company.

(e) **Cumulative Convertible Preference (CCP) Shares**
This was a unique innovation wherein the features of both the cumulative and convertible preference shares were combined in one instrument. But, unfortunately, it has ultimately proved to be a non-starter, so far.

(f) **Participating and Non-Participating**
Participating preference shares entitle the holders thereof to participate in the surplus profit (i.e. the balance amount remaining after paying the dividends, at certain rates, each year, on both the equity and preference shares). Similarly, such preference shareholders may also be entitled to the assets that may still be remaining [after meeting all the claims and dues of the Governments (both Central and State), of all the creditors and the preference shareholders (in that order)], according to some specified formula.

Shareholders of non-participating preference shares, however, will, of course, be not entitled to such shares in the surplus profit, nor in the residual assets (at the time of the liquidation of the company), as aforesaid.

Rights to Vote

Preference shareholders are entitled to vote only on the resolution placed before the company under any one or all of the under noted circumstances. These are:

(i) If the dividend(s) on preference shares are in arrear for the last two years or more, in the case of cumulative preference shares, or

(ii) If the preference dividends have not been paid for two or more consecutive years in the past, or for an aggregate period of three years or more, in the preceding six years, ending with the expiry of the immediately preceding financial year (of the company).

Reserves and Surplus

(a) **Reserves ("Retained Profits" or "Retained Earnings"):**
The Reserves comprise that portion of the net profit which has not been distributed as dividend to the share-holders, but is, instead, ploughed back in the business. Reserves may broadly be categorised under two heads:
(i) **Revenue Reserves**, and
(ii) **Capital Reserves**.

(i) **Revenue Reserves** comprise such reserves, which are constituted out of the revenue or income, generated out of the normal or usual line of business of the company.

(ii) As against this, the income generated from the sources, other than the usual business activity of the company, will go to constitute **Capital Reserves**.

The different types of Revenue Reserves are:

(i) General Reserves;
(ii) Investment Allowance Reserve;
(iii) Capital Redemption Reserve, like the Debenture Redemption Reserve
(iv) Dividend Equalisation Reserve.

Similarly, the various examples of Capital Reserves are:

(a) Premium on the issue of shares, credited to the Share Premium Account
(b) Revaluation Reserve

The **revaluation of assets** takes place generally under the following three conditions:

(a) On conversion of a Private Company into a Public Company.
(b) At the time of amalgamation of two or more Companies.
(c) When a Company is being sold out to another party/business house.

The revaluation of assets is computed as:
Revised value of the Fixed Assets [less] their Book Value = the amount of the Revaluation Reserve**.**

Statutory Reserves

Statutory Reserves are such reserves which have been created, as per the statutory obligations.

A Word of Caution

"Exchange Fluctuation Reserve" or "Reserve for Foreign Exchange Losses", or "Bad and Doubtful Debts Reserve" should be treated as 'Provisions', and must be shown under the head "Current Liabilities and Provisions", instead.

(b) Surplus

Surplus is the balance amount of the entire retained earnings which has not been earmarked for any specific expenditure. That is, after allocating the amount of retained earnings to the various items of Revenue Reserves and Capital Reserves, the amount still remaining, in balance, is know as the Surplus.

Buy Back (Purchase) of its Own Share by the Company

As provided under **Section 77 (1)**, a private or public company, limited by shares, or a company limited by guarantee having a share capital, could not buy back its own shares earlier. However, the Companies (Amendment) Act 1999, under **Sections 77A, 77AA and 77B**, as also the guidelines issued by SEBI in this respect, has since allowed the companies to purchase their own shares or other securities, but subject to certain conditions.

Secured Loans

The loan backed up by the charge on some of the borrower's tangible assets, in favour of the creditor, is known as the Secured Loan. Such charge is created by way of pledge and/or hypothecation (in respect of movable assets like the inventories, receivables and movable items of machinery) and/or mortgage (usually equitable mortgage) of immovable assets like land and building, plant and immovable items of machinery (imbedded to earth), etc.

Primary Security and Collateral (Additional) Security

Primary Securities comprise such items of the assets, on the basis of which the quantum of the working capital loan and/or the drawing power on the borrower's account, is determined, e.g., Stocks of inventories and Sundry Debtors. Similarly, the value of the fixed assets, like the items of machinery, which determine the quantum of the term loan, are, accordingly, known as the primary securities.

Collateral (additional) Security

But then, the bankers, and even the other creditors may usually prefer to doubly secure the loan by way of primary as also by some additional security. [Such additional security is called the "Collateral Security" in India. But, in the United States, the primary security itself is termed as the "Collateral".]

41.7 Types of Secured Loans

41.7.1 Term Loans

Term loans are usually granted by way of secured loans, that is, against some tangible security, usually for the purchase of fixed assets, like plant and machinery, land and building, etc. Further, term loans are granted, for a fixed term or period, ranging from three years to five years or seven years, or even more. And, these are required to be repaid also, in pre-determined instalments, over a period of time, and out of the surplus generated with the use of the tools of business (production), i.e. the items of fixed assets financed against.

41.7.2 Working Capital Loans (Also Known as Short-term Loans)

Working capital loan is in the nature of short-term loan. It may be shown just as secured loan (or even unsecured loans, as the case be) and, consequently, may not be included in the amount of current liabilities, shown in the balance sheet. Therefore, while analysing the balance sheet and reclassifying the various items of liabilities, we may have to add back the amount of working capital loan to the total current liabilities. Similarly, the amount of instalments, with interest, payable on term loans within 12 months from the date of the balance sheet, will also have to be included in the current liabilities. But, for finding out such information, we may have to look to the respective schedules of the balance sheet or else, we may have to call for further break-ups from the company.

41.8 Equitable Mortgage

In view of the fact that the stamp duty, exigible on the documents pertaining to an equitable mortgage is nominal (in that these are required to be stamped only as a simple agreement), usually only such (equitable) mortgage is created. The registered mortgage, however, is required to be stamped ad valorem (i.e. according to the value of the document – the debenture deed), which may come to a very huge amount. Besides, as equitable mortgage executed by the companies can be got registered with the Registrar of Companies, it has the effect of having a public notice, like in the case of the registered mortgage.

41.9 Unsecured Loans

As against secured loans, the unsecured loans are such loans against which no tangible security has been charged to the bank or to the financial institution or, to any of the creditors, like the promoters of the company, or their friends and relatives, etc.

41.9.1 Types of Unsecured Loans

(a) Public Deposits,
(b) Unsecured Loans from Promoters,
(c) Inter-Corporate Loans, and
(d) Unsecured Loan from Commercial Banks and Term Lending Institutions.

41.10 What is a Debenture?

Section 2 (12) says that 'Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the company's assets or not'. As described by Chitty, J., 'debenture means a document, which either creates a debt or acknowledges it, and any document which fulfils either of those conditions is a debenture'.

Palmer describes the debenture as 'any instrument under seal, evidencing a deed, the essence of it being the admission of indebtedness'.

41.11 Characteristic Features of a Debenture

On the basis of the aforementioned descriptions of a debenture, the following may emerge as the main characteristic features of a debenture:

(a) It is issued by a company and it is in the form of a certificate of indebtedness.
(b) It generally specifies the date of its redemption (repayment). It also provides for the repayment of the amount of the principal and interest, at the specified date, or on the dates on which each instalment will be payable.
(c) It generally creates a charge on the assets of the company or the undertakings of the company. Generally, the term '*pari passu*' is written in the terms and conditions of debentures. It means that all the debentures of a particular category will receive the money proportionately in the cases where the company is not able to discharge its whole obligation thereon. However, in the absence of such clause, the debenture holders would rank according to the rank of the issue, and if issued on the same date, then, in the order of time when they were issued (which is refereed to as 'by the serial number of the debentures').

41.12 Debenture Stocks

A company, instead of issuing separate debentures individually to the debenture holders, evidencing separate and distinct debts, may create one consolidated loan fund known as the 'debenture stock'. Such 'debenture stock' is divisible among a class of lenders, each of whom is given a debenture stock certificate, each evidencing a part of the whole loan to which he is entitled to receive the repayment.

Such debenture stock is analogous (partly similar) to the loan stock of the Government and local and public authorities. Such debenture stock is then the indebtedness itself, and the certificate evidences the stockholder's interest in it. Thus, while a debenture certificate is a single thing, which can be legally transferred only as one single entity, the debenture stock, instead, can be sub-divided and transferred in any fraction at the desire of the holder of the debenture stock. Further, while the debenture stock should invariably be fully paid, the debenture certificate may or may not be fully paid

41.13 Debenture Capital

As against the equity shareholders, who are considered to be the owners of the company (though just notionally), the debenture holders are considered to be the company's creditors, instead. That is, while the share capital

constitutes the owners' equity, the debenture capital is like the funds lent to the company at an agreed rate of interest, and re-payable after the stated and agreed period, say, after the expiry of the 6th, 7th and 8th year, from the date of allotment, in the ratio of say, 35%, 35%, and 30%, respectively. Thus, the debentures are usually issued for raising long-term debts. Besides, the company has the legal obligation to pay the amount of interest at the specified rate, and on the specified time, and redeem the debentures on the due date(s). There is, however, no such legal obligation on the part of the company, to pay the dividends on its shares, both equity and preference shares.

However, as in the case of equity and preference shares, debentures can as well be issued by way of:

(i) Public Issue,
(ii) Private Placement, and on
(iii) Rights Basis.

41.14 Types of Debentures

There are, generally, three main types of debentures on the basis of their convertibility (or otherwise) into equity shares. They are:

(a) Fully Convertible Debentures (FCDs),
(b) Partly Convertible Debentures (PCDs), and
(c) Non-Convertible Debentures (NCDs).

(a) Fully Convertible Debentures (FCDs)

As the name itself suggests, the fully convertible debentures, as per the agreement, may be compulsorily and necessarily converted into equity shares at a pre-stated price, as contained in the issue documents. There may also be cases where the conversion into equity shares may be at the option of the debenture holders, after the expiry of the stated period but, of course, some time within the stipulated time frame, thereafter. It could be say, any time between three and five years after the date of the issue, but within say, three months from the date of such announcement by the company, to be made between three and five years, as aforesaid.

For example, BSES Limited (now Reliance Energy) had issued fully convertible debentures of the face value of Rs 140, which were to be compulsorily converted into two equity shares of the face value of Rs 10, at a premium of Rs 60 each (i.e. at the cost of Rs 10 + Rs 60 = Rs 70), after the expiry of say, two years and three years respectively, from the date of the issue of the debentures. Thus, on the expiry of two years, Rs 70 (out of Rs 140), got converted into one equity share of the face value of Rs 10, and the balance amount of Rs 60 was credited to the share premium account. Thus, while dividend was, thereafter, payable on the equity share of Rs 10, interest was payable on the balance amount of Rs 70 only.

And, on the expiry of the third year, the balance amount of Rs 70 also got converted into one equity share of the face value of Rs 10, at a premium of Rs 60. And, thus, the entire amount of Rs 140, comprising the fully convertible debentures (FCDs), got repaid and satisfied in full, and all the debenture holders had now become the shareholders of the company, to the extent of two shares of the face value of Rs 10 each, against the holding of one FCD of Rs 140.

Some company may prefer to issue fully convertible debentures (FCDs) leaving the option of conversion in full, or in part(s), or not at all, on the debenture holder himself. The triple option convertible debenture (TOCD), issued by the Reliance Petroleum Limited (RPL) [since merged with the Reliance Industries], is a recent example in point. One debenture of the total amount of Rs 60 was issued, out of which two shares were to be issued after expiry of certain period, in two instalments of one share each, of the face value of Rs 10 each, at par. The balance amount of Rs 40 was to be converted into two shares, at a premium of Rs 10, each, at the triple options of the debenture holders. That is, the debenture holders had the following three options:

(a) To get the entire Rs 40 converted into two equity shares, at a premium of Rs 10 each, or

(b) To get one share for Rs 20 and retain the balance amount of Rs 20 as the non-convertible portion of the debenture, or even

(c) To retain the entire Rs 40 as a non-convertible portion of the debenture.

Here, as you may recollect, when the time came for the conversion of Rs 40 into equity shares, the market price, prevailing at the material time, was around Rs 12-14 only. Under the circumstances, no sane person would have opted for conversion of the debentures into equity shares @ Rs 20 each. The company, therefore, prudently decided, and got it approved in the general meeting of the debenture holders and share holders, that the Rs 40 would now get converted into three equity shares (at an average price of Rs 13.33 each) instead of only two, as was announced in the issue documents earlier. All the other aforesaid three options, and the conditions, however, had remained unchanged.

(b) Partly Convertible Debentures (PCDs)

Partly Convertible Debentures (PCDs) are usually issued in two parts, viz.,

(i) Convertible Portion (Marked Part-I or Part-A) and

(ii) Non-Convertible Portion (Marked Part-II or Part-B)

Further, mostly Part-A, the convertible portion, comprises Debenture-Cum-Share Certificate, wherein it is specifically stated that upto the specified date, the instrument will be treated as the debentures (of specified number and prime value e.g., 10 PCDs of Rs 100 each). And, at the lower portion of the document (Debenture-Cum-Share Certificate), it is specifically stated that with effect from the stipulated date, the certificate will be treated as the share certificate, instead, comprising two shares of the face value of Rs 10, on conversion of Rs 100 PCDs, at a premium of Rs 40 each, as had been stipulated in the issue documents.

Further, the Non-convertible Portion (Part-II or Part-B) throughout remains Non-convertible. That is, it is not converted into equity shares at any stage. It is, instead, redeemed after the specified period like after the 6^{th}, 7^{th}, and 8^{th} year in the ratio of 35%, 35%, and 30% respectively, or @ $1/3^{rd}$ portion (33.33%) each year, etc.

For example, Ranbaxy Laboratories Limited had issued in early 1990s, PCDs of the face value of Rs 200 each, comprising Part-A, and Part-B (i.e. convertible and non-convertible portions) of Rs 100 each. And, on the expiry of two years, the convertible portion was compulsorily converted into two shares of the face value of Rs 10 each (at a premium of Rs 40). The relative portion A of the certificate was issued in the nature of Debenture-Cum-Share Certificate, as discussed in the foregoing paragraphs, and with effect from the specified date, the same certificate was to be treated and traded as share certificates of the corresponding number of shares.

The second portion (Non-convertible Part), however, was redeemed after the expiry of the stipulated period, but at par, as the Non-convertible portion had been issued at "nil" or "zero" coupon (interest) rate. Even then this rights issue was substantially over-subscribed, by the existing shareholders, because they were very well rewarded in the form of equity share itself, at a nominal premium of Rs 40 only, when the (market) price of the equity share in the stock markets were being quoted at a much higher level at around Rs 700 each. However, as on the 15 May 2009, these shares were being quoted at Rs 199.80.

(c) Non-Convertible Debentures (NCDs)

The Non-convertible Debentures (NCDs), as the name itself suggests, is not converted into equity shares at any stage.

These are, instead, redeemed after the given period in the stipulated percentage at each stage, as per the issue documents, as has already been discussed earlier, while dealing with the non-convertible portion of PCDs.

It may be pertinent to mention here that the popularity and acceptability of the issues of FCDs, PCDs, and NCDs are usually in that order, whereby the FCDs are most popular and the NCDs are the least popular. This is so because, while the companies of good standing and repute, issue the FCDs and PCDs, at very attractive conversion terms, the NCDs do not have any provision for their conversion into equity shares.

Therefore, to make the NCDs somewhat attractive, the companies quote somewhat higher rate of coupon (interest) for them. The companies, however, prefer to issue NCDs for the undernoted main reasons:

(i) The risk of dilution of control of the existing major shareholders is completely avoided; and
(ii) The EPS (Earning Per Share) of the company's equity shares do not get adversely affected.

To add some sugar coating to the bitter "pill" (NCDs), some companies had resorted to an innovative way of giving detachable warrants, along with the NCDs, which could be exchanged for a stated number of the company's equity shares, at the specified price, after the expiry of a stipulated period. For example, Flex Industries had offered one such detachable warrant with every NCD. It, however, is an altogether different story that such detachable warrants were not found to be attractive enough to be exchanged for the equity shares, inasmuch as the market price of these shares had crashed to a much lower level at the material time.

41.14.1 Some Salient Features of Debentures

(a) Security
Debentures are usually issued against the security of the charge created by way of an equitable mortgage of the company's immovable properties, both present and future.

(b) Trustee
At the time of the issuance of the debentures, a trustee is appointed, by executing a Trust Deed, with a view to safeguarding the interests of the debenture holders, and ensuring that the investors may get the amount of interest periodically and regularly, and on time, and that the principal amount, too, is duly paid as and when it may fall due.

And, generally, the Commercial Banks, Insurance Companies, or Financial Institutions are appointed as the trustee and a mention to this effect is also made in the issue documents.

(c) Debenture Redemption Reserve (DRR)
With a view to further safeguarding the interest of the general public, investing in the debentures, the companies are required to create a Debenture Redemption Reserve, too, with at least 50% of the amount of the issue, before the process of redemption actually commences. This, however, is required to be done only if the maturity period of the debenture happens to be more than 18 months.

(d) Rate of Interest (or Coupon Rate)
The debentures are usually issued at a fixed pre-determined rate of interest, which is also referred to as the coupon rate. Earlier, a ceiling on the coupon rate used to be stipulated by the Union Ministry of Finance. But now, no such restrictions exist and the companies are free to stipulate the coupon rate at their own and sole discretion. But then, any prudent company would quote only a reasonable coupon rate, keeping in view the prevailing market conditions and forces, obtaining at the material time.

In some cases, the coupon rate may be "nil", too. For example, as has already been discussed earlier, Ranbaxy Laboratories Limited had issued, on rights basis, Partly Convertible Debentures (PCDs) of Rs 200 face value, wherein the non-convertible portion (Part-B) did not have any coupon rate. But, even then, the PCDs were fully subscribed (in fact, were highly over-subscribed) because the convertible portion of the PCDs had a very attractive term of conversion; that the Rs 100 was to be converted into two shares at an average price of Rs 50 only (Rs 40 being the amount of premium), when the prevailing market price, at the material time, was many folds higher, at around Rs 700. Thus, the investors (existing shareholders) were well rewarded and, therefore, they did not mind the "nil" coupon rate on the Non-convertible portion of the Debentures (PCDs).

(e) Fixed or Floating Coupon Rate
Generally, the coupon rate is fixed and stipulated in the issue documents. But, in some cases, it may be kept floating, periodically rising and falling with some other benchmark rate, like the Bank Rate, State Bank Advance Rate, or a certain percentage higher than the Bank's highest term deposit rate, etc. For example, it was the State Bank of India, which had issued unsecured, redeemable floating interest rate

bonds, for the first time in the year 1993. Such bonds were in the nature of Promissory Notes and the interest thereon was made payable annually at 3% above the bank's maximum term deposit rate.

(f) Period of Maturity

A company, as of now, is completely free to stipulate any maturity (redemption) period. Earlier, however, the average maturity period for Non-convertible Debentures could not be more than seven years. For example, it could be made redeemable after five, six and seven years, in the ratio of say, 35%, 35%, and 30% respectively. Such restrictions, however, have since been lifted.

41.14.2 Various Variations of Debentures

(a) Deep Discount Bonds

For example, the Small Industries Development Bank of India (SIDBI) had, in the year 1992, issued Deep Discount Bonds with the following features:

Face Value of each Bond	Rs 1 lakh
Issue Price	Rs 2, 500 only
Maturity Period	25 years
[From the date of allotment (i.e. 01.02.1993)]	

Descriptions	*Amount (Rs)*	*At the End of Years*
Options available to both the investors	5300	5
and the SIDBI to withdrawn or redeem	9600	9
respectively, at the end of the specified	15300	12
period(s) at the specified maturity	25000	15
(redeemed) value(s).	50000	20

(b) Warrant Attached with NCDs

In view of the fact that the Non-Convertible Debentures (NCDs) are generally not found to be attractive enough by the prospective investors, some companies issue one detachable warrant with each NCD, or one such warrant against every two NCDs. These warrants could be got converted into company's equity shares, at par, after certain specified period (say, after three years) but within some specified period of say, three months, from the date of such announcements made by the company.

For example, Flex Industries had issued NCDs, along with one detachable warrant each, entitling the investors to apply for one equity share of the company, at par, within a period of say, three months after the announcement on this behalf were made by the company. And, such announcement was to be made by the company after say, three years, but well within a period of 5 years, from the date of allotment of such NCDs.

[The fact that, at the material time, the market price of the share of the company had fallen far below par value (face value) and consequently no prudent debenture holder must have exercised the option, is quite a different matter].

(c) Optional Convertibility:

Some companies issue debentures with the provision that these could be converted into shares, after the expiry of a specified period and in the pre-specified ratio, as stated in the issue documents, but at the sole option of the debenture holders.

For example, the Straw Products Limited, in the year 1981, had issued 12% secured convertible debentures of Rs 500 each. Here, the investors were given the option to seek conversion of the debentures into a certain number of equity shares of the company, during a specified period, but at their own sole discretion, to opt for or against it.

The TOCD (Triple Option Convertible Debenture) issued by the erstwhile Reliance Petroleum Limited (RPL), as previously mentioned, is one of the most recent examples.

41.15 Debenture Trust Deed

A public issue of debentures involves a large number of debenture holders, and all those who subscribe to the issue are the creditors of the company. Accordingly, it is not possible for them to get a separate charge registered with the Registrar of Companies for every debenture holder separately. Therefore, the most common, convenient and feasible method of securing them all is to execute a 'trust deed' conveying the property of the company to the trustees and declaring a trust in favour of the debenture holders. A trust deed normally grants the trustees a fixed charge over the company's freehold and leasehold properties, and a floating charge over the rest of the property of the company. Such trust deed contains the terms and conditions, endorsed on the debenture certificates and specifies the rights of the debenture holders and the company. A trust deed normally contains clauses giving the trustees the following powers:

(a) To take a mortgage over the company's property. This way, the title deeds in respect of such mortgaged property are transferred to them (morgagees) and the company is thereafter prevented from creating any further charge over them (properties), ranking in priority to the debentures,
(b) To sell or lease the property and to renew the leases,
(c) To exchange the mortgaged property for any other suitable property,
(d) To modify the subsisting (existing) contracts applying to any part of the property,
(e) To compromise claims,
(f) To commence and defend actions, and
(g) To appoint a receiver on the security becoming enforceable.

41.15.1 Advantages of Debenture Trust Deed

(a) It becomes the function of the trustees to watch the interest of the debenture holders. The trustee are bound to act honestly and with due care and diligence. In fact, any clause in the trust deed, exempting them from the liability of the breach of their aforementioned duties as trustees, or which indemnifies them against such liability is void.
(b) The trustees have a legal mortgage over the company's property, such that the persons who subsequently lend money to the company cannot gain priority over the debenture holders.
(c) If and when the company makes a default in this regard, the trustees can take action for enforcing the security on behalf of the debenture holders.
(d) The trustees can ensure that the property charged is kept insured and properly maintained, as it would not be possible for a large and fluctuating body of the debenture holders to do so.

41.15.2 Appointment of Debenture Trustees (Section 117B)

A company, before the issue of a prospectus or a letter of offer to the public for subscription of its debentures, is required to fulfil the following conditions:

(a) To appoint one or more debenture trustees for such debentures to protect the interest of the debenture holders, and
(b) To write on the face of the prospectus or a letter of offer that the debenture trustees have given their consent to be appointed as the debenture trustees.

41.15.3 Debenture Redemption Reserve (DRR) [(Section 117 C]

After the commencement of the Amendment Act 2000, the company is required to create a 'Debenture Redemption Reserve' (DRR) for the redemption (repayment) of such debentures as and when these may fall due. For this purpose, the company shall credit to the DRR account sufficient amounts from out of the profit every year till such time the debentures are fully redeemed. Further, the DRR accounts shall be utilised by

the company only and exclusively for this purpose (i.e. for the timely redemption of the debentures periodically). The company shall pay the periodical interest and redeem the debentures according to the terms and conditions of its such issue.

41.15.4 Failure to Redeem the Debentures

If a company fails to redeem the debentures on the due date(s), any or all the debenture holders can make an application to the Company Law Board (CLB). The Company Law Board (CLB), in turn, after hearing the parties concerned, may direct the company by its order to redeem its debentures forthwith by paying the amount of the principal and interest due thereon.

Every officer of the company, who is in default, shall be punishable with imprisonment, which may extend up to three years, and shall also be liable to a fine which shall not be less than Rs 500 for every day during the period the default continues.

41.15.5 Remedies for Debenture-holders

In the case of a default by the company in repayment (redemption), the remedies for the debenture-holders depend on the fact whether he is secured or unsecured. This is so because, the right debentures for the maturity period of upto 18 months can be issued without any security charged there-against (i.e. unsecured debentures). Thus, the unsecured debenture holders are in exactly the same position as the other unsecured creditors are. Thus, the security charged against the secured debentures cannot be accounted for the discharge (repayment) of such unsecured debentures. But then, the unsecured debenture holders also can sue the company for the repayment of the principal and interest on their debentures, and can also file an application in the Court for the winding up of the company and prove his debt as the unsecured creditors of the company.

As against this, the secured debenture holders (i.e. where the trust deed has been executed) enjoy both the above mentioned rights, as the unsecured debenture holders enjoy, but in addition thereto, the secured debenture holders also enjoy the following other legal rights:

(a) **Sale of Assets**
Usually, one of the express terms and conditions of the debentures or the debenture trust deed is that the trustees have the powers of sale of the property charged against the secured debentures. However, if no such power is given in the debentures or the debenture trust deed, an application may be filed in the Court for an order to sell the property of the company for the purpose of repayments of the debentures.

(b) **Foreclosure**
The trustees may file an application in the Court for an order of 'foreclosure'. The effect of such order of foreclosure will be that the borrower's interest in the assets charged is completely extinguished, and the lenders become the owners of those property. But, for filing an application of foreclosure, it is necessary that all the debenture holders of the class concerned join hands. **[Wallace vs Evershed (1899) 1 Ch. 89]**.

(c) **Appointment of a Receiver**
In the cases where there is a trust deed, it (trust deed) usually provides that the trustees may appoint a Receiver. If no such power is given, an application may be filed in the Court, in the debenture action, to appoint a Receiver. And, on appointment of a Receiver, the assets become specifically charged in favour of the debenture holders, and the power of the company to deal with these properties in the ordinary course of business comes to an end (ceases). However, the company continues to exist till the time it is wound up.

41.15.5.1 Where no Trust Deed has been Executed

Where no trust deed has been executed, in favour of the debenture holders, a debenture holder may, on

default in the payment of principal or interest, bring an action (referred to as the 'debenture holders' action') on behalf of himself as also on behalf of the other debenture holders of the same class, praying for the following remedies:

(a) A declaration to the effect that the debentures have a charge on the assets of the company,
(b) An account of what the company owes (is required to repay) to the shareholders; the amount of assets; prior claims; and so on,
(c) An order of foreclosure or sale, and
(d) The appointment of a Receiver.

If a debenture holder owes a debt to the company, which is insolvent; the debenture holder cannot set off his debt against the liability he owes to the company. The rule is that a person who claims a share in the funds must first repay every thing he owes to the fund before he can claim a share in the fund. **[Re Brown and Gregory Ltd (1904) 1 Ch. 627].**

41.16 Investments in Company's Own Name

As provided under **Section 49**, all the invests made by a company on its behalf must be made in its own name. However, there are certain exceptions made to this rule.

41.17 Borrowing and Power to Borrow

The power to borrow, whether express or implied, includes the power to charge the assets of the company as a security against secured advances (borrowings) to the lenders of the money.

The Act does not expressly empower the companies to borrow money. Thus, most of the companies expressly make provisions for such borrowing power in the Memorandum of Association. In such cases, where its Memorandum of Association authorises the company to borrow, the Articles of Association provides for the method as to how to borrow money, and by whom such powers will be exercised. It may also fix the maximum amount that can be borrowed by the company. The maximum amount to be borrowed, may be enhanced, if such need arises, by getting a special resolution passed to this effect.

But a public company cannot borrow any amount unless it has been issued the certificate to commence business from the Registrar of Companies, in addition to the certificate of incorporation (from the Registrar of Companies). [(**Section 149(1)**]. A private company, however, can borrow immediately after securing the certificate of incorporation from the Registrar of Companies.

The power to borrow money is usually exercised by the directors of the company. However, the Articles of Association provides for certain restrictions on their borrowing powers. (**Section 293**).

41.17.1 *Ultra Vires* Borrowings

Any borrowing by the company will be declared as *ultra vires* in the cases where the company borrows money without any power to borrow, or when it borrows money more that its power to borrow, in contravention of the provisions made in the Memorandum of Association and the Articles of Association. Thus, all such loans are considered null and void and such lenders lose their rights to take any legal action against the defaulter companies. However, certain remedies are available to such (negligent) lenders.

41.17.2 *Ultra Vires* the Directors, not Company

But then all such loans are considered *ultra vires* the directors only, but are considered *intra vires* (i.e. valid) against the company. That is, if the borrowing is in excess only of the powers of the directors, but not of the company, for example, where the Articles of Association provide that the directors will have power to borrow

only up to the extent of Rs 10 lakh (and for borrowing in excess of this mount, prior approval of the shareholders must be obtained in the general body meeting), any borrowing beyond the amount of Rs 10 lakh, without such approval of the shareholders, shall be ultra vires the directors but not the company. This irregularity can be ratified and rendered valid by the company, by obtaining the required approval of the shareholders in the general body meeting. And, if ratified by the shareholders in the general body meeting, such loan shall become perfectly valid and, accordingly, binding on the company.

However, even if the company refuses to ratify the action of the directors, in obtaining the excess loan, the 'doctrine of in-door management' shall protect a lender, provided he (lender) can establish that he had advanced the money in good faith. The company may, in turn, prefer to proceed against the directors and claim indemnity.

41.18 Registrations of Charges (Section 125)

A company, which has power to borrow money, is also empowered to charge its assets to the lender, but subject to any limitation in its Memorandum of Association and the Articles of Association. Even the uncalled capital may be charged, but for this purpose the Articles of Association of the company must give the powers, and there must be nothing in the Memorandum of Association of the company to the contrary.

Moreover, as provided under **Section 125**, the following charges must necessarily be registered with the Registrar of Companies within 30 days after the date of their creation:

(i) A charge for the purpose of securing any issue of debentures.
(ii) A charge on uncalled share capital of the company,
(iii) A charge on any immovable property of the company, like its land and building, plant and machinery embedded to earth,
(iv) A charge on any book debt of the company,
(v) A charge, not being a pledge, on any movable property of the company,
[But it may be noted in this regard that the Act does not prohibit the registration of the charge created even by way of pledge].
(vi) A floating charge (known as the charge by way of 'hypothecation') on the undertaking (company) or any property of the company, including stock in trade (i.e. its raw materials, work in-process, finished goods, and consumable stores and spares).
(vii) A charge on the call made on the partly paid shares, but not paid after being called (i.e. asking the shareholders to deposit the next instalment on the partly paid shares when due).
(viii) A charge on a ship, or any share in the ship, and
(ix) A charge on goodwill, or a patent or a license under a patent, or a trade mark or a license under a trade mark, or a copy right or a license under a copy right.

However, the Registrar of Companies may allow the registration of a charge within the next 30 days, after the expiry of the first 30 days allowed, as aforementioned, but on the payment of a specified additional fee, provided the company is able to satisfy the Registrar of Companies that it had sufficient cause for not filing the required particulars or instruments (documents) and so on, within the initial specified period of 30 days.

41.18.1 Who should Register the Charge?

It is the duty of the company to send the required particulars or instruments (documents), as abovementioned, to the Registrar of Companies for the purpose of the registration of the charge within the stipulated 30 days of the creation of the charge in question. But then, even the creditors can send the required particulars or instruments (documents), as abovementioned, to the Registrar of Companies for the purpose of the registration of the charge within the stipulated 30 days of the creation of the charge in question. In such cases, the creditors can recover the registration charges, paid by them, from the company. (**Section 134**).

41.18.2 Effect of Non-Registration

In the cases where the charge has not been registered with the Registrar of Companies, within the prescribed period of 30 days from the date of its creation, it will have the following effects (legal ramifications):

(i) The charge becomes void, against the liquidator and any creditor of the company [**Section 125 (1)**]. However, the charge shall not be void against a purchaser of the property charged. [**State Bank of India vs Vishwanirayat (Private) Ltd (1987) 3 Comp. L.J. 171 (1989) Comp. Cas. 698].**

(ii) The debt, in respect of which the charge has been created, always remains valid. But it can be recovered only as an unsecured loan, and not as a secured loan. **[Section 125 (2)]**.

(iii) The money secured thereby becomes payable immediately. [**Section 125 (30].**

(iv) The company and every officer responsible may be subjected to a penalty up to Rs 500 for every day during which the default continues. [**Section 142 (1)**].

41.18.3 Date of Notice of Charge (Section 126)

In the cases where any charge on any property of a company, which is required to be registered under **Section 125**, has been so registered, as required, any person, acquiring such property of the company, or any part thereof, or any share or interest therein, shall be deemed to be having the notice of the charge as from the date of such registration with the Registrar of Companies.

41.18.4 Register of Charges to be Kept by the Registrar of Companies (Section 130)

The Registrar of Companies will arrange to keep a register in respect of each company, containing all the charges requiring registration, in respect of that company at one place, to facilitate the search in the respective register(s), on payment of the required fees for the search. The following particulars will be recorded in the register:

(i) The date of creation of the charge,
(ii) The amount secured by the charge,
(iii) Brief particulars of the property charged, and
(iv) The persons entitled to the charge.

In the case of the charge in regard to the debentures, keeping in view the benefits that a series of the debenture holders are entitled to, the following particulars must be registered:

(i) The aggregate (total) amount secured by the whole series of debentures,
(ii) The dates of the resolutions authorising the issue of the series of debentures, and the date of respective covering debenture deed, if any, by which the security is created or defined,
(iii) A general description of the property charged,
(iv) The names of the trustees, if any, of the debenture holders, and
(v) The amount or rate percentage (percentage of rate) of the commission or discount, if any, paid to any person subscribing or procuring subscriptions for any debentures of the company. (**Sections 128 and 129**).

The register so kept by the Registrar of Companies shall be open for inspection by any person on payment of the fee prescribed for every inspection.

41.18.5 Equitable Mortgage

The charge created by the company, created by way of an equitable mortgage in favour of the creditors, is also required to be registered with the Registrar of Company, which has the effect of a public notice of the charge so created by the company.

41.18.5.1 Why Equitable Mortgage?

The rationale behind creation of the charge by way of an equitable mortgage lies in the fact that the stamp duty exigible on the documents pertaining to an equitable mortgage is nominal, in that these attract the stamp duty only as a simple agreement. As against this, the documents pertaining to the registered mortgage are required to be stamped *ad valorem* (i.e. according to the value of the document – the debenture deed), which may come to a very huge sum, as the large scale companies usually issue debentures for a very large amount.

And, if we look at the relative advantage of the registered mortgage, it lies in the fact that such mortgage has the effect of a public notice, and thereby, any subsequent mortgage may not be held valid in the eye of the law. But then, in the case of limited liability companies, even the charge created by way of an equitable mortgage, has got to be reported to, and registered with, the Registrar of Companies, which, too, has the effect of a public notice. This is so because, all the creditors, before accepting any asset (movable and / or immovable) of a company as a security against the advance, are required to make a search in the books of the Registrar of Companies at his Office. This can be easily done just on the deposit of a nominal search fee, for the purpose. This is of a crucial importance so as to ensure that no prior charge has already been registered in regard to the movable and/or immovable assets and properties, now being offered by the company as a security against the current advance, now being granted to the company.

41.18.5.2 Steps and Procedures for Creating an Equitable Mortgage

The Directors of the Company, duly authorised on this behalf by the company, through a resolution to this effect, passed by the company, come to the office of the Branch Manager of the Bank, at the Branch concerned. They would then stand-up and actually hand over the relative title deed, in original, to the Bank Manager, stating that they are delivering the relative title deed to the bank on behalf of the company, with the intention of creating an equitable mortgage on the same, by depositing the title deed (usually original), for the purpose. And, the Bank Manager, in turn, stands-up and accepts the title deed, accordingly, and keeps it in his custody on behalf of the Bank.

The aforesaid act takes place in the presence of at least two witnesses, and all of them must be the Bank Officials only.

Why so? This is so, because, the whole episode is recorded in the Branch Document Register and is duly signed by the Bank Manager as also by the witnesses. And, as all these signatories are signing on behalf of the bank only, no stamp duty becomes exigible thereon, as it does not amount to an agreement, inasmuch as it has been signed by, and on behalf of, a single party. And, if it were to be signed by the witnesses belonging to both the bank and the borrower, it may have been construed as an agreement, and may have, therefore, to be stamped accordingly.

The borrower company is also required to hand over the title deed along with a title deed delivery letter, so as to evidence, in writing, that the title deed was actually delivered to the Bank Manager for the aforesaid purpose. Otherwise, the executives of the company may always have the option of taking the plea that the title deed was not actually delivered, but they had, by mistake, left the same at the Branch Manager's Office. And, in that event, the equitable mortgage may not be held valid, in the eye of law.

One stage ends here. And, the other begins. The Bank Manager, by way of an abundant precaution, also hands over a printed proforma letter, to be duly completed and signed by the Directors, on behalf of the company, and then to be posted later, per Registered Post, which, too, is recorded at the Branch of the Bank, along with the other relative documents.

This, too, is held as an evidence to prove that the equitable mortgage was created with the free will of the Directors, and that the Title Deed Delivery Letter was not got signed by them under duress, in which case the contract, as per the Contract Act, may be treated as void, *ab initio*.

And, by way of an additional and abundant precaution taken by the banks, the relative proforma has also since been got printed in the form of an Inland Letter, so as to incontrovertibly prove that the same letter had

been sent by the company's Directors, per Registered Post. Otherwise, if it were sent in an envelop, some unscrupulous companies may as well take the plea that some other letter (and definitely not the Title Deed Delivery Letter) was sent under the cover (envelop) in question, sent per Registered Post.

41.18.6 Certificate of Registration by the Registrar shall be Conclusive

The Registrar of Companies issues a certificate of registration of any charge registered with him, under his signature, stating the amount secured thereby. Such certificate will serve as a conclusive evidence and proof that the requirements of the Act, in regard to the registration of the charges, have been completed and complied with. The company, in turn, is required to endorse a copy of each such certificate of registration on every debenture or certificate of debenture stock, which is issued by the company, and the payment of which is secured by the charge so registered. A person who knowingly permits the delivery of any debenture or certificate of debenture stock without the required certificate of the registration endorsed upon it, shall be punishable with fine, which may extend to Rs 10,000 (**Section 133**). Here, it must be carefully noted that such endorsement of the charge shall be made on the debenture or certificate of debenture stock issued, before creation of the charge.

41.18.7 Modification of Charge (Section 135)

Whenever the terms or conditions, or the extent or operation, of any charge, registered with the Registrar of Companies, are modified, it shall be the duty of the company to send to the Registrar of Companies, the particulars of such modifications within 30 days. The particulars of modification are required to be filed in Form 8.

Further, under **Section 134**, a charge may be filed by the company or by any of the persons interested in the charge. But then, under **Section 135**, the modification of a charge can be filed only by the company, and none else.

41.18.7.1 What Constitutes a Modification

The term 'modification' includes variation (change) of any of the terms of the agreement, including the variation in the rate of interest, which may be by mutual agreement or by the operation of law. Even in the case where the rights of the charge holder are assigned to a third party, it will be regarded as a modification. Similarly, partial release of the charge on a particular asset or property, shall amount to the modification of the charge.

41.18.8 Memorandum of Satisfaction (Sections 138 to 140)

On payment or satisfaction of any charge, in full, the company must notify this fact to the Registrar of Companies within 30 days from the date of such payment or satisfaction. The Registrar of Companies, on receipt of such intimation from the company, shall arrange to send a notice to the holder of the charge in question, calling upon him to show cause within a time period specified in such notice (but not exceeding 14 days), as to why the payment or satisfaction should not be recorded in the Register of Charges, as intimated by the company to him (Registrar). And, if no cause is shown, the Registrar of Companies shall order that a memorandum of satisfaction shall be entered in the Register of Charges.

But, if the cause is shown, the Registrar of Companies shall record a note to that effect in the Register of Charges and shall inform the company that he has done so. The registrar may also record the memorandum of satisfaction, even if no intimation has been received by him from the company, on getting evidence to his satisfaction that any registered charge has been satisfied in whole or in part.

In the case where the Registrar of Companies enters a memorandum of satisfaction, as aforementioned, he shall furnish the company with a copy of the memorandum of satisfaction (**Section 140**).

41.18.9 Rectification of Register of Charges by Company Law Board

The Company Law Board has the power to extend the time for the registration of the charge or to order that the omission or misstatement in the Register of Charges be rectified.

The persons, who may apply to the Company Law Board for passing such an order, are the company or any interested person. The Company Law Board, however, has to be satisfied that the failure to register the charge or the omission or misstatement –

(i) Was accidental, or
(ii) Was due to inadvertence or some other sufficient cause, or
(iii) Is not of a nature that may prejudice (adversely affect) the position of the creditors or shareholders of the company, or
(iv) That on other grounds, it is just and equitable to grant relief.

In the cases where the Company Law Board extends the time for the registration of a charge, such order shall not adversely affect (prejudice) any rights acquired in respect of the property concerned before the charge is actually registered.

41.18.10 Company's Register of Charges (Section 143)

Every company must keep, at its registered office, a register of charges, and enter therein all the charges specifically affecting the property of the company, and all the floating charges on the undertaking, or on any property of the company giving in each case the following details:

(a) A short description of the property charged,
(b) The amount of the charge, and
(c) The names of the persons entitled to the charge.

If any officer of the company knowingly omits or wilfully authorises or permits the omission of any of the aforementioned entries, he shall be punishable with a fine which may extend to Rs 5,000.

41.19 Fixed and Floating Charges

41.19.1 Pledge and Hypothecation: A Comparison

(i) Fixed (specific) vs Floating (fluid, fluctuating, changing) Charge

As against pledge, in which case the charge is specific and fixed (i.e. it relates to only those specific items of goods actually pledged), the charge of hypothecation is in the nature of a floating charge, in that all the goods that are stored and stocked in the company's godown(s) or factory premises, etc., or even in transit, automatically get charged (hypothecated) to the creditors like banks, and the moment these stocks are taken out of the company's godowns, factory premises, etc., and/or from the possession of the company, such goods automatically get released, and are, accordingly, deemed to be out of the charge (of hypothecation) of the creditors like banks, too.

Thus, the various items of the goods keep going out and fresh items of the goods keep coming in, and the moment such goods come in, these get automatically charged, by way of hypothecation, to the creditors like banks. Similarly, the moment these goods go out of the possession of the company, these also get out of the hypothecation charge of the creditors like banks, simultaneously. Thus, as the actual (specific) stocks of goods, this way, keep changing and are turned-over, the charge of hypothecation is referred to as the floating charge, an ever-changing charge, over the ever-changing items of goods and stocks.

As we have seen earlier, while the charge, in respect of pledge is fixed and specific, in terms of the specified goods pledged, the charge in respect of hypothecation keeps floating, fluctuating and changing, with each and

every 'entry' and 'exit' of the goods. The hypothecation charge, thus, keeps shifting and changing over, with each and every event of the turnover of the goods.

(ii) Sale of Goods Pledged vs Hypothecated

In the case of the goods pledged against advances, the pledgee has the lawful right to sell the goods pledged, without obtaining specific prior permission of the Court, in the event of the pledgor failing to pay the debt, in time. Thus, in the case of pledge, the pledgee can sell the goods pledged, after giving a reasonable notice of such intended sale to the pledgor (as per **Section 176 of the Indian Contract Act**). The pledgor, however, in turn, has the right to redeem (vide **Section 177 of the Indian Contract Act**).

But, as against this, in the case of hypothecated goods, these cannot be sold off, to recover the outstanding in the loan account, without prior specific written order of a competent Court, on this behalf. The sale of the hypothecated goods, without the Court permission, may, however, become possible and permissible, provided the charge of hypothecation itself is got converted into the charge of pledge, instead, by the simple act of the delivery of a pledge letter, duly signed by the borrower concerned, to this effect.

But then, a defaulting and recalcitrant borrower may usually be most unwilling to sign such letter of pledge, so as to convert the charge of hypothecation into that of pledge, inasmuch as this is, obviously, going to be against his own 'interest'.

In such cases, however, some 'prudent and pragmatic' creditors like banks, if we may say so, have acted smartly (or have over-acted, over-smartly) by forcing the borrower, under coercion, to per force sign the letter of pledge, knowing full well that an agreement, signed under pressure, or threat, makes such an agreement as voidable (not void *ab initio),* i.e. at the option of the party whose consent was so caused (vide **Section 19 of the Indian Contract Act**). But then, such agreement may turn voidable, and be treated as void, only and only after it is proved to have been obtained under coercion (i.e. under threat and/or undue influence).

(iii) Priority of Pledge over Hypothecation

As per the provisions of law, the charge of pledge, created subsequently, after the creation of the charge of hypothecation, may have the priority and preference thereto (though created afterwards) provided, of course, that the pledgee did not have the knowledge and notice of the prior charge of hypothecation.

(iv) Registration of the Charge(s) of Hypothecation

Under **Section 125 of the Companies Act,** the charge of hypothecation of stocks of inventories and book debts [as also of equitable mortgage, created by the deposit of the title deed (usually in original) of the immovable property charged], must be registered with the Registrar of Companies, within 30 days from the date of the creation of the charge. The application, along with the relative legal agreement documents, needs to be filed in the office of the Registrar of Companies concerned. Such application can, however, be filed either by the borrower or by the creditor (banker) concerned.

Such registered charges may as well be got vacated, but such application, for the vacation of the registered charge, can be filed only by the borrowing company, and not by the creditor concerned.

Here, it must be observed and emphasised that, as per the requirement of the law, the application, for the registration of the charge, along with the relevant documents, must be filed with the Registrar of Companies within the stipulated time, and it is not necessary that it should be actually recorded and registered by the Registrar of Companies in his books, and/or a certificate of such registration must be issued by the Registrar of Companies, within such stipulated time itself. Just the act of filing, within the stipulated (30 days) time, is good enough.

Such application, along with the copies of the relative documents creating the charge, along with the brief particulars thereof, is to be submitted on Form-8, in triplicate.

[It may, however, be pertinent to mention here that the application for the modification of the charge, or the satisfaction of the charge, is required to be submitted on Form-10 and Form-17, respectively, in triplicate.]

Further, the registration of the charge, created by way of pledge of movable items of goods and/or movable items of machinery, is not statutorily compulsory, though it is permissible, all the same. The words used in the Act are 'not being a pledge', which implies that the intention of the framers of the law was that such registration

(of pledge) should not be necessary, inasmuch as the creditor, in such a case, happens to be in the possession of the goods charged (pledged).

(v) Date of Notice of the Charges

The date of the execution of a charge (i.e. the date of the signing of the relative documents) is the date of creation of the charge, for the purpose of computing the time for its registration, prescribed by **Section 125 of the Companies Act**.

(vi) Priority between the Charges of Hypothecation

If the charge has been executed earlier to another charge, but had been got registered afterwards (of course, within the prescribed time limit of 30 days), such a charge (executed earlier) will have the priority over the other; it having been registered subsequently, notwithstanding.

For example, suppose that the charge of hypothecation is executed by ABC Company on 1st July 2009 in favour of one creditor, and again subsequently on 21st July 2009 in favour of yet another creditor, and if these were filed for registration on 27th and 23rd July 2009, respectively, the charge executed on 1 July 2009 will have the priority over the charge executed on 21st July 2009, though the charge dated 1st July 2009 was filed for registration, subsequently, i.e. on 27th July 2009, but of course, within the stipulated time of 30 days.

In view of the aforesaid provisions of law, the banks and other creditors usually take the following precautions:

Before granting any advance to a Company, against the charge of pledge or hypothecation, the banks and other creditors first undertake a thorough search in the office of the Registrar of Companies (where the Company concerned is registered with) to ascertain, as to what are all the various charges, already created by the company in favour of the other creditors, and whether any of the goods, now being charged to the bank, are already charged to some other creditor(s) earlier by way of hypothecation or even pledge. Thereafter, only if the securities, now being offered, were found to be unencumbered in all respects, the bank and the other creditors would go ahead with the creation of the charge in its favour, and execute the necessary documents.

Further, after the bank and the other creditors, and the borrower, execute the necessary hypothecation documents, such documents are promptly submitted to the office of the Registrar of Companies concerned, for the purpose of the registration of the charge in his books.

This is a must, inasmuch as such registration is deemed to be a due public notice and, thus, any subsequent charge, on the goods concerned, even by way of pledge, will not have any priority, or preference, over such hypothecation charge.

Such documents have to be filed in the office of the Registrar of Companies within 30 days [raised from 21 days, vide **Section 62 and the Schedule to the Companies (Amendment) Act (31 of 1965) w.e.f. 15.10.1965**] from the date of its execution (vide **Section 125 of the Companies Act 1956**).

Further, after a month from the date of the execution of the document, yet another search needs to be conducted in the office of the Registrar of Companies, this time to ascertain whether any other charge had also been created, a little before the creation of such charge on the goods in favour of the bank, because, in that event, the prior charge of hypothecation will naturally have the priority and, thus, a preferential treatment, *vis-a-vis* the bank's and the other creditor's subsequent charge.

This is so because, the public has been given 30 days time to get the charge registered with the Registrar of Companies. Thus, a charge of hypothecation, created on 30th November 2008 can well be submitted for the required registration up to 29th December 2008 and, similarly, the hypothecation charge created in favour of the bank on 21st December 2008 can well be filed for registration by 19th January 2009. Further, supposing that the bank has filed the legal documents for registration of the charge with the Registrar of Companies on 23rd December 2008, and the other (prior) creditor as late as on 24th December 2008, the charge of the other (prior) creditor will have the priority over that of the bank and the other creditors, inasmuch as the priority will be computed from the date of the creation of the charge, and not from the date of the filing of the charge, inasmuch as the filing is valid, in the eye of law, so long as it is done within the stipulated time, i.e. within

30 days from the date of the execution of the documents. This is the rationale behind undertaking the second search in the office of the Registrar of Companies, after say, a month or so, of the execution and filing of the hypothecation documents in the office of the Registrar of Companies, for registration purposes.

One more word of caution and extra precaution. Usually, the formal recording in the office of the Registrar of Companies may take some time, maybe a couple of months or even more. Therefore, the bank's officer and the other creditors must take care to look into all the other documents filed with the Registrar of Companies for recording in its Register, though these are still lying pending for registration, of course, only such documents need to be verified which have been filed upto one month after the execution of the documents by the bank and the other creditors. This is so, because of one of the following two reasons:

(i) Either, the documents have been got executed well before the bank but the creditor has failed to get it registered with the Registrar of Companies, and the stipulated time (30 days) has lapsed;
(ii) Or, the documents have been got executed after the date of its execution in favour of the bank and the other creditors.

Thus, in the case number (i), as the stipulated period (30 days) has already elapsed, the same document may not be got registered, after the expiry of the stipulated 30 days. Accordingly, fresh sets of documents will have to be got executed, whereby the date of their execution will fall subsequent to the date of the execution of the documents by the bank and the other creditors, and hence the bank's charge will have the priority.

In the case number (ii), however, as the documents have themselves been got executed subsequent to the execution of the documents by the bank, these naturally, cannot have the priority over those of the bank.

But then, it will augur well if the bank and the other creditors will prefer to have such searches conducted in the office of the Registrar of Companies at regular half-yearly or yearly intervals to ensure that no subsequent charge (even second charge) has been created and registered, or even submitted for registration, with the Registrar of Companies. In such cases, the documents pertaining only to the intervening period need to be perused and examined.

(vii) Possession and Ownership

While in the case of the pledge, the possession of the goods pledged are transferred to the pledgee, in the case of hypothecation, however, the possession of the goods continues to remain with the borrower (hypothecator); only a floating charge is created thereon, in favour of the bank or the other creditors. But, so far as the ownership of such goods is concerned, it remains with the borrower in the cases both of the pledge and hypothecation.

(viii) Distinction between the Charge of Pledge and Hypothecation vs Mortgage

While the charges by way of pledge and hypothecation are created in respect of movable goods or items only, the charge in regard to immovable property (land and building) or even immovable items of plants and machinery, are required to be created necessarily by way of mortgage only.

41.20 Mortgages are Broadly of Two Types

(i) Registered Mortgage, and
(ii) Equitable Mortgage (by deposit of title deeds).

41.21 Why Equitable Mortgage?

The rationale behind creation of the charge by way of equitable mortgage is in the fact that the stamp duty exigible in the case of an equitable mortgage is nominal, i.e. the relative documents are required to be stamped as per a simple agreement. As against this, the documents pertaining to the registered mortgage have to be stamped *ad valorem* (i.e. as per the value of the relative document, like the debenture deed), which may come to a very huge amount, as the large scale companies usually issue debentures for a very large amount.

However, if we look at the relative advantage of the registered mortgage, it lies in the fact that such mortgage has the effect of giving a public notice, and thereby, any subsequent mortgage may not be held valid in the eye of the law. But then, in the case of limited liability companies, even the charge created by way of an equitable mortgage, is required to be reported to, and registered with, the Registrar of Companies, which too, has the effect of a public notice. This is so because, all the creditors, before accepting any asset of a company as a security against the advance, are required to make a search in the books of the Registrar of Companies at his office (on depositing a nominal search fee, for the purpose), with a view to ensuring that no prior charge has already been registered in regard to the immovable assets and properties, now being offered by the company as a security against the current advance, now being granted to the company.

41.22 Immovable Items of Machinery

As per the Transfer of Property Act, all the immovable property, including the immovable items of machinery, are required to be mortgaged, and that the charges by way of pledge and hypothecation can be created only for movable items of machinery and other movable goods.

Here, we must know that the items of machinery, embedded to earth, are treated as immovable. But, if say, only the four iron frames/angles are embedded to the earth, and the heavy lathe machine's all the four legs are tightened thereto, with nuts and bolts, such that the lathe machine can easily be removed just by loosening and removing the nuts and bolts, leaving the four iron frames/angles undisturbed, the whole lathe machine is considered to be movable. As against this, if the legs of the lathe machine themselves were embedded to the earth, and the machine could not have been removed without digging and disturbing the 'Mother Earth', it would be treated as an immovable property in the eye of law, and, accordingly, may necessitate mortgage thereof.

Let us Recapitulate

- A **share** is 'a share in the share capital of a company and includes stock, except where a distinction between stock and share is expressed or implied'. A share signifies the interest of a shareholder in the company, the right to receive dividends, to attend its meetings and vote at the meeting, and to have share in the surplus assets of the company, if any, in the event of the company being wound up.
- While the term 'share' represents the property, the term '**share certificate**', on the other hand, represents the evidence of the title of the member to such property.
- The share capital of a company is divided into a number of indivisible units of a specified amount. And each of such units is referred to as a 'share'.
- The term '**stock**' may be described as the aggregate (total) of the entire fully paid up shares of a company, owned by an individual, merged into one fund of the equal value. That is, it represents the set of the entire shares of the company, owned by an individual, put in one single bundle.
- Further, the stock is expressed in terms of money, and not in terms of so many shares. The stock may, thus, be divided into fractions of any amount and such fraction of the amount may be transferred like shares.
- Share capital comprises two **types of shares**:

  (**a**) Equity Shares (these are also known as Ordinary Shares), and
  (**b**) Preference Shares.

  There are the following types of equity shares:

  (**i**) With voting rights;

(**ii**) Without voting rights; and

(**iii**) With differential rights regarding the payment of dividend, voting or otherwise, according to such rules, and subjects to such conditions, as may be prescribed. Shares with differential voting rights, including non-voting shares, cannot exceed 25 per cent of the total issued share capital.

- The equity (or ordinary) shareholders of a company are virtually (or notionally) the owners of the Company. (The debenture holders, however, are the creditors to the Company).
- **Authorised capital** is the maximum amount up to the face value of which the company concerned has been authorised to issue shares (including both the equity and preference shares). While computing the amount of the authorised capital, only the face value of the shares is to be taken into account, and not the amount of the premium at which the shares had been issued. Further, the amount (only the face value) of the bonus shares issued, by capitalising the general reserves, will also be taken into account.
- **Issued capital** is the amount of the aggregate face value of the company's shares, for which the shares have been issued (that is, offered) for subscription by the general public, or by private placement.
- The amount, up to which the shares have been actually applied for by the investors, is known as the **subscribed capital**.
- **Paid up capital** is the amount paid along with the application (known as application money) and/or subsequently by way of call money on first, second, and final calls.
- **Par Value** is the amount written on the face of the share scrip, also known as the **face value**.
- **Book value** of the shares is the value of each share, plus the aggregate amount of the entire Reserves and Surplus, as per the books of the company, as all these belong exclusively to the equity shareholders, alone. Thus, the book value of each share, in percentage terms, would be equal to:

$$\frac{\text{(Fully Paid-up) Equity Share Capital + Reserves + Surplus}}{\text{Aggregate face value of such Shares}} \times 100$$

- The amount at which the shares are offered to the public, to subscribe thereto, is known as the **issue price**. Usually, the new companies come out with their first public issue at **par value** or **face value**.
- The shares are said to have been **issued at par** when the subscribers to the shares of the company are required to pay only the amount equivalent to the nominal value (face value) of the shares issued**.**
- The shares are said to have been **issued at a premium**, when the subscribers to the shares of the company are required to pay the amount higher than the nominal value (face value) of the shares issued.
- The Act does not stipulate any restrictions or conditions on the issue of shares by the company at a premium. But the Act has imposed the following restrictions on the use of the premium amount so collected:

  (**i**) The amount of premium cannot to accounted for as the profit of the company. Accordingly, it cannot be distributed as dividends.

  (**ii**) The amount of premium received should be kept in a separate bank account termed as the Share Premium Account or the Securities Premium Account of the company. Here, it must be noted that the **Amendment Act 1999** has since substitute the words 'Share Premium Account' with the words 'Securities Premium Account'.

  (**iii**) The amount of securities premium should be kept with the same sanctity as the share capital is kept.

  (**iv**) The amount credited to the Securities Premium Account cannot be treated as the free reserves of the company, as it is in the nature of a capital reserve.

- The shares are said to have been **issued at a discount**, when the subscribers to the shares of the company are required to pay the amount lesser than the nominal value (face value) of the shares issued.

- **Sweat equity share** means the equity shares issued by the company to its employees or directors at a discount or for consideration other than cash. Sweat equity shares may also be issued for providing know-how or making available intellectual property rights (like patents) or value additions, by whatever name called.
- **'Employee stock option'** means the portion given to the whole-time directors, officers, or employees of the company, giving them the rights or benefits to purchase or subscribe to the shares, at a future date, offered by the company at a predetermined price.
- **Employee Stock Purchase Scheme (ESPS)**
  - **(a) Eligibility** to participate in the scheme (ESPS)
    - (i) An employee shall be eligible to participate in the scheme (ESPS).
  - **(aa) Non-Eligibility** to participate in the scheme (ESPS)
    - (i) An employee, who is a promoter or who belongs to the promoter group shall not be eligible to participate in the scheme (ESPS).
    - (ii) A director who, either by himself or through his relatives or through any body corporate, directly or indirectly, holds more than 10 per cent of the outstanding equity shares of the company, shall not be eligible to participate in the scheme (ESPS).
  - **(b)** Approval of Shareholders,
  - **(c)** Pricing and Lock-in Period,
  - **(d)** Disclosure and Accounting Policy,
  - **(e)** Diluted earnings per share (EPS) pursuant to (as a result of) the issuance of the shares under the ESPS,
  - **(f)** The consideration received against the issuance of the shares under the ESPS.
- A company may, if so provided in its Articles of Association, capitalise its profits by issuing fully paid up shares to the members (shareholders), and thereby transferring the sums capitalised from the company's Profit and Loss Account or its General Reserve Account, to its share capital Such shares are referred to as **bonus shares**.
- The price at which a share is quoted and traded in the stock exchanges (BSE, NSE, etc.) is known as its **market value**. But, such market price may be said to be reliable enough, only if the shares are being actually traded daily, or at least frequently, as also in reasonably large volumes.
- The issue of shares to the members of the public through a prospectus is known as the **public issue**.
- The sale of shares to only a few investors is known as **private placement**. Such issues do not require the issuance of the formal prospectus nor any underwriting arrangements.
- When the shares are issued by way of public issue, rights issue or on private placement basis, and the shares applied for are allotted by the issuing company to the investors, it is know to have been purchased or obtained from the **primary market**.
- And later, when such original primary investors want to sell their shares to some one else, in the stock exchange, through a broker (or even on personal basis to their friends and/or relatives, etc.) such sales and purchases are known to have been transacted in the **secondary market**.
- **Preference share capital** can well be said to be a "two-in-one" instrument, a synthesis of the main features of both the equity shares and debentures.
- Different types of preference shares are: **Cumulative and Non-Cumulative**, **Callable and Non-Callable**, **Convertible and Non-Convertible**, **Redeemable and Non-Redeemable**, **Cumulative Convertible Preference (CCP) Shares**, and **Participating and Non-Participating**:
- Preference shareholders are entitled to vote only on the resolution placed before the company under any one or all of the under noted circumstances. These are:
  - **(i)** If the dividend(s) on preference shares are in arrear for the last two years or more, in the case of cumulative preference shares, or

(ii) If the preference dividends have not been paid for two or more consecutive years in the past, or for an aggregate period of three years or more, in the preceding six years, ending with the expiry of the immediately preceding financial year (of the company).

- The **Reserves** comprise that portion of the net profit which has not been distributed as dividend to the share-holders, but is, instead, ploughed back in the business. Reserves may broadly be categorised under two heads:

  (i) Revenue Reserves, and
  (ii) Capital Reserves.
  (i) **Revenue Reserves** comprise such reserves, which are constituted out of the revenue or income, generated out of the normal or usual line of business of the company.
  (ii) As against this, the income generated from the sources, other than the usual business activity of the company, will go to constitute **Capital Reserves**.

- The **revaluation of assets** takes place generally under the following three conditions:

  (a) On conversion of a Private Company into a Public Company.
  (b) At the time of amalgamation of two or more Companies, and
  (c) When a company is being sold out to another party/business house.

  The **revaluation of assets is computed as**:
  Revised value of the Fixed Assets [less] their Book Value = the amount of the Revaluation Reserve**.**
- **Statutory Reserves** are such reserves which have been created, as per the statutory obligations.
- **Surplus** is the balance amount of the entire retained earnings which has not been earmarked for any specific expenditure. That is, after allocating the amount of retained earnings to the various items of Revenue Reserves and Capital Reserves, the amount still remaining, in balance, is know as the Surplus.
- A private or public company, limited by shares, or a company limited by guarantee having a share capital, could not buy back its own shares earlier. However, the Companies (Amendment) Act 1999, under **Sections 77A, 77AA, and 77B** , as also the guidelines issued by SEBI in this respect, has since allowed the companies to **purchase their own shares or other securities**, but subject to certain conditions.
- The loan backed up by the charge on some of the borrower's tangible assets, in favour of the creditor, is known as the **Secured Loan**. Such charge is created by way of pledge and/or hypothecation (in respect of movable assets like the inventories, receivables and movable items of machinery) and/or mortgage (usually equitable mortgage) of immovable assets like land and building, plant, and immovable items of machinery (imbedded to earth), etc.
- As against the equity shareholders, who are considered to be the owners of the company (though notionally only), the **debenture holders** are considered to be the company's creditors. That is, while the share capital is the owners' equity, the debenture capital is like the funds lent to the company at an agreed rate of interest, and re-payable after the stated and agreed period, say, after the expiry of the 6^{th}, 7^{th}, and 8^{th} year, from the date of allotment, in the ratio of say, 35%, 35%, and 30%, respectively. Thus, the debentures are usually issued for raising long-term debts.
- There are, generally, three main types of debentures on the basis of their convertibility (or otherwise) into equity shares. They are:

  (a) **Fully Convertible** Debentures (FCDs), [Here, the entire amount is converted into equity shares].
  (b) **Partly Convertible** Debentures (PCDs), [Here, while one portion is converted into equity shares, the balance amount is paid back after the stipulated periods].
  (c) **Non-Convertible** Debentures (NCDs), [Such debentures are not converted into equity shares at any stage, and are, accordingly, fully redeemed after the stipulated period].

- In view of the fact that the stamp duty, exigible on the documents pertaining to an **equitable mortgage** is nominal (in that these are required to be stamped only as a simple agreement), usually only such (equitable) mortgage is created
- As against secured loans, the **unsecured loans** are such loans against which no tangible security has been charged to the bank or to the financial institution or, to any of the creditors, like the promoters of the company or their friends and relatives, etc.
- **Debenture** includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the company's assets or not. As described by Chitty, J., 'debenture means a document, which either creates a debt or acknowledges it, and any document which fulfils either of those conditions is a debenture'.
- On the basis of the aforementioned descriptions of a debenture, the following may emerge as the main characteristic features of a debenture:

  (**a**) It is issued by a company and it is in the form of a certificate of indebtedness.
  (**b**) It generally specifies the date of its redemption (repayment). It also provides for the repayment of the amount of the principal and interest, at the specified date, or on the dates on which each instalment will be payable.
  (**c**) It generally creates a charge on the assets of the company or the undertakings of the company. Generally, the term '*pari passu*' is written in the terms and conditions of debentures

- A company, instead of issuing separate debentures individually to the debenture holders, evidencing separate and distinct debts, may create one consolidated loan fund known as the '**debenture stock**'.
- As against the equity shareholders, who are considered to be the owners of the company (though just notionally), the debenture holders are considered to be the company's creditors, instead. Besides, company has the legal obligation to pay the amount of interest at the specified rate, and on the specified time, and redeem the debentures on the due date(s). There is, however, no such legal obligation on the part of the company, to pay the dividends on its shares, both equity and preference.

  However, as in the case of equity and preference shares, **debentures** can as well be **issued by way of**:

  (**i**) Public Issue,
  (**ii**) Private Placement, and on
  (**iii**) Rights Basis

- There are, generally, three main types of debentures on the basis of their convertibility (or otherwise) into equity shares. They are:

  (**a**) **Fully Convertible** Debentures (FCDs),
  (**b**) **Partly Convertible** Debentures (PCDs), and
  (**c**) **Non-Convertible** Debentures (NCDs).

- Some Salient Features of Debentures:

  (**a**) Security
  (**b**) Trustee
  (**c**) Debenture Redemption Reserve (DRR)
  (**d**) Rate of Interest (or Coupon Rate)
  (**e**) Fixed or Floating Coupon Rate
  (**f**) Period of Maturity
  (**g**) Optional Convertibility

- A public issue of debentures involves a large number of debenture holders, and all those who subscribe to the issue are the creditors of the company. Accordingly, it is not possible for them to get a separate

charge registered with the Registrar of Companies for every debenture holder separately. Therefore, the most common, convenient and feasible method of securing them all is to execute a '**trust deed**' conveying the property of the company to the trustees and declaring a trust in favour of the debenture holders. A trust deed normally contains clauses giving the trustees the following powers:

(**a**) To take a mortgage over the company's property. This way, the title deeds in respect of such mortgaged property are transferred to them (morgagees) and the company is thereafter prevented from creating any further charge over them (properties), ranking in priority to the debentures.
(**b**) To sell or lease the property and to renew the leases,
(**c**) To exchange the mortgaged property for any other suitable property,
(**d**) To modify the subsisting (existing) contracts applying to any part of the property,
(**e**) To compromise claims,
(**f**) To commence and defend actions,
(**g**) To appoint a Receiver on the security becoming enforceable.

- Advantages of Debenture Trust Deed

(**a**) It becomes the function of the trustees to watch the interest of the debenture holders. The trustees are bound to act honestly and with due care and diligence.
(**b**) The trustees have a legal mortgage over the company's property, such that the persons who subsequently lend money to the company cannot gain priority over the debenture holders.
(**c**) If and when the company makes a default in this regard, the trustees can take action for enforcing the security on behalf of the debenture holders.
(**d**) The trustees can ensure that the property charged is kept insured and properly maintained, as it would not be possible for a large and fluctuating body of the debenture holders to do so.

- **Appointment of Debenture Trustees (Section 117B)**

A company before the issue of a prospectus or a letter of offer to the public for subscription of its debentures is required to fulfil the following conditions:

(**a**) To appoint one or more debenture trustees for such debentures to protect the interest of the debenture holders, and
(**b**) To write on the face of the prospectus or a letter of offer that the debenture trustees have given their consent to be appointed as the debenture trustees.

- **Debenture Redemption Reserve (DRR)**

After the commencement of the Amendment Act 2000, the company is required to create a 'Debenture Redemption Reserve' (DRR) for the redemption (repayment) of such debentures as and when these may fall due. For this purpose, the company shall credit to the DRR account sufficient amounts from out of the profit every year till such time the debentures are fully redeemed.

- **Failure to Redeem the Debentures**

If a company fails to redeem the debentures on the due date(s), any or all the debenture holders can make and application to the Company Law Board (CLB).

- **Remedies for Debenture-holders**

In the case of a default by the company in repayment (redemption), the remedies for the debenture holder depend on the fact whether he is secured or unsecured. This is so because the right debentures for the maturity period of upto 18 months can be issued without any security charged there-against (i.e. unsecured debentures). Thus, the unsecured debenture holders are in exactly the same position as the other unsecured creditors are. The secured debenture holders (i.e. where the trust deed has been executed) enjoy both the above mentioned rights, as the unsecured debenture holders enjoy, but in addition thereto, the secured debenture holders also enjoy the following other legal rights:

(**a**) Sale of Assets
Usually, one of the express terms and conditions of the debentures or the debenture trust deed is that the trustees have the powers of sale of the property charged against the secured debentures.
(**b**) Foreclosure.
The trustees may file an application in the Court for an order of 'foreclosure'. The effect of such order of foreclosure will be that the borrower's interest in the assets charged is completely extinguished, and the lenders become the owners of those property.
(**c**) Appointment of a Receiver
In the cases where there is a trust deed, it (trust deed) usually provides that the trustees may appoint a Receiver. If no such power is given, an application may be filed in the Court, in the debenture action, to appoint a Receiver.

- Where no trust deed has been executed, in favour of the debenture holders, a debenture holder may, on default in the payment of the principal or interest, bring an action (referred to as the 'debenture holders' action') on behalf of himself as also on behalf of the other debenture holders of the same class, praying for the following remedies:
  (**a**) A declaration to the effect that the debentures have a charge on the assets of the company,
  (**b**) An account of what the company owes (is required to repay) to the shareholders; the amount of assets; prior claims; and so on,
  (**c**) An order of foreclosure or sale, and
  (**d**) The appointment of a Receiver.
- If a debenture holder owes a debt to the company, which is insolvent; the debenture holder cannot set off his debt against the liability he owes to the company. The rule is that a person who claims a share in the funds must first repay every thing he owes to the fund, before he can claim a share in the fund.
- All invests made by a company on its behalf must be made in its own name. However, there are certain exceptions made to this rule.
- The power to borrow, whether express or implied, includes the power to charge the assets of the company as a security against secured advances (borrowings) to the lenders of the money.
  Most of the companies expressly make provisions for such borrowing power in the Memorandum of Association. The Memorandum of Association authorises the company to borrow, the Articles of Association provides for the method as to how to borrow money, and by whom such powers will be exercised. It may also fix the maximum amount that can be borrowed by the company.
- A company, which has power to borrow money, is also empowered to charge its assets to the lender, but subject to any limitation in its Memorandum of Association and the Articles of Association. The **following charges must necessarily be registered** with the Registrar of Companies within 30 days after the date of their creation:
  (**i**) A charge for the purpose of securing any issue of debentures.
  (**ii**) A charge on uncalled share capital of the company,
  (**iii**) A charge on any immovable property of the company, like its land and building, plant and machinery embedded to earth,
  (**iv**) A charge on any book debt of the company,
  (**v**) A charge, not being a pledge, on any movable property of the company,
  [But it may be noted in this regard that the Act does not prohibit the registration of the charge created even by way of pledge],
  (**vi**) A floating charge (known as the charge by way of 'hypothecation') on the undertaking (company) or any property of the company, including stock in trade (i.e. its raw materials, work in-process, finished goods and consumable stores and spares),
  (**vii**) A charge on the call made on the partly paid shares, but not paid after being called (i.e. asking the shareholders to deposit the next instalment on the partly paid shares when due),

(**viii**) A charge on a ship, or any share in the ship, and
(**ix**) A charge on goodwill, or a patent or a license under a patent, or a trade mark or a license under a trade mark, or a copy right or a license under a copy right.

- It is the duty of the company to send the required particulars or instruments (documents), as abovementioned, to the Registrar of Companies, for the purpose of the registration of the charge within the stipulated 30 days of the creation of the charge in question.
- In the cases where the charge has not been registered with the Registrar of Companies, within the prescribe period of 30 days from the date of its creation, it will have the following effects (legal ramifications):

(**i**) The charge becomes void, against the liquidator and any creditor of the company.
(**ii**) The debt, in respect of which the charge has been created, always remains valid.
(**iii**) The money secured thereby becomes payable immediately
(**iv**) The company and every officer responsible may be subjected to a penalty up to Rs 500 for every day during which the default continues.

- In the cases where any charge on any property of a company, which is required to be registered, has been so registered, as required, any person, acquiring such property of the company, or any part thereof, or any share or interest therein, shall be deemed to be having the notice of the charge as from the date of such registration with the Registrar of Companies.

The Registrar of Companies will arrange to keep a **register in respect of each company**, containing all the charges requiring registration:

(**i**) The date of creation of the charge,
(**ii**) The amount secured by the charge,
(**iii**) Brief particulars of the property charged, and
(**iv**) The persons entitled to the charge.

In the case of the charge in regard to the debentures, keeping in view the benefits that a series of the debenture holders are entitled to, the following particulars must be registered:

(**i**) The aggregate (total) amount secured by the whole series of debentures,
(**ii**) The dates of the resolutions authorising the issue of the series of debentures, and the date of respective covering debenture deed, if any, by which the security is created or defined,
(**iii**) A general description of the property charged,
(**iv**) The name of he trustees, if any, of the debenture holders, and
(**v**) The amount or rate percentage (percentage of rate) of the commission or discount, if any, paid to any person subscribing or procuring subscriptions for any debentures of the company (**Sections 128 and 129**).

The register so kept by the Registrar of Companies shall be open for inspection by any person on payment of the fee prescribed for every inspection.

- The charge created by the company, created by way of an equitable mortgage in favour of the creditors, is also required to be registered with the Registrar of Company, which has the effect of a public notice of the charge so created by the company.
- The Registrar of Companies issues a certificate of registration of any charge registered with him, under his signature, stating the amount secured thereby. Such certificate will serve as a conclusive evidence and proof that the requirements of the Act, in regard to the registration of the charges, have been completed and complied with.
- Whenever the terms or conditions, or the extent or operation, of any charge, registered with the Registrar of Companies, are modified, it shall be the duty of the company to send to the Registrar of Companies, the particulars of such modifications within 30 days. The particulars of modification are required to be filed in Form 8.

- Further, a charge may be filed by the company or by any of the persons interested in the charge. But then, the modification of a charge can be filed only by the company, and none else.
- The term 'modification' includes variation (change) of any of the terms of the agreement, including the variation in the rate of interest, which may be, by mutual agreement or by the operation of law. Even in the case where the rights of the charge holder are assigned to a third party, it will be regarded as a modification. Similarly, partial release of the charge on a particular asset or property, shall amount to the modification of the charge.
- On payment or satisfaction of any charge, in full, the company must notify this fact to the Registrar of Companies within 30 days from the date of such payment or satisfaction.

  In the case where the Registrar of Companies enters a memorandum of satisfaction, as aforementioned, he shall furnish the company with a copy of the memorandum of satisfaction.
- The Company Law Board has the power to extend the time for the registration of the charge or to order that the omission or misstatement in the register of charges be rectified.
- Every company must keep, at its registered office, a register of charges and enter therein all the charges specifically affecting the property of the company, and all the floating charges on the undertaking, or on any property of the company giving in each case the following details:

  (**a**) A short description of the property charged,
  (**b**) The amount of the charge, and
  (**c**) The names of the persons entitled to the charge.

  If any officer of the company knowingly omits or wilfully authorises or permits the omission of any of the aforementioned entries, he shall be punishable with a fine which may extend to Rs 5,000.
- As against pledge, in which case the charge is specific and fixed (i.e. it relates to only those specific items of goods actually pledged), the charge of hypothecation is in the nature of a floating charge, in that all the goods that are stored and stocked in the company's godown(s) or factory premises, etc., or even in transit, automatically get charged (hypothecated) to the creditors like banks, and the moment these stocks are taken out of the company's godowns, factory premises, etc., and/or from the possession of the company, such goods automatically get released, and are, accordingly, deemed to be out of the charge (of hypothecation) of the creditors like banks, too.
- In the case of the goods pledged against advances, the pledgee has the lawful right to sell the goods pledged, without obtaining specific prior permission of the Court, in the event of the pledgor failing to pay the debt, in time.
- As per the provisions of law, the charge of pledge, created subsequently, after the creation of the charge of hypothecation, may have the priority and preference thereto (though created afterwards) provided, of course, the pledgee did not have the knowledge and notice of the prior charge of hypothecation.
- The charge of hypothecation of stocks of inventories and book debts [as also of equitable mortgage, created by the deposit of the title deed (usually in original) of the immovable property charged] must be registered with the Registrar of Companies, within 30 days from the date of the creation of the charge.

  Such registered charges may as well be got vacated, but such application, for the vacation of the registered charge, can be filed only by the borrowing company, and not by the creditor concerned.

  Here it must be observed and emphasised that, as per the requirement of the law, the application, for the registration of the charge, along with the relevant documents, must be filed with the Registrar of Companies within the stipulated time, and it is not necessary that it should be actually recorded and registered by the Registrar of Companies in his books, and/or a certificate of such registration must be issued by the Registrar of Companies, within such stipulated time itself. Just the act of filing, within the stipulated (30 days) time, is good enough.

  Such application, along with the copies of the relative documents creating the charge, along with the brief particulars thereof, is to be submitted on Form-8, in triplicate.

[It may, however, be pertinent to mention here that the application for the modification of the charge, or the satisfaction of the charge, is required to be submitted on Form-10 and Form-17, respectively, in triplicate.]

- The date of the execution of a charge (i.e. the date of the signing of the relative documents) is the date of creation of the charge, for the purpose of computing the time for its registration.
- If the charge has been executed earlier to another charge, but had been got registered afterwards (of course, within the prescribed time limit of 30 days), such a charge (executed earlier) will have the priority over the other; it having been registered subsequently, notwithstanding.
- Before granting any advance to a company, against the charge of pledge or hypothecation, the banks and other creditors first undertake a thorough search in the office of the Registrar of Companies, Further, after the bank and the other creditors, and the borrower, execute the necessary hypothecation documents, such documents are promptly submitted to the office of the Registrar of Companies concerned, for the purpose of the registration of the charge in his books.

  This is a must, inasmuch as such registration is deemed to be a due public notice and, thus, any subsequent charge, on the goods concerned, even by way of pledge, will not have any priority or preference, over such hypothecation charge.
- While the charges by way of pledge and hypothecation are created in respect of movable goods or items only, the charge in regard to immovable property (land and building) or even immovable items of plants and machinery, are required to be created necessarily by way of mortgage only.

Questions for Reflection

1. What are the main distinguishing features of a share and a share certificate?
2. What are the main distinguishing features of a share and stocks?
3. What are the main distinguishing features of an equity share and a preference share?
4. What are the main distinguishing features of an equity share issued at par, and an equity share issued at a premium? Explain with the help of an illustrative example in each case.
5. Write short notes on the following:
   (a) Issue of Sweat Equity,
   (b) Employee Stock Option Plan (ESOP), and
   (c) Employee Stock Purchase Scheme (ESPS).
6. What are eligibility to participate in the Employee Stock Purchase Scheme (ESPS) and who are not eligible to participate in the Employee Stock Purchase Scheme (ESPS)?
7. Write short notes on the following types of preference shares:
   (a) Cumulative and Non-Cumulative;
   (b) Callable and Non-Callable;
   (c) Convertible and Non-Convertible;
   (d) Redeemable and Non-Redeemable;
   (e) Cumulative Convertible Preference (CCP) Shares; and
   (f) Participating and Non-Participating.
8. Under what special circumstances are the preference shareholders entitled to vote?
9. Write short notes on the following types of debentures:
   (a) Fully Convertible Debentures (FCDs),
   (b) Partly Convertible Debentures (PCDs), and
   (c) Non-Convertible Debentures (NCDs).

10. How will you describe a debenture?
11. What are the main characteristic features of a debenture?
12. What do you understand by the term 'Debenture Stocks'? Explain.
13. Can the debentures be issued by way of Public Issue, Private Placement, and on Rights Basis? Explain.
14. (a) What are the main types of debentures that can be issued by a company on the basis of their convertibility (or otherwise) into equity shares?
    (b) Explain the characteristic features of each of them separately by way of some illustrative examples, in each case.
15. What are the salient features of debentures, in terms of their:
    (a) Security,
    (b) Trustee,
    (c) Debenture Redemption Reserve (DRR),
    (d) Rate of Interest (or Coupon Rate,
    (e) Fixed or Floating Coupon Rate,
    (f) Period of Maturity, and
    (g) Warrant Attached with NCDs.
16. (a) What is the significance of a Debenture Trust Deed?
    (b) What are the advantages of a Debenture Trust Deed?
17. What are the legal implications of the failure on the part of a company to redeem the Debentures on the due date(s),
18. What are the various remedies available to the debenture-holders, in the case of a default by the company in repayment (redemption) on due date(s)?
19. 'All investments made by a company on its behalf must be made in its own name.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.
20. (a) What are the various charges that must necessarily be registered with the Registrar of Companies?
    (b) Within how many days after the date of the creation of the charge, it must be registered with the Registrar of Companies?
    (c) Can the Company Law Board allow extension in the period of the registration of such charge, and if so, Company Law Board under what specific conditions?
21. (a) Who can approach the Registrar of Companies for the registration of the charge(s) on the assets of the company?
    (b) Who can approach the Registrar of Companies for the registration of the amendments to the charge(s) on the assets of the company?
22. What are the effects of non-registration of the charge by the creditors on the assets of the company?
23. With effect from which date any person, interested in the charge created by the company, will be deemed to be having the public notice of the charge?
24. (a) Who is required to keep the Register of Charges?
    (b) Is it freely open to the public for inspection of the charges created on the assets of the company?
    (c) What are the various particulars that are to be usually recorded in the Register of Charges?
    (d) What are the various particulars that are to be recorded in the Register of Charges in regard to the debentures?
    (e) Are the charges created by the company, by way of an equitable mortgage in favour of the creditors, also required to be registered with the Registrar of Company. Give your reasons for your answer.
25. What is the rationale behind creation of the charge by the company, by way of an equitable mortgage, instead of by way of a registered mortgage?
26. What are various steps and procedures involved in creating an equitable mortgage by a company?
27. Is the Certificate of Registration by the Registrar a conclusive evidence that all the formalities connected therewith have been duly completed? Write 'Yes' or 'No' as your answer.

28. What are the various changes in the terms of the loan granted to a company that constitute modifications in the charge?
29. (a) Differentiate between a fixed (specific) and floating (fluid, fluctuating, changing) charge.
    (b) What are the main differences between the charge created by a company by way of pledge and by way of hypothecation?
30. Under what specific circumstances the charge created by a company by way of pledge will have the priority over the charge created by the company by way of hypothecation?
31. Is the charge created by the company by way of hypothecation required to be registered with the respective Registrar of Companies? Give reasons for your answer.
32. 'If the charge has been executed earlier to another charge, but had been got registered afterwards (of course, within the prescribed time limit of 30 days), such a charge (executed earlier) will have the priority over the other; it having been registered subsequently, notwithstanding.' Do you agree with this statement? Give reasons for your answer by citing a suitable example to illustrate the point of your contention.
33. Distinguish between
    (a) The charges created by way of pledge and hypothecation, and
    (b) The charges created by way of hypothecation and mortgage.

Problems for Practice (With Suggested Solutions)

Problem 1

(a) Will an employee who is a promoter or who belongs to the promoter group be eligible to participate in the Employee Stock Option Plan (ESOP)?
(b) Will a director who, either by himself or through his relatives or through any body corporate, directly or indirectly, holds more than 10 per cent of the outstanding equity shares of the company, be eligible to participate in the Employee Stock Option Plan (ESOP)?

Write 'Yes' or 'No' as your answer.

Solution

(a) No.
(b) No.

Problem 2

'The power to borrow, whether express or implied, includes the power to charge the assets of the company as a security against secured advances (borrowings) to the lenders of the money.' Do you agree with the statement? Write 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 3

The charge of hypothecation is executed by XYZ Company on 1st June 2009 in favour of one creditor, and again subsequently on 21st June 2009 in favour of yet another creditor, and these were filed for registration on 27th and 23rd June 2009, respectively. Will the charge executed on 1st June 2009 have the priority over the charge executed on 21st June 2009? Give reasons for your answer.

Solution

As the charge of hypothecation is executed by XYZ Company on 1st June 2009 in favour of one creditor, and again subsequently on 21st June 2009 in favour of yet another creditor, and as these were filed for registration on 27th and 23rd June 2009, respectively, the charge executed on 1 June 2009 will have the priority over the charge executed on 21st June 2009, though the charge dated 1st June 2009 was filed for registration, subsequently, i.e. on 27th June 2009, but of course, within the stipulated time of 30 days.

Chapter Forty Two

Management of Company

"*Meetings are a symptom of bad organization. The fewer meetings the better.*
Peter F. Drucker

No agency is better than its account executives.
Morris Hite

The auditor is a watchdog and not a bloodhound
Lord Justice Topes

Lots of folks confuse bad management with destiny.
Kin Hubbard

So much of what we call management consists in making it difficult for people to work.
Peter F. Drucker

Effective managers live in the present but concentrate on the future.
James Hayes"

42.1 Need for Meetings

A company is an artificial person and not a human being; it is just a legal entity. Accordingly, it cannot work or discharge its functions on its own. Therefore, it has to work through the medium of some other human beings. Accordingly, it discharges its functions through the directors of the company, whoever are authorised on this behalf, through a resolution passed by the company. Further, as provided in the Act, the shareholders

also have been empowered to discharge certain functions. Those functions, which have been specifically and exclusively reserved for them under the Act, are to be discharged by them by participating in the general meeting called by the company. Under **Section 291**, the Board of Directors manage the affairs of the company. Under these circumstances, the meetings of the shareholders and the directors become necessary.

The Act has provided for different types of meetings of the shareholders. These meetings are the following:

(a) Statutory meeting,
(b) Annual General meeting,
(c) Extraordinary General meeting, and
(d) Class meeting.

We will now discuss these meetings one after the other.

42.2 Statutory Meeting (Section 165)

The following are some of the most important legal provisions regarding the 'statutory meeting':

1. Statutory meeting is required to be held only by a public company having a share capital. That is, a private company or a public company not having a share capital, are not required to hold such statutory meeting.
2. Such meeting must be held within a period of not less than one month and not more than six months from the date at which the company becomes entitled to commence its business.
3. A notice of the meeting is required to be sent to every member, stating it to be a statutory meeting, at least 21 days before the date of such meeting. Such notice shall be deemed to have been served (sent) on the expiry of 48 hours after it has been posted. (**Section *53***).
4. **Statutory Report**
   The Board of Directors is require to send a report (referred to as a 'Statutory Report') to each member along with the notice of the statutory meeting. Further, if the statutory report is forwarded later, it shall be deemed to have been duly forwarded, if it is so agreed by all the members entitled to attend the meeting and to vote at the meeting. A copy of the Statutory Report is also required to be sent to the Registrar of Companies after it has been sent to all the members.

   The Statutory Report is required to be certified as correct by at least two directors, one of whom shall be the managing director, if there is a managing director in the company.

   The auditors of the company are required to certify that part of the Statutory Report, which relates to the shares allotted, cash received thereon, and the receipts and payments and the balance of cash in hand.
5. The members present at the meeting may discuss any matter relating to the formation of the company, or any matter arising out of the Statutory Report without any previous notice having been given.
6. The meeting may adjourn, and the adjourned meeting has the same powers as the original meeting. Therefore, the adjourned meeting may do anything which could have been done at the original meeting.
7. **Penalties**
   In case a default is made in complying with the provisions of **Section 165**, the following legal effects (ramifications) will apply:
   (**i**) Every director or the other officer of the company, who is in default, shall be punishable with fine which may extend upto Rs 5,000 (**Section 165**), and
   (**ii**) The Registrar of Companies or a contributory may apply to the Court for the winding up of the company. (**Section 439**). However, the Court, instead of passing an order for the winding up of the company, may give the directions for the holding the meeting or for the filing of the Statutory Report.

8. It may be carefully noted in this context that this meeting is required to be held only once in the life time of a public company, having a share capital.

42.3 Annual General Meeting (AGM) (Sections 166 to 168)

The Annual General Meeting (AGM) is to be held every year. That is why it is named Annual General Meeting (AGM). The main provisions in regard to such meeting have been summarised as follows:

1. All the companies, whether public or private, whether having share capital or not, whether a limited company or an unlimited company, must hold the Annual General Meeting (AGM).
2. **Time Interval between the Annual General Meeting (AGM)**

   The meeting must be held in every calendar year (i.e. January to December), and not more than 15 months should elapse between two such meetings. However, the first Annual General Meeting (AGM) may be held within 18 months from the date of incorporation. If such Annual General Meeting (AGM) is held within that period, the company need not hold any such meeting in the year of its incorporation or in the following year. The maximum gap between two such meetings may be extended by three months by taking permission from the Registrar of Companies, who may so allow for any special reason.

   Further, such extension of three months may be allowed only by the Registrar of Companies. The Court has not been empowered under **Section 166** to grant such extension.
3. **Day and Hour of Meeting**

   The Annual General Meeting (AGM) must be held in the following days and time:

   (i) On any day which is not a public holiday,
   (ii) During the business hours,
   (iii) At the Registered Office of the company, or at some other place within the city town or village, in which the registered office of the company is situated. [**Section 166 (2)**].

   However, the bank holidays (for the purposes of closing), though declared as public holidays under the Negotiable Instruments Act, shall not be treated as public holidays for the aforementioned purpose. Accordingly, 1st April and 30th September shall not be treated as public holidays. Further, under. **Section 2 (38)**, if any day is declared by the Central Government as a public holiday, after the issue of the notice of the meeting, it shall not be treated as public holidays for the purpose of the Annual General Meeting (AGM).
4. **Business to be Transacted (Section 173)**

   The following business may be transacted in the Annual General Meeting (AGM):

   (a) **Ordinary Business**, which relates to the following matters:
      (i) Consideration of the accounts, the Balance Sheet and the Profit and Loss Account, and the reports of the Board of Directors and the auditors,
      (ii) Declaration of Dividend, if any,
      (iii) Appointment of the directors in the place of those retiring, and
      (iv) Appointment of auditors and fixation of their remuneration.

   (b) **Special Business**

   Any other business transacted at the meeting will be deemed as the special business. Further, with regard to all the special business, an 'Explanatory Statement' is required to be annexed to the notice of the meeting.
5. **Where the Annual Accounts are Not Ready for being placed in the Meeting**

   In such cases, it is open to the company to adjourn the Annual General Meeting (AGM) to a subsequent date, and fix a date for the next meeting when the accounts are expected to be ready for presentation and consideration in the meeting. Further, as the consideration of the annual accounts of the company

is only one of the various other businesses to be transacted in the Annual General Meeting (AGM), the directors are under the legal obligation to hold the meeting. Such adjourned meeting should, however, take place within the maximum time limit allowed under **Section 166**.

6. **Notice**
   The company must give 21 days notice to all the members of the company and the auditors. Such notice shall be deemed to have been served on the expiry of 48 hours after it has been posted. (**Section 53**). It is not obligatory on the part of the company to advertise the notice of the meeting in the newspapers. However, by way of an extra precaution, the company may do so with a view to avoiding any dispute by the shareholders, specially residing outside India, to the effect that they have not received the notice of the meeting.

42.4 Extra-Ordinary General Meeting (EGM) (Sections 169)

As provided in the **Clause 47 of Table A** (**Schedule –1**), all general meetings, other than the Annual General Meetings (AGMs), shall be called as the Extra-Ordinary General Meeting (EGM). An Extra-Ordinary General Meeting (EGM) is called to transact some special or urgent business that may arise in between the two Annual General Meetings (AGMs), **for example**, for change in the object of the company, for change in the location of the registered office of the company, for change in the share capital of the company, and so on. Further, every business transacted in the Extra-Ordinary General Meeting (EGM) is called 'special business'. Accordingly, every item on the agenda for the meeting must accompany an 'Explanatory Statement'.

42.5 Class Meetings (Section 107)

In the cases where it is proposed to alter, vary, or affect the rights of a particular class of shareholders (like where the accumulated dividends on cumulative preference share is to be cancelled), and it is not possible to obtain, in writing, the consent of the holders of the ¾ th of the issued shares of that class of shareholders, a meeting of the holders of such class of shares may be called. Such a meeting is referred to as the Class Meeting. Further, all the resolutions in a class meeting must be passed as special resolutions.

The holders of at least 10 per cent of the issued shares of that class, who did not consent to such resolution, may file an application in the Court within 21 days of such meeting to have the resolution cancelled. And where such application is made, the resolution shall not be effective unless and until it is confirmed by the Court.

42.6 Proxy (Section 176)

Every member of a company, entitled to attend and vote at a meeting, has the right to appoint another person, whether a member of the company or not, to attend and vote for him. But the proxy does not have a right to speak at the meeting.

The term 'proxy' is applicable to such person so appointed. The term 'proxy' is also used in the reference of the document/instrument by which a member of a company appoints another person to attend the meeting and vote for him therein. However, the proper (correct) name for such document is 'proxy form' or 'proxy paper'.

42.7 Passing of Resolution by Postal Ballot (Section 192A)

Section 192A allows the casting of votes to a member of the company through postal ballot in certain cases, and subject to certain conditions.

42.8 Maintenance of Accounts by Companies

All the companies are required to keep at its registered office proper books of accounts, giving a **true and fair view** of their financial affairs. **Section 209** enlists the books of accounts that are required to be maintained by the companies. These books are open to inspection, during the company's business hours, by any director and the Registrar of Companies, or an officer authorised by the Central Government. Such books are required to be maintained for a minimum period of eight years. Further, the Companies Amendment Act 1988 has made it obligatory on the part of the companies to maintain their accounts on accrual basis.

It is the responsibility of the Managing Director or the manager of the company to comply with these legal requirements relating to the maintenance of accounts. They may, however, engage a competent person and make him responsible for the maintenance of accounts. On any default in compliance of the legal provisions by the company, relating to the maintenance of accounts, every person charged with such responsibility of the maintenance of accounts, would be liable to be punished for imprisonment extending up to six months, or a fine extending up to Rs 10,000 or with both.

As provided under **Section 210**, at every Annual General meeting (AGM), the Board of Directors must lay before the members of the company the Balance Sheet and the Profit and Loss Account of the company. In the cases of non-profit making companies, an Income and Expenditure Account is required to be submitted, instead of the Profit and Loss Account.

Section 211 deals with the form (proforma) of the Balance Sheet and the details to be given in the Profit and Loss Account. The form (proforma) of the Balance Sheet and the details to be given in the Profit and Loss Account are given in Schedule VI of the Act. It may, thus, be observed that a specific proforma has been prescribed in the Act for the presentation of the Balance Sheet. But then, no such specific proforma has been prescribed in the Act for the presentation of the Profit and Loss Account. Only the details, required to be given in the Profit and Loss Account, have been provided in the Act.

The format in which the companies are required to present their Balance Sheet is given at **Table 42.1**.

Table 42.1 *Format of Balance Sheet*

(A) Horizontal Form or 'T' Form

Liabilities	*Assets*
Share capital	Fixed assets
Reserves and surplus	Investments
Secured loans	Current assets
Unsecured loans	loans, and advances
Current liabilities and provisions	Miscellaneous expenditures and (losses)
Total	Total

(B) Vertical Form

I Sources of Funds
1. Shareholders' funds
(a) Share capital
(b) Reserves and surplus
2. Loan funds
(a) Secured loans
(b) Unsecured loans
Total

(*Contd.*)

(*Contd.*)

II Application of Funds
1. Fixed assets
2. Investments
3. Current assets, loans and advances
Less current liabilities and provisions
Net current assets
4. Miscellaneous expenditures and (losses)
Total

Here, it may be mentioned that, as per the convention, prevalent in India, all the liabilities are shown on the Left Hand Side (LHS), and all the assets on the Right Hand Side (RHS) in the horizontal format. And accordingly, in the vertical form, first all the liabilities appear at the top, and thereafter assets are presented.

Further, the companies which are working for more than one year are required to give the Balance Sheets of at least two consecutive years for the purpose of intra-firm comparison of the company during these two years.

A Balance Sheet of the two consecutive years of a hypothetical company is given in **Table 42.2**.

Table 42.2 *Balance Sheet of Prakash Company Limited as on March 31, 2009*

(A) Horizontal Form or 'T' Form (Rs in million)

Liabilities	*2008*	*2009*	*Assets*	*2008*	*2009*
Share capital	30.00	30.00	Fixed assets	55.00	49.50
Equity	25.00	25. 00			
Preference	5.00	5.00			
Reserves and surplus	21.50	19.70	Investments	4.00	4.00
Secured loans	18.60	17.40	Current assets, Loans, and advances	36.20	29.70
Unsecured loans	10.80	5.30	Miscellaneous expenditures and losses	1.60	1.40
Current liabilities and provisions	15.90	12.20			
Total	**96.80**	**84.60**		**96.80**	**84.60**

Table 42.2 *(continued) Balance Sheet of Prakash Company Limited as on March 31, 2009*

(B) Vertical Form:

	(Rs in million)	
	2008	*2009*
I Sources of funds (or Liabilities)		
Share capital	30.00	30.00
Equity	25.00	25. 00
Preference	5.00	5.00
Reserves and surplus	21.50	19.70
Secured loans	18.60	17.40
Unsecured loans	10.80	5.30
Current liabilities and provisions	15.90	12.20
Total	**96.80**	**84.60**

II Application of Funds (or Assets)		
Fixed assets	55.00	49.50
Investments	4.00	4.00
Current assets, Loans, and advances	36.20	29.70
Miscellaneous expenditures and losses	1.60	1.40
Total	**96.80**	**84.60**

The Balance Sheet and the Profit and Loss Account of the company must be signed on behalf of the Board of Directors by at least two of the Directors, and countersigned by the Manager or the Company Secretary. In the companies where there is a Managing Director, such Managing Director should be one of such signatories. The Balance Sheet and the Profit and Loss Account of the company must be first approved by the Board of Directors, before these are submitted to the auditors for audit purposes. After completing the audit of the company, the auditors must submit their own 'Auditors' Report' which are also published in the company's Annual Report, along with its Balance Sheet and the Profit and Loss Account.

The report of the Board of Directors shall describe the company's state of affairs, the amount proposed to be carried over to the respective reserves, the amount recommended for dividend as also the change which might have occurred during the course of the financial year in regard to the nature of the business of the company. (**Section 217**). The report must also explain the adverse (qualifying) remark(s) of the auditors, if any. It must also include a list showing the names of all the employees of the company who receive the remuneration of Rs 12 lakh per annum or more (inclusive of the value of the perquisites). Besides, it must state whether any such employee is related to any director or manager of the company, and, if so, the name of such director must also be stated.

42.9 Appointment of Auditors

Under the Act, it is obligatory on the part of the company to appoint qualified auditors (a Chartered Accountant in practice) to audit the accounts maintained by the company. The first auditors may be appointed by the Board of Directors within one month of the date of incorporation of the company. If the Board of Directors does not appoint the first auditors, it may be done in the company's Annual General Meeting (AGM).

42.9.1 Re-appointment of Auditors

As provided under **Section 224 (3)**, the auditors may be automatically reappointed. At every Annual General Meeting (AGM), the retiring auditors, by whatever authority appointed, is automatically reappointed, unless–

(a) He is not qualified for reappointment, or
(b) He has given a written notice to the company of his unwillingness to be reappointed, or
(c) A resolution has been passed at that meeting (AGM) appointing some one else, instead of the present auditor, or providing specifically and expressly that he shall not be reappointed, or
(d) Where notice has been given of any intended resolution, appointing some one else, instead of the present auditor, but due to that person's death, incapacitation, or disqualification, the resolution has to be dropped.

42.9.2 Auditor's Report

This document is required with a view to ensuring that it is a clean report, certifying to the effect that the financial statements of the company have been prepared from the books of accounts, properly kept, in accordance with the generally accepted accounting principles, and above all, that these present a **true and fair view** of the company. And, in case there are some qualifying remarks in the report, we must look for the

explanations given by the management, as also to find out as to how far are these explanations convincing enough.

The live example in regard to the qualifying (adverse) remarks of the Auditors, given in the Annual Report of Kallam Spinning Mills Limited for the Year 2002-2003, will amply clarify the point. The statutory Auditors, in their report, at item No. 15, appearing at page number 20, have made the qualifying remarks reading as follows:

'In our opinion, the company does not have a regular internal audit system.'

(And, they have also taken an extra care to print these qualifying remarks in bold letters, as they are invariably supposed to present such remarks conspicuously and prominently).

The Management of the company, on their part, give their own explanations, justifying their action and stand. It is for the users of the Balance Sheet to see whether the company's explanations about the auditors' qualifying remark(s) are satisfactory and convincing or otherwise.

42.10 Payment of Dividends

The entire amount of the company's profit after tax (PAT) is not distributed as dividends amongst its shareholders. Only a portion of it is made available for the payment of dividends, after a portion (usually a major portion) of it is transferred to the 'Reserves' and the 'Surplus', if any, is kept as 'Surplus'.
The company must transfer from its profits to its 'Reserves' the following minimum amount, before declaring **dividends** at the rate mentioned in **Table 42.3**.

Table 42.3

Per Cent Rate of Dividends Proposed	*Minimum Percentage of Profit to be Transferred to the Reserves*
10 per cent to 12.5 per cent	2.5 per cent
12.5 per cent to 15 per cent	5.0 per cent
15 per cent to 20 per cent	7.5 per cent
20 per cent and above	10 per cent

A company may transfer a higher percentage of profit (i.e. more than the minimum 10 per cent), voluntarily to the 'Reserves' in accordance with the Rules framed by the Central Government in this regard (**Section 205**). However, no transfer of funds will be required to the 'Reserves', if the proposed dividend is less than 10 per cent.

Further, in the case of an inadequate profit or the absence of any profit, in any year, the company may declare dividends out of the previous years' accumulated profits and Reserves, in accordance with the Rules framed by the Central Government in this regard.

Here, it may be noted that any amount of dividend remaining unclaimed and unpaid for a period of seven years from the date the same had become due for payment, shall be transferred to the ' Investor Education and Protection Fund'. [**Section 205 C (2)**].

42.11 Payment of Interim Dividends

The Board of Directors of the company may declare interim dividend, i.e. the dividend which is declared by the Board of Directors of the company at any time between two Annual General Meetings (AGMs).

42.12 Investigation of the Affairs of the Company

The Act has given some protection to the shareholders and the creditors of a company by giving powers to the Central Government under certain circumstances to investigate into the following matters:

(a) The affairs of the company, and
(b) The ownership of the company.

42.13 Managerial Personnel

As a company is an artificial person, it cannot act on its own. Accordingly, it works through the medium of some human beings. Therefore, as per the Act, a company is necessarily required to have a Board of Directors. In addition to the Board of Directors, the following category of the managerial personnel may as well be appointed by the company. (**Section 197-A**):

(a) Managing Director, and
(b) Manager.

But then, **Section 197-A** does not prohibit the employment of other managerial personnel such as Executives or Whole-time Director, which do not come within the term 'Managing Director' or 'Manager'.

42.14 Legal Position of Directors

As defined by **Section 2 (13)**, the term 'director' includes 'any person occupying the position of a director, by whatever name called'.

42.14.1 Number of Directors

As provided under **Section 252**, every public company must have at least three directors. Every private company, whether it is a subsidiary of a public company or not, must have at least two directors.

However, a public company, having –

(a) A paid-up capital of Rs 5 core or more, or
(b) 1,000 or more small shareholders, may have a director elected by such small shareholders in the manner as may be prescribed, as per the Companies (Amendment) Act 2000. The term 'small shareholders' means a shareholder holding shares of the face (nominal) value of Rs 20,000 or less, in a public company to which this Section applies.

The aforementioned number of directors is the minimum number of directors required as per law. The Articles of Association of a company may, as it mostly does, stipulate the minimum and maximum number of directors of its Board, say, minimum 4 and maximum 10. Further, the Articles of Association of a company may fix within these limits the limit which will constitute the Board for the time being, say, 7, which falls within the aforesaid limit.

42.14.2 Increase in the Number of Directors

However, a company, in its Annual general meetings (AGMs), may, by an ordinary resolution, increase or decrease the number of its directors, but within the limits fixed in that behalf, by its Articles of Association. (**Section 258**). In certain cases, the increase in the number of directors may also require the approval of the Central Government. But then, if such increase in the number of directors will not exceed the total number of directors beyond 12 directors, the approval of the Central Government is not necessary.

42.14.3 Only Individuals to be Directors

Only individual persons, and no corporate body, association or firm, shall be appointed as the directors of the company. (**Section 253**).

42.14.4 Appointment of First Directors

The names of the first directors usually appear in the Articles of Association of the company. However, the Articles of Association, instead of naming the first directors, may empower the subscribers, or majority of them, to appoint the first directors.

42.14.5 Appointment of Subsequent Directors

The appointment of the subsequent directors can be made by the following:

(i) The subscribers to the Memorandum of Association **[Section 254, Clause 64 (Table A)]**,
(ii) The company in its Annual General Meeting (**Section 255 to 257, 263 to 265**),
(iii) The Board of Directors (**Sections 260, 262, and 313**),
(iv) The Central Government, and Third parties (**Section 255**).

42.14.6 Disqualifications of Directors

As provided under **Section 274**, the following persons are disqualified for being appointed as directors:

(i) A person found by the Court to be of unsound mind,
(ii) An undischarged insolvent,
(iii) A person who has applied for being adjudged insolvent,
(iv) A person who has been convicted anywhere in the world for an offence involving moral turpitude, and sentenced in regard thereto, to imprisonment for not less than six months, and for a period of five years has not elapsed from the date of the expiry of the sentence,
(v) A person who has not paid his calls on the shares for six months from the date fixed for the payment,
(vi) A person who has been disqualified by the Court under **Section 203**, which empowers the Court to restrain fraudulent persons from managing the companies, and
(vii) A person who is already a director of a public company, under certain circumstances specified under **Section 203**.

42.15 Minor as a Director

A minor may not be appointed as director of a public company or a private company which is a subsidiary of a public company, as he is not competent to enter into as valid contract. But nothing in the Act prohibits a minor from being appointed as the director in an independent private company. However, such minor director, even in an independent private company, can occupy the position as an ornamental and not an active and functional director.

42.16 Managing Director

As defined under **Section 2 (26)**, a Managing Director of a company is a director who, by virtue of an agreement with the company, or by virtue of a resolution passed by the company in its Annual General Meeting (AGM), or by its Board of Directors, or by virtue of its Memorandum of Association and its Articles of Association, is entrusted with substantial powers of management which would not be exercisable by him,

otherwise. The term 'Managing Director' includes a director, occupying the position of the Managing Director, by whatever name called.

The Managing Director is, thus, a director of the company, who carries on the day-to-day affairs of the company. He is the executive head of the company and, subject to the control of the Board of Directors, of the company, controls the affairs of the company. A director entrusted with managerial functions will be a Managing Director even though he may be called as a 'Technical Director' or a 'Technical Advisor'. But then, he has necessarily to be a member of the Board of Directors.

The Managing Director is also an employee. In the case titled **Employee State Insurance Corporation vs Apex Engineering (P) Limited, [(1988) 1 CLJ 10],** the Supreme Court has held that a Managing Director has a duel identity. A Managing Director performs the duties over and above the duties of an ordinary director, and therefore, can as well be treated as an employee.

42.16.1 Appointment of Managing Director

As provided under **Section 2 (26)**, a Managing Director of a company may be appointed in any one of the following four ways:

(i) By virtue of an agreement with the company,
(ii) By virtue of a resolution passed by the company in its Annual General Meeting (AGM),
(iii) By virtue of a resolution passed by the Board of Directors, and
(iv) By virtue of the company's Memorandum of Association and its Articles of Association.

42.16.2 Tenure of Appointment of Managing Director

As per **Section 317**, the term of office of the Managing Director cannot exceed a period of five years at a time. He may, however, be reappointed or re-employed or his term of office may be extended, but again for a period of five years on any one occasion. But such reappointment or extension shall not be sanctioned earlier than two years from the date on which it is to come into force (effect).

42.16.3 Disqualifications of Managing Director

Under **Section 267**, the appointment of the following types of persons as the Managing Director, or the whole-time director, of a company has been prohibited:

(i) Who is an undischarged insolvent, or has, at any time, been adjudged an insolvent, or
(ii) Who suspends, or has any time suspended, payment to his creditors, or makes, or has any time made, a composition with them, or
(iii) Who is, or has any time been, convicted by a Court for an offence involving moral turpitude.

Further, as the Managing Director has necessarily to be one of the directors of the company too, all the conditions of disqualifications involving a director stipulated under **Section 274** shall automatically apply in the case of a Managing Director and Whole Time Director, as well.

42.17 Manager

As defined under **Section 2 (24)**, a 'Manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole or substantially the whole of the affairs of the company, and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not'.

Thus, the person who manages and controls only one of the departments or branches of the company and not the whole or substantially the whole of the affairs of the company, cannot be called a manager, by whatever name he may be called, like 'Manager - (Production)', or 'Branch Manager' or whatever.

42.17.1 Only Individuals to be Manager

Only individual persons, and no corporate body, association or firm, shall be appointed as the manager of a company. (**Section 384**).

42.17.2 Disqualifications of Manager

Under **Section 385**, the appointment of the following types of persons as the manager of a company has been prohibited:

- **(i)** Who is an undischarged insolvent, or
- **(ii)** Who has, at any time within the preceding five years, been adjudged an insolvent, or
- **(iii)** Who suspends, or has any time suspended, within the preceding five years, payment to his creditors, or
- **(iv)** Who makes, or has any time made, within the preceding five years, a composition with his creditors, or
- **(v)** Who is, or has any time been, convicted within the preceding five years, by a Court for an offence involving moral turpitude.

However, the Central Government, by notification in the Official Gazette, may remove any of the aforementioned disqualifications incurred by any person either generally or in relation to any company or companies specified in the Official Gazette notification.

42.18 Whole-Time Director

In many of the Sections in the Act, the terms 'Whole-Time Director' and 'Managing Director' have been used side by side. This may naturally give rise to some confusion as to whether these two terms have been used in the Act as synonyms. But the fact is that these two terms have different meanings. Their positions and roles are different.

As we have seen earlier, the term 'Managing Director' has been specifically defined under **Section 2 (26)**. But no such specific definition has been provided in the Act for the term 'Whole-Time Director'. However, the explanation to the **Section 269** provides that the term 'Whole-Time Director' includes a director in the whole time employment of the company.

As regards the appointment, re-appointment, and remuneration of the Whole-Time Director, the same provisions are applicable in this case also as are applicable in the case of the Managing Director. Under **Section 269**, every public company and a private company, which is a subsidiary of a public company, must have a Managing Director or a Whole-Time Director, if its paid-up share capital is Rs 5 crore or more. Likewise, **Sections 267 and 268** providing for disqualifications of Managing Directors, and approval of the Central Government for their appointment and re-appointment, also are applicable in the case of the Whole-Time Director. Moreover, the provisions of **Sections 309 to 311**, dealing with the remunerations of the directors and the other managerial personnel are also applicable in the case of the Whole-Time Director.

42.18.1 Distinction between Managing Director and Whole-Time Director

The broad distinctions between the Managing Director and the Whole-Time Director are the following:

- **(a)** A Managing Director may be appointed in that capacity in two or more companies at the same time. But a Whole-Time Director cannot be appointed in more than one company simultaneously, as he is in the whole time employment of a company already.
- **(b)** The tenure of a Managing Director of a public company or a private company which is a subsidiary of a public company cannot be more than five years at a time. However, there is no such restriction for the employment of a Whole-Time Director.

42.19 Company Secretary

The **Companies (Amendment) Act 1974** has made it compulsory for all the companies, having a paid up share capital of Rs 25 lakh and above, to necessarily appoint a whole time company secretary. (**Section 383 A**). Further, **Section 2 (45)** has defined the 'Secretary' as a 'Company Secretary', within the meaning of **Section 2 (1) (c) of the Company Secretaries Act, 1980**, and includes any other individual, possessing the prescribed qualifications and appointed to perform the duties which may be performed by a Company Secretary, under the Companies Act, and any other ministerial and administrative duties.

Section 2 (45-A) has defined the concept of 'secretary in whole time practice' to mean a Secretary who shall be deemed to be in practice within the meaning of **Section 2 (2) of the Company Secretaries Act, 1980,** and who is not in full time employment (of the company).

42.19.1 Qualifications of Company Secretary

The following are the required qualifications of a company secretary:

(a) In the case of a company, having a paid up share capital of Rs 50 lakh and above, the membership of the Institute of Companies Secretaries of India, New Delhi.

(b) In the case of any other company, one or more of the following qualifications will be necessary:
  (i) The membership of the Institute of Companies Secretaries of India, New Delhi. [vide (a) above])
  (ii) A degree in law granted by any university,
  (iii) The membership of the Institute of Chartered Accountants of India (ICAI), constituted under the Chartered Accountants Act, 1949,
  (iv) The membership of the Institute of Cost and Works Accountants of India (ICWAI), constituted under the Cost and Works Accountants Act, 1959,
  (v) A post-graduate degree or diploma in management sciences granted by any University, or Institute of Management, Ahmedabad, Bangalore, Calcutta, Lucknow, Indore and Kozikhode,
  (vi) A post-graduate degree in commerce granted by any University,
  (vii) A diploma in company law granted by the Indian Law Institute,
  (viii) A Diploma in Corporate Secretarial Practice granted by the Delhi Administration,
  (ix) A membership of the Association of Secretaries and Managers, Calcutta, or
  (x) A Diploma in Company Law Secretarial Practice granted by the University of Udaipur.

Let us Recapitulate

- A company is an artificial person and not a human being; it is just a legal entity. Accordingly, it cannot work or discharge its functions on its own. Therefore, it has to work through the medium of some other human beings. Accordingly, it discharges its functions through the directors of the company, whoever are authorised on this behalf, through a resolution passed by the company. Further, as provided in the Act, the shareholders also have been empowered to discharge certain functions.
- The Act has provided for the different types of meetings of the shareholders. These meetings are the following:
  (a) Statutory meeting,
  (b) Annual General meeting,
  (c) Extraordinary General meeting, and
  (d) Class meeting.

- The following are some of the most important legal provisions regarding the **'statutory meeting'**
  1. Statutory meeting is required to be held only by a public company having a share capital. That is, a private company or a public company not having a share capital, are not required to hold such statutory meeting.
  2. Such meeting must be held within a period of not less than one month and not more than six months from the date at which the company becomes entitled to commence its business.
  3. A notice of the meeting is required to be sent to every member, stating it to be a statutory meeting, at least 21 days before the date of such meeting. Such notice shall be deemed to have been served (sent) on the expiry of 48 hours after it has been posted. (**Section 53**).
- **The Annual General Meeting (AGM)** is to be held every year. That is why it is named Annual General Meeting (AGM). The main provisions in the regard to such meeting have been summarised as follows:
- The meeting must be held in every calendar year (i.e. January to December), and not more than 15 months should elapse between two such meetings. However, the first Annual General Meeting (AGM) may be held within 18 months from the date of incorporation. If such Annual General Meeting (AGM) is held within that period, it need not hold any such meeting in the year of its incorporation or in the following year.

  The Annual General Meeting (AGM) must be held in the following days and time:

  (i) On any day which is not a public holiday,
  (ii) During the business hours,
  (iii) At the Registered Office of the company, or at some other place within the city town or village, in which the registered office of the company is situated. [**Section 166 (2)**].
- The following business may be transacted in the Annual General Meeting (AGM):

  (a) Ordinary Business which relates to the following matters:
  - **(i)** Consideration of the accounts, the Balance Sheet and the Profit and Loss Account, and the reports of the Board of Directors and the auditors,
  - **(ii)** Declaration of Dividend, if any,
  - **(iii)** Appointment of the directors in the place of those retiring, and
  - **(iv)** Appointment of auditors and fixation of their remuneration.

  (b) Special Business

  Any other business transacted at the meeting will be deemed as the special business.
  - In the cases, where the annual accounts of the company are not ready, for being placed in the meeting, is open to the company to adjourn the Annual General Meeting (AGM) to a subsequent date, and fix a date for the next meeting when the accounts are expected to be ready for presentation and consideration in the meeting.
  - The company must give 21 days notice to all the members of the company and the auditors. Such notice shall be deemed to have been served on the expiry of 48 hours after it has been posted. It is not obligatory on the part of the company to advertise the notice of the meeting in the newspapers.
  - As provided in the **Clause 47 of Table A (Schedule–1)**, all general meetings other than the Annual General Meetings (AGMs) shall be called as the Extra-Ordinary General Meeting (EGM).
  - In the cases where it is proposed to alter, vary, or affect the rights of a particular class of shareholders (like where the accumulated dividends on cumulative preference share is to be cancelled), and it is not possible to obtain, in writing, the consent of the holders of the ¾ th of the issued shares of that class of shareholders, a meeting of the holders of such class of shares may be called. Such a meeting is referred to as the Class Meeting.
  - The holders of at least 10 per cent of the issued shares of that class, who did not consent to such resolution, may file an application in the Court within 21 days of such meeting, to have the resolution cancelled.

- The term **'proxy'** is applicable to such person so appointed. The term 'proxy' is also used in the reference of the document/instrument by which a member of a company appoints another person to attend the meeting and vote for him therein.
- The Act allows the casting of votes to a member of the company through postal ballot in certain cases, and subject to certain conditions.

ACCOUNTS

- All the companies are required to keep at its registered office proper books of accounts, giving a **true and fair view** of their financial affairs. These books are open to inspection, during the company's business hours, by any director and the Registrar of Companies, or an officer authorised by the Central Government.
- At every Annual General meeting (AGM) the Board of Directors must lay before the members of the company the Balance Sheet and the Profit and Loss Account of the company.
- **Section 211** deals with the form (proforma) of the Balance Sheet and the details to be given in the Profit and Loss Account. The form (proforma) of the Balance Sheet and the details to be given in the Profit and Loss Account are given in **Schedule VI** of the Act.
- The format in which the companies are required to present their Balance Sheet is given at Table 42.1
- Here, it may be mentioned that, as per the convention, prevalent in India, all the liabilities are shown on the Left Hand Side (LHS) and all the assets on the Right Hand Side (RHS) in the horizontal format. And accordingly, in the vertical form, first, all the liabilities appear at the top, and thereafter, assets are presented.
- Further, the companies which are working for more than one year are required to give the Balance Sheets of at least two consecutive years for the purpose of intra-firm comparison of the company during these two years.
- The Balance Sheet and the Profit and Loss Account of the company must be signed on behalf of the Board of Directors by at least two of the Directors, and countersigned by the Manager or the Company Secretary. In the companies where there is a Managing Director, such Managing Director should be one of such signatories. The Balance Sheet and the Profit and Loss Account of the company must be first approved by the Board of Directors before these are submitted to the auditors for audit purposes. After completing the audit of the company, the auditors must submit their own 'Auditors' Report' which are also published in the company's Annual Report, along with its Balance Sheet and the Profit and Loss Account.
- The report of the Board of Directors shall describe the company's state of affairs, the amount proposed to be carried over to the respective reserves, the amount recommended for dividend, as also the change which might have occurred during the course of the financial year in regard to the nature of the business of the company.

AUDIT

- Under the Act, it is obligatory on the part of the company to appoint qualified auditors (a Chartered Accountant in practice) to audit the accounts maintained by the company. The first auditors may be appointed by the Board of Directors within one month of the date of incorporation of the company. If the Board of Directors does not appoint the first auditors, it may be done in the company's Annual General Meeting (AGM).
- The auditors may be automatically reappointed. At every Annual General Meeting (AGM).the retiring auditors, by whatever authority appointed, is automatically reappointed, unless –

  (**a**) He is not qualified for reappointment, or
  (**b**) He has given a written notice to the company of his unwillingness to be reappointed, or
  (**c**) A resolution has been passed at that meeting (AGM) appointing some one else, instead of the present auditor, or providing specifically and expressly that he shall not be reappointed, or

(**d**) Where notice has been given of any intended resolution, appointing some one else, instead of the present auditor, but due to that person's death, incapacitation or disqualification, the resolution has to be dropped.

- This document (Audit Report) is required with a view to ensuring that it is a clean report, certifying to the effect that the financial statements of the company have been prepared from the books of accounts, properly kept, in accordance with the generally accepted accounting principles, and above all, that these present a **true and fair** view of the company. And, in case there are some qualifying remarks in the report, we must look for the explanations given by the management, as also to find out as to how far are these explanations convincing enough.

DIVIDENDS

- The entire amount of the company's profit after tax (PAT) is not distributed as dividends amongst its shareholders. Only a portion of it is made available for the payment of dividends, after a portion (usually a major portion) of it is transferred to the 'Reserves' and the 'Surplus', if any is kept as 'Surplus'.
- The company must transfer from its profits to its 'Reserves' the minimum amount, before declaring the dividends at the rate mentioned in **Table 42.3**.
- A company may transfer a higher percentage of profit (i.e. more than the minimum 10 per cent), voluntarily to the 'Reserves' in accordance with the Rules framed by the Central Government in this regard. However, no transfer of funds will be required to the 'Reserves', if the proposed dividend is less than 10 per cent.
- Further, in the case of an inadequate profit or the absence of any profit, in any year, the company may declare dividends out of the previous years' accumulated profits and Reserves, in accordance with the Rules framed by the Central Government in this regard.
- Here it may be noted that any amount of dividend remaining unclaimed and unpaid for a period of seven years from the date the same had become due for payment, shall be transferred to the ' Investor Education and Protection Fund'.
- The Board of Directors of the company may declare interim dividend, i.e. the dividend which is declared by the Board of Directors of the company at any time between two Annual General Meetings (AGMs).
- The Act has given some protection to the shareholders and the creditors of a company by giving powers to the Central Government under certain circumstances to investigate into the following matters:

  (**a**) The affairs of the company, and
  (**b**) The ownership of the company.

- As a company is an artificial person, it cannot act on its own. Accordingly, it works through the medium of some human beings. Therefore, as per the Act, a company is necessarily required to have a Board of Directors. In addition to the Board of Directors, the following category of the managerial personnel may as well be appointed by the company :

  (**a**) Managing Director, and
  (**b**) Manager.

  But then, the Act does not prohibit the employment of other managerial personnel such as Executive Director or Whole-time Director, which do not come within the term 'Managing Director' or 'Manager'.
- The term 'director' includes 'any person occupying the position of a director, by whatever name called'.
- Every public company must have at least three directors. Every private company, whether it is a subsidiary of a public company or not, must have at least two directors.
  However, a public company, having –

  (**a**) A paid up capital of Rs 5 core or more, or
  (**b**) 1,000 or more small shareholders, may have a director elected by such small shareholders in the manner as may be prescribed, as per the Companies (Amendment) Act 2000. The term 'small

shareholders' means a shareholder holding shares of the face (nominal) value of Rs 20,000 or less in a public company to which this Section applies.

- The aforementioned number of directors is the minimum number of directors required as per law. The Articles of Association of a company may, as it mostly does, stipulate the minimum and maximum number of directors of its Board, say, minimum 4 and maximum 10.
- However, a company, in its Annual general meetings (AGMs), may, by an ordinary resolution, increase or decrease the number of its directors, but within the limits fixed in that behalf, by its Articles of Association.
- Only individual persons, and no corporate body, association or firm, shall be appointed as the directors of a company. (**Section 253**).
- The names of the first directors usually appear in the Articles of Association of the company. However, the Articles of Association, instead of naming the first directors, may empower the subscribers, or majority of them, to appoint the first directors.

  The appointment of the subsequent directors can be made by the following;

  (i) The subscribers to the Memorandum of Association [Section 254, Clause 64 (Table A)],
  (ii) The company in its Annual General Meeting (Section 255 to 257, 263 to 265),
  (iii) The Board of Directors (Sections 260, 262 and 313),
  (iv) The Central Government, and Third parties (Section 255).
- The following persons are disqualified for being appointed as directors:

  (i) A person found by the Court to be of unsound mind,
  (ii) An undischarged insolvent,
  (iii) A person who has applied for being adjudged insolvent,
  (iv) A person who has been convicted any where in the world for an offence involving moral turpitude, and sentenced in regard thereto, to imprisonment for not less than six months, and for a period of five years has not elapsed from the date of the expiry of the sentence,
  (v) A person who has not paid his calls on the shares for six months from the date fixed for the payment,
  (vi) A person who has been disqualified by the Court under **Section 203**, which empowers the Court to restrain fraudulent persons from managing the companies, and
  (vii) A person who is already a director of a public company, under certain circumstances specified under **Section 203**.
- A minor may not be appointed as director of a public company or a private company, which is a subsidiary of a public company, as he is not competent to enter into a valid contract.
- A Managing Director of a company is a director who, by virtue of an agreement with the company, or by virtue of a resolution passed by the company in its Annual General Meeting (AGM), or by its Board of Directors, or by virtue of its Memorandum of Association and its Articles of Association, is entrusted with substantial powers of management which would not be exercisable by him, otherwise.
- The Managing Director is, thus, a director of the company, who carries on the day-to-day affairs of the company. He is the executive head of the company and, subject to the control of the Board of Directors, of the company, controls the affairs of the company.

  The Managing Director is also an employee.
- A Managing Director of a company may be appointed in any one of the following four ways:

  (i) By virtue of an agreement with the company,
  (ii) By virtue of a resolution passed by the company in its Annual General Meeting (AGM),
  (iii) By virtue of a resolution passed by the Board of Directors, and
  (iv) By virtue of the company's Memorandum of Association and its Articles of Association.

- The term of office of the Managing Director cannot exceed a period of five years at a time. He may, however, be reappointed or re-employed or his term of office may be extended, but again for a period of five years on any one occasion.
- The appointment of the following types of persons as the Managing Director, or the whole-time director, of a company has been prohibited:
  - **(i)** Who is an undischarged insolvent, or has, at any time, been adjudged as an insolvent, or
  - **(ii)** Who suspends, or has any time suspended, payment to his creditors, or makes, or has any time made, a composition with them, or
  - **(iii)** Who is, or has any time been convicted by a Court for an offence involving moral turpitude.
- Further, as the Managing Director has necessarily to be one of the directors of the company too, all the conditions of disqualifications involving a director, shall automatically apply in the case of a Managing Director as well.
- 'Manager' means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole or substantially the whole of the affairs of the company, and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not.
- Only individual persons, and no corporate body, association or firm, shall be appointed as the manager of a company.
- The appointment of the following types of persons as the Manager of a company has been prohibited:
  - **(i)** Who is an undischarged insolvent, or
  - **(ii)** Who has at any time, within the preceding five years, been adjudged as an insolvent, or
  - **(iii)** Who suspends, or has any time suspended, within the preceding five years, payment to his creditors, or
  - **(iv)** Who makes, or has any time made, within the preceding five years, a composition with his creditors, or
  - **(v)** Who is, or has any time been, convicted within the preceding five years, by a Court for an offence involving moral turpitude.
- The term 'Whole-Time Director' includes a director in the whole time employment of the company.

  As regards the appointment, re-appointment, and remuneration of the Whole-Time Director, the same provisions are applicable in this case also as are applicable in the case of the Managing Director. Every public company or a private company which is a subsidiary of a public company, must have a Managing Director or a Whole-Time Director, if its paid up share capital is Rs 5 crore or more.
- The broad distinctions between the Managing Director and the Whole-Time Director are the following:
  - **(a)** A Managing Director may be appointed in that capacity in two or more companies at the same time. But a Whole-Time Director cannot be appointed in more than one company simultaneously, as he is in the whole time employment of a company already.
  - **(b)** The tenure of a Managing Director of a public company or a private company, which is a subsidiary of a public company, cannot be more than five years at a time. However, there is no such restriction for the employment of a Whole-Time Director.
- It is compulsory for all the companies, having a paid up share capital of Rs 25 lakh and above, to necessarily appoint a whole-time company secretary.

Questions For Reflection

1. Why is it necessary for the company to hold meetings?
2. Write short notes on the holding of the following types of meetings by a company:

(a) Statutory meeting,
(b) Annual General meeting,
(c) Extraordinary General meeting, and
(d) Class meeting.

3. What do you understand by the term 'Proxy'?
4. Can a member (shareholder) of a company cast his vote by postal ballot? Write 'Yes' or 'No' as your answer.
5. Write down the format (item–wise and in the sequential order) in which the companies are required to present their Balance Sheet under the Companies Act:
   (a) In the Horizontal Form or 'T' Form, and
   (b) In the Vertical Form.
6. Who may be appointed as the auditor of a company?
7. (a) Can an auditor be re-appointed?
   (b) Under what conditions can an auditor be not reappointed by the company?
8. (a) What are the importance and purpose of an Audit Report of a company?
   (b) What do you understand by the term 'qualified report' of the auditor?
   (c) Is it necessary for the management of the company to publish its response to the qualifying remarks of the auditors in its Annual Report? Write 'Yes' or 'No' as your answer.
9. (a) At what percentage rate of profit, a company must transfer minimum amount from its profits to its 'Reserves', before declaring the dividends?
   (b) Can a company transfer a higher percentage of profit (i.e. more than the minimum per cent), voluntarily to the 'Reserves'? Write 'Yes' or 'No' as your answer.
   (c) Under what specific conditions no transfer of funds will be required to the 'Reserves'?
   (d) In the case of an inadequate profit or the absence of any profit, in any year, can the company declare dividends out of the previous years' accumulated profits and Reserves?
   (e) To which specific Fund any amount of dividend, remaining unclaimed and unpaid for a period of seven years from the date the same had become due for payment, shall be transferred?
   (f) Can a company declare an interim dividend at any time between two Annual General Meetings (AGMs)? Write 'Yes' or 'No' as your answer.
10. What procedure should be followed for increasing or decreasing the number of Directors?
11. 'Only Individual persons, and no corporate body, association or firm, shall be appointed as the directors of the company.' Do you agree with this view? Write 'Yes' or 'No' as your answer.
12. (a) What is the process for the appointment of the first Directors?
    (b) What is the process for the appointment of the subsequent Directors?
13. Who are the persons who are disqualified for being appointed as directors?
14. Can a minor be appointed as director of a public company or a private company, which is a subsidiary of a public company? Give reasons for your answer.
15. (a) Who is the Managing Director of a company; how is he appointed and what is his managerial position and role in a company?
    (b) Is the Managing Director also an employee of a company? Write 'Yes' or 'No' as your answer.
16. In what different ways can a Managing Director of a company be appointed? Explain.
17. What is the tenure of appointment of a Managing Director?
18. What are the various disqualifications for the appointment of the Managing Director?
19. (a) What are the managerial roles and position of a manager in a company?
    (b) Can the person who manages and controls only one of the departments or branches of the company and not the whole or substantially the whole of the affairs of the company, be called a manager? Write 'Yes' or 'No' as your answer.
20. 'Only Individual persons, and no corporate body, association or firm, can be appointed as the manager of the company." Do you agree with this statement? Write 'Yes' or 'No' as your answer.

21. What are the various disqualifications for the appointment of a Manager?
22. What are the broad distinctions between a Managing Director and a Whole-Time Director of a company?
23. What are the required qualifications of a company secretary?

Problems for Practice (With Suggested Solutions)

Problem 1

Anurag Accessories Company Limited has issued a notice of the meeting to its every member, stating it to be a statutory meeting, well in advance, i.e. 15 days before the date of such meeting. Such notice is deemed to have been served (sent) on the expiry of 48 hours after it has been posted. Do you think that the company has acted according to the provisions of the Companies Act? Give reasons for your answer.

Solution

No. The company has not acted according to the provisions of the Companies Act, which states that a notice of a statutory meeting is required to be sent to every member, stating it to be a statutory meeting, at least 21 days before the date of such meeting. But the company has sent the notice, in the instant case, only 15 days before the date of such meeting, and not 21 days before the date of such meeting.

Problem 2

Krishna Construction Company Limited has issued a notice to all its members for holding its Annual General Meeting (AGM), on the 15th August 2009, at 10 pm. at a certain specified place, which falls within the city town, in which the registered office of the company is situated. Do you think that the company has acted according to the provisions of the Companies Act? Give reasons for your answer.

Solution

No. The company has not acted according to the provisions of the Companies Act, which, *inter alia*, states that, an Annual General Meeting (AGM) of the company must be held in the following days and time:

(i) On any day which is not a public holiday, and
(ii) During the business hours.

But the 15th August is declared as a public holiday every year as an Independence Day. Therefore, the company should not have fixed the AGM on the 15th August 2009, inasmuch as it happens to be a public holiday.

Further, the time fixed for the company at 10 pm. is also in contravention of the provisions of the Companies Act, which provides that the AGM must be held during the business hours. Here, it has been presumed that the business hours of the company is the usual timing upto 9 pm. or so, and not in any case, 10 pm. onwards.

The company is, however, found to have complied with only one of the several provisions of the Act in that it has fixed the AGM at a certain specified place, which falls within the city town, in which the registered office of the company is situated.

Problem 3

The company must transfer from its profits to its 'Reserves' the following minimum amount, before declaring dividends at the rate mentioned in the following Table:

Table

Per Cent Rate of Dividends Proposed	*Minimum Percentage of Profit to be Transferred to the Reserves*
10 per cent to 12.5 per cent	5 per cent
12.5 per cent to 15 per cent	10 per cent
15 per cent to 20 per cent	15 per cent
20 per cent and above	20 per cent

Do you agree with the above statement? Give reasons for your answer.

Solution

No. The correct statement should read as:

The company must transfer from its profits to its 'Reserves' the following minimum amount, before declaring the bonus at the rate mentioned in the Table .

Per Cent Rate of Dividends Proposed	*Minimum Percentage of Profit to be Transferred to the Reserves*
10 per cent to 12.5 per cent	2.5 per cent
12.5 per cent to 15 per cent	5.0 per cent
15 per cent to 20 per cent	7.5 per cent
20 per cent and above	10 per cent

Problem 4

The statutory Auditors, in their report of a company, have made the qualifying remarks reading as follows:

'*In our opinion, the company does not have a regular internal audit system.*'

The management of the company, in response to the adverse remarks of the statutory Auditors, have stated as follows:

"The Board is of the opinion that the operation of the Company is being run by professionals, whose activities are internally checked by their higher officials in the management hierarchy and it didn't have any materiality affecting the operations of the Company."

Do you think that the reply of the management of the company is satisfactory? Give reasons for your answer.

Solution

No. The reply of the management of **t**he company is not satisfactory. This is so because of the following reasons:

(i) It has been made imperative and obligatory on the part of all the companies in India that, depending upon the scale of operations of the company concerned, it must have an appropriate regular internal audit system in place.

(ii) Thus, the deciding factor is the scale of operations of the company, and not its management by the professionals, which is usually the position in almost all the large-scale companies.

(iii) And, the rationale behind the aforementioned statutory provision is obviously to ensure that the accounting and financial recording, management and reporting of the company, gets regularly checked, on a day-to-day basis, by its own internal auditor(s), inasmuch as it may not be possible for the statutory auditors themselves to check the financial aspects of the company, at the end of the year, in one go, as they have to work under some time constraint, too.

(iv) It may, thus, be rightly insisted upon by the shareholders of the company, that it must ensure that a suitable regular internal audit system is put in place forthwith.

Problem 5

Garima Garments Company Limited has appointed Shri Sudhakar Sharma who has recently applied for being adjudged insolvent. But he has not so far been adjudged insolvent. Do you think that the company has acted according to the provisions of the Companies Act? Give reasons for your answer.

Solution

No. The company has not acted according to the provisions of the Companies Act. This is so because, as per the list given in the Act, as to who are the persons who are considered to be disqualified as being a Director of a company, a person who has applied for being adjudged insolvent, is also included in the list of persons who are disqualified for being appointed as directors of a company. Therefore, the appointment of Shri Sudhakar Sharma is in contravention of the provisions of the Act.

Problem 6

Sun and Moon Company Limited is having a paid up share capital of Rs 75 lakh. It has appointed Suresh Gopal as the company secretary. He is well qualified, having the membership of the Institute of Chartered Accountants of India (ICAI). He is also a law graduate and has post-graduate degree in management sciences granted by the Institute of Management, Ahmedabad. Do you think that the company has acted according to the provisions of the Companies Act? Give reasons for your answer.

Solution

No. The company has not acted according to the provisions of the Companies Act. This is so because, as provided in the Act, **i**n the case of a company, having a paid up share capital of Rs 50 lakh and above, the membership of the Institute of Companies Secretaries of India, New Delhi, is the only required qualification of a person to be appointed as the company secretary of such company. As the company, in the instant case, is having a paid up share capital of Rs 75 lakh, i.e. above Rs 50 lakh, no degree/qualification, other than the membership of the Institute of Companies Secretaries of India, New Delhi, can make him eligible to be appointed as the company secretary in Sun and Moon Company Limited, which is having a paid up share capital of Rs 75 lakh.

Chapter Forty Three

Winding-Up and Dissolution of Companies

"*If you don't know where you are going, you might wind up someplace else.*
Aristotle

Whether you wind up with a nest egg or a goose egg depends on the kind of chick you married
Wall Street Journal

Every institution not only carries within it the seeds of its own dissolution, but prepares the way for its most hated rival.
Dean William R. Inge

The most dangerous aspect of present-day life is the dissolution of the feeling of individual responsibility.
Eugenio Montale"

43.1 Definition of Winding-up of a Company

The process whereby the life of a company is brought to its end, and its property is administered for the benefit of its creditors and its members (shareholders), is known as the winding–up of the company. An administrator, referred to as the 'liquidator', is appointed, who takes over the control of the company, collects its assets, pays the debts, and finally, distributes surplus, if any, amongst its members (shareholders), according to their rights, subject to the cost of his doing so. The statutory process by which this is achieved is referred to as the 'liquidation'.

There is a distinction between the winding–up of the company and the insolvency of the individual, in the sense that a company cannot be declared insolvent under the law of insolvency. Further, even a solvent company may be wound–up, which is not the case with the individuals.

43.2 Different Modes of Winding–up

There are the following three ways in which a company may be wound-up:

(a) Compulsory winding–up, under an order of the Court,
(b) Voluntary winding–up, and
(c) Voluntary winding–up under the supervision of the Court.

We will now discuss all the aforementioned three modes of winding–up, one after the other.

43.3 Compulsory Winding–up, under an Order of the Court

The winding–up by the Court is generally referred to as the 'Compulsory Winding–up'. The Court may order the winding–up of a company in the cases mentioned under **Section 433**. The Court will issue an order for the winding–up of a company on an application by any of the persons mentioned under **Section 439**, as discussed hereunder:

(i) The company itself by passing a special resolution, or
(ii) Any creditor or creditors, including any contingent or prospective creditor or creditors, or
(iii) A contributory or contributories, or
(iv) Any combination of creditors, company or contributories, acting jointly or separately, or
(v) The Registrar of Companies, or
(vi) Any person authorised by the Central Government as per **Section 243**, or
(vii) The Official Liquidator (**Section 440**).

43.3.1 Courts having Jurisdiction to Wind-up

The High Court, having the jurisdiction in regard to the place at which the registered office of the company concerned is situated, has the jurisdiction to wind–up the company, except to the extent to which the jurisdiction has been conferred on any District Court or District Courts, subordinate to the High Court. However, the application for the winding–up of a company, with a paid up share capital of Rs 5 lakh or more, has to be filed in the High Court.

The registered office of the company, for the purpose of **Compulsory Winding–up, under an order of the Court,** means the place, which has, longest been the registered office of the company concerned, during the period of six months immediately preceding the filing up of the petition for the winding–up.

43.3.2 Grounds for Compulsory Winding–up [Section 433 (3)]

The Court may wind-up a company in the following cases:

(a) Special Resolution

The company may resolve, by passing a special resolution, to the effect that the company would be wound–up by the Court. Such resolution may be passed for any cause whatsoever. However, the Court may not pass the order for the winding–up of the company concerned, if the Court finds such winding–up of the company to be opposed to the public interest or the interest of the company concerned as a whole.

(b) Default in holding Statutory Meeting

In case a default is made by the company in submitting the Statutory Report to the Registrar of Companies, or if the company fails to hold the statutory meeting, the company concerned may be ordered to be wound-up. The petition on this ground can be filed either by the Registrar of Companies, or the contributories. Further, if the petition is to be filed by any other person, it may be filed before the expiry of 14 days after the last day on which the statutory meeting must have been held. [**Section 439 (7)**].

(c) Failure to Commence Business

If a company does not commence its business within a period of one year from the date of its incorporation, or it suspends its business for a whole one year, it may be ordered to be wound up. Failure to commence its business or to carry on its business is not treated as a ground for the compulsory winding–up of the company, unless the company has no intention to carry on its business, or it has become impossible to do so. A company would not be wound–up simply because of some temporary interruption, such as the trade depression or because it is waiting for further capital to be subscribed. But in the cases, where the chances of the company resuming its business is rather slim or gloomy, the Court may order for its winding–up. [**Rupa Bharati Ltd vs Registrar of Companies (1969)Comp. L.J. 296**].

(d) Reduction in Membership

In the cases where the number of the membership of a company is reduced below the statutory minimum number of 7 in the case of a public company and two in the case of a private company, the company may be ordered to be wound–up.

(e) Inability to Pay Debts

If a company is unable to pay its debts, the Court may order for the winding–up of the company.

Under **Section 434**, the company shall be considered to be unable to pay its debts in the following circumstances:

- **(i)** A creditor for more than Rs 500 has served on the company at its registered office a demand for the repayment of the loan or payment of the amount of credit due, under his hand (i.e. duly signed by him), and the company has neglected for three weeks thereafter, to pay or secure or compound the sum to a reasonable satisfaction of the creditor, or
- **(ii)** Execution or other process issued on a judgement or order in favour of a creditor of the company is returned unsatisfied (i.e. not complied with), in whole or in part, or
- **(iii)** It is proved to the satisfaction of the Court that the company is unable to pay its debts, taking into account its contingent and prospective liabilities.

But an important condition that is required to be fulfilled in this regard is that the creditors must have a complete title to the debt and, that the debt must have become payable. That is, in the cases where there is a *bona fide* dispute pertaining to the debt, the company cannot be charged to have neglected to pay the debt.

(f) Just and Equitable

The Court may as well order for the winding–up of a company if it is of the opinion that it is just and equitable that the company should be wound–up. In the exercise of this power, on this ground, the Court will give due weightage to the interests of the company, its employees, its creditors, and shareholders as also the interest of the general public. In fact, the relief based on the ground of 'just and equitable' clause is in the nature of the remedy of the last resort; that is, in the cases where any other remedy may not be considered effective enough to protect the general interests of the company.

Further, while in the aforementioned five cases [from item (**a**) to item (**e**)], definite conditions must be fulfilled, in the case of the 'just and equitable' clause, the entire matter is left to the 'wide and wise' direction and discretion the Court. [**Hind Overseas (P) Ltd vs R. P. Jhunjhunwala (1977) ASIL XIIL**].

43.3.3 Commencement of Winding–up (Section 441)

The winding–up of the company by the Court shall be deemed to have commenced at the time of the filing of the petition for the winding–up. If no order for the winding–up of the company is passed by the Court, and the winding–up petition is dismissed, the date of filing of the petition for the winding–up becomes irrelevant. That is to say that, unless and until the winding–up order is passed, the company concerned will have to comply with the requirements of the Act, as is required of the companies not wound–up.

43.4 Voluntary Winding–up

'Voluntary Winding–up' is the winding–up of the company by its creditors or its members (shareholders), without any intervention by the Court.

Thus, there are two types of voluntary winding–up:

(i) The members' (shareholders') voluntary winding–up, and
(ii) The creditors' voluntary winding–up.

In the cases of the voluntary winding–up, the company and its creditors are left free to settle their affairs without going to the Court. However, they (creditors) may go to the Court for issuing the directions or orders, if and when necessary.

43.4.1 How a Company can be Voluntarily Wound-up?

A company may be voluntarily wound-up in the following manner:

(a) If the company, in its Annual General Meeting (AGM), passes an ordinary resolution for the voluntary winding–up, where the period fixed by the Articles of Association for the duration of the company has expired, or the event has occurred on which, under the Articles of Association, the company is to be dissolved.
(b) In the cases where the company resolves, by special resolution, that it shall be wound up voluntarily. **(Section 484).**

In the cases where the company has passed a resolution for voluntary winding–up, it must, within 14 days of the passing of the resolution, give notice of the resolution by advertisement in the Official Gazette as also in some newspaper circulating in the district where the registered office of the company is situated. Further, in the case of default to do so, the company and every officer of the company, who is in default, shall be punishable with a fine which may extend up to Rs 500 for every day during which the default continues. (**Section 485**).

43.5 Voluntary Winding–up under Supervision of the Court

At any time, after a company has passed a resolution for a voluntary winding–up of the company, the Court may pass an order to the effect that that the voluntary winding–up should continue, subject to the supervision of the Court. (**Section 522**). An application for such supervision order by the Court may be made either by a creditor, a contributory, the company or the liquidator.

Such an order is passed by the Court under the following circumstances:

(a) The resolution of the winding–up was got passed (obtained) by fraud, or
(b) The rules regarding the winding–up order is not being observed, or
(c) The liquidator is prejudicial or is negligent in collecting the assets.

In such a case, the Court gets the same powers as it has in the case of compulsory winding–up of the company under the order of the Court. The Court may also appoint an additional liquidator or liquidators. The Court may as well remove any liquidator and fill any vacancy caused by the removal or by death or by resignation of the liquidator. (**Section 524**).

A liquidator so appointed by the Court shall have the same powers, and shall be subject to the same obligations and in all respects shall stand in the same position, as if he had been appointed in accordance with the provisions of the Act, regarding the appointment of liquidator in the cases of voluntary winding–up, subject, of course, to any restrictions imposed by the Court. (**Section 525**).

Unless the Court imposes restrictions on the exercise of any powers by the liquidator, he will have all the powers conferred on a liquidator in the case of a voluntary winding–up. [**Section 526 (1)**]. Further, the Court

shall have as wide powers as it has in the case of a compulsory winding–up. Moreover, the Court may stay suits or legal proceedings. It can make or enforce calls and all other orders necessary for a beneficial winding–up of the company. [**Section** *526* (**2**)].

43.5.1 Powers of the Court to Order Compulsory Winding–up (Section 527)

The Court may pass an order for compulsory winding–up, superseding the order of winding–up under its (Court's) supervision. Thereafter, the Court may appoint a person who is the liquidator, either provisionally or permanently, to be the liquidator in the winding–up by the Court, in addition to, and subject to, the control of, the Official Liquidator.

43.5.2 Dissolution of a Company

In the case of the winding–up of a company under the supervision of the Court, the company is deemed to be dissolved from the date an order is issued by the Court to that effect. The Court will issue such an order when the affairs of the company have been completely wound-up, and the liquidator has made an application to the Court requesting it to pass an order for the dissolution of the company.

Where a company has been dissolved, in accordance with the due process of law (except under **Section** *560* – defunct companies), on the expiry of five years from the date of such dissolution of the company, the name of the company should be struck off from the register of the Registrar of Companies, after noting against its name that it has been dissolved.

43.6 Liquidators

The commencement of the legal process of the winding–up of a company does not put an end to the existence of the company. Its assets are to be realised and distributed among the debenture holders, creditors and shareholders, in that order, and so on. But first of all, the entire dues of the Central and the State Governments have to be paid in full.

For this purpose some one has to act as the agent of the company. Such agent is called the liquidator. For the purposes of filing the Income Tax Return for the income earned during the process of the winding–up, it has been held that the liquidator will be regarded as the principal officer of the company. (**Mysore Spun Silk Mills Ltd**).

43.7 What is Dissolution of Company?

A company is said to be dissolved when it ceases to exist as an entity for all practical purposes.. But it is not the extinction of the company. After dissolution, the company is kept in the state of 'suspended animation' for a period of two years. Under **Section** *559*, the dissolution of the company may be declared by the Court within a period of two years from the date of the dissolution. This means that within a period of two years from the date of dissolution, the company may be revived by the Court, if the Court declares the dissolution as void. The Court will do so on the application of the liquidator of the company concerned, or by any other person who appears in the opinion of the Court to be interested in the matter of dissolution of the company. [**Section** *559* (**1**)]. It, however, is the duty of the applicant to file a copy of the aforementioned order of the Court with the Registrar of Companies within 30 days after the passing (making) of the Court order. [**Section** *559* (**2**)].

43.8 Modes of Dissolution of Company

The dissolution of a company may be brought about in any one of the following three ways:

(a) In the case of a '**Defunct Company**', the dissolution of a company may be brought about by removal of its name from the register of the Registrar of Companies. (**Section 560**).
(b) In pursuance of **'Amalgamation'** or **'Reconstruction'** of a company, by the order of the Court, without winding–up. That is, where the 'Amalgamation' or 'Reconstruction' of a company is being carried out under **Section 394 (b) (iv)**.
(c) In pursuance of the **'winding -up'** of the company.

43.9 Dissolution of Defunct Companies (Section 560)

A defunct company is a company which has never commenced its business or which is not carrying on its business. The procedure of the dissolution of a defunct company, without resorting to the machinery of winding–up, as provided under **Section 560**, has been discussed hereafter.

(a) In the cases where the Registrar of Companies has reasonable ground (cause) to believe that the company is not carrying on is business, or is not in operation, he will send a letter to the company, by post, inquiring about whether the company is carrying on its business, or is in operation'.
(b) If the Registrar of Companies does not receive a reply to his aforementioned letter from the company within one month of his sending such letter to the company, he shall again, within a period of 14 days after the expiry of the aforementioned period of one month, send a letter to the company, this time by registered post, referring to the first letter, and stating therein that no answer to the first letter has been received and that, if an answer to the second letter is not received within one month from the date of the second letter, a notice will be published in the Official Gazette, with a view to striking off the name of the company concerned from his register.
(c) If the Registrar of Companies either receives an answer to his letter from the company concerned, to the effect that it is not carrying on its business or is not in operation, or does not, within one month after sending the aforementioned second letter, receive any answer from the company, he may publish in the Official Gazette, and send a notice to the company by registered post that, after the expiry of three months from the date of such notice, the name of the company will be struck from the register, unless the cause is shown to the contrary, and the company will be dissolved.

However, the dissolution of the company in the aforementioned manner will not affect the following:

(i) The liabilities, if any, of every director, manager or other officer, who was exercising any power of management, and every member of the company.
(ii) The power of the Court to wind-up a company.

43.9.1 Restoration of the Name of the Company

If a company, or any member or any creditor of the company feels aggrieved by the removal of the name of the company from the register of the Registrar of Companies, the Court may, on an application by the aggrieved party, any time within 20 years from the date of the publication in the Official Gazette of the notice of striking the name of the company, order that the name of the company should be restored in the register of the Registrar of Companies. The power of the Court to order for the restoration of the name of the company is discretionary, and will be given when the Court is satisfied of the following:

(i) That, after restoration of the name of the company, the company will be in a position to carry on its business, or
(ii) That, at the time of striking the name of the company from the register of the Registrar of Companies, the company was carrying on its business or was in operation, or
(iii) That, it is just and equitable that the name of the company should be restored.

The Court may also, on passing such an order, give such direction and make such provisions as may seem just for placing the company and all other persons in the same position, as nearly as may be, as if the name of the company had not been stuck off.

A certified copy of the order of the Court must be delivered to the Registrar of Companies, and upon such delivery of the order, the company shall be deemed to have continued in existence, as if its name had not been struck off.

43.10 Dissolution in Pursuance of Amalgamation or Reconstruction [Section 394 (1)]

The Court may, either by the order sanctioning the compromise or arrangement, or by a subsequent order, make provision for the dissolution, without winding–up, of the company, whose undertaking, property, or liabilities, either wholly or in part, under the scheme of amalgamation or reconstruction, is transferred to another company.

But no such order shall be passed by the Court unless and until the Official Liquidator has, on scrutiny of the books and papers of the company, made a report to the Court that the affairs of the company has not been conducted in a manner prejudicial to the interests of members or to the public interest. However, the Court can, within two years, declare the dissolution void.

43.11 Dissolution in Pursuance of Winding–up

The corporate existence of the company continues throughout the winding–up process till it is dissolved. It may be dissolved in the following manner:

(a) **In the case of Compulsory Winding–up (Section 481)**

The Court may pass an order dissolving a company in the following circumstances:

(i) If the affairs of the company have been completely wound up; that is to say that the assets have been collected and the liabilities have been paid, as far as practicable , or

(ii) The liquidator cannot proceed with the process of completely winding–up for want of funds and assets or for any other reasons whatever, or

(iii) Under the circumstances of the case, it is just and reasonable that an order of dissolution of the company should be passed.

After the making of the order of dissolution, the company shall be dissolved from the date of the order. [**Section 481 (1)**]. The Official Liquidator shall file a copy of the order of dissolution within 30 days of passing the order. [**Section 481 (1)**].

(b) **In the case of the Members' Voluntary Winding–up (Section 497)**

As soon as the Official Liquidator, after scrutinising the books, accounts and papers of the company, makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interests of the members or to the public interest, then from the date of the submission of the report to the Court, the company shall be deemed to be dissolved. But then, where the Official Liquidator reports that the affairs have not been so conducted, as aforementioned, the Court will direct him to conduct further investigation and submit his second report to the Court, and the Court may order that the company shall stand dissolved from a date specified in that order of the Court. [**Section 497 (b)].**

(c) **In the case of the Creditors' Voluntary Winding–up (Section 509)**

The legal provisions in this case also are the same as in the case of the Members' Voluntary Winding–up, as provided under **Section 497**, discussed above. However, the Court can, within two years, declare the dissolution void.

When a company has been dissolved in accordance with the due process of law, except where such dissolution has been made under **Section 560**, on expiry of a period of five years from the date of the dissolution of the company, the name of the company should be struck off from the register of the Registrar of Companies, after noting against its name that it has been dissolved.

Thus, we may observe that while in the case of the defunct companies the dissolution and extinction of the company takes place simultaneously (i.e. at the same time), in the other cases (of other than defunct companies), the extinction takes place after the lapse of a period of five years.

Let us Recapitulate

- The process whereby the life of the company is brought to its end, and its property is administered for the benefit of its creditors and its members (shareholders), is known as the winding–up of the company. An administrator, referred to as the 'liquidator', is appointed, who takes over the control of the company, collects its assets, pays the debts, and finally, distributes surplus, if any, amongst its members (shareholders) according to their rights, subject to the cost of his doing so. The statutory process by which this is achieved is referred to as the 'liquidation'.
- There is a distinction between the winding–up of the company and the insolvency of the individual, in the sense that a company cannot be declared insolvent under the law of insolvency. Further, even a solvent company may be wound-up, which is not the case with the individuals.
- There are the following three ways in which a company may be wound-up:
  - (**a**) Compulsory Winding–up, under an order of the Court,
  - (**b**) Voluntary winding–up, and
  - (**c**) Voluntary winding–up under the supervision of the Court.
- The **winding–up by the Court** is generally referred to as the **'Compulsory Winding–up'**. The Court will issue an order for the winding–up of a company on an application by any of the following::
  - (**i**) The company itself, by passing a special resolution, or
  - (**ii**) Any creditor or creditors, including any contingent or prospective creditor or creditors, or
  - (**iii**) A contributory or contributories, or
  - (**iv**) Any combination of creditors, company or contributories, acting jointly or separately, or
  - (**v**) The Registrar of Companies, or
  - (**vi**) Any person authorised by the Central Government as per **Section 243**, or
  - (**vii**) The Official Liquidator (**Section 440**).
- The High Court, having the jurisdiction in regard to the place at which the registered office of the company concerned is situated, has the jurisdiction to wind up the company, except to the extent to which the jurisdiction has been conferred on any District Court or District Courts, subordinate to the High Court. However, the application for the winding–up of a company, with a paid up share capital of Rs 5 lakh or more, has to be filed in the High Court.
- The registered office of the company, for this purpose, means the place, which has longest been the registered office of the company concerned during the period of six months immediately preceding the filing up of the petition for the winding–up.
- The Court may wind-up a company in the following cases:
  - (**a**) Special Resolution
  - (**b**) Default in holding Statutory Meeting
  - (**c**) Failure to Commence Business
  - (**d**) Reduction in Membership
  - (**e**) Inability to Pay Debts
  - (**f**) Just and Equitable

- The winding–up of the company by the Court shall be deemed to have commenced at the time of the filing of the petition for the winding–up.
- '**Voluntary Winding–up**' is the winding–up of the company by its creditors or its members (shareholders), without any intervention by the Court.
  Thus, there are two types of voluntary winding–up:
  (**i**) The members' (shareholders') voluntary winding–up, and
  (**ii**) The creditors' voluntary winding–up.
- A company may be voluntarily wound-up in the following manner:
  (**a**) If the company, in its Annual General Meeting (AGM), passes an ordinary resolution for the voluntary winding–up, where the period fixed by the Articles of Association for the duration of the company has expired, or the event has occurred on which, under the Articles of Association, the company is to be dissolved.
  (**b**) In the cases where the company resolves, by special resolution, that it shall be wound up voluntarily. In the cases where the company has passed a resolution for voluntary winding–up, it must, within 14 days of the passing of the resolution, give notice of the resolution by advertisement in the Official Gazette as also in some newspaper circulating in the district where the registered office of the company is situated
- **Voluntary Winding–up under Supervision of the Court**
  At any time, after a company has passed a resolution for a voluntary winding–up of the company, the Court may pass an order to the effect that that the voluntary winding–up should continue, subject to the supervision of the Court.
- An application for such supervision order by the Court may be made either by a creditor, a contributory, the company or the liquidator.
- Such an order is passed by the Court under the following circumstances:
  (**a**) The resolution of the winding–up was got passed (obtained) by fraud, or
  (**b**) The rules regarding the winding–up order is not being observed, or
  (**c**) The liquidator is prejudicial or is negligent in collecting the assets.

  In such a case, the Court gets the same powers as it has in the case of compulsory winding–up of the company under the order of the Court. The Court may also appoint an additional liquidator or liquidators. The Court may as well remove any liquidator and fill any vacancy caused by the removal or by death or by resignation of the liquidator.
- Further, the Court shall have as wide powers as it has in the case of a compulsory winding–up. Moreover, the Court may stay suits or legal proceedings. It can make or enforce calls and all other orders necessary for a beneficial winding–up of the company. [**Section 526 (2)**].
- The Court may pass an order for compulsory winding–up, superseding the order of winding–up under its (Court's) supervision. Thereafter, the Court may appoint a person who is the liquidator, either provisionally or permanently, to be the liquidator in the winding–up by the Court, in addition to, and subject to, the control of, the Official Liquidator.
- **Dissolution of a Company**
  In the case of the winding–up of a company under the supervision of the Court, the company is deemed to be dissolved from the date an order is issued by the Court to that effect. The Court will issue such an order when the affairs of the company have been completely wound-up, and the liquidator has made an application to the Court requesting it to pass an order for the dissolution of the company.
- **Liquidators**
  The commencement of the legal process of the winding–up of a company does not put an end to the existence of the company. Its assets are to be realised and distributed among the debenture holders,

creditors and shareholders, in that order, and so on. But first of all, the entire dues of the Central and the State Governments have to be paid in full.

- A company is said to be dissolved when it ceases to exist as an entity for all practical purposes. But it is not the extinction of the company. The dissolution of a company may be brought about in any one of the following three ways:
  - **(a)** In the case of a 'Defunct Company', the dissolution of a company may be brought about by removal of its name from the register of the Registrar of Companies.
  - **(b)** In pursuance of 'Amalgamation' or 'Reconstruction' of a company, by the order of the Court, without winding–up.
  - **(c)** In pursuance of the 'winding–up' of the company.
- A defunct company is a company which has never commenced its business or which is not carrying on its business.
  - **(a)** In the cases where the Registrar of Companies has reasonable ground (cause) to believe that the company is not carrying on is business, or is not in operation, he will send a letter to the company, by post, inquiring about whether the company is carrying on business, or is in operation'.
  - **(b)** If the Registrar of Companies does not receive a reply to his aforementioned letter from the company within one month of his sending such letter to the company, he shall again, within a period of 14 days after the expiry of the aforementioned period of one month, send a letter to the company, this time by registered post, referring to the first letter, and stating therein that no answer to the first letter has been received and that, if an answer to the second letter is not received within one month from the date of the second letter, a notice will be published in the Official Gazette, with a view to striking off the name of the company concerned from his register.
  - **(c)** If the Registrar of Companies either receives an answer to his letter from the company concerned, to the effect that it is not carrying on its business or is not in operation, or does not, within one month after sending the aforementioned second letter, receive any answer from the company, he may publish in the Official Gazette, and send a notice to the company by registered post that, after the expiry of three months from the date of such notice, the name of the company will be struck from the register, unless the cause is shown to the contrary, and the company will be dissolved.
- However, the dissolution of the company in the aforementioned manner will not affect the following:
  - **(i)** The liabilities, if any, of every director, manager or other officer, who was exercising any power of management and every member of the company.
  - **(ii)** The power of the Court to wind-up a company.
- If a company, or any member or any creditor of the company feels aggrieved by the removal of the name of the company from the register of the Registrar of Companies, the Court may, on an application by the aggrieved party, any time within 20 years from the date of the publication in the Official Gazette of the notice of striking the name of the company, order that the name of the company should be restored in the register of the Registrar of Companies. The power of the Court to order for the restoration of the name of the company is discretionary, and will be given when the Court is satisfied of the following:
  - **(i)** That, after restoration of the name of the company, the company will be in a position to carry on its business, or
  - **(ii)** That, at the time of striking the name of the company from the register of the Registrar of Companies, the company was carrying on its business or was in operation, or
  - **(iii)** That, it is just and equitable that the name of the company should be restored.

  The corporate existence of the company continues throughout the winding–up process till it is dissolved.
- It may be dissolved in the following manner:

(a) In the case of Compulsory Winding–up (Section 481)

The Court may pass an order dissolving a company in the following circumstances:

(i) If the affairs of the company have been completely wound up; that is to say that the assets have been collected and the liabilities have been paid, as far as practicable , or

(ii) The liquidator cannot proceed with the process of completely winding–up for want of funds and assets or for any other reasons whatever, or

(iii) Under the circumstances of the case, it is just and reasonable that an order of dissolution of the company should be passed.

(b) In the case of the Members' Voluntary Winding–up (Section 497)

As soon as the Official Liquidator, after scrutinising the books, accounts and papers of the company, makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interests of the members or to the public interest, then from the date of the submission of the report to the Court, the company shall be deemed to be dissolved.

(c) In the case of the Creditors' Voluntary Winding–up (Section 509)

The legal provisions in this case also are the same as in the case of the members' voluntary winding–up.

Questions for Reflection

1. (a) What is known as the winding–up of a company?.
   (b) Who is called the liquidator? What are his functions?
2. (a) What is the distinction between the winding–up of the company and the insolvency of the individual?
   (b) Can even a solvent company be wound-up?
3. What are the different ways in which a company may be compulsorily wound-up?
4. How and when and by whom can a compulsory winding–up, under an order of the Court, take place?
5. (a) What is the jurisdiction of the Court for compulsory winding–up?
   (b) What does the registered office of the company mean for this purpose?
6. On what different grounds a company may be compulsorily wound-up by the Court?
7. From which time the compulsory winding–up of a company takes place?
   (a) What is 'voluntary winding–up?
   (b) Name the two different types of voluntary winding–up.
8. How a company is voluntarily wound-up?
9. How and under what circumstances can a voluntary winding–up under the supervision of the Court take place?
10. The assets of a company, when realised, are distributed among the shareholders, debenture holders, and creditors as also the dues of the State and Central Governments, in which order of priority over the other?
11. What do you understand by the term 'Dissolution of Company'?
12. What are the different modes of dissolution of a company?
13. (a) Which company is called a Defunct Company?
    (b) How is a defunct company dissolved?
14. How can the name of a company be restored in the register of the Registrar of Companies?
15. How does the dissolution of a company in pursuance of amalgamation or reconstruction take place?
16. How does the dissolution of a company in pursuance of winding–up of a company take place?
17. How does the dissolution of a company in the cases of the members' winding–up take place?
18. How does the dissolution of a company in the cases of the creditors' winding–up take place?
19. 'While in the case of the defunct companies the dissolution and extinction of the company takes place simultaneously, in the other cases (of other than defunct companies), the extinction takes place after the lapse of a period of five years'. Do you agree with this statement? Write 'Yes' or 'No' as your answer.

Problems for Practice (With Suggested Solutions)

Problem 1

'The registered office of the company, for the purpose of Compulsory Winding–up, under an order of the Court, means the place, which has longest been the registered office of the company concerned during the period of twelve months immediately preceding the filing up of the petition for the winding–up.' Do you agree with this statement? Give reasons for your answer.

Solution

No. The correct statement must read as 'The registered office of the company, for the purpose of Compulsory Winding–up, under an order of the Court, means the place, which has longest been the registered office of the company concerned during the period of **six** months immediately preceding the filing up of the petition for the winding–up'.

Problem 2

The assets of a company, when realised, have been distributed among the shareholders, debenture holders, creditors, for the payment of the dues of the State Government and the Central Government, in that order of priority over the other. Do you think that it is legally in order of correct priority?

Solution

No. The correct priority should be in the order of the following priority, one after the other:

1. Dues of the Central Government in full,
2. Dues of the State Government in full,
3. Creditors,
4. Debenture holders,
5. Shareholders.

PART 8

Law of Industrial Disputes

(Industrial Disputes Act, 1947)*

Chapter Forty Four

Object, Scope, and Definitions

"*In a balanced organization, working towards a common objective, there is success.*
T. L. Scrutton

A straight path never leads anywhere except to the objective.
Andre Gide

A set definite objective must be established if we are to accomplish anything in a big way.
John McDonald

The object of love is to serve, not to win.
Woodrow Wilson

The man whose authority is recent is always stern.
Aeschylus

The wisest have the most authority.
Plato

Kindness out of season destroys authority.
Sandi"

44.1 Objects

As per the preamble of the Act, its objects are 'to make provision for the investigation and settlement of industrial disputes and for certain other purposes'. According to Patna High Court, the objective of the Act is the 'amelioration of the conditions of workmen in an industry'. Based on the judgements of the Supreme Court, delivered from time to time, the following objectives of the Act may emerge:

(i) To promote measures for securing and preserving amity and good relations between the employer and the employees, to minimise the differences between the employer and the employees and to get the disputes settled through the adjudicatory authorities;
(ii) To provide a suitable machinery for investigation and settlement of industrial disputes between the employer and the employees, between the employer and workmen, and between the workmen and workmen, with the right of representation by a registered trade union or by an association of employers;
(iii) To prevent illegal strikes and lockouts;
(iv) To provide relief to the workmen in the matters of lay-offs, retrenchment, wrongful dismissals, and victimisation; and
(v) To give to the workmen the right of collective bargaining and to promote reconciliation.

Thus, we may observe that the purpose of the Act is to harmonise the relationships between the employers and the employees, and to provide for a machinery to settle the disputes that may arise between the two parties, viz., the employers and the workmen/employees. And, if such disputes are not amicably settled, it would adversely affect the desired industrial peace and may result in dislocation and even collapse of the industrial establishments, which are so very essential for the life and wellbeing of the society. The desired industrial peace is secured and maintained through a voluntary negotiation or through a compulsory adjudication.

This Act applies to the workmen drawing wages not exceeding a specified amount per month, and governs the service conditions of such persons. It may be regarded as supplementary to the Indian Contract Act, 1872, whose aim and objective is to regulate the contractual relationship between the employers and the employees, like the contractual relationship between the master and servant, in an ordinary sense.

44.2 Definitions

44.2.1 Appropriate Government (Section 2)

An appropriate government means the following:

(a) The Central Government is the appropriate government in relation to any industrial dispute pertaining to any industry carried on by, or under the authority of, the Central Government, or by the railway company or concerning any such controlled industry such as may be specified or in relation to any industrial dispute concerning a banking or an insurance company or a mine, an oilfield or a major port or a Dock Labour Board and such several other establishments established under several respective Acts listed under **Section 2**, like the Industrial Finance Corporation of India (IFCI), Employees State Insurance Corporation of India (ESIC), Indian Airlines or Air India, Life Insurance Corporation of India (LICI), Oil and Natural Gas Corporation of India (ONGC), Deposit Insurance and Credit Guarantee Corporation of India (DICGC), Central Warehousing Corporation of India, Agricultural Refinance and Development Corporation of India, Unit Trust of India (UTI), Food Corporation of India (FCI), International Airports Authority of India, Regional Rural Bank, Export and Credit Guarantee Corporation of India (ECGC), or the Industrial Reconstruction Corporation of India, and so on;
(b) In relation to any other industrial dispute, the respective State government will be the appropriate government; and
(c) In relation to an industry carried on by or under the authority of the Central Government, or the industry located in more than one State, the appropriate government will be the Central Government, so that the dispute may be effectively managed.

44.2.2 Award [Section 2 (b)]

Award means an interim or final decision of any industrial tribunal of dispute or of any question thereto, by

any Labour Court, industrial tribunal or national tribunal. It also includes arbitration award made under **Section 10A**.

44.2.3 Employer [Section 2 (g)]

(a) In relation to an industry, the employer means an industry carried on by, or under the authority of, any department of the Central Government or a State Government. 'The authority as prescribed on this behalf or where no authority is prescribed, by the head of the department'.
(b) In relation to an industry, carried on by, or on behalf of, the local authority, the Chief Executive Officer of the industry concerned is the employer.

44.2.4 Industry [Section 2 (j)]

Industry means any 'business, trade, undertaking, manufacture or calling, and the latter engaged in any calling, service, employment, handicraft or industrial occupation or vocation of workmen.'

44.2.5 Industrial Dispute [Section 2 (k)]

An industrial dispute means 'any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment, or the terms of employment or the conditions of labour , or any person'. Thus, we see that the scope of the industrial dispute is very wide, and it includes various types of disputes among various categories of persons. **For example**:

(a) There must be an industry, employers and workmen. Further, there must be a collective will of a substantial or appreciable number of workmen, taking up the cause of the aggrieved workman/workmen concerned. The dispute must be first raised to the management and thereafter it must be rejected by it, when alone it could assume the nurture of an industrial dispute. Here, it is presumed that the management concerned is in a position to settle the dispute.
(b) There must be a real and substantial dispute or difference and it should be such in which the workmen, as a category of employees, are substantially involves; that is to say that there must be a 'community of interest'.
(c) The dispute or difference must be between employers and employers, or between employers and workmen, or between workmen and workmen;
(d) The dispute must be pertaining to the employment or non-employment, or the terms of employment; the term non-employment includes retrenchment or refusal to reinstate; or the dispute must be pertaining to the conditions of labour.
(e) There must be a contractual relationship between the employer and the workman.
(f) The industry involved in the dispute must be an existing industry and not a dead (closed) industry or an industry which is no longer in existence.
(g) An individual dispute can assume the nature of an industrial dispute provided it is taken up by a recognised trade union, or by a number of workmen.

44.2.6 Lay Off [Section 2 (kkk)]

Lay off means 'the failure, refusal or inability of the employer on account of shortage of coal, power or raw material, or the accumulation of stocks, or the breakdown of the machinery, natural calamity or for any other connected reason, to give an employment to a workman, whose name is borne on the muster roll of his industrial establishment and who has not been retrenched'.

44.2.7 Lockout [Section 2 (l)]

Lockout means 'the temporary closing of a place of employment, or the suspension of work, or temporary refusal by an employer to continue to employ any number of persons employed by him'.

Lockout is usually used as an instrument by an employer to exercise his authority to compel the workmen to accept his proposal, in the similar manner as the strike is usually used as an instrument by the employees/ workmen to exercise their collective bargaining power to compel the employer to accept their charter of demands. Accordingly, the lockout has been aptly described by the Supreme Court as the anti thesis of strike.

The main difference between lay off and lockout is that while in the case of lay off certain ground must be present there, as aforementioned; in the case of lockout the presence of any such ground is not necessary.

44.2.8 Retrenchment [Section 2 (oo)]

Retrenchment means 'the termination by the employer of the service of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action'.

The retrenchment includes termination of the services of a temporary employee after giving him due notice. The retrenchment includes termination of the services of the surplus employees for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action.

The services of a workman can be retrenched on the ground of continued ill health. Here, the term 'continued ill health' means any disease, infirmity or unsoundness of a person which makes it virtually impossible for him to discharge his duties.

44.2.9 Strike [Section 2 (q)]

Strike means 'a cessation of work by a body of persons employed in any industry acting in combination; or a concerted refusal to continue to work or to accept employment'. Mere cessation of work does not amount to strike unless it can be proved that such a cessation of work was a concerted and combined action to enforce the demand.

44.2.10 Settlement [Section 2 (p)]

It means 'a settlement which has been arrived at in the course of conciliation proceeding, and bind all workmen, and also which has been arrived at otherwise, but has been signed by both the parties and a copy thereof has been sent to the Government and the conciliation officer; and settlement, which is a bipartite agreement between the employer and the workmen'.

Thus, we observe that the term 'settlement' involves the following two types of settlements:

(a) A settlement which has been arrived at as a result of reconciliation proceeding, and
(b) A settlement which has been arrived at by way of a written agreement between the employer and the workmen.

However, in the cases where a settlement has been arrived at between the management and the association of workmen, in the course of conciliation proceeding, it is binding on all workmen.

44.2.11 Wages [Section 2 (rr)]

Wages means 'all remuneration capable of being expressed in terms of money, which would, if the terms of employment, expressed or implied, were fulfilled, be payable to a workman in respect of his employment or work done in such employment and includes:

(i) Such allowances (including D.A.) as a workman is, for the time being, entitled to;
(ii) The value of any house accommodation, or of supply of water, light, medical attendance or other amenity or of any services or any concessional supply of food grains or other articles; and
(iii) Any travelling concessions.

But wages does not include:

(i) Any bonus;
(ii) Any contribution paid for life insurance fund payable by the employer to any pension fund, provident fund or any amount payable to workman under any law; and
(iii) Any gratuity payable on the termination of his service.

Thus, the wages means the monetary gains available to the workman in return of his labour, skill, and energy at the disposal of his employer.

44.3 Various Methods of Investigation, Management and Settlement of Industrial Disputes

The various methods of investigation, management and settlement of industrial disputes, as laid down in the Act, can be classifies under the following categories:

(a) Conciliation
- (i) Works Committee;
- (ii) Conciliation Officer; and
- (iii) Board of Conciliation.

(b) Arbitration

Court of Enquiry.

(c) Adjudication
- (i) Labour Court;
- (ii) Industrial Tribunal; and
- (iii) National Tribunal.

We will now proceed to discuss all these methods of settlement of industrial disputes, one after the other.

(a) Conciliation

Conciliation is an important method of settlement of industrial disputes with the intervention of a third party. It is an attempt at the reconciliation of the differences between the parties amicably, and to bring out a settlement acceptable by both the parties. It may be said to be a friendly intervention of a mutually acceptable neutral person, who could facilitate the settlement of the dispute by finding out a meeting point, to avoid a deadlock, and to bring out a compromise formula to settle the dispute at the ealiest, to the satisfaction of the parties under dispute.

(i) Works Committee (Section 3)

The objectives of the Works Committee are the following:

(a) To promote measures for securing and preserving good relations between the employer and the employees; and
(b) To strive for minimising the difference of opinion in regard to matters of mutual interest between the employees and the employer. It is meant to create a sense of partnership or comradeship between the employers ad the workmen.

However, the decision of the Works Committee is neither an agreement nor a compromise. Besides, it is neither binding on the parties nor enforceable under the Act.

(ii) Conciliation Officer (Section 4)

The appropriate government is empowered to appoint a suitable number of conciliation officers, for the settlement of industrial disputes, by notification in the Official Gazette. The number of conciliation officers to be appointed is determined by the appropriate government on the basis of the volume of work and the nature of the industrial disputes that may actually exist or are likely to arise in the future. Further, a conciliation officer may be appointed for a specific area or some specific industries or for one or more specified industries and that too, either permanently or for a limited period of time.

Duties of Conciliation Officers

A conciliation officer has wide powers of making investigations into an industrial dispute, without delay, and has access to all matters affecting the merits and rights of settlement thereof. He may do all such things as he thinks appropriate to induce the parties to arrive at a fair and amicable settlement of the dispute. But then, he can only send his report but has no authority to pass a final order.

Further, if a settlement is arrived at in the course of conciliation proceedings, the conciliation officer must submit his report within 14 days or within such shorter period as may be fixed by the appropriate government, duly signed by both the parties to the dispute.

(iii) Board of Conciliation (Section 5)

The Board of Conciliation is constituted by the appropriate government as an ad hoc body to mediate and to induce the parties to arrive at a fair and amicable settlement of the dispute.

(b) Arbitration

Court of Enquiry (Section 6)

A Court of Enquiry is constituted by the appropriate government as an ad hoc body, as and when the occasion may arise. It can enquire into any matter connected with, or relevant to, the industrial dispute, but not into the dispute itself. The constitution of the Court of Enquiry and the name(s) of its member(s) are required to be notified in the Official Gazette. It may comprise one independent person, or such number of independent persons, as the appropriate government may deem fit. If there are more than two persons, one of them will be appointed as the Chairman of the Court of Enquiry. It is neither required to make any recommendation nor to resolve the dispute. It is, thus, merely a fact-finding body. Therefore, it is seldom appointed as it is in the nature of a superficial and an ad hoc body.

During the pendency of the proceedings of the Court of Enquiry, the following rights of the workers remain unaffected, as per **Sections 22, 23, and 33**:

(i) The right of the worker to go on strike;
(ii) The right of the employer to resort to lockout; and
(iii) The right of the employer to dismiss or to otherwise punish the worker in certain cases under **Section 33.**

(c) Adjudication

The ultimate legal remedy for the settlement of an unresolved industrial dispute is its reference to adjudication by the appropriate government. The adjudication involves intervention in the dispute by a third party appointed by the appropriate government with a view to deciding the nature of the final settlement.

On receipt of the report of the failure of conciliation, the appropriate government has to decide whether it would be appropriate to refer the industrial dispute to adjudication. There are various methods of adjudication, which have been discussed hereafter.

(i) Labour Court (Section 7)

One or more Labour Courts may be constituted by the appropriate government, by notification in the Official Gazette, for adjudicating on the industrial dispute relating to any matter specified in the Second Schedule of the Act, and for performing such other functions as may be assigned to it.

A Labour Court shall consist of only one person, which is to be appointed by the appropriate government.

The duties of the Labour Court are the following:

(i) To hold adjudication proceedings expeditiously, and
(ii) To submit the award to the appropriate government, on the conclusion of the proceedings, as soon as possible.

(ii) Industrial Tribunal (Section 7A)

The appropriate government may appoint one or more Industrial Tribunals for the adjudication of industrial disputes relating to any matter specified in the Second or Third Schedules of the Act. The matters which are in the nature of new demands and give rise to industrial disputes, which affect the working of a company or industry, are usually referred to as an Industrial Tribunal.

Further, an Industrial Tribunal, which consists of only one person, may be appointed by the appropriate government for a limited period on an ad hoc basis, or even permanently.

Powers of an Industrial Tribunal

The Industrial Tribunal is a judicial body, or at least a *quasi* judicial body. Therefore, it must serve proper notices to the parties by name. Any award made without serving the proper notices is basically wrong.

(iii) National Tribunal (Section 7B)

The Central Government may, by notification in the Official Gazette, constitute one or more National Tribunals for adjudication of industrial disputes, of the following nature:

(a) Disputes involving questions of national importance; or
(b) Disputes which are of such nature that industries in more than one State are likely to be interested in, or are affected by, such disputes.

National Tribunal consists of only one person. The duties of a National Tribunal are to hold proceedings of an industrial dispute referred to it by the Central Government expeditiously, and to submit the award to the referrer (i.e. Central Government) on the conclusion of the proceedings of the industrial dispute. When an industrial dispute has been referred to a National Tribunal, no Labour Court or Industrial Tribunal shall have any jurisdiction to adjudicate upon such matters.

Filling up of Vacancies (Section 8)

If any vacancy occurs in any office of the Labour Court or the Tribunal, the appropriate government shall appoint a person in the vacancy in accordance with the provisions of the Act

Finality of the Order (Section 9)

The main purpose of **Section 9** is to make immune any order of the appointment, made under **Sections 5 to 7** of the Act, from being questioned. **Section 9** specifically provides that no order of the appropriate government, appointing any person as the Chairman or any other member of a Board or Court, or as presiding officer of a Labour Court, Industrial or National Tribunal, shall be questioned in any manner whatsoever.

44.4 Voluntary Reference of Disputes to Arbitration (Section 10A)

Where an industrial dispute exists, or is apprehended to occur, and the employer and the workmen agree to refer the dispute to arbitration, they may, at any time, before the dispute has been referred to any authority under the Act, refer the dispute to arbitration by a written agreement. The award of the arbitration, however, has to be submitted to the appropriate government. Further, the provisions of the Arbitration Act, 1940, are not applicable to the arbitrations under the Industrial Disputes Act.

44.5 Procedure, Powers, and Duties of Authorities under the Act (Section 11)

The procedure and powers of Conciliation Officers, Boards, Courts and Tribunals have been discussed under **Section 11**, which has given wide powers to the forenamed authorities for the settlement of the industrial disputes.

As provided under **Section 11 (1)**, subject to any rules that may be made in that behalf, an arbitrator, board, court, industrial and national tribunals, shall follow such procedure as the authorities concerned may deem fit.

Section 11 (2) provides that conciliation officer, board, labour court, industrial, or national tribunal, for the purpose of inquiry into any existing or apprehended industrial disputes, can enter the premises of the employer to whom the dispute relates. However, before entering the premises of the employer, they are required to give reasonable notice to him (employer).

Section 11 (3) stipulates that every board, labour court, industrial or national tribunal, has the same powers as are vested in the Civil Court. That is, while conducting the enquiry, they are entitled to the following:

(i) To enforce the attendance of any person, and to examine him on oath;
(ii) To compel the production of documents and material objects; and
(iii) To issue commission for examining the witness on oath.

Any enquiry or investigation conducted by the aforesaid objective shall be deemed to be the judicial process within the meaning of the Indian Penal Code (IPC).

44.6 Jurisdiction and Powers of Tribunal and Court

The Labour Courts, Industrial, or National Tribunals, have the statutory duty to hold the proceedings expeditiously, and they are required to submit the award to the appropriate government concerned, on the conclusion of the proceedings, as soon as possible. They are empowered to follow such procedures as they may deem fit within the broad framework of the rules. The rules provide for the place and time at which the adjudication or arbitration meeting can be held. The jurisdiction of the Industrial Tribunal is not confined to merely administering law and enforcing the existing contracts. It can even change the terms of the existing contracts already entered into between the employer and the employees.

44.7 Award and its Commencement

As per the Act, 'award' means 'any interim or a final determination of any industrial dispute or the question relating thereto, by any Labour Court, Industrial or National Tribunal, and includes an arbitration award (made under **Section 10A**)'. An interim award means 'a temporary or provisional arrangement adopted in the meanwhile'.

Section 17(1) requires that every award, together with any minute of dissent recorded therewith, shall be published in the Official Gazette by the appropriate government concerned within 30 days of its receipt.

44.8 Settlement

As per the Act, settlement means the 'settlement which has been arrived at between the employer and the workmen in the course of conciliation proceeding'.

(i) Such settlement has got to be signed by the parties to the dispute and sent to the appropriate government with the report;
(ii) Settlements, which have been arrived at otherwise than in the course of conciliation proceedings, provided they have been signed by both the parties, and a copy thereof has been sent to the appropriate government and the Conciliation Officer; and
(iii) Settlements, which are bipartite agreements between the employer and the workmen.'

Under **Section 18 (1)**, a settlement arrived at by agreement between the employer and the workmen otherwise than in the course of conciliation proceedings, is binding only on the parties to the agreement. A

settlement arrived at, in the course of conciliation proceedings, however, is binding not only on the parties to the dispute, but also on the persons specified in **Section 18** (3)**.**

Let us Recapitulate

- The **objects** of the Act are 'to make provision for the investigation and settlement of industrial disputes and for certain other purposes'. In short, the purpose of the Act is to harmonise the relationships between the employers and the employees, and to provide for a machinery to settle the disputes that may arise between the two parties, viz. the employers and the workmen/employees.
- This **Act applies to** the workmen drawing wages not exceeding a specified amount per month, and governs the service conditions of such persons. It may be regarded as supplementary to the Indian Contract Act, 1872, whose aim and objective is to regulate the contractual relationship between the employers and the employees, like the contractual relationship between the master and servant, in an ordinary sense.
- **An appropriate government** means the following:
  - (**a**) The Central Government is the appropriate government in relation to any industrial dispute pertaining to any industry carried on by, or under the authority of, the Central Government or by the railway company or concerning any such controlled industry such as may be specified or in relation to any industrial dispute concerning a banking or an insurance company or a mine, an oilfield or a major port or a Dock Labour Board and such several other establishments established under several respective Acts listed under **Section 2** of the Act.
  - (**b**) In relation to any other industrial dispute, the respective State government will be the appropriate government; and
  - (**c**) In relation to an industry carried on by, or under the authority of, the Central Government, or the industry located in more than one State, the appropriate government will be the Central Government, so that the dispute may be effectively managed.
- **Award** means an interim or final decision of any industrial tribunal of dispute or of any question thereto by any Labour Court, industrial tribunal or national tribunal. It also includes arbitration award made under **Section 10A** of the Act.
- **Employer**
  - (**a**) In relation to an industry, the **employer** means an industry carried on by, or under the authority of any department of the Central Government or a State Government. 'The authority as prescribed on this behalf or where no authority is prescribed, by the head of the department'.
  - (**b**) In relation to an industry, carried on by, or on behalf of, the local authority, the Chief Executive Officer of the industry concerned is the **employer**.
- **Industry** means any 'business, trade, undertaking, manufacture or calling, and the latter engaged in any calling, service, employment, handicraft or industrial occupation or vocation of workmen. An industrial dispute means 'any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment, or the terms of employment or the conditions of labour, or any person.Thus, we see that the scope of the industrial dispute is very wide, and it includes various types of disputes among various categories of persons.
- **Lay off** means 'the failure, refusal or inability of the employer on account of shortage of coal, power or raw material, or the accumulation of stocks, or the breakdown of the machinery, natural calamity or for any other connected reason, to give an employment to a workman, whose name is borne on the muster roll of his industrial establishment and who has not been retrenched'.

- **Lockout** means 'the temporary closing of a place of employment, or the suspension of work, or temporary refusal by an employer to continue to employ any number of persons employed by him.

  The main difference between lay off and lockout is that while in the case of lay off certain ground must be present there, as aforementioned; in the case of lockout the presence of any such ground is not necessary.
- **Retrenchment** means 'the termination by the employer of the service of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action'.

  The retrenchment includes termination of the services of a temporary employee after giving him due notice. The retrenchment includes termination of the services of the surplus employees for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action.

  The services of a workman can be retrenched on the ground of continued ill health. Here the term 'continued ill health' means any disease, infirmity or unsoundness of a person which makes it virtually impossible for him to discharge his duties.
- **Strike** means 'a cessation of work by a body of persons employed in any industry acting in combination; or a concerted refusal to continue to work or to accept employment'. Mere cessation of work does not amount to strike, unless it can be proved that such a cessation of work was a concerted and combined action to enforce the demand.
- **Settlement** means 'a settlement which has been arrived at in the course of conciliation proceeding, and binds all workmen, and also which has been arrived at otherwise, but has been signed by both parties and a copy thereof has been sent to the Government and the conciliation officer; and settlement, which is a bipartite agreement between the employer and the workmen'.
- **Wages** means 'all remuneration capable of being expressed in terms of money, which would, if the terms of employment, expressed or implied, were fulfilled, be payable to a workman in respect of his employment or work done in such employment and includes:

  (i) Such allowances (including D.A.) as a workman is, for the time being, entitled to;
  (ii) The value of any house accommodation, or of supply of water, light, medical attendance or other amenity or of any services or any concessional supply of food grains or other articles; and
  (iii) Any travelling concessions.

  But **wages does not include:**

  (i) Any bonus;
  (ii) Any contribution paid for life insurance fund payable by the employer to any pension fund, provident fund or any amount payable to workman under any law; and
  (iii) Any gratuity payable on the termination of his service.

  Thus, the wages means the monetary gains available to the workman in return of his labour, skill and energy at the disposal of his employer.
- The various methods of investigation, management and settlement of industrial disputes, can be classifies under the following categories:

  (a) Conciliation
  - **(i)** Works Committee;
  - **(ii)** Conciliation Officer; and
  - **(iii)** Board of Conciliation.

  (b) Arbitration

  Court of Enquiry.

  (c) Adjudication
  - **(i)** Labour Court;
  - **(ii)** Industrial Tribunal; and
  - **(iii)** National Tribunal.

- **Conciliation**

Conciliation is a method of settlement of industrial disputes with the friendly intervention of a third party – a mutually acceptable neutral person – amicably, to facilitate the settlement of the dispute by finding out a meeting point, to avoid a deadlock.

(**a**) The objectives of the **Works Committee** are:

(**i**) To promote measures for securing and preserving good relations between the employer and the employees; and

(**ii**) To strive for minimising the difference of opinion in regard to matters of mutual interest between them; to create a sense of partnership or comradeship between them.

(**b**) **Arbitration**

Court of Enquiry is constituted by the appropriate government as an ad hoc body, as and when the occasion may arise. It can enquire into any matter connected with, or relevant to, the industrial dispute, but not into the dispute itself. During the pendency of the proceedings of the Court of Enquiry, the following rights of the workers remain unaffected:

(**i**) The right of the worker to go on strike;

(**ii**) The right of the employer to resort to lockout; and

(**iii**) The right of the employer to dismiss or to otherwise punish the worker in certain cases.

(**c**) The ultimate legal remedy for the settlement of an unresolved industrial dispute is its reference to **adjudication** by the appropriate government. The adjudication involves intervention in the dispute by a third party appointed by the appropriate government with a view to deciding the nature of the final settlement.

(**i**) One or more **Labour Courts**, consisting of only one person each, may be constituted by the appropriate government, for adjudicating on the industrial dispute relating to any matter specified in the Second Schedule of the Act, and for performing such other functions as may be assigned to it.

The **duties of the Labour** Court are:

(**a**) To hold adjudication proceedings expeditiously, and

(**b**) To submit the award to the appropriate government, on the conclusion of the proceedings, as soon as possible.

(**ii**) The appropriate government may appoint one or more **Industrial Tribunals**, consisting of only one person each, for the adjudication of industrial disputes relating to any matter specified in the Second or Third Schedules of the Act.

An Industrial Tribunal, may be appointed for a limited period on an ad hoc basis, or even permanently.

The Industrial Tribunal is a judicial body, or at least a *quasi* judicial body. Therefore, it must serve proper notices to the parties by name. Any award made without serving the proper notices is basically wrong.

(**iii**) The Central Government may, by notification in the Official Gazette, constitute one or more **National Tribunals**, consisting of only one person each, for adjudication of industrial disputes, of the following nature:

(**a**) Disputes involving questions of national importance; or

(**b**) Disputes which are of such nature that industries in more than one State are likely to be interested in, or are affected by, such disputes.

When an industrial dispute has been referred to a National Tribunal, no Labour Court or Industrial Tribunal shall have any jurisdiction to adjudicate upon such matters.

Every board, labour court, industrial, or national tribunal has the same powers as are vested in the Civil Court. That is, while conducting the enquiry, they are entitled to the following:

(i) To enforce the attendance of any person, and to examine him on oath;
(ii) To compel the production of documents and material objects; and
(iii) To issue commission for examining the witness on oath.

Award and its Commencement

'Award' means 'any interim or a final determination of any industrial dispute or the question relating thereto, by any Labour Court, Industrial or National Tribunal, and includes an arbitration award. An interim award means 'a temporary or provisional arrangement adopted in the meanwhile'.

Settlement means the 'settlement which has been arrived at between the employer and the workmen in the course of conciliation proceeding'.

(i) Such settlement has got to be signed by the parties to the dispute and sent to the appropriate government with the report;
(ii) Settlements, which have been arrived at otherwise than in the course of conciliation proceedings, provided they have been signed by both the parties, and a copy thereof has been sent to the appropriate government and the Conciliation Officer;
(iii) Settlements, which are bipartite agreements between the employer and the workmen'; otherwise than in the course of conciliation proceedings, is binding only on the parties to the agreement. A settlement arrived at, in the course of conciliation proceedings, however, is binding not only on the parties to the dispute, but also on the persons specified in **Section 18 (3).**

Questions for Reflection

1. What are the various methods of investigation, management, and settlement of industrial disputes, as laid down in the Act? Classify them under different categories.
2. Explain the following terms, as used in the Act, in your own language:
   (a) Conciliation:
      (i) Works Committee;
      (ii) Conciliation Officer; and
      (iii) Board of Conciliation.
   (b) Arbitration:
      (i) Court of Enquiry.
   (c) Adjudication
      (i) Labour Court;
      (ii) Industrial Tribunal; and
      (iii) National Tribunal.
3. What are the objectives of the Works Committee?
4. (a) Which authority can appoint a Conciliation Officer, in what manner, and for what purpose?
   (b) What are the duties of Conciliation Officers?
5. (a) Which authority can constituted a Board of Conciliation?
   (b) Is it an ad hoc body, or a permanent body?
6. (a) Which authority can constituted a Court of Enquiry?
   (b) Is it an ad hoc body, or a permanent body?
7. During the pendency of the proceedings of the Court of Enquiry, the following rights of the workers get affected:
   (i) The right of the worker to go on strike;
   (ii) The right of the employer to resort to lockout; and
   (iii) The right of the employer to dismiss or to otherwise punish the worker in certain cases.

Do you agree with this Statement? Write 'Yes' or 'No' as your answer.

8. The ultimate legal remedy for the settlement of an unresolved industrial dispute is its reference to adjudication by the appropriate government. Do you agree? Write 'Yes' or 'No' as your answer.
9. (a) Which authority can constituted a Labour Court; how and for what purpose?
   (b) What are the main duties of the Labour Court?
10. (a) Which authority can appoint an Industrial Tribunals; how and for what purpose?
    (b) What are the main duties of the Industrial Tribunals?
    (c) An Industrial Tribunal may consist of how many persons?
    (d) Industrial Tribunal is appointed for a limited period on an ad hoc basis, or permanently.
11. The Industrial Tribunal is a judicial body, or at least a *quasi* judicial body. What are the ramifications of such provision in the Act?
12. (a) Which authority can appoint a National Tribunal; how and for what purpose?
    (b) What nature of disputes is referred to the National Tribunal?
13. If any vacancy occurs in any office of the Labour Court or the Tribunal, which authority has the powers to appoint a person in the vacancy?
14. No order of the appropriate government, appointing any person as the Chairman or any other member of a Board or Court, or as presiding officer of a Labour Court, Industrial or National Tribunal, shall be questioned in any manner whatsoever. Do you agree? Write 'Yes' or 'No' as your answer.
15. What are the distinguishing features of the following?
    (a) A final determination of any industrial dispute or the question relating thereto, by any Labour Court, Industrial or National Tribunal, and an arbitration award; and
    (b) An interim award.
16. What do you mean by the term 'Settlement'?

Problems for Practice (With Suggested Solutions)

Problem 1

During the pendency of the proceedings of the Court of Enquiry, the employer has resorted to lockout. The Workers' Union has filed a case in the Court on the plea that during the pendency of the proceedings of the Court of Enquiry, the employer cannot resort to lockout. What are chances of the Workers' Union winning the case? Give reasons for your answer.

Solution

There is no chance of the Workers' Union winning the case. This is so because, as per the provisions of the Act, during the pendency of the proceedings of the Court of Enquiry, the right of the employer to resort to lockout, *inter alia*, remains unaffected.

Problem 2

During the pendency of the proceedings of the Court of Enquiry, the workers have gone on strike. The employer has filed a case in the Court on the plea that during the pendency of the proceedings of the Court of Enquiry, the workers cannot go on strike. What are chances of the employer winning the case? Give reasons for your answer.

Solution

There is no chance of the employer winning the case. This is so because, as per the provisions of the Act, during the pendency of the proceedings of the Court of Enquiry, the right of the workers to resort to strike, *inter alia*, remains unaffected.

Problem 3

The appropriate government has appointed a Labour Court consisting of only two persons. Do you think that the government has acted as per the provisions of the Act? Give reasons for your answer.

Solution

No. The appropriate government has not acted as per the provisions of the Act. Because, the Act provides that a Labour Court shall consist of only one person. Therefore, the appropriate government has acted in contravention of the provisions of the Act, by appointing two persons, instead of appointing only one person, as provided under the Act.

Problem 4

The appropriate government has appointed three Industrial Tribunals, consisting of only one person in each Industrial Tribunal, for the adjudication of industrial disputes relating to the matters which are in the nature of new demands and give rise to industrial disputes, which affect the working of a company or industry. Further, while two Industrial Tribunals have been appointed for a limited period on an ad hoc basis, the other one has been appointed permanently. Do you think that the government has acted as per the provisions of the Act? Give reasons for your answer.

Solution

The appropriate government has acted as per the provisions of the Act. This is so because, as per the provisions of the Act, the appropriate government may appoint one or more Industrial Tribunals, consisting of only one person in each Industrial Tribunal for the adjudication of industrial disputes relating to any matters, which are in the nature of new demands and give rise to industrial disputes, which affect the working of a company or industry.

Further, an Industrial Tribunal, which consists of only one person, may be appointed by the appropriate government for a limited period on an ad hoc basis, or even permanently.

Problem 5

An Industrial Tribunal has not served proper notices to the parties by name, and has made an award. Do you think that the award, pronounced by the Industrial Tribunal will be binding on the parties concerned? Give reasons for your answer.

Solution

The award, pronounced by the Industrial Tribunal, without serving proper notices to the parties by name, will not be binding on the parties concerned. This is so because, the Industrial Tribunal is a judicial body, or at least a *quasi* judicial body. Therefore, as provided in the Act, it must serve proper notices to the parties by name. Any award made without serving the proper notices is basically wrong.

Chapter Forty Five

Strikes and Lockouts; Lay Off, Retrenchment, and Closure

"*We must not only strike the iron while it is hot, we must strike it until it is hot.*
Tom Sharp

When you have the opportunity, you strike.
Rod Laver

A clever imagination, humorous request can open closed doors and closed minds.
Percy Ross

The penalty of leadership is loneliness.
H. Wheeler Robinson"

45.1 Prohibition of Strikes and Lockouts

Restrictions imposed on strikes can be broadly classified under the following two categories:

(a) Relating specially to public utility services; and
(b) Relating to the other industrial establishments in general.

Section 22(1) stipulates strict restrictions on strikes and lockouts in public utility services, unless the mandatory provisions of law are complied with. Strikes and lockouts in public utility services are prohibited unless the following conditions are fulfilled:

(i) A statutory notice of strikes or lockouts must be given by the workmen to the employer or by the employer to the workmen, respectively, within six weeks before going on strike or resorting to lockout;
(ii) There must be no strike or lockout within fourteen days of giving such notice;
(iii) In the cases where the date of the strike or lockout is specified in such notice, no strike can be called or lockout declared, before the expiry of that specific date;

(iv) In the cases where any conciliation proceedings are pending before a Conciliation Officer, no strike can be called or lockout declared, during the period during which any conciliation proceedings are pending, and seven days after the conclusion of such proceedings.

Section 22(2) provides that no employer carrying on any public utility service shall lockout any of the work place:

(i) Without giving the workmen a notice of lockout;
(ii) Within 14 days of giving such notice;
(iii) Before the expiry of the stipulated period; and
(iv) During the period any conciliation proceedings are pending before a Conciliation Officer, and one week after the conclusion of such proceedings.

Section 22(4) provides that the notice of strike shall be given by such number of persons to such number of persons in the prescribed manner. **[Section 22(5)]**.

In this context, it must be noted that the right to strike or demonstrate is not an absolute or fundamental right. But then, it has been recognised in almost all the democratic countries as a mode of redressal for resolving grievances for all the workmen.

45.2 Prohibition of Lockouts

The prohibition and restrictions provided under **Section 22(2)** against a lockout by the employer are similar to those against strike by workmen. Thus, for a lockout a notice under **Section 22(2)** is required to be given. Accordingly, a lockout without a proper notice is considered illegal under **Section 24**.

45.3 General Prohibition of Strikes and Lockouts (Section 23)

There are certain statutory legal restrictions which have been put on Strikes and Lockouts in all industrial establishments. These are known as 'General Prohibition of Strikes and Lockouts'.

Under **Section 23**, no workman who is employed in any industrial establishment shall go on strike in breach of contract, and no employer of any such workman can declare a lockout in the following conditions:

(i) During the pendency of conciliation proceedings before a Board, and seven days after the conclusion of such proceedings;
(ii) During the pendency of proceedings before a Labour Court, Industrial, or National Tribunal, and two months after the conclusion of such proceedings;
(iii) During the pendency of arbitration proceedings before an arbitrator, and two months after the conclusion of such proceedings; and
(iv) During the period in which a settlement or reward is in operation, relating to any of the matters covered by the settlement or award. But there is no restriction to call strike or to declare lockout in respect of other matters.

45.4 By Order of the Government

In the cases where an industrial dispute has been referred to a Board, Labour Court, Industrial, or National Tribunal, the appropriate government may, by order, prohibit the continuance of a strike or lockout in connection with such dispute which may be in existence on the date of the reference, or which has been referred to arbitration; and a notification has been issued under **Section 10A (4A).**

45.5 Illegal Strikes and Lockouts

The strikes and lockouts are deemed to be illegal when they are resorted to or declared in contravention of (i.e. not in compliance with) the provisions of the Act.

A strike and lockout is deemed to be illegal in the following circumstances:

(i) When the strike or lockout is resorted to or declared in contravention of (i.e. not in compliance with) the provisions of **Section 22** or **Section 23**, or

(ii) When the strike or lockout is commenced or declared in contravention of an order, passed by the appropriate government under **Section 10 (3)** and **Section 10 A (4A)**.

But, whether a strike or lockout is legal or illegal depends upon the circumstances of the case and the statutory provisions.

However, in the following cases the strike will not be considered as illegal:

(i) A strike in breach of the certified standing order, by itself (is not illegal but legal).

(ii) Where a strike is called strictly in compliance with the provisions of the Act. **For example**, where the workmen refuse to do additional work imposed on them by the employer under a rationalisation scheme.

(iii) Where a strike is resorted to with a view to influencing the employer to open negotiation regarding their demand, provided it does not affect in any way the provisions of **Sections 22 and 23**.

(iv) Where a strike or lockout is already in existence, in pursuance of an industrial dispute at the time of reference to a settlement machinery, provided that such strike or lockout, at the time of its commencement, was not in contravention of the provisions of the Act, or the continuance of such strike or lockout was not prohibited.

Here, the former condition is based on the principle of maintaining status quo, whereas the latter condition is based on the principle of exigency of public necessity.

(v) Where a lockout has been declared as a consequence of an illegal strike, or where a strike has been declared as a consequence of an illegal lockout.

(vi) Where a strike or lockout was commenced before, and continued during the pendency of arbitration proceedings, and also if it continued after a reference has been made to a Board, Labour Court, or any Tribunal.

Here, it may be noted with care that in the case where the strike is unjustified and the lockout is justified, the workmen will not be entitled to any wages at all. As against this, where the strike is justified and the lockout is unjustified, the workmen will be entitled to the entire wages for the period of the strike and lockout.

As a result of illegal strike, a workman loses the benefit of annual holidays with wages (as admissible to him under the Factories Act). Further, the striking workers may be suspended from employment pending further orders after an enquiry into their conduct. In extreme cases, such worker may even be dismissed for taking part in an illegal strike. However, dismissal of peaceful workers of an illegal strike can be sustained only if such punishment is expressly authorised in the Standing Orders. Further, when the striking workmen resort to violence, or are guilty of physical obstruction or intimidation, they may be dismissed even though the strike be just and legal.

45.6 Prohibition of Financial Aid to Illegal Strikes and Lockouts (Section 25)

No person shall knowingly expand or apply any money in direct furtherance or support of any illegal strikes or lockouts

45.7 Punishment for Illegal Strike

Under **Section 26**, in the case of an illegal strike, the guilty persons (i.e. the workmen who participate in such

illegal strike) are punishable. In this connection, a distinction has been made between the following types of strikes:

(a) Strikes which are both illegal and unjustified; and
(b) Strikes which are illegal but justified.

A strike is both illegal and unjustified where it has been resorted to in contravention of the provisions of the Act, and both the demand and behaviour of the striking workmen are wholly unjustified. As against this, a strike may be considered illegal but justified where it has been resorted to for a good (justified) cause and carried on in a peaceful manner. Thus, even an illegal strike may be declared justified or unjustified, depending on the foregoing circumstances. Accordingly, a violent strike is one where the workers obstruct the other workers from carrying on their work, or where they take part in violent demonstration and act in defiance of law; whereas the peaceful workers are those who are silent participants in the strike.

45.8 Offences and Penalties

Under Section 26, any workman who commences, continues, or acts in furtherance of an illegal strike, shall be punishable with imprisonment up to one month, or fine up to Rs 50, or with both.

Similarly, any employer who commences, continues, or otherwise acts in furtherance of an illegal lockout, will be liable to pay the wages to the workmen for the period of the illegal lockout. Further, the employer shall be punishable with imprisonment up to one month, or fine up to Rs 1,000, or with both.

We may, thus, observe that in both the cases the punishment by way of imprisonment is the same, i.e. for a period of one month, but punishment by way of fine is different in its quantum, i.e. Rs 50 in the case of the workers, and Rs 1,000 in the case of the employer.

Under Section 27, any person who instigates or incites others to take part in an illegal strike or lockout, or acts in the furtherance of such an illegal strike or lockout, is punishable with imprisonment up to six month, or with fine up to Rs 1,000, or with both.

Under Section 28, any person who knowingly gives financial aid, that is who knowingly extends or applies any money in direct furtherance or support of an illegal strike or lockout, is punishable with imprisonment up to six month, or with fine up to Rs 1,000, or with both.

Section 32 provides that where a person, committing an offence under the Act, is a company, or other body corporate, or an association of persons, every Director, Manager, Secretary, Agent, or other officers or persons concerned with the management, must be considered to be guilty of such offence. However, such person can be acquitted only if it can be proved that the offence was committed without his knowledge or consent.

45.9 Lay Off

As per the Act, lay off means the failure, refusal, or inability of an employer on account of shortage of coal, power or raw materials, or the accumulation of stocks, or the break-down of machinery, or for any other reasons, to give employment to workman, whose name is entered in the muster rolls of his industrial establishment, and who has not been retrenched.

Thus, a lay off is neither a temporary discharge of the workman, nor a temporary suspension of the contract of his service. In fact, it is merely a temporary suspension of his service contract. It arises only where there is a 'failure', 'inability', or 'refusal' on the part of the employer to provide employment to his workman, for the aforementioned reasons. This way, it does not terminate the employer–employee relationship.

In fact, lay off is a measure or a compromising device to cope with the temporary inability of the employer to gainfully offer employment to his workmen and to keep the industrial establishment in operation and production such that the workmen need not fall back upon strike, and the employer need not resort to closure or lockout.

45.10 Conditions Under Which the Workmen can be Laid Off

(a) Under the Traditional Law

Under the traditional laws, the management has the right to lay off its workers and readjust the labour force to suit the requirements of work. But then, even under the traditional laws, the right of the management to lay off its work force and to adjust the labour is not entirely discretionary.

(b) Under the Labour Laws

Under the labour laws, those establishments which have 'certified standing order' in pursuance of the **Industrial Employment (Standing Order) Act 1946**, are entitled to lay off its workmen as per the provisions of laws.

45.11 Prohibition on Lay Off

The **Amended Industrial Disputes Act, 1982** has laid down the following **prohibitions on lay off**:

(i) No workman (other than a *badli* workman or a casual workman), whose name is entered in the muster roll of an industrial establishment, shall be laid off by his employer, except with the previous permission of such authority as may be specified by the appropriate government by notification in the official Gazette, unless such lay off is due to shortage of power, or due to natural calamity; (and in the case of mine, such lay off is due to fire, flood, excess of inflammable gas or explosion).

(ii) In the case of every application for permission made **under Sub Sections 1 and 2**, the authority to whom the application has been so made, may grant or refuse the permission applied for, after making such enquiry as he may deem fit. He is also required to give the reasons, recorded in writing, for such refusal or for granting the permission.

(iii) In case the permission or refusal has not been granted by the appropriate authority to the employer within a period of two months from the date the application is made, the permission applied for shall be deemed to have been granted on the expiry of two months.

(iv) The provisions made under **Section 25 C** (other than the second provision thereto) shall apply to the cases of lay off referred to in the Section. These provisions are applicable to all industrial establishments wherein not less than 300 workmen are employed on an average per working day for the preceding twelve months.

(v) In the cases where no application for permission has been made within the period specified therein, or where the permission for lay off or the continuation of lay off has been refused, such lay off shall be deemed to be illegal from the date on which the workmen have been laid off, and the workmen shall be entitled to all the benefits under any law for the time being in force as if they had not been laid off **(Section 25M).**

45.12 Procedure of Lay Off

The Act does not lay down any procedure for the lay off. However, **Rule 75A of the Industrial Disputes (Central Rules 1957)** makes it obligatory on the part of the employer to provide a notice of the period of lay off within seven days of the commencement or termination of such lay off. Before resorting to the lay off, the employer must see that the following conditions have been duly satisfied:

(i) Refusal for employment of workmen can only be for the reasons specified in **Section 2 (kkk)** of the Standing Order;

(ii) The lay off should occur due to something beyond the control of the employer;

(iii) It should result in only temporary non-employment of the workman whose name appears on the muster rolls of the industrial establishment; and

(iv) The employer expects that within a reasonable time, the industry will continue operation and the workmen will be restored their rights;
(v) Lay off always occurs in a continuing concern. In the cases where the concern is closed for all times to come, the lay off does not have any relevance; and
(vi) A lay off cannot be declared merely for the reason that the employer suffered financial losses for the reasons beyond his control. Such lay off shall be unjustified and invalid too, and the workmen can claim full wages for the period of such lay off.

45.13 Lay Off Compensation to Workmen

Under **Section 25C**, the workmen who are laid off are entitled to compensation, even when the lay off is the result of a settlement between the employer and workmen, unless the settlement expressly provides otherwise.

45.14 Continuous Service

Continuous service is necessary on the part of the employee for being entitled to get the lay off compensation. A workman will be deemed to be in continuous service for a period, if during that period his service is not interrupted.

45.15 Workmen not Entitled to Lay Off Compensation

Under the following circumstances, no compensation is payable to the workman:

(i) Where the workman refuses to accept any suitable alternative employment offered to him by the employer. Such alternative employment may be in the same establishment or in any other establishment belonging to the same employer, or in the same town or village or at a place situated within a radius of five miles from the establishment to which he belongs, and the work in the alternative employment is of the same nature (i.e. it does not call for any other skill), and which carries the same wages.
(ii) Where a workman, who has been laid off, does not present himself for work at least once a day at the appointed time during the normal business hours ; and
(iii) Where the laying off is due to a strike or slowing down of production by the workman in another part of the establishment.

45.16 Retrenchment

As per the Act, retrenchment means the 'termination, by the employer, of the service of the workman, for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, but does not include voluntary retirement, compulsory retirement of the workman on reaching the age of superannuation, or termination of service on the grounds of continued ill health'.

45.17 Procedure for Retrenchment (Section 25G)

As per the Act, for the purpose of retrenchment, it is required that the workman must have been employed for a period of not less than twelve months, and that during those twelve months he had worked for not less than 240 days.

The employer is required to prepare a list of all workmen in the particular category from which retrenchment is contemplated, arranged according to seniority of service in that category. A copy of the list shall be displayed

on the notice board in a conspicuous place in the premises of the establishment, at least seven days before the actual date of retrenchment.

In this connection, the principle of 'last come first go' is required to be followed. It is a well-established principle of retrenchment that the management should first retrench the latest recruit first, and progressively retrench employees higher up in the seniority. The management can, however, retain those employees who, because of their competence, are required by the business, irrespective of their seniority.

45.18 Retrenchment Compensation

The workman is entitled to receive retrenchment compensation to relieve his hardship, which the retrenchment invariably causes, for no fault of the worker. This right is based on the ground of humane public policy. The object of retrenchment compensation is to give partial protection to the retrenched employee.

45.19 Continuous Service

For the purpose of claiming the retrenchment compensation, it is necessary that the workman must have been in the continuous service. **Section 25 B, Sub-Section (2)** defines continuous service for a period of one year or for a period of six months. **Clause (a) of Sub-Section (2)** provides that a workman shall be deemed to be in continuous service for a year provided:

(a) He has been in employment for 12 calendar months; and
(b) He actually worked for not less than:
  (i) 190 days in case of a workman employed below the ground in a mine; and
  (ii) 240 days in other cases.

It has further provided that any interruption of service on certain accounts like authorised leave, sickness, an accident, legal strike or lockout, cessation of work for no fault of the worker, shall not be considered as interruption of service.

45.20 Penalty for Lay Off and Retrenchment without Permission

An employer who acts in contravention of **Section 25 M or Section 25 N** shall be punishable with imprisonment for a term which may extend to one month, or with fine which may extend to Rs 1,000, or with both.

45.21 Closing Down of Undertaking (Section 25 FFA)

An employer, who intends to close down an undertaking of an industrial establishment, shall apply to the appropriate government, in a prescribed manner, for obtaining prior permission at least 60 days before the date on which the intended closure is to become effective. In such application, the employer must clearly state the reasons for the intended closure of the undertaking. Further, a copy of such application shall also be served simultaneously to the representatives of the workmen, in the prescribed manner.

However, nothing in this Section shall apply to the following:

(i) An undertaking in which
  (a) Less than 50 workmen are employed, or
  (b) Less than 50 workmen were employed, on an average, per working day.
(ii) Undertakings engaged in the business of building bridges, roads, canals, dams, or other construction work.

45.22 Compensation to Workmen in case of Closing Down of Undertaking (Section 25 FFF)

As per the Act, the workmen are entitled to compensation on closing down of the business. Where an undertaking is closed down for any reason, every workman, who has been in continuous service for not less than one year in that undertaking, immediately before such closure, shall be entitled to at least 60 days' notice and compensation as in the case of retrenchment.

But, if the undertaking is closed down on account of unavoidable circumstances that are beyond the control of the employer, such compensation shall not exceed his average pay for three months.

However, if an undertaking is closed down merely due to financial difficulties, or due to accumulation of indisposed stocks, or the expiry of the period of lease or the licence granted to it, or in a case where the undertaking is engaged in mining operation, due to exhaustion of the mineral in the area in which such operations are carried on, the same shall not be deemed to have been closed down on account of unavoidable reasons beyond the control of the employer.

Further, where any undertaking, which was set up for the construction of building bridges, roads, canals or dams, or other construction works, is closed on account of completion of the work within two years from the date on which the undertaking had been set up, no workman employed therein shall be entitled to the said compensation. But, if the construction is not so completed within two years, he shall be entitled to the notice and the compensation for every completed year of continuous service, or any part thereof in excess of six months.

Moreover, as per **Section 25K**, the provisions, pertaining to lay off, retrenchment and closure in an industrial establishment, shall apply to those establishments in which not less than 100 workmen were employed on an average per working day for the preceding 12 months.

45.23 Transfer of Proceedings

As per **Section 33B**, the appropriate government may, by order in writing and for reasons to be stated, withdraw any proceeding pending before a Labour Court, Industrial, or National Tribunal, and transfer the same to another Labour Court, Industrial, or National Tribunal, for the disposal of the proceedings.

45.24 Recovery of Money due to a Workman from an Employer

As per **Section 33C**, money due to a workman under a settlement or award can be recovered under the **Revenue Recovery Act**, provided the government, on application, empowers the Collector to do so.

45.25 Representation of Parties (Section 36)

A workman who is a party to a dispute shall be entitled to be represented in any proceeding by:

(a) An officer of a registered trade union of which he is a member;
(b) An officer of a federation of trade unions to which the trade union referred to in clause (a) above is affiliated; or
(c) Where a worker is not a member of any trade union, by an officer of any trade union connected with or by any other workman employed in, the industry in which the worker is employed.

Similarly, an employer who is a party to a dispute shall be entitled to be represented in any proceeding by:

(a) An officer of an association of employers of which he is a member;
(b) An officer of a federation or association of employers to which the association referred to in clause (a) above is affiliated; or

(c) Where the employer is not a member of any association of employers, by an officer of any association of employers connected with, or by any other employer engaged in the industry in which the employer is engaged.

No party to a dispute shall be entitled to be represented by a legal practitioner in any conciliation proceedings or in any proceedings before a Court.

In any proceedings before a Labour Court, Industrial, or National Tribunal, a party to a dispute may be represented by a legal adviser, with the consent of the other parties to the proceedings, and with the leave of the Labour Court, Industrial, or National Tribunal, as the case may be.

45.26 Prohibition of Unfair Labour Practice (Section 25 T)

No employer or a workman or a trade union, whether registered under the Trade Union Act or not, shall commit any unfair labour practice.

45.27 Penalty for Committing Unfair Labour Practice (Section 25 U)

Any person who commits any unfair labour practice shall be punished with imprisonment for a term which may extend to six months, or with fine which may extend to Rs 1,000, or with both.

45.28 Obligations and Rights of Employers and Workers

45.28.1 Obligations of Employers

The employers have the following obligations under the Act:

(a) Constitute 'Work Committee' and provide all facilities for its proper working;
(b) Implement all agreements, settlements and awards, and produce all documents, and render other assistance for conciliating and adjudicating disputes;
(c) Desist from declaring any illegal lockout;
(d) To pay lay off and retrenchment compensation, and re-employ laid off and retrenched workmen;
(e) Avoid any change in service and employment conditions without notice;
(f) Maintain status quo during the pendency of disputes on reconciliation and adjudication, and avoid taking disciplinary action against the workmen connected with the dispute, and 'protected workmen'. A 'protected workman' is a workman who is a member of the executive or other office bearer of a registered trade union, connected with the establishment.

45.28.2 Rights of Employers

The employers have the following rights under the Act:

(a) To retrench or lay off workers, as per the provisions of the Act;
(b) To appeal against the awards of arbitrators and tribunals;
(c) To declare lockout without notice when there is already a strike in existence;
(d) To claim certain information supplied to various authorities under the Act as confidential.

45.28.3 Obligations of Workers

The workers have the following obligations under the Act:

(a) To abide by the agreements or settlements arrived at in conciliation, and awards given by the tribunals and arbitrations;

(b) To desist from declaring or instigating any illegal strike;
(c) To cooperate with all authorities set up under the Act in resolving disputes amicably and expeditiously.

45.28.4 Rights of Workers

The workers have the following rights under the Act:

(a) To receive notice of any change in their working and service conditions;
(b) To receive lay off and retrenchment compensation;
(c) To be represented in any proceedings under the Act by an officer of a registered trade union of which he is a member, or by an officer of a trade union connected with, or by any other workman employed in the industry in which the workman is employed, and authorised in such a manner as may be prescribed;
(d) To recover legal and other dues from the employers under any agreement or award under the Act through the government. However, he has to file his claim within one year from the date on which money became due from the employer. The delay in filing the claim can be condoned for sufficient cause for not applying within the due date.

Let us Recapitulate

- Restrictions imposed on strikes are of two types:
  (a) Relating specially to public utility services; and
  (b) Relating to the other industrial establishments in general.
- **Strikes and lockouts** in public utility services are prohibited, unless the following conditions are fulfilled:
  (i) A statutory notice of strikes or lockouts must be given by the workmen to the employer or by the employer to the workmen, respectively, within six weeks before going on strike or resorting to lockout;
  (ii) There must be no strike or lockout within fourteen days of giving such notice;
  (iii) In the cases where the date of the strike or lockout is specified in such notice, no strike can be called or lockout declared, before the expiry of that specific date;
  (iv) In the cases where any conciliation proceedings are pending before a Conciliation Officer, no strike can be called or lockout declared, during the period during which any conciliation proceedings are pending, and seven days after the conclusion of such proceedings.

  The Act further provides that no employer carrying on any public utility service shall lockout any of the work place:

  (i) Without giving the workmen a notice of lockout;
  (ii) Within fourteen days of giving such notice;
  (iii) Before the expiry of the stipulated period; and
  (iv) During the period any conciliation proceedings are pending before a Conciliation Officer, and one week after the conclusion of such proceedings.

  The Act provides that the notice of strike shall be given by such number of persons to such number of persons in the prescribed manner.

  In this context it must be noted that the right to strike or demonstrate is not an absolute or fundamental right. But then, it has been recognised in almost all the democratic countries as a mode of redressal for resolving grievances for all the workmen.
- The prohibition and restrictions provided under the Act against a lockout by the employer are similar to those against strike by workmen. Thus, for a lockout a notice under **Section 22(2)** is required to be given. Accordingly, a lockout without a proper notice is considered illegal.

- The 'General Prohibition of Strikes and Lockouts' are certain statutory legal restrictions which have been put on Strikes and Lockouts in all industrial establishments. As per the Act, no workman, who is employed in any industrial establishment, shall go on strike in breach of contract, and no employer of any such workman can declare a lockout in the following conditions:
  - **(i)** During the pendency of conciliation proceedings before a Board, and seven days after the conclusion of such proceedings;
  - **(ii)** During the pendency of proceedings before a Labour Court, Industrial, or National Tribunal, and two months after the conclusion of such proceedings;
  - **(iii)** During the pendency of arbitration proceedings before an arbitrator, and two months after the conclusion of such proceedings; and
  - **(iv)** During the period in which a settlement or reward is in operation, relating to any of the matters covered by the settlement or award. But there is no restriction to call strike or to declare lockout in respect of other matters.
- In the cases where an industrial dispute has been referred to a Board, Labour Court, Industrial, or National Tribunal, the appropriate government may, by order, prohibit the continuance of a strike or lockout in connection with such dispute which may be in existence on the date of the reference, or which has been referred to arbitration; and a notification has been issued.
- The strikes and lockouts are deemed to be illegal when they are resorted to or declared in contravention of (i.e. not in compliance with) the provisions of the Act.

  However, in the following cases the strike will not be considered as illegal:
  - **(i)** A strike in breach of the certified standing order, by itself (is not illegal but legal);
  - **(ii)** Where a strike is called strictly in compliance with the provisions of the Act. **For example**, where the workmen refuse to do additional work imposed on them by the employer under a rationalisation scheme;
  - **(iii)** Where a strike is resorted to with a view to influencing the employer to open negotiation regarding their demand, provided it does not affect in any way the provisions of the Act;
  - **(iv)** Where a strike or lockout is already in existence, in pursuance of an industrial dispute at the time of reference to a settlement machinery, provided that such strike or lockout, at the time of its commencement, was not in contravention of the provisions of the Act, or the continuance of such strike or lockout was not prohibited;
  - **(v)** Where a lockout has been declared as a consequence of an illegal strike, or where a strike has been declared as a consequence of an illegal lockout;
  - **(vi)** Where a strike or lockout was commenced before, and continued during the pendency of, arbitration proceedings, and also if it continued after a reference has been made to a Board, Labour Court, or any Tribunal.
- No person shall knowingly expand or apply any money in direct furtherance or support of any illegal strikes or lockouts.
- As per the Act, in the case of an illegal strike the guilty persons (i.e. the workmen who participate in such illegal strike) are punishable. In this connection, a distinction has been made between the following types of strikes:
  - **(a)** Strikes which are both illegal and unjustified; and
  - **(b)** Strikes which are illegal but justified.
- A strike is both illegal and unjustified where it has been resorted to in contravention of the provisions of the Act, and both the demand and behaviour of the striking workmen are wholly unjustified. As against this, a strike may be considered illegal but justified where it has been resorted to for a good (justified) cause and carried on in a peaceful manner.

- There are some specified punishment and penalties in the cases of the offences of resorting to illegal strike by the workmen, and to the employer who commences, continues or otherwise acts in furtherance of an illegal lockout.
- **Lay off** means the failure, refusal or inability of an employer on account of shortage of coal, power or raw materials, or the accumulation of stocks, or the break-down of machinery, or for any other reasons, to give employment to workman, whose name is entered in the muster rolls of his industrial establishment, and who has not been retrenched.
- **Under the traditional laws**, the management has the right to lay off its workers and readjust the labour force to suit the requirements of work. But then, even under the traditional laws, the right of the management to lay off its work force and to adjust the labour is not entirely discretionary.
- Under the **labour laws**, those establishments, which have 'certified standing order' in pursuance of the **Industrial Employment (Standing Order) Act 1946**, are entitled to lay off its workmen as per the provisions of laws.
- The **Amended Industrial Disputes Act, 1982** has laid down the following **prohibitions on lay off**:
- No workman (other than a *badli* workman or a casual workman), whose name is entered in the muster roll of an industrial establishment, shall be laid off by his employer, except with the previous permission of such authority as may be specified by the appropriate government by notification in the Official Gazette, unless such lay off is due to shortage of power, or due to natural calamity; (and in the case of mine, such lay off is due to fire, flood, excess of inflammable gas or explosion).

  The Act does not lay down any procedure for the lay off. However, **Rule 75A of the Industrial Disputes (Central Rules 1957)** makes it obligatory on the part of the employer to provide a notice of the period of lay off within seven days of the commencement or termination of such lay off.
- A lay off cannot be declared merely for the reason that the employer suffered financial losses for the reasons beyond his control. Such lay off shall be unjustified and invalid too, and the workmen can claim full wages for the period of such lay off.
- The workmen who are laid off are entitled to compensation, even when the lay off is the result of a settlement between the employer and workmen, unless the settlement expressly provides otherwise.
- Continuous service is necessary on the part of the employee for being entitled to get the lay off compensation. A workman will be deemed to be in continuous service for a period, if during that period his service is not interrupted.
- Under the following circumstances, no compensation is payable to the workman:
  - **(i)** Where the workman refuses to accept any suitable alternative employment offered to him by the employer;
  - **(ii)** Where a workman, who has been laid off, does not present himself for work at least once a day at the appointed time during the normal business hours ; and
  - **(iii)** Where the laying off is due to a strike or slowing down of production by the workman in another part of the establishment.
- **Retrenchment** means the 'termination by the employer, of the service of the workman, for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, but does not include voluntary retirement, compulsory retirement of the workman on reaching the age of superannuation, or termination of service on the grounds of continued ill health'.
- For the purpose of retrenchment it is required that the workman must have been employed for a period of not less than twelve months, and that during those twelve months he had worked for not less than 240 days.

  An employer, who intends to **close down an undertaking** of an industrial establishment, shall apply to the appropriate government, in a prescribed manner, for obtaining prior permission at least 60 days before the date on which the intended closure is to become effective. In such application, the employer must clearly state the reasons for the intended closure of the undertaking. However, nothing in this Section shall apply to the following:

(**i**) An undertaking in which
  (**a**) Less than 50 workmen are employed, or
  (**b**) Less than 50 workmen were employed, on an average, per working day.
(**ii**) Undertakings engaged in the business of building bridges, roads, canals, dams, or other construction work.

- The workmen are entitled to compensation on closing down of the business. Where an undertaking is closed down for any reason, every workman, who has been in continuous service for not less than one year in that undertaking immediately before such closure, shall be entitled to at least 60 days' notice and compensation as in the case of retrenchment.
- The provisions pertaining to lay off, retrenchment and closure in an industrial establishment shall apply to those establishments in which not less than 100 workmen were employed on an average per working day for the preceding 12 months.
- The appropriate government may, by order in writing and for reasons to be stated, withdraw any proceeding pending before a Labour Court, Industrial, or National Tribunal, and transfer the same to another Labour Court, Industrial, or National Tribunal, for the disposal of the proceedings.
- Money due to a workman under a settlement or award can be recovered under the Revenue Recovery Act, provided the government, on application, empowers the Collector to do so.
- A workman who is a party to a dispute shall be entitled to be represented in any proceeding by:
  (**a**) An officer of a registered trade union of which he is a member;
  (**b**) An officer of a federation of trade unions to which the trade union referred to in clause (a) above is affiliated; or
  (**c**) Where a worker is not a member of any trade union, by an officer of any trade union connected with or by any other workman employed in, the industry in which the worker is employed.
- Similarly, an employer who is a party to a dispute shall be entitled to be represented in any proceeding by:
  (**a**) An officer of an association of employers of which he is a member;
  (**b**) An officer of a federation or association of employers to which the association referred to in clause (a) above is affiliated; or
  (**c**) Where the employer is not a member of any association of employers, by an officer of any association of employers connected with, or by any other employer engaged in the industry in which the employer is engaged.
- No party to a dispute shall be entitled to be represented by a legal practitioner in any conciliation proceedings or in any proceedings before a Court.
- In any proceedings before a Labour Court, Industrial, or National Tribunal, a party to a dispute may be represented by a legal adviser, with the consent of the other parties to the proceedings, and with the leave of the Labour Court, Industrial, or National Tribunal, as the case may be.
- No employer or a workman or a trade union, whether registered under the Trade Union Act or not, shall commit any unfair labour practice.
- The **employers** have the following **obligations** under the Act:
  (**a**) Constitute 'Work Committee' and provide all facilities for its proper working;
  (**b**) Implement all agreements, settlements and awards, and produce all documents, and render other assistance for conciliating and adjudicating disputes;
  (**c**) Desist from declaring any illegal lockout;
  (**d**) To pay lay off and retrenchment compensation, and re-employ laid off and retrenched workmen;
  (**e**) Avoid any change in service and employment conditions without notice;
  (**f**) Maintain status quo during the pendency of disputes on reconciliation and adjudication, and avoid taking disciplinary action against the workmen connected with the dispute, and 'protected workmen'.

- A 'protected workman' is a workman who is a member of the executive or other office bearer of a registered trade union, connected with the establishment.
- The **employers** have the following **rights** under the Act:
  - (**a**) To retrench or lay off workers, as per the provisions of the Act;
  - (**b**) To appeal against the awards of arbitrators and tribunals;
  - (**c**) To declare lockout without notice when there is already a strike in existence;
  - (**d**) To claim certain information supplied to various authorities under the Act as confidential.
- The **workers** have the following **obligations** under the Act:
  - (**a**) To abide by the agreements or settlements arrived at in conciliation, and awards given by the tribunals and arbitrations;
  - (**b**) To desist from declaring or instigating any illegal strike;
  - (**c**) To cooperate with all authorities set up under the Act in resolving disputes amicably and expeditiously.
- The **workers** have the following **rights** under the Act:
  - (**a**) To receive notice of any change in their working and service conditions;
  - (**b**) To receive lay off and retrenchment compensation;
  - (**c**) To be represented in any proceedings under the Act by an officer of a registered trade union of which he is a member, or by an officer of a trade union connected with, or by any other workman employed in the industry in which the workman is employed, and authorised in such a manner as may be prescribed;
  - (**d**) To recover legal and other dues from the employers under any agreement or award under the Act through the government.

Questions for Reflection

1. What are the various categories under which the restrictions imposed on strikes can be broadly classified?
2. What are the various strict restrictions stipulated in the Act on the following?
   (a) Strikes and lockouts in public utility services; and
   (b) Strikes and lockouts in the industries which do not fall under the category of public utility services.
3. The prohibition and restrictions provided under the Act against a lockout by the employer are similar to those against strike by workmen. Explain.
4. What do you understand by the term 'General Prohibition of Strikes and Lockouts'? Explain.
5. Under what various circumstances any strike and lockout will be deemed to be illegal? Explain.
6. Under what different cases, the strike will not be considered as illegal?
7. (a) In the cases where the strike is unjustified and the lockout is justified, the workmen will not be entitled to any wages at all. Do you agree? Write 'Yes' or 'No' as your answer.
   (b) In the cases, where the strike is justified and the lockout is unjustified, the workmen will not be entitled to the entire wages for the period of the strike and lockout. Do you agree? Write 'Yes' or 'No' as your answer.
8. No person shall knowingly expand or apply any money in direct furtherance or support of any illegal strikes or lockouts. Do you agree? Write 'Yes' or 'No' as your answer.
9. What are the various punishments and penalties that can be imposed in the cases of an illegal strike?
10. As provided under the Act, in the cases where a person, committing an offence under the Act, is a company, or other body corporate, or an association of persons, every Director, Manager, Secretary, Agent, or other officers or persons concerned with the management, must be considered to be guilty of such offence. However, such person can be acquitted under certain circumstances. Under what specific circumstances such person can be acquitted?

11. What does the term 'lay off' mean, as per the Act?
    Explain in your own language.
12. Under what specific circumstances can the 'lay off' be resorted to?
13. Under what conditions the workmen can be laid off, in the following cases?
    (a) Under the Traditional Law; and
    (b) Under the Labour Laws.
14. (a) What are the various prohibitions provided on lay off?
    (b) Under what circumstances the lay off shall be deemed to be illegal from the date on which the workmen have been laid off?
    (c) Will the workmen, in the case of an illegal lay off be entitled to all the benefits under any law for the time being in force as if they had not been laid off? Do you agree? Write 'Yes' or 'No' as your answer.
15. The Act does not lay down any procedure for the lay off. But, Rule 75A of the Industrial Disputes (Central Rules 1957) makes it obligatory on the part of the employer to follow certain procedures in regard to lay off. Explain these laid down procedures.
16. 'Lay off can occurs in a continuing concern as also in the cases where the concern is closed for all times to come'. Do you agree with this statement? Give reasons for your answer.
17. (a) Can a lay off be deemed to be justified and valid, if such lay off has been declared by the employer for the reason that the employer suffered financial losses for the reasons beyond his control? Give reasons for your answer.
    (b) If such lay off, in your considered opinion, will be deemed to be unjustified and invalid, what compensations can the workmen claim from the employer?
18. (a) Is continuous service necessary on the part of the employee for being entitled to get the lay off compensation?
    (b) Under what conditions will a workman be deemed to be in continuous service for the required period?
19. Under what specific circumstances, no compensation is payable to the workman? Explain.
20. As per the Act, retrenchment means the 'termination by the employer, of the service of the workman, for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, but does not include voluntary retirement, compulsory retirement of the workman on reaching the age of superannuation, or termination of service on the grounds of continued ill health'. Do you agree with this statement? Write 'Yes' or 'No' as your answer.
21. As per the Act, what are the various requirements for the purpose of retrenchment of a workman?
22. (a) What are the various rationale behind providing for retrenchment compensation to the workers?
    (b) What are the various conditions, laid down in the Act, for the purpose of claiming the retrenchment compensation by the employee(s)?
23. What procedures are to be followed by the employer, who intends to close down an undertaking of an industrial establishment?
24. In the cases of certain undertakings, who intend to close down the undertakings of an industrial establishment, nothing provided in the Act shall apply? What types of such undertakings of an industrial establishment are exempt in this regard?
25. 'No appropriate government can, even by order in writing and for reasons to be stated, withdraw any proceeding pending before a Labour Court, Industrial, or National Tribunal, and transfer the same to another Labour Court, Industrial, or National Tribunal, for the disposal of the proceedings.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.
26. 'Any money due to a workman under a settlement or award can be recovered under the Revenue Recovery Act, provided the government, on application, empowers the Collector to do so.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.

27. By what various association(s) of employers(s) / officer(s), an employer, who is a party to a dispute, shall be entitled to be represented in any proceeding? Name all of them.
28. 'As per the Act, the parties to a dispute are entitled to be represented by a legal practitioner in any conciliation proceedings or in any proceedings before a Court.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.
29. 'As per the Act, in any proceedings before a Labour Court, Industrial, or National Tribunal, a party to a dispute may be represented by a legal adviser, with the consent of the other parties to the proceedings, and with the leave of the Labour Court, Industrial, or National Tribunal, as the case may be.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.
30. What are the various obligations of the employers, as provided under the Act?
31. What are the various rights of the employers, as provided under the Act?
32. What are the various obligations of the workers, as provided under the Act?
33. What are the various rights of the workers, as provided under the Act?

Problems for Practice (With Suggested Solutions)

Problem 1

Restrictions imposed on strikes are applicable only in the case of public utility services; and not to any other industrial establishments in general. Do you agree? Give reasons for your answer.

Solution

No. I do not agree, because the restrictions on strikes can be imposed in the cases of both the public utility services; as also in the cases of the other industrial establishments in general.

Problem 2

In the following cases the strike will be considered as illegal:

(i) A strike in breach of the certified standing order, by itself;
(ii) Where the workmen refuse to do additional work imposed on them by the employer under a rationalisation scheme;
(iii) Where a strike is resorted to with a view to influencing the employer to open negotiation regarding their demand, and it does not affect in any way the provisions of the Act.
(iv) Where a strike or lockout is already in existence, in pursuance of an industrial dispute at the time of reference to settlement machinery, and such strike or lockout, at the time of its commencement, was not in contravention of the provisions of the Act, or the continuance of such strike or lockout was not prohibited.

Solution

In all the four cases, given in the problem, the strike will not be considered as illegal, because all such strikes are considered as legal as per the following provisions of the Act.

In the following cases, the strike will not be considered as illegal:

(i) A strike in breach of the certified standing order, by itself (is not illegal but legal);
(ii) Where a strike is called strictly in compliance with the provisions of the Act. For example, where the workmen refuse to do additional work imposed on them by the employer under a rationalisation scheme;
(iii) Where a strike is resorted to with a view to influencing the employer to open negotiation regarding their demand, provided it does not affect in any way the provisions of Sections **22 and 23.**
(iv) Where a strike or lockout is already in existence, in pursuance of an industrial dispute at the time of reference to a settlement machinery, provided that such strike or lockout, at the time of its commencement, was not in contravention of the provisions of the Act, or the continuance of such strike or lockout was not prohibited.

Problem 3

'Any person can knowingly expand or apply any money in direct furtherance or support of any illegal strikes or lockouts, so as to minimise the hardships faced by the poor employees/workmen.' Do you agree with this statement? Give reasons for your answer.

Solution

No. I do not agree with this statement, because it is in utter violation of the provisions of the Act, inasmuch as the Act provides that no person shall knowingly expand or apply any money in direct furtherance or support of any illegal strikes or lockouts.

Problem 4

'Where a person, committing an offence under the Act, is a company, or other body corporate, or an association of persons, every Director, Manager, Secretary, Agent, or other officers or persons concerned with the management, must be considered to be guilty of such offence. And such persons cannot be acquitted under any circumstances'. Do you agree with this statement? Give reasons for your answer.

Solution

No. I do not agree with this statement. In fact, **Section 32** of the Act provides that though such persons must be considered to be guilty of such offence, any of such persons can be acquitted, provided and only if it can be proved that the offence was committed without his knowledge or consent.

Problem 5

A casual workman has been laid off by his employer, without obtaining the previous permission of such authority, as has been specified by the appropriate government by notification in the Official Gazette. He has filed a suit on the ground that he has been laid off by his employer, without obtaining the previous permission of such authority. What are the chances of his winning the case? Give reasons for your answer.

Solution

The casual workman has no chance of his winning the case, because the Act has specifically provided that such notice is required in the cases of the workman (other than a badli workman or a casual workman), whose name is entered in the muster roll of an industrial establishment.

Problem 6

A laid-off workman had refused to accept a suitable alternative employment offered to him by the employer. Such alternative employment is in the same establishment or in any other establishment belonging to the same employer, or in the same town or village or at a place situated within a radius of five miles from the establishment to which he belongs, and the work in the alternative employment is of the same nature (i.e. it does not call for any other skill), and which carried the same wages. He had, however, not been paid any lay off compensation. Thereupon, the laid-off employee preferred to file a suit, in which he claimed the payment of the lay off compensation, he was legally entitled to. What are the chances of his winning the case? Give reasons for your answer.

Solution

The laid-off workman has no chance of his winning the case, because the Act has specifically provided that where the workman refuses to accept any suitable alternative employment offered to him by the employer, which satisfies the aforementioned circumstances, given in the problem above, such workman will not be entitled to Lay Off Compensation.

Problem 7

A workman, who had been laid off, did not present himself for work at least once a day at the appointed time, during the normal business hours, on the plea that he had already been laid off. He had, however, not been paid any lay off compensation. Thereupon, the laid off employee preferred to file a suit, in which he claimed the payment of the lay off compensation, he was legally entitled to. What are the chances of his winning the case? Give reasons for your answer.

Solution

The laid-off workman has no chance of his winning the case, because the Act has specifically provided that where the workman, who has been laid off, does not present himself for work at least once a day at the appointed time during the normal business hours, such workman will not be entitled to Lay Off Compensation.

Problem 8

A workman had been employed for a period of full twelve months, and that, during those 12 months he had worked for 230 days. He had been retrenched but, he had not been paid any retrenchment compensation. Thereupon, the retrenched employee preferred to file a suit, in which he claimed the payment of the retrenchment compensation, he was legally entitled to. What are the chances of his winning the case? Give reasons for your answer.

Solution

The retrenched workman has no chance of his winning the case, because the Act has specifically provided that only where the workman, who has been retrenched, had been employed for a period of not less than 12 months, and that during those twelve months he had worked for not less than 240 days, will not be entitled to retrenchment compensation. Thus, though the retrenched workman had been employed for a period of not less than 12 months, during those 12 months he had worked for less than 240 days, i.e. only for 230 days, which falls short of the required minimum 240 days.

Problem 9

A workman had been employed below the ground in a mine for 12 calendar months; and he had actually worked for 180 days. But, he had not been paid any retrenchment compensation. Thereupon, the retrenched employee preferred to file a suit, in which he claimed the payment of the retrenchment compensation, he was legally entitled to. What are the chances of his winning the case? Give reasons for your answer.

Solution

The retrenched workman has no chance of his winning the case, because the Act has specifically provided that only where the retrenched workman, employed below the ground in a mine, had been employed for 12 calendar months; and he had actually worked for not less than 190 days in case of a workman employed below the ground in a mine, he is not entitled to claim the retrenchment compensation. Thus, though the workman had been employed below the ground in a mine for 12 calendar months; he had actually worked for 180 days, which falls short of the required minimum 190 days.

Problem 10

The Act provides that an employer must apply to the appropriate government, in a prescribed manner, for obtaining prior permission at least 60 days before the date on which the intended closure is to become effective. In such application, the employer must clearly state the reasons for the intended closure of the undertaking. Further, a copy of such application shall also be served simultaneously to the representatives of the workmen, in the prescribed manner. But the employer concerned, intending to close down his undertaking of an industrial establishment, employing 45 workmen, had failed to apply to the appropriate government, in a prescribed manner, for obtaining prior permission at least 60 days before the date on which the intended closure was to become effective. The Employees' Union had, thereupon filed a suit claiming that in view of the fact that the employer concerned had not obtained the required prior permission from the appropriate government at least 60 days before the date on which the intended closure was to become effective. What are the chances of the employer winning the case? Give reasons for your answer.

Solution

The employer concerned has a good chance of winning the case, on the ground that such conditions, as aforementioned in the instant problem, do not apply, inter alia, in an undertaking in which less than 50 workmen were employed, or less than 50 workmen were employed, on an average, per working day.

Problem 11

A workman is not a member of any trade union, but is a party to a dispute, and is being represented in the proceeding by an officer of a trade union connected with the industry in which the worker is employed. The federation of trade union concerned has filed an objection to the effect that, as the workman concerned is not a member of any trade union, he cannot be represented by any officer of a trade union, even though connected with the industry in which the worker is employed. Do you think that the ground on which the federation of trade union has raised the objection is justified? Give reasons for your answer.

Solution

No. The ground on which the federation of trade union has raised the objection is not at all justified, because, as per the provisions of the Act, in the cases where a worker is not a member of any trade union, he can be represented in the proceeding by an officer of any trade union connected with or by any other workman employed in, the industry in which the worker is employed.

Problem 12

An employer is not a member of any association of employers, but is a party to a dispute, and is being represented in the proceeding by an officer of an association of employers connected with the industry in which the employer is engaged. The association of employers concerned has filed an objection to the effect that, as the employer concerned is not a member of any association of employers, he cannot be represented by any officer of an association of employers, even though connected with the industry in which the employer is engaged. Do you think that the ground on which the association of employers has raised the objection is justified? Give reasons for your answer.

Solution

No. the ground on which the association of employers has raised the objection is not at all justified, because, as per the provisions of the Act, where the employer is not a member of any association of employers, he can be represented in the proceeding by an officer of any association of employers connected with, in which the employer is engaged.

Problem 13

'An appropriate government may, by order in writing and for reasons to be stated, withdraw any proceedings pending before a Labour Court, Industrial, or National Tribunal, and transfer the same to another Labour Court, Industrial, or National Tribunal, for the disposal of the proceedings.' Do you agree with this statement? Write 'Yes' or 'No' as your answer.

Solution

Yes.

Problem 14

'Money due to a workman under a settlement or award can be recovered under the Revenue Recovery Act. But the government, on application, has not so far empowered the Collector to do so.' Can the money due to a workman under a settlement or award be recovered under the Revenue Recovery Act?

Solution

No. This is so because, as per the provisions of the Act, money due to a workman under a settlement or award can be recovered under the Revenue Recovery Act, provided the government, on application, empowers the Collector to do so. Thus, as the government, on application, has not so far empowered the Collector to do so, the money due to a workman under a settlement or award, cannot be recovered under the Revenue Recovery Act, until such time the government empowers the Collector to do so.

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